Trust Building and Trust Busting

Corporations, Government and Responsibilities

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IN A REPORT PUBLISHED IN 2002 BY the UK-based Forum for the Future, Roger Cowe and Jonathon Porritt argue that government should take an increasing role in the promotion of corporate citizenship (CC) and socially responsible investing (SRI) (Cowe and Porritt 2002).[1] I believe this argument, often neglected in dialogue on these issues, is one of crucial importance. Facing squarely the limitations of the market to create public trust in corporations and envisioning the role of government in the creation of such trust are vital if CC and SRI are to realise their full potential and play a legitimate role in 21st-century society.

The question of trust—trust in corporations and their interaction with society—has arisen repeatedly in the recent public outcry over a seemingly endless series of corporate scandals. Talk in the press is often of *restoring* trust in the corporate community. It is more accurate, however, to speak of *creating* such trust—a far more difficult task.

As the pendulum was swinging worldwide in the direction of market-driven economies during the 1990s, corporations gradually took on a qualitatively different and dramatically new role in society. In differing ways and at differing paces in Europe, Russia, China and much of the developing world, companies took over management of many industries once owned and operated by the state. Throughout the world, governmental regulation has become increasingly restrained and corporate self-regulation is the word of the day. Resource-strapped governments are looking to the corporate world to share an increasing part of social security burdens—from childcare to pension obligations. Revolutions in technology, communications and transportation have augmented corporations' power and broadened their global reach. Corporate

1 Cowe and Porritt use the vocabulary of 'corporate sustainability'. For this article, I have chosen to use the vocabulary of 'corporate citizenship'—the commitment by corporations to consider the broad social implications of their actions on major stakeholders—and 'socially responsible investing'—the use of the tools of the financial world to raise issues of corporate citizenship with corporations themselves and in society more broadly.

control over such essentials of daily life as water, the airwaves and national defence suddenly looms large. It is no wonder the public wants to know if it can trust these newly empowered companies to act in society's best interests. This question has particular resonance today when certain leaders of industry cannot even be trusted to report accurately on something as basic as earnings.

An unspoken assumption of the CC and SRI world is that corporations can ultimately be trusted in their new roles. It is increasingly clear, at the same time, that such trust cannot be created without three crucial elements: data, debate and consequences. By data, I mean the disclosure of basic metrics on corporations' social and environmental (sustainability) policies and practices. What, in fact, is their record in these areas? By debate, I am referring to informed and reasoned analysis of this data and to larger questions about the appropriate balance between corporate and governmental spheres. Which specific companies can be trusted to act in society's best interests and which cannot? What products and services can the market be trusted to provide? But data and debate, however thorough, are useless if they do not have consequences—if corporations or industries are not amply rewarded or penalised when they succeed or fail in their social and environmental efforts. Can society in fact ensure that 'good' companies will do better than the 'bad'?

Without all three of these crucial elements—facts, interpretation and concrete action—trust will never be complete. Those among us advocating 'doing well while doing good' have been remarkably successful in generating the initial phases of disclosure and debate essentially through market mechanisms. The momentum behind the Global Reporting Initiative and the fact that hundreds of corporations now publish sustainability, environmental and social reports demonstrate how far voluntary efforts have progressed toward making such disclosure a fact of corporate life. Moreover, mainstream financial firms increasingly acknowledge that such data has a place in their stock valuation and selection processes.

Driving this progress on disclosure and analysis are several market-related arguments. Companies implementing CC programmes will have a competitive advantage in the marketplace: they will be able to attract and retain better employees, attain greater customer loyalty through higher-quality products and services, save costs through environmental efficiency, and avoid regulatory entanglements by cultivating strong community and government relations (Waddock 2002: 151-59). Greater disclosure on social and environmental matters will lower the cost of capital for companies and whole stock markets, as the disclosure of data already does in the financial arena. Sustainability data helps SRI analysts identify better-managed companies, as well as long-term liabilities often unrecognised by mainstream analysts. They can therefore pick stocks with greater potential on the upside and less on the downside. In short, corporations with strong CC records will be more profitable than their peers and their stocks will outperform the market (Camejo 2002: 47, 52).

