

A Contextual Review of CSR Policy and Law in the UK

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Introduction

Although it is vague and hard to define,¹ corporate social responsibility (“CSR”) is widely regarded as the business contribution to sustainable development.² It requires long-term commitment to the management of all the resources and activities of the firm so that it positively maximises its social, environmental and economic impact.³ Such ideas are not new,⁴ though their repackaging under CSR has been paralleled by a growth in their popularity and importance⁵ to the extent that they are now rooted in mainstream management literature.⁶ Moreover, growing anxiety over such issues as pollution, climate change,

¹ P. Frankental, “Corporate social responsibility – a PR invention?”, (2001) 6(1) *Corporate Communications: An International Journal*, 18; L. Moir, “What do we mean by corporate social responsibility?”, (2001) 1 *Corporate Governance: International Journal of Business in Society*, 16.

² Department of Trade and Industry, *Corporate Social Responsibility: A Government update* (DTI/Pub 7201/1k/05/04/NP May 2004); European Commission, *Promoting a European framework for corporate social responsibility* (Green Paper, Luxembourg: Office for Official Publications of the European Communities, July 2001); European Commission, *Corporate Social Responsibility: A business contribution to Sustainable Development*, (Brussels 347 final, July 2002).

³ CSR, “Corporate governance, corporate sustainability, corporate citizenship and triple bottom line are becoming synonymous with the emerging effort to define ‘ethical business’”(P Castka, C Bamber, D Bamber and J Sharp, “Integrating corporate social responsibility (CSR) into ISO management systems – in search of a feasible CSR management system framework” (2004) 16(3) *TQM Magazine*, 216).

⁴ M. Kilcullen and J. Kooistra, “At least do no harm: sources on the changing role of business ethics and corporate social responsibility,” (1999) 27(2) *Reference Services Review*, 158; S. Wartick and P. Cochran, “The evolution of the corporate social performance model,” (1985) 10(4) *Academy of Management Review*, 758; A. Carroll, “A three-dimensional model of corporate performance,” (1979) 20(4) *Academy of Management Review*, 497.

⁵ M. Göbbels and J. Jonker, “AA1000 and SA8000 compared: a systematic comparison of contemporary accountability standards,” (2003) 18(1) *Managerial Auditing Journal*, 54; European Commission, *Mapping Instruments for Corporate Social Responsibility* (Directorate-General for Employment and Social Affairs, Luxembourg: Office for Official Publications of the European Communities, April 2003); M. Hopkins, *The Planetary Bargain: Corporate Social Responsibility Comes of Age* (St Martins’ Press: New York, 1999).

⁶ Castka *et al* (n 3); J. Harrison and R. Freeman, “Stakeholders, social responsibility, and performance: empirical evidence and theoretical perspectives,” (1999) 42(5) *Academy of Management Journal*, 479.

globalisation, terrorism, poverty and corporate malpractice has resulted in CSR being catapulted onto policy-making agendas. The response from international and national policy-makers has tended to favour voluntary approaches.⁷

The emphasis on voluntarism implies action without regulation: an approach endorsed by European and national policy-makers.⁸ Yet there is mounting pressure for legal intervention. This is explored by examining the Company Law Review, the Operating and Financial Review (“OFR”) regulations and other attempts to enact primary and explicit CSR legislation in the United Kingdom (“UK”). Events suggest that the legal scope of CSR is likely to broaden in the future.

The European Union (“EU”) and UK policy framework

The EU made its first pledge on CSR at the Lisbon Summit in March 2000. Heads of State agreed there on a new strategic aim: to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion. The Commission⁹ has since highlighted the importance of CSR in achieving this aim.

In July 2001 the European Commission published a Green Paper on CSR.¹⁰ This was an important policy document outlining Europe’s objectives of raising awareness,¹¹ launching a CSR debate and developing a promotional framework. The Green Paper presented a widely publicised definition of CSR, describing it as a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis. This endorsement of voluntarism was not seen as a substitute to, or subjugation of, regulations on social rights or environmental standards.

⁷ There has been a growth in voluntary initiatives (e.g. ISO14001, EMAS, Responsible Care, SA8000, Investors in People, Global Reporting Initiative, Ethical Trading Initiative, AA1000, FTSE4Good, Dow Jones Sustainability Group Index).

⁸ Department of Trade and Industry (n 2); Department of Trade and Industry, *Business and Society: Developing corporate social responsibility in the UK* (March 2001); European Commission 2001 (n 2).

