SHAREHOLDERS, STAKEHOLDERS, ETHICS AND SOCIAL RESPONSIBILITY

A Discussion of Views of Business Accountability

January 2002

CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

Table of Contents

Setting The Scene

Introduction

Background

Recent years have seen renewed focus on the social and environmental dimensions of economic activity, and in particular on the activities of the business sector.

This focus has many sources and strands.

It derives in part from the search for new ways of moulding society and the economy in the aftermath of the collapse of communism, and consequent discrediting of state-directed, centralised political and economic models.

It reflects concerns about the processes and effects of globalisation, and the way in which economic decisions and their social and environmental effects increasingly transcend traditional national and regional political jurisdictions.

It is driven in part by the increasing prominence and claims of non-government organisations seeking to fill some of these gaps in authority with the influence of 'civil society'.

This prominence has in turn has been both a cause and an effect of a shift in public opinion towards concerns for the social, cultural and environmental consequences of economic activity.

These shifts in public opinion matter to business.

Through the media, the internet, activist groups and non-government organisations, people have a greater willingness and capacity to monitor business activities than ever before.

And they have the power to reward and penalise behaviour of which they approve or disapprove, through co-ordinated or individual actions as consumers, investors, voters and litigants.

Aim of this paper

This paper discusses the sources and implications of one manifestation of these complex trends – the idea than businesses should focus beyond the financial bottom line and pay more attention to the wider ethical, social, environmental and other consequences of their activities.

It uses the loose term 'stakeholder orientation' to encompass a range of distinct but related ideas on modifying business behaviour, including stakeholder entitlement, corporate social responsibility, triple bottom line accounting and ethical investment. These definitions and distinctions are explored in more detail in *Appendix 1* on page 18.

Its focus is primarily on the limited liability corporation. This focus was chosen with some reluctance, as small businesses have a crucial role in the economy and society which has tended to be overlooked in much of the political and academic debate on stakeholder orientation.

But the specific applications of stakeholder orientation discussed below are, for the time being, mainly associated with limited liability, shareholder-owned corporations.

Further, while many of the issues discussed in this paper are relevant to owner-operated and unincorporated businesses, the questions of accountability and ownership this paper addresses centre mainly around the responsibilities of managers handling other people's resources, not their own.

What Are Corporations For?

For as long as businesses with limited liability have existed, there has been debate about how they should be owned, operated, regulated and motivated.

This paper begins by trying to group and define different ideas about the proper role of the corporation, and the different policies and practices that result from those ideas.

The shareholder-oriented firm

In Australia, the UK and the USA, the commonest understanding of the firm is of a shareholder-oriented institution. This is typically a limited liability joint stock company whose core function is seen as generating profits for its owners.

In this model, corporate governance focuses primarily on ensuring that managers and directors exercise responsible stewardship of shareholders' funds. There is no expectation that these agents have a responsibility to serve any other interests besides those of the people whose property they manage.

Most exponents of a shareholder-focused model of the firm recognise that it is appropriate to modify the behaviour of business owners, managers and directors in the light of the wider social costs and benefits their businesses' activities engender (although the extent of appropriate intervention is hotly debated).

So, firms' operations are constrained within a framework of laws designed to enforce protections for the interests of customers, employees, other businesses, the environment, the community, the government, and so on.

Under this shareholder-oriented model, these constraints are external. No more is expected of businesses than that they obey the rules as they go about their core function of generating profits.

This limited expectation can be expressed either negatively or positively.

Positive advocates of the shareholder-oriented firm assert that maximising profit within a framework of laws is both the most ethically appropriate behaviour of business managers and the most socially desirable, because it leads to the best economic and social outcomes.

This view has been stated with characteristic forcefulness by Milton Friedman, who argued 40 years ago that:

> *"… there is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game."*[1]

The negative view of shareholder orientation presumes that corporate ethics is an oxymoron.

In this view nothing better than avarice can be expected of business operators, and pursuit of owners' interests will be at the expense of the wider community, so a system of laws and regulations is necessary to force corporations to behave according to the community interest.

An oft-quoted observation from 18th century British jurist Edward Thurlow[2] sums up this view summarising the hopelessness of expecting altruistic behaviour from business:

> *"Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?"*

The stakeholder-oriented firm

This model of the shareholder-oriented corporation operating within a framework of rules has never been universally welcomed or accepted, as Thurlow's comments and Friedman's defensiveness indicate.

Nor has it always been applied. Social democratic and corporatist societies have enlisted business along with labour and government in a concerted effort to achieve some wider social and economic good – broad macro-economic management or more specific objectives such as limiting wage increases in order to control inflation or reduce unemployment, for example.

Recently, there has been a revival in centre-left political circles of interest in broadening the orientation of businesses' objectives as part of a wider approach to economic management. This has coincided and overlapped with developments in stakeholder theories of management[3], which argue that the activities of businesses (and government and non-government agencies) should be oriented towards furthering the interests of a range of social and economic groups, or 'stakeholders'.

Definitions of the related ideas of stakeholder theory, corporate social responsibility and triple bottom line accounting are explored in *Appendix 1: Defining Terms and Concepts* on page 18.

Some advocates of a stakeholder-oriented approach to the corporation in fact hold very similar opinions to the negative view of the shareholder-oriented firm. They see businesses as inherently anti-social and avaricious, and therefore in need of extensive legal and regulatory restraints to make them give due consideration to implications of their operations on employees, customers, competitors, the environment and the community.

But there is a less hostile view which hopes that businesses will voluntarily incorporate broader interests into decision making processes.

Perhaps the most well-known political advocate of this form of stakeholder orientation is British Prime Minister Tony Blair, who has argued:

> *"We cannot by legislation guarantee that a company will behave in a way conducive to trust and long-term commitment. But it is surely time to assess how we shift the emphasis in corporate ethos, from the company being a mere vehicle for the capital market, to be traded, bought and sold as a commodity, towards a vision of the company as a community or partnership in which each employee has a stake, and where a company's responsibilities are more clearly delineated."*[4]

The resurgence of interest in stakeholder theory and other views that firms should take a broader focus than the interest of shareholders alone has many sources.

In its form most hostile to business, it reflects the views of the more radical elements of the anti-globalisation movement, and their related antipathy to corporate activities and rights. While Marxist solutions to the perceived evils of capitalism may have been largely discredited, an underlying hostility to capitalism persists (see also the section *Profits should not come first* on page 6).

Its more mainstream political expression lies in the resurgent 'third way' politics of Britain's new Labour already discussed, whose electoral successes make it an attractive role model to centre-left parties in Europe and elsewhere, including Australia.

While it would be a mistake to assume too much common ground in the various forms of social democratic revival currently under way – for example, the government of France's view of the degree of intervention needed in the labour market is very different to that of Britain's – Governments and political parties are adopting 'stakeholder' views of the economy which extend, though in different ways, to the corporation.

At a fairly diffuse social level, it reflects a response to the changing climate of community opinion which has underpinned that political sea-change, including increased environmental awareness and concern, disquiet at globalisation, hostility to corporations and a view that political processes fail to deliver the social and economic outcomes people want.

And at a practical level, many businesses are exploring or embracing ideas and practices which are stakeholder-oriented. The following section explores why businesses are becoming stakeholder-oriented.

Why do Firms Become Stakeholder-Oriented?

These attempts to shift the focus of the corporation towards stakeholders are not new.

What does seem new is the readiness with which some corporations are willing, and even eager, to abandon a shareholder orientation in favour of a wider focus.

Under headings[5] such as triple bottom line accounting, corporate social responsibility, stakeholder capitalism and ethical investment, many businesses are incorporating environmental, social, stakeholder and ethical dimensions of their activities into core objectives along with shareholder returns.

