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# **Corporate Social Responsibility Indexes: Measure for Measure**

*An investigation into the ethical basis of criteria used to derive  
corporate social responsibility indexes*

A thesis submitted in fulfilment of the requirements for the

Degree of Master of Arts

at the

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by

Stephen Timperley

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## **Abstract**

This thesis investigates criteria used by research agencies that publish ratings of business organisations in respect of their corporate social responsibility (CSR) performance and the relationship of these criteria to underlying ethical principles.

Companies are rated according to CSR criteria. Observation of different rating agencies' results for the same, or similar organisations, shows a significant variation in results. Variations in rating must result either from different criteria being applied or from criteria addressing similar topics being assessed in a different way. Criteria from different rating agencies are found to be comparable. Thus if rating criteria are derived from an ethical view of the responsibilities of business organisations, then inconsistent results may be explained by variations in the ethical basis of corporate social responsibility used by agencies.

Subject companies are rated under broad categories such as corporate governance, human rights and the environment. These categories contain specific criteria. My investigation compares the criteria used by major rating agencies and identifies the ethical basis, if any, that can be attributed to each criterion.

The study finds that there are clearly identifiable links between a number of criteria used by each rating agency and the ethical theories selected for evaluation. Further, there is sufficient difference between the agencies to characterise each in relation to one or more of the ethical theories selected. There is inconsistency, however, within each agency's basis of principles as well as between agencies, which indicates an unsatisfactory lack of explicit relationship between the general, and reasonably consistent, definition of corporate social responsibility and application of coherent ethical principles.

In practical terms around 10% of all investments in the United States, representing 2.3 trillion dollars, are invested in ethical or screened funds that rely on these and similar rating agencies results to determine CSR performance of firms. The large variation in results demonstrated in my thesis suggests that very significant

financial decisions are based, at least in part, on inconsistent data. I suggest in my conclusion that if agencies were to consider, justify and clearly state the ethical basis from which their criteria derive, then investment managers and their clients could be more certain that their CSR principles were being upheld.

## **Acknowledgements**

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## **Introduction**

### ***The Thesis***

This thesis investigates criteria used by research agencies that publish ratings of business organisations in respect of their corporate social responsibility (CSR) performance and the relationship of these criteria to underlying ethical principles.

Companies are rated according to CSR criteria. Observation of different rating agencies' results for the same, or similar organisations, shows a significant variation in results. Variations in rating must result either from different criteria being applied or from criteria addressing similar topics being assessed in a different way. Criteria from different rating agencies are found to be comparable. Thus if rating criteria are derived from an ethical view of the responsibilities of business organisations, then inconsistent results may be explained by variations in the ethical basis of corporate social responsibility used by agencies.

This study is primarily to determine whether there are identifiable links between the criteria used by rating agencies in assessment of organisations' corporate social responsibility performance and definable ethical theory. A secondary proposition is that the difference in assessments between rating agencies for similar organisations may be due to criteria being derived from different ethical bases.

### ***Methodology***

This study aims to relate criteria used by rating agencies to ethical theory. A survey was carried out using the internet and other published corporate literature to identify the predominant corporate social responsibility (CSR) rating agencies currently active. The criteria for selection were that the agencies demonstrated representative characteristics, published their rating criteria to some degree, and were significant in terms of client numbers or investment influence. The frequency of reference to each agency in company reports or by investment fund

managers, and the ubiquity of each agency, gave an indication of its importance in international investment or reputation rating.

The study is not intended to be a full survey of all rating agencies, neither does it claim that all agencies meeting the selection criteria have been included.

Requirements for the sample are to provide a representative set of methodologies and rating criteria.

Nor is this study about the quality of research by the ratings agencies, the validity of methodology, or the effectiveness of measures on targeted objectives, such as stakeholder value. The key characteristic is simply the existence of specific criteria which are used to determine a rating or ranking for organisations in respect of corporate social responsibility.

Six agencies were identified as being significant, either through the size of their international market influence or, in the case of Reputex, an Australasian aspect. David Vogel's 2006 edition of *The Market for Virtue* confirms the significance of three of those selected:

The three most widely used ethical fund indexes are the Domini 400 Social Index, which is based on the research of KLD discussed above; the Dow Jones Sustainability World Index (DJSI World); and the FTSE4Good Index.<sup>1</sup>

Having identified the agencies for study, I collected published evidence of the rating criteria used by the agencies. This was generally available from their web sites, either as web pages or downloadable documents. The detail and presentation of criteria varied considerably between agencies but I was able to obtain similar levels of information from all the agencies selected.

In order to establish the ethical basis on which the rating criteria could have been derived I considered recent academic literature - mainly papers published in journals - to identify candidate theories of ethics to relate to CSR criteria. Three ethical theories - Common Good, Social Contract and Virtue ethics - were chosen

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<sup>1</sup> Vogel, D. (2006). *The Market for Virtue*. Washington: The Brookings Institution, p. 35.



as representing a range of currently discussed theories on which business models might draw. In addition I included Friedman's theory of capitalism in relation to social impact as a possible underpinning of rating criteria, and a thought-basis that I have called the Pragmatic Business View. The criteria used by each rating agency were analysed to determine their relationship to any of these five sets of principles.

The literature review was carried out to identify recent writing or earlier significant articles on each of the ethical bases where these had been applied in some way to business ethics and, specifically, to corporate social responsibility. This review validated my selection of agencies from a different perspective; positively by means of frequency of reference to selected agencies, and negatively by failing to reveal other significant rating agencies in operation. One important aspect in relating ethical theories to corporate ethics is in the status of an organisation as a moral agent, and I thus included this topic in my literature review.

The bulk of my initial research work was in analysis of each agency's rating criteria and determining equivalence where different terminology and categorisation had been employed across agencies. This resulted in a reduced set of categories of criteria which enabled me to sort and compare criteria from all of the selected agencies. As this work progressed, I was able to make an initial assessment of how specific criteria might have been derived from one or more of the five theoretical bases described.

The final analysis was to take these assessments of correlation between criteria and underlying ethical basis and consolidate them under each set of principles. This revealed the degree to which criteria are comparable across different rating agencies and the consistent or inconsistent application of an underlying ethical basis used by each agency to derive its criteria.

The process of defining a number of underlying sets of principles and relating particular actions to them was used by Dyck and Kleysen<sup>2</sup> in a study to determine whether Aristotlean virtues could be recognised as a framework for business management alongside conventional management theories. Their study categorised the key elements of each framework (or set of principles) and matched empirical management activities to each category within each framework. This permitted Dyck and Kleysen to make observations about underlying management theory. In my study I have described five sets of principles or ethical theories and defined categories covering CSR criteria. The observation, in my study, is the actual criteria used by various rating agencies. These criteria could thus be matched with an underlying theory where there is clear correlation.

### **Conclusions**

The main conclusion of the thesis is that many criteria used by rating agencies do have an identifiable ethical basis. Criteria in similar categories specified by the different agencies show definable characteristics of one or more of the theories selected. These links are sufficiently strong to claim such relationships and to enable an assessment of the theories favoured by individual agencies. This is not to claim a conscious use of underlying principles, but the bias towards a particular, or any, theory might be explained by the history of each agency and its business motivation.

The secondary conclusion is that while some categories of criteria across the agencies would result in a comparable assessment for a particular organisation, or similar companies, other criteria are defined in such a way as to lead to very different ratings. The primary example of this is in the product-related criteria which produce sufficient variation in assessment for one agency to exclude a particular company from rating but another agency to award a superior performance rating to a similar organisation.

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<sup>2</sup> Dyck, B., & Kleysen, R. (2001). Aristotle's Virtues and Management Thought: An Empirical Exploration of an Integrative Pedagogy. *Business Ethics Quarterly*, 11(4), p. 565.

## ***Thesis Organisation***

Chapter 1 considers a number of definitions of corporate social responsibility (CSR) and sustainability, a term much in vogue in assessing CSR performance. I conclude that although definitions vary in wording, there is a close correlation in their intent. This eases the comparison of agencies' results as we can assume that they are, at least in broad terms, assessing the same thing. This chapter includes a brief discussion about corporations as moral agents. While I argue that, de facto, rating agencies do treat corporations as moral agents the consideration is relevant in the wider context of responsibility and attribution to individuals, office holders or groups.

Chapter 2 introduces the rating agencies I have selected and justifies their selection on the basis of ubiquity and influence. I summarise the categories of criteria used by these agencies and explain how I group differently termed but similarly intended criteria for comparison. Appendix A shows the agencies with their details in tabular form; Appendix B gives a comparative table of criteria; and Appendix C tabulates the broad characteristics of theory for each category of criteria. These tables were invaluable during my analysis and have been included for reference.

Chapter 3 introduces the ethical theories, or underlying principles, to which I relate particular criteria. It includes a summary of each theory, in all cases related to the business context and supported by recent literature.

In Chapters 4 and 5 I examine the criteria used by each agency in detail and determine the links to ethical theory. Chapter 4 looks at corporate governance issues common to most organisations and on which all agencies rate participating companies. Chapter 5 is concerned with controversial business issues examined in detail by only one agency but demonstrating some strong links to the potentially underlying theories.

My conclusions are summarised in Chapter 6 discussing how agencies' criteria are implicitly biased towards one or two ethical theories, thus explaining some of

the differences in resulting company assessments. While not directly associated with the link between criteria and underlying principles, four other differences between agencies have been briefly examined and the discussion set out in Appendix D. None of the differences has a direct influence on my conclusions, but the discussion is included as relevant to rating agencies' overall approach and results.

## **Chapter 1:**

### **CSR and Ethics**

#### ***CSR Defined***

Corporate social responsibility definitions range from emphasis on compliance with international standards and protocols to a requirement for business to consider the social and community aspects of products and services. Even the most ‘compliant’ definitions all indicate a responsibility for business beyond straightforward legal compliance. For example, the UK government offers this definition of corporate social responsibility:

the voluntary actions that business can take, over and above compliance with minimum legal requirements, to address both its own competitive interests and the interests of wider society.<sup>3</sup>

The World Business Council for Sustainable Development defines CSR as,

the continuing commitment by business to behave ethically and contribute to economic development while improving the life of the workforce, their families and the local community and society at large.<sup>4</sup>

The New South Wales State Chamber of Commerce gives a comprehensive definition of CSR:

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. CSR is larger than corporate community

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<sup>3</sup> UK government website, [www.csr.gov.uk/whatiscsr.shtml](http://www.csr.gov.uk/whatiscsr.shtml).

<sup>4</sup> World Business Council for Sustainable Development.

involvement or strategic corporate philanthropy and extends to a range of management practices and business initiatives.<sup>5</sup>

An organisation that provides a rating and assessment service is the UK-based Business in the Community (BitC) - one of my selected agencies. BitC discriminates between the concept of CSR which, it believes, implies a separate set of processes within a business, and 'responsible business'. Nevertheless, apart from that discrimination, which is probably implicit in other definitions of CSR, responsible business is described as:

the process by which a company manages, measures and reports its commitments to improve its positive impact on society and the environment. This is managed within the company through its operations, products or services and through its interaction with key stakeholders such as employees, customers, investors and suppliers.<sup>6</sup>

Corporate social responsibility is strongly linked with the concept of sustainability. Sustainability refers to all human activity and, in practical terms, the way that private citizens and businesses conduct their day-to-day activities using resources of all kinds. Concerns for sustainability range from energy use, waste production and disposal, and more generally the depletion of finite resources such as oil. CSR includes all elements of sustainability in the context of business, but with significant additional ethical and social elements.

A frequently quoted definition of sustainability is from the World Business Council for Sustainable Development (WBCSD):

We define sustainable development as forms of progress that meet the needs of the present without compromising the ability of future generations to meet their needs.<sup>7</sup>

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<sup>5</sup> The State Chamber of Commerce (NSW), *Taking the First Steps, An Overview of Corporate Social Responsibility in Australia*, February 2001.

<sup>6</sup> BitC website, [www.bitc.org.uk/resources](http://www.bitc.org.uk/resources).

<sup>7</sup> WBCSD website, [www.wbcsd.org](http://www.wbcsd.org) - frequently asked questions.

The Dow Jones Sustainability Indexes (DJSI), another of the agencies we will consider in more detail for their assessment criteria, gives a definition of ‘corporate sustainability’:

a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments.<sup>8</sup>

Sustainability is concerned with long-term conservation of resources and avoidance of activities that create a debt or burden for future generations. In the business environment this means that the true cost of running a business, including real costs of resources and the implications of product lifecycles, such as waste disposal, must be taken into account. In economic language, externalities are evidence that these true costs are not being met within the business. Examples include many extractive businesses that pay a nominal royalty to governments for raw materials such as oil or coal that is not related at all to the cost of replacement or of developing renewable resources. Few manufacturing industries include the cost of recycling or disposal of their product at the end of its productive life; plastic bags are an obvious example, and electronic consumer products are an increasingly visible burden on those responsible for safe waste disposal or reuse.

Definitions from investment-oriented sources tend to emphasise economic sustainability and continuous development while non-business definitions emphasise more general concerns such as inter-generational responsibilities. The DJSI definition is representative in that it takes a shareholder view rather than a community view, and the wording is consistent with our later findings that DJSI criteria are more focussed on governance and risk management than wider community concerns.

The WBCSD definitions, in contrast, introduce strong statements regarding ethical behaviour and quality of life. This stretches the more conservative and traditional business concept of social responsibility which, as we will see in

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<sup>8</sup> DJSI website, [www.sustainability-index.com](http://www.sustainability-index.com) - home page.

Chapter 3, was articulated by Milton Friedman and David Henderson, among others.

Both sustainability and CSR definitions can be graduated from compliant definitions to those explicitly including social, ethical and quality of life elements. There are numerous further examples of sustainability and CSR definitions from business organisations, academic papers, non-government organisations with specific environmental and CSR interests, and individual corporations. While they vary in wording and emphasis there is an underlying consistency in meaning and it is not difficult to reconcile differences.

The six rating agencies considered all describe their concepts of corporate social responsibility either as a definition or by narrative and setting expectations of corporate behaviour. While, as we will see, the results of applying each agency's CSR criteria result in considerable variation in the ratings for particular companies, or otherwise comparable organisations, I am satisfied that the concept of CSR is sufficiently understood and common among the agencies that differences are attributable to factors other than definitional variations of corporate social responsibility.

### ***Corporation as a Moral Agency***

If we are to regard corporate social responsibility as an exercise of ethics, then we have to identify the moral agency. There are two possible candidates as moral agent; the corporation itself, or individuals within the corporation who collectively exercise moral judgement. While I am persuaded by the arguments, some of which are discussed below, that consider corporations to be moral agencies in themselves, my thesis does not rely on that view of the moral agency status of corporations. The existence and ubiquity of the CSR rating agencies I describe in subsequent chapters, and the very substantial amount of money invested based on their resulting indexes means that there is a widely accepted view that corporations can be held to moral account and are, de facto, regarded as moral entities, or at least agents acting with enough collective consistency for this to be a rational proposition.



Nevertheless the moral agency of corporations does have a bearing on the relationship between the ethical or principled basis for determining appropriate criteria for CSR assessment. The following analysis outlines views of justification for corporate social responsibility, including counter-views that CSR is not a legitimate concern for business.

Goodpaster and Matthews<sup>9</sup> proposed a case for the corporation having a conscience by analogy, as a joint stock company is regarded legally as a person. Their paper is significant as it explicitly develops the theme of the corporation as a legal person, leading to equivalence with the moral agency concept of a natural person. While not the first of such arguments, in 1982 it was an early and well developed example.

Goodpaster's paper sets the scene by defining the responsibilities associated with a person; predominantly those of being held accountable, rule following and decision making. If these are elements necessary to moral responsibility, two character traits lie across them; rationality and respect. Rationality is about making considered decisions, including those affecting others, and respect is about consideration of consequences for others. An agent acting ethically will make rational judgements and be a respectful decision maker. These elements are set out to pre-empt the objection that acting ethically and responsibly is not a "vague"<sup>10</sup> notion.

Goodpaster then goes about "projecting responsibility to corporations."

If a group can act as a person in some ways, then we can expect it to behave like a person in other ways. For one thing, we know that people organised into a group can act as a unit. As business people well know, legally a corporation is considered a unit.<sup>11</sup>

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<sup>9</sup> Goodpaster, K. E., & Matthews Jr, J. B. (1982). Can a Corporation Have a Conscience? *Harvard Business Review*, 60(1), 132.

<sup>10</sup> Ibid, p. 134.

<sup>11</sup> Ibid, p. 135.

The argument contends that there are responsibilities and traits required for ethical decision making; that people exercise these responsibilities and display traits; and a corporation, which is a legal person, can also exercise responsibilities and display traits.

It is self-evident that decision-making does take place in a corporation, and the elements described by Goodpaster do not seem to be particularly controversial. This leaves the question of whether corporations display moral traits. Goodpaster claims that:

we can readily see differences in moral responsibility among corporations in much the same way that we see differences among persons [natural persons]. . . . . Some have institutionalized awareness and concern for consumers, employees, and the rest of the public in ways that others clearly have not.<sup>12</sup>

As further evidence of the soundness of an analogy between natural persons and the corporation as a legal person, “we may expect to find stages of development in organizational character that show significant patterns.”<sup>13</sup>

Donaldson, writing at the same time as Goodpaster and Matthews, attributes similar traits to corporations. “Some people assume that the moral attitudes and performances of all corporations are roughly the same. This misrepresents the situation. Corporations, like people, exhibit a variety of moral profiles.”<sup>14</sup> This not only continues the analogy of corporations and people, but is another way of demonstrating that they exhibit ethical characteristics in their own right, and that these characteristics vary as they do in people.

This line of argument establishes a case for regarding the corporation as a moral agency by strong analogy with a person. The secondary argument proposes that,

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<sup>12</sup> Goodpaster, K. E., & Matthews Jr, J. B. (1982). Can a Corporation Have a Conscience? *Harvard Business Review*, 60(1), 132, p. 135.

<sup>13</sup> Ibid, p. 136.

<sup>14</sup> Donaldson, T. (1982). *Corporations and Morality*. Englewood Cliffs, N.J.: Prentice-Hall.

“the hand of management”,<sup>15</sup> which is shorthand for the corporation exercising moral judgement through its managers, is required because Friedman’s invisible hand of the market (after Adam Smith) and Galbraith’s dependence on governmental law and rules both fail to deliver ethical decision-making for corporations.<sup>16</sup>

More recently, in 2006, Denis Arnold uses an argument from intentionality to support the idea that corporations can be regarded as moral agencies. In his essay “Corporate Moral Agency”<sup>17</sup> Arnold states that, “the main conclusion of this essay is that it is plausible to conclude that corporations are capable of exhibiting intentionality, and as a result they may be properly understood as moral agents.”<sup>18</sup> This conclusion is reached by considering the possibility of shared intentionality. Arnold’s example is based on two people travelling at different times to the same place for related reasons. Regardless of the variations in practical plans, their intentions are similar and can be said to be shared. Shared intentionality is developed in Arnold’s essay to the point that ‘corporate intentionality’ can be shown. This is based on a corporate internal decision structure, existing within any commercial organisation, whereby different people in specific roles have a common purpose achieved through a structured process. The corporate internal decision structure is prescriptive (Arnold quotes Peter French) and tells agents of the corporation how they ought to act. Arnold concludes that, “As with shared intentions, corporate intentions are neither a set of individual mental states, nor the mental state of some superagent.”<sup>19</sup> Finally, Arnold acknowledges that, “for corporations to be properly regarded as moral agents, a further condition must be satisfied. Corporations must be capable of reflectively endorsing corporate intentions.”<sup>20</sup> This condition is frequently met when corporations evaluate past decisions, and modify existing plans.

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<sup>15</sup> Goodpaster, K. E., & Matthews Jr, J. B. (1982). Can a Corporation Have a Conscience? *Harvard Business Review*, 60(1), 132, p. 137.

<sup>16</sup> Ibid, p. 137.

<sup>17</sup> French, P. A., & Wettstein, H. K. (Eds.). (2006). *Shared Intentions and Collective Responsibility* (Vol. v. 30). Boston, MA.

<sup>18</sup> Ibid, p. 281.

<sup>19</sup> Ibid, p. 291.

<sup>20</sup> Ibid, p. 291.

There are, of course, counter arguments from those who wish to show that corporations are not moral agents in themselves and that it makes little sense to attribute human characteristics to them. Buchholz and Rosenthal in their 2006 paper entitled *Integrating Ethics all the Way Through: The Issue of Moral Agency Reconsidered*<sup>21</sup> counter Goodpaster and Matthews', and Donaldson's arguments. In the abstract of their paper they summarise their position as:

A view which rejects both these alternatives sees the corporation as a type of community where there is a dynamic tension between the corporation as a whole and the individuals who are part of the corporation.<sup>22</sup>

Their argument outlines, "a consistency between moral actions on the part of individuals and moral actions that are the results of collective action on the part of the organization."<sup>23</sup> In one sense, what we call corporate ethics is simply the sum of ethical behaviour of the individuals making up the organisation.

For the purpose of my analysis it is sufficient that ethical criteria are, in a very serious and widespread way, applied to corporate activities, and it is these criteria that I will align with the five sets of principles described in Chapter 3.

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<sup>21</sup> Buchholz, R., & Rosenthal, S. (2006). Integrating Ethics All the Way Through: The Issue of Moral Agency Reconsidered. *Journal of Business Ethics*, 66(2), 233-239.

<sup>22</sup> Ibid, p. 233.

<sup>23</sup> Ibid, p. 238.

## **Chapter 2:**

### **Rating Agencies and their Criteria**

#### ***Selection Process***

The rating agencies to be considered were selected, as described in the *Methodology* section of my Introduction, on the basis of significance, materiality, publication of criteria and assessment approach, and ubiquity. As noted, there is supporting evidence that the selected agencies are the predominant organisations currently operating in this field and that they are genuinely representative.

The agencies are introduced in detail below. The *Rating Agency Table* (Appendix A) provides a reference table of the selected agencies with summarised information about their domicile, aims and objectives, and an overview of the categories and scope of their assessment criteria.

During the course of my research from early 2006 to mid-2008 all of the agencies updated their published material and refreshed their statements of intent and purpose. In general this did not significantly change the criteria, approach or results achieved. RepuTex was an exception in that at the start of my study RepuTex was clearly a reputational rating agency (see *Rating Agencies' Aims* in this chapter) as demonstrated by its own goal statements, but in 2007 published a number of investment-oriented indexes based on combinations of its CSR-rated companies. For the purposes of this study I have regarded RepuTex as a reputational rating agency, as this has relevance in some of my subsidiary observations comparing reputational and investment-oriented agencies.

#### ***The Selected Agencies***

##### ***Dow Jones Sustainability Indexes***

Dow Jones Sustainability Indexes<sup>24</sup> (DJSI) are managed by collaboration between Dow Jones Indexes, SAM Group and STOXX Limited. The latter two

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<sup>24</sup> <http://www.sustainability-index.com/>.

organisations are index specialists that carry out research to compile and maintain investment indexes, mainly aimed at fund managers. SAM specialises in sustainability assessment and, as a result, DJSI has some emphasis on sustainability which is combined with the overall breadth of the STOXX assessment under Dow Jones' brand.

The indexes aim to be attractive to investors by suggesting that superior performance and favourable risk/return profiles will lead to increasing long-term shareholder value.<sup>25</sup> Criteria are categorised in economic, environmental and social groups with weighted sub-categories in each group. A Corporate Sustainability Assessment Questionnaire is used to gather information from participating organisations and verification is carried out by means of an external audit by PricewaterhouseCoopers. The questionnaire is publicly available.<sup>26</sup>

Information provided through the questionnaire is augmented by a study of company reports, media and stakeholder reports, and personal contact by SAM analysts with assessed organisations. Once rated, organisations are monitored constantly by SAM through media review so that any significant corporate event can be examined for impact and reassessed against the criteria.

DJSI indexes are licensed in 14 countries and DJSI claims over \$US5 billion invested across these index funds.

#### *FTSE4Good Index*

The FTSE4Good Index Series has been designed to measure the performance of companies that meet globally recognised corporate responsibility standards, and to facilitate investment in those companies.<sup>27</sup>

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<sup>25</sup> [http://www.sustainability-index.com/06\\_html/sustainability/sustinvestment.html](http://www.sustainability-index.com/06_html/sustainability/sustinvestment.html).

<sup>26</sup> [http://www.sustainability-index.com/djsi\\_pdf/general\\_questionnaire\\_2006.pdf](http://www.sustainability-index.com/djsi_pdf/general_questionnaire_2006.pdf).

<sup>27</sup> [http://www.ftse.com/Indexes/FTSE4Good\\_Index\\_Series/index.jsp](http://www.ftse.com/Indexes/FTSE4Good_Index_Series/index.jsp).

The FTSE Group produces and maintains a number of indexes of which the FTSE4Good series is its service providing information on socially responsible investment for the financial community.

Ethical Investment Research Service (EIRIS) carries out the research and assessment for the FTSE Group. The process is similar to that of the Dow Jones Sustainability Index in that questionnaires, direct contact and scrutiny of public documentation, including media reports, are used. Regular updates are requested by EIRIS and media reports are monitored.

The criteria are published on the FTSE website. In contrast to some other rating organisations, companies operating in ‘controversial’ fields, such as tobacco and nuclear weapons, are excluded. This indicates a preliminary assessment as conglomerates may have these activities as a part of wider manufacturing and service operations.

Around 450 companies are currently included in the index.

### *KLD Indexes*

KLD Indexes constructs indexes for investors who integrate environmental, social and governance factors into their investment decisions. KLD’s indexes are designed to be transparent, representative and investable.<sup>28</sup>

The research methodology is similar to that of the other rating agencies and includes direct contact with rated companies, media monitoring, public documentation, government information and access to research findings from other research organisations covering global corporations. The KLD Socrates database is used as a repository of research data and is made available on subscription to other organisations.

The indexes are clearly aimed at investment management, comparable with the DJSI and FTSE4Good indexes. KLD has a considerable range of indexes

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<sup>28</sup> [http://www.kld.com/indexes/about\\_indexes.html](http://www.kld.com/indexes/about_indexes.html).

including a recently launched Global Climate 100 Index that tracks companies involved in alternative and ‘green’ energy research and manufacture of related products.

KLD publishes comprehensive assessment criteria on its website. These are separated into ratings indicators, which include a ‘product’ category, and a ‘Controversial Business Issues’ category which includes adult entertainment, weapons manufacture and tobacco.

KLD claims that \$US8.5 billion is currently invested in funds defined through its indexes.

### *Business in the Community*

BitC produces and manages the Corporate Responsibility Index (CRI):

Business in the Community is a membership of companies with the leadership to translate corporate values and commitments into mainstream management practice. Our membership comprises over 750 members including over 70 of the FTSE 100 companies with a further 2,000 engaged through a network of 90 plus global partners. Together our membership employs over 14.7 million people in over 200 countries worldwide.<sup>29</sup>

Rating data are self-assessed using a questionnaire and externally audited by the global accounting and consulting company Arthur D Little. The criteria and specific indicators are publicly listed on the BitC website:

Business in the Community's CR Index [CRI] is the UK's leading benchmark of responsible business, helping companies to integrate and improve responsible business across their business, and providing a systematic approach to managing, measuring and reporting their impacts on society and the environment.<sup>30</sup>

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<sup>29</sup> [http://www.bitc.org.uk/who\\_we\\_are/index.html](http://www.bitc.org.uk/who_we_are/index.html).

