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Doing Well by Doing Good



Dr Doug McTaggart

Economists often appear to be held in low esteem by the general community. For example, I read a piece about economists in the *Financial Review* some months ago that said the following:

‘There was a time, in 1931 for instance, when Australia was thankful to have economists about. Times have apparently changed. Our present experts in the dismal science have fallen into disrepute with their fellow countrymen. It is said on the one hand that they have helped us get into our present fix and, on the other hand, that their present advice to get us out of it is bad.

These charges are much more than just an itch on the palms of businessmen. The irritation is felt in all sections of the community who are disturbed by the sort of advice acted on by the Federal Government.’

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Dr McTaggart has held various positions as an academic economist, most recently Professor of Economics and Associate Dean at Bond University. Prior to joining QIC he was the Under Treasurer and Under Secretary of the Queensland Department of Treasury. He is currently a councillor on the National Competition Council, a director of the Investment & Financial Services Association, Deputy Chancellor and a council member of the Queensland University of Technology.

He was, until recently, president of the Economic Society, Australia and a member of the Australian Accounting Standards Board. He holds an Honours degree in Economics from the Australian National University, and a Masters Degree and PhD from the University of Chicago.

This commentary could well apply to economists' predilection with so-called economic rationalism, and the ills it apparently has imposed on today's society. However, the language may well give away the fact that the piece was written on August 23, 1951, in the editorial of the AFR.

I am not sure why economists have always been held in such low regard. And, in fact, it goes back to the days of Thomas Malthus who managed to get the 'dismal science' tag put upon the profession for his dire warnings, in 1798, of mass woe and famine caused by the population growing faster than production. Of course, his predictions turned out to be wrong because he didn't allow for changes in people's behaviour brought about by their changing circumstances.

We have seen many instances of similar wrong predictions from economists (and others) ever since. And economists' opinions, forecasts or guesses usually turn out to be wrong precisely because people can understand them, and then adapt and do something very different. In a sense, the mere identification of a problem, and its consequences, almost automatically brings about the problem's solution — usually because it is in someone's interest to provide it.

I am prepared to admit to being a trained economist. Worse still, in the minds of some, I am a University of Chicago trained economist so I have been steeped very much in the free market tradition of Hayek, Friedman and others. So it might seem unusual to speak about corporate giving, charity and community engagement in a market context, but I want to identify the paradox of an increasingly globalised, competitive world pushing companies down the path of benevolence.

Given my background, you might imagine that the following quote to have come from me:

'If you are in business, you are in business for one thing, to make money. You must do everything fiducial, legal and moral to achieve that goal. And making excellent products that are expertly marketed is the primary way of making money.'

In fact, that was not a quote from me. It was from Albert J. Dunlap, *Chainsaw Al*, when he was CEO at Sunbeam. Al went on to say:

'Corporate charity exists so that CEOs can collect awards, plaques and honors, so they can sit on a dais and be adored. But that is not what the shareholder is paying them ...for.'

He also said:

'If I want a friend I'll get a dog.'

Of course Al apparently cooked the books at Sunbeam, driving the company into ruin and bringing the wrath of the law in the US and a probable gaol term upon his head. But he did articulate a widely held view among the leaders of the corporate world.

In fact, earlier this month, Tony Howarth, chief executive of Westpac's Challenge Bank and a member of the Prime Minister's community-business partnership council said:

'I don't believe that for public companies that it [philanthropy] is a real option for them. For the pure philanthropic gift, you are actually giving away shareholders' money. It is for shareholders to make that decision.'

This is a view that has a very long tradition, according to some, dating back to at least Adam Smith who published the *Wealth of Nations* back in 1776 and introduced the notion of the 'invisible hand'. The invisible hand is a metaphor for the principle of everyone pursuing their own self-interest bringing about the public or social good. This is sometimes referred to by economists as the First Theorem in Welfare Economics. It is a view in which, narrowly interpreted, there is no role for altruism or acting in the interests of someone else.

Now it didn't take too long after Adam Smith's work to be digested before people realized that there were exceptions, breakdowns to his principle. Significant among these were the existence of externalities — for example, pollution — and public goods — for example, national defence and mass immunizations — that created a role for government to address and fix these sources of market failure. Consequently we have had the growth of government over the last 150 years.

