A NEW BUSINESS AGENDA FOR GOVERNMENT

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Executive summary

A new business agenda for government explores the value of 'soft' forms of government intervention as a supplement to traditional regulatory and fiscal tools.

The delivery of government policy objectives often relies on the behaviour of business. However, in many areas hard regulation cannot ensure the required response from the private sector. This report addresses the Government's predicament. In particular it examines:

- The potential role of soft interventions by government to shape voluntary behaviour of companies;
- How soft government intervention is currently used in five policy areas;
- The coherence and effectiveness of the Government's agenda for promoting voluntary action and corporate social responsibility;
- How Government could harness activity by investors and other stakeholders more effectively in order to achieve public policy goals.

The analysis and the recommendations are informed by a survey of 500 UK company directors. This survey explores directors' views on the issues above as well as the social and environmental policies adopted by the organisations which they represent.

Is there scope for improvement on hard regulation?

Chapter 1 sets out the problems of hard regulation. It calls into question how far traditional forms of intervention alone can create effective controls on business that will fully reflect popular preferences or promote the public interest. For example, Chapter 1 explains how direct regulation can be both over and under-inclusive, affecting too many or two few commercial activities. Importantly, direct regulation cannot always lend itself to changing commercial activities, particularly when innovation or a shift in business culture is required.

The Government clearly desires to improve the way in which it regulates markets. However, a system of 'better' regulation cannot be implemented without a clear understanding of the relative efficacy of the tools that can be deployed by the state to alter business behaviour.

Numerous reforms since 1997 have put pressure on regulating departments to have a robust rationale for their preferred form of intervention. Surprisingly, however, the conceptual framework adopted to aid such decisions is relatively unsophisticated. In order to put this political appetite to good use, a more systematic analysis of the different mechanisms available to government is required. So too is a clear strategy to ensure that a soft approach will enforce behaviour over and above that achieved by imposing a regulatory floor.

This chapter defines soft government intervention as 'intervention without a primary recourse to fiscal or legislative changes'. It provides a theoretical framework for addressing the question of what soft policy instruments are likely to offer and how they can be used more effectively. Soft intervention is shown to take a variety of different forms:

- **Unstructured soft:** for example, disseminating information, raising awareness and publicising best practice
- **Structured soft:** for example, promoting guidelines on conduct
- **Unstructured hard:** for example, general positive duties
- **Hard frameworks with a soft impact:** for example, corporate governance legislation and mandatory disclosure

This chapter argues that none of the main objections to the use of soft intervention are fatal as they are either rejections of regulation *per se*, or can be overcome as long as the state is diligent in its exercise of an oversight role and ensures that appropriate standards are enforced in a legitimate and accountable way.

As the corporate response to all types of soft intervention is essentially 'voluntary', the chapter argues that a prerequisite for its successful implementation is non-governmental pressure on companies to improve their social and environmental performance: 'interested, informed and empowered stakeholders' who can drive a coincidence between public and private interest.

This convergence of interests can occur naturally. It can also be artificially manufactured by government activity that generates or harnesses external pressure. Either way transparency about corporate operations is critical. Disclosure of information about corporate practices can also overcome some of the limitations of the soft approach, for example, where the 'reform' it induces is an appearance of change rather than a genuine improvement in performance.

A reliance on soft intervention to bring about a convergence of public and private interests must be informed by an understanding of the non-governmental pressure in place. Where this approach is considered to be appropriate Government should give a greater priority to action to stimulate these pressures. Notably, the new Companies Bill should be seen as a window of opportunity.

The new Companies Bill should be put before Parliament as soon as possible. Its introduction in the Queen's speech should make an explicit reference to the Government's desire to see the proposed changes in corporate governance 'further align public and private interests' rather than to simply improve corporate governance.

Although disclosure is the cornerstone for corporate governance reforms, it must be recognised that without an effective strategy to reduce information asymmetries, *other* soft forms of government intervention will also be set to fail. The proposals for social and environmental reporting in the 'Operating and Financial Review' (OFR) should aim to enhance civil and market activism. **Disclosure requirements in the new Company Bill must take into account wider policy objectives. Importantly, social and environmental elements of the OFR, should be classified as core (mandatory) or at least be put on the same legal footing as the financial elements.**

A soft centre? The Government's use of soft intervention

Chapter 2 relates the theoretical question of what soft intervention can achieve to the reality of contemporary policy-making. It shows that the exploration of the use of soft policy tools is far from a hypothetical concern. Chapter 2 presents five issues where policy goals depend upon changing business practices through the *complementary* use of soft tools. This chapter describes in detail how the Government attempts to promote a voluntary response by companies in order to:

- reduce **employment rate gaps** experienced by certain ethnic minority groups and **pay gaps** experienced by women;

- improve **employees' basic literacy and numeracy** and the ability of employees to control their **work-life balance**; and
- reduce companies' **emissions of greenhouse gases**.

Chapter 2 shows the extent to which the type of soft Government initiatives used are similar across this disparate range of issues. Intervention tends to be 'structured' codes of conduct or 'unstructured' awareness-raising initiatives. However, the context for each issue varies widely, with each enjoying different levels of business interest and co-operation.

New evidence is presented of UK directors' engagement in these five areas of policy as well as directors' varied levels of awareness of the soft tools employed to rally their support for change. The evidence suggests that Government involvement in voluntary guidelines does appear to carry weight in the business community, for example, almost all directors are aware of the Investors in People award.

The strength of the IiP brand means that it is an important asset to the Government and one which should be protected. However, it is possible that too much reliance is being placed on Investors in People to improve a range of workforce practices. The scheme is in danger of being spread too thinly and failing to actually deliver change in all the areas in which it is active. **The Government's current aspiration to improve take-up of the Investors in People award should be matched by a commitment to tailor and strengthen this initiative to encourage business to help deliver on policy priorities.**

Overall, this chapter argues that there is confusion over how to achieve policy goals which rely on private input and little consideration has been given to whether soft intervention will bring about the change desired. This is particularly acute for issues which are likely to appeal to a narrow corporate constituency. Indeed, it is far from obvious that soft mechanisms are being used effectively.

This chapter recommends that **the Government makes a realistic assessment of what a voluntary corporate response is likely to contribute to policy goals**. This will require the development of a better understanding of those issues and/or sectors where soft intervention is most likely to be able to bring about change.

The Government should build on the research presented in this report to explore the take-up and awareness of the entire range of soft initiatives that it currently deploys. **The Government should also endeavour to research the type of support required by businesses which are hoping to reform their practices in line with public policy objectives. A concerted effort must be made to increase take-up of the support provided.**

The misunderstanding of corporate social responsibility

Business endeavours will have a commercial rationale. Chapter 3 shows that both inside and outside government, corporate social responsibility (CSR) is not seen to be any different. The ability of companies to benefit by reacting to social and environmental issues clearly underpins both government interest and policy development in this area. However, having accepted the reality of commercial imperatives, this chapter argues that the raison d'être for a government agenda for CSR must be the realisation of policy goals, not the promotion of private gains.

A clear theme in the rhetoric which surrounds the development of CSR policy is that it should be about 'core' business competencies. This sentiment is encouraging as it is ostensibly in line with the requirements of policy issues such as those discussed in Chapter 2. Unfortunately, however, this commitment has yet to permeate government *involvement* in CSR.

The divergence of 'CSR policy' from those areas where policy goals rely on voluntary corporate action is clear. To date, the corporate responsibility agenda has been spread across *core* and *peripheral* business activities, many of which are only of tangential use in achieving public objectives. In order for this divergence of policy to be overcome, **the Government's promotion of CSR must focus on core business operations** rather than peripheral philanthropic activities which cannot themselves deliver public policy objectives.

At present, there is an explicit commitment within the Government that corporate responsibility remains a 'primarily business driven agenda'. Not only is regulation avoided, intervention centres around promoting the financial case for voluntary action. Many soft tools – such as those with a 'hard' framework – are manifestly considered to be out of bounds. Decent minimum levels of performance are explicitly limited to (new) regulation rather than suggestions of how to go *beyond* legislative obligations, such as ambitious targets to which organisations should aspire.

Chapter 3 recognises that in the instances where there is both a public and private advantage to reforming business practices, CSR activity can be precisely a money saving/making initiative. Here it is possible to pinpoint the *direct* commercial rationale for changing behaviour using *passive* soft tools aimed at simply increasing awareness of potential commercial gains. However, business benefits of voluntary socially or environmentally-minded activities can be direct *or* indirect. Indirect benefits rest on the reaction to corporate conduct from a range of stakeholders: the media, voluntary organisations, consumers, investors and employees. This process is dynamic.

Chapter 3 argues that the Government can stimulate and strengthen non-governmental pressure with *active* soft tools that shape the markets in which companies operate. It concludes that **successful soft intervention and CSR policy should not be restricted to areas of corporate activity that can already cite a proven business case**. This restricts government involvement to one of *passive* soft intervention.

