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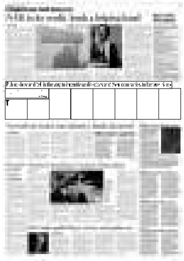

Public show and tell is the way to incentivise directors and their companies to behave nicely

Two models have emerged to ensure directors are socially responsible. Disclosure of company practices is the superior option, writes **Ian Ramsay**.

THERE is enormous interest in the role of company directors in implementing corporate social responsibility (CSR). There are many reasons for this, including the growing power and influence of companies in our daily lives, privatisations that have led to companies taking over what were government functions, and the significant controversy created by James Hardie in its dealings with those who contracted asbestos-related diseases as a result of contact with James Hardie products.

According to commentators, companies should engage in socially responsible activities because such activity can increase sales and market share, increase appeal to investors, strengthen the brand position of the company, and increase the company's ability to attract, motivate and retain employees.

But how do we go about ensuring that company directors do engage in socially responsible activities? Two alternatives have recently been highlighted by two separate inquiries dealing with CSR and company directors. The inquiries are being conducted by the Corporations and Markets Advisory Committee (the Federal Government's main corporate law reform advisory body) and the parliamentary Joint Committee on Corporations and Financial Services.

The terms of reference for both inquiries focus on two approaches to directors and CSR. The first is to change the law of directors' duties to require directors to take into account the interests of stakeholders other than shareholders when making corporate decisions. The second focuses on company disclosure of CSR practices. It does not mandate that directors adopt certain practices but requires disclosure of what the company does with a view to ensuring that those practices are debated and evaluated outside the company.

A number of potential problems arise from changing the law of directors' duties to allow or require directors to prioritise non-shareholder interests over the interests of shareholders. This approach may make directors less accountable, may be inconsistent with other parts of our corporate law, and would result in vesting additional discretions and powers in the Australian Securities and Investments Commission and the courts when it is not clear they would want these additional discretions or whether it is an appropriate role for them.

The disclosure approach has grown in importance and we have seen significant changes in disclosure of CSR practices. The 2005 KPMG international survey of CSR reporting, which examined the CSR reporting of the world's largest corporations (about 1600 of them), found CSR reporting had increased steadily since 1993 and substantially in the past three years. The type of CSR reporting had also changed significantly, from purely environmental reporting until 1999 to sustainability (social, environmental and economic) reporting.

A prominent example of the disclosure approach to CSR is the recent British requirement for listed companies to publish an annual Operating and Financial Review (OFR), in which they must identify and disclose material social and environmental matters. Earlier this year, Britain's Accounting Standards Board issued a reporting standard on the OFR.

A critical issue is ensuring that any disclosure does accurately reflect the actual practices of the company. However, the approach has several advantages. Such disclosure can generate wide-ranging and important debate on the value of particular practices. It has the flexibility to promote different practices to suit the wide variety of circumstances companies operate in. Disclosure also helps shareholders and other stakeholders monitor CSR practices and can help companies build stronger relationships with stakeholders. Directors may also benefit from learning about the CSR practices of other companies and disclosure should create a climate in which directors reflect on their company's CSR practices in order to determine if they are appropriate.

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