DIRECTORS' DILEMMAS

By rethinking 'progress' and re-orientating company strategies towards a focus on sustainability, directors can contribute to the reforms mankind must achieve for sustainability, writes *Ken Coghill*.

Corporate Social Responsibility (CSR) is acquiring a new significance and urgency as climate change rushes at business like a massive firestorm threatening to consume all in its path. However a recent survey suggests many boards of directors have yet to accept their responsibilities to their companies and of their businesses to society.

The nature of climate change risks and responses to them is beyond the purpose of this article; rather, it concerns directors' responsibilities to inform themselves and act accordingly. It urges leadership by directors rather than simply following market signals, which are clearly lagging severely and unacceptably and failing in this instance.

A survey of chief executive officers (CEOs) and chief financial officers (CFOs) conducted in 2008 by East & Partners for PricewaterhouseCoopers indicated that a mere 5 per cent of those 303 leading companies to respond had acted to implement the most basic step required to prepare for the new emissions trading scheme (ETS). Only one in 20 had established a budget to measure and report carbon emissions, as required by legislation, and only 8 per cent of company boards had independently considered the business risks posed by climate change. The survey confirms that directors are failing to lift their eyes from their companies' current performance reports to scan these massive risks.

Although the survey related only to actions within companies to meet the direct impact of the ETS, the issue involves the wider community – greenhouse gas emissions generated by a company contribute to climate change which affects every person in every community in every nation. To that extent, everyone is a stakeholder in that company. Directors have a right to take stakeholders interests into account, as shown in the Australian Parliamentary Report 2006 on corporate responsibility and in the guidelines prepared for Australian industry superannuation investment managers. These guidelines argue that a company is responsible for the social and environmental impacts of its actions, especially in actions which threaten the sustainability of the environment on which we all depend.

This view of a wide corporate responsibility is complemented by the concept of companies having a licence to operate, sometimes termed a community or social licence to operate. The concept of licence to operate is often seen as invoking informal obligations, but it has more profound implications than are apparent at first glance.

Companies and their directors operate in enormously privileged positions granted to them by democratic processes. How could companies function as unincorporated organisations run by men and women enjoying no special rights or protections? If that were possible, would not those advocates of laissez faire capitalism cast off the chains of regulation and operate their enterprises as loose associations of otherwise perfectly independent individuals? Only criminal enterprises operate in that way. For legitimate enterprises, the idea is nonsense, but reflecting on it reinforces the point that corporations law is social legislation that creates a framework without which neither companies nor directors could function efficiently or effectively. Laws made by elected parliamentarians, exercising the democratic authority of the citizens and empowered to act in the public interest, create rights for directors and their companies, rights that are not shared by others. Those rights carry with them a mutual obligation for directors to respect the privileges granted to them by acting in accordance with the public interest.

In summary then, corporations law requires boards of directors to act responsibly in the best interests of their companies. That interest is an enlightened self-interest that must have regard to environmental impact and be consistent with the mutual obligation to respect the public interest.

The way in which directors understand, interpret and discharge these responsibilities is profoundly important to the futures of individual companies and the sustainability of the environment. To do so, responsibility for the impact of their decisions on the environment must be central to directors thinking.

Directors are derelict in their responsibilities if they don't use board meetings to direct CEOs and CFOs to plan and budget for monitoring, reporting and reducing greenhouse gas emissions.

THE PROGRESS PROBLEM

Mankind and our enterprises – the nature of our economy – can only survive if progress is re-orientated towards environmental sustainability.

What do we mean by progress? Progress is neither a constant nor a universal concept. In times of war, progress is the reduction and cessation of hostilities. Other measures of 'progress' include growth in Gross Domestic Product (GDP), increases in the Human Development Index (HDI) and improvements in people's freedom to fulfil their desires. Less tangible are improvements in ethical behaviour, in spiritual development and standards of governance.

For a board of directors, it may be growth in the corporation's single bottom line, higher productivity of capital, plant or personnel, increased market share, development of new domestic or export markets, improved efficiency of energy use, research and development success, better standards of corporate social responsibility or combinations of these and other measures.

Political leaders often fail to reflect on this basic issue. A Singapore minister who has thought more deeply about this than many is Mah Bow Tan, the National Development Minister. In February he told Parliament that "(w)e just feel that economic growth does not necessary lead to progress and may not benefit the environment and people".

Contrast that with the 'revealed preferences' of directors, for whom progress often appears to mean ever increasing conversion of limited resources into goods and services to boost material lifestyle. Features of progress include processed foods, refrigerated and other superior forms of food preservation and storage, greater reliance on labour-saving devices, larger and more complex homes, rapid transport of people and goods by powered vehicles and sophisticated communications.

The pursuit of corporate interests is fuelled by several drivers. Population increases produce demand for particular goods, services and jobs. Technological innovation and changes in design, whether functional, purely aesthetic or fashionable, lead to increases beyond maintaining a steady-state. 'Success' is represented by growth in consumption rather than maintenance of acceptable levels of consumption.

Companies' dependence on an economy in which surpluses are generated by processes that are destroying the features of the environment required for our more basic needs is a paradox that highlights some of the enormous adaptive difficulties directors face. The writer Ronald Wright has highlighted a paradox reflected in what he calls "progress traps". These are innovations

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that appear to offer attractive solutions but actually have longer-term counterproductive effects. Wright asks whether these traps arose from the selection pressures to which man was exposed during evolution.

However, the paradox of reliance on unsustainable expropriation of resources of the land, water and air can be resolved if it is recognised that there are alternative, viable conceptions of progress. Redefining Progress, a US-based NGO, has proposed a Genuine Progress Indicator (GPI). The GPI recognises that the quality of lives can be improved without increasing material consumption. The GPI integrates social and environmental capital such as clean air, safe streets and the preservation of habitat into a single measure which better reflects the things that make our lives more secure and satisfying (see Table 1).

clearly suggest that there is a significant, growing gap between consumption and the real quality of life.