The starting point for a cross-government agenda for engaging companies in the delivery of public policy must be the achievement of public objectives rather than the promotion of business interests. As it is presently constructed, it seems that the contribution made by CSR policy to achieve public goals, beyond that accomplished by regulation, is both marginal and muddled. There appears to be little collective commitment within the Government to develop a robust notion of what it means to be a 'responsible' organisation.

However, this is argued to be symptomatic of a lack of clear and joined-up thinking. The failure to develop a coherent story about corporate responsibility is indicative of the fact that there is no robust rationale for where, when or how to engage business in promoting social and environmental objectives.

Chapter 3 recognises that there is an outstanding question about how best to develop CSR policy and to co-ordinate the Government's demands on the private sector. The present situation is unsatisfactory. The ministerial brief for CSR is separated from other portfolios that depend on effective voluntary corporate action. An understanding about the reality of corporate social responsibility is an essential asset for all ministers and policy-makers with a remit reliant upon corporate support. However, Chapter 3 also argues that **there is a need for a**

governmental 'clearing house' for the demands made on the private sector. This should serve to ensure better administrative joining-up across departments, in the promotion of soft initiatives, including those such as free advice to companies.

The Holy Grail? The effective promotion of voluntarism

Chapter 4 further endorses the argument that a widespread change in boardroom practices is unlikely to occur in the absence of 'market' forces. It presents evidence indicating that more UK company directors consider *non-governmental* pressures – from employees, customers, business representative groups and shareholders – to be important in encouraging their organisations to think about its social and environmental impact than the proportion who think that the *Government* itself is important.

This has significant implications for CSR policy as well as the more general use of soft intervention. The Government should move away from a preoccupation with promoting the direct business case and the *passive* use of soft tools. Policy-makers should instead make a concerted effort to encourage civil and market actors who are already shown to exert strong pressure in support of responsible corporate behaviour. *Active* forms of soft intervention, which alter the commercial environment in which companies operate, have the potential to prompt wide-ranging corporate action in support of public objectives such as environmental sustainability and equality.

The degree to which this approach is likely to result in significant improvements in corporate social and environmental performance depends on two factors. The first is whether shareholders (in effect, institutional investors) become an effective source of internal accountability and pressure to reform behaviour.

As this chapter explains, for the foreseeable future the UK company law framework will place shareholders at the centre of corporate governance. Therefore, the Government must reinforce this pressure for social and enviornmental improvements. In the short-run there should be a review of the extent to which recent developments such as disclosure by pension funds, have actually brought about changed behaviour in the investment industry. Further legislative obligations to disclose should be implemented if the voluntary approach has not been sufficiently adopted. **Myners' influential review of the pension industry should be replicated for the insurance industry. The Government should also have a long-run commitment to addressing short-termism in the investment community**.

The second factor for the success of soft intervention is the extent and the intensity of the pressures that market and civil society actors are able to impose on companies for improved standards of conduct. This highlights the need for Government intervention that is designed to strengthen the ability of stakeholders to influence corporate conduct; harnessing this pressure for public ends. Chapter 4 makes a number of recommendations:

- **Additional research must be conducted to understand the impact of labels on *consumer* decisions and whether more can be done to reinforce consumer pressure in support of social and environmental agendas. Where codes of practice and/or logos are supported by the Government, these must be a central element of initiatives aimed to facilitate active consumerism.** In particular this should be reflected by the Government helpline 'Consumer Direct'.
- The spread of good practice within individual *sectors* and throughout commercial relationships should also be encouraged. **All government-supported reporting and labelling initiatives should include disclosure about standards within other organisations in the supply-chain. All business representative groups should be encouraged to publish a strategy for responding to the various 'soft' demands from government**: a code of practice for voluntary action in their sector.
- The Government's own social and environmental objectives should be at the heart of all *public expenditure*. **Improved guidance should be provided to public agencies on how to take advantage of the scope to use their buying power to enhance corporate practices, but beyond this the Government should actually *encourage* agencies to do so.** This recommendation should be met for both social and environmental issues as an important step in using the Government's buying power in a more sustainable way.

- **There should be a clear timetable for Equal Pay Reviews after which these requirements should be made mandatory. Government guidelines on employee consultation must cover the reform of social and environmental policies *in addition to* those issues accepted to be of 'direct' interest to employees.**

Chapter 4 argues that without reforms such as these, the potential of soft intervention to provide an effective complement to hard regulation will continue to be constrained; as will the Government's ability to martial corporate support that cannot be achieved by direct regulation and fiscal incentives. However, it is not just the Government that stands to gain from reform. A further alignment of public and private interests will benefit society and improve the environment in which all businesses operate.

Introduction: The Government's predicament

Business can make or break the Government's efforts to create a more equal and environmentally sustainable society. Aspirations, which strike at the heart of a just society, require corporate action beyond simply generating income and jobs, for example to increase employment of ethnic minority groups; increase women's income in relation to men's; and reduce emissions of greenhouse gases. Governments can act in a variety of ways to shape company behaviour, for example through regulation and fiscal incentives. However, there are both practical and political limits to the use of direct regulation.

Labour made a concerted effort to befriend business in the 1990s and then sustain a mutually supportive relationship in its attempts to make itself electable and prove its economic credentials. As a consequence New Labour has had an ambiguous view of the role of regulation, seeing its importance for the efficient functioning of a market economy whilst being concerned about the impact of legislation on innovation, competitiveness and its hard won, fragile relationship with business.

The pressure of reconciling these divergent demands has bedevilled the quest for a clear account of the role of the private sector in realising the public interest. Likewise, there is little clarity over the best means by which to intervene in corporate behaviour. Where policy goals rely on sector-specific innovation or changing attitudes within the business community, then the complexity of these decisions is exacerbated by the fact that blunt legislation and financial incentives can be ineffective.

There are a number of grounds on which the presence of a positive relationship between the *strength* of government intervention and its impact on corporate behaviour can be questioned. Not least among them is that legislative obligations can be circumvented or simply disregarded without detection and loopholes can be found in systems of taxation. Likewise, the notion of *voluntary* behaviour by companies becomes contentious when one recognises that although action may not be mandatory in the legal sense, the (potential) pressure of civil or market actors sometimes leave companies with little choice but to respond to the demands of their stakeholders.

This report examines three responses to the Government's predicament. Although there is already some evidence of the application of all three, all are possible contenders for a much needed strategy to guide state intervention in corporate activity which falls outside the grasp of hard regulation.

The first response is to use *soft* intervention – from exhortation to voluntary codes of conduct – *instead* of hard regulation. The former manipulates what is essentially voluntary corporate activity and, unlike the latter, involves minimal red tape. This conserves the Government's political capital in the business community.

Indeed, it is critical to have a nuanced understanding of regulation; recognising that light-touch intervention is an important part of policy makers' tool kit. This goes with the grain of the Government's 'better' regulation agenda. Since 1997 this has not been used as a euphemism for *de*-regulation, instead the Government has displayed a genuine appetite to strike the right balance between different types of intervention in markets.

However, the distinction between different regulatory mechanisms is complex and can be overplayed. In reality, soft forms have limitations and tend to be adopted to raise standards above a hard regulatory floor. In addition, in many situations the Government's choice of policy tools is restricted, for example when the UK is obliged to implement European directives into law. Arguments that 'soft' regulation is synonymous with 'better' regulation must be treated with suspicion.

The second response is that Government should promote 'corporate social responsibility'; encouraging companies to go beyond their legislative obligations to engage in behaviour which is mutually beneficial to themselves and society.

In the jargon of the early 2000s, many organisations articulate their voluntary activity undertaken in the interests of their (public) stakeholders as 'corporate social responsibility'. However, the term CSR conflates many divergent points of view. Some organisations see corporate social responsibility as synonymous with philanthropy. Indeed, there are many ways in which companies can promote public objectives by supporting third parties (for example giving cash or making donations in kind to charities or by forming partnerships such as 'cause related' marketing arrangements). These joint endeavours can be commendable and provide many voluntary sector organisations with desperately needed resources. However, our interest in 'social activism' in areas that are peripheral to the core operation of an organisation is secondary. Our primary concern in this report is where changing internal or *core* corporate practices is critical to realising social and environmental objectives.

Formal involvement in the amorphous concept of CSR is problematic for Government and its use as a policy tool is constrained by the need to focus on activities where there are recognised commercial benefits. These issues are reflected in the poor way in which CSR policy has been developed to date. Notably, the business case (rather than policy goals) is upheld by Government as the raison d'être for any corporate action. This strategy puts tight restrictions on how and when the state can act and sends confusing signals about the Government's advocacy on behalf of business interests. It is considered appropriate that financially beneficial activities can be encouraged through *passive* soft intervention, signalling to companies what is in their own commercial interest.