The rest of this section looks at why that might be the case.

Mutual Reinforcement

Probably the key reason for the increased prevalence of explicitly stakeholder-oriented policies in businesses is that they are to a large degree compatible with, and even conducive to, the promotion of shareholder interests.

We have already seen that the stakeholder and shareholder views most hostile to corporations share a common diagnosis - that business will never voluntarily act according to the community interest - and a common prescription - heavy and extensive regulation to ensure that the community's needs are not ignored in the pursuit of profit.

In a similar vein, there is considerable overlap between the policies which will be adopted by a stakeholder-oriented and a shareholder-oriented corporation.

Good Behaviour is Profitable

From a business perspective, a persuasive case for adopting a stakeholder orientation is that good corporate citizenship is profitable.

At its most fundamental level, the underpinning mechanism of commerce in free markets is ethical - voluntary co-operation to mutual gain. A strong case can be argued that this is a more ethical foundation than alternative mechanisms for distributing goods and services which, while perhaps driven by more altruistic motives than self-interest, tend to be achievable only through compulsion and confiscation.

At a more practical level, ethical business is generally profitable business. Contrary to anti-corporate myth, businesses in competitive markets which repeatedly sell over-priced or shoddy goods, which fail to pay suppliers, which exploit or under-pay workers or which harm the communities they operate in are usually not profitable for any length of time (although exceptions do exist, at least temporarily).

So good managements and responsible boards have always stressed ethical behaviour on the part of employees and agents, and more general business virtues such as courtesy, honesty, value for money and reliability, knowing these to be a considerable source of long-term competitive advantage (see also page 9).

A recent report by the NSW State Chamber of Commerce summed up the advantages of corporate social responsibility for the business community generally and for individual enterprises:

> *"The business community benefits when companies act responsibly. It gains a voice in the political arena, legitimacy, trust, power and freedom from regulations. These gains ensure that Australian companies will be competitive in domestic and global markets. Enterprise level benefits can be grouped into four areas; operating performance, market goals, human resources and external relations."*[6]

Many businesses have embarked tentatively or reluctantly on stakeholder-oriented programs only to embrace them with increasing enthusiasm as they are seen to yield dividends.

Companies have implemented triple bottom line accounting and in the process achieved improvements in operating efficiency or savings in input or waste management costs that have greatly exceeded both the cost of the program, and expectations.

But the gains from ethical trading practices and environmental responsibility are not new, so they are not in themselves enough to account for the ***increase*** in the number of businesses which publicly and explicitly commit to one or more forms of stakeholder orientation.

The increase in business activity in this area may in part reflect opportunity. In recent years there has been rapid growth in the range and depth of courses and consultancies, advisory bodies, literature and academics available to assist businesses which wish to adopt a systematic approach to business ethics, corporate social responsibility or triple bottom line accounting, for example.

Yet this increase in the opportunities for devising and implementing stakeholder-oriented policies may itself be an effect of increased demand for these services, rather than the cause for their adoption.

Bad Behaviour is Costly

Rather than corporate virtue being rewarded more richly than in the past, a more plausible explanation for corporations' increased stakeholder orientation may be that its absence is being more heavily penalised.

The community is becoming more concerned about the behaviour and ethics of the firms they do business with (and those they don't).

They have more opportunities to monitor, publicise and respond to business behaviour – through the media, the internet, and via pressure groups such as Corpwatch[7] established specifically in order to monitor and criticise corporate behaviour.

Not only are people more informed about corporate behaviour, they are more willing and able to influence and penalise that behaviour, as consumers, investors, voters and litigants.

Consumer activism has been targeted at corporations including BP Amoco, Monsanto, Nike, Nestlé and Disney.

The reputations of corporations and their brands have been shown to be vulnerable to concerted publicity campaigns, and businesses have been forced to respond to activists' allegations, even when they were ill-founded.[8]

Ethical investment funds screen out businesses whose products and/or practices they believe immoral, and many claim that investors can make as good or even better returns from investing in these firms than in the general run of corporations[9].

More hard-nosed corporate investment analysts have also turned their attention to the social, ethical and environmental practices of the businesses they invest in, driven not so much by desire to penalise behaviour deemed immoral, as by concern for the financial risks associated with it.

In part this may reflect under-estimation of risk in the past. But it seems to be driven more by the fact that the financial penalties associated with being held guilty of improper behaviour are much greater than ever before, whether guilt is in the eyes of the public (as with Shell[8]), or the courts.

Boards and directors, as well as shareholders and investment analysts, are reacting to this changed risk environment.

The USA has led the way in the rising tide of litigiousness which has seen huge damages claims awarded against tobacco and gun manufacturers, those who produce faulty goods, polluters and so on.

Appendix 2 provides some examples of the astronomical sums involved in some of the most expensive cases, and the seeming lack of proportion between damage caused and penalties inflicted in others.

This phenomenon is not limited to the USA, nor is it always excessive and/or disproportionate.

But its effects on costs is affecting business (and also not-for-profit and government agency) behaviour.

In Western Australia, workers' compensation premiums have risen sharply while accident and injury rates have not.

Escalating liability insurance has been blamed for the withdrawal of rural obstetrics services[10] and the closure of riding schools[11] and threatening police-sponsored Blue Light dances for young people in Western Australia[12].

These phenomena in turn are part of an ongoing process in which the limitations on the liability of businesses and their agents have been steadily unwound, through increases in the penalties applied to corporations and their employees for behaviour perceived to harm individuals or other businesses, and in the range of behaviours which are penalised.

Examples in Australia include:

– Proposals in Victoria to greatly increase penalties for breaching occupational safety and healthy regulations, and facilitate prosecution for corporate manslaughter.[13]
– in Western Australia and other states, the employer is vicariously liable for sexual harassment committed by an employee.[14]

This paper does not try to address the difficult questions of how far corporations should be held responsible for the effects of their business activities or for their employees' behaviour.

Rather, the point is that the cost of such penalties affects businesses' bottom lines. Increasing the range of activities subject to penalty, or the magnitude of penalties imposed, means that a profit-maximising corporation will make increased efforts to ensure that the penalty is avoided – after all, that is the point.

In summary, a business whose sole purpose is to generate returns for its shareholders has good reason to avoid the costs of acting unethically - whether it is to protect a corporate or brand image, to avoid the damaging effects of consumer boycotts, to attract and retain the investment dollars of shareholders concerned to invest ethically or investment managers concerned at the risks of unethical investment, or to escape the widening net of corporate crimes and liabilities, and the increasing penalties they attract.

The financial rewards of virtue and costs of transgression represent a strong business case for behaving ethically.

And for those seeking to persuade businesses to adopt a stakeholder focus, the attractions of profitable virtue are, understandably, stressed.

For example, the NSW State Chamber of Commerce paper on corporate social responsibility argues[15] that:

> *"Most Australian business leaders would like their company to have a positive impact on society and the environment. Yet in the day-to-day commercial pressures to maximise shareholder value and profitability, managers are wondering if they can afford to have 'fuzzy feelings' about their business operations."*

However, many advocates of stakeholder-oriented corporations go much further than endorsing profitable virtue and eschewing costly vice, or allowing business leaders to feel positive about their firms' activities.

The case for putting other interests ahead of profits and shareholders' welfare is discussed in the next section.

Profits should not come first

Distaste for an excessive desire to accumulate wealth and earn profit is even older than suspicion of the corporation, as the biblical warning that *"the love of money is the root of all evil"*[16] attests.