Now, after decades of growth of government in all spheres of human activity, particularly in the area of welfare and income support, we are seeing new forces at work. The forces of globalization and competition are apparently rolling back the influence and scale of government, bringing about a reduction in regulatory control, reductions in restrictions on trade and otherwise initiating reduced scope of government activity.

We are seeing governments vacate areas of community and welfare support they have had for many years as their own domain. This process is probably most advanced in the United States, but in one way or another is impacting on most governments worldwide.

This evolution — ostensibly powered by globalization and the 'need' for countries to be globally competitive and the requirement that government not be a burden — has, according to many pundits, delivered a golden era of growth throughout the latter half of the 1980s and into the 1990s, notwithstanding the fact we are now exiting a global cyclical downturn, which in some important cases was recession.

However, as these gains have largely been delivered to the western industrial world, the benefits globally have been very unevenly distributed, as the following figures show. In 1998:

40 percent of additional world wealth was generated in the USA;
25 percent in Western Europe;
21 percent in Asia; and
14 percent in the ROW.

By the end of the 1990s, the richest 20 percent of the world's population possessed 86 percent of GNP, 74 percent of all telephone lines and 93 percent of the entire Internet use in the world.

Within the main beneficiary countries of this impressive growth and accumulation of wealth there is ongoing and increasing debate about how it is distributed. Have the rich become richer and the poor poorer? Reputable and serious publications such as the *Economist* magazine now ask: 'Does inequality matter?'

It is against this backdrop of strong economic growth on the one hand and possibly growing inequality on the other, while governments are withdrawing, that we are seeing at the macro level a global backlash against the tide of globalization. At the micro level we are seeing a rise in community unease and unrest and a growth in shareholder activism. As a defensive mechanism, corporate entities are asking the question, do they have social and community responsibilities and, if so, how are they best addressed?

We have seen these issues locally with respect to banks, Telstra, regional services, sustainable growth, and we will see it more and more.

It is no wonder that we are witnessing a proliferation of terms such as corporate citizenship, corporate social responsibility, enlightened self-interest, corporate community activity, stakeholder relations and triple bottom line accounting enter into popular discourse, particularly within the business community. I will collectively call the activities described by these terms as corporate engagement with the community.

This evolution in both discourse and actions was succinctly captured in a piece in the *Financial Review* a while back entitled 'Can globalisation save itself' by James Rose. Rose is writing about the globalisation paradox:

'We want better consumer choice and cheaper prices, but we also want to be healthy, fulfilled, gainfully employed, and connected spiritually, socially and culturally with our fellow creatures and the wider world.'

But these requirements for a balanced and fulfilling life come at a cost because somehow and somewhere they must be provided and we can provide more of them when we are doing well economically. I find it more than coincidental that the most active periods of social unrest over the last 50 years, the end of the 1960s and now at the end of the 1990s, have both occurred following the longest periods of sustained, strong global growth on record, when society is best able to actually afford to provide for the lifestyle being demanded.

Rose goes on to say, and I quote:

‘Even as the globalisation paradox threatens to twist us all into gibbering wrecks, a solution emerges from within the very heart of the beast itself. There was no storming of the barricades, no hoisting of flags on building tops, no mobs and no trashing of commerce. It happened almost overnight. It is a result of the very gaps between the State and the community that we all felt so uncomfortable with. It happened when we were all forced to take responsibility for our own financial future and were told not to rely on government handouts. It happened when we all became stakeholders.’

Further:

‘The crucible of the debates and disputes of the new century will be the corporate meeting halls and boardrooms. The most important decisions will be, already are, the result of proxy ballots. As such, the outsiders are already on the inside. The stakeholders are mobilised.

Shareholders especially.’

In view of this changing social and business environment, a cynic would claim that the new found corporate conscience is a defensive mechanism to protect the business community from more coercive actions of governments as those governments see an avenue to withstand or even turn back the tide of globalisation. This is probably right and, in this case, as a free-market economist with a belief in Adam Smith’s invisible hand, I disagree with the view put forward by Thomas A’Beckett in T.S. Eliott’s in *Murder in the Cathedral* —

‘Above all the greatest treason is to do the right thing for the wrong reason’.

This view is the antithesis of the invisible hand proposition wherein everybody acting in their own self-interest brings about the social good.

