INTERNALISING CORPORATE SOCIAL RESPONSIBILITY (CSR) – LOOKING BEYOND DIRECTORS’ DUTIES

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ABSTRACT

There is an increasing interest on the issue of corporate responsibility and what is the role of corporate law and directors’ duties in ensuring companies adopt responsible business practices. This article reviews the reasons why focusing on director’s duties provisions to ensure that corporations adopt and implement socially responsible business practices is inadequate. This article uses the asbestos compensation claim in Australia as an example of the inadequacies of the directors’ duties provision. It also suggests what external factors must be in place to achieve CSR within the corporate legal framework without the drastic change of codifying directors’ duties to stakeholders.

KEY WORDS: Directors, Responsibility, Corporate, Compensation

INTRODUCTION

Within the Asia-pacific region, jurisdictions that share a common corporate law heritage such as Malaysia, Singapore and Hong Kong are reviewing the general corporate law rules as well as the more specific rules relating to directors’ duties. While the focus is on the traditional fiduciary duties and duty of care, skill and diligence, there is an increasing interest on the issue of corporate responsibility and what is the role of corporate law and directors’ duties in ensuring companies adopt responsible business practices. The rules relating to directors’ duties are still undergoing review within these jurisdictions and the question whether directors’ duties provision should be amended to expressly provide that directors owe a duty to specific category of stakeholders is still unresolved. This article reviews the reasons why focusing on directors’ duties provisions to ensure that corporations adopt and implement socially responsible business practices is inadequate, using the asbestos compensation claim in Australia as an example of the inadequacies of the directors’ duties provision and argues that it is possible to achieve CSR within the corporate legal framework without the drastic change of codifying directors’ duties to stakeholders.

CODIFYING DUTY TO STAKEHOLDERS AND ITS SHORTCOMINGS:

From a corporate law perspective, corporate social responsibility has often been considered in relation to directors’ duties on the basis that as the organ of the company having authority to make business decisions on behalf of the company, directors are well-placed to ensure that the company adopts and implements socially responsible business practices (Sealy, 1987). While the common law has developed in such a way that directors are not in breach of their duty towards the company when they consider stakeholders’ interests so long as this is also in the best interest of the company, it has not gone to the extent of making it an obligation for directors to consider stakeholders’ interest. At common law, the duty to act in the best interest of the company has been interpreted to allow directors to consider stakeholder’s interests, such as creditors and employees. In relation to employee’s interest, in Teck Corp v Miller, the learned judge referred to the traditional view in Parke v Daily News Ltd. that “...the directors owe a duty to the company. The company shareholders are the company...no interest outside those of the company’s shareholders can legitimately be considered by the directors.” The learned judge went on to state that this traditional proposition “...must yield to the facts of modern life” so that “...if today directors of a company were to consider the interests of its employees, no one would argue that in so doing, they would not be acting in the best interest of the company.” Nonetheless, “...it would be a breach of duty for directors to disregard entirely the interest of the company’s shareholders in order to confer a benefit on its employees.” More recently, in the Bell Group Ltd. (in liq) v Westpac Banking Corporation (No 9), it was held that “[B]ut it does not follow that in determining the content of the duty to act in the interests of the company, the concerns of shareholders are the only ones to which attention need be directed or that the legitimate interests of other groups can safely be ignored.” Parkinson
(1993) stated that stakeholders in relation to corporations can be divided into those groups who are ‘affected by the company’s mainstream business’ and with whom the company ‘comes into contact as a necessary part of carrying on its business’ such as employees, consumers or neighbours. The other category are groups ‘who fall outside the company’s ordinary commercial operations.’ Wider community interests have not been discussed by the courts in the context of directors’ duties.

The debate on finding legitimacy for corporate social responsibility within corporate law rules can be categorised thus: those who argue that directors should be required to consider wider stakeholders’ interests, those who propose that directors should be given managerial discretion to consider wider stakeholders’ interest. Within the latter category, the views are also divided as to whether the types of stakeholders whose interests should be considered by directors when making corporate decisions should be specifically provided for within corporate legislation.

In the UK Modern Company Law Review’s Strategic Framework Consultation Document (March, 2000), several questions on corporate social responsibility were put for public consultations:

1. whether the current law that requires directors to operate companies for the benefit of shareholders should be retained;

2. alternatively, whether it should be possible, or even obligatory, for directors to operate companies for wider public interest purposes or purposes that is in line with the economic interests of those with business relationships with the company and that this should be allowed even though this was not, even in the long term, be consistent with shareholders’ best interest.

