Governance of the Social and Environmental Kind

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No corporate ostrich could have had its head far enough in the sand to miss the rise and rise of corporate governance.

The stunning collapses of the last two years have thrust the corporate activists onto centre stage. With the increasing reliance of the population on investment markets to provide for retirement nest-eggs, industry focus should, and is, increasingly turning to long-term shareholder value. Governance and sustainability principles are perfectly placed to compliment this approach.

Corporate governance is about the management of corporate business enterprises and the mechanisms by which such management is supervised. Corporate governance is most frequently associated with the rules governing the operation and management of corporations, for example, the legal constraints and duties imposed by the *Corporations Act 2001*. The organisational structure of the company, its "static" procedures and reporting channels, such as board composition and the division of powers between directors and shareholders, are ordinarily specified in the company's constitution.

But, as the recent spate of corporate crashes illustrate, the company's day-to-day management, its "dynamic" account of the processes of corporate activity, is often a better indicator of good governance and company health. This dynamic state of the conduct of a company's affairs is its continuing pattern or mode of governance and includes the management of social and environmental responsibilities.

Sustainability and governance

The broad concept of sustainability, borrowed from the natural sciences, enhances principles of good corporate governance making the corporate entity more accessible to those who are trying to understand and evaluate its performance. As indicators of company health, social and environmental risk indicators can be seen as comparable in some respects to other signal values such as a company's price to earnings ratio, dividend yield or various other traditional financial ratio analyses.

The fit between sustainability and sound economic management is less awkward than it may appear at first glance. In industry parlance, corporate sustainability refers to the triumvirate of bottom lines – social, environmental and economic. The management of the triple bottom line and governance structures addressing social and environmental risk can be rightly brought into the fold of corporate governance.

For example, the financial risks flowing from management of environmental impacts have increased in line with the increasing number and severity of regulatory measures, and with changing market expectations. These risks can be material to the financial position of listed companies and therefore to the governance of the company.

To use an infamous illustration, Paul Anderson's departing (and understated) comment from BHP Billiton that "Ok Tedi consumed a disproportionate amount of management time" is an indication of the direct impact an environmental disaster can have on corporate management. Likewise, the recent experience of Mayne Group Limited, a major listed healthcare company, demonstrates the extent to which lack of attention to public trust, reputation, and the ethical obligations of its own medical practitioners, has the potential to undermine core business strategies and sharemarket performance. Equally, we have seen the role of social accountability in policy debates relating to the banking and telecommunications sectors.

Disclosure of social and environmental risk

Unlike major environmental catastrophes or social upheaval, the day-to-day governance of a company is not necessarily discernible in relation to isolated acts or events. It emerges from a consideration of the governance of the corporation as a whole, including its inactions or omissions over time. An argument can therefore be made that continuous corporate disclosure of social and environmental risk (and its mitigation) is important to enable assessment of financial risk. The global trend in the accounting profession toward the development of new forms of internal assessment (for example the use of the balanced scorecard) and external reporting (for example value reporting) is indicative of the growing market demand for more accurate and complete corporate information.

However, methods for disclosing material environmental risk are still imperfect. One reason for the difficulty is that there are vast differences in the exposure of particular industries or companies to social and environmental impacts. This makes the standardisation of disclosure practices contentious and the link to responsible financial management variable.

Social and environmental issues vary across different companies, industry sectors, and over time. A recent study[1] showed that oil and gas companies demonstrating above average performance across a range of parameters including resource efficiency, development of new markets for clean fuels and renewable energy, and environmental management capacity, had financially outperformed their industry compatriots over a five year period. Similar research[2] in the pulp and paper sector in the US found that market values could be reduced by greater than 10% in some companies in the absence of appropriate mitigation strategies.

Despite the variability in social and environmental awareness across industries, and the mixed reports of financial benefits reaped, the overwhelming majority of companies now recognise social and environmental responsibility as a par for the course of sound economic management. A recent global survey[3] conducted by Ernst & Young found that 94% of companies believe the development of a corporate social responsibility strategy can deliver real business benefits. However, a practical commitment to this recognition is some way off with only 11% of respondents having made significant progress in implementing the strategy in their own organisation.

While a growing body of research suggests that social and environmental management can impact the financial bottom line, the link is not always tenable, and when it is, it is not always direct. Nonetheless, the rising community and business concern over management of non-financial impacts necessitates the disclosure of material social and environmental issues in company reports.

Where does corporate Australia stand within the quagmire of mixed expectations and demands?

Only twenty three of Australia's largest listed companies currently provide an environmental report, despite research conducted by Monash University into the environmental disclosure practices in the S&P/ASX200 which suggests that the risk of environmental exposure threatening an additional 60 companies makes an environmental report of this type crucial[4]. In addition to considering the appropriateness of verified corporate environmental reports, companies should review their Director Statements under s299(1)(f) of the *Corporations Act*. Environmental disclosure can also be integrated into the company's Annual Report and published on corporate websites.