<sup>30</sup> [http://www.bitc.org.uk/what\\_we\\_do/cr\\_index/index.html](http://www.bitc.org.uk/what_we_do/cr_index/index.html).



BitC compares its index with those of the FTSE4Good and DJSI by stating, “The FTSE4Good and the Dow Jones are investment-based indexes but the Corporate Responsibility Index is a management tool providing meaningful feedback and a focus for future action.”<sup>31</sup> To expand this explanation, the investment indexes are provided for fund managers who invest money on behalf of clients, mainly pension funds. This enables them to offer socially responsible investments backed by credible research and monitoring. In contrast, the Corporate Responsibility Index is aimed at corporate development in the social responsibility field, but the results are published by the British *The Sunday Times* as a ranked table so that successful companies clearly gain public exposure from participation:

The Index includes all sectors, regardless of the core business activity, and does not make ethical assessments. The Index simply looks at how legal businesses operate responsibly with regards to communities, the natural environment, their employees, suppliers, customers and consumers.<sup>32</sup>

This is an interesting statement with the denial of ethical assessment immediately succeeded by a list in which a company’s operation is assessed over a wide range of topics that have strong ethical concerns and relevance. That the CRI is an assessment is undeniable - its purpose is to rate and rank companies by their performance against CRI criteria.

The 2005 CRI claimed 130 participants employing 4.2 million employees and corporate turnover of nearly £700 billion.

#### *Corporate Responsibility Index (Australia)*

The BitC Corporate Responsibility Index is run and managed in Australia by the St James Ethics Centre. Two newspapers, *The Sydney Morning Herald* and *The*

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<sup>31</sup> [http://www.bitc.org.uk/what\\_we\\_do/cr\\_index/frequently\\_asked.html#how\\_does\\_the\\_index\\_compare\\_to\\_the\\_ftse4good\\_or\\_the\\_dow\\_jones\\_index](http://www.bitc.org.uk/what_we_do/cr_index/frequently_asked.html#how_does_the_index_compare_to_the_ftse4good_or_the_dow_jones_index).

<sup>32</sup> [http://www.bitc.org.uk/what\\_we\\_do/cr\\_index/frequently\\_asked.html](http://www.bitc.org.uk/what_we_do/cr_index/frequently_asked.html).

Age are financial partners, with Ernst and Young, another global accounting and consulting company, acting as partners and auditors:

The Corporate Responsibility Index is a strategic management tool to enhance the capacity of the business to develop, measure and communicate best practice in the field of corporate social responsibility. It does this through benchmarking corporate social responsibility strategy and implementation process.<sup>33</sup>

The CRI is a self-assessed process overseen by the St James Ethics Centre. Ernst & Young audit survey returns for completeness and consistency and meet with a number of participant organisations where there is a need for clarification or further information. The supporting newspapers both publish annual results and commentary on the process.

Approach and criteria are identical to the British CRI. The Australian CRI is included in this study as its results demonstrate some contentious issues that have their roots in the assessment criteria.

#### *RepuTex Ratings and Research Services*

RepuTex is an Australian agency, based in Melbourne, but also providing services from Asian offices. “The range of services offered by RepuTex reflects the growing international trend for companies to adopt a more focused and managed approach to both reputation and social profile as corporate assets.”<sup>34</sup>

The participants are the top 100 companies in Australia, top 20 companies in New Zealand, government departments and NGOs. The survey methodology is similar to that of the other rating organisations, using publicly available data, direct contact and in-house researchers.

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<sup>33</sup> [http://www.corporate-responsibility.com.au/about/about\\_cri.asp](http://www.corporate-responsibility.com.au/about/about_cri.asp).

<sup>34</sup> <https://secure1.impactdata.com.au/reputex/>.

RepuTex changed from being a reputational agency to publishing investment-oriented indexes during the course of my study. At the start of the study in 2006 the stated goal was, “to create a commercially viable public rating system for social responsibility to augment universally accepted credit rating models.”<sup>35</sup> Currently the published data on the website has changed completely to reflect the indexes. Now, “RepuTex is an investment research and consulting firm which quantifies the impact of emerging risks such as carbon, corporate governance and geo-political risk for the investment and corporate sectors.”<sup>36</sup>

The 2006 goal clearly anticipated the move to investment index publication and, as pointed out in a later section of this chapter, *Context of Ratings*, the management of RepuTex have experience in the analogous financial rating industry.

### ***Rating Agencies’ Aims***

Rating agencies’ aims fall broadly into two groups: as a guide and aid to investment fund managers and, to a lesser extent, private investors; and to provide a comparative rating for organisations to measure their own performance against others as a basis for improving corporate social responsibility performance, and to enhance their reputation.

Of the selected agencies DJSI, FTSE4Good and KLD all publish and maintain indexes for investment purposes. These indexes include straightforward ‘sustainability’ indexes, such as DJSI’s World, North American and Euro Sustainability indexes. Indexes are licensed by fund managers who build investment products for pension funds and other investors who wish to participate in ‘ethical’ investment. KLD maintains a number of ‘social’ indexes and have recently started the Global Climate Index, noted previously, that identifies and tracks companies involved in products or services related to mitigation of factors in global warming.

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<sup>35</sup> [https://secure1.impactdata.com.au/public2/s\\_reputex\\_methodology.asp](https://secure1.impactdata.com.au/public2/s_reputex_methodology.asp).

<sup>36</sup> <http://www.reputex.com.au/>.

At the time of my investigation BitC and Reputex aimed their services at organisations that individually wish to have a comparative rating either universally, within their business sector, or within a geographic range of operations. While all rating agencies offer services such as consultancy to client organisations, reputational agencies publish ratings tables showing comparative performance of client companies. A difference between these reputational rating agencies and the former investment-oriented group is that investment ratings are carried out on organisations with stock market presence, generally the largest companies operating in a particular market, while the latter group of agencies depend to some extent on self-selected organisations that wish to be rated. In practice, companies seeking a reputational rating are often the subject of assessment by the agencies establishing and maintaining investment oriented indexes. As noted Reputex, since my investigation, has become a publisher of indexes for investors but, significantly, uses its original criteria and methodology.

Both groups of agencies licence their methodology for use in different geographic markets; for example, the Australian SAM Sustainability Index is a licensee of DJSI indexes. SAM is the research company used by DJSI to provide its research and rating services and this methodology is licensed worldwide. Similarly the Corporate Responsibility Index in Australia uses the same methodology as Business in the Community in the United Kingdom, under licence from that agency. In my analysis, licensed instances are not evaluated separately, as criteria are common with the parent agencies'. A significant example from CRI in Australia is, however, included as the results directly illustrate some anomalous and counter-intuitive results from applying these criteria.

### ***Context of Ratings***

CSR ratings and rankings vary significantly between rating agencies for particular companies, or companies that appear to be similar in relevant ways. My thesis is directed at explaining at least some of the differences in results between agencies by identifying the ethical basis of agencies' criteria. If criteria can be linked to these ethical bases, and agencies are shown to base their criteria on different views, then this explanation will have validity.

Companies' performance is assessed against corporate social responsibility criteria, rated and ranked to provide information for investors, consumers, employees and other interested parties in the community. The science of CSR rating is relatively new and a small number of agencies, of which those selected are both typical and significant, have created methodologies to gather data, assess companies' performance and publish ratings. Agencies publish their criteria for assessment but the level of detail varies significantly. As an example, KLD provides very detailed and often qualitative criteria for its assessments, such as the \$500,000 maximum remuneration for a chief executive officer, while BitC only provides a general approach and broad areas of assessment.

There is a clear analogy between CSR rating agencies and financial rating agencies such as Standard & Poor's and Moody's. The current chair of Reputex, Graeme Lee, is the former Managing Director of Standard and Poor's in Australia,<sup>37</sup> suggesting similarities in underlying methodology. In contrast with financial indexes, however, CSR ratings have a low degree of comparability. A spectacular example is of the BitC index giving British American Tobacco (BAT) a 'gold' rating (better than 90%) in six out of seven categories and an overall ranking of third in the Australian Corporate Responsibility Index.<sup>38</sup> Similarly, in the BitC Responsibility Index 2005 Executive Summary for UK companies, Imperial Tobacco received a score of greater than 95% for 'Outstanding Performance' in 'Social Impact Areas'.<sup>39</sup> In its assessment KLD eliminates BAT from any ranking on the basis that it is a business that knowingly harms its consumers.

David Vogel, in *The Market for Virtue*,<sup>40</sup> notes the variation in measurement of corporate social performance pointing out that a variety of methods of data collection from surveys, public documents, organisational practices, disclosure and reputation are used. He also points out that self-assessment is prevalent and

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<sup>37</sup> <http://www.reputex.com.au/about-us.asp>.

<sup>38</sup> [http://www.corporate-responsibility.com.au/PDFs/cr\\_results\\_2005.pdf](http://www.corporate-responsibility.com.au/PDFs/cr_results_2005.pdf).

<sup>39</sup> [http://www.bitc.org.uk/what\\_we\\_do/cr\\_index/past\\_index\\_results.html](http://www.bitc.org.uk/what_we_do/cr_index/past_index_results.html).

<sup>40</sup> Vogel, D. (2006). *The Market for Virtue*. Washington: The Brookings Institution, p. 30.

factors such as corporate profitability<sup>41</sup> can influence a CSR rating. Vogel suggests that, “Studies that employ a narrower range of criteria capture only some of the policies usually associated with corporate responsibility.”<sup>42</sup> This is directly relevant to my thesis. While Vogel’s book is mostly concerned with the relationship of CSR performance to financial returns, clearly assessment criteria are a critical element of achieving a contestable rating.

Financial rating criteria have been developed over a long period and financial rating agencies tend to reach similar conclusions about creditworthiness and financial strength for any given organisation. This suggests that criteria are aligned and cover similar topics and requirements. Conversely, the disparity between CSR rankings from different agencies suggests that there is no similar agreement and commonality surrounding social responsibility criteria. Differences in the underlying ethical basis of such criteria may go some way to explaining these variations.

### ***Choice of Criteria***

Definitions of corporate social responsibility are reasonably comparable and common so that, *prima facie*, we should expect that the criteria used in assessing, rating and ranking organisations’ CSR performance would be similar regardless of the use for which the assessment is intended. As I noted in *Context of Ratings* this does, however, assume a maturity of the whole concept of CSR applied to corporations and associated assessment processes. Henderson<sup>43</sup> and many others argue that CSR is not a new concept, but the change is in its promotion to be highly visible in the media and influential in determining investment decisions, together with a very public embracing of its principles by large, often multi-national, corporations. In practice this means that comprehensive rating has only developed to any sort of global scale in the last five to ten years, with many of the agencies and most of the indexes being at the younger end of this range.

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<sup>41</sup> Vogel, D. (2006). *The Market for Virtue*. Washington: The Brookings Institution, p. 31.

<sup>42</sup> *Ibid*, p. 31.

<sup>43</sup> Henderson, D. (2001). *Misguided Virtue: False Notions of Corporate Social Responsibility*. Wellington, N.Z.: New Zealand Business Roundtable.

It is not surprising, therefore, to find that published ratings and rankings from different agencies result in different overall assessments of apparently similar companies, or in some cases the same organisation. What is more surprising are the quite spectacular anomalies, as demonstrated by the example of tobacco producers being either highly rated or totally excluded. Even taking the relative immaturity of the rating process into account, the financial consequences of such anomalies would be expected to have encouraged rapid alignment between rating agencies or, if this were not possible or practical, a re-definition of the ratings to specify the intent of the rated outcome more accurately. In the tobacco example, if the CRI rating was published as a corporate management assessment rather than a social responsibility rating, Simon Longstaff's defence of the rating, discussed in Chapter 5, *Inclusion of Products in Evaluation*, would not have been necessary. KLD's exclusion of tobacco companies on the grounds, inter alia, of harm to users would not then be inconsistent with the CRI rating.

Given the significance of the financial and reputational consequences resulting from rating agencies' assessments, and the transparency of the assessment process assured by the use of external auditors, it is evident that agencies are carrying out a competent assessment within their briefs and against their specified criteria. For the purpose of my thesis, it is thus reasonable to assume that the criteria used in assessment are a significant, if not the only significant, basis of this variation in result.

### ***Identification and Alignment of Criteria***

My first task was to examine the published criteria for each rating agency and identify high-level criteria with their overall intent. Each agency uses different terminology and part of this task was to determine the intent of each high-level criterion group and relate it other agencies' categories where these are directly comparable. Some consolidation has been possible, for example 'Labour Practice' and 'Workplace' categories contain very similar criteria and have been linked under *Labour practice*. Similarly, the DJSI category of 'Corporate Citizenship' is equivalent in intent to 'Community' for KLD and BitC.

Where rating criteria are divided into, for example, core and advanced, high and low impact divisions, or are situation-specific, the significant features have been included at this high level, but the divisions not separated.

Clearly there are considerable differences in the criteria used in each category and it is ethically significant where some rating agencies have not included explicit criteria at all in particular categories. Emphasis varies across reputation and perception of performance, compliance with laws and conventions, philanthropy and a wider responsibility for both management of the firm and the impact of its products and services.

The resulting set of criteria is thus a consolidation of each agency's stated criteria that I have used for direct comparison, analysis of differences, and as a basis for deduction of the probable underlying ethical principles. A *Table of Criteria* is included for reference in Appendix B.

### ***Approach to Analysis of Criteria***

Five rating agencies have been selected as significant in global CSR assessment and having published rating criteria. The Corporate Responsibility Index (Australia), discussed in its rating of BAT, is an application of BitC methods and criteria licensed from BitC and its criteria are thus not separately assessed.

My approach is to take, first, the categories identified as common across most agencies and representing high-level criteria:

- ❖ Governance
- ❖ Community
- ❖ Employees and labour
- ❖ Environment
- ❖ Product

These categories are examined under the overall heading of corporate management criteria in Chapter 4 as they are all concerned with the way in which the company is run and to some degree its impact on the community, including



the environment. Only two of the rating agencies apply criteria directly relating to the use of company output rather than the process of manufacturing and selling products and supply of services but I include this category in corporate management.

Particularly noteworthy is the section from KLD concerning controversial business issues which, as well as considering products' impact on users and the community in general, gives a much clearer, although still implicit, indication of the ethical basis for selection of the controversial issues. Given the significance of these issues I have discussed these in some depth in Chapter 5.

Each rating agency has criteria that are either similar to those discussed or not of sufficient materiality to include in the analysis, thus the criteria listed and analysed are not a complete set for each agency, but are representative of agencies and the rating and assessment process as a whole. To emphasise my methodology, the agencies and criteria examined are representative of those used throughout the rating industry for CSR, but it is not necessary for my analysis for them to be comprehensive or exhaustive.

For ease of reference I have provided an agency-related guide to criteria in each category set out in the *Table of Criteria* in Appendix B and summarised how each of the ethical theories might be applied to these derived categories in the *Reference Table* in Appendix C.

## **Chapter 3:**

### **Ethical Principles**

#### ***Introduction***

My thesis contends that the criteria used in evaluating and rating companies' CSR performance are a significant factor in explaining differences and incongruities that arise from different rating agencies' assessment of the same, or similar organisations. This chapter examines possible ethical foundations of corporate social responsibility on the premise that an understanding of CSR justification will reveal of the basis for setting rating criteria, and thus help to explain the differences in assessment results.

The following five sets of principles have been selected as potential candidates for the creation of criteria.

#### ***Friedman and Legal Compliance***

The late Milton Friedman was a leading advocate of business', or more relevantly business managers', obligations being restricted to compliance with legal requirements of the community in which they operated. His view was that the only social responsibility of business is to satisfy the owners' desire to maximise profit. This doctrine was set out in *Capitalism and Freedom*<sup>44</sup> in 1962, but caught the public attention in an article in the *New York Times Magazine* in 1970 entitled *The Social Responsibility of Business is to Increase its Profits*.<sup>45</sup>

The substance of the article is that corporate executives are employees of business owners. Such corporations are owned by shareholders, frequently a large number of individuals who have delegated their rights of ownership to the managers and executives of the organisation. Shareholders only invest in companies to receive a return on their investment, thus managers must comply with the owners' implicit rights to maximise their return. Significantly in North America, and to a large

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<sup>44</sup> Friedman, M. (1962). *Capitalism and Freedom*. Chicago: University of Chicago Press.

<sup>45</sup> Friedman, M. (1970). The Social Responsibility of Business is to Increase its Profits. *New York Times Magazine*, September 13, 1970.

degree in Europe and the rest of the western world, pension funds hold a very substantial portion of equity. Ownership, although nominally dominated by these funds is, in reality, distributed among a huge number of beneficial owners who are likely to depend on the earnings from their funds in retirement.

Friedman argues the business manager has no right to exercise any discretion in taking decisions that do not maximise the company's profit. He or she would be "spending someone else's money for a general social interest."<sup>46</sup> Friedman is careful to make the distinction, as did Adam Smith<sup>47</sup>, between managers and proprietors. "If he [the individual proprietor] acts to reduce the returns of his enterprise in order to exercise his 'social responsibility', he is spending his own money, not someone else's."<sup>48</sup> Friedman's argument is based on this custodial duty of managers for their owners' assets and wellbeing, this wellbeing being simplified as an increase in profit.

As a secondary argument, Friedman questions managers' credentials for making 'social responsibility' decisions even if this were desirable. In an example regarding action to reduce inflation, Friedman surmises that a manager "is presumably an expert in running his company – in producing a product or selling it or financing it. But nothing about his selection makes him an expert on inflation."<sup>49</sup> This makes sense in Friedman's world where the sole object of management is to increase profit; however, it is a consequence of this assumption. In a parallel argument Friedman also questions managers' political mandate to make such decisions; "can self-selected private individuals decide what the social interest is?"<sup>50</sup>

Friedman, who has been recognised as an expert economist, is being quite dogmatic about theories of social science and philosophical ethics. It would be interesting to hear him defending his own competence in the field of social

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<sup>46</sup> Friedman, M. (1970). The Social Responsibility of Business is to Increase its Profits. *New York Times Magazine*, September 13, 1970, p. 2.

<sup>47</sup> Smith, A. (1776). *The Wealth of Nations* (2003 ed.). New York: Bantam Dell.

<sup>48</sup> Friedman, M. (1970). The Social Responsibility of Business is to Increase its Profits. *New York Times Magazine*, September 13, 1970, p. 3.

<sup>49</sup> Ibid, p. 2.

<sup>50</sup> Friedman, M. (1962). *Capitalism and Freedom*. Chicago: University of Chicago Press, p. 133.

science when the expert manager is clearly unable to cross these boundaries. In general business it is doubtful that managers would be selected who do not have a good understanding of matters, including inflation, outside that of the immediate business. That breadth of knowledge is just seen as part of contemporary management practice.

Elaine Sternberg, in *Just Business*,<sup>51</sup> expands on Friedman's views. She also argues that a business' sole obligation is to its owners, the shareholders. Shareholders' interests are met simply by creating financial returns on their investment. While there are sustainability requirements - shareholders like to see good returns into the future, not just immediately – there is no requirement for a business to be a 'good citizen' unless there is a direct, financial benefit associated with such behaviour. If corporate behaviour is driven purely by financial requirements there is no room for ethical decisions, except for prudential purposes to avoid antagonising customers and suppliers, and where goodwill creates additional or more profitable business.

Sternberg takes the argument further and suggests that if managers spend corporate resources on community or social activities that do not have a directly identifiable benefit to shareholders, then they are acting not only as poor managers, but unethically. They are spending shareholders' funds with no mandate – an echo of Friedman's position. This position may be tenable if the only obligation of the company or managers to society is to obey the law. All of the other theories considered in this chapter describe further obligations in the way a company and its managers act within and towards the community.

In summary, Friedman puts the argument for managers of business having a sole responsibility to increase profit for their owners or, in a broader sense, protecting the direct property rights of these owners. There is no additional moral responsibility for the company as long as it "stays within the rules of the game",<sup>52</sup> which means complying with legislation, and normal business practice.

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<sup>51</sup> Sternberg, E. (2000). *Just Business: Business Ethics in Action* (2nd ed.). Oxford: Oxford University Press.

<sup>52</sup> Friedman, M. (1970). The Social Responsibility of Business is to Increase its Profits. *New York Times Magazine*, September 13, 1970, p. 4.

Sternberg, and numerous subsequent writers, mainly from an economics background, support these lines of argument.

This approach denies that a corporation can be considered, in any way, as a moral agent. Other positions that we will examine attribute moral agency to a corporation, either as a pseudo-person or as a collection of moral agents - people.

The counter-argument to Friedman and Sternberg's position is in their missing the point that economic issues are only one of the factors in considering the function of a business enterprise within society. Friedman claims that, "The basic problem of social organisation is how to co-ordinate the economic activities of large numbers of people."<sup>53</sup> While economic activity is materially important for any society, to claim it as even the basic problem, let alone the sole significant problem, is questionable.

Donaldson summarises the position against Friedman's apparently narrow, economist's view. "Friedman's claim that the social responsibility of business is merely to increase its profit is either in error or incomplete." He goes on to argue that, "It is in error if it is meant to imply that the force of a hypothetical fiduciary agreement between manager and stockholder prevents managers from using the social contract as a yardstick for responsible managerial activity." This is justified in that voluntary agreements may have exceptions and overriding considerations, such as moral obligations. Donaldson also claims that Friedman's position is incomplete in that it ignores the fact that, "there may be other responsibilities which are incumbent on the manager stemming from different sources – in this case, from a moral obligation generated through a social contract."<sup>54</sup> To paraphrase Donaldson's 'incompleteness' argument, Friedman takes the view that the only responsibility of business is to increase profit, while Donaldson points out that while this is a primary obligation it is can not be put forward as the sole obligation. Of other potential obligations, moral responsibility (in this case defined through a social contract) is a significant example, and most relevant to our discussion here.

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<sup>53</sup> Friedman, M. (1962). *Capitalism and Freedom*. Chicago: University of Chicago Press, p. 12.

<sup>54</sup> Donaldson, T. (1982). *Corporations and Morality*. Englewood Cliffs, N.J.: Prentice-Hall, p. 56.

A practical issue with legal compliance being used as a proxy for ethical compliance is simply that laws can not relate effectively to every incident and set of complex circumstances. Further, as we will see with Schudt's example of a polluting incident in a later section of this chapter, local laws may just not anticipate certain industrial events. As Donaldson comments, "No matter how legal mechanisms may be constructed, they would need to be – as they always have been – standardized and applied according to general rules. But because standardized formulas never fit all situations precisely, a margin of immoral but legally permissible behaviour will remain."<sup>55</sup>

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<sup>55</sup> Donaldson, T. (1982). *Corporations and Morality*. Englewood Cliffs, N.J.: Prentice-Hall, p. 165.

### ***The Pragmatic Business View***

Friedman and Sternberg take a reasoned and clear-cut view that the responsibility of business is to increase its profits and that any attempt by managers to introduce other concepts of social responsibility is a misuse of shareholders assets, politically unmandated, and morally wrong.

A commonly and publicly reported view put forward by business representative groups takes the tone of Friedman's argument without the rationale. I am using the term Pragmatic Business View (PBV) to encapsulate a set of attitudes commonly expressed in business. The PBV can be summarised as believing that free markets and the 'invisible hand' are the best way for business, and the community, to develop and prosper. Government regulation of business should be minimised as good business will succeed. Wealth will trickle down to poorer members of society and the emphasis is on growing overall wealth rather than being concerned with its distribution. In contrast with Friedman, however, the PBV accepts that business does have social responsibilities beyond simply observing local laws and apart from community marketing activities, but it does not accept specific obligations beyond legal requirements. Business commentary frequently includes support for globalisation and free flow of capital, unhindered by governmental regulation, and sees CSR proponents (including businesses that have embraced CSR practice) as threatening the autonomy of business and the free market. This distrust of legislation and desire for businesses to have the maximum freedom of action appear to underlie a significant number of the agencies' criteria, as I will show.

David Henderson provides an articulate exposition of the PBV in his book, *Misguided Virtue*<sup>56</sup>. This book is published by the New Zealand Business Roundtable, a traditional business association and, while Henderson's views "have not been endorsed by the Business Roundtable"<sup>57</sup>, they clearly reflect many of the attitudes, beliefs and concerns of this and similar organisations.

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<sup>56</sup> Henderson, D. (2001). *Misguided Virtue: False Notions of Corporate Social Responsibility*. Wellington, N.Z.: New Zealand Business Roundtable.

<sup>57</sup> *Ibid*, p. ix.

The first, and perhaps remarkable, comment in Henderson's Foreword is, "That businesses have social roles and responsibilities is not at issue. This point cannot be emphasised too strongly."<sup>58</sup> This is clearly a departure from Friedman. Quite specifically Henderson suggests that:

shareholders and boards of directors may be willing, and arguably should be willing, to risk or forgo profits at the margin for such causes as ensuring product safety, disclosing possible safety risks, reducing harmful pollution, eschewing bribery, or dealing fairly with other parties, even where no legal obligations are in question.<sup>59</sup>

Friedman would accept that shareholders, as owners, and boards of directors working in shareholders' interests, 'may' take such socially responsible action but he would object to the suggestion that they 'should' forgo profit. The second, rather more subtle point, is Henderson's distinction between corporate social responsibility and Corporate Social Responsibility (CSR).<sup>60</sup> He defines the first (lower case version) as "the responsibilities that businesses should recognise and live up to, over and above those that are imposed on them by law."<sup>61</sup> This he regards as nothing new or remarkable. The second (upper case version) he defines and interprets in some detail as a modern doctrine. In fact he refers to CSR as the "new gospel"<sup>62</sup> rather reflecting his cynical tone in examining CSR aims. The key issue seems to be the threat of fundamental change in the role and expectation of business which is explicit in Henderson's claim that "[believers in CSR] want to redefine the purpose, the *raison d'etre*, of business."<sup>63</sup> He claims that CSR:

assigns a central role to corporations themselves, arguing for a new and wider conception of what private business stands for and how it should be conducted. In taking this line, it parts company from the teachings of standard economics.<sup>64</sup>

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<sup>58</sup> Henderson, D. (2001). *Misguided Virtue: False Notions of Corporate Social Responsibility*. Wellington, N.Z.: New Zealand Business Roundtable, p. vi.

<sup>59</sup> *Ibid*, p. 3.

<sup>60</sup> *Ibid*, p. 1.

<sup>61</sup> *Ibid*, p. 1.

<sup>62</sup> *Ibid*, p. 39.

<sup>63</sup> *Ibid*, p. 42.

<sup>64</sup> *Ibid*, p. 2.



This concern for change is echoed in his discussion of major multi-national corporations that have embedded CSR in their business philosophy. He refers to Shell as “one of the international businesses which has moved furthest in rethinking its aims and operations”.<sup>65</sup> This is so deeply embedded that Shell’s “reports and company statements do not emphasise CSR as such, they in fact give expression to its ideas”.<sup>66</sup> Henderson finds this surprising and disturbing, perhaps reflecting the in-built conservatism of the Pragmatic Business View, however, nowhere in the book is there any consideration that the new way of thinking, demonstrated by Shell and other companies, may have merit.