In fact, I see the current corporate response as an outcome of broader market forces pushing the business community to adopt the changing values of the wider community. A typically Chicago School explanation, wherein the market adapts and heals itself.

The defensive response from business must be a good thing. Business are realizing that the community offers them a ‘licence to operate’ and the terms of that licence are very much dictated by the attitudes, of the day, of the community. Businesses are realising that the stakeholders in the business are the stakeholders the community decides to be the stakeholders. These attitudes change over time and businesses must be aware of the trends and move with them. We now see, for example, the banks coming out with subsidized accounts for pensioners. Far from being an egregious example of account cross subsidization, this is now an investment in community goodwill.

However, it would be unfortunate if this is the only response from the corporate world — to be dragged kicking and screaming into 21st century community standards. I say this because there is a lot of high quality academic work showing that doing good in terms of community social responsibility can mean doing well financially for the firm. And there are a number of reasons for this. Doing good can:

- Improve employee recruitment and retention — because it helps improve the public image and self-image of a company; and, depending on the activities can lead to improved job satisfaction
- Improve productivity — for the same reasons and through improved employee skills
- Improve customer loyalty and improve sales — specifically through cause-related-marketing, but more generally through improved public image
- Produce a positive public policy environment — avoiding legalistic and bureaucratic enforcement mechanisms that inevitably are worse than anything a firm might choose to do itself.

That is, positive, proactive, corporate engagement in community activities can support and enhance the key long-term strategies of a business. Corporate engagement can be part of the vision and mission of a business and yield long-run financial gains to that business.

Doing good can mean doing well

It is often argued that financial analysts do not value corporate engagement and firms that practise it will be marked down in the market. This is a testable hypothesis and the data do not seem to back it up. Towers Perrin, in a US study, identified 25 companies that excelled in managing relationships with five types of stakeholders: investors, customers, employees, suppliers and the communities in which they operate. Their analysis showed that these ‘stakeholder superstars’ outperformed the S&P 500 by more than double over 15 years from 1984 to 1999 in terms of delivered shareholder value:

S&P 500: 19 percent annual compound p.a. growth rate
Stakeholder superstars: 43 percent

Other studies have shown similar results — doing well socially improves financial performance that then helps support the social activities of those companies. A virtuous cycle develops wherein shareholder value is in fact increased.

Closer to my field of business, investors increasingly appear to be drawn towards firms offering positive social performance, as indicated by the growth in socially responsible investing (SRI) or ethical investing. In Australia, socially responsible investments among institutional investors and superannuation funds are reputed to amount to \$2 billion now and are predicted to grow to \$35 billion over the next ten years. In this country we are seeing this growth in SRI portfolios coupled with growing investor interest in corporate governance, proxy voting habits, sustainable investment and other socially driven issues.

We are seeing the growth in the creation of Reputation Indexes, beginning in Australia with the recent SMH/Age Good Reputation Index, which ranked firms according to their rankings on market impact, finances, ethics, social impact, environmental attitudes and employee management policies.

However, according to a recent survey of Australian companies by the Corporate Citizenship Research Unit at Deakin University, and written up recently in the AICD's *Director* magazine, there is still a significant gap between the rhetoric and the reality of corporate engagement. Corporate Australia is still very much in the 'being forced to adapt to changing community standards' mode rather than being in the 'invest in corporate engagement' mode because it is good financially in its own right. Corporate engagement is still very a short-term activity, even if ongoing, rather than being a strategic tool supplementing other long-term strategies of the business.

While there is growing pressure for companies to be involved, and to report on their involvement, many companies are struggling with how to be involved and with how to report.

Triple bottom line accounting, where corporate performance is measured along three lines — profits, environmental sustainability, and social responsibility — is not well understood, nor are the tools available because there is little agreement, at this stage, on how to best quantify the second and third bottom lines. But this is changing. Corporate attitudes are changing and corporate engagement will continue to grow rapidly, albeit from a relatively small base at the moment. Investment in corporate engagement will become a core part of a business' long-run strategy.

So, as you graduates now emerge into the broader community, take your positions in corporate entities, firms, whatever, always recognize and try and understand the community in which you operate. Respect its values and look to the changing trends that adapting community attitudes bring about. If you can get ahead of the trend you can do well by doing good.

Good luck, and thank you.