In Australia, the *Financial Services Reform Act* 2001 ("FSRA") now requires the disclosure statement of financial products to include information about the extent to which the product issuer does or does not take into account labour standards and environmental, social and ethical considerations. In the UK, the recent White Paper reviewing company law[5] recommended the need for: "Environmental disclosure... and that directors need to take account of a wide range of factors such as the company's impact on the environment which the Government believes every director needs to consider as first among equals".

The new provisions of the FSRA are yet to have a substantial impact on mainstream corporate reporting or socially and environmentally responsible corporate practices in Australia. Additional incentives, such as ASIC disclosure guidelines and enforcement powers, would make the conversion of the financial disclosure statement in the FRSA into material changes in financial practices more effective.

In the meantime, as traditional concepts of corporate governance expand to include the governance of social and environmental factors, boards and management are encouraged to review their regulatory and community liabilities, identify their key areas of social and environmental risk and report on meaningful steps taken towards their mitigation. ●

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1 Innovest Strategic Value Advisors Inc, Energy Sector Carbon Risk Exposure, July 2002.
2 Repetto, R. and Austin, D. *Pure Profit: The Financial Implications of Environmental Performance*, World Resources Institute, March 2000
3 "Corporate Social Responsibility: Unlocking the value", Ernst & Young, August 2002
4 The research by Monash University was conducted in March/April 2002. For further information about the research, please contact the writer.
5 Modernising Company Law, Command Paper CM 5553, Presented to Parliament by the Secretary of State for Trade and Industry, by Command of Her Majesty July 2002

LAWYERS *for* FORESTS

Lawyers for Forests –
Corporate Accountability and Forests

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Lawyers for Forests, Inc. ("LFF") is an independent, non-politically aligned, association of legal professionals working in the corporate, government and community sectors. It was established in 2001 to address growing concern among members of the legal community about native forest management in Australia and, more particulary, Victoria. LFF has four broad purposes, which are:

- to promote the conservation and better management of Australia's native forests;
- to increase the accountability of government and business for their forest management policies;
- to stimulate and encourage public interest in the value and importance of protecting native forests and related environmental issues; and
- to provide pro bono legal advice and undertake law reform and policy development activities to further these purposes.

LFF has three committees that focus on particular areas related to its purposes: Law and Policy, Access to Justice and Corporate Awareness. This article examines some of the activities engaged in by the Corporate Awareness Committee.

LFF and the Wilderness Society – A partnership against the woodchippers

Contrary to the common perception that destruction of old growth forests is confined to developing countries, large-scale devastation of Australia's natural heritage is proceeding at an unprecedented rate. One Australian company, Gunns Ltd, is, according to its own literature, the largest exporter of woodchips in the southern hemisphere. This year Gunns Ltd will export approximately 5.5 million tonnes of woodchips out of Tasmania's forests, more than doubling the rest of Australia combined. The Wilderness Society has calculated that at least 65% of chips exported are sourced from old growth, high conservation value forests. Forests currently being ravaged include the world heritage quality Tarkine in the North-West of the State and the extraordinary Styx Valley of the Giants where 400 year old Eucalyptus Regnans rise to over 90 metres, making them the tallest flowering hardwood plants on earth.

The dominant form of logging in Tasmania, as in Victoria and New South Wales, is clearfelling, where hundreds of hectares of forest are completely flattened each year. The cleared area, with plenty of good, usable wood left on the ground, is then bombed from helicopters with jellified petroleum incendiaries similar to napalm. The searing heat created by this scorched earth policy destroys many seeds left in the ground and in most cases the area is then converted into a monoculture plantation by re-seeding with exotic species or a few economically valuable species. In Tasmania, to protect the seedlings, the area is baited with carrots dipped in 1080 poison, killing any native wildlife that grazes on the young trees. Tasmania is the only state in Australia which still clearfells rainforest and sanctions the poisoning of its native animals.

Community opposition to the practices of Gunns Ltd in Tasmania is running high, with a broad cross section of the community, including many traditional conservatives, now supporting an end to the destruction. Despite this increasingly vocal opposition to its practices, Gunns Ltd is steadfastly refusing to listen and continues to clearfell log massive areas of pristine forest.

In response to this ecological vandalism, LFF joined with The Wilderness Society's forests campaigner (and former LFF Corporate Awareness Committee convener), Leanne Minshull, to take the fight for our forests into the boardrooms. The approach has been to target those organisations that own significant amounts of Gunns Ltd equity – the large institutional investors including the major banks – in order to place pressure on the company to change.

Shareholder groups, consisting of shareholders holding at least $500 worth of shares, were set up by The Wilderness Society for each of the