The Modern Company Law Review decided to adopt the ‘enlightened shareholder value’ which has its foundation in the view that directors should promote the success of the company for the benefit of its shareholders and in doing so, may take into consideration the impact that the company’s decision will have on stakeholders. It rejected the ‘pluralist approach’ that mandates directors to consider stakeholders’ interests. The Modern Company Law Review stated that the statement on directors’ duties “requires directors to act in the collective best interests of shareholders, but recognised that this can only be achieved by taking due account of wider interests.” This view was reflected in section 172(1) of the UK Companies Act (2006) which introduces the duty of directors to promote the success of the company. The UK Companies Act (2006) uses statute as an educational tool by clarifying what are the categories of stakeholders’ interest that should be relevant for the duty of directors to promote the success of the company. The UK Companies Act (2006) uses statute as an educational tool by clarifying what are the categories of stakeholders’ interest that should be relevant for decision-making, i.e., employees, customers, suppliers, the community and the environment and creditors (section 309). This approach is viewed as providing a strong normative element that will encourage boards to consider stakeholders’ interest (Fisher, 2006).

Nonetheless, there are serious shortcomings in relying or focusing on directors’ duties to ensure that companies adopt responsible business practices. Although codification of the categories of stakeholders is seen as a method to address the shortcomings of the common law, it does not explain how the competing interest between the respective stakeholders themselves or between the shareholders and stakeholders. For example, evidence from Australia showed that union shareholders’ campaigns involved traditional corporate governance concerns which are within shareholders’ interest such as non-performance based executive remuneration and independence of board members (Anderson & Ramsay, 2006). But there are also pursuit of others interests which are not immediately relevant or apparent to be relevant to shareholders’ interests for example halting job cuts and increasing employee entitlements. Sealy was of the view these conflicting interest makes the duties practically unenforceable but has also subsequently stated that section 172(1) of the UK Companies Act 2006 suggests that when there is conflicting courses of action, directors must simply take their ‘own good faith business decisions’ (Sealy & Worthington, 2007). However, there is an absence of objective criteria and that there seems to be no standard to measure good faith (Keay, 2007). What amounts to failure to promote the success of the company is unclear; how will the courts balance the claims between shareholders and employees, for example “…in the event of the company directors favour employees interest and pay smaller dividends (Baxt, 2005).” It is to be noted that the UK Modern Company Law Review did consider whether stakeholder’s interest can be considered by directors even though this was not, even in the long term, be consistent with shareholders’ best interest. This proposition in the end did not find statutory support in the UK Companies Act 2006.

Another confusion of section 172 of the UK Companies Act 2006 is that while it is introduced as a new directors’ duty provision, in actual fact, what it does is merely allowing directors to consider wider community interest but not obliging directors to do so. Although this allows considerable discretion to directors to decide when and how to take into account the interest of employees and other stakeholders and theoretically encourages socially responsible business decision, (Mitchell, 2005) this discretion may be self-serving to directors, enabling them to justify various decisions on stakeholders’ interests without any specific standards when challenged by shareholders. Nonetheless, it must also be noted that the ambiguity in section 172(1) of the Companies Act 2006 relating to how best to handle competing interests also exist under the common law. The possibility of self-serving justification also exists under the common law. The point is that the codification of
directors’ duties to take into consideration stakeholders’ interest does not resolve these concerns identified under common law.

In the case of breach of duty of care, there must be proof of breach based on the standard of care and proof of causative loss where the company must show that the directors’ failure to consider stakeholders’ interests has caused the loss suffered by the company. There are views that directors who allow company to engage in violations of law that is intended to protect the community’s interest (for example environmental law) may be negligent in their duties to the company at common law, in breach of their duties of good faith to the company as fiduciaries and/or in breach of their statutory duty of care (Biefeld, Higginson, Jackson & Ricketts, 2007). However, relying on duty of care to ensure directors adopt responsible business practices and consider stakeholders’ interest is problematic for the following reasons. A breach of duty of care requires the proof of loss or damage to the company and that it was the directors’ conduct that causes the loss or damage to the company. Furthermore, there should be a prior conviction or civil action against the company by outsiders under relevant laws or legislations such as laws relating to the laws of torts, (Jivan & Forster, 2007) consumer protection, labour or environmental protection. If there were to be personal liability on the directors, this must be provided for by the relevant statute which should be capable of identifying the appropriate person within the corporation that is to be made accountable for the corporation contravening the relevant legislation. These are two issues that cannot be solely dealt with by corporate legislation or corporate regulatory authority.