The third response to the Government's need to alter corporate behaviour without recourse to hard regulation or tax is to shape the market, altering the commercial environment in which decisions are made. Indeed, empowered market actors – employees, investors, consumers – are a prerequisite for most 'voluntary' socially or environmentally minded corporate activity. Non-governmental pressure motivates compliance with soft regulation. Similarly, from a policy perspective, the interesting elements of CSR are where companies respond to their stakeholders' demands and allow themselves to be held accountable for these actions.

This third response is the most significant development and deserves further exploration. Effective forms of soft intervention will largely be *active* ones which empower market actors. Critically, this is not premised on a naïve faith in market benevolence. Market action can be reinforced and directed in the public interest.

Intelligent and determined promotion of *market* activism, such as that of shareholders, should be part of the Government's broader account of *civil* activism. By demonstrating how citizens can promote social progress as economic as well as democratic actors, the Government can develop a model of civic engagement that is both more concrete and more ambitious.

None of this is to say that soft intervention is a panacea; its contribution is inherently limited. However, without a clear-headed assessment of how to enhance the use of this approach it will be a missed opportunity.

This report presents the Government with a much needed analysis of these issues. This work is informed by quantitative research conducted with 500 UK company directors in summer 2002. This primary research sheds light on the views of corporate Britain and informs our recommendations on how the Government should reform its use of soft mechanisms in specific policy areas as well as across the broader issue of corporate social responsibility. A detailed analysis of the data is presented in the ippr publication *What's on the agenda? How UK directors contribute to social and environmental objectives*, the key findings of which are highlighted in this report (Joseph 2002a). Unless stated, the data set out below refers to the whole sample and is broken down to show results for the service and industrial sectors as well as for directors representing small, medium and large organisations.

1. Is there scope for improvement on hard regulation?

A new business agenda for government explores the value of 'soft' forms of government intervention as a supplement to traditional regulatory and fiscal tools. In the most general sense, soft interventions are government initiatives designed to promote voluntary (that is, not legally obligatory) business behaviour in line with public policy agendas. A more elaborate explanation of the concept is set out below.

This chapter provides a framework for addressing the questions of what soft policy instruments are likely to offer and how they can be used more effectively. As Chapter 2 will illustrate, these are not merely matters of academic interest. Since 1997 measures of a non-mandatory kind have been an increasingly explicit feature of Government policy, for example, in relation to improving equality of pay and opportunity in the workforce; providing basic skills training and the option of flexible working practices; and reducing emissions of greenhouse gases. A reliance on soft policy tools has not, however, always been matched by a commitment to evaluating the efficacy of this approach.

This chapter introduces the discussion by highlighting the growing interest on the part of the Government in soft intervention as part of the drive towards 'smart' or 'better' regulation. Soft regulation is then located within the broad menu of regulatory forms, and a framework is put forward that makes explicit the available varieties of soft intervention. The possible advantages of soft intervention over hard regulation are considered, together with the conditions for the effective operation of soft policy tools and the main objections to relying on them as a means of changing business behaviour. This chapter concludes with the challenges that this presents to the Government.

Better regulation in contemporary politics

Slowly but surely, the debate about regulation is moving away from a simple dichotomy of those who are 'for' and those who are 'against' government intervention in business behaviour. Increasingly, there is a more thoughtful discussion across the public and private sectors about what the various options have to offer:

- doing nothing;
- regulating in the traditional sense; and
- having recourse to the range of softer forms of intervention in the middle ground.

In part this reflects the need to arrive at the most effective mode of delivering policy, as 'there is no reason to believe that direct state intervention is always the most appropriate solution' and 'there are often conditions that dictate that an alternative to state regulation is more effective' (BRTF 2000a p26).

However, this more thoughtful debate is also a consequence of the desire to avoid unnecessarily increasing the regulatory burden, a real benefit of which is the ability to promote policy objectives whilst expending a minimum amount of political capital fighting the vociferous anti-regulation lobbies.

The Confederation of British Industry has warned of the business costs imposed by regulation. The British Chambers of Commerce have a 'cut the red tape' campaign, citing their 'burdens barometer', which (misleadingly) aggregates the total cost of regulation to business. Between January 2000 and May 2001 the cost is said to have risen to £15 billion, a composite figure which includes everything from the introduction of the Minimum Wage to the Working Time Directive (BCC 2003). The Institute of Directors has stated that 'the message is clear; Government must cut back on regulation now for the sake of our business, our prosperity and jobs' and it has urged members to send in their own 'red tape stories' to post on the IoD website (www.iod.com).

The Government is sensitive to these views. The 2001 Labour Party business manifesto was explicit that the Government was committed to 'deregulate as desirable, and regulate with as light a touch as possible' (Labour Party 2001). The private sector is more amenable to market-driven constraints on its behaviour and is keen to encourage a shift towards policy frameworks that rely on a self-interested business response to market pressures. Possible state encroachment upon what is seen as an essentially voluntary terrain such as prescriptive regulation for 'corporate social responsibility' (see Chapter 3) is interpreted as 'regulation by stealth' and opposed as such (CBI 2001).

In this report our interest in alternative regulatory forms does not arise from their capacity to reduce burdens on business, though of course if they have this effect, so much the better. Rather, our aim is to assess their ability to achieve a more complete realisation of public policy objectives than can be obtained by reliance on conventional regulation alone.

Commitment inside the Government to consider soft intervention

There is now an accepted view inside the Government that 'the alternatives to state regulation can play an important part in ensuring a regulatory regime that promotes business competitiveness while at the same time providing appropriate levels of protection to workers, consumers and the environment' (BRTF 2000b). A number of recent changes have formalised the commitment to this agenda.

The so-called 'better regulation' agenda puts the onus on regulating departments to give more thorough consideration to the potential (risks, costs and benefits) of non-regulatory ways to meet policy objectives. The Better Regulation Task Force has played a central role. It was established at the end of 1997 as an independent advisory body. Its original terms of reference were to advise the Government on action which improves the effectiveness and credibility of regulation by ensuring that it is necessary, fair and affordable as well as simple to understand and administer (Cabinet Office 2003a). In 1998 BRTF published five principles to be used as a template to judge and improve the quality of regulation. These were updated in 2000 as: transparency; accountability; proportionality; consistency; and targeting. In 2002 BRTF's terms of reference were altered to reflect this (BRTF 2003).

The most comprehensive statement of the Task Force's view on the range of possible approaches to regulation is contained in its report *Alternatives to State Regulation*. Here it extended its principle-based approach to explore the range of regulatory alternatives which spans schemes without any Government involvement, to those that are created and managed by Government, but 'stop short of direct regulation enforced through the courts' (BRTF 2000a p4).

Using more than 50 case studies of codes of practice it identified five characteristics which should prompt policy makers to consider using alternatives to state regulation:

- fragmented markets with large numbers of small operators;
- a broad range of stakeholders with varying interests;
- a fast-changing environment which could be hindered by static regulations;
- where regulation requires high levels of expertise; and
- where this expertise is spread across a range of different groups.

In 1997 the 'regulatory impact unit' (RIU) was established in the Cabinet Office to support the Task Force and promote its principles as well as to work with other government departments, agencies and regulators to help ensure that regulations are fair and effective. It explicitly notes the importance of striking the right balance so that regulations do not impose unnecessary burdens on business or stifle growth. Since then RIUs have been created in all regulating departments.

In every department a minister has been nominated as responsible for ensuring effective regulation and a high-level ministerial panel has been convened to oversee this stream of work. Members of the ministerial Panel on Regulatory Accountability (PRA) include the Secretary of State for Trade and Industry, the Chief Secretary to the Treasury and the Minister of State for the Cabinet Office. The chairman of the BRTF and the Small Business Service also attend meetings. The panel's terms of reference are 'to take a strategic overview of the regulatory system; to tackle instances where progress on regulatory reform is blocked; and call ministers to account for new regulation and their performance and in addressing the burden of existing regulation' (Cabinet Office 2003b).

In August 1998 the Prime Minister announced that no proposal for regulation which has an impact on business should be considered by ministers without a regulatory impact assessment being carried out. Partly in response to the BRTF's report on alternatives to state regulation, the Regulatory Impact Unit guidance on 'good policy making' and the regulatory impact assessment process obliges departments to consider alternative approaches. The soft alternatives promoted include:

- improving advice or information
- using a code of practice (noting that approved codes of practice have the force of law and are themselves subject to a regulatory impact assessment process)
- asking the industry to regulate itself (RIU 2000).

The Task Force has recently criticised departments for failing to act in accordance with the regulatory impact assessment process and give proper consideration to alternatives to state regulation (BRTF 2002a). It therefore recommends that the role of departmental RIUs be expanded to ‘more of a policy options impact role’ in order to ensure that departments give ‘serious’ consideration to alternatives to state regulation in setting policy. Its initial recommendation that the DTI does so in relation to employment regulation has been heeded - ensuring that there is an independent expert considering what form of intervention to use. The expectation was that other departments and agencies with an interest in employment would follow the DTI’s lead.