In 19th and 20th century political thought, the view that the pursuit of profit is the cause of the world's social and economic miseries was a recurring theme in the politics of the left (and sometimes the right) and was described by Karl Popper as "Vulgar Marxism":

> *"The average Vulgar Marxist believes that Marxism lays bare the sinister secrets of social life by revealing the hidden motives of*

greed and lust for material gain which actuate the powers behind the scenes of history; powers that cunningly and consciously create war, depression, unemployment, hunger in the midst of plenty, and all the other forms of social misery, in order to gratify their vile desires for profit."[17]

Few modern advocates of stakeholder-oriented corporations would own the label "Marxist" (vulgar or otherwise). But while many accept that the pursuit of profit does not necessarily and deliberately create economic and social distress, they do not accept either the free marketeers' view that social and economic welfare are usually best served by leaving corporations alone to pursue profit.

A key issue seems to be intent. St Paul did not describe money as the root of all evil (as is sometime misquoted), but rather the love of it.

Popper distinguishes "vulgar" Marxists (who believe that capitalists consciously and deliberately create misery for material gain) from the authentic kind who see war, poverty and unemployment as:

"... unwanted social consequences of actions, directed towards different results, by agents who are caught in the network of the social system"

Stakeholder theories of business assume that social and economic outcomes in the best interest of stakeholders will be realised only if that is what economic agents set out to achieve.

This is in marked contrast to the classical economists' view that individuals' pursuit of their own interests generally leads to the best outcome for society as a whole, even though that may not have been what those individuals intended. This was stated most famously by Adam Smith, whose description of an investor led by the 'invisible hand' also contains a caution to suspect the claims of businesses purporting to act altruistically:

"....by directing ... industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it."

Stakeholders and Business Ethics

At its most simple, stakeholder theory is a business performance tool compatible with a core objective of maximising shareholder value. It provides a framework for the systematic consideration of the interests of parties with which a firm has relationships. To the extent that such systematic consideration enhances the firm's viability and performance, it adds to shareholder value. It makes no special demands for business ethics or corporate social responsibility.

However, most modern stakeholder theorists go beyond specifying mechanisms for business performance to argue a system of business ethics. And in order to do this, the furthering of stakeholder interests must be not just a profitable consideration, but a right.

What Elaine Sternberg[25] defines as 'entitlement stakeholding' requires that shareholders hold no unique or superior rights over the activities of the firm compared to others who might be affected by its activities. As Freeman put it:

"The reason for paying returns to owners is not that they 'own' the firm but that their support is necessary for the survival of the firm." [18]

This presupposes a radically different view of both ethics and property rights than the one which underpins the shareholder-oriented view of business.

Managerial objectives

The discussion so far has focussed mainly on dichotomies between the interests of owners and other stakeholders. But managerial interest might be a key factor driving the push beyond shareholder orientation.

Within the modern firm, the manager holds a special place. Ever since the 1930s[19] it has been recognised that the interests and objectives of the owner and operator of businesses may differ, and managerial theories have developed over the years to explore that relationship. Agent-principal models describe the ways in which managers might seek to maximise their own benefits at the expense of shareholders if they have some degree of discretion over profit levels. Theories suggest that managers might seek to enhance their staffing levels, status, salaries, perks and pet projects even if these diminish shareholder value.

Indeed, much modern law on corporate governance is designed to allow shareholders and potential owners to scrutinise management performance in order to reduce the agent-principal problem.

The idea that managements should willingly or even enthusiastically adopt stakeholder-oriented practices even at the expense of shareholder value should not be particularly surprising in the light of these ideas.

Managers and chief executives have little or nothing directly to lose (except to the extent they are shareholders) by undermining shareholders to the benefit of other stakeholders, assuming they can escape shareholder sanctions.

And they have much to gain. They are, after all, stakeholders themselves. It is unpleasant to be branded a social pariah or ecological vandal, and agreeable to be viewed as socially responsible – as the NSW State Chamber of Commerce[20] points out, business leaders would like their firms to have a positive impact on society and the environment, but *"... are wondering if they can afford to have 'fuzzy feelings' about their business operations."* Stakeholder orientation legitimises those impulses.

Different views of accountability

This document has rather loosely used the phrase stakeholder-orientation to cover a wide range of related concepts including stakeholder theory, corporate social responsibility, triple bottom line accounting and business ethics.

There are some conceptual and other differences between these ideas.

Most stakeholder theorists would see the financial, social and environmental strands of triple bottom line accounting, for example, sitting comfortably within a stakeholder framework. But environmental activists in particular might argue that the environment sits uneasily as a 'stakeholder' alongside employees and suppliers.

Elaine Sternberg differentiates between essentially managerial stakeholder theories which argue that management should properly consider stakeholder interests in making decisions, and 'stakeholder entitlement' approaches which ascribe explicit rights to a range of parties with interests in a corporation. Such entitlement may require direct stakeholder representation in decision making.

Triple bottom line accounting proposes explicit and systematic quantification of social and environmental objectives in the same way as financial objectives, but unlike stakeholder entitlement it is typically envisaged as an internal process controlled by directors and managers.

Both triple bottom line and stakeholder theory are more concrete and far-reaching than the somewhat woolly precepts of corporate social responsibility, but both are also more prescriptive.

These ideas are explored more fully in *Appendix 1 Defining Terms and Concepts* on page 18.

While clearly not identical, the key precepts of triple bottom line accounting, corporate social responsibility and stakeholder theory have more similarities than differences.

They share a common theme of changing the orientation of business activities in order to achieve an economically, socially and/or morally better outcome than a narrow focus on shareholder value.

The next section looks at the effects of implementing such policies, and whether they are desirable.

What Should Business Do?

Underpinning Values

The preceding sections sketch an outline of current thinking on the role and responsibilities of corporations. Here, we examine the implications, effects, problems and underlying ethics of each.

Business ethics

The concept of business ethics generally refers to the values which underpin the decision making and behaviour of employees, managers and directors of a firm.

There are many definitions of business ethics. The Woodstock Theological Center identifies eight core values which it argues are *"critical to a strong ethical climate and a healthy ethical role for business in the larger society"*[21] - responsibility of purpose, responsibility to constituencies, honesty, reliability (including competence and quality), fairness, integrity, respect for the individual, and respect for property.

The concept of business ethics is itself controversial.

Libertarian economist Ludwig von Mises has argued that imposing ethical standards beyond self-interest on the marketplace inevitably, if unintentionally, leads to tyranny:

> *"[Social reformers] ... want to ban those motives that direct the individual's action in the market economy (they call them selfishness, acquisitiveness, profit-seeking) and to replace them with other impulses (they call them conscientiousness, righteousness, altruism, fear of God, charity). They are convinced that such a moral reform would in itself be sufficient to safeguard a mode of operation of the economic system, more satisfactory from their point of view than that of the unhampered capitalism, without any of those special government measures that interventionism and socialism require.*
>
> *"The supporters of these doctrines fail to recognize the role that those springs of action they condemn as vicious play in the operation of the market economy. The only reason that the market economy can operate without government orders telling everybody precisely what he should do and how he should do it is that it does not ask anybody to deviate from those lines of conduct that best serve his own interests."*[22]

Other analysts who share von Mises' advocacy of economic freedom maintain that ethical values are essential to the successful operation of the market.

However, some question whether business ethics are distinct from personal ethics.

According to the President of the Acton Institute, Rev. Robert A. Sirico:

> *"There is no business ethics or social justice as such. There are only ethics and justice."*[23]

Differences in the understanding of businesses' ethical responsibilities lead to radically different interpretations of the proper constraints on business activities and the nature of the interest they seek to serve. These are examined below.