⁹ European Commission 2001 and 2002 (n 2).

¹⁰ European Commission 2001 (n 2).

¹¹ As part of its awareness-raising campaign the Commission released a compendium of Member State initiatives on CSR. See European Commission, *Corporate Social Responsibility: National public policies in the European Union* (Directorate-General for Employment and Social Affairs, Luxembourg: Office for Official Publications of the European Communities, January 2004).

Following extensive consultation the Commission published a Communication¹² that reaffirmed the Green Paper's definition and set out what it considered a consensus on three aspects of CSR. Firstly, it is behaviour over and above legal requirements and is voluntarily engaged in since it is in businesses' long-term interests. Secondly, it is intrinsically linked to sustainable development, entailing the integration of economic, social and environmental issues in business operations. Thirdly, it is not an optional add-on to core activities, since it has a fundamental effect on how businesses are run. When discussing the EU framework for CSR, the Commission outlined the following principles for action: (a) recognition of the voluntary nature of CSR, (b) the need for credibility and transparency of practices, (c) focus on activities where Community involvement adds value, (d) a balanced and all-encompassing approach, including economic, social and environmental issues as well as consumer interests, (e) attention to the needs and characteristics of SMEs and (f) support and compatibility with existing international agreements and instruments.

The Commission then described a strategy aimed at increasing knowledge of the positive impacts of CSR, exchanging experiences and good practice, promoting and developing management skills, fostering CSR among SMEs, facilitating convergence and transparency of practices, integrating CSR into Community policies and creating an EU Multi-Stakeholder Forum.

The EU Multi-Stakeholder Forum was established in October 2002.¹³ Its objective was to foster CSR and promote innovation, transparency and convergence of practices and instruments. This was to be achieved by improving knowledge about the relationship between CSR and sustainable development and by investigating the feasibility of common guiding principles for CSR practices and instruments. In its final report¹⁴ the Forum again restated the Green Paper definition, stressing that CSR is the voluntary integration of environmental and social considerations into business operations (over and above legal requirements and contractual obligations). More specifically, the Forum proclaimed that CSR: (a) requires the commitment of management, (b) is about core business activities, (c) is one of many ways of achieving economic, social

¹² European Commission 2002 (n 2).

¹³ European Commission, *EU Multi-Stakeholder Forum on Corporate Social Responsibility* (August 2003). See http://europa.eu.int/comm/enterprise/csr/index_forum.htm and also http://forum.europa.eu.int/irc/cmpl/csr_cu_multi_stakeholder_forum/info/data/en/csr%20ems%20forum.htm

¹⁴ EU Multi-Stakeholder Forum on CSR, *Final results and recommendations* (June 2004).

and environmental progress, and for integrating these concerns into business practices, (d) complements other ways of ensuring high environmental and social performance, (e) is an ongoing learning process, (f) must impact up and down the supply chain and (g) benefits are achieved when companies communicate their activities in a transparent and meaningful way. The Forum also proclaimed that practices are improved when there is stakeholder dialogue, and practices and tools are converging on a market-led basis; moreover, practices must take account of different contexts and challenges when companies are operating in developing countries and/or situations of weak governance.

Primary responsibility for establishing the economic, environmental and social framework conditions for sustainable growth and entrepreneurship was said to rest with governments and public authorities. It was recommended that public authorities establish an appropriate legal framework and suitable economic and social conditions so that companies wanting to go further with CSR would benefit in the market place.

Voluntarism indicates a lack of legislative activity on CSR. Impetus from the Lisbon Summit, however, resulted in the Accounts Modernisation Directive (2003/51/EC),¹⁵ which modifies the reporting requirements in directors' reports so that from 2005 certain companies will be required to report on non-financial matters. The Directive states that, to the extent necessary for an understanding of the company's development, performance and position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the business.¹⁶ Importantly, non-financial key performance indicators were now seen to include information on employee issues and the environment.

In the UK, the Government appointed the world's first Minister for CSR in March 2000. The Minister's early work focused on developing the business case, encouraging good practice, promoting CSR internationally and joining up action across Government. Three related All-Party Parliamentary Groups were established – on Corporate Governance, Corporate Social Responsibility and Socially Responsible Investment – with the Group on CSR being established to promote debate, improve understanding and encourage business interaction with wider society. In 2001 the Government published its first CSR report,¹⁷ stressing its

¹⁵ [2003] OJ L178/16. This amends earlier Directives: 78/660/EEC ([1978] OJ L 222/11); 83/349/EEC ([1983] OJ L193/1); 86/635/EEC ([1986] OJ L372/1); and 91/674/EEC ([1991] OJ L374/7).