Furthermore, if social corporate responsibility is to be ensured through its codification under directors’ duties’ provisions, another question that arises is the enforceability of the provisions. Shareholders may not have sufficient incentive to bring litigation against the directors on matters that does not involve their immediate and direct interests. In the case of the newly introduced codification of duty to consider stakeholders’ interest i.e., duty to promote the success of the company under section 172(1) of the UK Companies Act 2006, courts are also unlikely to grant leave to bring derivative action when there is no adverse financial effect as a result of “...a failure in the process of decision-making by the directors required under section 172 (1).”

In addition, it is noted that section 172 (1) of the UK Companies Act 2006 does not give a direct right to stakeholders to enforce compliance with the section. It is not disputed that it is a correct proposition of law that shareholders should not be given a direct right to enforce directors’ duties provisions. This is because “...there is a real danger that such a provision would blur rather than clarify the purpose that directors are to serve. In doing so, it could make directors less accountable to shareholders without significantly enhancing the rights of other parties.” However, codification of duty to stakeholders needs to be supported by clear statements relating to its enforcement. On this point, there has been a proposal to resolve this issue. A modified version of the UK approach was suggested to the Australian Parliamentary Joint Committee on Corporations and Financial Services in 2006. The suggestion is that instead of a statutory provision, there should be a default replaceable rule, similar in contents to section 172(1) of the UK Companies Act 2006, except that it will be in the constitution of the company as part of the replaceable rule under Australian corporate law where the company is free to adopt this provision or opt out of it. Essentially, this proposal relies on the concept that the company’s constitution is a contract between the company and its members, enabling members to take action to enforce compliance with the statutory contract (Lumsden and Fridman, 2007). However, this proposal is couched in terms of giving directors’ discretion to consider stakeholders’ interest and decision n cases like John Shaw and Sons (Salford) Ltd v Shaw (which states that where powers’ are granted to directors, it cannot be usurped by the general meeting, unless the articles is altered) and NRMA v Parker (where McLelland J stated that it is not within the general meeting’s authority to express an opinion as to how power vested by the constitution of the company in some other body or person ought to be exercised) will apply.

It has also been suggested that this statutory duty should be publicly enforced by the regulatory authority (Lumsden and Fridman) so that the problem of enforcement by stakeholders and/or shareholders can be circumvented. However, this suggestion will not be achievable or useful where there have been reservations by the regulatory authority itself. It is also worth noting that the road taken by the UK Companies Act 2006 in codifying directors’ duties in relation to stakeholders came about at a time when there is rising concern about the exposure that boards collectively and directors individually face in relation to third party legal actions. Thus, codification of directors’ duties is seen as an appropriate and balanced response to allay concerns about liability risks of directors as well as a guide to courts not to expand or create new duties. The UK Modern Company Law Review, in completing the structure stated that:

Finally on directors’ duties, we suggested that the statement should be exhaustive, in the sense that it should not be open to the courts to develop new principles, as opposed to developing the existing principles, as opposed to developing the existing principles by reference to particular case. We argued that such wider developments in this very important commercial field should be a matter of Parliament.

Lessons from Abestos Compensation Claim in Australia- Balancing ‘Best Interests of the Company’ and ‘Social Responsibility’:
An example of the inadequacies of corporate law can be seen in the asbestos compensation claims in Australia involving the James Hardie group of companies (Dunn, 2007). The Hardie Group has been involved in manufacturing asbestos products in Australia. Realising that there is a rise in the number of asbestos compensation claims and the fact that the amount of liability or the number of claims could not be ascertained with certainty, the James Hardie group decided to protect the rest of the company in the group by isolating the liability risk of its subsidiaries that manufactured the relevant asbestos linked products. This is done by setting up a trust, the Medical Research and Compensation Foundation which was capitalized with $293 million to fund future asbestos compensations claims. The shares of subsidiaries that manufactured the relevant asbestos linked products were transferred to the Foundation. The Foundation effectively became the holding company of the two subsidiaries. The assets of these two subsidiaries were also transferred to another company in the group, JHIL (which was restructured into a new entity called ABN 60). In 2001, ABN 60 transferred its assets to a company which James Hardie group incorporated in the Netherlands, JHI NV. ABN 60 had issued partly paid shares to JHI NV and ABN 60 represented that it would be able to make a call on these partly paid shares to the amount of $1.9 billion to meet future claims. Because of this, the New South Wales Supreme Court approved the transfer of ABN 60 assets to JHI NV. In March 2003, ABN 60 had cancelled the unpaid portion of the partly paid shares issued to JHI NV, a transaction which was carried out without the knowledge of the court or the Australian Stock Exchange.