Rather, Henderson responds in a puzzled tone later in the book when he talks of the true commitment to CSR within the business community. He accepts that:

From the evidence presented here, it is apparent that, for many of the firms that have endorsed it, the concept of CSR appears as much more than a convenient form of words. It is not a pose, nor is it just a reluctant concession to outside critics and pressures. ... the examples and quotations I have cited here, which could easily have been multiplied, give evidence of genuine and widespread conviction.<sup>67</sup>

An earlier book by Henderson, *The Changing Fortunes of Economic Liberalism*,<sup>68</sup> while not specifically addressing CSR issues, does give some insight into Henderson’s theories, which I am regarding as representative of the Pragmatic Business View. He argues that liberalism, defined loosely as freedom for businesses to operate unrestricted by government rules and oversight, is desirable in its own right and leads to better economic performance than that of businesses operating in a more legislatively controlled environment. He tabulates “Economic Freedom Ratings”<sup>69</sup> for a number of countries between 1975 and 1995. By his criteria New Zealand leads the table in both increase and in absolute measures of economic freedom. In his final analysis, however, he accepts that New Zealand’s

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<sup>65</sup> Henderson, D. (2001). *Misguided Virtue: False Notions of Corporate Social Responsibility*. Wellington, N.Z.: New Zealand Business Roundtable, p. 17.

<sup>66</sup> *Ibid*, p. 18.

<sup>67</sup> *Ibid*, p. 83.

<sup>68</sup> Henderson, D. (1999). *The Changing Fortunes of Economic Liberalism*. Wellington: New Zealand Business Roundtable.

<sup>69</sup> *Ibid*, p. 20.

economic performance has been significantly worse (by comparison of gross domestic product per head) than that of other countries – Ireland is specifically mentioned – with much lower economic freedom ratings.<sup>70</sup> He compares the UK with Japan and observes similar results.

Henderson offers no real explanation of why his assertion that more economic freedom leads to better economic performance is specifically unsupported by his own data. His tone is again of puzzlement analogous to his lack of understanding of the widespread support for CSR from major corporations, as well as what he regards as pressure groups. This point is made not as a criticism of Henderson's essays – he is honest and sets out the facts – but as a characteristic of the Pragmatic Business View.

As an illustration of the source of Henderson's puzzlement, articles in the popular press, such as a recent piece in *USA Today*, relate a growing assertion that, “clashing views may be finding common ground, say business experts on the movement known as ‘corporate social responsibility’, or CSR.”<sup>71</sup> The ‘clashing views’ here are well summarised:

Activists have argued for decades that companies, as good corporate citizens, are morally obligated to adopt socially responsible business practices. On their end, companies say they exist to sell products, make money and please shareholders – not to save the world.<sup>72</sup>

Henderson's worry is that some very large and influential corporations are taking CSR seriously and this is emphasised in the article's quotations from large American companies like General Electric, Toyota, DuPont and Alcoa. The dichotomy is shown among these quotations, however, with roughly equal attention being given to the ‘virtuous cycle’ and to evidence that, “What's good for business must also be good for the environment and for people worldwide.”<sup>73</sup> Like Shell's embedded CSR principles, a study in the article suggests that these

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<sup>70</sup> Henderson, D. (1999). *The Changing Fortunes of Economic Liberalism*. Wellington: New Zealand Business Roundtable, p. 99.

<sup>71</sup> Iwata, E. (14 February 2007). *Businesses Grow More Socially Conscious*. *USA Today*.

<sup>72</sup> *Ibid.*

<sup>73</sup> *Ibid.*, Dawn Rittenhouse, DuPont.

companies with full commitment to CSR beyond immediate economic gain are, “the early adopters, the alphas of the modern business world.”<sup>74</sup>

It is noteworthy that Henderson’s language is emotive, using terms like ‘doctrine’, ‘believer’, ‘gospel’, ‘zealots’, and the like to describe CSR proponents, while corporate business is described in measured, serious terms. Not unexpectedly, the *USA Today* article also has some emotive terms, referring to CSR as a ‘movement’ and Arena’s reference to the CSR adopters as ‘alpha’ companies. Henderson acknowledges support for CSR from very substantial businesses as well as the ‘believers and zealots’ and so it is surprising that he doesn’t examine this evidence in more detail to see why such support is forthcoming.

*The Economist* has, over the past ten years or so, adopted a sceptical tone regarding CSR although more recent articles give a rather more balanced assessment of the place of CSR within the economic discipline that the magazine naturally enough follows. In a 2002 feature<sup>75</sup> two interesting, and relevant, propositions are offered in an explanation of the confusion or uncertainty around how much influence CSR should have in running a company. The article uses Enron’s collapse to explain the high profile of CSR issues at the time of writing. “The collapse of Enron and the rash of subsequent scandals have made all of American business seem like an ogre who leaves entire communities high and dry when things go wrong.”<sup>76</sup> This leads to the first distinction, between Anglo-Saxon capitalism and stakeholder capitalism, of which Enron is an example of the former:

In Europe and Asia, the battle is often said to be between Anglo-Saxon shareholder capitalism, which says that companies should pursue exclusively the interests of their shareholders, and stakeholder capitalism, which acknowledges that companies are also responsible to their workers and local communities.<sup>77</sup>

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<sup>74</sup> Iwata, E. (14 February 2007). Businesses Grow More Socially Conscious. *USA Today*. Christine Arena, *High Purpose Company*.

<sup>75</sup> Lots of it About - Corporate Social Responsibility. (2002). *The Economist*, 365(8303).

<sup>76</sup> Ibid, p. 74.

<sup>77</sup> Ibid, p. 74.

Originally (up to the 19<sup>th</sup> century) even Anglo-Saxon companies were required to obtain a charter from the monarch, “only if they were nominally pursuing the public good”.<sup>78</sup> The split arose when:

In Britain and America, the new joint-stock companies were freed from any obligation other than to obey the law and pursue profits. By contrast, in continental Europe (and later in Japan) companies were asked to pursue the interests of their various stakeholders, notably those of the state.<sup>79</sup>

The second proposition offered by *The Economist* article is confusion between capital markets and corporate business. Richard Tedlow of Harvard Business School is quoted as arguing that “critics [of CSR] ... confuse the habits of capital markets with those of companies. Capital markets may be ruthless in pursuing short-term results. Corporations, he says, have always tended to be more long-termist.”<sup>80</sup>

My concept of the Pragmatic Business View is an uncomfortable mix of belief in Friedmanite business principles with a conflicting, and mainly undefined, feeling among managers that business should be cognisant of community needs and values. The two propositions summarised in this article could help explain why executives have this confusion and discomfort. In the first instance Anglo-Saxon capitalists, who are mainly running American and British businesses, are compared with and do businesses with continental and oriental business people who are much more aligned with stakeholder capitalism which, as described, takes into account community and state interests. The second instance is rather more technical, but it is easy to see how the public, including the concerned investor and community group, would not discriminate between capital markets and the businesses that are based on that capital.

In further illustration of the PBV the same *Economist* article quotes another Harvard professor, Rosabeth Moss Kanter, who “talks about most parts of the Anglo-Saxon world having a ‘CEO club’ that successful businessmen are

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<sup>78</sup> Lots of it About - Corporate Social Responsibility. (2002). *The Economist*, 365(8303), p. 75.

<sup>79</sup> Ibid, p. 75.

<sup>80</sup> Ibid, p. 76.

desperate to join. The price of admission is doing your bit for society.”<sup>81</sup> This paints a picture of a set of senior business people who give nominal credence to the social responsibilities of business while still operating under Friedmanite principles.

In a later, 2004, article *The Economist* returns to its sceptical view and echoes Henderson’s emotive language. While the article is about a debate on compulsion to meet what are currently voluntary CSR standards, a number of phrases are reminiscent of Henderson. It talks about, “One of the biggest corporate fads of the 1990s”<sup>82</sup> and the “flowering of corporate social responsibility”. A little further on, “CSR, at any rate, is thriving. It is now an industry in itself.” In a direct but unattributed reference to Friedman the article asks, “is it really for managers and NGOs to decide social-policy priorities among themselves?” This article, in tone as much as in content, illustrates Henderson’s approach in demeaning the underlying concepts of CSR without any substantial, structured argument, and I include this as a main feature of the PBV.

While characteristics of the Pragmatic Business View can be described in some detail, and certainly draw on Friedman, there is no discernable, coherent set of values or principles underlying the beliefs. The overall thrust seems to be a defensiveness aimed at all regulation of business, suspicion of any imposed (whether by regulation or community pressure) obligations, and a deep resistance to change, despite corporate business being a relatively recent phenomenon. If the pragmatism in respect of social responsibility were simply to enable an organisation to be perceived by the community, customers and other businesses in a way that encouraged them to do business, or protected the organisation against boycotts or negative sentiment, then Friedman might condone such actions as they would increase profit, or protect from loss of earnings. I believe, however, that Henderson, *The Economist* articles, and the other press reports quoted show a concern for actions beyond those motivated and calculable by profit. The discomfort I note is that business managers and executives do make socially

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<sup>81</sup> Lots of it About - Corporate Social Responsibility. (2002). *The Economist*, 365(8303), p. 76.

<sup>82</sup> Two-faced Capitalism; Corporate Social Responsibility. (2004). *The Economist*, 370(8359), p. 59.

responsible decisions for other than demonstrable profit motives even in companies that argue against this as a role for business. This mismatch of principle and action is an indicator of the Pragmatic Business View.

## **Social Contract**

Most people in the first world have grown up in a society where companies operate under a set of laws giving them a status different to that of an individual, whether that individual is acting as a trader or simply going about family or personal matters. This explains the popular view that limited liability companies are somehow part of the natural order of society, and we tend not to see that their status has been relatively recently created. In Adam Smith's<sup>83</sup> time, business was generally run through partnerships where individuals pooled their resources, including capital and expertise, and ran a business. These people had no special protection against creditors, indeed the opposite; all partners were jointly and individually responsible for the partnership's commitments, as is still the case for modern partnerships.

Limited liability companies have two characteristics disliked by Smith, both relevant to our discussion on social responsibility. First, the special laws that apply to corporations give protection to individual investors, limiting their losses and their responsibilities. These laws have changed and proliferated, particularly since the beginning of the twentieth century, driven primarily by American state legislation.<sup>84</sup> Second, management of businesses was separated from ownership. Shareholders, as corporate owners, do not have day-to-day insight into their companies' operations and, increasingly over the last 100 years, are detached from the concept of how the company works, where it has its plants, what staff are employed, and the overall means of management. The sole reliable information is in the form of published financial reports quarterly or annually. This divorce of owner from manager lost, in Smith's view, a moral decision-making constraint. Managers are simply not using their own resources and are targeted to produce maximum financial returns unconstrained by personal responsibility for their operations.

Special privileges were granted by society to companies, through political legislation, to encourage businesses to be set up that would otherwise be beyond

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<sup>83</sup> Smith, A. (1776). *The Wealth of Nations* (2003 ed.). New York: Bantam Dell.

<sup>84</sup> Bakan, Joel. (2005). *The Corporation*. London: Constable.

the resources of a typical partnership, or would pose too great a risk for any individual. These laws evolved at the time of industrialisation and world trade where enterprises could no longer grow from family business, but had to start at a certain size. Heavy manufacturing and shipping are examples where start-up scale required significant resource input.

During the twentieth century, with an accelerating trend towards the millennium, corporations became so large and laws evolved so much in favour of their security and autonomy, that they now have great political power. This means that corporations can influence creation of further beneficial laws through lobbying, the leverage of money and having a generation of corporate managers available and with the resources and contacts necessary to become politicians. In principle, moneyed landowners, industrialist and business people have always had disproportionate influence politically, but the change is one of scale and separation. Corporations can now be fiscally larger than some countries, many states and most local government entities. The separation of ownership and management means that the managers have little ownership in the corporation, and little direct responsibility beyond short-term profit, for which they are judged and rewarded. The corporation has, in effect, taken on a political life of its own – a republic within a country.

There are a number of reasons for which corporations could be said to have a contract with the community. First, the community, through its legislation, has given corporations or, specifically, joint stock companies special privileges in order that they may develop in ways that might not be possible without this form of protection. Any such contract must have a consideration for both parties, but the community's consideration is not explicit. The implicit benefits include employment, wealth creation, and material progress. These benefits can only be enjoyed by the community if provided in a meaningful manner, and not offset by disadvantages such as destruction of the environment, exploitive working conditions and poor quality or dangerous products. Many aspects of these potential community problems are, of course, covered by legislation; however, legislation tends to lag such issues and in any case can never specifically address all permutations of community concern arising from corporate activities. It seems



reasonable that the contract with the community giving specific privileges to the company should be reciprocated by the company's consideration for the community beyond simply obeying legislation.

Second, building on Adam Smith's concern about the separation of ownership and management of companies, is the place of the company in the community. The owner/manager in Smith's period was a natural person and a member of the community. He or she may have been kind, callous, mean or generous, but his or her position in the community would have borne responsibilities. The governance role in a joint stock company is carried out by a legal person – the corporation. Arguably the owner/manager's responsibilities have transferred to the legal entity and these responsibilities include all the elements of social contract associated with a natural person.

Third, the political power and influence of corporations, which are unelected, means that they have very significant ability to change legislation affecting all people in a community, regardless of whether these people have any financial link with the corporation or any desire for given change. This de facto power is inherently undemocratic, compared with the explicit processes of democracies. Practically, it would be difficult for large corporations to avoid any influence on community politics, so that there should be a commensurate responsibility to act in ways beyond the immediate benefit of the corporation where change affects the community as a whole.

Donaldson is more specific about the nature of a social contract relating to corporations. He considers that, "It [a social contract] represents not a set of formally specified obligations, but a set of binding, abstract ones."<sup>85</sup> He refers to the corporation's 'indirect obligations'.

His basis for applying contractarianism to corporations is by analogy with the political social contract. "If the political contract serves as a justification for the existence of the state, then the business contract by parity of reasoning should

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<sup>85</sup> Donaldson, T. (1982). *Corporations and Morality*. Englewood Cliffs, N.J.: Prentice-Hall, p. 36.

serve as the justification for the existence of the corporation.”<sup>86</sup> He refutes Friedman’s assertion that corporations have a right to exist on the basis of freedom of individuals to associate and carry out business as they wish, and Adam Smith’s justification of productivity, by arguing that while these may be reasons for the existence of corporations they are not sufficient in themselves – the justification is at best incomplete. “To say that an organization produces wealth for society is not sufficient to justify it from a moral perspective, since morality encompasses the entire range of human welfare.”<sup>87</sup> The means of generating wealth are therefore morally significant.

Not only do corporations exist as a free association of business people, they have a requirement for special rights. Donaldson points out that these rights, such as use of resources and employment of staff, must be granted by society as a special privilege. This is demonstrated by the myriad of laws pertaining to corporate existence, operation and behaviour in all countries.

Donaldson expands his analogy with the concept of the political social contract by outlining the ideas of social change and reform, and the arguments from a state of nature. His third point, however, seems the most relevant to our topic and this is that both parties (or all parties) to a contract must be consenting. This implies that parties must enter a contract with an understanding of the agreements and consequences, and do so freely and reasonably. Further, no-one would enter into an agreement to their own detriment and, “no party should be asked to conclude a contract which places him or her in a position worse than before.”<sup>88</sup> This will have a bearing on some of the rating criteria we examine later.

Donaldson goes on to examine the benefits and disadvantages to society - specifically consumers and employees - that corporate operation brings. The advantages are self-evident and include pay for work, production of useful goods and, underlying this, an efficiency and certainty not achievable by a notional small manufacturer or other service provider. Against these advantages are the, again

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<sup>86</sup> Donaldson, T. (1982). *Corporations and Morality*. Englewood Cliffs, N.J.: Prentice-Hall, p. 37.

<sup>87</sup> Ibid, p. 38.

<sup>88</sup> Ibid, p. 44.

obvious, drawbacks of resource consumption and potential misuse of economic power and, underlying these, issues of worker exploitation, loss of personal accountability and unwarranted, unmandated political power.

None of this is an argument that corporations are good or bad, simply that any parties to a contract must exercise restraint and operate with respect for the other, and that both parties must benefit. Specifically, morality can not be excluded from the benefit analysis as Friedman claims:

The productive organization cannot be viewed as an isolated moral entity unconstrained by the demands of society, for its very reason for existing lies with its capacity to satisfy certain social interests. Productive organisations ... are subject to moral evaluations which transcend the bounds of the political systems that contain them.<sup>89</sup>

This social contract view of corporate social responsibility seems certain to be a factor in deriving at least some CSR criteria. Most definitions of CSR include the concept of the company having obligations to stakeholders outside those directly associated with the company, such as employees and shareholders. Similarly, there is frequent reference to obligations beyond those of legal compliance. While Friedman would consider legal compliance to be sufficient in meeting a company's obligations to the community, social contractarians would look for evidence of the reciprocity of benefits between company and community. As we will see in analysing rating criteria, the social contract forms a rational basis for a number of criteria concerned with employment, employees and their families.

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<sup>89</sup> Donaldson, T. (1982). *Corporations and Morality*. Englewood Cliffs, N.J.: Prentice-Hall, p. 57.

### ***Virtue (the Good Life)***

As a basis of setting criteria for CSR assessment, the concept of regarding the corporation first, as a moral entity and, second, as an Aristotelian agent, has appeal. It supports the very concept of moral agency for a corporation and looks for the idea of taking a holistic view of character and Aristotelean mean, or moderation. The disadvantage of taking a virtue ethics approach is a potential lack of measurability – we want to assess the company as a whole according to its balanced approach, which means that there is little opportunity for creating a set of quantitative criteria that are then rated. Intuitively, though, this approach has appeal just because it balances conflicting requirements or pressures and gives rise to something like a corporate character. Donaldson, in *Corporations and Morality*<sup>90</sup>, illustrates this character by a negative example of the Hooker Chemical Company, which knowingly polluted waterways, and a positive example of the Cummins Engine Company that built in ethical evaluation during assessment of any new product or process.

Virtue ethics has an extensive classical literature and much modern commentary, but for the purposes of considering its application to corporations and business I will constrain this summary to writing specifically concerning virtue ethics and business.

George Bragues<sup>91</sup> starts his application of virtue ethics to corporations with *eudaimonia* and gives Aristotle's meaning of this as, "activity that makes appropriate use of our capacities, a way of life in which we are optimally functioning in accord with our purpose as human beings."<sup>92</sup> He also relates the "intellectual virtue of *phronesis*, often translated as practical wisdom, or prudence" to business, and "*sophia*, or wisdom ... grasping necessary truths as distinct from the conditional and probable truths comprehended by prudence."<sup>93</sup>

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<sup>90</sup> Donaldson, T. (1982). *Corporations and Morality*. Englewood Cliffs, N.J.: Prentice-Hall.

<sup>91</sup> Bragues, G. (2006). Seek the Good Life, Not Money. *Journal of Business Ethics*, 67, 341-357.

<sup>92</sup> Ibid, p. 343.

<sup>93</sup> Ibid, p. 353.

Bragues goes into some detail relating Aristotle's virtues to corporate life and in doing so derives eleven specific, practical and applicable activities that would contribute to business becoming "a more conducive site for the realization of Aristotle's vision of human excellence."<sup>94</sup> Examples of the eleven are participatory workplaces, resources committed to pure research, and advertising that appeals to reason rather than raw imagery. Three of his activities are to do with supporting liberal arts students, and the promotion and time for liberal arts study for business-trained employees. While these may be worthy activities, the important point in Bragues' article is that Aristotelian virtue ethics can be used as a basis for justifying ethical activities and, more specifically, creating criteria from a sound ethical basis.

Surendra Arjoon puts forward *Virtue Theory as a Dynamic Theory of Business*.<sup>95</sup> This paper is relevant to my discussion in that it not only applies virtue ethics directly to business but proposes, "Virtue theory offers a more appealing, practical, unified and comprehensive theory of ethics in business than traditional approaches."<sup>96</sup> Critically, Arjoon considers individuals' ethical motives rather than the corporation as a moral entity, however, the basis of virtue ethics applied in business will provide some guidance to assessing the rating agencies criteria.

Arjoon considers that Aristotle's view of moderation, "This concept of the intermediate or moderation" to be "at the heart of virtue theory."<sup>97</sup> Arjoon lists virtues as, "prudence or practical wisdom, courage or fortitude, self-mastery or temperance, and justice or fairness." These are the cardinal virtues. Relevant to business practice, he distinguishes between moral virtues that are "concerned with the will and can be acquired through regular practice" and "intellectual virtues [that] are acquired through learning."<sup>98</sup> A further distinction, again highly relevant to business, is between internal goals that are "unique, intangible, unlimited in supply, and have intrinsic value" and external goals such as profits, wealth, power

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<sup>94</sup> Bragues, G. (2006). Seek the Good Life, Not Money. *Journal of Business Ethics*, 67, 341-357, p. 354.

<sup>95</sup> Arjoon, S. (2000). Virtue Theory as a Dynamic Theory of Business. *Journal of Business Ethics*, 28(2), 159-178.

<sup>96</sup> Ibid, p. 173.

<sup>97</sup> Ibid, p. 163.

<sup>98</sup> Ibid, p. 163.

and success. The argument developed here is essentially that individuals' internal goals, relating to self-fulfilment and flourishing, will be the driving force for achievement of external goals. This perhaps provides the link between individuals' morality and corporate outcomes reflecting that morality.

Arjoon uses the term 'common good' throughout his paper but this is a descriptive term used in context rather than the basis of ethics that I have used in categorising theories for considering criteria. The common good is a set of outcomes resulting from virtuous actions in business and is demonstrated by examples such as adoption by companies of work/life strategies, elder care, fitness centres and flexible working hours.<sup>99</sup> Arjoon makes some strong observations on the purpose and outcome for business. One is that, "profits are no more the purpose of a business than eating is the purpose of life."<sup>100</sup> This is fundamental to his argument based on the distinction between internal and external goals. Achieving internal goals is the real purpose of individuals so that in a business context the outcome of profit and other external goals is a result rather than the purpose. The analogy with eating is apt. Further, "Business is essentially a social organization where people are organized to achieve a common purpose - promoting the common good." Finally, "The ultimate goal of business then is to provide an environment that would allow and would encourage people to achieve their goals which at the same time promotes and realizes business and societal goals."<sup>101</sup> This is a very different conclusion from Friedman's - that the business exists solely to make a profit within the legal constraints imposed by the community.

In *The Cultural Paradigm of Virtue*,<sup>102</sup> Carter Crockett picks up Thomas Kuhn's<sup>103</sup> model of paradigms suggesting, in a similar sense to Arjoon, that virtue ethics provides a comprehensive model, or paradigm, for business.

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<sup>99</sup> Arjoon, S. (2000). Virtue Theory as a Dynamic Theory of Business. *Journal of Business Ethics*, 28(2), 159-178, p. 164.

<sup>100</sup> Ibid, p. 167.

<sup>101</sup> Ibid, p. 168.

<sup>102</sup> Crockett, C. (2005). The Cultural Paradigm of Virtue. *Journal of Business Ethics*, 62(2), 191-208.

<sup>103</sup> Kuhn, T. S. (1970). *The Structure of Scientific Revolutions* (Second ed.). Chicago: University of Chicago Press.

Crockett summarises a number of ethical approaches before outlining his virtue paradigm. In contrast with other teleological theories, “The virtuous, teleological end is very different from that which egoism or other consequentialist theories are directed.”<sup>104</sup> Egoist theories imply individuals’ pursuit of their own, self-interested ends, albeit in the business environment, that tend to have a simple mandate, whereas the virtuous purpose is intangible and, being akin to a perfect result, is always out of reach. This relates well to the previously discussed writers’ views of fulfilment for individuals, excellence and flourishing. Echoing Arjoon, Crockett claims that, “Organizational excellence is meant to be valued in its own right as intrinsically worthwhile”<sup>105</sup> so that internal goals are the real purpose while external goals result from collaborative activities. Crockett talks about “character and practical wisdom, based on facts as well as values” which are similar to Arjoon’s moral and intellectual virtues.

Robert Solomon, in his 1992 paper subtitled *An Aristotelean Approach to Business Ethics*, is firmly of the view that the company can be regarded as a community and that Aristotelean ethics is appropriate because personal qualities are applied as, “membership in a community, a community with collective goals and a stated mission.”<sup>106</sup> He argues that there is no contention between individuals’ own interests and the community good, and Solomon paraphrases Aristotle in that, “one has to think of oneself as a member of the larger community, the *Polis*, and strive to excel, to bring out what was best in ourselves and our shared enterprise.”<sup>107</sup> Modern corporations are real communities that “enjoy a shared sense of *telos*.”<sup>108</sup>

Having established that corporations are Aristotelean communities for the purpose of applying ethical principles, Solomon examines six dimensions of virtue ethics. These are community, excellence, role identity, holism, integrity and judgement. For community, he argues against the individualism of Hobbes and, of course,

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<sup>104</sup> Crockett, C. (2005). The Cultural Paradigm of Virtue. *Journal of Business Ethics*, 62(2), 191-208, p. 198.

<sup>105</sup> Ibid, p. 199.

<sup>106</sup> Solomon, R. C. (1992). Corporate Roles, Personal Virtues: An Aristotelean Approach to Business Ethics. *Business Ethics Quarterly*, 2(3), 317-339, p. 321.

<sup>107</sup> Ibid, p. 322.

<sup>108</sup> Ibid, p. 325.

Friedman's implied solitary profit motive. Solomon repeats that Aristotle regards us, "first of all members of a community." Excellence is reflected in Aristotle's *arete* which, while translated as either virtue or excellence is nuanced by Solomon as "doing one's best, excelling, and not merely toeing the line."<sup>109</sup> The essence of this is an active rather than passive striving for excellence with avoidance of unethical behaviour not being sufficient.

Role identity is, "to adopt a certain standard of excellence and conscientiousness that is largely defined by the job itself."<sup>110</sup> Solomon claims that all ethics is contextual. In relation to business this means that simple rules can not apply to members of a company holding radically different positions, from general manager to operational employees. We will see a reflection of this where some of the rating agencies apply different measures to companies operating in different industries, for example extractive industries which have a different environmental impact expectation from the service sector.

Integrity, in Solomon's terms, requires balance between compliance with the community's rules and procedures - company policy - and moral courage where social roles may require these rules to be over-ridden. "Integrity represents the integration of one's roles and responsibilities and the virtues defined by them."<sup>111</sup> Judgement or *phronesis* is noted by Bragues as practical wisdom, which relates well to Solomon's views. Finally holism is the ability to take a wide view of the immediate community - the company - with the wider social environment and, of course, one's personal character. Solomon states that, "Good employees are good people"<sup>112</sup> indicating that business ethics can not be separated from personal and social morality. This refutes the theory that business ethics allows different standards to be applied, for example Albert Carr's theory that business is a game with implied, but universally understood, rules that permits business behaviour unacceptable in private life. This alternative standard is not compatible with ethical holism.

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<sup>109</sup> Solomon, R. C. (1992). Corporate Roles, Personal Virtues: An Aristotelean Approach to Business Ethics. *Business Ethics Quarterly*, 2(3), 317-339, p. 327.

<sup>110</sup> Ibid, p. 327.

<sup>111</sup> Ibid, p. 328.

<sup>112</sup> Ibid, p. 329.



