BITC, INSIGHT & FTSE, 2005. *Rewarding virtue: effective board action on corporate social responsibility.*
UKSIF summary, 2009.

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I. Key points

- Corporate responsibility is imperative to business success in the long-term.
- Law and CSR have the same purpose, which is to limit the action of individuals for collective benefit. However, they are not identical.
- In order to maximize financial returns to shareholders, markets need healthy competition, free flows of information and an absence of harmful externalities.
- Companies are rewarded to behave irresponsibly in the form of market failure, organization's culture, objectives as well as performance targets. Thus, boards have a important role in making companies resist temptations of irresponsible behaviour and reinforce responsible behaviour:
    - At the market level:
        - Strategy and business model: design a business model that respond to market failure and create value over the long-term
        - Approach to regulation: support both self-regulation and government intervention to correct problems in markets
    - Organizational level:
        - Executive remuneration: reward performance over the long-term
        - Setting of standards and values: state the corporate responsibility's standards
        - Leadership: foster a culture of responsible behaviour starting at the top
        - Enforcement: the existence and visibility of sanctions are important
    - Reporting:
        - Include CSR information in the OFR (now Business Review)
        - Include information of the board' governance in its report on corporate governance

- Include information in the remuneration report how intangible, CSR and long-term are incorporated into the remuneration framework
- Issue a CSR report

II. Key quotes

- "…corporate responsibility is a precondition for sustainable long-term value creation." (BITC et al 2005, p. 6)
- "People often misunderstand corporate responsibility. Some define it, mistakenly, as voluntary action beyond the requirement of the law." "Corporate responsibility is also part of the law, its ethical principles shape legislation and regulatory guidelines". (BITC et al 2005, p. 6)
- "…corporate responsibility sets the terms of an implicit contract between companies and society and is therefore a pre-requisite for long-term value creation" (BITC et al 2005, p. 10)
- "The boundaries set by the corporate responsibility contract impose limits on the pursuit of self-interest to enable collectively valuable outcomes" (BITC et al 2005, p. 12)
- "It should be no surprise that the law often embodies corporate responsibility principles. The purpose of both is the same, to set limits on the actions of individuals and companies in order to serve collective interests" (BITC et al 2005, p. 13)
- "While law and corporate responsibility overlap, they are not identical, Not all laws are good laws" (BITC et al 2005, p. 13)
- "The problem is that ethics and self-interest are often in conflict, and if the economists' assumption is right, then self-interest will always win, and ethical standards will be powerless to motivate behaviour" (BITC et al 2005, p. 14)
- "Market failure is a matter of degree. No market is perfect and, conversely, even the most flawed markets can deliver some useful outcomes" (BITC et al 2005, p. 18)
  - Negative externalities: "occur when the actions of market participants impose costs on others" (BITC et al 2005, p. 18)
  - Public goods: "Markets (…) give little incentive to companies to provide public goods" (BITC et al 2005, p. 18)
  - Competition problems: "In non-competitive markets, companies have the power to influence the price or quantity of goods sold" (BITC et al 2005, p. 18)
  - Information asymmetry: "Where consumers cannot accurately assess value, companies have an incentive to exploit their ignorance by overcharging or under-delivering on quality" (BITC et al 2005, p. 18).
- "In 2001, the Association of British Insurers – a large association of UK institutional investors – gave further impetus to this development by issuing

guidelines for disclosure by companies of significant risks associated with corporate responsibility" (BITC et al 2005, p. 19).
- "Self-regulation has an obvious role to play in failed or developing states and other countries where governments lack the capacity or the will to regulate effectively" (BITC et al 2005, p. 20).
- "Where companies fail to regulate their own behaviour voluntarily, government intervention may be the only available remedy for market failure" (BITC et al 2005, p. 20).
- "Companies often exploit market failure nevertheless. And when they do so, it is often because of short-termism and difficulties in giving weight to intangible assets" (BITC et al 2005, p. 21)
- "The problem with market failure is that the benefits are financial (increased revenues and lower costs), but the costs are intangible (erosion of customer loyalty, employee commitment and reputation)" (BITC et al 2005, p. 22).
- "The principal value of corporate responsibility for a company's shareholders accrues over the long-term and through intangible value drivers" (BITC et al 2005, p. 24).
- "There is also evidence that moral commitment varies across the population. Some people are more willing to do the right thing than others, and there are some 'bad apples'" (BITC 2005, p. 25).

III. Best practices

- Halifax Financial Services: has promoted simpler products and invested in consumer education in order to reduce information asymmetry
- BA: expressed support for a market-based approach based on pricing emissions and suggested that the airline industry should be included in the EU Emissions Trading Scheme
- Westpac: included in the executive scoreboard employee commitment, customer satisfaction and loyalty with profitability and value creation.
- BHP: BHP Billiton Group Scorecard applied to all Executive Committee members and incorporates specific health, safety, environment and people KPIs.
- BT: has included reduction in customer dissatisfaction in the Corporate Scorecard to determine senior executives' annual bonus, besides Earnings per Share and free cash flow.
- National Grid: aims at ensuring that internal incentives and control structures delivers responsible behaviour. The board reviews internal controls and has a subcommitte for in-depth review (Risk and Responsibility Committee).
- GSK: the board has set out the company's Corporate Responsibility Principles and the code of conduct. The framework includes:
    - Anonymous Integrity Helpline

- Over 9,000 senior and middle managers undergoing annual training certification process
- Business unit managers completing annual self-assessment questionnaire
- Induction training and targeted training
- 954 disciplinary actions, 256 dismissals and separations