The sum of $293 million was arrived at through a valuation report commissioned by James Hardie in February 2001 which stated that future claims could amount to $286. This figure however was revised later that year to $574.3 million and subsequent valuation indicated a further increase, highlighting the fact that the Foundation was underfunded. In December 2003, the Foundation announced that it would be unable to meet future compensation claims as the amount it had was insufficient.

The Australian government responded to this 'injustice' by setting up an independent inquiry, the Jackson inquiry to specifically look into this asbestos compensation matter (Jackson, 2004). The Jackson inquiry found that the decision of the James Hardie management to separate the company from its asbestos-related liabilities was designed to the detriment of the public and, in particular, existing and potential tort claimants against the company. It also found that the total claim against James Hardie could be up to $2.24 billion and that the directors were aware that the compensation fund could be underfunded.

In addition, the Corporations and Markets Advisory Committee (CAMAC) and the Parliamentary Joint Committee on Corporations and Financial Services (PJC) began a review of the current legal and regulatory framework for corporations. The CAMAC report, published in December 2006, The Social Responsibility of Corporations had the following terms of reference:

(1) Should the Corporations Act be revised to clarify to what extent to which directors may take into account the interest of specific classes of stakeholders or the broader community when making corporate decisions?
(2) Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?
(3) Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?
(4) Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

The CAMAC report concluded that there was no need for the Corporations Act to be revised to require directors to take into account the interests of specific classes of stakeholder or the broader community when making corporate decisions. It was also unnecessary for the Corporations Act to be clarified to explain to what extent to which directors may take into account the specific classes of stakeholders or the broader community when making corporate decisions. To answer the question of how companies should be encouraged to adopt socially and environmentally responsible business practices, CAMAC proposed the “business approach to corporate responsibility”, that reliance be placed on voluntary industry initiatives and government’s role in creating and enforcing policy that shape corporate behaviour on social and environmental issues. By designing, maintaining and strengthening the legislative and regulatory framework, the government could promote responsible corporate behaviour. Within corporate law and regulatory framework, the changes suggested were in relation to the use of disclosure and reporting to encourage responsible conduct. Company auditors should review the existence of such sustainability disclosure and also make recommendations to the board as to the adequacy of such disclosure. This legal framework is sufficiently supported by self-regulation provided by the ASX through its Listing Rules and Corporate Governance Council principles.

In the meantime, the PJC review was completed earlier and was published in June 2006. The terms of reference for the PJC review were more extensive than the CAMAC report requiring a review of the current legal framework, including the Corporations Act. Apart from the scope raised by the CAMAC report, the PJC review had to consider the following:
Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholders’ interests by incorporated entities and/or their directors;

The appropriateness of reporting requirement associated with the issues raised by the PJC terms of reference.

The PJC’s report, Corporate Responsibility: Managing Risk and Creating Value did not recommend any codification of stakeholders’ interest under directors’ duties provision, concluding that there was no need to put in a permissive provision as the current law is sufficiently flexible to enable consideration of stakeholders’ interest. There was much emphasis given to the use of strategies outside corporate law. Similar to the CAMAC report, there was recommendation of the use of reporting to encourage responsible business practices although sustainability reporting should remain voluntary. The PJC considered that there may be a need in the future for a standardized reporting framework on sustainability issues and suggested that the Global Reporting Initiative Framework could be considered as the basis for a voluntary Australian sustainability reporting framework. Corporate responsibility performance measures was to be included and considered as part of the remuneration packages for directors and it is shareholders and stakeholders who should encourage company to do this.

A very interesting point of the CAMAC and PJC reports is that despite the intense public interest and expectation that James Hardie should not be allowed to separate itself from the potential asbestos compensation claims, the Australian model did not consider codification of corporate social responsibility within the corporate law framework as an appropriate solution to ensure or encourage corporations to be responsible corporate citizen.