¹⁶ Member States can exempt companies from this obligation.

¹⁷ Department of Trade and Industry (2001).

responsibility for promoting the business case and in providing leadership by helping to achieve consensus on vision and priorities for action. These developments reflect a policy perspective that clearly endorses the voluntary approach articulated at EU level. In May 2004 the Government released a CSR update in which the Minister said he remained convinced that the focus should be a voluntary one although the “policy framework must use the right mix of tools – including fiscal and regulatory measures where appropriate – to boost socially and environmentally responsible performance”.¹⁸ Compliance with legal requirements was, therefore, seen as the base that businesses should go beyond “in the interests of business and the rest of society”. The Government stresses the importance of working in partnership with the private sector, community bodies, unions, consumers and other stakeholders so that innovative approaches to the development and application of best practice (which are equated to the maintenance of minimum levels of performance in health and safety, equal opportunities and the environment) can be encouraged. It continues in a similar vein, emphasising the need for open and constructive dialogue and the creation of a policy framework that encourages and enables responsible behaviour by businesses.

In short, extant policy emphasises voluntary approaches to CSR. Yet policy-makers recognise that CSR does not operate outside existing or future legal frameworks. Moreover, if the intention is to encourage businesses to go beyond basic compliance, then it is incumbent on policy-makers to create an enabling legal environment within which CSR can flourish. The design of the legal framework, within which this strategy can operate, is clearly important and is outlined below.

Assessing the impact of existing regulatory regimes in the UK

Voluntarism reflects unease with legislation that requires company executives to assess and report on their CSR performance. This is underlined by a company-law framework offering legal protection for shareholders in preference to other stakeholders.¹⁹ The recent Company Law White Paper²⁰ stresses that the basic goal for directors is the company’s success in the collective best interests of its shareholders (in preference to employees, customers, suppliers, communities and the

¹⁸ Department of Trade and Industry (2004), 4.

¹⁹ See, Frankental, *op. cit.*

²⁰ Department of Trade and Industry, *Modernising Company Law* (Cm 5553-1 July 2002).

environment). Recent and unsuccessful attempts by Private Members to pass explicit CSR legislation also demonstrate the lack of support for more compulsory measures.

Yet, the policy emphasis on voluntarism does not imply unbridled self-governance because there is a broad set of legal frameworks that coerce firms into tackling their wider impacts and internalise their externalities. Current frameworks, therefore, provide an important backdrop for many aspects of a firm's internal and external stakeholder relationships. Human rights law, for instance, is already an integral part of CSR.²¹ Other measures providing basic rights, that can affect corporate behaviour, include environmental protection, sex, race, religious and disability discrimination, consumer product satisfaction and safety, protection of visitors, and employee health and safety; the EU has made a significant contribution to many of these. An example of a measure that is more clearly aligned to CSR is the July 2000 amendments to the Pensions Act of 1995, requiring trustees of occupational pension schemes to make public their policies on social, environmental and ethical issues when making investments.²² Approaches like this, however, are still industry-specific and notable in their rarity.

While current legal frameworks affect many aspects of a firm's activities and can impact on stakeholder relationships, they can be individually and collectively criticised for failing to go far enough in protecting and engaging stakeholders. In addition to the claim that they are fragmented, issue-specific, piecemeal and reactive, there is the concern that they affect stakeholder relations without necessarily encouraging genuine engagement or dialogue. This is because firms do not have to consider their wider impacts in a tactical, holistic or integrated way, or develop management systems that incorporate CSR principles into strategic and operational decision-making. Nor do they have to report accurately their impacts to external stakeholders such as business partners, customers, suppliers, shareholders, investors and consumers. As Sternberg²³ has argued, senior managers are only obliged to run the

²¹ D. Kinley, "Lawyers, Corporations and International Human Rights Law," (2004) 25(10) *Company Lawyer*, 298.

²² These measures are the subject of some criticism. See, D. Coles and D. Green, *Do UK Pension Funds Invest Responsibly? A Survey of current practice on Socially Responsible Investment* (July 2002), <http://www.justpensions.org>.

²³ E. Sternberg, *Corporate Governance: Accountability in the Marketplace* (London: Institute of Economic Affairs 2004).

company in accordance with the corporate objectives set by their shareholders.

