THE PURSUIT OF PROFIT AT ALL COSTS

Corporate law as a barrier to corporate social responsibility

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Following the human tragedy that occurred on Boxing Day, 2004, when a tsunami hit coastlines off the Indian Ocean, considerable donations were made to various tsunami relief funds. Some of these donations came from corporations, which raises questions about the role of corporations and the extent to which corporate management should have the discretion to engage in philanthropy and in corporate social responsibility more generally. Does the duty on directors to act in the best interests of the corporation preclude such donations or at least limit the exercise of what has come to be termed 'corporate social responsibility' or 'CSR'?

In early January 2005, a spokesman for the Australian Shareholders' Association, Stephen Matthews, criticised corporate donations to aid in tsunami relief. It was reported that:

> The Australian Shareholders Association has expressed disapproval at companies pledging money to the tsunami relief effort in Asia, saying they have no approval for their philanthropy. Association spokesman Stephen Matthews says firms should not generally give without expecting something in return. Mr Matthews says that in most circumstances, donations should only be made in situations that are likely to benefit the company through greater market exposure.[1]

It was subsequently reported that this attitude had drawn significant criticism from within the community, causing the Australian Shareholders' Association to seek to clarify the comments that had been made, by saying that the Association was not opposed to such donations, but that they should be fully disclosed to shareholders.[2]

Some interesting issues arise out of Mr Matthews' comments, which are consistent with Milton Friedman's view that 'corporate expenditure on social causes is a violation of management's responsibility to shareholders to the extent that the expenditures do not lead to higher shareholder wealth'.[3]

This article considers what is meant by the director's duty to act in the best interests of the company and the extent to which this might impact on the ability of corporations to act in a socially responsible manner. As part of this discussion the question of what is meant by CSR is addressed, as well as the nature and extent of the exercise of voluntary CSR by Australian companies. This article concludes on the basis that some corporate law reform is desirable to enable boards of directors to take into account social responsibilities when making decisions. It is also argued that CSR should be regarded as a justification for regulatory intervention, when social policy requires corporations to do more than pursue profits.

The duty to act in the best interests of the company

Company directors are under a duty to act in the best interests of the company under s 181 of the *Corporations Act 2001* (Cth) and under general fiduciary principles. The company has been defined in this regard to mean 'the shareholders as a whole',[4] or where a company is insolvent, 'the creditors'.[5] In either case, it is the financial interests of those groups — as linked to the company's financial interests — that are regarded as relevant. This would seem to preclude an exercise of discretion by directors in favour of social welfare, unless clear benefit to shareholders in terms of financial return, can be demonstrated. Put another way, directors will potentially breach their duty to act in the best interests of shareholders if they exercise social responsibility in a manner that might compromise company profits.

Australian case law confirms this general position, with a qualification. Where an exercise of social responsibility or philanthropy can benefit a company, for example by improving the company's reputation, then such acts can be justified:

> A Company may decide to be generous with those with whom it deals. But — I put the matter in general terms — it may be generous or do more than it need do only if, essentially, it be for the benefit of or for the purposes of the company that it do such. It may be felt appropriate that the company acquire the reputation of being such.[6]

An American court seems to have recognised a broader corporate discretion, justified by a sense of corporate obligation alone, to engage in philanthropy. In upholding a corporate donation to Princeton University, which it has to be said may well have had reputational and hence financial benefits for the company, the New Jersey Supreme Court referred to the company's 'long-visioned ... action in recognizing and voluntarily discharging its high obligations as a constituent of our modern society'.[7]

There is an argument that given the enormous power and resources harnessed by corporations in modern society, CSR should itself be a legal requirement, and corporate social obligations should be recognised and not hampered by legal duties to pursue an agenda of pure self-interest. To what extent does our corporate

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3. Milton Friedman quoted in Bernadette M Ruf et al, 'An Empirical Investigation of the Relationship between Change in Corporate Social Performance and Financial Performance: A Stakeholder Theory Perspective' (2001) 32 *Journal of Business Ethics* 143, 143.

4. *Greenhalgh v Arderne Cinemas* [1945] 2 All ER 719.

5. *Kinsela v Russell Kinsela Pty Ltd (In Liq)* (1986) 4 NSWLR 722.

6. *Woolworths v Kelly* (1991) 22 NSWLR 189 (Court of Appeal), 226 (Mahoney JA).

7. *AP Smith Manufacturing Co v Barlow*, 39 ALR 2d 1179 (1953), 1192.