As a result of the Jackson inquiry, the Australia Securities and Investment Commission (ASIC) initiated legal action against directors of James Hardie in relation to the statement as to the ability of the subsidiary company to meet future asbestos compensation claims. Attempt was made to rely on the directors’ duty provision under the Australian Corporations Act 2001 relating to breach of duty of care and diligence in Australian Securities and Investments Commission (ASIC) v Macdonald (No 11). The litigation involved an action by the ASIC in relation to information disclosed by the company relating to the company’s asbestos and compensation fund. Essentially the litigation relied on the announcement made to the ASX in relation to the ability of the Foundation to fully fund any future compensation claim. The allegation was that the directors knew that the announcement was false and misleading and yet they approved the release of the statement. The ASIC brought the case against the directors and focused on the announcement made by the company to the Australian Stock Exchange (ASX) that the company’s asbestos and compensation fund was fully funded. The court held that section 180 of the Corporations Act 2001 dealing with duty of care, skill and diligence was breached when the board failed to ensure that the draft announcement that there were sufficient funds to pay compensation was not misleading or deceptive. This was because despite evidence that there were uncertainties as to actuarial calculations, the board allowed an emphatic announcement that the funds were fully funded, i.e. the statement was unqualified and too unequivocal. Findings were also made against the company and its officers with regard to false statements and failure to provide information to the stock exchange. While ASIC was successful in its application, there are cautious views that the case was a decision of a single judge and could be appealed. At first glance the company has not suffered any loss or damage out of the announcement. However in this case the company was implicate of making false and misleading statements and penalty was imposed on the company. Thus, the breach of duty of care, skill and diligence can be upheld as the directors had caused the false and misleading statement to be issued. Despite the directors’ contention that there was reasonable delegation and reliance, the judicial view was that the special facts of the case do not allow delegation in relation to the preparation of the statement issued to the regulatory authority. ASIC also applied for disqualification orders against the directors, which were duly granted. It has been highlighted that some of the directors would be able to avoid personal liability for the breach of duty due to indemnities available to them (Moran, 2009). On appeal, the finding of directors’ liability was overturned because of the lack of evidence as to whether the announcement was approved at the board meeting or modified without the board’s knowledge or approval. But for this factual finding, the directors would have been held liable because the appellate court was also of the view that this was not a situation where the directors should be allowed to rely on the expert report relating to the actuarial calculations.

From a theoretical corporate law perspective, what James Hardie did was to rely on the separate legal entity and limited liability concept to ensure that liability risks of its subsidiaries will be isolated. This was a legal and valid business decision which unfortunately led to the potential torts claimant rights being rendered futile. Although under the law, the limited liability and separate legal entity doctrines may be set aside by the court, the decisions by James Hardie to isolate the business risk that it faces was not against the law. This was decided in James Hardie & Coy Pty Limited & Ors v Hall (as Administrator of the estate of Putt). In this case, Hall attempted to sue the holding companies of his employee, James Hardie & Company Pty Ltd which was a company incorporated in New Zealand. Hall was exposed to asbestos while working for his employee. The trial judge allowed the application on the basis of enterprise liability and that the holding company owes a duty of care to the employee. On appeal, the court decided that to enable the claim by Hall to succeed, the court would
have to decide that the holding company owed a duty of care to the employee of its subsidiaries which would require the court to lift the corporate veil. This, the court did not do.

While it may also be argued that the transaction was structured to evade existing legal obligations, there was a substantial amount of funds that has been put into the Foundation to be used to pay future claimants although subsequently the amount was found to be insufficient. However, ‘undercapitalisation’ is not a reason for lifting the corporate veil, unlike in some jurisdictions. Arguably, what the board decided to do in terms of steps taken to isolate liability risks of the company and to reincorporate in a different jurisdictions was in the best interest of the company. This will enable the company to continue its business and promote the long term sustainability of the company. Although the statement “best interest of the company” is to include stakeholders interest, the situation in Hardie James’ reincorporation highlights the difficulty of having to decide how to resolve competing interests and that applying the managerial discretion allowed to be exercised by directors, the decisions would have been upheld as within the law. In fact in Australian Securities and Investments Commission (ASIC) v. Macdonald (No. 11), the directors were held not in breach of section 181 of the Corporations Act 2001 since they believed that their decision was in the best interest of the company.