In a later, 2004 article, *Aristotle, Ethics and Business Organisations*,<sup>113</sup> Solomon refines his narrative on the application of Aristotelean ethics to business, and specifically with reference to social responsibility. He emphasises the concept of *telos*, relating this to ‘purposiveness’:

...purposiveness transcends the realm of business and defines its place in the larger society, though the popular term ‘social responsibility’ makes this sound too much like an extraneous concern rather than the purpose of business as such. On both an individual and corporate level, the importance of the concept of excellence is intricately tied to this overall teleology, for what counts as excellence is defined both by its superiority in practice and its role in serving larger social purposes.<sup>114</sup>

In this reflective article, Solomon gives more room to the concept of *eudaimonia*, interpreting this as flourishing or doing well, not surprisingly parallel with Bragues’ definition. Solomon, in the same context, also emphasises that corporations do have character, as I suggested at the start of this chapter, and are, “neither legal fictions nor financial juggernauts but communities, people working together for common goals.”<sup>115</sup> This theme is continued where Solomon proposes, in respect of individual responsibility, that “the corporation is one of those sums that is greater than its many constituent parts.”<sup>116</sup>

These narratives are representative accounts of virtue ethics in business which demonstrate an application of the Aristotelian virtues. For our present purposes, it is sufficient that a reasonable case can be made for applying virtue ethics to business and potentially can be considered as a comprehensive theory of ethics in business. If we accept that the corporation can be a moral agent independent of its members, then there is a direct analogy with Aristotle’s virtuous man. In my

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<sup>113</sup> Solomon, R. C. (2004). Aristotle, Ethics and Business Organisation. *Organisation Studies*, (25), 1021-1043.

<sup>114</sup> Ibid, p. 1023.

<sup>115</sup> Ibid, p. 1026.

<sup>116</sup> Ibid, p. 1031.

attribution of rating agencies' criteria to one or more of the ethical principles set out in this chapter, I particularly relate Virtue to criteria that display or suggest a basis in the idea that business serves a 'larger social purpose' coupled with the concepts of excellence, personal fulfilment, and those indicating a genuinely holistic outlook on the place and function of business in society.

## **Common Good**

If we evaluate CSR criteria based on ethics derived from the common good we find close parallels with those that could be attributed to virtue ethics. The common good approach is based on universal, or at least widespread, benefits.

Antonio Argandona<sup>117</sup> outlines a theory of the common good in the context of stakeholder theory. His definitions include, “a common good is everything that is a good to more than one person, that perfects more than one person, that is common to all.”<sup>118</sup> This is amplified as, “the set of social assumptions or conditions that make it possible for the members of society (and also for the lesser societies) to realise their personal objectives.”<sup>119</sup> Further, “the common good is the good of society and also the good of its members, insofar as they are part of society, since the goal of society is not independent of the goals of its members.”<sup>120</sup>

What is evident in these definitions is the alignment of individual goals with that of society, in whatever grouping we choose to consider. It is important, particularly in the CSR context, that Argandona includes ‘lesser societies’ along with individuals in his definition. These lesser societies would be groups without the significant social, political or economic power of large corporations. This suggests that large organisations – political, social or commercial – will have responsibilities to take into account not only individual members of society but other groupings; perhaps by a large corporation treating a small supplier with appropriate respect and not abusing its position of economic power.

Together with the alignment of individual and societal aims there is a qualification of universality of the good. “A good is common or universal when it can be communicated to or shared by all, at least in theory.”<sup>121</sup> Examples given of universal goods are a beautiful building that can be appreciated by all and which

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<sup>117</sup> Argandona, A. (1998). The Stakeholder Theory and the Common Good. *Journal of Business Ethics*, 17, 1093-1102.

<sup>118</sup> Ibid, p. 1095.

<sup>119</sup> Ibid, p. 1095.

<sup>120</sup> Ibid, p. 1095.

<sup>121</sup> Ibid, p. 1096.

contributes functionally to community life and, more abstractly, truth that can be possessed both individually and communally, without exclusion or diminution. These are appropriate examples in that possession, or benefit from them, does not diminish anyone else's benefit – there not an issue of distributive justice.

Velasquez,<sup>122</sup> in his discussion of the obligations of international business, takes a similar approach to defining the common good. He notes that the common good benefits all members of society and that goods are not divisible, in the sense that they have a finite distribution of use.<sup>123</sup> His examples, related to global business, are of maintaining a congenial global climate, safe transportation routes and avoidance of nuclear war.<sup>124</sup> While it would not make sense to attribute these obligations solely to business these examples illustrate the universality and indivisibility characteristics stated by Argandona. Global elements are significant as trans-national corporations have the ability to move potentially damaging activities between countries to avoid illegality but not mitigate moral damage. Velasquez implicitly recognises that a corporation can be viewed as a single, enduring entity. His argument is that corporations are bureaucratic entities in which, “the identity, the fundamental structure, and the dominant objectives of the corporation endure” so that, “the particular values and aspirations of individual members of the corporation have a relatively minimal and transitory impact on the organisation as a whole.”<sup>125</sup>

A problem identified by Velasquez is the free-rider problem, illustrated by the Prisoner's Dilemma.<sup>126</sup> A corporation that takes an action supporting the common good may diminish its profitability, or other benefit, and allow other competitors to gain at its expense. If all competing organisations took a similar action, then no competitive advantage or disadvantage would occur, and the community at large would benefit, but this is not a rational decision. Clearly this situation occurs not just in regard to the common good but where an ethical action is taken based on any underlying theory and would support Friedman's argument for simply

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<sup>122</sup> Velasquez, M. (1992). International Business, Morality, and the Common Good. *Business Ethics Quarterly*, 2(1), 27-40.

<sup>123</sup> Ibid, p. 29.

<sup>124</sup> Ibid, p. 30.

<sup>125</sup> Ibid, p. 30.

<sup>126</sup> Ibid, p. 34.

obeying legislation (mitigated, of course, by having adequate legislation to prevent unfavourable universal outcomes).

McCracken and Shaw<sup>127</sup> note that while an objective is stated, such as profitability or gaining competitive advantage, rationality still allows decision-makers to base their actions on achieving other ends. In the prisoners' scenario, McCracken suggests that martyrdom, honour or helping other prisoners could be objectives that would explain apparently irrational behaviour. This is relevant as a counter to Friedman's position. While profit is the prime motive, it does not exclude other motives that drive rational, but different actions.

Returning to Argandona's article, he summarises the practical consequence of considering corporate activities in respect of the common good by confirming that all stakeholders will not only contribute but be affected by the company's activities and, beyond stakeholders, all of society will be affected:

The common good extends beyond the confines of the company. If the good comes from human sociability, all the company's relationships will carry an element of common good. We therefore have to extend the list of stakeholders to include customers and suppliers, banks and unions, the local community, the authorities (at different levels), interest groups, competitors and so on until it encompasses all men of all times, by virtue of the unity of the human family.<sup>128</sup>

While Velasquez and Argandona relate the common good to international business and stakeholder theory respectively, they have a very similar conception of the common good as it pertains to the behaviour of businesses. The critical characteristics are universality, indivisibility and the validity of regarding a corporation as a single entity. These give us some basis for assessing CSR criteria.

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<sup>127</sup> McCracken, J., & Shaw, B. (1995). Virtue Ethics and Contractarianism: Towards a Reconciliation. *Business Ethics Quarterly*, 5(2), 297-312, p. 299.

<sup>128</sup> Argandona, A. (1998). The Stakeholder Theory and the Common Good. *Journal of Business Ethics*, 17, p. 1099.

## Chapter 4

### Corporate Management Criteria

#### ***Governance***

##### *Governance category*

The governance category is significant for two reasons: first, it highlights a number of specific ethical areas of concern, such as bribery and executive remuneration; second, there are clear differences between rating agencies in explicit or implicit inclusion of governance, and more generally management, as a concern of social responsibility.

FTSE4Good and BitC do not use corporate governance as a category but have criteria that fit with our definition, which includes the four elements discussed below. The other three agencies - DJSI, KLD and RepuTex - do use the term and their criteria include elements of directors' responsibilities and accountability, transparency in ownership and structure, and appropriateness of directors' remuneration. DJSI includes diversity in this category in respect of the number of women on the board. RepuTex adds specific elements of risk management, audit and compliance and shareholder relations.

KLD lists its detailed criteria under 'strengths' and 'concerns', where it considers the same topic with positive or negative implications echoing, to some degree, the Aristotelian mean discussed under *Virtue (the Good Life)* in achieving a balance between two extremes indicated under strengths and concerns.

##### *Executive remuneration*

While not explicitly stated by any of the rating agencies, there is a significant reason that excessive executive remuneration is contrary to ethical principles. Executive remuneration is determined notionally by shareholders but in practice by the executive or board. In other words, senior managers and directors largely determine their own remuneration. This is a distributive justice issue – paying oneself disproportionately is clearly not just, as the payment comes from either

shareholders' funds or is at the expense of other employees' salaries and legitimate company expenditure. There is justification by an argument that senior executives contribute much more to the organisation, require greater experience and have scarcer skills than other, less well remunerated employees. This argument supports some difference between the chief executive's salary and a production worker, so the debate is about how much difference.

Under its criteria for corporate governance strengths, KLD includes, "The company has recently awarded notably low levels of compensation to its top management or its board members."<sup>129</sup> Under concerns, the same comment is made substituting, "notably high levels of compensation." 'High' and 'low' are quantified in the criteria. There is no universal agreement, or stated methodology, for calculating this factor so the quantitative measures used by KLD, and others, are necessarily based on a subjective sense of fairness and equity. As noted in *The Selected Agencies* section, DJSI contracts its assessments to the SAM Group. Under governance, the SAM questionnaire requires participating companies to list the remuneration of directors and senior management<sup>130</sup> but the assessment criteria, in terms of acceptability and quantitative guidelines are not published. RepuTex does not explicitly include senior management remuneration under the corporate governance section.

The common element is that executive remuneration should be constrained. Some individual companies quantify acceptability as a ratio of top salaries to either lowest or average company salaries - for example senior executives should not earn more than ten times the company average - while KLD has established the actual monetary values it considers as a strength or concern in regard to corporate responsibility. KLD is specific in quantifying the 'high' limit for chief executive officer (CEO) compensation as \$10 million per annum and \$100,000 per annum for outside directors, and the 'low' rating limits of \$500,000 for a CEO and \$30,000 per annum for directors. In an interesting local example, the New Zealand Herald<sup>131</sup> pointed out that technicians at Telecom, the dominant New

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<sup>129</sup> KLD Research & Analytics, Inc., *Social Ratings Criteria*, 2006.

<sup>130</sup> SAM Research, Inc., *Corporate Sustainability Assessment Questionnaire*, 2006, p. 6.

<sup>131</sup> *Telecom Technicians Wait 9 Years for Raise*. 22 September 2007. *The New Zealand Herald*.

Zealand telecommunications carrier, had not had a pay rise for nine years and earned a salary of around 0.8% of the newly appointed chief executive. Apart from the issues of the company having refused to negotiate an agreement, the article made a number of comparisons with the chief executive's salary and allowances. His accommodation allowance was more than twice the technicians' total salary.

On what basis can specific limits be regarded as fair and just? KLD's \$10 million per annum is literally orders of magnitude greater than most employees' salaries. The living costs of a chief executive are not inherently different from, for example, a middle manager, bearing in mind that the CEO is compensated for all directly incurred expenses from entertaining, travel and networking activities, down to golf club membership, in addition to her salary. On any basis of fairness it seems difficult to justify a salary one hundred times that of a middle manager. There are likely to be differences in education, inherent ability and perhaps effort, but these would seem to be more appropriately a factor of two or three times the middle manager's. The CEO just cannot work a hundred times more hours or in any other conceivable way one hundred times harder. Further, the CEO often has security of a guaranteed termination payment regardless of the reason for termination, which middle managers do not enjoy. This reduces the risk of failure in the role so that increased remuneration is not a risk premium. While KLD criteria benefit from having a quantitative measure, there is no discernable basis in any of the theories described supporting the amount set as a reasonable limit. Even Friedmanites would have to accept that the money comes from shareholders and reduces profitability; empirical evidence from business shows that size of CEO remuneration does not relate reliably to increased profits.

In terms of ethical theory, the concept of fairness and just rewards for work relates well to Virtue. Justice would be served if everyone in the organisation is fairly rewarded - they receive what is due to them for their contribution and efforts. Excessive executive remuneration would be unjust. The Friedman and legal compliance model would consider remuneration of directors and managers to be an internal company issue approved by shareholders (however notionally) and thus not a matter of fairness or ethics. The Pragmatic Business View would be



influenced more by media reports causing concern among the general public over excessive executive remuneration than any inherent elements of justice.

My conclusion for executive remuneration criteria is thus that the KLD criteria have a strong link with concepts from Virtue theory and that DJSI's criteria, following a similar line but more implicit reasoning, can be attributed a weak link to Virtue.

#### *Clarity of responsibility and accountability*

Two main themes emerge from this section: first, that corporate accountability should be clearly understood both inside and outside the organisation, and company performance and activities should be widely and accurately reported, not just to shareholders but publicly; second, that CSR, sustainability and non-financial issues should be part of this accountable, transparent and reported structure.

The ethical issue about accountability is related to defined responsibility. While accountability is attributed to either the board or, more usually, specific executives this does not conflict with regarding the corporation as a moral agent. Roles (occupied by individuals) in the organisation are responsible for certain activities and outcomes, but the structure, policies and operation are components of the organisation. Individuals have little direct and immediate influence on the overall direction, structure, policies and day-to-day operation of a corporation of any significant size. Activities confirm and continue processes established over time. Obviously policies and processes have been set by individuals, usually collaboratively, but they develop in line with the organisation's character and culture. Exceptional individuals can have an impact on the way a company works but rarely would a quantum change occur due to one individual's efforts.

Moral responsibility might be viewed contractually in this context. The corporation has a responsibility to its shareholders to perform certain functions, including legal compliance, maximising returns to shareholders, and meeting obligations of corporate citizenship however these obligations are defined.

Regardless of what the obligations entail, the corporation has accepted them and the structure is such that it has devolved them to individuals appointed to certain roles. The individuals appointed to these roles have an employment contract with the corporation which includes meeting certain performance criteria. This contractual view is not synonymous with the *Social Contract* theory outlined in Chapter 3 but draws on similar principles. Not every activity is specified in an employment contract; indeed, many job descriptions are quite general and in modern management tend to be outcome rather than task oriented. This means that the individual employee is required to carry out duties beyond simply observing the letter of his or her contract. First, the intent of the job within the corporation is mutually understood and the employee has obligations to further the company's interests within the scope of her role. Second, there is a wide range of accepted practices and principles associated with employment, outside any legal or contractual requirements, that both employer and employee observe. So, while not synonymous with the relationship between company and community in a contractual context, the employer and employee contractual relationship is analogous.

Transparency, which tends to be included with the agencies' criteria for accountability, does not seem to be necessarily linked with having clear responsibilities defined or, indeed, meeting these standards. Perhaps the link is in policing the performance. If roles and responsibilities are set but concealed within a senior management group, then there is no external monitoring of achievement, which leaves the group susceptible to individuals' manipulating accountabilities and concealing failures. This is not the whole story, however. Transparency is evidence of honesty and a willingness to be held accountable and is again different from simply apportioning responsibility and meeting obligations.

The DJSI SAM questionnaire seeks information on the structure and reporting of the board and senior management groups, in particular concerning formal responsibility for aspects such as audit, strategy development, board remuneration, CSR and sustainability. Information is sought on formal corporate policies and documentation. KLD has criteria concerning political accountability

in terms of public policy leadership, and transparency in the sense of communicating and reporting on a “wide range of social and environmental performance measures.”<sup>132</sup> RepuTex has criteria in a section headed ‘Organisational structure and management’ in its international criteria and indicators, and this contains the requirement that, “The organisation has a publicly documented and transparent corporate structure which clearly delineates and communicates responsibilities within the organisation.”<sup>133</sup> Further, there are requirements for board accountability and integration of CSR as a “core component” of operations.

Social Contract theory is relevant here, first from the contractarian aspect of accountability and, second, although the formal contract is between the board and shareholders, failure to meet obligations has wider impact on the community. Transparency, interpreted as evidence of honesty, reinforces the public interest in a corporation’s activities and fits the Social Contract model. This seems to fit comfortably with many business notions where both explicit and implicit agreements exist between employer and employee, businesses, the business and its customers, and across the whole range of suppliers of materials and services. CSR criteria use this model and extend it to include the wider community, regarding the obligations discussed under *Ethical Principles* as one of many contractual arrangements and agreements.

Other ethical principles do have relevance, and could have a weaker link with responsibility and accountability criteria. A virtuous corporation should be honest and open in its dealings and a requirement for clarity and responsibility can be considered essential to meeting Good Life requirements. The Friedman legal compliance model would be satisfied with executives meeting legal requirements and observing their strictly defined terms of employment. Transparency would have no significance, and honesty would be irrelevant except where leading to illegal acts. Criteria based on the Pragmatic Business View would look for the reputation of transparency and accountability, beneficial in achieving a positive public face for the corporation, but these elements would have no principled basis

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<sup>132</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006.

<sup>133</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.

in the PBV. Finally, the Common Good would only be impacted if lack of accountability led to disastrous corporate performance, such as renegeing on supplier contracts or other negative community outcomes.

Principles of the Social Contract can thus be linked with DJSI, KLD and Reputex's criteria discussed above and the formalisation of responsibilities and general accountability justify regarding this as a strong link.

### *Risk management*

Risk management immediately brings to mind 'First, do no harm', commonly quoted as the chief principle of the Hippocratic Oath and, perhaps more generally, taken as a fundamental ethical principle. The original context is different in that professionals, including doctors, have a relationship with their clients and patients and an obligation to carry out their services in a skilled and careful fashion. Risk in the corporate environment may well include this aspect in that consumers and users of their services should expect to be protected from incidental or careless harm. Risk is also considered in the financial sense; investors and trading partners can suffer material loss if the corporation fails in any way to sustain its business. Employees are vulnerable to business failure as many workers' livelihood is dependent on a secure income, and where this income is from a large, dominant employer, alternative employment may be difficult to obtain after a major business closes.

A different but equally significant risk, perhaps greater in terms of human impact, is to a community which can suffer through exposure to physical and environmental damage. This ranges from spectacular and devastating incidents like the leak of lethal gas from the Union Carbide plant in Bhopal, the Amoco Cadiz oil spill and the Chernobyl nuclear power plant meltdown, to more insidious and frequent instances of minor but cumulative pollution and human poisoning from chemicals, waste and other toxic emission risks.

No activity is risk free. Businesses must therefore make decisions based on assessment of risk against the benefit realised from a particular activity or process,

and attempt to achieve a balance. A significant issue is where the risk lies and who would be affected. Shareholders take a calculated risk in providing financial resources for a business to operate. Provided that the information about that business is honestly and clearly stated, this seems to be a fair approach and, should the risk materialise, then shareholders have not been unjustly treated. It would be problematic, however, if a corporate decision to pursue a particular course of action exposed others, who were not party to the decision, to a risk. This could be concerned with the safety of a production unit (as in Bhopal and Chernobyl) or a risky financial venture that could result in loss of jobs should it fail. In the latter case employees would not have been involved in the decision, but would be affected in a substantial way. The direct involvement of stakeholders in any decision affecting them in some way would seem to justify risk, if thoroughly assessed and explicit, while decisions on risk affecting unconsulted stakeholders, whether employees or the community at large, would seem to be less easily justified.

DJSI, through the SAM questionnaire, includes a comprehensive survey of risk and crisis management in a separate section from corporate governance. The risk management element relates to conventional financial and corporate business risk while crisis management refers to sustainability monitoring with, interestingly, a reference to “management of crisis situations that can have a damaging effect on reputation.”<sup>134</sup> Reputex also has specific criteria for risk and financial management although its requirements are broader than those indicated by SAM. Reputex specifically requires the board to “demonstrate that it effectively oversees the organisation’s management systems to preserve and enhance the value of the organisation’s resources, both for financial stakeholders and the wider community.”<sup>135</sup> Despite SAM’s use of the term ‘reputation’, it is the Reputex rating agency, promoted as a basis for assessing, inter alia, a “managed approach to both reputation and social profile as corporate assets”<sup>136</sup> that looks for a stronger commitment to community and stakeholder risk mitigation than DJSI through the SAM assessment.

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<sup>134</sup> SAM Research, Inc., Corporate Sustainability Assessment Questionnaire, 2006, p. 8.

<sup>135</sup> Reputex, General Criteria and Indicators – International (Level 1), 2005.

<sup>136</sup> <https://secure1.impactdata.com.au/reputex/>.

Friedman would require only compliance with the law, regardless of whether local laws offer adequate, or any, protection to the community and stakeholders. Both DJSI and RepuTex considerably exceed this requirement. There can, thus, be considered a link with the more exacting ethical principles discussed. The Good Life model fits with both the intent and breadth of both agencies' requirements, however, neither specifies exactly, or even generally, what risks must be managed, leaving interpretation open to those risks that a 'good' company would mitigate. Balance would be established between the probability of occurrence and resulting impact, and cost of mitigation in economic and resource terms. While this balance would seem to relate to elements of virtue ethics the requirements of the agencies' criteria are too general to regard Virtue as a basis.

The requirements of both agencies exceed those that the Pragmatic Business View would consider reasonable, however, the DJSI concern with 'reputation' is reflective of a PBV concern. PBV would consider that legal compliance is the basic obligation, with better risk management at the company's discretion. If legal requirements were considered inadequate to offer protection, based on general company practice or public expectations, then more stringent risk management principles would apply. This approach moves the requirement past Friedman's legal compliance and the reference to reputation is a pointer that justifies a weak link for DJSI criteria to the PBV.

RepuTex specifically includes the 'wider community' as a significant stakeholder and this points to a basis in either the Common Good or Social Contract, as failure has an impact beyond the Friedmanite view of stakeholders as shareholders, managers, and those people and organisations directly involved in a financial relationship with the organisation. I have thus attributed a weak link to both theories as a basis of RepuTex criteria for risk management.

### *Countering bribery*

Bribery is intuitively corrupt, at least in traditional western business. The immorality of bribery comes from an illegitimate enrichment of individuals at the

company's expense, coupled with a lack of honesty and transparency. At one level, bribery is stealing, while companies that know about and tolerate the practice are at best concealing the transaction from their shareholders, stakeholders and the general public. Bribery involves an inherent conflict of interest, as an individual who has power to influence a transaction illegitimately must be working outside his or her primary and explicit responsibility.

Only FTSE4Good includes countering bribery as a specific item. A number of business sectors, such as oil and gas producers, mining and aerospace are identified as "more likely to have the highest levels of exposure to risk of engaging in bribery."<sup>137</sup> Another line of the matrix is that certain countries have a higher risk of bribery. The FTSE4Good criteria use the Transparency International Corruption Perception Index and the World Bank Governance Indicators list as quantitative measures for the degree of bribery risk. Countries with a history of experiencing bribery in business, whether through corrupt government or from a tradition of doing business in this way, rate as high risk on this list. The business sectors rated as high risk are mainly those using natural resources, often in third-world countries, and nearly all with high value products. This means that a single deal can be worth very large amounts of money - consider sales of aircraft - which puts pressure on commission-based sales people. Where large sums of money are transacted, a relatively small portion skimmed off the transaction can be insignificant corporately but extremely tempting to individuals.

The issue of differing legal attitudes to bribery worldwide are illustrated in commentary on legal cases in the United States. In one example from 2002 there is a report of a ruling that it was legal for an American company, American Rice, Inc.,<sup>138</sup> to bribe Haitian customs officials in order to reduce customs duties and tax. The ruling was on the basis that corrupt payments were defined in law as assisting the company to retain or obtain business, and this was not the purpose of American Rice's bribe. In a more recent press release from the US Embassy in

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<sup>137</sup> FTSE4Good, FTSE4Good Index Series Inclusion Criteria, 2006, p. 10.

<sup>138</sup> [www.commondreams.org/views02/0426-02.htm](http://www.commondreams.org/views02/0426-02.htm).

Cambodia,<sup>139</sup> the same act (the 1977 Foreign Corrupt Practices Act) is shown to have been used not only to prosecute American companies found to be using bribery, but also non-American companies operating in any way in the United States, even if only by using the American banking system. Similar commentaries report the arrest of a French, Alcatel executive passing through the United States for just this type of transgression. These examples illustrate both confusion over how the law can be applied to counter bribery, and the difficulties of applying national laws internationally.

The Friedman model demands legal compliance but in some jurisdictions bribery would not be illegal; the previous examples demonstrate some of the shortcomings of depending on strict legal definitions. Assessment would require that there is a reasonable belief that the transaction is legal in whatever jurisdiction is relevant. If the overall transaction increased the company's profits, then the Friedman view seems to condone the practice.

The Common Good would appear to be prejudiced if individuals in an organisation, and public officials or anyone in the community with power to confer benefits, were to receive money for granting these benefits. This is an issue of distributive justice as much as honesty. The FTSE4Good criteria are certainly not explicit in their basis of condemning bribery but the emphasis on this particular issue indicates a strong concern. Demonstrably there can be financial gain for corporations that condone bribery, particularly in countries and communities where there is cultural acceptance. The Common Good is damaged by bribery in two ways; long-term business is prejudiced as decisions are not based on fair trade and mutual benefit for parties to a contract; and a few individuals benefit materially from their positions of authority or influence unrelated to their actual contribution to the business being transacted. It is thus reasonable to attribute a strong link to the Common Good for FTSE4Good anti-bribery criteria with a weaker link to Virtue, acknowledging justice and fairness concerns. A virtuous organisation would not permit bribery as it compromises honesty, transparency and fairness to individuals.

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<sup>139</sup> [www.phnompenh.usembassy.gov/pr\\_032907.html](http://www.phnompenh.usembassy.gov/pr_032907.html).



## **Community**

### *Community category*

All the rating agencies relate community investment, corporate citizenship and gifts in kind or of money, to the category of ‘community’. At first sight this seems to overlook a large number of other criteria that affect both the immediate and wider community of each business, but it is simply the way that criteria groups have been structured that create this apparent anomaly. Other criteria categories such as ‘environment’ and ‘human rights’ profoundly impact the community and are given their own major headings by all agencies discussed in this paper. This means that, effectively, the community category comprises philanthropy in its various guises.

### *Philanthropy*

Philanthropy is referred to by a number of terms: philanthropic contributions/voluntary social investments (DJSI); making charitable donations (FTSE4Good); charitable giving (KLD); community company support (BitC); and community investment and philanthropic support (RepuTex). If we define philanthropy as a voluntary donation, all of the terms used by the various agencies are closely correlated.

All criteria include explicitly the idea of giving and voluntarism. The differences at this terminology level are more subtle. BitC talks of community support which implies not just gifts (whether of material or time and effort) but a broader and longer term intent with outcome being relevant. If the community is ‘supported’ then something positive has been achieved. If a donation is made, then a potentially positive outcome may result but conceivably there could be waste or simply hoarding of the resource. Anecdotal evidence, including media reports and films, suggest that material aid sent to some needy areas of the world is diverted by officials or other powerful groups for their own gain. The donation is indisputable but the outcome of doubtful philanthropic value. This is noteworthy in relating criteria to an underlying set of principles as BitC’s other criteria tend more to compliance and activities rather than outcomes.

