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**Keynote Address to the 11th FINSIA-Melbourne Banking and
Finance Conference 2006**

Corporate Responsibility – Managing Risk and Creating Value

**11:00am to 11:45am, Tuesday 26 September, 2006
RMIT University, MELBOURNE**

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- Thank you for the opportunity to speak today on the work of the Joint Statutory Parliamentary Committee on Corporations and Financial Services, which I Chair.
 - The Australian Parliament makes extensive use of committees, delegating to them some of the powers and tasks which it is unable to perform in the large, formal environment of the House of Representatives and Senate Chambers.
 - In conducting their Inquiries, committees are ideal fact finders; able to investigate and prod, ask difficult questions, request the production of documents, consider evidence, draw conclusions and make recommendations to government.
 - They also consider legislation and scrutinise public administration and service delivery. In doing so, they contribute significantly to the development of government policy.
 - In providing a public forum for the presentation of views from a cross section of the Australian Community, with frequent hearings conducted in all capital cities and regional Australia, committees provide an effective public conduit of information and ideas to the Parliament.
 - Importantly, committees are not constrained by procedural formalities and may take the form of Round Table discussions.
 - Comments can be taken from the floor and field trips allow people at the coalface to raise their concerns directly with committee members.
 - Once a committee has completed its Inquiry the final report, including recommendations, are tabled in Parliament.

- The Government endeavours to respond to the recommendations of a committee within three months from the date of tabling.
- However, the final report does not represent the only outcome of an Inquiry.
- The Inquiry itself may promote public debate and, in some cases, provoke action by government, or a government agency or even the private sector prior to the handing down of a report.
- Turning specifically to the Parliamentary Joint Committee on Corporations and Financial Services, I was appointed Chairman of the Committee by the Prime Minister following the re-formation of the Committee after the 1996 election and subsequently reappointed in 1998, 2001 and 2004.
- Despite several name changes, its activities have not changed significantly.
- Essentially the Committee role is to carry out Inquiries on ASIC related activities or the Panel.
- This includes the operation of the corporations legislation and any other legislation in Australia which the Committee deems to affect significantly the operations of the corporations legislation, especially financial services.
- My Committee has played a key role in the Howard Government's extensive financial, legal and regulator reform agenda over the last decade, contributing to the creation of a world class regulatory framework, driving innovation and wealth creation, while providing a safe and fair investment environment.
- The CLERP process and the Financial Services Reform Act have been especially important in this regard.
- Turning now to the main issue of my presentation today, the Committee has recently completed an Inquiry and Report into Corporate Responsibility.
- The committee's inquiry generated enormous interest from a broad spectrum of corporations, organisations and individuals.
- In fact, the committee received some 146 submissions — the most submissions received by this committee in the last decade — and conducted wide-ranging hearings with an extensive cross-section of relevant stakeholders.

Aims of the Inquiry

- At the outset, allow me to touch on the main aims of the Inquiry.
- Essentially, the Inquiry examined corporate responsibility and sustainability reporting in Australia for incorporated entities, including for-profit and not-for-profit organisations.
- The terms of reference were broad and included:
 - The extent to which organisational decision-makers, including directors, have an existing regard and should have regard for the interests of stakeholders other than shareholders and the broader community.
 - 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. In this context, the Inquiry also examined whether revisions to the legal framework, particularly to the Corporations Act, are required.

Defining Corporate Responsibility

- Corporate responsibility relates to taking a long-term view of shareholder interests and is usually described in terms of a company or organisation considering, managing and balancing the economic, social and environmental impacts of its activities.
- In this context, corporate responsibility is about protecting and nurturing our shared heritage, whether that be addressing environmental concerns or encouraging more ethical investment practices which, in the long-run, adds to shareholder value and enriches community life.