Despite the failure of tort claimants to make the holding company liable for the subsidiaries James Hardie had agreed subsequently to meet the shortfall over a 40-year period. A reason for this is the concern about reputational risk and how loss of reputation has impacted the company’s sustainability as there were vigorous successful boycotts by consumer groups of the company’s products overseas, a government ban of the company’s products and threats of specific legislation to make the holding company liable (Hills, 2005).

A ‘No-Codification’ Approach To Achieving Csr:

Much of the corporate law in countries like Malaysia, Singapore and Hong Kong has been influenced by law reform in UK due to a common legal background and legal history, and to some extent by Australian developments. However, on the issue of corporate responsibility, Malaysia has not followed the UK approach in codifying directors’ duty to promote the success of the company, i.e. ‘the corporate social responsibility provision.’ The Malaysian Corporate Law Reform Programme (CLRP) which was initiated in 2004 has suggested in its Final Report (2008) that whilst directors should take into consideration stakeholders’ interest, there should not be any codification of wider stakeholders’ interest within corporate legislation. Since the Malaysian Corporate Law Reform Programme was only concluded in 2008, the recent amendment to the Malaysian Companies Act 1965 in 2007 did not deal with this point. It is unclear as to how this will be reflected in the rewrite of the Companies Act 1965. However, if the CLRP recommendation is accepted, this would mean that the current legal position will be retained and that Malaysia will not follow the UK approach.

Is the Malaysian approach to non-codification reflected in other common law jurisdictions in the Asia-Pacific region? In Singapore and Hong Kong, the law relating to directors’ duties is also evolving. Singapore has conducted and completed its corporate law reform exercise and concluded then that it will follow the UK approach in relation to directors’ duties (Report of the Company Legislation and Regulatory Framework Committee, 2002). but this has yet to materialize. Recently, however the issue of codification of directors’ duties for Singapore has resurfaced where the Singapore Minister of Finance announcing that there are two options being considered and these are either along the lines of the UK Companies Act 2006 or through best practices guidelines similar to the approach in Hong Kong, but there is still no conclusion as the issue of duty to stakeholders. In the meantime, Hong Kong has also deliberated on codifying directors’ duties. The Hong Kong Companies Ordinance 1997 does not contain any statutory provision dealing with fiduciary duty or duty of care, skill and diligence except in relation to disclosure by a director of material interest in contracts. The contents of directors’ fiduciary duties are to be found in various codes and guidelines such as the Hong Kong Institute of Directors “Guidelines for Directors” and “the Guide for Independent Non-Executive Directors” as well as the “Non-statutory Guidelines on Directors’ Duties” issued by the Hong Kong Companies Registry. However, in mid-2006 the Hong Kong government embarked on a comprehensive rewrite of the Hong Kong Companies Ordinance. The preliminary conclusion at the consultative stage was that whilst the directors’ duty of care skill and diligence is to be codified, the fiduciary duties shall remain uncodified. The new Companies Bill 2011 gazetted on 14 January 2011 does not contain a duty to promote the success of the company. It is highly unlikely that there will be a codification of directors’ duty to stakeholders in Hong Kong (Ji, 2010).

In Malaysia, disclosure and reporting seems to be the most popular method in internalizing responsible corporate practices. There are various voluntary schemes in Malaysia that rely on the use of disclosure and reporting as a regulatory strategy to encourage responsible business practices in Malaysia. Examples are the Association of Chartered Certified Accountants (ACCA) Malaysia Environmental and Social Reporting Award which was introduced since 2002 and has since been renamed to Malaysia Sustainability Reporting Award and the Malaysia Corporate Responsibility Malaysia Awards 2008 and 2009 created by the Institute of Corporate Responsibility Malaysia. International standards such as the Sustainability Reporting Guidelines issued by the Global Reporting Initiative are indirectly assimilated into Malaysia due to the affiliation and involvement of the
professional bodies in Malaysia to the international associations such as the ACCA. The Malaysian stock exchange, i.e. Bursa Malaysia had also introduced a reporting requirement for listed companies in 2004 that relates to corporate social responsibility. The listed company is to provide a description of its corporate social responsibility activities or practices in its annual reports or if there is none, then to provide a statement to that effect as is stated under Appendix 9C, item 29 of Chapter 9 of the Listing Requirement of Bursa Malaysia. The contents of the reporting framework for corporate social responsibility should include environmental issues and social responsibilities initiatives such as community involvement, equal opportunity, workforce diversity, human rights, supplier relations, child labour, freedom of association and fair trade. This is quite similar to the approach in the UK.