Maximising shareholder value

The underpinning ethical values of the view that business executives' key responsibility is to maximise shareholder value are based on three related principles:

- Respect for individuals' dignity and autonomy implies a preference for voluntarism and co-operation over coercion.
- Respect for property rights implies that no person should have the right to direct someone else's property to a particular use without their consent.
- There is a moral (as well as legal) obligation to honour contracts.

Again, Friedman[24] expresses these views forcefully. On voluntarism, he argues:

> *"The political principle that underlies the market mechanism is unanimity. In an ideal free market resting on private property, no individual can coerce any other, all cooperation is voluntary, all parties to such cooperation benefit or they need not*

participate. There are no 'social' values, no 'social' responsibilities in any sense other than the shared values and responsibilities of individuals. Society is a collection of individuals and of the various groups they voluntarily form."

Stakeholder Orientation

The case for stakeholder orientation beyond that consistent with maximising shareholder value is based on a different set of principles.

As described by Elaine Sternberg[25], the stakeholder entitlement view has as its central tenet:

> *"...that organisations, and particularly businesses, must do more than just take their shareholders into account. It maintains that organisations must instead be accountable to all their stakeholders, and that the proper objective of management is to balance their competing interests."*

Both the stakeholder and shareholder oriented view of the role of business raise fundamental questions about accountability. These are discussed on page 12 below.

The next section explores whether these views are in fact in contradictory.

A False Dichotomy?

Most companies which have adopted codes of ethics, corporate social responsibility, triple bottom line accounting, stakeholder orientation and so on would argue that it is a false dichotomy to claim that businesses can serve the interests of shareholders or of stakeholders, but not both.

And for practical purposes, they are largely right. As discussed in *Mutual Reinforcement* on page 4, it is very much in the interests of shareholders that their businesses act ethically and are seen to do so.

Furthermore, a strong case can be argued that it is becoming more profitable to adopt socially responsible practices than in the past, and more costly not to.

Even the arch critic of corporate social responsibility, Milton Friedman[26], has recognised the shareholder benefits of claiming social and environmental virtue, although this does not mean he approves:

> *"Friedman once described oil company television ads as 'turning his stomach' for they made it seem that the purpose of energy companies was to preserve the environment. However, Friedman adds that he would probably sue oil company executives if they didn't engage in such 'nonsense' because oil companies must profess social responsibility to appeal to the public-at-large, remain competitive and ensure profits."*

Image or reality?

Such contempt for insincere business claims to corporate virtue is more common from the political left than the right, and points to one of the key problems with the view that social responsibility and profitability go hand in hand.

If firms are in fact seeking to maximise shareholder value, and using social or environmental or stakeholder interests as a means to that end, what matters is not that they do the right thing, but that they are thought to be doing the right thing.

As corporations have become more adept at promoting ecologically and socially responsible images, and at managing adverse publicity, there is inevitably suspicion that they are not actually changing their social and environmental practices by anything like the extent they claim.

For example, Corpwatch[7] issues 'greenwash' awards to corporations which it believes makes false or exaggerated claims to environmentally friendly practices.

If public perception is what matters, then the rewards of virtue do not necessarily go to those businesses which are the most virtuous, but rather to the most adept self-promoters.

And the reverse is also true – firms which have quietly practiced high standards of business ethics, ecological sustainability and social support for years may get little credit for it.

This process is made worse by the activities of some environmental organisations which have raised the stakes in terms of the damage which can be inflicted on corporations when they are perceived to do the wrong thing, while reducing the capacity of businesses to defend themselves against unfounded or unreasonable attacks.

The unfortunate lesson of the Brent Spar case (see *Appendix 3* on page 20) would seem to be that publicity management and damage control in the event of a hostile campaign by an environmental group can do more to protect a company's reputation than acting in a manner which scientific investigation determines is the most environmentally benign. The fact that many of Greenpeace's allegations against Shell turned out to be unfounded made little difference either to the debate or its outcome.

If the truth of a company's claim to environmental or social rectitude has no influence on the critique of that company by social justice and environmental activists, then the company will have little incentive to do anything other than produce the very 'greenwash' the activists despise.

These difficulties exist only to the extent that a business's reputation for social and environmental virtue is seen as a means to supporting long-term shareholder value. If social and environmental concerns are rated equal or superior to the interest of shareholders in their own right, then firms will be less concerned with the image and more with the substance of their social and environmental impacts. Even if they get no public relations kudos from these activities, they will be undertaken for their own sake.

However, there are a raft of different practical, ethical, social and economic implications of moving ***beyond*** showing regard for stakeholders' interests because it is in the interests of the corporation and its owners, to concede that stakeholders (or the social and environmental bottom lines, or social responsibilities) have a claim equal or superior to the interests of shareholders in determining how a corporation is operated and its surpluses distributed.

These are examined in the next section.

Flaws of Stakeholder Entitlement

Conflicting Priorities and Values

The first difficulty raised by stakeholder entitlement is resolving conflicts between values, objectives and stakeholders' interests.

Views on ethical behaviour and social responsibilities differ. Are the manufacturers of morning-after contraceptive pills accessories to murder or socially responsible contributors to both population control and women's autonomy? Are the creators of genetically modified foods irresponsibly courting ecological disaster or helping to eliminate world hunger? Are financial institutions which lend to developing countries condemning their populations to debt-ridden poverty or providing them with the means to escape it?

Among a firm's stakeholders, the conflicts become more concrete. The interests of customers and employees, employees and owners, owners and the community in which the business is operated, are obviously going to conflict on occasion.

More basic questions arise. Who is a stakeholder (virtually anyone, according to Freeman's[18] definition)? Are all stakeholders given equal weight, or do some get more consideration than others (eg full-time compared to part-time employees)? How are managers to know what its stakeholders' interests are? What if an activity harms some stakeholders and benefits others? What happens when the members of a class of stakeholders have interests which are not identical (eg some employees want weekend work, others don't)?.

Most importantly, given the difficulty of knowing what stakeholders' interests are and of eliminating conflicts between them, how is a balance to be achieved?.

Commenting on a similar list of conflicts and questions, Sternberg[27] argues that:

> *"It may now be objected that such problems are, nonetheless, routinely resolved in practice. And indeed they are. But the way that they are managed, is by using the*

substantive goal of the organisation as a decisive criterion. If the purpose of the corporation is to maximise long-term owner value, or to produce the environmentally-friendliest widgets, or to provide employment for the blind, that purpose enables managers to identify which groups need to be considered, and which of their perceived benefits are relevant and legitimate; it indicates how benefits are to be ranked, and how conflicts are to be resolved. To be workable, stakeholder theory must employ the very substantive objectives that it explicitly rejects."

Not only that, but Sternberg points out that the theory of stakeholder entitlement is not compatible with any organisation (not just a business) having any substantive objective.

Under stakeholder theory, environmental protection, educational excellence, community health, employment of the disabled, care for the aged, equal opportunity or sporting success are no more legitimate as primary aims of an organisation than maximising shareholder value. Each assumes that some stakeholder interests are so important they override others, and in stakeholder theory that assumption is not accepted.

Accountability and Governance

A second and related issue is accountability.

Accountability requires that individuals must account to others for the decisions they make and the way they behave. It also requires defined authority, so that those to whom agents are accountable are entitled to exact penalties on agents who fail to perform.

In a typical corporation directors are accountable to shareholders, while employees and other agents are accountable, through managers, to directors.

As Sternberg says,

> *… stakeholder theory explicitly repudiates both sorts of accountability. Doing so is indeed one of the defining features of stakeholder doctrine.*[28]

In its place, it proposes a structure of accountability which is so diffuse as to be unenforceable. Any bad management decision or employee action can be justified on the grounds that it is in the interest of some stakeholder group.