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law, and particularly the duty to act in the best interests of the company, impact on the exercise of social responsibility by corporations?

The impact on CSR of the duty to act in the best interests of the company

It is argued that CSR is still open to corporations as a matter of directors' discretions, given the courts' reluctance to interfere in the business judgments of directors.[8] We see this in case law,[9] and it is further strengthened by the enactment of the business judgment rule in s 180(2) of the *Corporations Act 2001* (Cth). However, a blatant disregard for the impact of a decision on financial return to shareholders would no doubt be viewed as a breach of directors' duties. Decisions such as that in *Parke v The Daily News Ltd & Others*[10] illustrate the potential for shareholders to take action to prevent an exercise of CSR as being in breach of directors' duties. This case concerned an *ex gratia* payment to employees who were being made redundant. A shareholder was successful in having the payment stopped on the basis that the company could not show that the payment would have been in the financial interests of the company. Plowman J stated that the 'defendants were prompted by motives which, however laudable, and however enlightened from the point of view of industrial relations, were such as the law does not recognise as a sufficient justification'.[11]

It is useful at this point to consider what is meant by CSR. Parkinson defines it to include 'profit-sacrificing social responsibility', which would clearly breach the requirement on directors to maximise returns to shareholders. 'Profit-sacrificing social responsibility' is:

> behaviour that involves voluntarily sacrificing profits, either by incurring additional costs in the course of the company's production processes, or by making transfers to non-shareholder groups out of the surplus thereby generated, in the belief that such behaviour will have consequences superior to those flowing from a policy of pure profit maximisation.[12]

Those superior outcomes may include strategic benefits to a corporation, for example in terms of its public image and reputation, and in that sense may result in profit return in the long term, notwithstanding short-term profit sacrifice. This might be referred to as strategic CSR. Alternatively, those superior outcomes may be more philanthropic, being socially beneficial but not necessarily of strategic benefit to the corporation. This might be referred to as non-strategic.

CSR might also be defined in terms of whether it is relational responsibility or social activism. Relational responsibility is defined by Parkinson as a form of CSR which 'attempts to promote the welfare of groups such as employees, customers, or neighbours, who are affected by the company's mainstream business activities', whereas social activism 'refers to conduct which is putatively beneficial to society or particular interest groups, but which falls outside the scope of the company's ordinary commercial operations'.[13]

It seems that social activism is more likely to fall within the realms of non-strategic social responsibility, and therefore be more offensive to the legal duties of directors. It is undoubtedly an exercise of non-strategic, profit-sacrificing social responsibility that is most likely to be in breach of corporate law duties. Strategic CSR will be tolerated by corporate law in the sense that its ultimate goal remains profit maximisation for shareholders. Bakan refers to Milton Friedman's view in this regard: the 'executive who treats social and environmental values as means to maximise shareholders' wealth — not as ends in themselves — commits no wrong'.[14]

It is the inoffensive, strategic CSR that Bakan claims is being undertaken by corporations, in an attempt to improve their reputations and, in a sense, hide their true, self-interested natures:

> Corporate social responsibility is their new creed, a self-conscious corrective to earlier greed-inspired visions of the corporation. Despite this shift, the corporation itself has not changed. It remains, as it was at the time of its origins as a modern business institution in the middle of the nineteenth century, a legally designated 'person' designed to valorize self-interest and invalidate moral concern.[15]

With the above dichotomies in mind, one can ask whether Australian companies are predominantly engaged in strategic and therefore inoffensive (from a legal standpoint) CSR or whether they potentially breach corporate law by engaging in non-strategic, profit-sacrificing CSR. Following from this, one can ask whether the law should do more to permit or require non-strategic, profit-sacrificing CSR.

What are Australian companies doing in relation to CSR?

Tsunami donations

Reports of corporate donations to tsunami relief included $1 million each from Qantas, National Australia Bank,[16] Telstra, the Commonwealth Bank,[17]

8. See discussion in John Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (1994) 279.

9. *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483; *Charterbridge Corp Ltd v Lloyds Bank* [1970] Ch 62.

10. *Parke v The Daily News Ltd & Others* [1962] 2 All ER 929.