Under the UK Companies Act 2006, companies are required to publish a business review specifying the risks faced by the company’s business. Listed companies are required through the listing rules to report on employees, social and community issues and environmental activities to enable an understanding of the company’s business. It is worth noting that in 2005, the UK Modern Company Law review recommended that there should be a statutory obligation for public and listed companies to publish and Operating and Financial Review (OFR) as part of the full annual report. The contents of the OFR would cover all that is material in the directors’ view for users to achieve a proper assessment of the performance and future plans and prospects of the business and would include, where relevant, its relationships with employees and others and its impact on the community and environment. There would be an audit of the process adopted by the directors in preparing the OFR but auditors will not be asked to audit the judgement made by the directors in terms of materiality of the information presented in the OFR. However, this suggestion was not enacted into law. Recently, the UK’s Large and Medium-sized Companies and Groups (Accounts and Reports) (Regulations 2008) has introduced the requirement that will have the result of promoting stakeholders’ interest and reinforce the ‘enlightened shareholders value’ of the UK Company Law Reform programme. Listed companies must include a statement in their directors’ remuneration report setting out how they have taken employee pay and employment conditions into account when determining directors’ pay for the relevant financial year. In doing so, companies must have regard to the pay and employment conditions of its own employees, and the employees of any other undertakings within its group. As a comparison, section 299(1)(f) of the Australian Corporations Act requires that the director’s report should include the company’s performance in relation to financial regulation if the company’s operation is subject to any particular and significant environmental law or regulation.

In addition, the Malaysian Accounting Standard Board’s (MASB) Reporting Standards states that outside the financial statements, companies should present information that explains and describes the main features of the company’s financial performance and financial situation and the risk and uncertainties that the company faces. This information may include additional information such as environmental reports and value added statements, particularly in industries where environmental factors are significant and where employees are considered to be an important user group. The Standards suggests that management is encouraged to include this information if they believe that these additional statements will assist users in making economic decisions.

There are views that companies could also be encouraged to internalise corporate social responsibility through activist shareholders’ initiatives. Shareholders’ activism may take any one of the following forms: “...from gaining corporate control (corporate raiding in 80s America) to instituting shareholder litigation to other forms of influence changing corporate directions without changing the stake of control (such as accessing the proxy system, making proposals and initiating dialogue, or relationship investing) (Chiu, 2008). What is the state of shareholders activism in Malaysia? There is an increasing awareness of shareholders’ rights and responsibilities in Malaysia. Much of this is owed to the involvement of regulatory authorities and government backed initiatives in creating awareness for the need to have better legal and regulatory framework for shareholders and investors. Better shareholders’ protection has been part of the corporate governance reform since 1999 when the High Level Finance Committee on Corporate Governance identified key areas in for review and published the Code on Corporate Governance. On the law reform side, the Corporate Law Reform Committee was established in 2004 with the main objective of reviewing Companies Act 1965 and recommending reform of the law where relevant. At the same time, the government went ahead with the implementation of some of the recommendations of the High Level Finance Committee on Corporate Governance which was included into the 2007 amendment to the Companies Act 1965 introducing, amongst others, the statutory derivative action. As a result of the High Level Finance Committee on Corporate Governance, the Minority Shareholders’ Watchdog Group (MSWG) was established in 2000. MSWG has been quite vocal in sharing its views on corporate governance issues by directly engaging with companies where MSWG has been appointed as proxy or by identifying issues that should be raised by shareholders at upcoming general meeting of listed companies and issuing statements on certain proposals involving shareholders’ right.

Nonetheless, shareholders activism in relation to social and environmental issues is still scarce. In more advanced economies with a more mature civil society, there are a few reported instances of activist shareholders, i.e. union shareholders and environmentalists shareholders relying on non-litigious engagement with boards to achieve changes in business practices. In Malaysia, reports on similar activities are not common.
In most cases, the activist shareholders have often relied on the need to maintain good reputation, goodwill and relationship with consumers and governments to ensure financial stability as reasons to influence corporations to adopt socially responsible business practices. They must also be able to convince the general meeting that there is a business case for their proposals. For example, on the issue of compliance with international labour standards, a business case for its adoption would be the need to maintain company’s reputation to enable continued operation and growth as this will improve workplace relations which will ensure that the company is reliably able to supply products to its customers. A business case for environmental issues could be the need to tap into new resources (for example, resolutions proposed for energy-based companies), maintain competitive advantage such as citing a rival company’s leadership role in introducing hybrid vehicles and its subsequent capture of global market shares (Rembert, T., Nowlan, 2005).