Community investment (RepuTex) is another interesting use of words almost in a reverse of the BitC example. RepuTex has a good proportion of outcome-oriented criteria but ‘investment’ implies input rather than an achievement, although good investments would expect to pay dividends in some way. Friedman would expect the dividend to be to the donor in terms of goodwill and more business, but in this context we can assume that a social dividend is envisaged.

The DJSI (SAM) questionnaire asks comprehensive questions about the value of community contributions, their impact in terms of both “social outcomes and impact” and “impact on corporate reputation and stakeholder satisfaction”.<sup>140</sup> It requests details of monetary and in-kind donations as well as employees’ voluntary work and other partnerships. FTSE4Good lists four areas of assessment: a quantified charitable donation measure; operation of payroll giving schemes; gifts in kind or staff secondments; and management responsibility at a senior level.<sup>141</sup> KLD’s community category of criteria is completely philanthropically oriented, reflecting the North American emphasis on philanthropy in relation to CSR in general. The criteria are: charitable donations, including a metric; innovative giving; non-US charitable giving; support for housing; support for education; and volunteer programmes.<sup>142</sup> KLD also includes ‘concerns’ in the criteria including company activities that have had a negative impact on the community, tax issues (in relation to community taxes) and concerns around lending and finance.

In a similar context to that discussed in executive remuneration, philanthropy requires some sort of measure to determine what should be regarded as satisfactory or mean. BitC measures philanthropic contributions as a percentage of company profit together with staff time, in-kind donations and management time. Under an ‘advanced’ heading, measurement of community impact is extended to evaluating the impact of community programmes and perception measures. RepuTex criteria assume philanthropic contributions and give more

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<sup>140</sup> SAM Research, Inc., Corporate Sustainability Assessment Questionnaire, 2006, p. 17.

<sup>141</sup> FTSE4Good, FTSE4Good Index Series Inclusion Criteria, 2006, p. 4.

<sup>142</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006.

emphasis to evaluating and ensuring their effectiveness. RepuTex requires that, “The organisation has strategies and publicly declared guiding principles to give direction to its community investment programmes” and that “these incorporate frameworks to appraise socioeconomic need in the community.”<sup>143</sup>

In philanthropy, KLD uses a metric of 1.5% of net earnings as an appropriate level of donation per annum, although it does allow the company to have “otherwise been notably generous in its giving.”<sup>144</sup> RepuTex does not specify acceptable levels of donation but looks for “long term sustainable relationships with the community sector and non-profit organisations” and requires evidence of philanthropic donation as “a reasonable proportion of profit” and other resources including staff time.<sup>145</sup> Both DJSI and FTSE4Good require measures of philanthropic donation but do not specify assessment criteria.

As argued in the discussion on executive remuneration, 1.5% of net earnings seems to be a purely arbitrary figure, although Peter Singer suggests that:

anyone who has enough money to spend on the luxuries and frivolities so common in affluent societies should give at least 1 cent in every dollar of their income to those who have trouble getting enough to eat, clean water to drink, shelter from the elements, and basic health care. Those who do not meet this standard should be seen as failing to meet their fair share of global responsibility, and therefore as doing something that is seriously morally wrong.<sup>146</sup>

Singer is talking about individuals in western society; however, in corporate terms earnings are profit and thus resources able to be distributed while an individual’s income has to maintain the family first. One per cent of individual income is thus a more significant portion of disposable income than the equivalent level of company earnings.

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<sup>143</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.

<sup>144</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006.

<sup>145</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.

<sup>146</sup> Singer, P. (2002). *One World: The Ethics of Globalisation*. Melbourne: Text Publishing Company, p. 212.

There is no measure of philanthropy that could be said to be satisfactory based on any of the described ethical principles. We can identify exceptional philanthropic actions where an individual (or conceptually an organisation) gives away a very large proportion, or all of its assets, and we can consider complete lack of donation from wealthy individuals or organisations as misanthropic. One potential measure of ethical philanthropy is for wealthy individuals to give to the needy until their resources equate to those of the recipients. While this seems theoretically just in that everyone in the world would have equal material resources, there are practical problems. The first is simply that very few people would be prepared to donate until they are effectively impoverished. Even if so inclined they might argue that providing for their family and immediate community can be better achieved by their retaining and managing their own resources. To extend this argument, any productive individual can demonstrate that by utilising their resources well they can produce more and better goods that will benefit the community, whether directly (and potentially by continuing donation) or through providing work, income and necessary goods. At the other extreme, resource wealthy individuals may argue from an equal opportunity position. Their hard work or just good fortune has enabled them to acquire wealth and their only obligation is to dispose of it as they see fit. In a corporate environment this is Friedmanite. Any measure between these extremes is more likely to be judged relative to others' contributions than deriving from some measurable ethic.

Clearly, philanthropy is perceived as a key component of CSR in the criteria for all agencies. The agencies' criteria are similar in the scope of what is meant by community donations, although using different terminology, but there is a difference in the sophistication of criteria. The two large investment-led agencies, DJSI and FTSE4Good emphasise measurement of donations, including company time and gifts in kind; a measure of input. KLD and Reputex have criteria that measure effectiveness of such donations and KLD specifically looks at 'innovative giving' and checks for 'negative economic impact'; a measure of outcome. The difference is not absolute as all agencies, with the exception of FTSE4Good, include some element of evaluation of outcome and effectiveness, including community and stakeholder perception. There may be a relevant

distinction between a deontological approach, using criteria that require certain acts to be performed in order to 'be' philanthropic, and a more utilitarian approach where criteria seek evidence of positive outcomes.

Philanthropy, by definition, is a moral good. The issue here is to what extent and in what way organisations should perform philanthropic acts or, indeed, if philanthropy is a proper concern of business organisations. Friedman would say that giving corporate resources to the community, or anyone else, is simply misappropriating the owners' resources, unless it can be shown that there is a net business benefit, measurable in profit terms, by so doing. This means that Friedmanite donations are really marketing costs and not philanthropic. Company law in many western jurisdictions requires managers to exercise judgement in spending corporate resources, necessitating that such expenditure is to the shareholders' benefit. Interpreted on a strictly financial basis, this supports Friedman and makes it theoretically illegal for a manager to make a philanthropic gift or donation. In practice, companies and their managers are not prosecuted for philanthropy, although shareholders can exercise their voting rights if they wish to determine philanthropic policy and could direct the board not to make donations.

The Social Contract could be taken to require a return to the community of at least part of excess funds or profit in the form of 'community investment' or philanthropic donation. The rights and obligations of a company licensed by the community may well include donation simply by virtue of its position as a wealthy community member, however this model is better related to Virtue and I can not relate any of the agencies' criteria specifically to the Social Contract.

The virtuous organisation would be philanthropic just because it is in a position to assist others and Virtue requires not only material donation but considered application of these resources to assist others fulfil their potential. Corporations have highly skilled planning and management abilities that should be applied in philanthropy - it is not good enough just to send money. This seems to be the thrust of KLD's criteria requiring 'innovative giving' and all agencies that require impact and outcome assessment, and I thus attribute a weak basis for KLD's criteria to a Virtue ethics viewpoint.

The PBV does not follow Friedman except to confirm that corporations have no obligation to the community, including making philanthropic donations, but companies are free to assist if the corporate governance policy is so determined. The PBV probably does not discriminate at all between philanthropy and achieving business benefit, whether by direct financial return, longer term reputation benefits or, more cynically, mitigating or pre-empting any negative community view of the company. This is an example of pragmatism over principle. DJSI, FTSE4Good and BitC all suggest a link between their criteria and the PBV as defined. I have attributed a weak link for the first two agencies but a strong link for BitC on the basis that they specify measurement of perception in the community.

The Common Good requires the company, as a corporate citizen, to act as any other wealthy citizen who would offer support to those less well endowed or having a particular need. KLD's explicit concern that any philanthropic activity should have a measurable positive outcome for the community suggests a stronger link with the Common Good than is attributable to any of the other agencies' criteria.

## ***Employees and Labour***

### *Employees and labour category*

All rating agencies have comprehensive criteria in this category and employees are clearly stakeholders even in the most conservative definition of stakeholder theory.

Human rights criteria are included in this category from their relevance to direct employees and those involved in the supply chain. This captures issues with western corporations using arms-length manufacturers in the third world where wages and conditions of employment would be problematic if factories operated under the western brands.

Diversity is a specific criterion for several agencies, and includes issues around employment of women and minorities.

### *Labour practice*

Much employment practice is reflected in legislation in western countries, and it is debatable whether practice has preceded legislation or legislation has resulted from common and best practice. The criteria used by the rating agencies exceed the requirements of legislation in most countries but have some basis in law. Health and safety is prescriptive in many jurisdictions, as is freedom of association and, specifically, union membership. There is a wealth of union legislation in most western countries offering protection and special rights to unions and their members. (This makes an interesting parallel with the contractarianism discussed in the context of company law.) International charters and principles are also prevalent in the criteria and the investment oriented agencies in particular refer to these as a basis of CSR in the context of labour relations.

The SAM questionnaire for DJSI has a comprehensive section on labour practices. This includes reference to the United Nations, including the International Labour Organization, and Organisation for Economic Co-operation and Development guidelines and charters, health and safety practice and “human capital development”.<sup>147</sup> Many quantitative measures are used including the ratio of compensation paid to management, supervisors, specialists and operational employees. Employee benefits are assessed and detailed questions are asked regarding staff appraisal, training needs and career development. Negative factors are assessed with questions about layoffs and freedom of association, such as union membership.

FTSE4Good has a similar range of concerns although criteria are not spelled out in the detail of the SAM questionnaire. These criteria have some quantitative indicators, such as annual training reviews and union membership or other representation, but otherwise require evidence of systems, policies and reporting.

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<sup>147</sup> SAM Research, Inc., Corporate Sustainability Assessment Questionnaire, 2006, p. 12.

KLD lists its criteria under the heading of employee relations. Criteria include health and safety, fairness in dealing with unions and the employees represented, and involvement of employees in stock options, decision making and generally receiving information. Profit sharing schemes and retirement benefits are further specific financial elements of labour relations assessed. Concerns include labour reductions (layoffs), evidence of health and safety issues such as fines, and poor union relations.

BitC has a comprehensive scope of criteria for staff and employee practices with most of the previously listed criteria present. Information is sought on quantitative data, for example workforce profile by gender, staff absenteeism and value of training provided to staff.<sup>148</sup> RepuTex covers similar ground under headings of employee development and training, workplace relations and remuneration, and organisational culture and diversity.<sup>149</sup>

The most representative ethical theory applying to labour practice criteria appears to be the Social Contract. As noted, unions have a contractarian relationship with employers through legislation, and so do employees. While the Social Contract was discussed in an organisation and community context, the extra-legal aspects of labour practice can also be seen in this light. Health and safety, fairness in remuneration and non-discrimination can all be regarded as part of the wider contract between corporations and the community, of which employees are specifically interested members in relation to the corporation's activities and behaviour. Financial rewards including health services, provision for retirement and profit sharing can be simply part of a remuneration package, but are frequently held by recipients to be of more benefit than the cold dollar value of such perquisites.

The contractual balance is between a fair commitment to meeting obligations and avoidance of neo-paternalism. In Victorian Britain individual business owners, or at least a substantial number, accepted a duty of care for their employees and

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<sup>148</sup> Business in the Community, Indicators that Count, 2006, p. 9.

<sup>149</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.



families. This social contract still exists but with power now better balanced between the individual's need for employment and the employer's need for labour. I have assessed KLD's criteria as strongly influenced by Social Contract principles. This is in recognition of the criteria requiring evidence beyond simply meeting legislative requirements, and of an emphasis on general well-being and care where this is related, even peripherally, to the corporation's activities. RepuTex and BitC both require rated companies to show evidence of employee development, including training, and I have thus attributed a weak link to Social Contract principles to these agencies' criteria.

The Common Good has some application in labour relations. It is in the whole community's interest, including the company's to have a healthy, reasonably affluent and fulfilled workforce. Employees are frequently consumers and customers of the corporation in some direct manner, and certainly have a wide circle of influence in the community regarding their employer's products, services and general behaviour. The Common Good is met by a balance of respect and mutual benefit that reaches beyond employees and their immediate families. Despite this general comment, I can not attribute a distinct link from any of the agencies' criteria specifically to Common Good as I believe the phrasing of criteria, particularly by KLD, RepuTex and BitC above, are more strongly contractual.

The virtuous organisation must respect and care for individuals for whom it has a financial and physical responsibility. The golden mean in this context is fair and just reward for employees, with provision of adequate and safe working conditions. Opportunities provided by the employer to make full use of talents and achieve aspirations recall *eudaimonia* - making appropriate use of our capacities and optimally functioning as human beings. Those criteria giving prominence to training, skill and talent development certainly suggest a Good Life attitude within the corporation. While this general fairness and justice approach is present in many of the criteria, it is only KLD's that I feel move enough towards the concept of encouraging and supporting employees to achieve self-fulfilment and maximising their abilities and talents. I have thus identified a weak link with

Virtue with KLD's criteria in labour practice, as the Social Contract principles appear more dominant in this category.

The Friedman model would again require only legal compliance unless increased profit for the shareholders could be created by providing additional benefits to employees, either financially or in working conditions. In this case the Pragmatic Business View would be that looking after employees has financial benefits to the organisation by reducing turnover, promoting company loyalty and generally achieving a more productive workforce. The PBV encounters difficulties in countries where the workforce is unlimited and does not have the sort of balanced power relationship that most western employers and employees achieve. Both DJSI and FTSE4Good criteria exceed the requirement to observe laws, but do give significant weight to official guidelines, practices and protocols. While these are not mandatory in a legal sense there would be reputational benefits for companies to claim compliance with such international protocols. This is creditable but avoids companies being required to account for the outcomes of meeting these commitments - it is enough to be seen to comply and assumed that employees will benefit. For this reason I attribute the criteria to a weak basis in the Pragmatic Business View as compliance will clearly benefit the company in the community's perception of employee treatment and potentially with better staff productivity.

The comments made regarding qualitative criteria in the *Executive remuneration* section also apply to the measures specified by various agencies under this more general *Labour practice* section. My conclusion still holds that a particular quantitative measure can not be related to any of the ethical principles discussed.

### *Human rights*

The concept of human rights is one of the more publicly visible topics addressed by applied ethics. The United Nations Declaration of Human Rights (UNDHR) crystallised debate in a single, authoritative document that has become a standard reference for considering the treatment of people in a variety of situations. Two of the rating agencies providing investment index assessment refer to the UNDHR

with DJSI offering compliance as one option among several codes of conduct, while FTSE4Good requires definitive compliance with the UNDHR. RepuTex refers to internationally accepted standards, which may be a roundabout way of including the declaration, while KLD tends to be explicit about issues which are certainly covered by the UNDHR but does not refer to the Declaration.

In a similar way that the ‘community’ category has been restricted, with many community issues dealt with under more granular headings, so have human rights issues been covered in categories like employment and governance. This means that the specific criteria discussed in this category differ between the rating agencies. The significance of this category, however, is in addressing human rights as a topic, including reference to the codes, rather than any particular manifestation of human rights and I will relate the selected theoretical bases to the criteria with this in mind.

Human rights criteria are mainly linked with the employment and labour relations category, although RepuTex includes human rights under governance. Regardless of whether we take a stakeholder or community view of a corporation’s influence and impact, the people most directly affected by a corporation’s behaviour and management are its employees. The distinction between the criteria of labour practice and human rights could be argued to be one of degree. Labour practice includes the way employees are treated including employment contracts, remuneration, career and skill development, through to retirement and family support. In western-world operations differences in these criteria rarely threaten human rights but in developing countries, where labour is plentiful and expectations of working conditions are minimal, labour practice certainly does infringe human rights.

One of the SAM questions for DJSI asks if the respondent company endorses the United Nations Declaration of Human Rights. The impact of this criterion is reduced as the question<sup>150</sup> only asks if the respondent company endorsed “one or more” of three conventions, including the UNDHR. Presumably companies

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<sup>150</sup> SAM Research, Inc., Corporate Sustainability Assessment Questionnaire, 2006, p. 12.

would be equally rated whether they endorse one or all, and the other two (OECD Guidelines for Multinationals and ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy) while related, are not specifically human rights charters. FTSE4Good criteria include all three policies but require support for the UNDHR in addition to one of the labour guidelines rather than, as DJSI requires, one from three. This suggests rather more emphasis on human rights specifically, as distinct from worthwhile but more general multinational labour policies.

BitC's criteria refer only to, "Perception of the company's performance on human rights by the local community."<sup>151</sup> There is no reference to frameworks and charters, and no particular issues, such as transparency or indigenous rights in the criteria. The requirement is further weakened by the measure being simply 'perception' of performance - by whom and to what standard is not specified.

Under Friedman's principles, legal compliance is the yardstick against which companies should be held responsible. Supporters of Friedman's theory would argue that development of UNDHR and similar codes, which have in many jurisdictions been incorporated into legislation, justifies their stance. The community has, in effect, expressed its standards of performance for commercial undertakings, and of course other groups, by promoting these codes of conduct and building them into the legal system. Friedmanites would argue that companies should not be obliged to exceed legal requirements for issues covered by human rights codes of conduct and may point to the promulgation of such codes as evidence that their approach works.

I attribute links between DJSI and FTSE4Good criteria to the Pragmatic Business View which will be close to the Friedman position in regard to human rights. This view would support legal compliance and point to mechanisms such as union relations and non-discrimination policies as practical implementation routes for both human rights and voluntary additional benefits offered by the employer in respect of working conditions. Both agencies are explicit in the guidelines and

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<sup>151</sup> Business in the Community, Indicators that Count, 2006, p. 9.

international standards to which companies should conform, and I have attributed a strong link for DJSI by virtue of its clear compliance requirements, while FTSE4Good uses similar protocols and standards but is less clear about precise compliance requirements and so is attributed a weak link. BitC has also been attributed a weak link with PBV principles, but in its case as perception of performance in human rights makes up the main criterion and this seems to be significantly a matter of self-interest to the company.

While using legal compliance as the yardstick, the Friedmanite and PBV view would consider it acceptable, if not obligatory, that corporations should be involved in formulating laws affecting the way that business can be run. Friedman's principle that the obligation of business is to be profitable translates to light-handed legislation or laws that are silent on many matters concerning business. Such issues as human rights and diversity would, in Friedman's world, not require special legislation, protocols or international agreements. His argument would be that if business were left alone to perform its function, then the market would ensure that the best and most efficient companies would prosper, and that benefits would accrue not only to the owners but to employees, consumers and the community in general. In practice businesses, particularly in the United States, spend a great deal of time, effort and money in lobbying politicians in order to avoid or mitigate what business sees as restrictive legislation.

KLD takes a different approach and does not refer to any of the charters or frameworks, including the UNDHR. One criterion is that the company demonstrates transparency on overseas sourcing and has "particularly good union relations outside the US" or has undertaken "outstanding or innovative" initiatives in this area. This is also reflected in supply chain evaluation under *Labour practice* criteria. As a positive criterion, KLD looks for "industry leadership on human rights issues" and "outstanding transparency and disclosure". A further criterion concerns relations with indigenous peoples, specifically, "proposed or current operations (either in or outside the US) that respect the sovereignty, land,

culture, human rights, and intellectual property of indigenous peoples.”<sup>152</sup> The reference to transparency and (for an American based rating agency) emphasis on rest-of-world operations tends to indicate that the main human rights concerns are in developing countries, although the requirements neatly capture all trans-national operations including those in culturally different societies that may be considered to breach human rights.

RepuTex does not refer to charters or international standards but does capture a broad set of criteria in its requirements, and does refer to “internationally accepted human rights standards and norms.” The main requirement is that, “The organisation has developed policies and procedures that address human rights risks and responsibilities across its workforce, supply chain, and business partnerships as well as in communities impacted by its operations.”<sup>153</sup> Reference to the supply chain, partnerships and communities indicates a requirement for responsibility beyond that of people directly employed.

Bearing in mind that we apply Virtue to an organisation by strong analogy with a person, then the organisation should behave like an exemplary citizen, and foremost in this behaviour would be respect for people including, as I noted in the *Labour practice* section, the encouragement and opportunity for people to achieve a state of *eudaimonia*. The virtuous organisation would not be involved in any practices subject to its direct or indirect control that created avoidable hurt or difficulty to people, and thus compliance with the UNDHR and similar codes would be taken for granted. Virtue would be displayed by forward looking and prudent policies and practice - exercise of *phronesis* - that would benefit all stakeholders in achieving their goals. I have attributed strong links between both KLD’s and RepuTex’s criteria to Virtue principles. KLD’s criteria are strongly worded to require not just compliance with standards but to be aware and effective in treating all employees and labour resources with respect and consideration. The company is required to show innovation and a significant point for a United States domiciled organisation is the specific requirement to apply the principles globally. Some American corporations have sheltered behind

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<sup>152</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006.

<sup>153</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.

claims of ignorance or lack of influence in the way contractors or foreign subsidiaries treat their employees, and KLD has excluded this as a defence of poor human rights among associated businesses. Reputex is less explicit but is strongly outcome-oriented in wording its criteria in the human rights section. This distinguishes its approach from those agencies' criteria I have attributed to PBV and also suggests a global requirement for treating employees and associates with respect and in a fair and just manner.

Contractualism does not seem to be a strong basis for the human rights criteria except in the sense of compliance with community developed codes and standards. Naturally, relationship with the community and members includes respect and fair treatment, but this does not apply specially to the Social Contract basis. In modern social thought the Common Good would normally be expected to be based on members of society having equal treatment and opportunities, however, there could be envisaged successful societies in which members are allocated particular roles, with a corresponding loss of freedom of choice that infringes our modern view of human rights. Plato's Republic is an example. The Common Good and this loss of freedom of choice do not seem to be mutually exclusive. The criteria in this section are thus not necessarily or strongly related to the Common Good basis.

### *Diversity*

Diversity is an indicator used by the agencies and is included here as a separate topic as it has considerable prominence in some sets of criteria. An interesting aspect is the application of diversity; in some cases an assumption that it applies to employment of women, while other indicators include ethnic, cultural, sexual orientation and other minority categories.

Gilbert, et al., in a 1999 article<sup>154</sup> proposed that affirmative action - the process of positive discrimination in hiring and promoting people from minority groups - was being superseded by a more mature concept of diversity management.

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<sup>154</sup> Gilbert, J. A., Stead, B. A., & Ivancevich, J. M. (1999). Diversity Management: A New Organizational Paradigm. *Journal of Business Ethics*, 21(1), 61-76.

Affirmative action was, and still is, associated with a number of disadvantages. These include resentment that people who had never experienced negative discrimination being given precedence over others; lower hiring and performance standards being applied in preferring minority candidates; the stigmatisation of beneficiaries; and minority candidates being perceived as less competent than others.<sup>155</sup> Gilbert's article proposes that rather than discriminating in favour of minority candidates, a more mature approach is to recognise that employees from diverse backgrounds and cultures can add special value to an organisation, "valuing difference as opposed to assimilation".<sup>156</sup> The example given is of an Exxon employee whose Asian culture demanded that she must wait for silence before speaking in a meeting. This rarely occurred. When the reason for her non-participation was recognised she was given time at the end of each meeting to speak and was found to be able to provide a valuable "reflective viewpoint of what transpired in each meeting."<sup>157</sup> This illustrates the difference between valuing difference and the assimilation which is implied by straightforward preferential hiring policies.

Sadly, a 2007 article in the same journal by Anthony Libertella, et al,<sup>158</sup> suggests that diversity management has not taken root and that the problems associated with affirmative action, such as minorities still being over-represented in lower paying and less desirable jobs, as well as Gilbert's concerns, are still common. Libertella confirms the 1999 article's statement that affirmative action originated in order to "overcome the effects of past types of discrimination within the society and especially the workplace, by allocating jobs and resources to members of specific groups, such as minorities and women."<sup>159</sup> Affirmative action is contrasted with the concept of equal opportunity, a "passive strategy" which only requires "the absence of individual acts of discrimination" while an equal opportunity policy "deals with groups and the common good."<sup>160</sup> Libertella

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<sup>155</sup> Gilbert, J. A., Stead, B. A., & Ivancevich, J. M. (1999). Diversity Management: A New Organizational Paradigm. *Journal of Business Ethics*, 21(1), p. 69.

<sup>156</sup> Ibid, p. 62.

<sup>157</sup> Ibid, p. 69.

<sup>158</sup> Libertella, A., Sora, S., & Natale, S. (2007). Affirmative Action Policy and Changing Views. *Journal of Business Ethics*, 74(1), 65-71.

<sup>159</sup> Ibid, p. 65.

<sup>160</sup> Ibid, p. 67.



comments that there is an issue of fairness with affirmative action - it might not be fair for a qualified white, male candidate to lose out to a minority candidate, if that were the sole difference - but, “Sometimes, sacrificing someone’s fortune for the greater good of society might be better than no action.”<sup>161</sup>

In the SAM questionnaire for DJSI questions are related to the International Labour Organisation Convention #111, and require details of female employees as a percentage of the workforce, and a general question asks for a similar breakdown, “based on minority, culture or similar”.<sup>162</sup> Under remuneration, the average salary for non-management staff is requested broken down for male and female employees.

FTSE4Good criteria have an indicator requiring the annual report or website to indicate a policy and commitment to “equal opportunities and diversity”.<sup>163</sup> Specific questions are set on “flexible working arrangements” with sub-questions on child care support, maternity leave and flexible working time that are relevant to female employees, although paternity pay is also an indicator. A metric applied is that, “more than 10% of managers being women or the proportion of managers who are women or from ethnic minorities exceeding two-fifths of their representation in the workforce concerned.”<sup>164</sup>

KLD has a main section on diversity following KLD’s standard approach of strengths and concerns. Strengths are indicated by having a woman or member of a minority group as the chief executive officer, having members of minorities (including the disabled) making up one-third of the board of directors, and contracting specifically with women- and minority-owned businesses. Similar child care and provision of support mechanisms are listed similar to the FTSE4Good scope. Specific indicators are included requiring “innovative hiring programs”<sup>165</sup> for employment of the disabled or, alternatively, evidence of “a superior reputation as an employer of the disabled.” Gay and lesbian policies are

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<sup>161</sup> Libertella, A., Sora, S., & Natale, S. (2007). Affirmative Action Policy and Changing Views. *Journal of Business Ethics*, 74(1), p. 69.

<sup>162</sup> SAM Research, Inc., Corporate Sustainability Assessment Questionnaire, 2006, p. 11.

<sup>163</sup> FTSE4Good, FTSE4Good Index Series Inclusion Criteria, 2006, p. 4.

<sup>164</sup> Ibid, p. 4.

<sup>165</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006.

included as indicators, for example, “The company has implemented notably progressive policies towards its gay and lesbian employees” and a particular note is made that benefits should be available to “domestic partners”, clearly aimed at being inclusive of same-sex couples. Concerns are the negative of strengths - the company has no women on the board or has infringed legal requirements or been involved in controversies about affirmative action or other diversity controversies.

From the reputational rating agencies, BitC requires respondents to give information on the “workforce profile”<sup>166</sup> by gender, race, disability and age. In their specific category, this profile is compared with the “community profile” for the same indicators. This would provide a comparison of the employee ratios against the community ratios, but it is not stated how a target would be derived. RepuTex looks at “organisational culture and diversity”<sup>167</sup> in which the requirement is to have “demonstrated commitment to workforce diversity” with a request for “diversity statistics, recruitment and diversity strategies and an EEO policy.” While targets are not specified, metrics are sought.