11. Ibid 948.

12. Parkinson, above n 8, 261.

13. Ibid 267.

14. Joel Bakan, *The Corporation: The Pathological Pursuit of Profit and Power* (2004), 34.

15. Ibid 28.

Foster's Group, Visy Industries, Westfield Group, Travelex and News Corp.[18] ANZ Bank contributed $500,000 to match $500,000 donated by staff, and this response, as well as donations by other banks, led to media comments in relation to the banking sector that 'there can be more to the sector than the bottom line'.[19] The Australian Shareholders' Association's criticism of these donations seems linked to their potentially non-strategic, profit-sacrificing nature. They are not necessarily strategic donations linked to the companies' core businesses, but rather they are an example of social activism in the sense described by Parkinson. Nevertheless, community attitudes at the time seemed to be in favour of such donations, and the corporate sector in fact received criticism for not giving enough.[20] It seems that the community expectation is that corporations, as legal entities, should exhibit the same generosity and compassion, in the event of such a tragedy, as natural people.

For corporations such as banks, which benefit from consumer approval and a positive social reputation, such generosity can be justified within the constraints of the duty to act in the best interests of the company. There is some evidence that financial performance can improve with improved CSR, and also that shareholders can benefit from a company meeting the demands of stakeholders more generally.[21] It is perhaps for this reason that corporate social responsibility which falls within the realms of 'social activism', such as the majority of charitable donations, is most likely to occur in corporations conducting business in 'socially or environmentally sensitive industries with a consumer focus', according to a recent study undertaken in the UK.[22] Notably, in such cases even 'social activism' CSR takes on strategic characteristics, making it legally acceptable. For corporations which do not need to be concerned with consumer approval, and which could not justify philanthropy on the basis of benefiting from an improved social reputation, the position is less clear. The boards of such corporations might well be in breach of their duties to the corporation by sacrificing profits in the name of philanthropy.

The Rio Tinto example

Strategic, relational CSR is evident on most corporate web sites. This is social responsibility that is strategically linked to companies' business interests and is therefore unlikely to offend corporate law. It can be justified on the basis of potential economic benefit and more sustainable returns to shareholders. John Hall, the manager of Corporate Relations at Rio Tinto Australia, wrote an article acknowledging that Rio Tinto's

> licence to operate depends on community acceptance of, and support for its activities ... The business case is clear: we aim to maximise shareholder value over the total life of the resources and assets that we manage, which is typically several decades. With that time span it obviously makes good business sense to invest in the future by earning the trust and respect of people who could be a part of our community for many years to come. Good community relations provide a surer basis for effective, uninterrupted business operations.[23]

He gave examples of the ways in which Rio Tinto, a group of mining and energy companies, benefits in economic terms from working with communities in a socially responsible manner. Rather than distribute funds over a broad range of causes and charities, the companies in the Rio Tinto group enter into community partnerships of strategic importance to the business. An example is the partnerships with indigenous communities in the areas where Rio Tinto operates. Hall reports that agreements are negotiated with the indigenous communities, and that funding is provided for those communities to have independent negotiators acting on their behalf. The agreements involve such things as funding for community development, employment and training, and assistance to set up indigenous business enterprises, some of which might then assist in mine construction and ongoing earthmoving support.

This is a clear example of strategic, relational CSR, which appears to benefit the communities in which Rio Tinto operates, but which will never involve social welfare activities which do not satisfy the underlying strategic purpose. If a government were to decide, for example, that as a matter of policy mining companies needed to give significantly more to the communities in which they operated (perhaps by supporting infrastructure notwithstanding that it was unrelated to their mining activities), then legislation to permit and require such an exercise of CSR would be necessary.

Australian banks

Three of the major four banks are similarly engaging in relational but probably strategic — and hence legally inoffensive — CSR.

Westpac Bank published a social impact report in 2003, where it stated that:

> For us corporate responsibility means conducting our business so that we meet our financial, social and environmental responsibilities in an aligned way. At its core, it is simply about having a set of decent values and behaviours that underpin our everyday activities; our transparency; our desire for fair dealing; our treatment of our people; our attitudes to and treatment of customers; and our links into the community.[24]

The report refers to Westpac's work in enhancing financial literacy, and also to its involvement in the No Interest Loans Scheme (NILS) in Tasmania.[25] These are schemes run by community organisations for consumers who are unable to access affordable commercial credit to buy essential items such as washing machines and fridges. The loans are generally in the vicinity of between $600 and $1000, and one year is allowed for repayment.[26] Funds tend to be derived from philanthropic trusts and the corporate sector, and more recently banks such as Westpac have offered their support. The default rate on these loans is 10%,[27] which represents a high risk for lenders. Interestingly, as recently as 2001 it was reported that banks had declined to contribute to NILS, with the Australian Bankers' Association saying that it would not support such a scheme, and that the primary responsibility for

16. Above n 2.

17. Eric Johnston, *Australian Assoc Criticizes Cos for Tsunami Aid Pledges* (7 January 2005) Yahoo! Australia & NZ Finance <http://au.biz.yahoo.com/050107/18/p/2vkj.html> at 21 November 2005.