It is also worth noting that where institutional shareholders in other jurisdictions are often industry-led coalitions, the influential institutional shareholders in Malaysia are made up largely of government-linked corporations and the government/state pension funds. The establishment of the minority Shareholders’ Watchdog Group (MSWG) is an example of a government-led initiative to ensure better protection of minority shareholders by shareholders themselves. The corporate responsibility initiatives in Malaysia are normally government-driven due to the involvement of government in business (Ong, 2008). In 2004, the government launched its Government-Linked Corporations (GLC) Transformation programme in 2004. In relation to corporate responsibility, GLCs are guided by the Silver Book which clarifies that GLCs’ primary objective is to enhance shareholder returns and meet the needs of other stakeholders.

The threat of litigation for failure to consider socially responsible business practices is also a very material factor why companies should adopt responsible business practices. In some jurisdictions, there are an increasing number of litigations involving company’s practices that are alleged to have contributed to climate change (Wallace, 2008) or litigations involving liability for human rights violations (Ryngaert, 2008) or even liability for failure to provide a safe working environment. In addition to litigations, lobbying by special interest group against companies which are believed to be insensitive to stakeholders’ interest have affected company’s market share and consequently, eroded shareholders value. Unfortunately in Malaysia, there are no reported instances of shareholder’s litigation in relation to managerial discretion to make socially responsible business decisions. Stakeholders’ activism in the area of corporate social responsibility is largely driven by the community and its changing expectations. Ideally, changes in community expectations as to the importance of socially responsible business practices would ultimately affect shareholders’ personal views which would then be reflected in the collective decision-making by shareholders (Farrar, 1998). The absence of a sophisticated base of investors or a mature civil society may have an impact on whether shareholders have the will or the incentive to insist companies adopt socially responsible business practices.

Conclusion

The debate on the role of directors’ duties in relation to corporate responsibility is still evolving in Malaysia, Singapore and Hong Kong and it is open to debate whether the corporate law reform in these jurisdictions will adopt the concept of the ‘enlightened shareholder value’ with or without having this codified within corporate legislations. The ‘enlightened shareholder value’ of UK and the ‘business approach to corporate responsibility’ of Australia are substantially the same in that both approaches allow directors to consider a combination of stakeholders’ interest to ensure that the business of the company is sustainable as this would be in the long-term interest of the shareholders as a whole.

However, putting too much reliance or relying solely on directors’ duties provisions, i.e., enlightened managerial discretion is inadequate. This is not to say that directors’ duties are not useful to protect shareholders’ interest and to ensure accountability of directors. Nonetheless, it alone, may not be suitable for the purpose of ensuring that corporate social responsibility is internalized by corporations. The James Hardie case study reflects the tension between law and business efficacy, the competing conflict between shareholders and stakeholders interests and the inadequacies of corporate law. Alternative measures need to be considered to ensure corporate social responsibility is implemented by corporations.

The focus of discussion should be readdressed to emphasise that the corporation as an artificial legal person, but a person nonetheless, must comply with external laws and regulations that affect the social and business community within which corporations exist and thus corporations must consider stakeholder theory in managing the company’s affairs irrespective of whether the corporate social responsibility is provided for within the corporate legislation. A very important point is to ensure that companies consider and deliberate on whether its existing business practices is legal and are designed with no or the least harm on society and environment, not merely how much has been spent by a company for philanthropic purposes. It may be appropriate to consider by industry grouping what are basic social responsibilities issues that are to be adopted and implemented by companies in the same industry. Legislations on several aspects of social, environmental, health and safety and labour issues, amongst others which corporations must consider to carry on its business should be put in place.
and must be enforced. A more updated and viable corporate criminal liability framework must also be put in place (Hasani, 2008). Nonetheless, corporate law rules is still useful especially in relation to principles that relates to and encourages shareholders’ role and activism where changes could be made to increase the flow and quality of information on sustainability issues to shareholders and investors. While the perception is that listed companies are becoming more forthcoming as to their environmental and social obligations practices, the information disclosed are normally self-proclaimed.

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