With employees and managers acting as both agents and stakeholders, the chain of accountability turns into a self-referential loop in which the exercise of self-interest at the expense of other stakeholders can be legitimised.

To the extent that all stakeholders' interests must be taken into account when significant decisions are made, management is likely to be cumbersome and unresponsive.

For such a model to be effective would demand profound changes in law and corporate governance.

At present, shareholders unhappy with the way a board manages their assets are free to invest elsewhere, or, if a majority of shareholders agree, to dismiss the board. Managements which do not maximise shareholder value are at risk of hostile takeover. Employees who do not carry out the instructions of management can be sacked.

These structures of incentive and accountability are explicitly designed to ensure that management has a strong incentive to put shareholder interests first, within the constraints of the law. They are based on and reinforced by a structure of corporate governance rules which recognise that managements might not of their own volition always pursue shareholder value as their central priority, and which try to ensure that as near as possible they are made to do so. This is an environment in which both custom and law aim to ensure a management team which consistently made decisions which are not in the interests of its shareholders does not last.

For as long as shareholders retain the freedom to buy and sell shares and the right to sack directors, those directors are likely to continue to accord special priority to shareholders' wishes.

Whether a legal structure based on accountability to stakeholders could be made workable is debatable.

What is certain is that such a model would bear little relationship to the system of economic freedom and property rights which underpins our current system.

Where the wider aims of corporate social responsibility are pursued by management authority, the effect is more akin to theft than respecting stakeholder entitlements. As Friedman[24] argues:

> '"*What does it mean to say that the corporate executive has a 'social responsibility' in his capacity as businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers.*
>
> [in pursuing such interests] *"... the corporate executive would be spending someone else's money for a general social interest. Insofar as his actions in accord with his 'social responsibility' reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending the customers' money. Insofar as his actions lower the wages of some employees, he is spending their money."*

And even assuming that such pursuit of social and environmental objectives with other people's resources is legitimate, the manner of that pursuit is unaccountable.

In democracies like Australia, most people are familiar with and unperturbed by the processes by which property rights are routinely constrained or removed in the service of the common good, whether through the payment of taxes to support government services and transfers, through laws limiting pollution and noise, zoning restrictions on the use of buildings, and so on.

We might disagree fiercely about how much tax should be raised, from whom, and how the money should be spent. Opinions differ no less on appropriate legislation and regulation, whether the issues is the location of heavy industry, the suburban speed limit or the fencing of swimming pools.

In a democracy, these controversies about how to tax and how much to tax, what to spend and what laws to pass, are subject to public and media scrutiny and community consultation, institutional restraints and the final test of the ballot box.

As Friedman[29] describes it, the use by business leaders of other people's money in pursuit of a broader social objective is analogous to the government's role as taxer, re-distributor and regulator, but without the accountability:

> *"We have a system of checks and balances to separate the legislative function of imposing taxes and enacting expenditures from the executive function of collecting taxes and administering expenditure programs and from the judicial function of mediating disputes and interpreting the law."*
>
> *"Here, the businessman self-selected or appointed directly or indirectly by stockholders - is to be simultaneously legislator, executive and jurist. He is to decide whom to tax by how much and for what purpose, and he is to spend the proceeds - all this guided only by general exhortations from on high to restrain inflation, improve the environment, fight poverty and so on and on."*

In effect, the business person becomes a civil servant, and must be made accountable in a similar manner:

> *"On grounds of political principle, it is intolerable that such civil servants - insofar as their actions in the name of social responsibility are real and not just window dressing - should be selected as they are now. If they are to be civil servants, then they must be selected through a political process. If they are to impose taxes and make expenditures to foster 'social' objectives, then political machinery must be set up to guide the assessment of taxes and to determine through a political process the objectives to be served."*

Stakeholder orientation beyond that which is consistent with maximising shareholder value opens a whole range of issues of principle concerning property rights and freedom of choice, corporate governance, transparency and political, social and commercial accountability.

Outcomes

This leads to the last but most important objection to stakeholder-oriented models of the firm.

The fundamental assumption of triple bottom line accounting, corporate social responsibility, ethical investment, stakeholder entitlement and similar theories is that they will yield better outcomes – for some parties, at least - than an economy in which firms are primarily engaged in maximising long-term value for their shareholders within a framework of laws.

As discussed under *Profits should not come first* on page 6, this reflects the widely-held view that good outcomes can only arise from good intentions and that the profit motive is intrinsically distasteful, along with the understandable desire of executives to feel good about what they do, highlighted by the NSW State Chamber of Commerce[15] passage already quoted:

> *"... most Australian business leaders would like their company to have a positive impact on society and the environment."*

Above all, it reflects lack of faith in the capacity of the 'invisible hand' of the free market to deliver a better economic, environmental and social outcome than the good intentions of business leaders, suitably stiffened by laws, incentives and stakeholder responsibilities.

Proponents of this view point to the failure of free markets to deliver social, economic and environmental outcomes as good as we might wish, and conclude that the economic system is a failure. With traditional socialist remedies for the failures of capitalism widely discredited, a new model of controlled and tempered capitalism is emerging.

This view has been characterised by David Henderson[30] as 'new millennial collectivism', which includes traditional anti-liberal views which see *"the market economy as heavily populated by losers and victims, whose welfare depends on collective measures on the part of 'society'", and* the growing influence of anti-market non-government organisations.

According to Henderson, it has two doctrinal underpinnings.

Firstly, an 'alarmist consensus' which sees globalisation as:

> *"... a newly-arisen economic tidal wave which is sweeping peoples and governments before it and creating an anarchic borderless world. In this supposed new world, national governments are losing control, while newly empowered multinational enterprises are increasingly able to decide outcomes, and to exploit workers and keep down environmental standards, in a growing range of countries. For many people, these developments are seen as intensifying already serious threats to the environment, threats chiefly arising from market-driven transactions: the earth itself, and various eco-systems within it, are classed among the victims of the present economic system."*

Secondly, an assumption that:

> *"... the existence of large disparities is an evil, and that it gives proof of remediable injustice."*

There are many flaws in new millennial collectivism, but two are of crucial importance.

Firstly, it denies the evidence from rich countries and poor, in economic terms and in terms of wider measures such as literacy and life expectancy, that the market system has delivered the highest living standards and the fastest growth in living standards of any political or economic system in history.

There is no evidence that the plight of poor countries is caused by globalisation. Yet as Henderson says:

> *"So strong is the presumption of injustice that arguments and evidence to the contrary are often set aside. Consider for example the poor countries that have fallen further behind in recent years. Probably not one of them would now be better off, and some might be worse off, if growth elsewhere in the world had been slower, in which case the gap would have widened less. What really matters is not the gap as such, but the progress of these countries."*

Those who doubt the efficacy of the 'invisible hand' have never yet been able to point to an economy or society where a visible hand has done better, whether that hand is guided by the state, a plurality of stakeholders, or well-intentioned business leaders.

In a publication released in April 2001, the Chamber of Commerce and Industry of WA detailed the reasons for its support of a free enterprise economy[31].

It argued that no other economic system has proved as capable as free enterprise of providing the economic circumstances most likely to deliver a sustained high standard of living. The history of the modern West is an astonishing and unprecedented story of both wealth and freedom increasing and spreading to an extent once unimaginable.

In such a system, the production, distribution, pricing and consumption of goods and services are primarily determined by the choices of individuals, whether acting alone or as corporate entities.

Entrepreneurship, innovation and consumer choice ensure that scarce resources are continually employed in a manner which most effectively matches the changing needs and wants of society. Competition ensures that goods and services are delivered as efficiently as possible, and provides a perpetual spur for innovation and improvements in quality, quantity and efficiency. Resources are directed toward their most effective uses.