How far these profit-driven motivations can push disclosure and the adoption of CC programmes remains to be seen. Certainly, some companies will implement CC programmes in order to gain competitive advantage. But how many companies and for how long? Once the leaders in this strategy have established their pre-eminence and erected high barriers to entry, why should others struggle along behind? Why not compete mercilessly in other areas: price, convenience, service? Companies may do an excellent job on reporting on today's hot social or environmental issue because it is high on the investor's or customer's mind. But what about tomorrow? Why should they go to the bother and expense of reporting consistently on toxic waste disposal when overseas labour standards are in the headlines? Or on energy efficiency when investors are clamouring for better corporate governance?

SRI data may give stock pickers an advantage today. What's to say, however, that tomorrow that advantage won't be arbitraged away? Once all Wall Street uses this data, won't the stocks of the better companies be bid up and any potential for purchasing them at undervalued prices disappear? What happens to CC when, as corporations often argue, customers want something not in their or society's best interests? Should car companies abandon the SUV (sport utility vehicle) market if hybrids are better for the environment? Should fast-food restaurants stop selling French fries because rice cakes are better for one's health? Can you trust companies to act in society's best interest only when they believe it is also in their own self-interest? Surely the two aren't always going to be identical.[2]

The question is whether these market-driven motivations are in fact strong enough to force consistent and systematic data disclosure, broad-ranging and widely publicised debate, and serious consequences. I wonder whether anecdotal, shifting disclosure by a changing cast of corporate characters will create a basic set of data that will be trustworthy. I wonder whether analysis of this data narrowly focused on stock valuation and targeted only at the financial community will satisfy the general public. I wonder whether companies can turn outrage into trust by boasting that CC programmes increase profits and then distributing these gains only to managers in extravagant bonuses and to already well-heeled stockowners.

I worry that the market alone cannot create trust, the kind of trust that corporations will need if they are to play in domains once reserved for government. Such trust requires systematic efforts. Trust is trust in a system. Individual players can abuse this trust, but others will not abandon their efforts if the system itself is sound. If corporations are to be trusted to play in the social and environmental spheres, they must operate within a trustworthy system. To be trustworthy, the disclosure of the data, its analysis and the consequences all must be systematic.

It is not surprising or accidental that advocates of CC and SRI have looked first to market forces to create and popularise these disciplines. It is much easier to tap into anecdotal self-interest than to create elaborate systems. Indeed, *systematic* disclosure, debate and consequences are not really in the self-interest of individual actors. These are rather classic public goods—goods that are in society's broadest interest to create and maintain, but for which it is not in the private interest of any one player to foot the bill.

In general, *private* goods can be said to be 'exclusive', that is, only available to a limited number of people, and to be 'rivalrous in consumption', that is, they are exhausted in their use (Kaul *et al.* 1999). A visit to an upscale restaurant is a private good because it is available only to those able and willing to pay for it, and it is rivalrous because, once a meal is consumed, it is not available to others. By contrast, *public* goods are said to be neither exclusive nor rivalrous in consumption. A traffic light is a public good. It is non-exclusive because its use is available to all, and it is non-rivalrous because, used by one, it is still useful to the rest—in fact, the more using it, the greater its good. However, although we all may recognise the benefit of having a traffic light on a given corner, why should I pay for it myself if you refuse to pay but still benefit?

It is increasingly clear, to my way of thinking, that the difference between the anecdotal and systematic when it comes to SRI and CC disclosure, debate and consequences is the difference between private and public goods, between self-interest and trust. The systematic creation and maintenance of these three essentials is necessary to the creation of *public* trust in corporations in their new roles. Conse-

2 In January 2003, British Telecom and the Forum for the Future hosted a conference entitled 'Just Values: What Happens When Responsible Business Doesn't Pay?', at which this issue was discussed. A transcript of this conference is available through the websites of British Telecom (www.bt.com) or the Forum (www.forumforthefuture.org.uk).

quently their cost, whatever it may be, must be borne in some crucial part by the public. While any individual corporation or investor may be momentarily motivated by the market to drive one part of this system forward, the market is too fickle to create the comprehensive, the predictable, the reliable and the inevitable.