Across the rating agencies there is specific mention of age, gender, sexual orientation, women, race, disability and minorities. The gender and women criteria are mainly oriented towards the number of women in management or board roles while the other categories are related to the percentage employed and, for some agencies, compared with the community.

There is a distinction, only marginally referenced in the criteria, between lack of discrimination for irrelevant reasons (the diversity categories) and positive discrimination, even if lightly applied. There is a fine line between positive discrimination and affirmative action which gives preference to people in these categories, and equal opportunity which should be blind to them. The Common Good is met by not having minority groups of any type marginalised, and the Social Contract could be seen as having an obligation to look after people who have difficulties, of whatever cause, within the community. Libertella made a strong case that preferential treatment, although unfair to some individuals, can be

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<sup>166</sup> Business in the Community, Indicators that Count, 2006, p. 9.

<sup>167</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.

for the common good. Supporters of positive discrimination can point to public acceptance of, for example, African-Americans in management roles in American companies that arguably would not have occurred in the timescale without positive discrimination. I believe that all agencies' criteria can be attributed to the Common Good, with KLD and Reputex being more strongly linked than the other agencies' considered.

For Friedmanites, employees would be simply selected, trained and retained for their economic value as contributors to profit. There would be no positive discrimination and, in an ideal Friedmanite situation, these diversity factors would have no relevance. This is an interesting outcome as it would tally with the more liberal views that employment should be on merit and colour, gender and culture blind. The aim, however, of all diversity policies seems to be removal of the need for any special treatment for members of these groups, with which Friedmanites would concur. The PBV would resist any legislated compulsion to positive discrimination, and possibly equal employment opportunity (EEO) if this were to be seen as restricting an employer's choice of candidate. The PBV might support an employer's right to discriminate if he or she wished to run a business with a certain cultural character, which would be difficult if EEO policies were strictly enforced.

The Good Life would expect the company to treat all people with respect as citizens regardless of any of these difficulties, and allow them to use their talents. While criteria could have some basis in Virtue principles I do not think that there is sufficient evidence in the presentation of criteria to make this attribution.

## ***Environment***

### *Environment category*

This category probably has the highest public profile among the non-business community. Employment issues directly affect a locality while environmental issues are now seen, appropriately, as global concerns with associated worldwide visibility and focus. Rating agencies' criteria can be separated into three groups.

The first, basic requirement is to minimise harm to the natural environment and preserve resources. Note that there is implicit acceptance that most commercial operations have some impact on the environment, use non-renewable resources to a greater or lesser degree, and are thus in the long term unsustainable. Criteria in this group include commitment to recycling, energy efficiency and reduction of pollution. This approach has been promoted and practised for some years.

Sustainability is a more recent concept in the context of CSR and takes the activities and criteria in the first group a step further with the target being effectively a zero net use of resources and no long term impact on the environment. Activities are similar to those in the first group. As an example, KLD looks for innovative policies suggesting a significant upgrade in performance from simply reducing impact.

The third set of criteria is concerned with the company's specific resources. There are two sub-sets here. The first concerns businesses that are inherently high-impact or non-sustainable, such as mining companies, traditional energy producers and heavy manufacturers. Several agencies have a different category of criteria for these industries. The second sub-set is about use of the company's products. This could include coal miners, whose product produces pollution and toxic waste when used as intended, but also included are tobacco companies whose products are inherently harmful and fast-food chains whose wares are potentially harmful to people if used incautiously.

Analysis will show that there are clear differences between the rating agencies' inclusion and use of criteria that relate to these conceptual divisions.

### *Environment*

The SAM questionnaire for DJSI asks for information about environmental performance, reporting and then adds industry specific criteria related to, for example, oil companies and others with potentially high impact. The performance

criterion is sub-titled “Eco-Efficiency”<sup>168</sup> and is presented as a table of quantitative measures. These measures include carbon dioxide emissions, total water use, energy consumption and waste generation. Respondee are asked to give actual figures for each of the past four years and to indicate a reduction target. The reporting question relates to how and where environmental issues and performance are reported in the public arena, for example on the company website, in an annual report or in specific sustainability reporting. Industry specific criteria are related to particular issues in that industry.

The FTSE4Good criteria also discriminate between industries with a table of three industry categories labelled high, medium and low impact sectors.<sup>169</sup> These sectors have, as would be expected, office and service based businesses regarded as low impact, general manufacturing, hospitality and retailing in the medium sector, and the high sector containing agriculture, heavy manufacturing, oil and power generation. Perhaps surprisingly the high impact sector contains fast food chains and tobacco which, at first sight would seem to be more socially than environmentally high impact. Indicators or criteria are split into policy, management and reporting. Policy covers comprehensiveness of corporate environmental policies and “strategic moves towards sustainability”.<sup>170</sup> Management criteria tend to implementation of policy, definition of responsibilities and auditing. Reporting covers the content, including quantitative data, but does not indicate the breadth of distribution of reports, although stakeholder dialogue is an indicator.

BitC has similarities to SAM’s approach by requiring quantitative details of energy consumption, waste and emissions, with some specific emissions requiring to be listed. Recycling is a criterion and a measure is set around prosecutions for environmental offences.

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<sup>168</sup> SAM Research, Inc., Corporate Sustainability Assessment Questionnaire, 2006, p. 10.

<sup>169</sup> FTSE4Good, FTSE4Good Index Series Inclusion Criteria, 2006, p. 3.

<sup>170</sup> Ibid, p. 3.

KLD, as for other categories, lists strengths and concerns under broadly parallel headings. Strengths include beneficial products and services<sup>171</sup> whereby companies' business positively contributes to environmental protection or efficiency. Environmental impact reduction specifically includes requirements for use of clean energy, prevention of pollution and use of recycled materials. Positive actions include proactive activities in the environmental area, voluntary compliance and a "superior commitment to management systems". Concerns cover general environmental risks such as emissions of toxic chemicals, being fined or prosecuted for violation of environmental legislation, liability for hazardous waste and generally being involved in controversial activities. Specific criteria relate to ozone depleting chemicals and agricultural chemicals. If a substantial part of the company's revenues are from combustion of oil, coal or other fuels, this is seen as negative, being a contributor to climate change.

RepuTex has a significantly comprehensive set of criteria divided into policy, management systems, voluntary codes, product stewardship, sustainability investing and commitment to ecologically sustainable development.<sup>172</sup> Policy is not just a governance issue but must be publicly available and cover all operations of the organisation. Environmental management systems must be similarly ubiquitous and there is a requirement to demonstrate actual reduction of negative environmental impact. Under voluntary codes, credit is given for support and commitment to appropriate protocols, treaties and standards while the product stewardship criterion is about incorporating environmental and human health impacts, in addition to conventional financial criteria, into product lifecycle assessment and development.

RepuTex's sustainability heading requires company-wide incorporation of sustainability principles and that, "the corporation has a culture which actively promotes the value of the environment and encourages the development, adoption and equitable transfer of environmentally sound technologies."<sup>173</sup> The final criterion is for demonstrable compliance with legal requirements. In order to

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<sup>171</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006.

<sup>172</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.

<sup>173</sup> Ibid.

meet these criteria companies must demonstrate a profound commitment to the inclusion of environmental values in all aspects of their operation. As usual for Reputex, complying with the law is assumed, although in this category it is explicit. The depth of the commitment is illustrated by requiring policies and environmental management systems to cover all operations, and more importantly to show the results of policies and systems. Outcome is a factor in rating, rather than just demonstrating process. Another far-reaching requirement is in considering product lifecycle and development in relation to the environment. Continuous improvement is not only good management but required to gain credibility in environmental rating criteria.

Environmental metrics are included by a number of agencies. BitC requires carbon dioxide emissions to be stated alongside other greenhouse gases, but does not give any indication of what would constitute a satisfactory level. KLD has an innovative negative measure - “the company’s liabilities for hazardous waste exceed \$50 million”<sup>174</sup> - but the remaining agencies, while requiring metrics among the environmental items, do not publish their quantitative criteria. Again, this is not to say that quantitative criteria do not exist, but it does seem significant that some agencies publish them for certain topics. Unlike measures in the *Executive remuneration* and *Labour practice* sections some environmental metrics will be based on either internationally agreed targets or scientific calculations considered to produce an acceptable outcome, whether in global warming or local pollution. These measures are not ethically significant *per se* but do have a tangible basis.

Friedman, as with all other criteria, would regard the limit of a business’ responsibility to maintain or protect the environment as that prescribed by law. In the case of physically high impact industries such as mining, energy and heavy manufacturing, it is reasonable to assume that Friedmanites would consider it the law’s function to anticipate any unacceptable environmental impact and legislate for appropriate protection. If that has not occurred, then the community has recourse to its legislative process to enact such laws. It would not be the place of

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<sup>174</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006.

business to propose new laws controlling environmental impact nor to impose voluntary constraints on itself. The exception to this would be if the business considered that it would alienate its customers by pursuing a legal but unpopular course of action in which case Friedman would allow managers to take a decision, based purely on economic outcomes, by modifying business behaviour to mitigate negative customer sentiment. The agencies' criteria all include elements of legal compliance but add elements of voluntary constraint beyond legal requirements.

The basis of all the agencies' criteria appear to be most appropriately attributable to Social Contract principles, with KLD and Reputex having a strong link and the remaining three agencies a weak link. The strong link is based on KLD requiring consideration not only of manufacturing impact and use of materials and energy, but also of the end use of the product or service. It is thus not sufficient to be an environmentally efficient manufacturer if the resulting product is destructive in some way. Reputex has a similar theme but emphasizes product stewardship and sustainability. In the detailed narrative Reputex requires continuous monitoring of products to improve both production and use in environmental impact terms.

Social Contract based criteria would expect to take into account the desires of the community potentially affected. This could lead to different standards in different company plants as, of course, could legal compliance. Poorer communities - for example African mining towns - would reasonably value income over long term environmental protection, simply because the workers and their families may be on a subsistence wage and any constraint on the company employing them could be seen as endangering their employment and day-to-day livelihood. Companies could argue that they are meeting their implied contractual obligations to such communities, although taking a trans-national view it would be difficult to justify environmental destruction at a particular site if richer communities are being protected to a greater extent just because there are labour alternatives. Conversely, if a company reacts to community concerns by improving its environmental performance or rectifying actual destructive activities, then this could be seen as meeting community obligations in a contractual sense.



DJSI, FTSE4Good and BitC, in a similar approach to the previous categories examined, tend to take a more compliance-oriented approach although in this environment category they all identify the importance of impact analysis, improvement and elements of sustainability. I believe that their criteria are, like KLD and RepuTex's, founded in Social Contract principles, but the attribution of a weak link reflects this inclination to compliance rather than outcome.

Of the other sets of principles, the Common Good basis for criteria is perhaps reflected in the international codes to which companies are required to comply. It removes the element of relativity that could be justified by a contractual basis, as the common good extends to the direct, local community and also wider communities, both national or international. The difference is in the breadth of concern. The virtuous organisation would also take a long term and wider view than just the local community by asking what a 'good' company would do to protect the environment and the economic, aesthetic and welfare impact on all people. Not only would such a company comply with codes and regulations, and make its own decisions to improve its environmental performance, but it should set an example to other organisations, either in its industry or its locality and provide positive assistance and encouragement to strive for better environmental sustainability.

Finally, the Pragmatic Business View is, as usual, loosely based on Friedman's limit of obligation to obey the law, but modified by response to community concerns provided the response is seen as voluntary. Environmental concern, or its appearance, is a strong marketing tool and PBV practitioners could easily justify mitigation of environmental impact and other initiatives aimed at reducing negative impact, as just good business.

## ***Products***

### *Product category*

There are striking differences between rating agencies in respect of their evaluation of the products and services of the assessed organisations. The

treatment ranges from no mention of the company's product, through to the impact of certain industries on the environment to assessment of the product's value to users. It is in this area that the startling differences in rating companies are exposed - where tobacco producers can be rated as socially responsible organisations through their corporate governance competence, or rejected from CSR rating altogether as producers of physically and socially harmful products. The reason for these differences will become apparent in considering each agency's treatment of products and services.

#### *Product related criteria*

No mention is made in the SAM questionnaire for DJSI of the rated company's products and services apart from, by implication, some environmental criteria. Similarly, the FTSE4Good criteria link company operations, and thus the business they are in, with environmental issues and concerns, and categorise companies as low, medium and high impact. Low impact sectors include finance, information technology and property investment; medium impact sectors include building, engineering and transport; while high impact sectors include power generation, oil and gas, agriculture and, interestingly, fast food chains. The other product reference by this agency is in relation to supply chain standards where certain product sectors are noted as high risk.

The issue of including fast food chains as high impact is partly due, perhaps, to the current publicity arising from their reputed contribution to obesity and an unhealthy diet in general, as well as excessive packaging and waste production. There is also criticism, particularly in the United States, that intensive meat production on behalf of fast food restaurants is in itself energy inefficient compared with provision of ingredients for menus that may be regarded as more balanced. While these are real criticisms, the chains may suffer because of their high visibility to the general public and of course their ubiquity in the high street. An absolute measure of waste production and health concerns would probably rate fast food considerably below other high impact sectors such as mining, oil and gas, and vehicle manufacturers.

In contrast to these two agencies, KLD has an extensive set of criteria concerning products and the business of the rated organisation. In the ‘strengths’ indicators there are criteria regarding quality assurance, measured by recognition within “U.S. industry” and research and development investment and effort recognised by “bringing notably innovative products to market.”<sup>175</sup> Other strengths include “provision of products and services for the economically disadvantaged” and “the company’s products have notable social benefits that are highly unusual or unique for its industry.” This is the first indicator concerned with the purpose and use of the end-product rather than the quality of the product or the competence of management of the organisation. The product itself has ethical significance according to KLD’s criteria. Following KLD’s standard format, concerns are listed. These are more oriented to quality and safety, with product safety being measured by fines, penalties and controversy. Similarly marketing controversies are an indicator of concern as are anti-trust actions or accusations. Specific mention is made of “nuclear safety problems” for energy companies and issues around defective products.

KLD alone has a further category of *Controversial Business Issues*, which we will examine in some detail in Chapter 6. These issues are all product related - the concern arises from the impact of using the product or service on the community, specifically mentioning customers. The existence of this section in the rating criteria is important in that it indicates a strong bias towards the recognition, outlined above, that products have ethical significance in themselves.

BitC aligns with DJSI and FTSE4Good in that there are no criteria for products other than peripherally in environment and, specifically, product labelling.

RepuTex has two categories relating to product. The first is “product stewardship and lifecycle”<sup>176</sup> which is in the environmental group but goes beyond simply mitigating environmental impact. The criterion requires that decision making processes within the organisation incorporate “the environmental and human health impacts of products and services as well as economic considerations.” The

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<sup>175</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006.

<sup>176</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.

second category is a complete section<sup>177</sup> which provides specific criteria by industry type. Industry groups are Automobiles; Food and Retailing; Energy/Oil and Gas; Banks, Financials and Real Estate; Transportation; Paper and Forest Products; Metals and Mining; Telecommunications and Technology; and Utilities. Many of the criteria are environmentally related but the financial sector, for example, has criteria related to “sustainable or socially responsible institutional investing and project finance” and energy production takes account of human impact as well as the more obvious environmental risks.

Friedman would again regard all business activities as legitimate, particularly the sale of any product or service for profit, provided that no laws are broken in the particular jurisdiction in which the company operates. This means that environmental concerns associated with industries such as mining and energy would be satisfied as long as the company complied with local legislation. This is a reflection of the Friedmanite view of environmental criteria. The same principle would apply to the inherent impact of product use on consumers. To use the familiar example of tobacco, where smoking is legal then this would be seen as a legitimate product and no criticism should apply to a company making profits from tobacco, even if significant harm is being done to its users. Friedman would regard fast food as an entirely legitimate business with the responsibility for proper use of its products lying with consumers, including parents if their children tended to be overweight. Healthy eating, Friedmanites would argue, is a personal responsibility.

The Pragmatic Business View would tend, in the product related criteria, towards Friedmanite principles. A typical PBV response would be along the lines that consumers are well informed and should be free to make a choice of whether, or how, they use products. Smokers, the argument goes, are aware of the risks. Further, many products can be used to excess or misused and cause users harm so that consumers should exercise personal responsibility for their choices. The agencies that do not mention products and services as a category of CSR criteria - DJSI, FTSE4Good and BitC - must rely on such arguments. While not stated

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<sup>177</sup> RepuTex, Sector Specific Criteria and Indicators – International (Level 1), 2005.

explicitly, the fact that products do not fall into an ethical category must be supported by the principle of legality. This inference is supported by these agencies having strong criteria for legal compliance in all other governance areas. A weak link is attributed to the PBV for these three agencies, in this case largely on the basis of a general approach in this category of exceeding Friedman's standard but not demonstrating any discernable link to the other theories.

Both KLD and Reputex have criteria that exhibit the characteristics noted in the *Product category* commentary - impact on the environment and assessment of the product's value to users. Both have comprehensive criteria that consider the special characteristics of certain industries, such as mining and energy production parallel with their environmental criteria, but both agencies go beyond environmental impact by considering not only human impact but positive value to consumers and the community. KLD specifically mentions value to the disadvantaged. Harm to people seems to fall into either environmental criteria or into a different set concerned with a wider sense of wellbeing. Regardless of the boundary, KLD in particular looks for social benefits from products and services and "innovative products". Beneficial products as described by both KLD and Reputex in terms that are indisputably contributors to the Common Good and this enables a weak link to the theory to be attributed. The motivation for innovation, quality and positive attributes may be from a sense of Social Contract and I feel that this is sufficiently set out to warrant a weak link to this theory for both agencies criteria.

Certainly the virtuous organisation should strive to produce goods and services that are admirable, use all of its skills and expertise, and meet the requirements of the community, but none of the agencies develop requirements in their criteria to make a link to Virtue for this category.

### ***Summary of Linked Criteria***

The following table sets out the criteria for each rating agency that could be linked to one or more of the ethical principles set out in *Chapter 3*. I have noted that there is either a strong (S) or weak (W) link. Criteria not noted as linked to a

particular theory demonstrated insufficient connection to any particular set of principles. This strength or weakness refers solely to the degree to which the criterion relates to an underlying principle and does not imply any inherent weakness in the statement of requirements.

As all rating agencies either explicitly or implicitly include compliance with the law as a requirement, I have not included a Friedmanite link in the table. While the Friedman doctrine still has significant - perhaps even dominant - influence, there are no criteria or individual agencies that can be said to be purely Friedmanite. Where compliance with extra-legal protocols, standards and agreements are the main criterion I have identified the Pragmatic Business View (PBV) as the underlying principle. The PBV can be regarded as based on Friedman's principles but with acknowledgement of additional requirements beyond the purely legal.

Figure 1: Principles, Criteria and Agencies Table

<i>High-level criteria</i>	<i>DJSI</i>	<i>FTSE4Good</i>	<i>KLD</i>	<i>BitC (CRI)</i>	<i>RepuTex</i>
<b>Governance</b>					
<i>Executive remuneration</i>	Virtue (W)		Virtue (S)		
<i>Clarity of responsibility and accountability</i>	Social Contract (S)		Social Contract (S)		Social Contract (S)
<i>Risk management</i>	PBV (W)				Common Good (W) Social Contract (W)
<i>Countering Bribery</i>		Virtue (W) Common Good (S)			
<b>Community</b>					
<i>Philanthropy</i>	PBV (W)	PBV (W)	Virtue (W) Common Good (S)	PBV (S)	
<b>Employees &amp; Labour</b>					
<i>Labour practice</i>	PBV (W)	PBV (W)	Virtue (W) Social Contract (S)	Social Contract (W)	Social Contract (W)
<i>Human rights</i>	PBV (S)	PBV (W)	Virtue (S)	PBV (W)	Virtue (S)
<i>Diversity</i>	Common Good (W)	Common Good (W)	Common Good (S)	Common Good (W)	Common Good (S)

<i>High-level criteria</i>	<i>DJSI</i>	<i>FTSE4Good</i>	<i>KLD</i>	<i>BitC (CRI)</i>	<i>RepuTex</i>
<b>Environment</b>					
<i>Environment</i>	Social Contract (W)	Social Contract (W)	Social Contract (S)	Social Contract (W)	Social Contract (S)
<b>Product</b>					
<i>Product related criteria</i>	PBV (W)	PBV (W)	Common Good (W) Social Contract (W)	PBV (W)	Common Good (W) Social Contract (W)
<b>Count of links</b> (of which S)					
<i>PBV</i>	5 (1)	4	0	3 (1)	0
<i>Social Contract</i>	2 (1)	1	4 (3)	2	5 (2)
<i>Virtue</i>	1	1	4 (2)	0	1 (1)
<i>Common Good</i>	1	2 (1)	3 (2)	1	3 (1)
<b>Total links</b>	<b>9</b>	<b>8</b>	<b>11</b>	<b>6</b>	<b>9</b>

The figures in brackets indicate the number of links that were attributed as *Strong* within the count for each agency.



## Chapter 5: Controversial Business Issues

### *Controversial issues category*

KLD alone among the rating agencies examined has a category of controversial business issues.<sup>178</sup> This category represents community concerns and it would be reasonable to assume that the elements might change over time as certain concerns are allayed and others rise in community awareness, either through groundswell or simply through changes in politics or technology. The main sections in this category are all products or services that can be regarded as having an impact on public wellbeing and morality in the sense of well discussed topics and often conflicting opinion.

While these could be considered in the previous *Products* category, there are several reasons for treating them separately. First, the category raises the wider question of whether there is ever an ethical issue as long as a company manufactures products or provides services that are legal and desired by consumers who use them voluntarily. Second, while the public morality concern is easily seen for each of these issues, there are strongly conflicting, and often supportable, views on whether these products and services are inherently immoral or not. In previous categories there is much less room for debate over the ethics of each category - few people would argue that the environment should be harmed, or human rights abused, but there are legitimate arguments for and against abortion and the right to produce and consume alcohol. Third, assessing an organisation as belonging to one of these industry sectors is sufficient in itself to either significantly influence its CSR rating or eliminate it from even being considered as a socially responsible company. This is different from assessment in the other categories where there is no such elimination.

In this *Controversial issues category* we find strong links to the Common Good in three of the five groups. The only attribution is one weak link to the Social Contract. In the previous analysis of *Corporate Management Criteria*, KLD's

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<sup>178</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006, p. 12.

criteria links were fairly evenly divided between the Common Good, Social Contract and Virtue, so that the conclusion in this controversial business issues section shows a bias to one theory as a basis for evaluating the issues.

While KLD treats each of the nine issues separately, I will discuss them in five groups:

- nuclear power (safety and environment)
- firearms and military (death and injury)
- abortion and contraception ('right to life')
- alcohol and tobacco (health and traditional morality)
- adult entertainment and gambling (traditional morality and potential for harm)

To conclude this chapter I have made a more general analysis of the inclusion or exclusion of products and services provided by assessed companies as a basis for CSR evaluation. This discussion returns to the example of the tobacco industry and we may conclude that a Friedmanite approach has been taken where a product, simply by virtue of its being legally manufactured and regardless of the consequences of its use, can be considered either socially responsible or disregarded in an ethical assessment.

### *Nuclear power*

Of the controversial business categories only nuclear power is primarily a safety issue, although KLD is unusually indirect in its criteria which do not mention safety, or indeed any other consequential difficulty, in respect of owning nuclear power stations, processing fuel or disposing of waste. KLD's criteria consider any association with the nuclear industry by owning, managing or supplying nuclear power stations negative to CSR. Implied or assumed CSR issues are in pollution, risk to communities and the environment, difficulty of waste disposal, and potential for supply of weapons materials. These issues are different for nuclear energy, compared with other large scale energy or manufacturing industries, simply by virtue of the scale of consequential damage. A gas-fired power station can emit toxic waste and may cause significant damage in an

accidental explosion, but similar nuclear emissions or explosion would cause damage orders of magnitude greater in terms of environmental destruction, human health and loss of life, and the latency of such effects.

Twenty years after the Chernobyl power station accident radiation is still expected to make large areas of Russia uninhabitable for many years. A United Nations press release<sup>179</sup> estimates that up to 4,000 people will die as a direct result of the Chernobyl accident, however, the same press release acknowledges that 4,000 cases of thyroid cancer in children are a direct result of exposure to Chernobyl radiation, although only 9 deaths have so far occurred in this group. 350,000 people were relocated from the area around the accident which proved a “deeply traumatic experience” for those involved, not least because they had already been exposed to significant radiation. Apart from direct human health costs, economic and social costs have been immense. The same report states that 784,320 hectares of farmland have been taken from production, and talks about the stigma of living even in relocated communities. The UN figures are disputed by many agencies, including Greenpeace<sup>180</sup> which refutes the basis of the UN statistics with its own report showing that eventual deaths could reach 140,000.

Regardless of the eventual outcome of this accident, even conservative data demonstrates that the impact on the immediate community, country and across continental Europe was extreme in comparison with any other actual or potential man-made disaster, even though the accident was quickly contained.

Nuclear power carries a very low risk of accidental, catastrophic impact, but that potential impact, as we can see from the Chernobyl example, is of such a huge, persistent and unmanageable scale that the moral issue seems to be whether anyone or any organisation is entitled to expose the community to such a risk, however slight the likelihood of occurrence. Apart from accidental disasters, there is also an incentive for terrorist attack, or threat of attack, for precisely the same reason - the scale of devastation that would result from an explosion involving nuclear material. An associated terrorist risk is that of theft of nuclear

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<sup>179</sup> United Nations, *Chernobyl: The True Scale of the Accident*, 6 September 2005.

<sup>180</sup> <http://www.greenpeace.org/international/news/chernobyl-deaths-180406>, April 2006.

material that could be used in manufacturing nuclear weapons or as low technology 'dirty' bombs that can cause widespread radiation injury. Again, the risk of such an event may be small but the consequences extreme.

Arguments for and against nuclear power tend to be based on the controllability of this risk. Given the experience of some fifty years of commercial nuclear power generation, and the low number of serious accidents, proponents can argue that there is a vanishingly small chance, particularly with newer technology and better security, of an accident or successful terrorist attack. They can add to the case by pointing out that alternatives to nuclear power, such as fossil-fuel fired power stations, cause pollution and in their history have contributed to a large number of deaths, injury and disability from their operation and associated activities such as mining. Historically the balance is in favour of nuclear power. The issue remains, however, that even a minute chance of an accidental or criminal event leading to an explosion spreading radio-active material, with the likelihood of thousands of immediate deaths and possibly millions of people suffering long-term health problems across generations, is extremely difficult to justify morally when there are alternative power sources available.

A further, significant environmental issue arising from the use of nuclear power is that of disposal and storage of nuclear waste. Such waste is highly toxic in several respects and, critically, remains so for millennia. This means that safe encapsulation and disposal is almost impossible. Whatever the method used for isolating radioactive waste to keep it safely contained, we can not have any reliable assurance that it will remain viable over hundreds, and certainly not thousands, of years. This means that the problem, and cost, is simply passed on to future generations who have not had the benefit of the cheap power supplied. While this may be mitigated on the basis that future generations are likely to be richer, and more technologically capable of resolving these long-term storage issues, it is still wrong to impose the cost on them with no associated benefit.