Individuals are free to use their income and wealth in any way that they like, to choose to spend, save or give it away, as they prefer.

This is not to deny a role for government in the production and distribution of goods and services. Governments should ensure the provision of public goods which the private sector would not deliver unprompted or would not deliver efficiently. They have a role as regulators or service providers in markets which are unlikely to function efficiently in isolation, such as natural monopolies.

These roles are properly performed by government through regulation, not by business executives choosing to undermine the interests of their shareholders.

By increasing business costs, blurring accountability and impeding the efficient operation of capital markets, the advocates of corporate social responsibility and stakeholder entitlements would impede the business sector's capacity to make its greatest contribution to the economy and society.

The real virtue of the good corporate citizen is that it generates returns for investors by providing customers with the goods and services they want, at prices they are prepared to pay, while proving trustworthy and responsive enough to earn repeat business. In the process, it creates jobs, bids up wages, pays taxes, and innovates in the perpetual search for an advantage over its competitors. All of this contributes far more to society than pious good intentions.

Of course, it should obey the law as it goes about these functions and may well go beyond the law. And government has a proper role in shaping that regulatory environment, to enforce protections for the environment, the customer and so on which good business practice alone might not dictate.

As we have seen, it can be profitable to be seen as socially and environmentally responsible, and costly to be seen as irresponsible.

Yet there are dangers in this approach. A more recent paper by Henderson[32] argues that:

> *"It may indeed be true, or eventually become true, that a general adoption of CSR* [corporate social responsibility] *would promote the objective of making MNEs* [multi-national enterprises] *better liked and appreciated, and thus help to keep them alive and profitable in an unfriendly world. But this would come at the cost of accepting false beliefs, yielding to unjustified attacks, and impairing the functioning of the market economy."*

Henderson's paper concludes[33] with a warning of the potential damage which corporate social responsibility and related movements could inflict.

Though lengthy, it is worth quoting in full:

> *"CSR is often presented, by moderates and enthusiasts alike, as a sober and judicious response to challenges that have to be met and new developments on the world scene. Such a description does not fit the facts. Many of the alleged new developments have not in fact taken place: they are part of the mythology of global salvationism. Because the myths are largely believed, because the rationale and functioning of a market economy are not well understood, and because of widespread acceptance of the need for deliverance from above, the assessment of issues and events by many international businesses, and by others in the business milieu, appears as neither judicious nor informed. Appeasement, and the wish to disarm opposition, go together with a large measure of sympathy with, and acceptance of, a collectivist perspective. The views and demands of NGOs and other hostile critics are treated as more soundly based and more representative than they really are. A misleading view of the world is uncritically accepted.*

> *"CSR is flawed in its prescription as well as its diagnosis. What it proposes for individual businesses, through 'stakeholder engagement' and giving effect to the 'triple bottom line', would bring far-reaching changes in corporate philosophy and practice, for purposes that are open to question and with worrying implications for the efficient conduct of enterprises. Across economic systems and political boundaries, it would strengthen existing tendencies to regulate transactions, and to limit competition, in ways that would further restrict the opportunities and freedom of choice of people and enterprises. These various effects, both within firms and beyond them, would undermine the market economy and reduce welfare. Despite the attractions of the phrase and the hopes that it appears to offer, the adoption of CSR marks an aberration on the part of the many businesses concerned, and its growing hold on opinion generally is a matter for concern."*

Conclusions

The appeal of corporate social responsibility, triple bottom line accounting and stakeholder entitlements is undeniably strong, and not only for parties who stand to gain directly from its implementation.

Some business leaders doubtless accept the analysis of what Henderson calls 'global salvationism' and 'new millennium collectivism' – that the world environment is in crisis, that poverty and inequality are spiralling, that economic growth only benefits the rich while causing injustice and social decay for the rest, and that the cause of these woes is free market ideology underpinned by greed and untempered by social, ecological, cultural or ethical constraints.

Most business leaders probably do not have any coherent ideological commitment to global salvationism, but nor are they necessarily aware that it is wrong in all its major tenets. And so, for a business leader who wants to act ethically and responsibly, and to be seen to do so, it is natural to go along with the popular prescriptions that global salvationism proposes without necessarily accepting the diagnosis which underpins it. The language and intent of corporate social responsibility and related ideas seem moderate, reasonable and virtuous. After all, who wants to be a public advocate of corporate social ***ir***responsibility?

Business leaders who recognise the flaws and dangers of anti-corporate activism nonetheless have a duty to respond to their effects on the business environment. The most hard-nosed executives will not in fact maximise profits if they fail to protect and enhance their corporations' name and brand image, to avoid consumer boycotts, to attract and retain investment dollars, and to escape the widening net of corporate crimes and civil liabilities, and the increasing penalties they attract.

Even if a business leader holds the posturing of corporations making inflated claims of environmental or social credentials in contempt, they may be negligent in their responsibility to shareholders if they refuse to follow suit. Such gratification of personal values at the expense of owner interests is precisely the kind of failure to exercise responsible stewardship which shareholder orientation will not allow.

Indeed, even giving public expression to disagreement with the prevailing acceptance of corporate social and environmental responsibility may invite a public outcry which could be harmful to the corporation. So a chief executive who took seriously the responsibility to maximise shareholder value wouldn't do it.

There is clearly a paradox here. Business leaders committed to maximising shareholder value are obliged by that very commitment to maintain a reputation for social and environmental responsibility and to keep quiet any reservations they might have.

So dissenting business operators are largely absent from the debate on the merits of corporate social responsibility, triple bottom line accounting, and so on.

Their silence should not be read either as an admission of guilt of the long list of accusations levelled against corporations by the global salvationists, nor as representing acquiescence in some imagined consensus on the entitlements of multiple stakeholders.

But it does place a particular onus on less constrained commentators – in academia, the media, think tanks and business associations, for example - to look critically into the claims, assumptions and implications of stakeholder advocates.

Society, the environment and the economy would all lose out if anti-corporate ideology is allowed to hold sway because no-one dares to contest its presumption of exclusive moral virtue.

Appendices

Appendix 1 Defining Terms and Concepts

Corporate Social Responsibility
There is no single commonly accepted definition of corporate social responsibility. Some examples of definitions include:

> *"Corporate Social Responsibility (CSR) refers to a range of practices that a business might adopt to ensure that it operates in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of business."*

– From 'Taking The First Steps: An Overview Of Corporate Social Responsibility In Australia' NSW State Chamber of Commerce, February 2001, p. 5.

> *"Corporate social responsibility is essentially a concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment."*

– From 'Promoting a European framework for corporate social responsibility', EU Green Paper, July 2001, p.5

> *"Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large"*

– From 'Corporate social responsibility: making good business sense' World Business Council for Sustainable Development, January 2000.

This report also outlined five key areas of concern – human rights, employee rights, environmental protection, community involvement, and supplier relations.

Stakeholder Theories
Stakeholder theories and models are generally more precise than concepts of corporate social responsibility, but different versions and models have emerged.

Originally, stakeholder theories were essentially management tools, representing ways of systematically considering the interests of people and organisations capable of having a material impact on a business's performance.

Over time this has changed, in two important ways.

Firstly, the range of people and groups identified as stakeholders has broadened, to include (by Freeman's 1984 definition):

> *"any group or individual who can affect or is affected by the achievement of the organization's objectives"*

– From Freeman, R.E. (1984) 'Strategic management: A stakeholder approach.' Boston: Pitman. P.46

Secondly, the status of stakeholders has changed, from groups whose interests should be considered as part of good management practices, to groups entitled by their stakeholder status to influence the operation of the business, or at least have it influenced in their interests. These are what Sternberg[25] has described as 'entitlement stakeholders'.