The 2000 guidance to policy-makers issued by the Cabinet Office’s Regulatory Impact Unit was reviewed in 2003. The RIU consultation paper *Better Policy Making* emphasises the need to consider all forms of regulation. The Better Regulation Task Force called upon the review to take account of the need for better analysis of alternatives to state regulation. Indeed, the subsequent guide to regulatory impact assessment included an extended list of possible non-legislative options (RIU 2003). The Public Accounts Committee also recommended that more was done to explore alternatives to state regulation (CPA 2002).

In November 2002 the Task Force committed to undertake its second review of *alternatives to state regulation* (BRTF 2002b). This project was due to be completed by summer 2003 having considered the pros and cons of all forms of alternatives to direct regulation. At the time of writing in summer 2003 the Regulatory Reform Action Plan, which followed the Regulatory Reform Act 2001, was also being implemented (Cabinet Office 2002). It included 260 proposals to rationalise the regulatory process, to be delivered through a variety of means including simplification of the administrative process as well as de-regulation.

There is a palpable commitment within the Government to the modernisation of the regulatory system. And as Chapter 2 will discuss, across a number of social and environmental policies soft forms of intervention are already being used. However, in order to put this political appetite to good use, a more systematic analysis of the different methods of intervention available is required and so too is a better appreciation of where they have already been introduced and to what effect. The following section provides the theoretical basis for this discussion.

A framework for understanding regulation

A wide range of tools is at the state's disposal when attempting to change corporate behaviour. As the previous section has shown, there is increasing evidence of pressure emanating from the Cabinet Office for other departments to have a robust rationale for their preferred form of intervention. Surprisingly, however, the conceptual framework adopted to aid such decisions is relatively unsophisticated. This section provides a more nuanced consideration of the ways in which government can change business behaviour. In doing so it defines soft intervention and sets the parameters for a discussion of the use of this approach.

Distinction between hard and soft regulation

Direct, 'command and control' government regulation refers to both the prescriptive nature of regulation (the command), as well as its enforcement via the imposition of some negative sanction (the control). Therefore, the distinction between 'hard' regulation and 'soft' regulation can be defined in terms of these two criteria. For example, in the fields of pollution control or occupational health and safety, certain technologies or procedures are mandated by hard regulation: prescribed legal obligations backed by criminal sanctions for non-compliance.

Taxation and other forms of economic intervention, such as tradable pollution permit schemes, are designed to increase the price of certain activities and force companies to internalise any of the costs of their operations that they might otherwise impose on society. Economic instruments can also be regarded as hard regulation in that they attach financial consequences (negative or positive) to certain acts with a view to deterring or encouraging them. However, unlike command and control, they do not impose absolute obligations. For example, if the conduct in question is still privately profitable given the obligation to pay a tax, the 'regulatory signal' is *not* to refrain from the behaviour.

The traditional definition of soft regulation is where one or both of the above criteria are not satisfied. The Better Regulation Task Force's definition of 'alternative' regulation is, for example, regulation that 'stops short of direct government regulation enforced through the courts' (BRTF 2000a p4).

The assumption (questioned below), is that direct government regulation can guarantee policy outcomes by altering behaviour in the way specified. In contrast, under a soft regulatory regime outcomes are contingent on the degree of *voluntary* compliance (take-up), given that organisations are not obliged to comply by law.

Of course, constraints on corporate activity can also emanate from (and even be exclusively 'enforced' by) non-governmental actors. An example of this 'civil' regulation would be a media campaign against an organisation, heightening the possibility of a consumer boycott forcing a u-turn in company policy.

Table 1.1 sets out the traditional typology of hard, soft and civil regulation: on the basis of whether corporate behaviour is prescribed; regulations are mandatory (that is, backed by an agency with statutory powers); and hence whether the outcome is specified and certain or contingent on corporate and third party reactions.

It might be noted that in some cases the behaviour required by regulation is at such a high level of generality as to be in effect non-prescriptive. For example, legislation might stipulate an aspiration or general objective and be vague about how the outcome is to be achieved (at least prior to the accumulation of case law). In these cases the result will be contingent on the actual behaviour of those subject to the regulation, and should accordingly be classified as soft. For example, thousands of public bodies are now subject to the general positive duty contained in the Race Relations (Amendment) Act 2000 to promote 'race equality and good community relations'. While many of them are also subject to specific duties (prescriptive procedural requirements), such as to prepare a race equality scheme, others, including parish councils, are subject to only the general duty.

Table 1.1 Traditional typology of regulation

Traditional typology	*Prescriptive*	*Mandatory*	*Policy outcome*
Hard	✔	✔	Specified (certain)
Soft	✔	✘	Contingent on take-up
	✘	✔	Contingent on behaviour
Civil	✘	✘	Contingent on take-up and behaviour

Where the traditional typology is inadequate

The simple hard/soft/civil typology set out in Table 1.1 fails to articulate the full range regulatory possibilities on two counts.

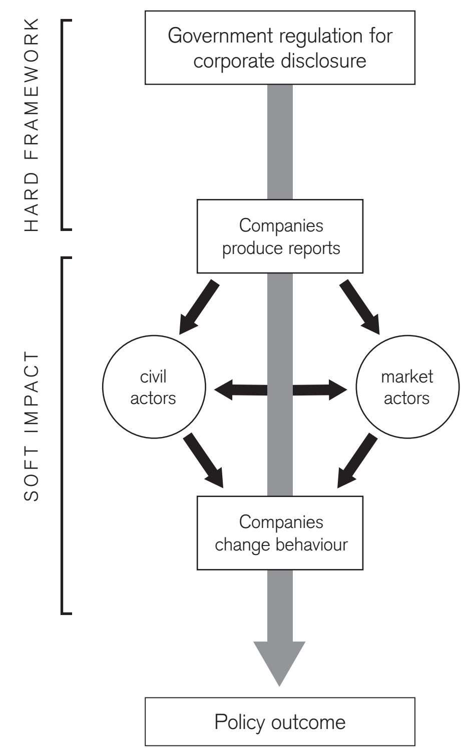
First, there is the important use of hard regulatory requirements that may be prescriptive with respect to the behaviour that they seek to ensure, but whose ultimate outcome is unspecified and so uncertain. In other words, the behaviour prescribed by regulation does not *equate* to the eventual outcome desired by policy-makers, instead it creates the circumstances that encourage or enable a desirable shift in behaviour. As Figure 1.1 shows, these 'hard frameworks' have a 'soft impact'.

Disclosure requirements are an example. While disclosure itself may be mandated, the obligation to collect and reveal social or environmental information is largely a means for achieving the end of modifying the behaviour of the reporting organisation. The eventual outcome will be contingent on each organisation's response. This is in contrast to employment law and environment and health and safety regulations which prescribe business conduct.

The changes in 1999 to the Pensions Act, which oblige pension fund trustees to be transparent about the extent to which they take social, environmental and ethical issues into account in their investment policies and decisions about 'engagement' with company managements, are another case in point. The Act does not require trustees to take these issues into account, nor set out how they should do so and, by default, it fails to indicate what this improved transparency seeks to achieve, both in terms of the behaviour of the fund and of the businesses in which the fund may invest. Nevertheless, as discussed below, the disclosure of their 'statement of investment principles' appears to have had a significant effect in stimulating an interest on the part of the investment industry in the social and environmental impacts of companies, which may in turn have an impact on the way in which those companies behave (see page 90).

More directly, it may be the company itself that is required to disclose information about its social or environmental performance. Here, increased transparency should help shareholders hold management to account regarding these issues (such as, where disregard of social or environmental effects is damaging to the business) and may also lead to strengthened pressure from those directly affected or other civil society organisations. The proposals for mandatory reporting within an Operating and Financial Review (see page 96) can be viewed in this light.

Figure 1.1 The soft impacts of hard disclosure regulation



Second, the simple typology is inadequate in that it does not explicitly take account of the possibility of government intervention in regulation that is itself essentially non-governmental. The Government can enhance the effectiveness of civil regulation, such as, through disclosure requirements, as just described, or more informally, for example by naming and shaming poor performers or endorsing voluntary codes of conduct.

It is important that proper emphasis is given to these aspects of the soft regulatory armoury. As discussed further in the next section and again in Chapter 3, interventions that stimulate the market and civil society pressures on companies for improved social and environmental performance provide a commercial imperative for change. This is *active* soft intervention with 'teeth', not merely the *passive* encouragement for companies to do what is already in their financial interests.

From regulation to a new framework of intervention

Recognising the blurring of traditional categories of hard, soft and civil regulation, and that command and control is not the only route to altering company behaviour, *intervention* is a more appropriate term than regulation.

This report defines soft intervention as 'government intervention without a primary recourse to fiscal or legislative changes'.