The role of corporations in society

- Importantly, the issue of corporate responsibility brings into focus the question of the role of corporations in society and how government can best mediate this relationship in the national interest.
- Recent cases of corporate collapse and environmental negligence have rightly hastened issues related to corporate responsibility to more central consideration in industry and government.
- One only need to think of the recent collapse of HIH in Australia and Enron in the United States to get a sense of the profound affect these issues can have on our lives.
- The ensuing heightened public awareness has acted as an important driver for corporate responsibility issues evolving into a practical mechanism for companies to re-assess and manage in different ways their non-financial risks and create additional long-term financial value.
- This is also reflected in the fact that financial markets are increasingly driven by how well companies manage their non-financial risks with institutional investors beginning to engage with companies over the long-term in an effort to improve their social, environmental, governance and financial performance – to change the direction of the ship rather than jumping ship, so to speak.
- This trend is supported by a range of studies and data showing that companies with good corporate governance and corporate responsibility practices experience roughly 10 to 12 per cent increase in their market evaluation.
- This is an important point borne out in our Inquiry.

The drivers of corporate responsibility

- In providing relevant background in assessing what role government should play in corporate responsibility, therefore, it is important to understand the drivers of corporate responsibility.
- Given that the traditional focus of corporations has been on generating profit to provide a financial return to shareholders, the question arises: why would a profit-driven company choose to engage in such activities that have the potential to distract them from pursuing their main business interests, that being responsibly to

drive shareholder value and grow their profitable position as strict financial criteria would dictate?

- First, as touched on previously, the dominant motivations for improved sustainability performance are the usual economic forces of informed and competitive commercial markets.
- The other main motivating factors are the recent changes in community expectations, as well as a growing range of companies genuinely committing to ethical decision making.
- The inter-connections between these drivers are proving to be reinforcing in nature.
- In addition, numerous international developments, such as the United Nations Global Compact initiative, are also playing an important role in driving social and corporate awareness of the importance of these issues globally.
- The growing strength of these drivers bring to bear new and significant pressures to which companies need to respond and adapt in novel ways in order to remain competitive in their respective markets.
- Collectively, these pressures are promoting the wide spread understanding that behaving without regard to corporate responsibility principles causes corporations immense commercial damage.
- Leading companies in this area have realised that integrating the notion of sustainability and corporate responsibility into their everyday business practices can have a range of benefits in building company value.
- This includes creating more effective alliances and working relationships with employees, suppliers, communities and environmental groups.
- Improvement, however, in the structures and quality of these relationships are usually difficult to measure accurately, diffuse in impact and cumulative.
- As such, evaluation and benchmark measurements also need to evolve in order to adequately capture these new performance targets.
- It is also apparent that different companies are influenced differently by drivers depending on company attributes such as the nature of the business, size, location and industry sector.
- The detail of these points are borne out in the Report's findings, with a great deal of evidence highlighting the many innovative ways Australian companies are employing responsible corporate approaches to managing risk and to creating corporate value in areas beyond a company's traditional core business.
- It is for these reasons that the committee recommended against additional legislation to mandate corporate responsibility activity.
- In addition, at a time when business is seeking and government is responding positively to a reduction in strangulating red tape, further costly and unnecessary regulation regarding corporate responsibility is likely to be counter-productive.
- Most importantly, it would be counter-productive in terms of inducing a strong corporate responsibility culture which is one of the main goals the government has in addressing community concerns and broader national interests.

Voluntary VS mandatory reporting of corporate responsibilities

- This conclusion was supported by a range of arguments our Committee heard as to whether reporting should be voluntary or mandatory.
- We concluded that reporting should remain voluntary.
- In particular, we took note of evidence suggesting that mandatory reporting would lead to a ‘tick the box’ culture of compliance.
- This is an undesirable outcome and one that works against the principles underpinning corporate responsibility.
- We believe that it is important for companies to be encouraged strongly to engage voluntarily in sustainability reporting rather than being forced to do so.
- A separate issue was that of the adoption of a voluntary standardised sustainability reporting framework.
- The most prominent and widely accepted of these is the Global Reporting Initiative, an international reporting framework favoured by many submitters.
- The Committee is strongly supportive of the GRI but believes that it is too early to recommend it as the voluntary Australian framework.
- The Committee, however, does encourage greater industry-led uptake and disclosure of corporate responsibility activities.
- Of particular interest was the example from overseas: the United Kingdom organisation Business in the Community.
- This industry-led network assists businesses to develop practical and sustainable solutions to manage and embed responsible business practice.
- We support the establishment of such a network in Australia and recommend that the Australian Government provide appropriate seed funding.
- Although several organisations with similar aims currently exist in Australia, there is no single accepted over-arching business-based body to provide co-ordination.
- I hope this will develop.