A website established to promote discussion of the nature of the corporation, proposes the following definition.

> *"Stakeholder management involves the following policies and processes:*
>
> - *Corporations should routinely monitor the status of stakeholders, and take relevant stakeholder interests into account in decision making.*
> - *Corporations should communicate openly and clearly with stakeholders, particularly about their respective contributions and benefits, and about the probability and severity of downside risks to which they may become exposed as a result of their contact with the corporation.*
> - *In dealing with stakeholders, corporations should adopt processes and modes of behavior that are accessible to relevant parties, and appropriate in view of their*

commitments, contributions and risks.

- *Corporations should attempt to distribute the benefits of their activities as equitably as possible among stakeholders, in the light of their respective contributions, costs and risks.*
- *Corporations should avoid altogether activities that might give rise to unacceptable risks to stakeholders (e.g., Bhopal-type catastrophes)."*

– From 'Redefining the Corporation: An International Colloquy' on http://www.mgmt.utoronto.ca/~stake

Triple Bottom Line

Triple bottom line accounting has a more recent and easily-traced pedigree than corporate social responsibility or stakeholder theory, and so its broader definition is easier to identify. The term was coined by John Elkington in his 1997 book 'Cannibals With Forks: The Triple Bottom Line of 21st Century Business'

The three bottom lines targeted under Elkington's approach aim to promote policies which are economically viable, environmentally sound and socially responsible.

Appendix 2 Litigation Awards – Some Examples from the USA

McDonalds

Perhaps the most oft-quoted case of damages being awarded against a corporation was the US$2.7 million in punitive damages and US$160,000 compensatory damages awarded by a jury in 1994 against a McDonalds restaurant to Stella Lieback. Mrs Lieback suffered third-degree burns after spilling the coffee in her lap while attempting to remove the cup's lid in her grandson's car. The judge reduce the punitive award, and the case was eventually settled for an undisclosed amount.

Nursing Homes

'The Economist' magazine reported in March 2001 that litigation had pushed up the cost of liability insurance in Florida nursing homes to almost US$13,000 a bed. Florida subsequently passed legislation capping liabilities.

– 'The people v America Inc', The Economist, 22 March 2001.

General Motors

In 1993 the petrol tank of a Chevrolet Malibu exploded after it was hit by another vehicle, causing extensive burns to several people in the vehicle. They subsequently sued General Motors. A jury in California awarded the victims damages against GM of $4.9 billion. The Supreme court subsequently threw out the rising, describing it as "grossly excessive".

– 'GM and the Law', The Economist, 15 June 1999.

BMW Paint Job

In 1990 Dr. Ira Gore, Jr, purchased a new BMW 535i in Alabama. About nine months later he learned that the car had been partially refinished. He sued the retailer and the German and US BMW operations for constituted fraud, suppression of material fact, and breach of contract. A jury awarded US$4,000 in compensatory damages and US$4 million jointly against the BMW defendants in punitive damages. The punitive damages were subsequently reduced.

Toshiba

In 1989 Toshiba reached a settlement totalling US$2.1 billion to settle a class action brought by two people alleging its laptop computers were defective. It was claimed that the flaw could lead to information being lost or damaged when copying data to floppy disks.

The settlement was reached despite the fact that no-one had ever complained to Toshiba or otherwise reported actual damage being caused by the 'defect'. Toshiba executives were reported as saying that the settlement was to avoid the kind of damages which might be awarded had it faced, and lost, a jury trial.

– - Pollack, Andrew. 'Toshiba to Spend $1 Billion to Settle Laptop Lawsuit', 30 October 30, 1999.

– http://www.nytimes.com/library/tech/99/10/biztech/articles/30toshiba.html

Appendix 3 The Brent Spar Case

The following summary of the Brent Spar case is copied from the 1998 Annual Achievement Lecture to the Institution of Mechanical Engineers, detailing Shell's experience during the Brent Spar case.

This and other information from Shell is available from its web site (which has a Brent Spar dossier).

Greenpeace's web site also has material on the issue, and the BBC site covered it quite extensively (and includes an apology to Greenpeace for reportedly misrepresenting some of its claims).

www.shell.com
www.Greenpeace.org
www.bbc.co.uk

The Brent Spar installation

The Brent Spar was unlike any other installation in the North Sea. It had a unique function: both to store oil, and to offload the oil from its storage tanks into tankers offshore. It was constructed as a huge floating buoy, fabricated from steel, and moored to the sea bed in the North Sea by six anchors. Its displacement was 66,500 tonnes, its floating draught 109 metres, its total height 137 metres and its dry weight 14,500 tonnes.

The buoy was designed and built in the mid 1970s. The larger hull section was fabricated in a horizontal position in a dry dock in The Netherlands, and floated and towed to Norway to be rotated into the vertical floating position then mated to the top deck section. The whole unit was then towed to the Brent Field for final installation.

While the Spar was robust and fit for the purpose for which it was designed, modern structural analysis using finite element analysis rather than the less advanced techniques available at the time of its design, showed that the original installation sequence could not safely be repeated in reverse order. Such an operation would impose unacceptably high stresses in the hull structure. Decommissioning by simply reversing the original build process was therefore not an acceptably safe option. Another solution had to be found.

The original deep water disposal plan

Following the shut down and demanning of Brent Spar in 1991, Shell Expro commissioned some 30 studies over four years to review the decommissioning options. Initially studies looked at methods of bringing Spar onshore for scrapping, but the more this was studied the more the technical difficulties became apparent. From an initial list of 13 potential solutions, the most viable were narrowed down to a short list of two: onshore dismantling in the UK, and deep sea disposal. These were evaluated in detail to determine the Best Practicable Environmental Option (BPEO)(see note 1) which, in accordance with UK Government requirements, was identified by Shell Expro and then recommended to the UK Government for its approval. The BPEO can be described as a practical balance of technical feasibility, environmental, safety and cost considerations.

Before making its final submission to the UK Government, Shell Expro commissioned an independent evaluation by Aberdeen University (see note 2). This concluded that the deep sea disposal option was preferable when judged against the required BPEO criteria. Both deep sea disposal and onshore scrapping in the UK were judged to have minimal environmental impact; however deep sea disposal had a significantly lower fatality risk and lower cost.

A relatively limited consultation as required by the UK Government was undertaken with parties directly affected, and elicited no objections. In February 1995 the UK Government publicly announced its formal approval, and in accordance with international Conventions, notified its partner European governments in the North East Atlantic maritime area (see note 3), none of whom objected within the normal timeframe.

Having thus undertaken rigorous engineering analysis of the disposal options including independent assessments, having complied with all national and international regulations, and having undertaken the required consultation, Shell Expro made plans to carry out deep sea disposal in the good weather period of summer 1995. However, the plan sparked off a concerted campaign by Greenpeace, which eventually captured global publicity. On 30 April 1995, shortly before work was due to begin, activists boarded the Spar, attracting notable media coverage. The Greenpeace campaign was based on various allegations, of which the more significant were:

- *That the Spar was a 'toxic time bomb' and '14,000 tonnes of toxic rubbish', containing '5,500 tonnes of oil' and 'hidden' toxic chemicals*
- *That Shell had not carried out a proper inventory of the Spar's contents*
- *That its disposal was a precedent for 'more than 400' North Sea platforms to be 'dumped at sea'*
- *That the matter had been decided secretively*
- *That it was wrong on principle to dispose of waste material of any kind in the ocean.*

Many of these allegations were grossly exaggerated, untrue or misleading, and were later publicly shown to be so. However it is noteworthy that the latter two are based either on perceptions or pertain to particular beliefs or values. They continued to resonate as worthy of further consideration when other allegations had been widely accepted as untrue.