Ronald Ingelhart in his World Value Survey (2006) also shows that material standards of living are not correlated with happiness and satisfaction with life as a whole. All societies have a broadly similar proportion of people who are happy and satisfied with life as a whole. The one significant departure in the past 50 years was the low proportion recorded in the former communist states of central and Eastern Europe.

QUALITY OF LIFE

The unfamiliar philosophical challenge for directors is to satisfy human needs through goods and services that improve the real quality of life. Directors must face the futility and ultimate risk posed by products

Table 1: Genuine Progress Indicator component factors

Genuine Progress Indicator = D+E+F+G+H+I-J-K-L-M-N-P-R-S-T-V-W-X-Y+Z+AA

Positive factors (contribute to GPI)

- **B** Personal consumption
- **D** Weighted personal consumption (BxC)
- **E** Value of household work and parenting
- **F** Value of higher education
- **G** Value of volunteer work
- **H** Services of consumer durables
- **I** Services of highways and streets
- **Z** Net capital investment
- **AA** Net foreign borrowing (+ve or -ve)

Negative factors (high values diminish GPI)

- **C** Income distribution index
- **J** Cost of crime
- **K** Loss of leisure time
- **L** Cost of underemployment
- **M** Cost of consumer durables
- **N** Cost of commuting
- **O** Cost of household pollution abatement
- **P** Cost of motor vehicle accidents
- **Q** Cost of water pollution
- **R** Cost of air pollution
- **S** Cost of noise pollution
- **T** Loss of wetlands
- **U** Loss of farmland
- **V** Loss of primary forests and damage from logging roads
- **W** Depletion of non-renewable energy resources
- **X** Carbon dioxide emissions damage
- **Y** Cost of ozone depletion

Source: Adapted from Talberth, Cobb, and Slattery 2006

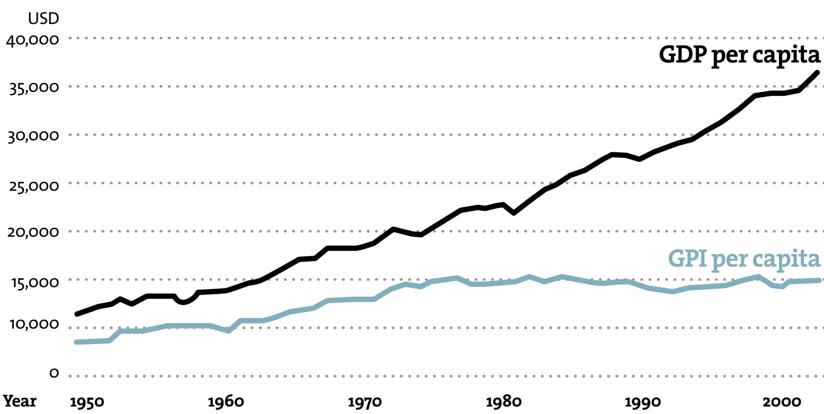
In using such an indicator, note that some constituent components are incommensurate – the classical paradox of comparing 'apples and oranges.' For example, having arrived at a good public transport service, how can one unit of public transport quality be compared with the quality of a manufactured product? The relative values assigned to them are at best matters of judgment. Making such judgments is often outside the responsibilities and importantly outside the experience of very many company directors.

Nonetheless, this indicator has conceptual value (see Figure 1). Talberth, Cobb and Slattery's findings

that increase consumption thereby causing damage to the environment on which our lives depends and depletion of the resources on which those material standards of living depend. Most dangerously, such production brings a declining sustainability to our lifestyles and a heightened risk to both consumption levels and the security that is such an important part of our real quality of life.

Directors do not face any shortage of technical solutions to greenhouse gas emissions. They are well known. Massive efficiency improvements could be easily and economically introduced. Many 'new' technologies have been known for decades. Most are

Figure 1: Per Capita Gross Domestic Product vs Genuine Progress Indicator (US) **Source**: Redefining Progress 2007



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affordable and relatively simple. Other potential technical solutions are under development.

These solutions enable directors to re-direct their corporate strategies into products and services more consistent with sustainability and thereby assist mankind to rely on environmentally sustainable activities through which to generate the economic surpluses necessary for essential services and an acceptable quality of life.

The problems are not technological but concern mankind's capacity to avoid another of Wright's progress traps. The fundamental necessity is to reduce consumption of carbon-based fuels and other resources. Technological innovations such as carbon capture and sequestration reek of "progress trap" rather than promise of a long-term solution. The problems require behavioural changes.

The great challenge facing directors and others is a re-thinking of progress as orientated towards environmental sustainability. Rather than the squandering of limited resources as the source of economic surpluses, the focus will be switched to placing a high value on the production of social and environmental goods and on curbing damage to our shared atmosphere and other parts of the environment.

Their responsibilities require that directors understand deeper issues affecting both the futures of their individual enterprises and the society in which enterprises are embedded. Leadership by business leaders on these issues has been coming for several years through bodies such as the World Economic Forum and the World Business Council for Sustainable Development.

The directors of BHP Billiton showed the way forward. In 2005, the company said it recognised "the intrinsic link between sound sustainability performance and long-term business viability". BHP Billiton had been guided by the Global Reporting Initiative (GRI) since 2002. GRI's board includes a leading Australian director, Dr Judy Henderson, Chair Northern River Catchment Management Authority, NSW Government.

By rethinking 'progress' and re-orientating company strategies towards a focus on sustainability following the advice of the GRI, directors can contribute to the reforms mankind must achieve for sustainability. By accepting the challenge, directorships can become sustainable.

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