The main moral issue concerning nuclear power generation is thus in its safety and the extreme consequences of either accidental or criminal damage. This concern would relate to an ethical view based on the Common Good. No

economic benefit can be justified if there is a finite, however small, risk of what may effectively be annihilation of a community and long term health effects on a huge population. While this risk can be balanced by risks posed by other methods of energy production and distribution, nuclear power remains the only system of power generation capable of devastating such a large area and its population. Similarly, leaving waste to be managed and contained by future generations is clearly not in the Common Good.

### *Military and firearms*

In both the firearms and military categories criteria are concerned with manufacture of firearms and military equipment in general, and in retailing firearms to the public. It must be assumed from the lack of a 'selling military equipment' criterion that buyers are not the public but states and governments. Both categories have criteria relating to the rated organisation owning or being owned by companies in that industry so that a business not itself engaged in manufacture of military equipment but owned by one would be rated accordingly. There are quantitative criteria for the cut-off points of ownership. The military criteria include not only the manufacture of complete weapons systems but also of components and, again, a numerical measure of the percentage of revenue or an absolute value is stated as the cut-off point for being assessed in the military category.

Military equipment can be used to keep peace and to prevent war. Firearms can be used for legitimate sport including target shooting. Two moral arguments emerge here. Military equipment, including firearms, is designed specifically to cause death or disability to humans. In the unlikely but conceivable scenario that no-one had weapons, then aggression would be severely constrained or, at least, the results of aggression would be a fraction of the impact from armed combatants. This is hypothetical and as soon as the first combatant picked up a stick to hit her opponent an inevitable escalation would have begun. The argument in favour of sporting firearms is supportable only if the weapons are designed for that purpose. Some are. Olympic shooters use guns that would be impractical to use in the field, although they would still be potentially deadly.

Most guns, however, are designed for military use, shooting animals in the wild, or self-defence. Unfortunately a self-defence weapon is functionally identical to an attack weapon.

In the case of individuals using firearms a freedom of choice argument can be used. Individuals should be trusted to use guns sensibly and ethically, just as they would use many other potentially dangerous devices, such as motor vehicles and cooking knives. The difference between cooking knives and guns is that while a cooking knife can be misused and cause injury or death, it has a primary peaceful purpose for which most people acquire and use knives. A gun's primary purpose is to cause death or injury, even in self-defence. Edmund Byrne, in his paper *Assessing Arms Makers' Corporate Social Responsibility*, considers that "Human rights violations are, however, being brought about de facto with small arms"<sup>181</sup> - the insightful point here being that the simple existence, or rather bringing into existence, of guns is unethical.

A justification of military equipment, and indeed armies, can be proposed in respect of their peace-keeping function, either as a balanced threat of destruction to potential aggressors or, in an unbalanced situation, by being able to deter further violence by demonstrating overwhelming force. This argument has merit and there are numerous historical examples of occupation, deterrence and peace-keeping that have saved lives and property. In 1999 the New Zealand Government replaced an unarmed police presence in East Timor with armed troops. While the police had been unable to prevent rioters causing property damage, personal injury and loss of life, the armed forces were able to restore order with minimum use of weapons. Clearly the threat of force in these circumstances was able to result in a positive outcome (although not necessarily a long-term success). There are many examples where this has failed - in recent times the invasion of Iraq is conspicuous - but arguably failures may have been inevitable.

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<sup>181</sup> Byrne, E. (2007). *Assessing Arms Makers' Corporate Social Responsibility*. *Journal of Business Ethics*, 74(3), p. 213.

In the context of CSR rating there is a feeling that the exclusion of firearms and military equipment manufacturers and distributors is a case of investors and consumers of other products from such companies wishing to express their disapproval of violence in any organised form. There is little chance that weapons will cease to be manufactured and distributed so that the practical outcome of identifying, rating and thus excluding companies from some business and investment is not likely to have this effect. It may cause diverse organisations whose business is predominantly other than military to sell or dispose of their military operations, but this would tend to result in specialist military and firearms manufacturers outside the CSR-compliant community. These specialist companies would be able to charge a premium to counteract the difficulties of supply chain constraints and any investor boycott.

For these reasons there is little likelihood of significant change in weapon production even if the CSR movement becomes hugely influential. The ethics behind CSR censure and associated action must, therefore, be deontologically based as outcomes are unlikely to be materially changed.

In considering concern about the manufacture and sale of military equipment and specifically firearms my conclusion is that a deontological morality is in play, rather than real expectation of bringing about significant change in war-like activities and violence in general. Regardless of profit, organisations just should not be involved in producing weapons capable of widespread destruction and in the knowledge that many will find their way into the hands of unscrupulous leaders and result in non-combatant deaths and injury. A stronger case would argue that there are no just wars and that violence can never be justified. This is a deontological argument and does not relate well to any of the theories under consideration as a basis of CSR criteria.

### *Abortion and contraception*

The abortion issue has criteria regarding manufacture of “abortifacient products”<sup>182</sup> and ownership of hospitals and other medical care facilities that provide abortions or related services. The contraceptives criteria include companies that licence or brand contraceptive products and those manufacturing contraceptives. Both issues, in common with all the categories in the controversial issues section of KLD’s Social Ratings Criteria, have criteria for either owning other companies in that field of business or of being owned by such companies. Percentages of ownership are specified for these criteria to be met.

The antipathy to abortion and contraception has a significant but not exclusive basis in religion, particularly Catholicism. An American public survey found that 50% of opponents of abortion cite religious belief as the reason for their opposition.<sup>183</sup> Of supporters, 35% cited “personal nonreligious beliefs” and 22% “education”. Apart from underlying religious principles, the main reason for opposition to abortion is the belief that abortion is nothing less than killing a human being. Much of pro- and anti-abortion debate focuses on the point at which a foetus can be considered to be a person. This point ranges from the time of conception; a more indistinct time at which the foetus has recognisable human traits such as a heartbeat; a state of development when the foetus could live if born; and birth. Some religions are concerned with ensoulment, and this could be at any of these stages of development, but is often regarded as at the point of conception. Going further back in the development cycle, there are views that ova are potential humans, and this is one of the objections to contraception - that it is artificially preventing a human life from being created. Many other views are put forward including Peter Singer’s position that personhood is the critical factor in how we should treat humans, rather than membership of the species *Homo sapiens*.<sup>184</sup> All of these views are concerned with whether abortion, or indeed contraception, takes a human life, equating the act with murder.

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<sup>182</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006, p. 12.

<sup>183</sup> <http://abcnews.go.com/sections/us/DailyNews/poll010702.html>,

ABCNEWS/Beliefnet Poll, 2007.

<sup>184</sup> Singer, Peter (2000); *Writings on an Ethical Life*, Harper Collins, London, p. 128.



A different moral objection to contraception is based on the view, often religiously based, that sex is intended as a means of reproduction, and should not be used simply for pleasure or to satisfy personal desires. A weaker but prevalent view is that sex between unmarried or otherwise uncommitted people is simply immoral and that contraception is an aid to this immorality.

The latter view can be related to a number of community concerns. Most human communities have historically been centred on family, a wider group such as extended family, work grouping such as hunters, or villages. Modern communities still have these groupings although western communities are said to be increasingly individualistic, or with families comprising only immediate parents and children rather than the more traditional extended family that includes grand-parents, aunts and uncles of the children, and partners of newly married or committed couples. Sexual relationships have always been, and still are, a significant part of marriage and partnership, and these institutions are significant within all communities. It is thus in communities' interest to retain a special status for these relationships otherwise the structure of the community, at a number of levels, is threatened. Again historically, sexual behaviour and restraint has been a significant issue in communal life, and it is easy to see that ready access to contraception has the potential to remove one of the most practical inhibitors to promiscuity - that of pregnancy outside a committed relationship. One moral basis for objection to contraception, and therefore to those companies that produce contraceptive devices and drugs, would be based on this concern for destabilising a community and reducing the family-sourced control over behaviour.

Abortion and contraception are not as easy to relate to any one of the ethical theories in isolation. The Social Contract theory would support a company taking into account the genuine beliefs and desires of its community, however, large companies have geographically and socially distributed communities and as the issues are strongly argued both for and against it would be hard to accurately reflect communities' balanced wishes. Nevertheless, the Social Contract theory has relevance. The PBV would be concerned with company image and may well be inclined to avoid involvement in these products and services as a defence

against criticism and a constraint to selling other company products. Virtue would only be relevant for anti-abortionists if the company were to take a similar view and a principled stand against providing abortion services or associated products.

### *Alcohol and tobacco*

Alcohol and tobacco have almost identical sets of criteria associated with these controversial products. As well as company ownership, the criteria are concerned with licensing, manufacturing (including intermediate products) and retailing. Cut-off points are specified for qualification as retailers and associated product manufacturers.

Manufacture, promotion and the sale of alcoholic drinks and tobacco products is controversial for reasons of health, personal conduct and accountability, and some religious prohibition. Smoking tobacco and drinking alcohol do appear to be ethically different. Alcohol drunk in moderation can have beneficial effects including easing of social interaction, display of hospitality and some demonstrable nutritional benefits, such as those found for red wine in relation to heart disease. Smoking has no demonstrable health benefits and has been shown to be damaging to human health even with very limited consumption. Passive smoking, whereby non-smokers are subjected to others' smoke, is also health-threatening. One product is thus capable of use with no ill effects and has some positive benefits, while the other is always damaging, however consumed. Unfortunately alcohol is potentially addictive and damaging when consumed in excessive quantities or over time. Not only is the health of the consumer affected but consumption diminishes the consumer's inhibitions leading to poor judgement, lack of co-ordination and loss of control. In practical terms this can result in road accidents, uncharacteristic violence and self-harm, as well as hurtful or disruptive social behaviour.

Knowingly causing harm to one's self or others is a moral issue and is attributable to both sets of products, perhaps more so to tobacco in self-harm and more to alcohol in harm to others. There is a freedom of choice argument that individuals

should be able to use legal products as long as they are aware of the consequences to themselves and do not cause others harm. A counter argument is that even self-harm hurts others in the community - family and friends through distress at illness or death of a loved one and the economic cost of looking after an unnecessarily sick person.

It is difficult to reconcile the objective of commercial companies to be profitable by selling products and services with an ethical approach that would require them to take all possible steps to ensure that people do not become addicted, and do not indulge in products in a way that is seriously hazardous either to the individual, immediate family and friends, and society as a whole. Use of tobacco to any extent is harmful and it is difficult to imagine how tobacco companies could still base their business on that product and avoid these harmful effects. Alcohol can be used without harm but clearly companies producing alcoholic drinks want to sell the maximum volume and would find it difficult to exercise the degree of restraint in, for example, advertising and promotion that would lead to only moderate and controlled consumption. Both tobacco and alcohol producing companies have a history of marketing to susceptible groups in order to gain a lifetime commitment to use of the product. In the case of alcohol, teenagers are presented with glamorous images of a drink-enhanced lifestyle, and specific advertising of products such as alco-pops (sweet, pre-mixed alcoholic drinks) can only be aimed at this group. Tobacco companies have recently been exposed again for targeting illiterate middle-eastern youths to start smoking by promotions, including giving away cigarettes at sports venues. Similar practices have been recorded through Asia and Africa as a reaction by the tobacco companies to western countries stepping up anti-smoking campaigns and legislation.<sup>185</sup>

Products like alcohol and tobacco are controversial because of the harm caused to users and their immediate families and social group. As noted, there is a difference between alcohol, which can be consumed safely and with positive effects, and tobacco which is always health threatening. The Common Good

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<sup>185</sup> <http://www.takingontobacco.org/qofm/m0109.html>.

appears to be the most relevant basis for concern about these products. Even though their effects are primarily on the individuals using or, in the case of alcohol, abusing them there are widespread negative social impacts on costs of unnecessary health care, criminality, injury and damage that tend to result from alcohol abuse, and the effect on immediate families and friends of both health issues and potential violence among users.

### *Gambling and adult entertainment*

Gambling and adult entertainment CSR rating criteria vary in relation to differences in the services provided. As well as the company ownership criteria common to both, gambling has a licensing criterion and one for manufacturing “goods used exclusively for gambling, such as slot machines, roulette wheels, or lottery terminals.”<sup>186</sup> The adult entertainment equivalent is, “companies that produce adult media products including movies, magazines, books, calendars, and websites.”<sup>187</sup> Gambling has a supporting products and services criterion and a major one of owning and operating gambling facilities such as casinos and race tracks. Adult entertainment’s equivalent is phrased as being a ‘provider’ of such services as pay-per-view adult entertainment.

Gambling and adult entertainment - the latter a euphemism for pornography and to some degree prostitution - are frequently prohibited by religious beliefs. The association may well be with frivolous activities. The opportunity to win or lose money with no investment of honest labour makes gambling a subject of prohibition, while adult entertainment deals with a commercial exploitation of sex - literally a taboo subject in many religious beliefs.

Non-religious concerns with gambling are perhaps twofold. Some people are susceptible to gambling and can become, effectively, addicted. Companies providing such services thus have a commercial incentive to encourage continued participation which may lead to (or be a result of) addictive behaviour - effectively exploitation of the addictive potential. This leads to loss of money for

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<sup>186</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006, p. 14.

<sup>187</sup> Ibid, p. 12.

the consumer of such services which in turn can promote criminal activities to fund the addiction. In less extreme cases there can be a negative impact on families of gamblers if essential household money is lost.

Regardless of consequential poverty and its effects, there is an underlying feeling for some people that gambling is simply wrong because its aim is to gain money with no productive effort. This is one element of religious antipathy as well but not constrained to religious belief. A secondary issue with gambling is the criminality associated with many apparently legitimate gambling businesses. The very high turnover of money, its cash basis and the fact that there is no tangible output means that it is easy to launder illegal funds and conceal the source, and destination, of such funds. This is not an inherent factor of the gambling business but is a very practical consideration in current communities.

The concerns with adult entertainment include stronger religious prohibition of frivolous sex, particularly that on a commercial basis devoid of love. Practical concerns include the potential for exploitation, particularly of young women; emotional damage to participants in the production of pornography and provision of sexual services; and harm to consumers of such services from similar emotional damage to users and hurt to partners and families. Counter arguments appeal to freedom of choice both for participants and providers of these services.

Gambling and adult entertainment are again related to the Common Good, although there are deontological arguments against both. Companies operating in these industries could also be considered responsible to their communities through a Social Contract if the community regarded the activities as undesirable. Larger companies in operating in these fields have made much of being responsible, for example by vetting gamblers to detect those with a gambling addiction, by contributing to gambling rehabilitation organisations, by ensuring that actors in adult entertainment movies are of legally responsible age, and demonstrating other protective processes to avoid some sorts of harm to participants.

Disregarding any religious or deontological arguments it would be possible for both gambling and adult entertainment industries to be run with minimal physical or economic harm to both consumers and participants, however, psychological

injury would be difficult to attribute directly to participation in either activity, and eradicate. This is why the Common Good would seem to be the overriding basis of such criteria.

### ***Summary of Links from Controversial Business Issues***

Of the five categories derived from KLD's nine sections, the underlying theory for three has been shown to be the Common Good. These categories were nuclear power, alcohol and tobacco, and gambling and adult entertainment. Compared with my assessment in the corporate management criteria categories the links can be regarded as strong (S) in each case.

The Social Contract appeared to be at least partially the basis for KLD's stand on abortion and contraception, but this would be a weaker (W) link. The military and firearms category did not relate directly to any one of the theories being considered as a basis for rating criteria and I noted that giving a negative rating to companies engaged in production and sale of military equipment and specifically firearms must have a deontological basis.

### ***Inclusion of Products in Evaluation***

The most striking differences resulting from assessment by CSR rating agencies are due to the inclusion or exclusion of criteria related to the use and impact of products and services that are the *raison d'être* of the company under evaluation. This suggests an underlying and profound variation in the principles from which rating criteria derive.

### ***Exclusion of tobacco company***

The agencies, including DJSI, FTSE4Good and BitC, which do not include product use and impact in their assessment produce ratings that are in some cases counter-intuitive in the context of socially responsible corporations. The obvious, and much examined class, is that of the tobacco companies. Any defence of their

product in terms of unproven harm has now disappeared with even the tobacco companies accepting the harm caused by their products but claiming to educate their users about the potential effects of smoking, although the practical reality is somewhat different. In general, the companies do not discuss the health hazards and use freedom of choice arguments in support of their product.

The spectacular inclusion of British American Tobacco (BAT) as the second rated company in the Corporate Responsibility Index (CRI), a licensed use of BitC methodology and standards, in Australia in 2005 provoked intense discussion. The CRI is administered by the St James Ethics Centre in Sydney whose director, Simon Longstaff, published a trustees' report, over half of which was a justification for the inclusion of BAT in the index. He argues that 'open entry' is desirable for consideration in the index, but of course the issue is not about inclusion but of success in a comparative rating with other organisations. Open entry would be admirable if the result more appropriately reflected the social impact of the company. Longstaff's key point, however, "is to challenge, at its root, the claim that business has no obligation beyond conformance with the law."<sup>188</sup> He continues, "Tobacco companies rely on this position as their ultimate defence when they claim their right to sell a legal product. In making this claim they have rejected the proposition that companies might go beyond what is lawful to do what is responsible and right."<sup>189</sup> He goes on to propose that ethical obligations exist prior to the law and:

If we exclude tobacco companies from participation in programs like the CRI, then we effectively concede to them the argument on which they ultimately rely. It is our view that it is better to engage them in a process that exposes them to new ideas and in doing so, challenges the core beliefs that otherwise allow them to prosper from the preventable deaths of millions who cannot escape their addiction.<sup>190</sup>

A positive result in terms of convincing the tobacco companies to change their core business as a result of this engagement seems unlikely. In Longstaff's own

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<sup>188</sup> Longstaff, S. (2005). 2005 Corporate Responsibility Index: Trustee's Report *Living Ethics* (64), p. 4.

<sup>189</sup> Ibid, p. 4.

<sup>190</sup> Ibid, p. 4.

report he quoted Michael Prideaux, a BAT executive, who briefed the board in 2000 about participation in corporate social responsibility assessment in the following manner:

The process will not only help BAT achieve a position of recognised responsibility but also provide ‘air cover’ from criticism while improvements are made. Essentially it provides a degree of publicly endorsed amnesty.<sup>191</sup>

Longstaff is looking for recognition of corporate responsibility beyond legal compliance as the route to social responsibility. In the case of BAT this can only mean a complete change of business away from supplying tobacco products, unless some means could be found to render them harmless. No tobacco companies have even claimed to be close to this. Prideaux’ board briefing, while admittedly only a part of the briefing text, is cynical. The clear indication is that any recognition in the CSR field provides relief from criticism and, in Longstaff’s words, the continuing ability to prosper from the preventable deaths of millions.

In short, this is a poor defence of the CRI to give a reliable indication of corporate social responsibility. It may be accurate to congratulate BAT on its governance, strategy, and even environmental impact, but it is impossible to reconcile a gold star in the “Performance and Impact, Social”<sup>192</sup> category.

In the context of my thesis, this example provides evidence supporting two assertions: that the assessment criteria are a significant factor in determining rating results; and that criteria derive from a set of underlying principles, or ethical theories. Longstaff promotes the necessity of challenging the claim that legal compliance is the only obligation for companies - the Friedman doctrine. What Longstaff fails to enunciate is the principles that would support the promotion and sale of an inevitably hazardous and addictive product while meeting social responsibilities. This seems to indicate a very significant incongruity.

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<sup>191</sup> Longstaff, S. (2005). 2005 Corporate Responsibility Index: Trustee's Report *Living Ethics* (64), p. 4.

<sup>192</sup> CRI, 2005 Australian Corporate Responsibility Index Results, 15 May 2006, [www.corporate-responsibility.com.au](http://www.corporate-responsibility.com.au).



### ***Legal Products and Ethics***

It seems anomalous that only one of the considered rating agencies explicitly examines the assessed companies products and services for social impact when there is such detailed and specific examination of governance, code compliance and treatment of employees by all the other rating agencies. Unless there is some spectacularly dysfunctional behaviour in those latter categories, products must have the greatest effect on communities - after all, the company was established to perform the function of manufacturing, dealing in or selling that product.

This lack of product analysis points to a strong, implicit inclination to Friedmanism and the principle that a business is entitled to make and sell any product or service that is legal in its community, with consideration of any social impact - good or bad - outside the brief of its corporate managers and directors. The PBV, as conceived, would generally support the right of a company to follow whatever legal business it wished, and there is little anecdotal evidence of business leaders outside committed CSR companies expressing doubts as to whether some products and services should be constrained or terminated for reasons of negative social impact. An argument put forward in defence of continuing to sell harmful products is that consumers are well informed and should have the freedom to exercise that choice regardless of outcome. This is a potential, and important, PBV argument but not a Friedmanite defence. The Friedmanite view is simply that the company has no direct concern as to how the products are used and any resulting impact, so that the defence is not required.

Proponents of the Social Contract and the Common Good would certainly consider that companies should not produce and sell harmful products - the contractual view being that the company is licensed to operate, with special privileges, in the community and should be respectful of the communities needs in return, even if not formally legislated. There is also an issue of informed choice regarding the consequences of product use. Community members who are not able to evaluate the consequences of using certain products should have some degree of protection from potential harm. This means that companies have an

obligation to inform their users of negative consequences of using their products as well as benefits. If, as might be the case in less educated or literate communities, individuals have limited ability to understand these consequences, then arguably companies should not expose people to this risk of potential and unanticipated injury. The Common Good is clearly not served if individuals or groups of users of a particular product suffer harm.

The virtuous company would be concerned if harm occurs due to its activities but would also take into account the freedom of choice argument. Here a balance would have to be struck between allowing this choice and the potential harm. This might, for example in the case of manufacturers of alcoholic drinks, consist of a genuine and rigorous information campaign aimed at promoting responsible use of their drinks and perhaps some form of rehabilitation assistance for those individuals who have failed to achieve the golden mean in consumption.

## **Chapter 6:**

### **Conclusion**

#### ***Thesis***

This study is primarily to determine whether there are identifiable links between the criteria used by rating agencies in assessment of organisations' corporate social responsibility performance and definable ethical theory. A secondary proposition is that the difference in assessments between rating agencies for similar organisations may be due to criteria being derived from different ethical bases.

From the analysis of corporate management criteria used by major rating agencies, and the controversial business issues rated by one particular agency, I have been able to show that there are links between many criteria and ethical theory. There is significant variation in the ethical basis of criteria both within each agency's criteria and between agencies. This variation supports my secondary proposition.

My conclusions are:

- ❖ topics used in CSR assessment are common to all agencies but emphasis on certain topics varies
- ❖ there is a definable link between rating agencies' assessment criteria for CSR and ethical theory
- ❖ different agencies use criteria that are implicitly derived from different theories of ethics
- ❖ the agencies examined range from having relatively few attributable ethical links (BitC) to a significant proportion of criteria being attributable (KLD)
- ❖ the Friedman doctrine of business responsibility being solely to make profit within the law is a prevalent underlying basis of principle for some agencies
- ❖ The Common Good and Social Contract theories, as defined, are demonstrably more frequently used as a basis for setting criteria than Virtue or the Pragmatic Business View

- ❖ the resulting variation between ratings of similar organisations could be largely resolved by an explicit statement of the ethical basis of assessment and hence derivation of criteria
- ❖ the large investment (trillions of \$US) in ethical funds that is influenced by CSR ratings should motivate agencies to establish a more coherent underlying basis of evaluation

### ***Conclusions from Link Data***

Linking particular criteria from each rating agency is necessarily subjective; however there are clear differences between agencies from which conclusions may be drawn. While I have indicated either a strong or weak link to the theories I have not used this discrimination as a weighting factor, as I do not think that there are sufficient grounds for making this a quantitative measure.

BitC and FTSE4Good have a total of 6 and 8 links attributed respectively, while DJSI and RepuTex each have 9, and KLD 11 links. My initial conclusion from this grouping is that the criteria used by those agencies with fewer links are more general, or simply that their criteria do not have a distinct basis in one of the ethical theories. Agencies with a greater number of attributable links have more specific criteria that can be aligned with one or more of the sets of principles. From the narrative in Chapters 4 and 5 it is clear that KLD has such criteria and my descriptions and links to theories have consistently found more to say about KLD than the other agencies. Intuitively, DJSI appeared more likely to be in the general criteria group from the narrative section, but a more objective count of links shows it to be closer to the specific criteria set. Conversely RepuTex appeared to have specific and detailed criteria but the eventual number of links matched DJSI's. BitC and FTSE4Good appeared to be more general, with BitC's six attributable links being consistent with their non-specific descriptions and tendency to compliance.

The next discrimination concerns the balance of links across the theories. Again there is a clear difference in the results between rating agencies. DJSI, FTSE4Good and BitC have a weighting towards the Pragmatic Business View.

This is unsurprising as DJSI and FTSE4Good have evolved from traditional investment oriented organisations and BitC represents mainly conservative business interests. I have been critical in developing my proposition for the characteristics of *The Pragmatic Business View* described in Chapter 3 in that I believe the PBV represents an underlying Friedmanite principle, mitigated to a greater or lesser degree by the requirement to show community concern, rather than applying any coherent ethical principles. I still think that this is a reasonable criticism of these three agencies although I would not equate their efforts at promoting some degree of CSR with Henderson’s and *The Economist’s* strongly stated antipathy to the concept.

<i>Ethical theory</i>	<b>Corporate management criteria links</b>	<b>Controversial business issue links</b>	<i>Total</i>
<i>PBV</i>	12	-	<b>12</b>
<i>Social Contract</i>	14	1	<b>15</b>
<i>Virtue</i>	7	-	<b>7</b>
<i>Common Good</i>	10	3	<b>13</b>
<b>Total links</b>	<b>43</b>	<b>4</b>	<b>47</b>

*Figure 2: Links between Criteria and Theory*

The above table shows the number of links attributed between criteria and each theory. That 47 criteria showed sufficient characteristics to be linked with one of the theories (excluding Friedman) suggests that this exercise justifies the analysis. Dyck and Kleysen’s process, noted in *Methodology*, appears to be workable in this scenario.

The Social Contract received most links from the corporate management criteria. The current thinking behind applying contractualism to CSR is illustrated by a submission made by the Consumers’ Federation of Australia to a Parliamentary Joint Committee on Corporations and Financial Services in 2005. This submission succinctly sets out a case for corporate social responsibility based on

the social contract. The Federation's focus is "primarily on advancing the interests of disadvantaged and vulnerable consumers."<sup>193</sup> The paper reminds the Joint Committee of the relatively recent history of joint stock companies and of their charter which was granted for the public good. In particular, "It is the community ultimately that gives organisations a 'licence to operate'. In return for this community confidence, organisations need to act to benefit the community."<sup>194</sup> This is consistent with the discussion in Chapter 3 of the *Social Contract* model. The paper emphasises that, "The general principle however is that all organisations owe a social responsibility to their communities in which they operate." The paper mentions the ratings provided by Reputex and considers that such ratings "are increasingly driving a greater acceptance of SR [social responsibility]."

Clearly the Social Contract is an acceptable and understandable model on which to base the requirement for companies to exercise social responsibility, so that my findings of a weighting towards that theory are not surprising in the context of this paper.