18. *Australian shareholders group gripes at corporate tsunami donations*, Yahoo! Australia & NZ Finance (7 January 2005) <http://au.biz.yahoo.com/050107/33/p/2vlf.html> at 21 November 2005.

19. Valerie Khoo, *Community Matters* (22 January 2005), smh.com.au <http://smh.com.au/articles/2005/01/21/1106110919147.html?0neclick=true> at 21 November 2005.

20. Above n 2, reporting comments made by Dick Smith.

21. Ruf et al, above n 3.

22. Stephen Brammer & Andrew Millington, "The Development of Corporate Charitable Contributions in the UK: A Stakeholder Analysis' (2004) 41 *Journal of Management Studies* 1411, 1430.

23. John Hall, 'The social responsibility of corporations' (2002) 27 *Alternative Law Journal* 12, 13-14.

24. Westpac, *2003 Social Impact Report*, 10.

25. Ibid 34-35.

26. Robert Drake, 'NCOSS No Interest Loans Development Project Report', Council of Social Service of NSW, October 2001, 2.

27. Ibid 12.

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such a scheme should sit with government 'who have the necessary expertise in targeting welfare assistance to make the scheme effective and accountable'.[28]

In a relatively short period of time, banks' attitudes to CSR seem to have undergone a visible transformation.

ANZ is involved in three major initiatives to assist low-income consumers. First, it has established a 'Saver Plus' program that helps low-income consumers save for education by matching every dollar saved for that purpose with two dollars. This program was developed in conjunction with the Brotherhood of St Laurence and is being trialed in three locations in Victoria and NSW.[29] The Saver Plus program has also been expanded through a partnership with The Smith Family, to operate in Queensland.[30]

Secondly, ANZ has established a foundation to address the problem of financial illiteracy. It is conducting research to ascertain the level of adult financial literacy, and is developing programs aimed at supporting community organisations that assist low-income groups with financial education.[31] It announced the launch of its 'Money Minded' adult financial education program on 21 October 2004. The program will be offered through a partnership with the Brotherhood of St Laurence.[32]

ANZ has also conducted research into the size and nature of financial exclusion and is seeking to address the issue of meeting the needs of those excluded from mainstream financial institutions, by developing a microfinance model in partnership with Brotherhood of St Laurence.[33] Microfinance involves financial structures which enable resources to be pooled and returned to the community, aimed at assisting people on low incomes who have limited or no access to mainstream financial institutions.

On 23 March 2004, National Australia Bank announced the launch of its 'Step Up' program being undertaken in conjunction with the Good Shepherd Youth and Family Services.[34] The program involves the making of loans of between $800 and $3000 to low-income consumers at a fixed interest rate of 7.1%. A two-year trial period is currently being undertaken, in five locations in Victoria and NSW. The bank's executive general manager for financial services has stated that this 'is a break-even product for the bank but it will make a huge difference for people who would not otherwise have access to affordable credit for household necessities'.[35] The loans are intended to be for the purchase of household goods and services such as refrigerators, washing machines and beds. In this respect they are not unlike NILS, except that interest is payable. A benefit to low-income consumers is the opportunity to build a relationship with a bank and develop a credit history.

The Commonwealth Bank appears to be the only one of the four major Australian banks to fail to deal with the concept of CSR in any respect, on its web site or otherwise.

While the initiatives outlined above are commendable, they might be described as a mere band-aid on the gaping wound which is financial exclusion and lack of access to just and adequate financial services for low-income consumers. It is unlikely, however, that the boards of banks will be prepared to take more significant steps in addressing financial exclusion without regulatory measures being taken to both permit and require such potentially profit-sacrificing steps. There is little doubt that in contributing to overcoming problems of financial exclusion, the boards of banks are mindful of their responsibilities to shareholders, and in the absence of regulatory requirements that they do otherwise, will limit their contributions to what might be termed 'strategic' CSR; that is, CSR which enhances reputation and therefore contributes to shareholder wealth.