Regulation versus Voluntarism

One of the key debates concerns the effectiveness and efficiency of regulation. Selecting the correct regulatory framework and assessing how good it is at achieving those framework goals, are essential. For example, one of the problems of an approach, based on a collection of fragmented regulations with minimum standards, is deciding what the minimum regulatory requirements should be and what should be left to corporate discretion. This raises questions. Should regulatory standards be tightened? Will too much regulation stifle innovation or good will? Can businesses be trusted to act in society's interests? What are those interests and who determines what they are? As Milton Friedman²⁴ pointed out: "If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is?"

Given these difficulties, it is hardly surprising that views differ on the extent to which CSR can, and should, be regulated. So, when the Commission invited comments on its Green Paper, more than 250 responses were received from various bodies.²⁵ Businesses favoured voluntarism, arguing that one-size-fits-all solutions were inappropriate and that regulation would be counterproductive. Equally predictable, trade unions and civil society organisations said that voluntary initiatives would not protect workers' and citizens' rights, arguing that it was essential that there was a regulatory framework that established minimum standards and ensured a level playing-field.

Voluntarism is frequently predicated on the 'business case' argument that shareholders benefit from CSR since it makes a company more appealing to employees, suppliers, customers, communities and socially responsible investors.²⁶ Business benefits are said to include reduced costs through eco-efficiency programmes, avoidance and minimisation of risk, increased competitiveness, improved stakeholder relationships, enhanced corporate brand/reputation, greater capacity for innovation, attraction and retention of high quality staff and access to

²⁴ M. Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), 133.

²⁵ European Commission (2002).

²⁶ R. Cowe, "Behave responsibly, by order of the law," (2003) 132 *New Statesman*, 26.

ethical investor funds.²⁷ It is even argued that these regulation-liability issues and the ongoing pressure of consumers, governments and society create a licence to operate.²⁸

Another argument is that regulations fail to provide the sovereignty and incentives for an efficient response, given the plurality of environmental, political, cultural, geographical, social and economic contexts facing businesses. A firm trading in a local community will face different pressures from one that trades with many nations. The size of a firm, regardless of its trading boundaries, can also affect CSR practice.²⁹ SMEs can be subject to a number of distinctive and intrinsic characteristics that set them apart from larger firms, thus affecting the content, nature and extent of CSR activities.³⁰ The final report of the EU Multi-stakeholder Forum³¹ suggests that the issues, approaches and tools most relevant for different sizes of SMEs may vary, while the DTI³² insists that “the approach, challenges and opportunities would be very different as between a small software company operating exclusively in the UK and a multinational mining company”.

There is also a fear that regulation would be counterproductive. The International Organisation of Employers³³ warned that “to regulate or standardize such an inherently dynamic process of voluntary action would stifle this very fundamental characteristic”. Similarly, David Varney, former Chairman of Business in the Community, says that we must motivate, not legislate, stressing that “compulsory corporate responsibility runs the risk, as with many regulatory outputs, of enforcing the lowest common denominator rather than promoting the best possible practice”.³⁴ He argues that legislation would make CSR “a pedestrian issue of legal compliance, rather than a dynamic matter of business sustainability”. Also,

²⁷ Department of Trade and Industry (2004); Business in the Community, *The Business Case for Corporate Responsibility* (December 2003).

²⁸ EU Multi-Stakeholder Forum on CSR (n 14).

²⁹ EU Multi-Stakeholder Forum on CSR (n 14); Department of Trade and Industry (n 2); European Commission, *European SMEs and social and environmental responsibility* (Observatory of European SMEs No.4 2002).

³⁰ European Commission (n 29).

³¹ EU Multi-Stakeholder Forum on CSR (n 14).

³² Department of Trade and Industry (n 2), 7.

³³ International Organization of Employers, *Corporate Social Responsibility: An IOE Approach* (Geneva: March 2003) – Introduction: The role of business in a changing society.

³⁴ See <http://www.bite.org.uk/>.

Mary Francis, Director General of the Association of British Insurers, suggests that it would be counterproductive to adopt a “bossy-boots mindset”, determined to make companies behave in ways we decide are good for them. To her, “we are not qualified to set absolute standards, for emissions for example, or to define how many cigarettes it is ethical for supermarkets to sell”.³⁵ A basis for her argument is that regulated CSR would eliminate the right of companies to differentiate themselves by competing to be more responsible; responsibility, she says, implies an element of free-will.