As Chapter 2 shows, across many policy objectives it is now possible to identify a number of complementary types of government intervention applied *simultaneously*. These can be described within five broad categories, from no intervention and a reliance on civil regulation to hard regulation. These are shown in Table 1.2.

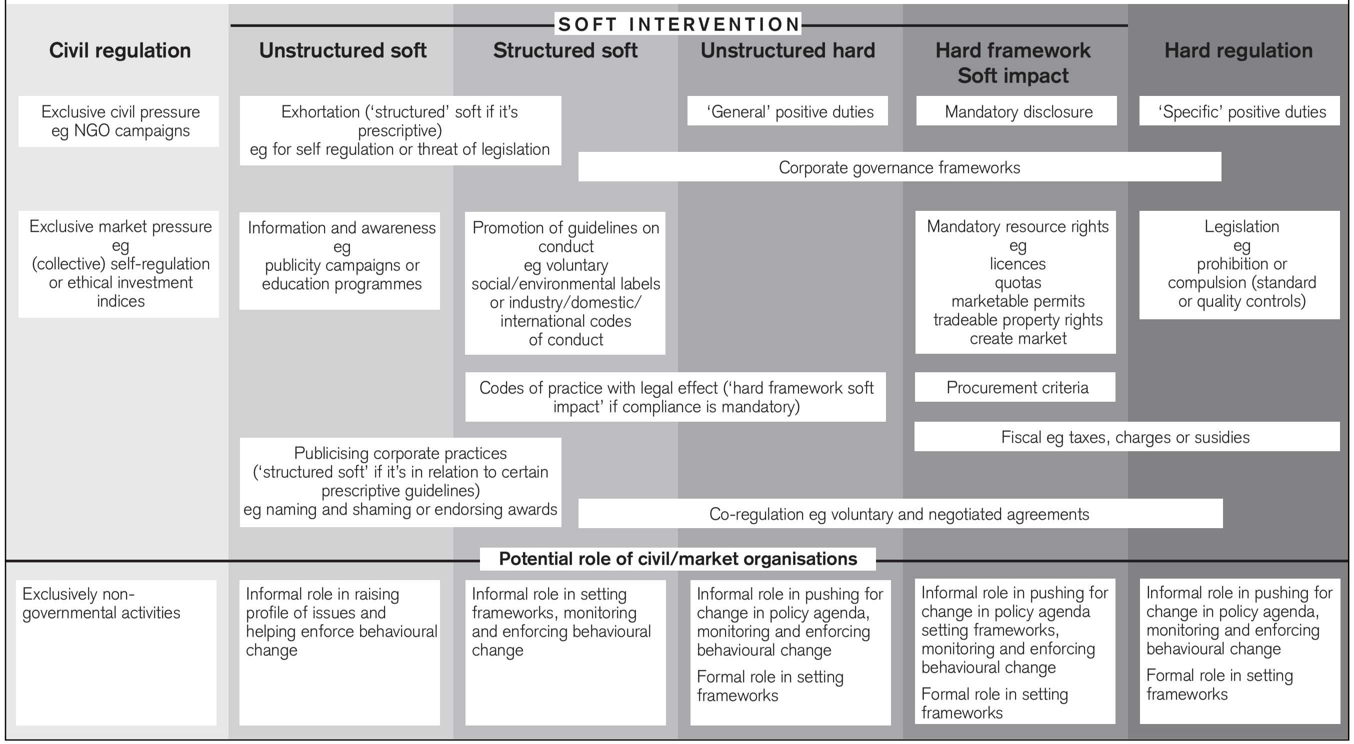
<table>
<caption>Table 1.2 New categories of government intervention</caption>
<tr><th>Traditional typology of regulation</th><th colspan="2">New category of intervention</th><th>Prescriptive</th><th>Mandatory</th><th>Policy outcome</th></tr>
<tr><td rowspan="2">Hard</td><td colspan="2">Hard</td><td>✔</td><td>✔</td><td>Specified (certain)</td></tr>
<tr><td rowspan="4">Soft</td><td>Hard framework soft impact</td><td>✔</td><td>✔</td><td rowspan="2">Contingent on behaviour</td></tr>
<tr><td rowspan="2">Soft</td><td>Unstructured hard</td><td>✘</td><td>✔</td></tr>
<tr><td>Structured soft</td><td>✔</td><td>✘</td><td>Contingent on take-up</td></tr>
<tr><td rowspan="2">Civil</td><td>Unstructured soft</td><td>✘</td><td>✘</td><td rowspan="2">Contingent on take-up and behaviour</td></tr>
<tr><td colspan="2">Civil</td><td>✘</td><td>✘</td></tr>
</table>

As with most attempts to categorise possible forms of government intervention, Table 1.2 is more accurately seen as a spectrum. Within each category there are a number of policy tools, some of which span multiple categories. Examples of each type are set out in Figure 1.2.

As Figure 1.2 shows, civil and market actors can have a key role in both developing and implementing soft intervention. The formality of this role refers to their relationship with government and the policy-making process. 'Informal' denotes a role independent of official processes. The inclusion of non-governmental actors in policy-making or enforcement raises the issue of the legitimacy of NGOs to fulfil these roles, for example, the need for transparency about NGO funding and lines of accountability. These potential criticisms of soft intervention as well as responses to them are discussed in more detail below (see page 25).

As Chapter 2 shows, soft intervention is currently relied upon for the delivery of numerous important policies in the public interest. An understanding of the range of options open to government is critical in areas where traditional forms of regulation are unlikely to achieve the desired results. The following section explores the potential limitations of harder forms of intervention and the circumstances under which soft intervention is likely to be effective in bringing about change.

Figure 1.2 The spectrum of government intervention



The potential of soft intervention to deliver

This section explores what soft intervention may offer policy-makers in comparison to harder forms, as well as the conditions that need to be in place for it to be effective. Although there is a political appetite to adopt soft mechanisms, the challenging criteria for success undoubtedly limit the situations in which they are likely to make a valuable contribution.

The limitations of hard regulation

It is easy to summarise the intended benefits of hard regulation: it has a specified outcome, and subject to an effective enforcement mechanism, ensures the achievement of policy goals. However, in reality an array of potential limitations exists.

The most obvious is that enforcement is often far from effective. As Chapter 2 shows, the minimum standards imposed by regulation across some key workforce issues have not achieved desired outcomes such as equal pay and a diverse workforce. Indeed, it seems impossible to secure anything like full compliance with the vast range of regulatory provisions. It would require monitoring and enforcement activity on a scale that would be prohibitively expensive even if it were feasible.

Aside from the problems of enforcing the rules, it will often be impossible adequately to specify, within the parameters of regulatory standards, the changes in behaviour that an underlying policy commitment requires (Ayres and Braithwaite 1992; Gunningham and Grabosky 1998). Regulation does not easily lend itself to changing the processes or culture embedded in many different types of organisation. Furthermore, even if policy makers could adequately define what it is they hope to achieve, they may not have the experience to know the best way to ensure change. Of necessity, standard-setters are remote from the companies whose conduct they seek to modify. The Government has only limited information about the ways in which each individual business operates and about how to minimise the adverse effects of their activities or encourage them to promote public policy goals.

Regulation also largely depends on the imposition of uniform standards that are not tailored to the operational circumstances of specific companies, although there may be some flexibility in enforcement. As a result of these factors there is a tendency for controls to be *under-inclusive*: they may fail to catch all forms of harmful conduct or fail to raise standards of performance to the 'optimal' level. Controls may also be *over-inclusive*, having the unintended consequence of interfering with legitimate activities (Baldwin and Cave 1999; Gunningham and Gabrosky 1998).

That controls may be under-inclusive is a serious matter. Regulation via externally imposed rules often engenders a minimal compliance approach, in the sense that while the rules may be followed, those subject to them may pay little regard to their underlying purpose. For example, in the health and safety field it has been suggested that for many companies the aim is simply to satisfy legislative requirements, rather than to focus directly on the health and safety needs of employees (Haines 1997; Hoffman 2001). Likewise, companies may pay the statutory minimum wage, but continue to impose undisclosed costs on low-paid staff (Abrams 2002; Toynbee 2003). Minimal compliance with the letter, rather than the spirit of regulation may undermine the achievement of policy objectives.

The fact that regulation necessarily operates by laying down uniform standards creates another problem. Because of a natural reluctance to impose obligations that many businesses will find it impossible to meet, there is an inevitable lowest common denominator effect, with the law setting minimum, base-line standards. Companies that could, without disproportionate expense, perform above the statutory minima are given no incentive to do so. Nor do relatively static rules provide businesses with any encouragement to explore innovative approaches to reducing regulated hazards or to adopt a programme of continuous improvement.

Economic instruments, such as taxation and tradable permits, might in principle be able to overcome some of these difficulties. For example, in relation to the environment, by creating an ongoing incentive to develop new ways of reducing waste. However, the extent to which such advantages are obtained in practice is as yet unclear. There may be unintended side-effects of altering the economic context of business operations, and economic instruments are not appropriate across all policy areas (Gunningham and Grabosky 1998; Orts 1995). For example, the message implicit in giving companies financial incentives to treat all their employees fairly is likely to be considered unacceptable.

