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The Good the Bad and the Ugly of Corporate Responsibility

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What more appropriate time to be debating the good, the bad and the ugly of corporate responsibility.

With public trust in corporations at an all time low and cynicism at an all time high, it’s common to hear people say that the interests of corporations can never be reconciled with the public interest.

And it is not uncommon to hear that the whole notion of corporate responsibility is just disingenuous blather.

In fact, with so many interpretations, corporate social responsibility as a term is almost without common meaning.

And as an inadequately defined and understood concept it tends to be divisive.

So let’s move on from the confusing and divisive language and get back to the real question.

The question that has been asked ever since the father of capitalism Adam Smith wrote his *Inquiry into the Origins and Causes of the Wealth of Nations* in 1776:

- Is it possible for corporations to maximize profit and at the same time serve the public interest by contributing to human, social and environmental capital?
- Is it desirable?
- Is it foolish to try?

Or to put it another way, will the unfettered pursuit of corporate profit, without adequate attention to the public welfare, ultimately set crippling and unnecessary limits on capitalism, making it less creative, less dynamic, and less sustainable, as Peter Drucker has argued?

What is not always understood is that Smith in fact described a system based on 'enlightened self interest', and not one based on personal advantage at the ultimate expense of the common good.

In his earlier work, *The Theory of Moral Sentiments* in 1759, Smith had underpinned his 'capitalist' system with the virtues of justice, fairness and honesty. Smith saw neither selfishness nor greed as virtues and regarded the spheres of human conduct - economic, social, moral, and political - as interwoven and mutually dependent.

So how did we end up in a world where corporate behaviours are so widely seen to be at odds with that envisaged by the father of capitalism?

Much of the answer can be traced back to the nineteenth century and the influence of Social Darwinism - a philosophy whose essence is that human societies work best when the principle of 'survival of the fittest' is exercised with the <u>minimum</u> constraint.

Following this philosophy, a 'laissez faire' libertarian form of capitalism soon dominated, built on the belief that the market works best if unfettered by regulation or externally imposed obligations.

Called 'brute capitalism' by Steve Young, the Executive Director of the Caux Round Table, its popularity dipped somewhat with the socially unpleasant consequences of depression and war.

But it made a resounding recovery in the last few decades.

The problem with brute capitalism, however, is that in the end narrow self-interest and personal advantage inevitably get elevated to the status of core values. And as a result public trust in corporations goes out the window.

I think the following tongue in cheek story, built on the recent Enron scandal, provides a vivid example of how the public sees ‘brute capitalism’. It goes like this:

*You have **two** cows.*

*You sell **three** of them to your publicly listed company, using letters of credit opened by your brother-in-law at the bank.*

*You then execute a debt-equity swap with an associated public offer so that you get all **four** cows back, with a tax exemption for **five** cows.*

*The milk rights for **six** cows are then transferred through an intermediary to a Cayman Island company, secretly owned* *by the majority shareholder who sells the rights to all* ***seven*** *cows back to your listed company.*

The annual report then declares that the company owns ***eight*** *cows, with an option on one more, which of course triggers the multi-million dollar executive performance bonuses.*

Yes this is an exaggeration, although some of the revelations of greed and deceit in recent corporate scandals do beggar belief.

Exaggeration it might be, but public markets do appear increasingly less capitalist, at least in the sense that owners are no longer proprietors.

Owners today operate more as ‘detached punters’, many with their interests delegated to their superannuation, investment and insurance funds.

But when the funds themselves have little expectation of really being able to directly influence the operation of companies, the prevailing behaviour is to play the market -

moving in and out quickly, with less and less focus on long-term holdings and long-term value.

Not surprisingly, this has impacted senior management behaviour and how they're seen. For example, as a result of corporate scandals and alleged excesses, they're increasingly being accused of viewing themselves as the object and beneficiaries of the bets, rather than seen as the proprietors of lasting enterprises.

One certainly should start worrying when the Economist magazine itself features an article titled *'Pigs, pay and power'*, claiming that executive pay lay at the heart of capitalism's troubles.

But it doesn't have to be this way.

A moral form of capitalism is possible, where the interests of the firm are reconciled with the public interest.

Good companies **are** out there today demonstrating that they can embody and express concern for the public welfare without sacrificing profitability.

Doing the right thing by society, which may be little more than doing no harm, and doing the right thing by the firm **can be** mutually re-enforcing goals.

At its core, moral capitalism simply means not trampling on the interests of others in the pursuit of corporate interests. It involves corporations being concerned with the principles of right and wrong and conforming to standards of behaviour and character based on those principles.

Or to use corporate-speak, widening the concept of corporate value in ways that align the strategic needs of the owners of the capital with those of the relevant stakeholders on which the ongoing viability of the business depends.

The way forward involves corporations accepting accountability for the externalities of their business activities that impact the public and stakeholder interests.

And to recognise that in doing so, they will take risk out of their business, enhance their ‘social licence to operate’ and reputational capital, and thereby add to shareholder value.

In other words, businesses must find a point of equilibrium in blending self-interest with principles and values that accord with the public good. A point that ensures the primary and legal obligation of the business to operate profitably is not compromised, but enhanced.

This means practicing ‘enlightened self-interest’, or as Adam Smith would have put it, ‘self-interest considered upon the whole’.

What is clear is that if we want our capitalist system to be a more sustainable one, and a more efficient one, and certainly one which is more uniformly admired, then corporations must marry their own self-interests to a sympathetic regard for the well-being of others.

Encouragingly there is a growing view in equity and investment markets that this is the right strategy.

So in summary, there is no question that companies can do good and do well at the same time.

The message is that the pursuit of excellence in business does not require companies to forget their moral sense.

In fact if we are to sustain the prosperity of our companies and our society, business leaders are going to have to move beyond the walls of their institutions and truly learn to create community.

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