Who is business responsible to?

MODULE 5 | PART B.2 | STUDENT COMPANION

Before deciding what to report, an organisation must decide who it owes responsibility to, and for what. Shareholders have **specific rights**, such as dividends, gained when they invest, in exchange for limited liability and no role in management. Wider stakeholders usually have **interests** rather than enforceable rights.

Two views

Shareholder primacy Milton Friedman; Adolf Berle in the 1930s	Social contract Merrick Dodd in the 1930s
Business has one social responsibility: maximise profit while playing by the rules	Society grants the right to operate and can set the terms
Investors risk their own capital, so directors answer to them alone	Limited liability and perpetual succession are privileges that bring duties to the community
Spread responsibility too widely and directors answer to no one	Benefits must be seen to outweigh the costs to society

Converging today

Many leaders now see long-term shareholder returns as depending on other stakeholders' concerns

Can shareholder primacy support sustainable development?

Not on its own. Sustainable development requires a business to take account of its environmental and social impacts, and it does not rank short-term profit above fairness between generations or between people alive today. Whether companies should put others' interests ahead of shareholders remains contested.

What the law says

MODULE 5 | PART B.2 | AUSTRALIA AND THE UNITED KINGDOM

- **Corporations Act s. 299(1)(f):** directors' report on performance against significant environmental regulation.
- **Section 299A:** material sustainability risks arguably belong in the operating and financial review.
- **ASX Recommendation 7.4:** disclose material exposure to environmental and social risks.
- **Modern Slavery Act:** larger entities report on risks in operations and supply chains.

Australia: section 181

Act in good faith in the best interests of the corporation, and for a proper purpose

Reading one

Stakeholders and the environment are part of the company's best interests

Reading two

The duty pushes directors to maximise profit; CSR risks becoming promotion

Result

Some uncertainty about how far directors can go for stakeholders

United Kingdom: section 172

Promote the company's success for its members as a whole, having regard to:

- Long-term consequences
- Employees' interests
- Supplier and customer relationships
- Community and environment
- Reputation for high standards
- Fairness between members

Since 2019

Large UK companies publish a section 172 statement explaining how directors had regard to these matters

Case note - James Hardie: in 2001 the company set up a foundation to compensate people harmed by asbestos products made by its former subsidiaries, and announced it was fully funded. A NSW special commission of inquiry (report, September 2004) found it was massively underfunded. After public pressure, James Hardie signed a funding agreement in November 2006, and the courts later found directors had breached their duty of care by approving the misleading announcement.

Sources: Special Commission of Inquiry into the Medical Research and Compensation Foundation, report (2004); James Hardie, Amended Final Funding Agreement announcements (2006-07); ASIC v Hellicar [2012] HCA 17; UK SI 2018/860 (section 172 statement).