Alternatively, if CSR is good for business³⁶ and voluntary reporting is the preferred approach, then why do so few companies report on their wider impacts? In 2000 the Prime Minister challenged the top 350 FTSE companies to report on CSR by the end of 2001. There was a disappointing response suggesting that, despite the rhetoric, the ‘business case’ is an invention. Doane³⁷ says that there are two core problems with the ‘business case’ argument. Firstly, market mechanisms rely on informed consumers, yet “the perfectly informed ‘ethical consumer’ is non-existent”. Secondly, “the incentives for business are simply insufficient”. Doane argues passionately:

Delivering on the broader sustainability agenda through voluntary means seems a naïve ideal at best and a manipulated half-truth at worst, proffered only by those who want to avoid so-called ‘red-tape’ where it is in their best interest.

Similarly, Henderson³⁸ points to the continuing scepticism that CSR provides financial benefits. This is reinforced by Kluth,³⁹ who says that, for a “business to commit money on an indefinite basis to activities that

³⁵ See <http://www.mallenbaker.net/csr> .

³⁶ For arguments that CSR is good for business performance, see D. Grayson and A. Hodges, *Corporate Social Opportunity! Seven Steps to Make Corporate Social Responsibility Work for Your Business* (Greenleaf Publishing 2004); Department of Trade and Industry (n 2); Business in the Community (n 27); European Commission 2001 (n 2); T. Swift and S. Zadek, *Corporate Responsibility and the Competitive Advantage of Nations* (The Copenhagen Centre & Accountability,2002); World Business Council for Sustainable Development, *Corporate Social Responsibility: making good business sense* (January 2000).

³⁷ D. Doane, *Market failure: the case for mandatory social and environmental reporting* (New Economics Foundation, March 2002), 1-2.

³⁸ D. Henderson, *Misguided Virtue: False Notions of Corporate Social Responsibility* (London: Institute of Economic Affairs, 2001).

³⁹ A. Kluth, “Why should corporate responsibility be altruistic?”, *Ethical Corporation Online* (May 2004), <http://www.ethicalcorp.com>

may have no material relationship to business operations, at best, is questionable and, at worst, destroys shareholder value". Kluth argues that altruism fails because it cannot guarantee a commitment to CSR through good and bad times. Firms are more likely to embrace CSR when profits are up – when they can afford the luxury of investing in responsible initiatives – or when their reputation has been tarnished by poor publicity!

There is also a concern that voluntary approaches could lead to differences between what firms say they do and what they actually do in practice. Research undertaken by Adams⁴⁰ led to the conclusion that company reports on ethical, social and environmental issues do not demonstrate accountability to key stakeholder groups. Likewise, Green⁴¹ says that many FTSE 350 companies still do not produce regular social and environmental reports and, furthermore, there are no consistent standards amongst those that do:

This can make it difficult to distinguish substance from gloss, and means that companies taking corporate responsibility seriously must compete with the ‘free-riders’ in their industry who do not.

Similarly, Andy King MP points out that *even* companies recognise that, for CSR to be effective, there must be a common set of enforceable rules (a ‘level playing field’). He argues that the Government must play a key role, because:

As long as social and environmental reporting remains voluntary, I believe that only good companies will improve while those less responsible will continue to escape the scrutiny they deserve, even taking advantage of the lack of regulation to exploit stakeholders.⁴²

⁴⁰ C. Adams, “The ethical, social and environmental reporting-performing portrayal gap,” (2004) 17(5) *Accounting, Auditing and Accountability Journal*, 731.

⁴¹ S. Green, “Time to clean up business and inject real substance into corporate social responsibility,” (2004) *The Barrister*, Issue 20 (<http://www.barristermagazine.com/>).

⁴² See <http://www.epolitix.com> .

An example of how a company can appear to be applying CSR principles has been poignantly outlined by Waddock.⁴³ The company was:

... one of six companies recently profiled in a report on corporate involvement in economic development by the Boston College Centre for Corporate Citizenship for its innovative programs to help minorities and women. This company won six environmental awards in 2000, has widely recognized human rights, environmental, anti-corruption and anti-bribery, and climate change policies. Recognition of its performance, both financially and as a corporate citizenship came in multiple business publications... To solidify its corporate citizenship in the public's eyes, it issued a triple bottom line report covering not only its economic but also its social and environmental performance. The only problem? You guessed it. The company is Enron.