Finally, state regulation often reacts slowly to new sources of harm or shifts in social norms and public opinion (Stone 1975). Even before formal action is taken, the commitment to recognise public concern in future policy changes and a systematic consideration of the options (which might involve the creation of a commission or taskforce) takes time.

The extent to which national governments have lost the ability to set their own regulatory agendas should not be exaggerated (Hirst and Thompson 1996). However, these constraints call into question how far we can rely on traditional forms of regulation alone to create a framework of effective controls on business that fully reflects popular preferences or optimally promotes the public interest. Although it is important that the availability of non-state forms of regulation should not be used as an excuse by public authorities for abdicating their responsibility for imposing acceptable minimum standards, the pressures on governments to avoid highly prescriptive forms of regulation are another reason for exploring the potential of alternative approaches. The following section sets out the advantages of using soft intervention to complement harder forms. These are set out alongside the limitations of hard regulation in Table 1.3.

Soft intervention as a complement

Much of the case for employing soft intervention as a supplement to harder forms of regulation is premised on the existence of non-governmental pressure on companies to improve their social and environmental performance (Ayres and Braithwaite 1992; Gunningham and Rees 1997). Soft intervention can stimulate, strengthen or direct potential pressure from a range of stakeholders – employees to NGOs – to promote elements of the 'public interest'. The evidence of this pressure is evaluated in Chapter 4.

As Figure 1.2 illustrates, soft forms of intervention include process standards (for example, environmental management systems), collective industry self-regulatory schemes, voluntary frameworks established by inter-governmental bodies or the private sector, and partnerships between government and civil society (co-regulation). Government intervention may both strengthen the incentives to participate in these voluntary schemes (for example, where disclosure requirements increase the vulnerability of companies to market pressure), and also improve the functioning of the schemes themselves, for example where government brokers or endorses a code of standards.

An important advantage of these (largely) non-state forms of control is that they bring the standard-setting process closer to the activity to be regulated. Standards may therefore be devised with the specific circumstances of the company or industry in mind, reducing problems of under- or over-inclusiveness. Because public pressure, unlike legal rules, reflects open-ended expectations about higher standards, it also provides companies with incentives to strive for continuous improvement, and thus to adopt mechanisms to bring this about, such as target-setting with the progressive raising of standards and disclosure of performance.

Stakeholder participation in standard setting can facilitate learning and innovation, potentially leading to the adoption of standards that strike a better balance between corporate and third party 'stakeholder' interests. Other advantages are that non-governmental rule-making can respond more rapidly to new problems created by corporate activity than can the legislative process, and there is evidence that businesses may be more disposed to comply with rules if they have participated in drawing them up (Gordon 2000). These potential advantages of employing soft forms of intervention are summarised in Table 1.3 below. However, in order to be effective certain conditions must be met.

Conditions for effective soft intervention

The voluntary response of individual organisations to soft government intervention is likely to depend on a complex decision-making process and as such will be unique in each instance within every organisation. However, it is possible to identify general conditions for its successful implementation as a policy tool. These external criteria for success are also included in Table 1.3.

A necessary but insufficient condition is a coincidence between the public and private interest. That is, significant improvements in corporate social and environmental performance are likely to occur only when they are also consistent with the company's (long-term financial) interests. This coincidence can either occur naturally or be artificially manufactured by generating or harnessing external pressure sufficient to align divergent interests. As Chapter 3 explains, instances with a direct 'business case' are limited and therefore government intervention to promote voluntary action must not be confined to passive intervention in order to raise awareness of 'money saving' opportunities. *Active* soft intervention is more usefully employed to alter the commercial environment in order to bring about a coincidence of public and private interests.

In order to have a mutual public-private desire to change corporate behaviour, the policy issue in question must have interest and support from one or more stakeholder groups who are willing and able to exert market pressure. This can be applied directly, or in the case of the media, by provoking others to do so. The downside of falling foul of this market intervention must be adequate to make a 'voluntary' response in an organisation's interest.

Compliance with all forms of soft intervention is largely dependent on empowered stakeholders. The mechanism for translating stakeholder pressure into a corporate response has to be effectively targeted: tailored to the specific area of corporate practice that the public has an interest in being altered. For example, there is no guarantee that employee pressure to reform human resources policy through adherence to a general code of conduct will necessarily deal with unacceptably low-wages or safety at in the workplace.

Ultimately, whether companies have the incentive to change will depend on the potential weight of demands exerted by employees, customers, investors and others. The resources deployed to realise these wishes are not necessarily directly financial; for example, a sector can threaten exclusion from its industry association. Hence some sources of market pressure are only directly relevant to certain organisations: shareholders and institutional investors are not relevant to small partnerships; individual customers to manufacturers; nor employees to sole traders. Chapter 4 goes on to discuss the existence of these stakeholder pressures in more detail as well as what the Government can do to promote them.

Although interested, informed and powerful civil and market actors are necessary for the success of soft intervention, they are insufficient to guarantee it. A further prerequisite for success is outside the power of policy-makers: rational corporate behaviour. It will never be possible to accurately predict the response of business to soft intervention and other

Table 1.3 Soft intervention as an effective supplement to hard regulation

Limitation of hard regulation	*Advantages of market and civil involvement*	*Form that soft intervention must take*	*External criteria for success of soft intervention*
Lack of effective enforcement mechanism	Improves compliance eg by extending detection mechanisms and imposition of penalties to non-governmental actors and market forces	Involve an implicit/explicit benchmark, so that non-governmental actors can decide whether organisations are complying	Civil or market pressure in support of, as well as knowledge of corporate compliance. Information on corporate practices needs to be accessible to those mediating or applying pressure to change corporate practices
Over-inclusive: unintended consequences	Better understanding of market to avoid undesirable side-effects of intervening in market	Corporate and other stakeholder participation in standard setting	Clear business representative group to consult or other stakeholders with specialist knowledge
	Each organisation decides its own rational course of action as compliance is 'voluntary'	Intervention is targeted on specific outcomes/processes and individual organisations have autonomy over the extent and form that corporate action takes	Civil/market compliance mechanisms are targeted to promote desired outcome without affecting other areas of 'legitimate' activity
Under-inclusive: can only promote minimal compliance with policy goals eg no pressure to improve behaviour over time	Impose pressure for far-reaching and continuous improvement in corporate practices	Escalating targets or clear exposure linked to increasing stakeholder expectations (eg through formal engagement) or public benchmarking against best performers in the market	Stakeholder interest and intolerance of minimal compliance and industry 'laggards'

Limitation of hard regulation	*Advantages of market and civil involvement*	*Form that soft intervention must take*	*External criteria for success of soft intervention*
Slow reaction to popular demands eg rigid and bureaucratic processes	Direct reflection of (changing) popular preferences	Developed by non-governmental actors with clear accountability to members or initiated and supported by high levels of public interest	Popular demands for changed corporate behaviour exist (eg there is market or civil interest in the issue which is articulated)
Erect barriers to trade by setting international standards	Avoid contentious formal international regulatory processes	Minimal/informal government involvement in market intervention mechanism	Civil/market stakeholders willing and able to lead development of market intervention mechanisms as well as enforce compliance
Unacceptable political expense of hard regulation eg political capital spent fighting powerful interest groups	Avoid political expenditure, by ensuring that compliance is voluntary and burden of regulation is not imposed, but becomes part of an individual organisation's decision-making process	Little/informal government intervention and compliance is ensured by non-governmental actors alone	Civil/market stakeholders willing and able to lead development of standards as well as enforce compliance

voluntary initiatives. As Chapter 3 shows it is impossible to reduce all corporate decisions to straightforward financial calculations.

Although these are demanding conditions for successful soft intervention, the effects of this type of government action cannot be dismissed as trivial and its adoption remains contentious. The next section sets out the criticisms of using soft methods to drive change in business practices.

The limitations of soft intervention

While it is possible to identify a number of ways in which soft intervention is capable in theory of compensating for the limitations of hard regulation, whether the benefits are likely to be obtained in practice is more difficult to assess. There is a danger that the business response to market and civil society pressures will be to create an appearance of change rather than a genuine improvement in performance. Companies may also use voluntary initiatives to forestall more rigorous mandatory regulation: just doing enough to reduce the pressure for intervention, but not adequately fulfilling public policy objectives. This process may operate in a more subtle way, where business with its superior technological knowledge is able to define the range of apparently practicable solutions.

Problems such as these emphasise the importance of transparency about the impact of corporate practices. So too does it highlight the need for openness about the voluntary standards with which companies claim to comply, and the extent to which they actually comply. Nor should forms of self-regulation be confused with involvement in charitable and community programmes. While often of value, such image-building activities can have the purpose of shifting public attention away from the problems created by the core business. Enron was highly regarded for its philanthropic activity.