CSR, externalities and planning a report

MODULE 5 | PART B.2 | CONCEPTS

What CSR definitions share

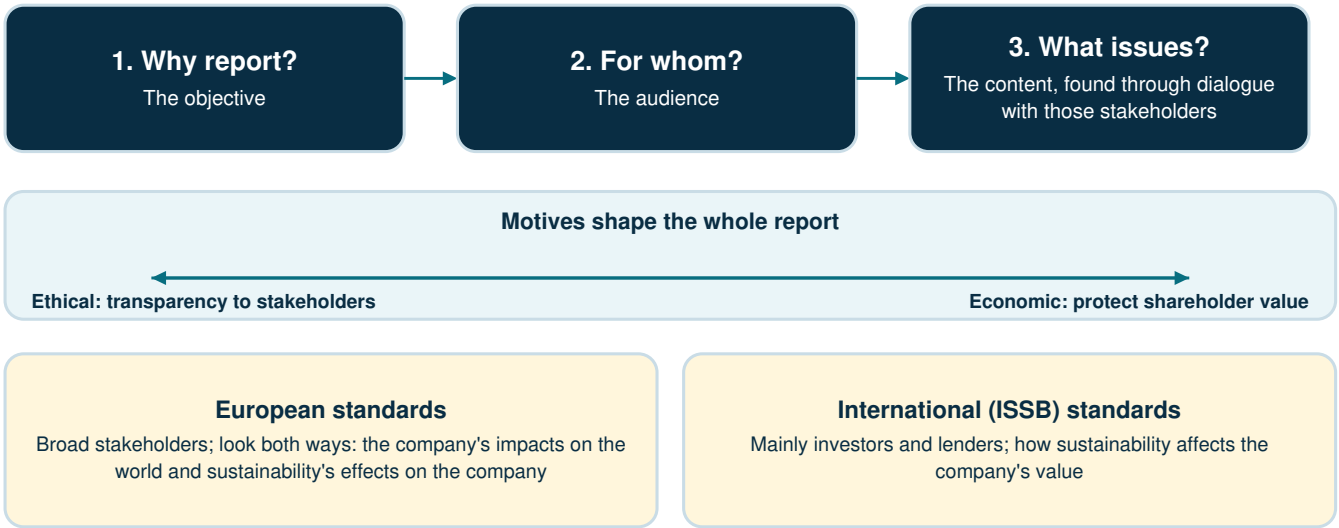
There is no single agreed definition, and the idea keeps evolving. Early thinking assumed companies would act responsibly on their own; research suggested they mostly did so under stakeholder pressure, so regulation grew. Definitions share two features: responsibilities **beyond shareholders**, and **beyond simply providing goods and services**. CSR reporting is the public disclosure of how an organisation interacts with, and affects, the societies and environments it operates in.

Externalities

An **externality** is an impact on parties outside the organisation who did not agree to, or take part in, the decision that caused it. It can be a cost or a benefit. When prices leave out costs such as pollution, goods are underpriced, overproduced, and profit is overstated compared with the cost to society.

Case note - NSW container deposit scheme (from 1 December 2017): people receive a 10-cent refund for each eligible drink container returned. Beverage suppliers pay a contribution per container, which funds the refunds and the scheme. A cost of litter once borne by councils and the environment now sits partly with producers.

Planning the report



Source: NSW EPA, Return and Earn; Exchange for Change supplier contributions.

Practice questions

MODULE 5 | PART B.2 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Two views of one decision

Imagine **Kinross Timber**, which runs a sawmill on the edge of a regional town. Its licence conditions are met, but neighbours complain about sawdust and night-time noise. The board is considering a $400,000 upgrade, with dust extraction and acoustic walls, that the law does not require. Argue the decision first from Friedman's shareholder primacy view, then from the social contract view.

Question 2 - Why, for whom, what?

Imagine **Harbourside Ferries**, a private ferry operator with a government contract, deciding to publish its first sustainability report. Apply the three planning questions: why report, for whom, and what issues should it cover?

Kinross Timber and Harbourside Ferries are imagined teaching examples.

Worked answers

MODULE 5 | PART B.2 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Kinross Timber

Shareholder primacy (Friedman): the mill already plays by the rules, so the upgrade is justified only if it increases profit, for example by avoiding future regulation, protecting the licence at renewal, or cutting costly disputes. Spending $400,000 purely to benefit neighbours would be spending shareholders' money on a social goal that is not the company's job.

Social contract: the town grants the mill its practical licence to operate. Dust and noise are costs imposed on people who did not agree to them, so the mill should reduce them if its benefits are to keep outweighing its costs to the community. Ignoring the complaints risks protests, tougher conditions or loss of community support.

Good answers notice that the two views can converge: protecting community support may also protect long-term shareholder value.

Question 2 - Harbourside Ferries

Question	A strong answer would include
Why report?	To be accountable for its impacts as a public transport provider, to support contract renewal and public trust, and possibly to meet lender expectations. The motive, ethical or economic, will shape the report.
For whom?	Passengers, the contracting government agency, employees, harbour communities and environmental groups, as well as owners and lenders.
What issues?	Found through dialogue with those groups: fuel use and emissions, wash and noise affecting the shoreline, passenger safety and accessibility, reliability, staff safety and conditions, and fares.