The OFR Regulations

In March 1998 Margaret Beckett of the DTI launched a long-term review of company law. This was carried out by an independent Company Law Review Steering Group (CLRSG) and its aim was to develop a simple, modern, efficient and cost-effective framework for undertaking business activity. Its final report⁴⁴ stated that there was a “well-developed system of financial reporting, which is essentially quantitative and historic”, but that companies are “increasingly reliant on qualitative and intangible assets such as the skills and knowledge of their employees, their business relationships and their reputation”. Information on future plans, opportunities, risks and strategies should, therefore, be considered as important as the historical review of performance.

The CLRSG proposed that companies of significant economic size be required to produce, as part of their annual report and accounts, an OFR.⁴⁵ It would provide information on direction, performance and “all

⁴³ S. Waddock, “Fluff is not enough – managing responsibility for corporate citizenship,” *Ethical Corporation Online* (March 2002), <http://www.ethicalcorp.com>.

⁴⁴ Company Law Review Steering Group, *Modern Company Law: For a Competitive Economy* (Final Report, June 2001), 3.33.

⁴⁵ *Ibid.*, 3.34-3.45. A voluntary form of OFR exists. The Accounting Standards Board issued a statement of best practice in 1993 and a revised statement in 2003. It has been suggested that there is already a high level of compliance and that the introduction of a compulsory OFR is unnecessary. Indeed, some “have expressed

other aspects which the directors judge necessary to an understanding of the business, such as key business relationships and environmental and social impacts”. Essentially, there was a desire to improve transparency in corporate reporting. The CLRSG claimed that the requirement to produce an OFR would improve the quality, usefulness and relevance of information available to the markets and to everyone with an interest in the company. It suggested that this was best achieved through the provision of mandatory and discretionary information. Firstly, it was recommended that there should be three mandatory items: (a) the company’s business, strategy, and principal drivers of performance, (b) a review of the development of the company’s business over the year and (c) the dynamics of the business, including events, trends and other factors which may substantially affect future performance. According to the CLRSG, these issues are universally relevant to an understanding of company performance and so there is no reason why all companies within the scope of the requirement should not report on them. Secondly, the OFR should contain discretionary information on important areas like corporate governance and reputation, employee and community relationships, environmental and social issues, and customers and ethical issues. Significantly, however, it was suggested that it should be for the directors to decide which of these issues are relevant to an understanding of the business and, therefore, need to be included in the OFR.

The CLRSG’s OFR recommendations were adopted in the Government’s Company Law White Paper.⁴⁶ Part Two recounts the Government’s position on the OFR and, as Goddard⁴⁷ maintains, it is in this context that the White Paper refers to CSR. On proposals for an OFR, it is declared that companies should provide more qualitative and forward-looking reporting as well as information that is quantitative, historical or about internal company matters. The White Paper acknowledged that, in deciding in good faith what would be most likely to promote the success of the company, directors should take account of factors within and outside the company, which are relevant to achieving its objectives. These include relationships with employees, customers and suppliers, the company’s impact on the wider community and the company’s impact on the

concern that replacing the present voluntary OFR with a mandatory requirement will stifle innovation in a fast-developing field and lead to defensive, less informative, ‘boilerplate’ reporting.” The CLRSG says these concerns are “misplaced” (*ibid.*, 3.36).

⁴⁶ Department of Trade and Industry (n 20), 4.28-4.41.

⁴⁷ R. Goddard, “Modernising Company Law: The Government’s White Paper,” (2003) 66(3) *Modern Law Review*, 402.

environment. The requirement to provide information, however, is somewhat moderated since its inclusion in the OFR should be where it is relevant to an assessment of the company's business. It is further tempered by the use of the word, "material". It states that "the new requirement to report, for example, on material environmental issues would be a major contribution to both corporate social responsibility and sustainable development initiatives". Attention is drawn to the word, "material", since it will ("of course") be for directors to decide precisely what information is material to their business.⁴⁸ It is again significant that directors will be responsible for how these issues are covered in the OFR. According to the Government, this will lead to companies providing the right quantity and quality of information. Moreover, any company that fails to do so will "risk adverse comparison and questions from shareholders and others" and, ultimately, "the directors may need to defend the process behind their reporting before the courts".