Creating these systems can be difficult, but it is by no means impossible. In each area, government will want to evaluate what its most vital and useful role can be, and how (least expensively) to play that role. Undoubtedly, the resulting systems will be varied, tailored to specific cultures and needs, carefully balanced, and often complex. Currently, their ultimate form may be unpredictable, but in each area the challenges faced and the issues to be addressed are already clear.

Data and disclosure

Governments at various levels will soon come face to face with the question of whether disclosure of CC data needs to be required or should remain voluntary. At an international level, enforcement mechanisms for required disclosure are lacking, so voluntary initiatives will certainly be stressed. At a national level, however, required disclosure may become the preferred route. Already the French government has adopted requirements that publicly traded French companies must disclose extensive employee relations, community and environmental data in their annual reports. Requiring systematic disclosure immediately raises complicated questions about the *variability* in the relevant data, the most useful *formats* for its presentation, the appropriate *quantity* to be disclosed, and what *costs* should be incurred and by whom.

As useful as it may be, required disclosure in prescribed formats at a national level will not tell the whole story. Industry-level and company-level voluntary disclosure will provide important supplementary information.[3] Whether governments choose to promote required or voluntary disclosure through regulation, stock exchange listing requirements or accounting practices and policies remains to be seen.

Debate and analysis

To be credible, a wide-ranging public debate about corporations' role in society will need to take place. To be meaningful, this debate must be based on assumptions that company-reported data is *truthful and verifiable*, that analyses of this data are based on the work of *independent and objective* SRI and CC researchers, that *industry-specific data and technical issues* can be competently analysed, that accountants or other analysts can value companies' *intangible assets and contributions to society*, and that these analyses are available throughout society, not solely to the financial community.

A climate for informed and trustworthy debate will be created only when government lends a hand in the reconceptualisation of corporate governance structures to encourage the opening of certain democratic avenues, promotes the demystification of the esoteric vocabulary of high finance and corporate deal-making, and assures the availability of financial resources for what is in effect 'pure' or theoretical research in these areas.

Consequences

Without consequences, data and debate will be meaningless. Corporations excelling at CC should benefit substantially, while those that abuse the public trust should pay a substantial price. On the

3 For a variation on this vision of the future of reporting, see recent work coming out of PricewaterhouseCoopers (DiPiazza and Eccles 2002).

upside, companies may gain market share, shelf space or public contracts because their CC commitments tipped the scales in purchasing decisions. Awards and enhanced reputation may shower down on the heads of leading business luminaries. On the downside, firms' revenues may dry up because of unacceptable corporate social or environmental practices, their cost of capital may soar, their exposure to lawsuits may increase, or they may face increased governmental antitrust initiatives. Real consequences will mean companies thrive or die because of CC decisions, just as they do because of their business acumen.

To be acceptable to society, these rewards and punishments should be demonstrably fair. To be fair, a system with credibility is needed within which these rewards and punishments are meted out predictably. This public good can be realised when government assures that all companies are operating on *level playing fields,* that problems of *free-riders* are addressed, and that the systems that are constructed *do not inhibit corporations' abilities to innovate and generate wealth.* Finally, government can do all this credibly only if it appears free of *undue influence* from the corporate sector.[4]

Our world is currently placing a substantial bet on corporations to help address the challenges of the coming century. Government can—and should—use the SRI and corporate social responsibility (CSR) disciplines to help create systems worthy of society's trust, a trust that will be necessary today if we are to create a viable and livable society tomorrow.

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4 The questions of trust in corporations raised here have their parallel in questions of trust in government. If government is perceived as unduly or inappropriately influenced by corporations on key social and environmental issues, or if corporate-related political gridlock consistently prevents government from adequately addressing issues of broad social concern, systematic trust will also suffer. SRI is well suited to raise issues critical of government in a highly public, but orderly, fashion. Its frequent alliance with public interest and non-governmental organisations as they address governmental policy issues is one avenue for such approaches. Equally important, SRI's exclusionary screening process (i.e. refusal to invest in industries such as tobacco or nuclear arms) provides a second avenue through which SRI raises issues of the appropriateness of government's role to the level of public debate. SRI's role in the international movement to dismantle South Africa's legal apartheid system was one example of a successful application of these approaches.