Corporations and Markets Advisory Committee private Inquiry

- As I am sure you all know, our public Inquiry ran in conjunction with the Corporations and Markets Advisory Committee private Inquiry which asked whether revisions to the Corporations Act are required so that directors have regard for particular classes of stakeholders other than shareholders.
- The CAMAC inquiry seeks guidance on what role, if any, the Government should play in promoting companies to act responsibly in the social context through initiatives such as voluntary codes of practice.
- It also asks whether companies should have to report, as part of their mandatory requirements, on the social and environmental impact of their activities.
- The CAMAC Inquiry is expected to present their findings by the end of this year.

- As the CAMAC Inquiry was not a public inquiry, the Committee thought it beneficial to have external and public input from those who would stand to be affected by any change in the regulatory arrangements governing corporate responsibility.

Director's duties

- A significant part of the Inquiry's evidence, both from those 146 written submissions received and from witnesses at the public hearings, addressed the arguments for and against more regulation of corporate responsibility and the role of Government in promoting and/or enforcing corporate responsibility.
- Critical to these arguments is the current legal framework, particularly the Corporations Act 2001, including Directors Duties and whether their mandate permits, precludes or is neutral towards directors considering the interests of stakeholders other than shareholders.
- In particular, consideration was given to Section 181 of the Corporations Act.
- We found that, despite some isolated instances where directors have interpreted their duties narrowly, for example, in the James Hardie case, the vast majority of Australian company directors are taking an enlightened self-interest approach.
- As highlighted previously, the issues driving this enlightened self-interest approach relate to a growing range of longer-term considerations which impact on financial bottom line results.
- The Committee considers that an interpretation of the current legislation based on enlightened self-interest is the best way forward for Australian corporations.
- Further, the Committee concluded that there is nothing in the current legislation which genuinely constrains directors who wish to contribute to the long-term development of their corporations by taking account of the interests of stakeholders other than shareholders.
- An effective director will realise that the well-being of the corporation comes from strategic interaction with a range of stakeholders and attending to non-financial risks in the pursuit of building long-term company value, including, for example, reputation and recruitment advantages.
- Given that the constraint on Directors is not legislative in nature, the solution is unlikely to be legislative in nature and adding a mandatory tick-box approach to accountability would be counter-productive to inducing a strong grass roots culture of corporate responsibility.
- The conclusion of the Committee is that amendment to the Corporations Act, and in particular to the provisions setting out directors' duties, is not required.
- However, the Committee gave extensive consideration to other non-legislative ways in which the Government might encourage greater corporate responsibility.

Encouraging corporate responsibility

- This consideration was in line with the strong message received by the Committee that government has a key role to play in the education of company directors, investors and other stakeholders.

- We support activities already in place, such as the Prime Minister's Community Business Partnerships and conclude that the Australian Government could increase its involvement in this area.
- Further, we recommend the development of educational materials to encourage corporate responsibility for institutional investors and for the not-for-profit sector.
- The other key area where the government should demonstrate leadership is through best practice initiatives in its own agencies and activities.
- The Committee commends those government agencies that undertake sustainability reporting but we recommend that, to show greater leadership and to encourage more reporting by government agencies, the Australian Government establish voluntary sustainability reporting targets for government agencies.
- We recommend also that the Australian Government establish voluntary targets for government agency procurement in areas such as water, waste, energy, vehicles and equipment.

Institutional investors

- Of particular interest to the many here today involved with managed funds, including superannuation, is that a good deal of evidence to the committee concerned the role of institutional investors and the important influence they can have on corporate behaviour.
- As indicated, institutional investors are more likely to take a long-term view of a company's financial performance.
- Despite the focus of institutional investors on financial performance, evidence suggests that increasingly they are considering non-financial factors that can present significant risks and opportunities for a company's future financial performance.
- This is highlighted by the enormous financial muscle of superannuation funds globally which are creating tailored voting policies on corporate responsibility and sustainable business practices.
- Full integration of social and environmental factors into superannuation-fund analysis of companies, however, is expected to take some time due to inherent difficulties in formalising and standardising evolving models of analysis.
- This is all the more reason why the role of government should be to encourage and facilitate corporations to evolve innovative solutions to corporate responsibility issues based on key drivers, rather than enforce behaviour through costly and restrictive regulation.
- However, it is important to acknowledge that a significant impediment to institutional investors engaging more with the non-financial performance of companies is the deficiency in non-financial information.
- The Committee recommends that the Australian Stock Exchange's Corporate Governance Council should provide further guidance to companies on how best to inform investors of material non-financial performance by disclosing their top five sustainability risks and by providing information on the strategies to manage those risks.