The Government chose to implement the OFR and the provisions of the Account Modernisation Directive using secondary legislation through powers available under the Companies Act 1985.⁴⁹ The Consultative Document and Draft Regulations⁵⁰ were published in May 2004.⁵¹ The executive summary confirms the distinction between mandatory and discretionary information, stressing that the OFR is to be produced for shareholders.⁵² Following extensive consultation, the draft regulations were implemented by the Companies Act 1985 (Operating and Financial Review and Directors' Report, etc.) Regulations 2005.⁵³ These Regulations amend the Companies Act 1985 to require directors of quoted companies to prepare an OFR each financial year.⁵⁴ Where a company fails to comply

⁴⁸ Department of Trade and Industry (n 20), 4.32-4.33. In this respect the White Paper has been described as "something of a half-way house." (See, ENDS, "Company law shake-up set to stimulate environmental reporting," (2002) 330 July).

⁴⁹ "The result is something of dog's dinner, with numerous amendments to existing statutes which themselves have already been amended several times". (See ENDS "OFR legislation adapted to fit closely with EU requirements," (2004) 352 May).

⁵⁰ Draft statutory instrument entitled, "The Companies Act 1985 (Operative and Financial Review and Directors' Report) Regulations 2004."

⁵¹ Department of Trade and Industry, Draft Regulations on the Operating and Financial Review and Directors' Report: A consultative document (DTI/Pub 7294/3/k/03/04/NP May 2004).

⁵² Although the OFR will be prepared for shareholders, it will be relevant for other stakeholders.

⁵³ Statutory Instrument 2005 No. 1011.

⁵⁴ Section 234AA, "Duty to prepare operating and financial review." After considering the Review recommendations that public and large private companies should prepare an OFR, the Government decided that

with the provisions relating to the preparation and contents of the OFR, every director, who knew that it did not comply or was reckless as to whether it complied or not and failed to take all reasonable steps to prevent the review from being approved, is guilty of an offence and liable to a fine – importantly, the Regulations do not include a ‘safe harbour’ provision. In terms of content, the OFR⁵⁵ is to be a balanced and comprehensive analysis of (a) the development and performance of the business of the company during the financial years, (b) the position of the company at the end of the year, (c) the main trends and factors underlying the development, performance and position of the business of the company during the financial year and (d) the main trends and factors which are likely to affect the future development, performance and position of the company. Importantly, the OFR must be prepared so as to enable the members of the company to assess the strategies adopted by the company and the potential for those strategies to succeed.

The OFR must include (a) a statement of the business, objectives and strategies of the company, (b) a description of the resources available to the company, (c) a description of the principal risks and uncertainties facing the company and (d) a description of the capital structure, treasury policies and objectives and liquidity of the company. Yet, information relating to employees, environmental matters and social and community issues is to be included “to the extent necessary” to comply with the general requirements of the review. By using the phrase, “to the extent necessary”, the OFR adopts the language of Directive 2003/51. Its inclusion replaces “material”. According to the Government, it is preferable to follow the wording of the Directive since this helps to avoid confusion with the specific use of “material” in accounting.⁵⁶

The statutory requirement for an OFR is supported by standards giving guidance on best practice and ensuring high levels of consistency of reporting. These standards have been prepared by the Accounting Standards Board.⁵⁷ In order to give time for businesses to prepare for the OFR and to review the new standards, the OFR became a legal

it should only apply to quoted companies (see Department of Trade and Industry (n 51)), of which there is estimated to be approximately 1290.

⁵⁵ Schedule 7ZA (paragraph 1), inserted into the Companies Act 1985.

⁵⁶ Department of Trade and Industry (n 51), 3.25: “the draft Regulations do not use the term, ‘material,’ though the concept remains the same.”

⁵⁷ Accounting Standards Board, *Reporting Standard 1 – Operating and Financial Review* (London: ASB Publications, May 2005).

requirement for all UK quoted companies for financial years beginning on, or after, 1st April 2005.

Pressures for Further Change

The OFR has been criticised for the large amount of discretion given to directors over what can be included within the Review. Indeed, the Association of Chartered Certified Accountants, when assessing the Draft Regulations, pointed out that they provide directors with “ample opportunity” not to include environmental or other non-financial matters.⁵⁸ The Corporate Responsibility Coalition (CORE) goes further by suggesting that they fail to impose a duty on directors to reduce adverse environmental and social impacts – they only have to report them in certain instances.⁵⁹ According to CORE, the phrase, “to the extent necessary”, is a weak one. CORE also suggests that, despite the CLRS’s recommendation, the OFR confines the target audience to shareholders, thus ignoring the interests of other key stakeholders such as suppliers, employees, consumers, communities and NGOs. Furthermore, in 2004 Deborah Doane, chair of CORE, argued the Government’s response had been “hijacked” by big business: “as long as company law is aimed at protecting shareholder interests [there will be an inevitable] trade-off between profits and reining in certain social and environmental impacts”.⁶⁰