Insofar as the incentive for companies to participate in, and comply with the requirements of non-mandatory schemes depends on market and civil society pressure, as Table 1.3 shows its application is likely to be limited. For example, experience suggests that while there is considerable interest from consumers in some policy areas (for example, child labour and environmental issues that have a direct impact on health) in others there is very little. This pressure has been described as 'uneven and fickle', with, for example, high levels of consumer concern about labour conditions in the textile industry in Bangladesh not being matched by interest in the leather industry where the problems have been equally serious, if not worse (PIU 2000 p158).

Patchy popular interest tends to be reflected in patchy coverage of voluntary initiatives. A recent study revealed that codes setting labour standards within a product supply-chain are common only in a few sectors, chiefly clothing, sports goods, and carpets (Haufler 2001). Perhaps for similar reasons, participation in environmental initiatives is mainly undertaken by the largest companies and they address only a limited range of problems.

Scholars in this field argue that although civil regulation has 'changed some behaviour, incrementally and unevenly', the evidence is scattered and difficult to analyse systematically. 'Firms such as Nike and Reebok do pay their workers in Vietnam more today than they did a few years ago. Companies such as BP Amoco and Shell have reduced their emissions of greenhouse gases and pollutants in measurable ways... but these changes are neither profound nor revolutionary, and in many cases they occur only at the margins' (Haufler 2001 p112).

In addition, companies differ in the extent to which they are exposed to market and civil society pressure for higher standards of practice. An important factor is the sector that a company is in. For example, individual consumers have more clout when an organisation sells directly to them competing on the reputation of its brand. This market exposure is also dependent upon the structure of the industry.

Monopolistic on the one hand and highly fragmented industries on the other are less likely to be vulnerable to pressure to alter their behaviour. However, individual businesses should not be discussed in isolation. Supply chain pressure can push market exposure upwards, or 'downstream' to organisations that would otherwise be unaffected. Likewise, a strong industry membership group or a small number of market leaders committed to driving change throughout a sector can compensate for a fragmented market structure.

Objections to soft intervention

There are well-founded doubts about the coverage and effectiveness of soft initiatives. The desirability of using government intervention that relies on the reaction and input of non-governmental organisations (NGOs) and other stakeholders has also been called into question.

Doubts are raised over the *legitimacy* of 'private' standard setting by business and civil society groups as these arrangements exclude elected governments and the broader public interest perspective that they bring (Wolf 2002). This objection ignores the problems of 'regulatory overload', however, that are an important reason for looking to alternative, non-state forms of regulation. It also rests on the questionable assumption that in order to be legitimate, standards must be projected 'top down', by governments. This is in contrast to ideas of pluralism (and subsidiarity), which support the role of norm creation by those directly involved in an activity or affected by its consequences, or institutions mediating the interests of the parties involved.

It is important that the state is diligent in exercising an oversight role and in ensuring that appropriate standards are enforced where private activity fails to generate sufficiently rigorous and effective norms. It should also be borne in mind that the content of many 'private' regulatory codes is derived from, and they are often little more than a means of giving effect to, international conventions to which states are signatories. Such sources include the Universal Declaration of Human Rights, ILO conventions, and conventions on climate change and biodiversity (Zadek 2001; CEC 2002).

One element of the legitimacy criticism focuses on the role played by NGOs in civil and soft regulation. NGOs are not in general representatives of, or accountable to the causes they claim to serve, but rather are interest groups with agendas of their own. The issues on which NGOs choose to campaign may lead to an arbitrary concentration of 'voluntary' corporate activity in particular areas at the expense of those with greater public policy salience. In addition, campaigns may be based on questionable research and an inadequate investigation of the likely consequences of what is being proposed.

These factors emphasise the importance of transparency applied to NGOs as well as to companies, for example, in relation to sources of funding and the evidential basis of their arguments (Willetts 1998). But they do not detract from the value of civil and market pressures in general, or soft interventions to support them. It should also be noted that ultimately the success of NGO campaigns depends on their ability to influence market participants and other actors whose behaviour impacts on business (Secrett 2002). It is the reaction of these groups that necessitates a corporate response. For this reason, the characterisation of the role of NGOs in influencing corporate behaviour as one of 'blackmail and concession' is misplaced (except where campaigners use unlawful means to interfere with corporate activities directly or have recourse to intimidation) (Wolf 2002). NGOs play a part in collecting and disseminating information about corporate practices and co-ordinating stakeholder action, but they have limited coercive power of their own without the potential ability to prompt wider civil and/or market reaction.

A different type of criticism is that private regulatory activity, like any form of regulation, increases business costs, thereby reducing the efficiency of the corporate sector and hence the prosperity of society as a whole (Henderson 2001; Wolf 2002). The costs in question include those that result from the greater complexity of decision-making and the delay and expense involved in any stakeholder consultation, as well as the direct costs of complying with standards higher than those set in hard regulation.

Cost increases are not inevitable, however, since there may be compensating gains, for example, from energy savings or improved employee morale (as discussed on page 65). But even where costs do increase, this is not necessarily a fatal argument, any more than it is against regulation that takes a more conventional form. Where the effect of regulation is to force companies to bear costs that they might otherwise externalise onto third parties or society in general, this can be interpreted as an increase in efficiency rather than a reduction in it. Society may also legitimately choose to protect other, non-economic values, even though this might be at the expense of profit.

One further objection to soft intervention should also be mentioned. This is that those, usually large, high-profile companies that are particularly susceptible to external pressure, are given an incentive to press for conventional regulation to be introduced to match the standards that they have adopted, in order to protect their competitive position (Henderson 2001; Wolf 2002). In this way the regulatory burden is inexorably ratcheted up. However, those who do not view regulation as inherently undesirable are likely to view this is an advantage of civil regulation rather than an objection to it. It suggests the existence of a virtuous process whereby voluntary standards harden into enforceable legal ones, and are extended to all companies in a sector, as opposed just to those that are especially vulnerable to market pressure.

Challenges for the Government

Where hard regulation is inappropriate or insufficient, numerous other options are available. As this chapter explains, there is a range of soft methods which government can use to influence corporate behaviour. The traditional typology set out at the start of this chapter fails to reflect the full range of forms of state intervention, and places insufficient emphasis on soft mechanisms that reinforce and direct non-governmental pressure.

While there is a considerable appetite within the Government to strike the right balance between different types of intervention, before there can be any hope of implementing an effective system of 'better' or 'smart' regulation, there must be a clear understanding of the relative efficacy of all the tools that can be deployed.

The following chapter relates the largely theoretical analysis developed here to five contemporary policy objectives, illustrating how the onus is regularly placed on soft intervention to drive change. However, this is largely in the absence of comprehensive policies to ensure that this approach can deliver.

The preference for light-touch intervention cannot just be based on political judgements about the need to conserve corporate goodwill. **Where the public interest relies on changes in business behaviour, the use of soft intervention must be matched by a commitment to ensure that it will achieve the desired contribution to policy objectives.**

Many forms of soft intervention which produce a convergence of public and private interests cannot be effective on their own or as a complement to harder regulation without interested, informed and powerful civil and market actors.

A reliance on soft intervention to bring about a convergence of public and private interests must be informed by an understanding of the non-governmental pressure in place and policies to stimulate these pressures should be considered simultaneously.

2. A soft centre? The Government's use of soft intervention

This chapter focuses on five examples of policy where, to varying degrees, the Government relies on voluntary action from business, beyond that imposed by a regulatory floor or fiscal incentives. Soft intervention is used to deal with the challenges posed by global warming and to encourage reforms which would improve fairness and productivity in the workplace as well as a fairer and more efficient labour market. This chapter explores:

- the efforts made to reduce **employment rate gaps** experienced by certain ethnic minority groups and **pay gaps** experienced by women. This debate is also relevant to other groups that find it hard to receive fair treatment in the labour market and the workplace, notably the disabled and over 50s;
- policies to increase the access and volume of work-based training and education to improve **employees' basic literacy and numeracy** and the ability of employees to control their **work-life balance** through access to flexible working patterns and other 'family-friendly' initiatives;
- the soft schemes in place to reduce companies' **emissions of greenhouse gases**.

Across these five key policy issues the Government is explicit about the need for change in business practices. Many such public interest goals require shifts in attitudes as well as corporate innovation (organisational and sector-specific changes that might not be adequately encouraged by traditional forms of state intervention). In addition to regulatory and fiscal interventions, soft initiatives are expected to play a significant *complementary* role. The exception is for work-based training and education where soft intervention is a potential *substitute* for a statutory framework, which the Government hopes to avoid.

Applying the framework of soft intervention developed in Chapter 1, Figure 2.1 shows the range of soft mechanisms already adopted by the Government to encourage voluntary corporate action in support of these five agendas.