Another article concerning Reputex illustrates that the Friedman doctrine is still extant. Gary Johns wrote a piece in the Australian Financial Review in 2003 disparaging the newly formed Reputex's Good Reputation Index. The explicit concern of the article is that companies that choose not to respond to Reputex questions, either in part or completely, appear to be marked negatively. The underlying message is that the concept of measuring reputation in this manner is "an instrument for advancing a number of political agendas: corporate social responsibility, stakeholder capitalism, and sustainability."<sup>195</sup> Friedman's principles are reflected in Johns' summary lead-in from disclosure and reporting:

Governments will establish rules from time to time that will apply to all corporations which will include requirements to disclose certain information. Beyond those requirements,

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<sup>193</sup> Consumers' Federation of Australia. (2005). *Submission on the Inquiry into Corporate Responsibility*. Melbourne, p. 1.

<sup>194</sup> *Ibid*, p. 1.

<sup>195</sup> Johns, G. (2003). Survey Pushes Overt Agendas: The Good Reputation Index. *Australian Financial Review*, p. 1.

and the many that arise from contractual obligations and in the course of building relations with any groups a corporation chooses, there is little point to the social responsibility-as-reputation measurement exercise.<sup>196</sup>

In other words corporations' responsibilities are defined by law and, other than compliance with the law, organisations are free to choose their relationships and have no further social or community obligations.

### **Overall Conclusion**

None of the rating agencies' criteria are linked exclusively to one of the sets of principles put forward as potential underlying theories on which CSR criteria could be based. The Social Contract has most links across the agencies' corporate governance criteria. Adding in the controversial business issues criteria brings the Common Good within two instances of links to the Social Contract. Looking at each agency, RepuTex has over half of its links identified in the Social Contract column, while the next biggest proportion is found in DJSI with PBV links. The other agencies have a spread of linked theories although there are discernable leanings. It should be acknowledged, however, that this study is small in a quantitative sense, and it would be inappropriate to draw further conclusions based on the statistical sample.

The conclusion that can be drawn from these differences is that no agency appears to have taken a single underlying theory of ethics (or more broadly, a set of principles) as the basis for defining its criteria in all categories. Further, the weighting towards, for example, Pragmatic Business View by DJSI and the Social Contract by RepuTex suggests that there is an underlying difference in the basis of derivation of criteria across agencies, but all except the two mentioned have a less definable weighting to any of the theories.

A characteristic of the published criteria is a lack of justification as to why particular criteria are even considered to be relevant to CSR rating. I have

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<sup>196</sup> Johns, G. (2003). Survey Pushes Overt Agendas: The Good Reputation Index. *Australian Financial Review*, p. 2.

attempted throughout the commentary on criteria to infer the reason that criteria have been selected from an ethical point of view. There are no examples within the published criteria reviewed for this study of any justification or relation of the criteria to such theories. This suggests that the reasons for including certain topics, for example executive remuneration or nuclear power, are so self-evident that no justification is required or, alternatively, that the criteria are based on perceived public opinion that would tend to indicate an intuitive and non-analytical basis. As the clients of rating agencies are investment managers, corporate public affairs executives and the general public, this may be a pragmatically acceptable approach.

It certainly sounds reasonable to be wary of nuclear power generation and coal mining companies with the current high profile of global warming and potential terrorist activities, as it would be reasonable to include gambling and arms production to encompass more traditional moral views. Finding that the Social Contract, followed by the Common Good, leads the basis of defining criteria, we might assume that the general public's moral view of business is weighted towards contractualism. The Consumers' Federation paper certainly supports this principle. Similarly, that the DJSI criteria are weighted towards the PBV might indicate that the rating agency evolved most directly from the investment business is still strongly influenced by the softened Friedman principles that I have labelled the Pragmatic Business View.

From a practical, business point of view it would aid interpretation and use of the ratings if agencies were to clearly state the basis on which their criteria were established. Socially responsible investment just in the United States is reported by the Social Investment Forum<sup>197</sup> as US\$2.29 trillion. Much of this investment is based either directly or indirectly on ratings of the agencies whose criteria and assessments have been examined in this paper. The large variation in results of ratings suggests that very large investment decisions are being made by fund managers and others in the financial sector based on inconsistent evaluations. If each rating agency were to clearly state its basis of establishing criteria, then the

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<sup>197</sup> <http://www.socialinvest.org/resources/sriguide/srifacts.cfm>.



resulting rating would be understandable in the context of its underlying principles. Variation in ratings between agencies would thus be comprehensible as measuring different requirements or, if based on the same principles, reveal errors or misinterpretations of data which can be resolved.

If each agency considered and published its basis of establishing criteria we may find that certain categories of CSR criteria were best evaluated by, for example, relating criteria to the Common Good or Virtue ethics, while other categories might be more acceptably related to the Social Contract. Variation between principle bases within one agency's assessment criteria is not inherently irrational as long as that basis is published and some justification set out. The essential requirement to meet both a practical business outcome and to satisfy consistency from an ethical stance is that the underlying ethical basis is considered, justified and clearly stated so that use of the rating data is fully informed.

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References in the text to Internet sources were included in the period from April 2007 to December 2007. The home websites of rating organisations are unlikely to change but specific web pages may have moved, been updated or superseded.

## Appendix A - The Selected Rating Agencies

Figure 3: Rating Agency Table

<i>Agency</i>	<i>Domicile and range</i>	<i>Mission</i>	<i>Criteria</i>
<i>Dow Jones Sustainability Indexes</i>	Switzerland (Zurich) with global range.	“Dow Jones Sustainability Indexes are the first global indexes tracking the financial performance of the leading sustainability-driven companies worldwide. Based on the cooperation of Dow Jones Indexes, STOXX Limited and SAM they provide asset managers with reliable and objective benchmarks to manage sustainability portfolios.”	Weighted criteria categorised by Economic, Environment and Social.

<i>Agency</i>	<i>Domicile and range</i>	<i>Mission</i>	<i>Criteria</i>
<b><i>FTSE4Good Index</i></b>	United Kingdom domicile with global offices	<p>“1. To provide a tool for responsible investors to identify and invest in companies that meet globally recognised corporate responsibility standards.</p> <p>2. To provide asset managers with a socially responsible investment (SRI) benchmark and a tool for socially responsible investment products.</p> <p>3. To contribute to the development of responsible business practice around the world.”</p>	Criteria based on: Environmental, Social and Stakeholder, Human Rights, Supply Chain Labour Standards, and Countering Bribery categories.
<b><i>KLD Indexes</i></b>	USA (Boston) with ratings for trans-national and global corporations.	“KLD Indexes construct indexes for investors who integrate environmental, social and governance factors into their investment decisions. KLD’s indexes are designed to be transparent, representative and investable.”	Indicators categorised by Community, Corporate Governance, Diversity, Employee Relations, Environment, Human Rights, and Product. Additional criteria around Controversial Business Issues such as adult entertainment, weapons and tobacco.

<i>Agency</i>	<i>Domicile and range</i>	<i>Mission</i>	<i>Criteria</i>
<b><i>Business in the Community (BitC)- Corporate Responsibility Index</i></b>	United Kingdom (nationally) working with UK companies, including multi-nationals.	“Our purpose is to inspire, challenge, engage and support business in continually improving its positive impact on society.”	‘Core’ indicators including Marketplace, Environment, Workplace and Community with ‘Specific’ indicators under the same headings.
<i>Corporate Responsibility Index - licensed from BitC</i>	Australia. Managed by the St James Ethics Centre and governed by a board of Trustees.	“The CRI is a strategic management tool to enhance the capacity of businesses to develop, measure and communicate best practice in the field of corporate social responsibility.”	As for the UK index.
<b><i>RepuTex Ratings and Research Services</i></b>	Australia (Melbourne). Ratings for top 100 Australian and top 20 New Zealand companies, with expansion into China.	“Our goal is to create a commercially viable public rating system for social responsibility to augment universally accepted credit rating models.”	Indicators include Corporate Governance, Workplace Practices, Social Impact and Environmental Impact.

All text in quotation marks is from documents published on websites as at April 2007.

## Appendix B - Table of Criteria

Figure 4: Table of Criteria

<i>High-level criteria</i>	<i>DJSI</i>	<i>FTSE4Good</i>	<i>KLD</i>	<i>BitC (CRI)</i>	<i>RepuTex</i>
<b>Governance</b>					
<i>Executive remuneration</i>	<ul style="list-style-type: none"> <li>• list remuneration of directors &amp; senior management</li> </ul>		<ul style="list-style-type: none"> <li>• low levels of remuneration for top management</li> </ul>		
<i>Clarity of responsibility and accountability</i>	<ul style="list-style-type: none"> <li>• structure and reporting of board &amp; senior management groups</li> <li>• corporate policies and documentation</li> </ul>		<ul style="list-style-type: none"> <li>• political accountability</li> <li>• transparency in reporting &amp; communication</li> </ul>		<ul style="list-style-type: none"> <li>• publicly documented and transparent structure</li> <li>• integration of CSR as a core component</li> </ul>
<i>Risk management</i>	<ul style="list-style-type: none"> <li>• financial and corporate governance risks</li> <li>• crisis management</li> </ul>				<ul style="list-style-type: none"> <li>• risk management systems protecting financial stakeholders and the wider community</li> </ul>
<i>Countering Bribery</i>		<ul style="list-style-type: none"> <li>• compliance with international codes and indicators</li> </ul>			



<i>High-level criteria</i>	<i>DJSI</i>	<i>FTSE4Good</i>	<i>KLD</i>	<i>BitC (CRI)</i>	<i>RepuTex</i>
<b>Community</b>					
<i>Philanthropy</i>	<ul style="list-style-type: none"> <li>• community contributions related to social outcomes</li> </ul>	<ul style="list-style-type: none"> <li>• quantified donations in kind and financially</li> <li>• management responsibility at a senior level</li> </ul>	<ul style="list-style-type: none"> <li>• charitable donations</li> <li>• innovative giving</li> </ul>	<ul style="list-style-type: none"> <li>• percentage of profit donated</li> <li>• impact of community programmes and perception</li> </ul>	<ul style="list-style-type: none"> <li>• strategies to give direction to philanthropy</li> <li>• measurement of socioeconomic need in the community</li> </ul>
<b>Employees &amp; Labour</b>					
<i>Labour practice</i>	<ul style="list-style-type: none"> <li>• compliance with international codes and standards</li> <li>• qualitative measures of employment benefits</li> </ul>	<ul style="list-style-type: none"> <li>• evidence of systems, policies and reporting</li> <li>• qualitative measures of employment benefits</li> </ul>	<ul style="list-style-type: none"> <li>• health and safety</li> <li>• fairness in employee relations</li> <li>• concerns for lay-offs and health issues</li> </ul>	<ul style="list-style-type: none"> <li>• quantitative measures of employment indicators</li> <li>• general employment practice concerns</li> </ul>	<ul style="list-style-type: none"> <li>• employment development and training</li> <li>• organisation culture and diversity</li> </ul>
<i>Human rights</i>	<ul style="list-style-type: none"> <li>• endorsement of international codes</li> </ul>	<ul style="list-style-type: none"> <li>• endorsement of international codes</li> </ul>	<ul style="list-style-type: none"> <li>• transparency on overseas sourcing</li> <li>• industry leadership on human rights issues</li> </ul>	<ul style="list-style-type: none"> <li>• perception of human rights concerns by the local community</li> </ul>	<ul style="list-style-type: none"> <li>• internationally accepted standards</li> <li>• policies, procedures and responsibility for human rights issues</li> </ul>
<i>Diversity</i>	<ul style="list-style-type: none"> <li>• compliance with international convention</li> <li>• breakdown of employees by gender, culture and minorities</li> </ul>	<ul style="list-style-type: none"> <li>• published policy and commitment</li> <li>• metrics of women in management</li> <li>• flexible working arrangements</li> </ul>	<ul style="list-style-type: none"> <li>• woman or minority person as CEO</li> <li>• innovative hiring programmes</li> <li>• gay and lesbian policies</li> </ul>	<ul style="list-style-type: none"> <li>• workforce profile by gender and race</li> <li>• employee ratios of minorities</li> </ul>	<ul style="list-style-type: none"> <li>• organisation culture and diversity</li> <li>• diversity statistics and strategies</li> </ul>

<i>High-level criteria</i>	<i>DJSI</i>	<i>FTSE4Good</i>	<i>KLD</i>	<i>BitC (CRI)</i>	<i>RepuTex</i>
<b>Environment</b>					
<i>Environment</i>	<ul style="list-style-type: none"> <li>• environmental reporting and performance</li> <li>• specific industry criteria</li> <li>• emissions, waste and energy</li> </ul>	<ul style="list-style-type: none"> <li>• industry categories</li> <li>• corporate policies and moves towards sustainability</li> <li>• responsibilities and auditing</li> </ul>	<ul style="list-style-type: none"> <li>• beneficial products and services</li> <li>• environmental impact</li> <li>• legal claims and controversies</li> </ul>	<ul style="list-style-type: none"> <li>• energy, waste and emission details</li> <li>• recycling</li> <li>• prosecutions for environmental offences</li> </ul>	<ul style="list-style-type: none"> <li>• publicly available policy</li> <li>• ecologically sustainable development</li> <li>• compliance with voluntary codes</li> </ul>
<b>Product</b>					
<i>Product related criteria</i>			<ul style="list-style-type: none"> <li>• research and development of innovative products</li> <li>• products provide notable social benefits</li> </ul>		<ul style="list-style-type: none"> <li>• product stewardship and lifecycle</li> <li>• human health and economic impact of products</li> </ul>
<b>Controversial Business Issues</b>					
<i>Controversial business issues</i>			<ul style="list-style-type: none"> <li>• list of industry types regarded as controversial with criteria by sector</li> </ul>		

## Appendix C - Criteria and Theory Reference Table

Figure 5: Reference Table

The categories examined in the following table represent the common high-level criteria determined in examination of the five rating agencies' published assessment criteria.

<i>Criteria</i>	<i>Friedman/compliance</i>	<i>Pragmatic Business View</i>	<i>Social Contract</i>	<i>Virtue</i>	<i>Common Good</i>
<b><i>Governance</i></b>	Legal compliance and profit maximisation	No particular obligations other than legal compliance	No particular obligations other than legal compliance	Applying <i>eudaimonia</i> , <i>phronesis</i> and <i>sophia</i> . Prudence	Likely involvement of any directly interested part
<b><i>Community</i></b>	Legal compliance and profit maximisation	Acknowledgement of responsibility to community but activity should be at business' discretion	Obligation to community to act as an individual business owner would	Acting as a citizen	Wide view of stakeholders including all members of the community
<b><i>Employees and labour</i></b>	Legal compliance and profit maximisation	Practical relations through unions or directly with employees and observation of non-discrimination laws	Neo-paternalism; loyalty for service including families; non-discrimination particularly in relation to local community composition	Treating employees as citizens, with respect; non-discrimination; citizenship	Considering impact of decisions on the community

<i>Criteria</i>	<i>Friedman/compliance</i>	<i>Pragmatic Business View</i>	<i>Social Contract</i>	<i>Virtue</i>	<i>Common Good</i>
<i>Environment</i>	Legal compliance and profit maximisation	Legal requirements observed but additional efforts at business' discretion	Particular concern for the local environment	Proper concern for the environment	Long-term view including global issues affecting widest stakeholder group (everyone)
<i>Product</i>	Legal compliance and profit maximisation	Meets legal requirements	Meets legal requirements	Fitness for purpose	Impact on consumers and all members of the community

## **Appendix D - Agencies' Approach**

### *Differences in approach*

Within the corporate management criteria, agencies demonstrate a number of differences in the way in which information is gathered and the type of information sought. In the body of the thesis I have analysed the criteria as stated by each rating agency and related these, where there is a definable link, to one or more of the underlying theories set out in Chapter 3.

In the course of this analysis a number of other differences, not related directly to criteria, were noted and contribute to variation in the ratings for particular or similar companies between agencies. The following sections address these differences in approach and briefly note potential relationships to the theories. I have not included these aspects in the body of the thesis as I believe the agencies' approach, while related to the theories, also influences the expression of criteria which have been considered in detail.

### *Compliance*

The approach to compliance is a discriminator between the rating agencies. All agencies refer to the law, international standards and protocols, and other codes in some categories of CSR criteria to determine a rating of CSR performance. There is, however, a distinction between those agencies that seem to rely more on external codes and agreements and those that prefer to set their own standards.

Some of the standards and protocols used as indicators are ILO (International Labor Organization) Core Labour Standards, the UN Global Compact, OECD (Organisation for Economic Co-operation and Development) Guidelines and the United Nations Declaration of Human Rights, all in the context of human rights and employees and labour. FTSE4Good lists these as measures of compliance. In contrast, KLD does not mention any of these specific standards in its Employee Relations and Human Rights categories preferring to describe acceptable CSR performance in these categories in its own words. The only reference to compliance is in the Employee Relations category where a 'concern' is measured if, "The company has recently either paid substantial fines or civil penalties for

wilful violation of employee health and safety standards.”<sup>198</sup> RepuTex takes a similar approach to KLD in the area of human rights and employee practices, with the only external indicator being, “a clear support for promotion of internationally accepted human rights standards and norms.”<sup>199</sup>

DJSI through the SAM questionnaire uses a number of international standards as indicators although there are numerous questions and requirements aimed at determining how far the assessed company has implemented codes of conduct and policies in all categories evaluated for CSR rating. In the labour practice sections DJSI refers to compliance with ILO conventions numbers 87, 98, 100 and 111, the ILO Guide to Worker Displacement, and the ILO SafeWork practices when evaluating performance around diversity, remuneration equity, freedom of association, health and safety, and other labour practices. In the human rights category SAM asks questions about compliance with the UNDHR (Declaration of Human Rights), the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, and OECD Guidelines for Multinational Enterprises.

BitC takes a slightly different view while acknowledging the Global Reporting Initiative (GRI) and other standards of reporting it notes that “most companies will wish to select from the total universe of possible indicators rather than just rely on one source.”<sup>200</sup> No other protocols or standards are referenced by BitC in its published criteria.

Considering compliance, we can see a distinction between DJSI and FTSE4Good both of which quote international standards and protocols as part of their core evaluation criteria, and KLD and RepuTex that describe criteria, particularly around human rights, labour relations and reporting in their own terms.

BitC is interesting in that, while acknowledging reporting standards, the criteria suggest that companies can use whatever policies, standards or regimes they

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<sup>198</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006, p. 8.

<sup>199</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.

<sup>200</sup> BitC, Indicators that Count, 2006, p. 4.

choose as long as it is within a framework called ‘Winning with Integrity’ drawn up in 2000 by a “business led taskforce.”<sup>201</sup>

The advantage of using an externally defined standard as one of the rating criteria is that much detailed work and consultation has been applied to the derivation of the standard and there should be clarity in its intent and measures of compliance. The disadvantage seems to be that these standards have not been specifically created for the purpose of measuring a company’s CSR compliance, or even that part of CSR to which the standard could apply. The agencies that have expressed their criteria in their own terms have made a specific decision as to how CSR performance should be measured in each category rather than adopting a pre-set standard. Pragmatically, there is no indication that one approach is better, in the sense of more accurate, than the other; however, the variation may help us to infer the principles used by the rating agencies.

DJSI and FTSE4Good have both evolved from financial institutions concerned specifically with trading stock in limited liability companies. Their objective is to provide indexes to assist investment managers meet their clients’ preferences for selection of stocks in which to invest. Ethical funds are only one set of indexes maintained by these agencies. It seems unexceptional that there will have been an application of the principles used in financial matters to the criteria uses in these agencies’ evaluation criteria. Financial transaction are typically binary - right or wrong - and accurately measurable. Compliance with detailed conventions and protocols can be measured in this way more readily than meeting, for example, KLD and Reputex’s more descriptive and aspirational requirements. Fundamentally, this seems to be the application of financial techniques and methodologies, firmly established as rules, to the measurement of CSR performance, compared with an outcome-oriented set of ethical principles.

Relating this approach back to our five sets of principles or ethical bases, there is a strong inclination towards the Friedmanite approach in terms of process if not intent. Friedman painted a simple picture of business’ requirement to comply

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<sup>201</sup> BitC, Indicators that Count, 2006, p. 4.

with the law and nothing further in relation to social responsibility. By using external standards, this process is similar in that DJSI and FTSE4Good can rate their evaluated companies by compliance with these standards. This does not mean, however, that the standards themselves are based on Friedman's principles.

### *Process versus outcome*

Another difference discernable between rating agencies' criteria is related to the previous discussion on compliance. Those agencies relying on compliance with the law, international standards, protocols or any other external prescription for behaviour are making the assumption that such compliance will bring about a desirable outcome, analogous to rule-utilitarianism. Other agencies, as we have seen, have criteria that are less oriented to following policies or standards but are more specific about the outcomes to be achieved.

If we take labour relations and human rights as a general example of the categories in which DJSI and FTSE4Good have looked for compliance with international standards, we can contrast this approach with some of the other agencies' criteria. Under diversity, KLD specifies a metric for the board of directors so that, "women, minorities, and/or the disabled hold four seats or more on the board of directors, or one-third or more of board seats if the board numbers less than twelve."<sup>202</sup> For employment of the disabled the requirement is for evidence of "innovative hiring programs; other innovative human resource programs for the disabled." With gay and lesbian employees the requirement is for "notably progressive policies" and, "In particular it provides benefits to the domestic partners of its employees."<sup>203</sup> The outcomes specified here relate to actual numbers of minority (in the widest sense) board members; innovation rather than compliance; and practical support for all partners of employees whether gay, lesbian or heterosexual. The comparison here is to compliance with International Labor Organization conventions discussed above. The ILO conventions are certainly intended to have positive outcomes similar to those

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<sup>202</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006, p. 6.

<sup>203</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006, p. 8.



specified by KLD, but there is potential for organisations to comply but still fail to achieve the outcomes intended.

RepuTex was instanced in the *Compliance* section as having few, if any, criteria based on simple compliance with external standards and policies. As a further example in parallel with KLD's criteria, for human rights RepuTex seeks "evidence of the implementation of procedures and frameworks to prevent violations of those rights."<sup>204</sup> Under a social impact category, related in this paper to both human rights and diversity, RepuTex requires "the implementation of strategies to overcome discriminatory barriers relating to age, gender, disability, culturally and linguistically diverse communities, indigenous peoples..."<sup>205</sup> While the distinction between requiring compliance with a set of rules and these KLD and RepuTex criteria may seem subtle, the difference is between compliance and achievement. The wording of the latter criteria clearly seeks evidence of action rather than creation of policies within the company.

Under human rights, KLD is seeking evidence that, "The company has undertaken exceptional human rights initiatives" and in relation to indigenous populations, "has established relations with indigenous peoples near its proposed or current operations ... that respect sovereignty, land, culture, human rights, and intellectual property."<sup>206</sup> This compares with other agencies complying with, for example, the UNDHR. In a similar way to the ILO conventions, the UNDHR is an excellent set of principles but it is not difficult to imagine circumstances in which companies can reasonably claim compliance without actually achieving any of the specific outcomes mentioned on KLD criteria.

### *Emphasis*

An emphasis on certain criteria is demonstrated by the comprehensiveness of assessment questions and guidelines within the criteria for each agency. Many criteria within the corporate management group are similar across agencies in terms of the weighting given to particular topics. For example, philanthropy is

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<sup>204</sup> RepuTex, General Criteria and Indicators – International (Level 1), 2005.

<sup>205</sup> Ibid.

<sup>206</sup> KLD Research & Analytics, Inc., Social Ratings Criteria, 2006, p. 10.

given broadly similar emphasis by all of the included rating agencies, although there are other differences in requirements. In contrast, DJSI through its SAM questionnaire gives a great deal of emphasis to risk management. This earns a separate section. Bribery is another topic treated with varying emphasis. FTSE4Good has a specific item on bribery and links the likelihood of bribery, or perhaps the opportunity, to certain industry sectors such as mining and aerospace. Reputex treats environmental criteria in more detail than the other agencies, although it is a significant section for all the rating organisations. There are specific requirements not just in environmental measurement and performance but a broader requirement around stewardship of resources, sustainability and human impact. Further examples are apparent from the detail described in Chapter 4.

#### *Investment indexes or reputation*

In considering *Rating Agencies' Aims* in Chapter 2, it was clear that there were two groups: those creating and maintaining indexes for investment managers and others; and agencies providing a service, usually directly to companies, rating their CSR performance, compared with peer organisations. Having examined the categories in which CSR performance is assessed and having looked at significant criteria, we can determine whether there are any consistent differences in the criteria that align with each of these groups.

We noted under the *Compliance* section that DJSI and FTSE4Good both arose from the finance sector, and attributed this as a possible reason for their tendency to favour compliance measures over more descriptive or innovative requirements in some categories. If the criteria for these two agencies display such similarities, and both are concerned with provision of investment indexes, then there may be a link with this characteristic as well as with their origin. It is self-evident that agencies evolving from financial institutions are likely to be in the business of rating for investment indexes, and thus we should not conclude that similarity of criteria is due to the function rather than provenance.

In the reputational group, BitC certainly has few compliance requirements comparable to DJSI and FTSE4Good, but does use the 'Winning with Integrity'

concept and, as we noted, accepts any appropriate framework such as the GRI as an indicator of CSR performance is the relevant area.

Just comparing these two examples in each of the investment oriented and reputational groups, we could discern a distinction along group lines. The financial orientation of the DJSI and FTSE4Good indexes parallels criteria with many similarities.

KLD and RepuTex, however appear to be counter-examples to even this basic grouping. KLD is purely oriented to production of investment-directed indexes although, as for any of the agencies, it does provide consulting services for companies wishing to independently analyse and improve their performance or, at least, their ratings. RepuTex, at the start of my research in 2006 was purely a reputational rating agency. In 2007, however, its business expanded to offer investment indexes comparable with the business orientation of the other investment-oriented agencies.

KLD's criteria, as we have demonstrated in Chapter 4 and 5 possibly have least similarity to the other agencies, except RepuTex. In broad terms KLD's criteria are strongly outcome-oriented, require innovation and evidence of actual results, and do not depend on compliance with standards. The *Controversial Business Issues* category is unique among this set of agencies and, additionally, KLD considers the impact of the use of products and services rather than considering just corporate management issues. These characteristics are in contrast to DJSI and FTSE4Good.

RepuTex, in its reputational guise, is closer in its approach to KLD than any of the other agencies. Its criteria are comprehensive, require innovation and evidence of successful application, and have few references to standards and compliance. It is the only agency other than KLD to consider the company's products and services as part of its CSR evaluation. Significantly, having changed its business to provide investment indexes, RepuTex has not chosen to change its criteria or methodology. Since late 2006 the same criteria have been used to evaluate the

performance of companies for inclusion in indexes as were used for comparative reputational rating.

We have to conclude, therefore, that while there is a strong link for DJSI and FTSE4Good between their approach and criteria, and their background of arising from financial institutions, this is not necessarily related to the function of providing investment indexes. KLD is an index provider and has quite a different approach and strongly differentiated criteria.

We noted a weak similarity with BitC's approach, but Reputex's methodology and criteria are much closer to those of KLD than the reputational agencies. Finally, that Reputex could change its function from providing reputational ratings to compiling and maintaining investment indexes without altering its basic methodology and criteria, confirms that there is no strong link between criteria and the functional groups described here.