Dissatisfaction with existing and proposed frameworks is also reflected in efforts to introduce consolidated CSR measures, particularly, in the form of primary legislation making environmental and social reporting mandatory. In 2002⁶¹ Linda Perham MP sponsored the Corporate Responsibility Bill, which made provision for companies to produce and publish reports on environmental, social and economic matters. It would have placed a duty on directors to consider environmental, social and economic impacts and take all reasonable steps to minimise their negative impacts. The Bill was also far-reaching because it would have affected companies with an annual turnover of not less than £5m. Although the Bill received the backing of CORE and over

⁵⁸ ENDS “Risks and opportunities posed by draft OFR regulations,” (2004) 352 May.

⁵⁹ *Ibid.*

⁶⁰ Reported in the Guardian, 19 May 2004 (<http://www.guardian.co.uk>).

⁶¹ Linda Perham has twice attempted to introduce legislation to make companies produce and publish reports of their social, environmental and economic impacts.

230 MPs signed an Early Day Motion in support of its principles,⁶² it failed because of lack of Government support.

The Performance of Companies and Government Departments (Reporting) Bill was the most recent attempt to enact consolidating mandatory CSR principles. Again, the Bill (a Private Member's Bill) was sponsored by CORE but was tabled by Andy King MP, who stated that its aim was "to inject some real substance into the fashionable but lamentably ineffective 'pick-and-mix' practice of corporate social responsibility".⁶³ The Bill, which was given its first reading on 7th January 2004, made provision for the preparation of an OFR which was to include an informed assessment of the company's impacts on the environment and on any communities in which the company operates. When promoting a company's objectives, a director would have had to take account (in good faith) of all material factors that it is practicable in the circumstances for him to identify. Material factors are those which a person of care and skill would consider relevant, including the company's need to foster business relationships (including those with employees, suppliers and customers), the company's impact on the environment and communities and the company's need to maintain a reputation for high standards of conduct. A director would also have had to take all reasonable steps to minimise the company's impacts on communities and the environment.

Unlike the Corporate Responsibility Bill, the Performance of Companies and Government Departments (Reporting) Bill would have applied to fewer companies because the boundaries had been raised so that two of the following conditions had to be met: (a) a turnover of £50m or more, (b) a balance sheet of at least £25m and (c) at least 500 employees. Although the Bill failed (owing to lack of parliamentary time), it shows that the OFR is much more limited in scope and represents a missed opportunity for many people. It also suggests that support for consolidated CSR legislation is unlikely to subside in the future. In fact, CORE has recently announced that it is trying to gather support for its Companies (Impact on Communities Abroad) Bill, which would require the Government to complete a twelve-month investigation and review into UK companies' negative impact abroad and recommend legal changes on how this can be addressed in a report to Parliament.

⁶² Guardian, 25 November 2002 (<http://www.guardian.co.uk>).

⁶³ See, <http://www.epolitix.com>.

Conclusions

Linda Perham, the Labour MP who tabled the Corporate Responsibility Bill, stated that the “weight of opinion in Britain and Europe suggests governments will have to act”.⁶⁴ The continuing pressure by the EU to place CSR on the policy-making agenda and the passing of the OFR indicates that the UK Government is already beginning to. As we have strived to show, the scope of the legal response to CSR is contentious owing to the overarching scope of the term itself. At this time, pressure is focused on mandatory reporting. There have been several attempts to introduce provisions incorporating mandatory reporting on environmental and social issues. This includes a director’s duty of care.

Recent events, specifically, with regard to the Company Law Review and the establishment of a mandatory OFR, are significant. Yet, they can be said to represent a half-way house in the debate over “regulation versus voluntarism”. The incorporation of the qualification, “to the extent necessary”, supports this. What is clear is that this is likely to be a basis for the development of more CSR measures. Indeed, the CLRSG, when discussing the OFR, suggested that, “at least initially”, the requirement should apply to a more restricted range of public companies and to very large private companies, and that, as the “practice of such disclosure” became “widespread and well understood”, these thresholds would be expected to be “reduced”.⁶⁵

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⁶⁴ Independent, 13 June, 2002 (<http://www.independent.co.uk>).

⁶⁵ Company Law Review Steering Group (n 44), 3.44-3.45.