Over the ensuing two months, the Greenpeace campaign attracted significant attention, particularly in continental Northern Europe, and most notably in Germany. The German Government, facing elections and political challenges to its 'green' credentials, changed its initial position and lodged a protest to the UK Government.

Activists were removed from the Spar to major media attention. At an international conference concerned with broad issues of North Sea pollution, various European governments called for a ban on sea disposal of disused oil installations, isolating the UK and Norway, the only countries with the significant problem of eventual disposal of the largest, heaviest, more difficult structures.

As Shell Expro towed the Spar to the disposal site, a boycott of Shell products started in Germany and 200 service stations were damaged, two fire-bombed and one raked with bullets. On 20 June 1995 the British Prime Minister publicly defended the disposal plan in Parliament only hours before an announcement by Shell UK that the operation would be halted.

The decision was welcomed by protestors and celebrated by Greenpeace as a major victory, but Shell UK was publicly attacked both by deeply angered British Government ministers, and by scientists who saw it as a reversal of sound environmental decision-making.

Throughout the early part of 1995, the argument of scientific precision and regulatory rigour had been consistently and tirelessly presented, and gained considerable support in the UK. However it was not a set of messages lending itself to easy sound bites; nor was it visually dramatic. It was also difficult to match the speed of the misinformation propagated by Greenpeace via satellite links and the Internet.

That the Brent Spar was a unique and difficult installation, that it was not the first of 400 installations to be disposed in the deep sea, that a responsible organisation such as Shell would not dispose of it were it full of toxic waste, that detailed studies and an independent inventory had been professionally carried out, and other similar points did achieve significant penetration in the UK, but were not widely appreciated by the media and members of the public elsewhere.

Shell was starkly reminded of a tenet it already recognised, but had on this occasion at least allowed to 'slip', that it could not take public understanding or trust for granted.

Endnotes

[1] Friedman, Milton (1962), "Capitalism and Freedom", University of Chicago Press

[2] Lord Chancellor of England Edward First Baron Thurlow, cited in Business & Society Review, No. 72, Winter 1990, p. 51

[3] There seems to be no commonly agreed point of origin of stakeholder theory, but Freeman's 1984 book 'Strategic Management: A Stakeholder Approach' (Boston: Pitman) was a key foundation of current stakeholder analysis.

[4] Quotation taken from Peters, P. "Tony Blair's "Stakeholder Economy": A Midterm Assessment", October 1999 , on the Lexington Institute's web site. *Original source* Blair, A., Singapore speech as reported in "At Last, A Big Idea," New Statesman & Society, January 1996. http://www.lexingtoninstitute.org/corpgov/stakeholder.htm

[5] For the rest of this section, the phrase 'stakeholder orientation' is used to describe all of these disparate concerns where they are incorporated into core business objectives. Their separate qualities are discussed in detail on page 18.

[6] "Taking The First Steps: An Overview Of Corporate Social Responsibility In Australia" NSW State Chamber of Commerce, February 2001, p. 6. First paper in a series entitled "the common good"

[7] see http://www.corpwatch.org

[8] *Appendix 3* summarises the example of Brent Spa, where Greenpeace ran a campaign which included a range of assertions subsequently shown to be false, but which nonetheless led Shell Expro to abandon plans to sink its Brent Spar installation in the North Sea.

[9] In an article on the financial and market information website TheMotleyFool, Chris Rugaber concludes that socially responsible investment funds do not necessarily yield lower rates of return, but that differences in performance may be short-term effects of differences in portfolio composition. Fees and expenses tend to be higher than for other comparable investment funds.

See Rugaber, "socially responsible investing" 28 March 2001, on http://www.fool.com/Specials/2001/sp010329.htm

[10] A recent report by the AMA reported that increasing defence costs for obstetrics care to $35,000 for specialist obstetricians and $9,000 for general practitioners contributed to a 26 per cent decline over 5 years in the number of obstetrics providers in Australia. Regional services are particularly hard-hit because they tend to spread costs over fewer patients. The AMA argued that 'there will be rural regions where obstetric care is unavailable and women will have to travel to major medical centres to have their babies.'

From 'Obstetrics – State of Play', Australian Medical Association, May 2001

[11] Milan, Andre. 'So are we being taken for a ride?', The West Australian, 8 January 2002, p.14.

[12] Blue Light organisers 'face an increase in public liability premiums from $15,000 a year to $58,000 a year'

- Ben Harvey, 'Blue Light under threat', The West Australian, 29 January 2002

[13] Crimes (Industrial Manslaughter) Bill 2001

[14]Equal Opportunity Act, 1984

[15] 'Taking The First Steps', p.7

[16]1 Timothy 6:10

[17]Popper, Karl (1945). 'The Open Society and Its Enemies' Vol. 2. Routledge and Kegan Paul.

[18] Evan, W and Freeman, R (1993) 'A Stakeholder Theory of the Modem Corporation: Kantian Capitalism,' in Beauchamp and Bowie, Ethical Theory and Business, p. 82

[19] Berle, A. A and Means, G. 'The Modern Corporation and private Property', New York, Macmillan, 1932.

[20] Quote already cited on page 4, for source see note 6 above

[21] 'Creating and Maintaining an Ethical Corporate Climate', Woodstock Theological Center Seminar in Business Ethics, Georgetown University Press, 1990

[22] Ludwig von Mises, 'Human Action: A Treatise on Economics', 4th ed., ed. B. Greaves (New Haven: Yale University Press, 1949; San Francisco: Fox & Wilkes, 1966), 725, 729—30.

[23]Sirico, Robert. 'The Bedrock of Business Ethics' in Religion and Liberty, Acton Institute, May-June 200.

[24] Friedman, Milton. 'The Social Responsibility Of Business Is To Increase Its Profits', article in originally printed in the New York Times (1970), accessed from http://homepages.bw.edu/~dkrueger/BUS329/readings/friedman.html

[25] Sternberg, Elaine 'The Stakeholder Concept: A Mistaken Doctrine', Foundation for Business Responsibilities, Issue Paper No. 4, November 1999. Sternberg differentiates between two essentially benign ideas about stakeholders and a third strand she calls stakeholder entitlement theory:

> *"Two of usages of 'stakeholding' are commonplace and unobjectionable. The first is a conventional observation about motivation: people are more likely to take an interest in a process when they consider that they have a stake in its outcome; the stake need not be financial. The second innocuous usage is simply a reminder that the world is complex: many factors must ordinarily be considered when pursuing even ostensibly simple outcomes. This is a basic truth that successful businesses have long understood and respected"*

[26] Quotation reproduced with permission from Jennings, Marianne M and Entine, Jon. 'Business With A Soul: A Re-examination Of What Counts In Business Ethics', Hamline (Minnesota) Journal of Law and Public Policy, Fall 1998. Original Friedman quotation sourced as Milton Friedman, 'Milton Friedman Responds', Business & Society Rev. 5 (1984).

[27] Source as note 25 above, page 20.

[28] Source as note 21 above, page 21.

[29] Source as note 24 above

[30] Henderson, David. 'Anti-Liberalism 2000: The Rise of New Millennium Collectivism', thirtieth Wincott lecture, 12 October 2000. From http://www.iea.org.uk/pdf/op115.pdf

[31] "In Support of Free Enterprise, Chamber of Commerce and Industry of WA, April 2001. p.7

[32] Henderson, David. 'Misguided Virtue: False Notions Of Corporate Social Responsibility', New Zealand Business Roundtable, June 2001. p.86

[33] Source as note 27 above, page 90.