28. Ibid, quoting David Bell, CEO of the Australian Bankers' Association.

29. ANZ, *Saver Plus Progress and Perspectives*, August 2004.

30. ANZ, 'ANZ announces $1 million expansion of matched savings program' (Press Release, 14 September 2004).

31. ANZ, *Making a difference to financial literacy*, July 2004.

32. ANZ, 'ANZ launches Australia's first comprehensive adult financial education program' (Press Release, 21 October 2004).

33. ANZ, *Community Development Finance in Australia: A Discussion Paper*, May 2004.

34. See NAB, *Set Up Low Interest Loans*, <http://www.national.com.au/Community/0,,49804,00.html> at 23 October 2004.

35. Ibid.

Conclusion — is legislative change appropriate?

This article has discussed the potential breach of the duty to act in the best interests of the company, where directors engage in a form of CSR which might be defined as non-strategic, profit-sacrificing, social activism. Philanthropy in the form of charitable donations, for example to the tsunami relief appeal, is a form of CSR that might fall within the parameters of such a definition.

Following the 2004 tsunami disaster, there was a call for corporations to exhibit the qualities that natural people (hopefully) might exhibit in acting beyond self-interest, for example empathy, care and concern for humanity, and generosity. Given the power and resources held by corporations in modern society, this idea is an attractive one. Do we really want such extensive power and resources held by entities that are legally compelled to act only in their own self-interest?

The social expectation that companies will behave as good corporate citizens and exercise voluntary CSR, often seems to conflict with the legal requirements on boards of directors. This was very apparent in comments made by the chair of the board of the James Hardie group of companies, Meredith Hellicar, in response to criticisms of the group's restructure, which saw a separation of the group's ongoing asbestos liabilities from the balance sheet of group companies, leaving a shortfall in funds available to meet its liabilities to victims of asbestos disease:

> In considering the sometimes competing- or even conflicting — requirements of the law, community expectations and our own moral precepts, we did not respond with offers of funding support for any shortfall of the foundation.[36]

The nature of directors' duties is currently under review in Australia in the context of extending those duties to a broader stakeholder group, beyond shareholders. On 23 March 2005 the Parliamentary Secretary to the Treasurer requested the Corporations and Markets Advisory Committee (CAMAC) to refer to it the issue of directors' duties and CSR. CAMAC has been asked to report on a number of matters, including whether the *Corporations Act 2001* (Cth) should be revised to require directors to take into account the interests of specific classes of stakeholders when making corporate decisions.[37] Similarly, the Parliamentary Joint Committee on Corporations and Financial Services is conducting an inquiry into 'the extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders'.[38] Notwithstanding the current interest in this question, the fact remains that corporate directors are discouraged by corporate law in its present form from considering the interests of a broader stakeholder group unless there is a clear legal requirement that they do so, or clear strategic benefits to the corporation in doing so.

A redefinition of directors' duties to specifically allow for non-strategic, profit-sacrificing CSR is, however, problematic in a number of respects. Counsel who assisted the Special Commission of Inquiry into the Medical Research and Compensation Foundation, which considered the James Hardie group restructure, expressed the view that the *Corporations Act 2001* (Cth) ought to be amended to make it clear that corporate boards should be entitled to have regard to matters of social responsibility.[39] This would seem to be a sensible position, but should it extend to allowing boards to engage in profit-sacrificing philanthropy? Are directors to be given *carte blanche* discretion to decide appropriate social causes in which to invest? Are directors, and the corporations under their management, the appropriate vehicles for redistribution of wealth in society? The answer to these questions is surely 'no'. However, there does seem to be a compelling argument in favour of government, in its redistributive capacity, using the concept of CSR to justify targeted regulatory measures against corporations, for example to require banks to contribute more significantly to overcoming the problem of financial exclusion in Australia.

Where, as a matter of social policy, the pursuit of profits at all costs cannot be entertained, government should regulate to permit and require an exercise of CSR by corporations, or corporations conducting businesses within certain sectors, with a view to achieving clear regulatory outcomes. Failing that, corporations are unlikely to do more than exercise a form of strategic, relational CSR, which will be inadequate to achieve policy goals.

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[Editor's note: For another view on this topic, readers are referred to (2005) 30(4) *Alt LJ* 154-8, 'Were Corporate Tsunami Donations made Legally?' by Peter Henley.]

36. Mathew Charles, 'Hardie Bid to Woo Investors', *The Courier-Mail* (Brisbane), 16 September 2004, 37.

37. CAMAC, *Reference in relation to directors' duties and corporate social responsibility* (March 2005) <http://www.camac.gov.au> at 21 November 2005.

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