- We also recognise the potential of the relatively new operating and financial review provisions of the Corporations Act for the disclosure of material non-financial information.
- We recommend that each company auditor monitor and review disclosures made under the Operating and Financial Review provisions and make recommendations to their company's board regarding the adequacy of the disclosures.
- Finally, for institutional investors, the Committee supports the adoption of the United Nations Principles for Responsible Investment and, in particular, recommends that the recently established Future Fund should become a signatory.

Labor's supplementary report

- The support of Labor committee members for the bulk of this report is welcomed.
- However, I believe Labor's decision to issue a supplementary report was unnecessary and regrettable.
- It appears to me an attempt at some product differentiation even though, by and large, the narrative of Labor's report restates much of the Committee's report.
- To the extent to which Labor's report differs, particularly in its recommendations, the business community should note very carefully that their report advocates more government intervention, regulation and red tape.
- The Howard Government, on the other hand, has been developing ways to rationalise, reduce and coordinate regulation across Government.
- This is demonstrated in the fulfilment of an important election commitment with the establishment of the Uhrig Review, the recommendations of which were adopted by the Government and provide a consistent framework for public sector governance structures across Federal Government Companies, Trading Enterprises and Statutory Authorities.
- Building on this commitment and among a number of key initiatives of recent times, the Taskforce on Reducing Regulatory Burdens on Business recently released its Report entitled 'Rethinking Regulation'.
- The Government adopted 158 of the 178 recommendations set out in the Report, paving the way for further productivity gains in the Australian economy through cost savings for business and more efficient Government operations across the three tiers of government in Australia.

Conclude

- In moving forward, flexibility is a core concern and is one of the strengths of Australia's regulatory framework.
- Based on a mixture of regulation, co-regulation and encouragement of industry best practice, these flexible arrangements are reinforced in our recommendations, which can be tailored to the circumstances of different companies.
- Over the course of the inquiry, the Committee has been encouraged by the evidence of increasing engagement by Australian companies and Australian government agencies with sustainable practices and sustainability reporting.
- However, it is important that further progress is made.

- The Australian Government and the Australian Securities and Investments Commission, where appropriate, should monitor progress.
- The Committee strongly supports further successful engagement in the voluntary development and the wide adoption of corporate responsibility.
- We believe that the recommendations contained in this report will play an important part in driving progress in the ongoing adoption of corporate responsibility practices in Australia.
- Finally, I end by observing that corporate responsibility is no longer something that can be dismissed or marginalised.
- It is emerging as an important driver of innovation, the creation of new and niche market opportunities, a means to differentiate company identity and a significant investment attractor.

END

Additional notes

Brief review of the recommendations

- The key recommendations, among twenty nine, of the report include:
 - That amendment to the directors' duties provisions within the Corporations Act is not required.
 - That sustainability reporting should remain voluntary.
 - Although not recommending the Global Reporting Initiative (GRI) at this stage as the voluntary Australian framework, the committee recommends that the Australian Government should continue to monitor its uptake, and provide guidance to the business community on how to apply the GRI Framework.
 - That the Australian Stock Exchange's Corporate Governance Council should provide further guidance to companies on how to best inform investors of material non financial performance, by disclosing their top five sustainability risks, and by providing information on the strategies to manage those risks.
 - That each company auditor monitor and review disclosures made under the recently introduced operating and financial review provisions of the Corporations Act, and make recommendations to the company Board regarding the adequacy of the disclosures.
 - The establishment, with government seed funding, of an industry-led organisation (the 'Australian Corporate Responsibility Network') modelled on the UK's Business in the Community initiative, to assist businesses to develop practical and sustainable solutions to manage and embed responsible business practice.
 - The establishment by government of voluntary targets for government agency sustainability reporting.