Figure 2.1 The reliance on soft intervention across five key policies

SOFT INTERVENTION			
Unstructured soft	**Structured soft**	**Unstructured hard**	**Hard framework Soft impact**
Exhortation • to publish environmental reports • to engage in 'human capital accounting' • to introduce flexible work practices		'General' duties • *Directors' duties in new Companies Bill*	Mandatory disclosure • *OFR in Companies Bill* • Requirements on Pension Fund Trustees
Information and awareness to companies • Carbon Trust • Equality direct • Work-life balance campaign • Workplace basic skills advisors • Environment and Energy Helpline	Promotion of guidelines on conduct • Investors in People and model for work-life balance *also to include skills development* • Environmental management systems • ISO14001 and EMAS • EOC's model for pay reviews		Corporate governance frameworks • *Reforms of non-executive director posts*
Publicising corporate practices • Supporting ACCA and BiE awards • Naming and shaming those not producing environmental report • Fair pay champions, the Castle Awards and EU handbook • Great places to work initiative • *CRE award for diversity*	Codes of practice with legal effect • EU eco-label		Codes of practice with legal effect (compliance is mandatory) • EU energy label

Italics denote proposed intervention.

This chapter presents new evidence of corporate engagement in these issues as well as UK directors' awareness of the soft tools employed to rally their support for change. It shows the extent to which the type of government initiatives used are similar across a disparate range of issues which enjoy very different levels of business co-operation. This begs the question of how much consideration has been given to the reliance on the complementary role of soft tools. Indeed, the Government itself stands to lose if this approach is not used effectively. Achieving many targets which it has set itself depends on the voluntary response of business.

Equal opportunities across all ethnic minorities

The Race Relations Act 1976, subsequently strengthened by the Race Relations (Amendment) Act 2000, is the key legislation in place to prevent *direct* discrimination where one person is treated less favourably than another in a comparable situation on grounds of racial or ethnic origin (HMSO 2000). This regulatory floor is also designed to address *indirect* discrimination but here it is complemented and reinforced by a raft of soft measures. This latter type of discrimination occurs when an apparently (race) neutral practice puts people of any racial or ethnic origin at a disadvantage compared with others in the absence of an appropriate and legitimate reason for the practice (SU 2003). A classic example would be recruitment practices that are unintentionally biased against certain groups.

There is a range of government active labour market policies including the New Deals, Employment Zones and Action Teams for Jobs. Although these initiatives are not generally targeted at helping ethnic minority groups into jobs, these groups will be disproportionally affected given the policies' focus on deprived areas where the majority of ethnic minorities live (PIU 2001a) and focus on disadvantaged groups. (More direct effects include Action Teams for Jobs' aim to challenge employer perceptions of people from ethnic minority backgrounds PIU 2001a).

Although it is problematic to talk in general terms about people from ethnic minority groups given variations both between and within any group of people, it is clear that significant inequalities still exist between different ethnic groups' experience of the labour market in the UK.

In summer 2002 eight per cent of those covered by the UK Labour Force Survey identified themselves as members of an ethnic minority group. Evidence shows that ethnic minorities as a whole are more likely to be unemployed, low paid and poor than their white counterparts (PIU 2001a). This leads to greater social exclusion with knock-on effects such as poor health. Ethnic minority unemployment is more than double that of comparable white sub-populations and analysis points to a growing employment rate gap since 1997 (DWP 2002). Although unemployment rates for Pakistani, Bangladeshi and Black Caribbean men have been falling since the mid 1990s, in 2000 the rate of unemployment for these groups was still at least ten per cent greater than the rate for White men (SU 2003).

Evidence also shows that these groups are hindered in their workforce progression. The Labour Force Survey shows that since the 1990s White and Indian men are approximately twice as likely to hold professional or managerial posts as Pakistani, Bangladeshi or Black-Caribbean men. Evidence from a survey of a quarter of the FTSE100 companies also illustrates this problem. Ethnic minorities made up over five per cent of all employees, but only three per cent of junior and middle managers and one per cent of senior managers (Runnymede Trust 2000). Indeed, a 2003 review into non-executive directors found that people from ethnic minorities held only one per cent of these positions (Higgs 2003).

There are complex reasons for the gaps in employment and pay rates between men, women and different ethnic groups. Occupational and sectoral segregation can in part explain pay differentials between ethnic minorities and their white counterparts. For example, over half of working Bangladeshi men were employed in the restaurant industry and one in eight working Pakistani men were employed as taxi drivers or chauffeurs (SU 2003). However, although location, educational attainment and cultural differences are all contributory factors in this segregation, direct and indirect discrimination still seem to prevent people from securing equal opportunities or receiving equal pay for work of equal value. For example, it is estimated that in 2000 the weekly earnings of a Bangladeshi man were half that of his White counterpart, controlling for the influence of age, education, economic environment and family structure (SU 2003).

The Prime Minister's Strategy Unit was asked in 2001 to review the experience of ethnic minorities in the labour market. Its interim report published in 2002 states that 'there remains strong evidence to suggest that race based discrimination is still a factor in the labour market which negatively impacts on the demand for ethnic minority labour' (PIU 2002). However, research conducted for this report indicates that the majority of UK directors say that their organisation has an equal opportunities policy in place (see Table 2.1). However, Table 2.2 also shows that few organisations collect the information necessary to systematically evaluate whether their policy is effective, particularly in relation to ethnic minority groups.

The Government is keen to address this issue. In the 2002 Spending Review a public service agreement (PSA) target was set for the

Table 2.1 UK company directors' adoption of equal opportunities and workforce diversity policies

Does your organisation have a policy on any of the following…?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Promoting equal opportunities	73%	69%	89%	82%	67%
Changing the profile of the workforce in relation to minority ethnic groups	11%	7%	25%	10%	11%

Base: All respondents. Column percentages. Weighted tables

Table 2.2 UK company directors' collection of information on equal opportunities for women and ethnic minorities

Does your organisation collect internal information on any of the following...?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
How pay relates to job title/ job grade	54%	49%	73%	60%	50%
The number of employees by gender	53%	45%	82%	60%	48%
The number of employees by ethnic group	38%	31%	64%	40%	37%
Job title/grade analysis by gender	31%	26%	47%	31%	31%
Job title/grade analysis by ethnic group	22%	18%	35%	25%	20%

Base: All respondents. Column percentages. Weighted tables

Department for Work and Pensions and Department of Trade and Industry to increase the employment rates of ethnic minorities, reducing the difference with the overall rate by spring 2006. The National Employment Panel has responsibility for developing policy to meet this objective in partnership with the private sector, although, implementation will be via Job Centre Plus (the former Employment Service).

At the time of writing, summer 2003, a number of non-governmental initiatives were in place to address indirect discrimination by changing organisations' policies. The Commission for Racial Equality (CRE) is the publicly funded non-governmental body set up under the Race Relations Act to tackle discrimination and promote racial equality. In 2003 it was promoting best practice in the private sector, for example through its 'leadership challenge'. In addition, a number of business-led projects were in place such as 'Race for Opportunity' set up by the membership organisation Business in the Community in order to promote best practice in workforce diversity.

In March 2003, the Strategy Unit's final report on how to improve the position of ethnic minority groups in the labour market made a number of recommendations all of which were accepted by the Government (HMT 2003). The Unit further endorsed the soft approach to complement regulation, aiming to ensure that employers have adequate information, support and guidance made available to them on both legislative and non-legislative standards. It also wanted to see incentives to encourage and award best practice (SU 2003). As a result of this piece of work a number of new soft initiatives were put in place.

In particular, as a result of the Unit's report, by 2004 the Advisory Conciliation and Arbitration Service (ACAS) will double the size of and further publicise the support it offers through the 'Race Relations Employment Advisory Service'. One element of ACAS's work to date has been to deliver the confidential helpline 'Equality Direct' (see page 38). By mid 2006, DTI will have conducted an independent review of how the information and support mechanisms available to employers about race equality can be strengthened as well as the extent to which they meet the needs and influence the practices of employers.

With respect to awarding best practice, the Unit concluded that 'a review of the range of award and recognition schemes raises concerns over whether it is broad enough in terms of the industries or sectors covered or sufficiently recognised to have a significant impact'. It concludes that by the end of 2004 the CRE should have examined the options of more high profile award and recognition schemes to encourage employers to offer equal opportunities to ethnic minorities, again emphasising the potential of a soft approach.

Narrowing the gender pay gap

The gender 'pay gap' can be defined as the average earnings of female employees expressed as a proportion of the average earnings of male employees. The introduction of the 1970 Equal Pay and Sex Discrimination Acts rapidly reduced the gap after 1975 when the Acts came into force. It fell from 30 per cent, but since then further progress has been slow. In 2002 the gap in hourly wages was 19 per cent (Dench et al 2002).

Some important legislation introduced by the Labour Government since 1997 will also have had a disproportionate impact on women's pay: the National Minimum Wage, part-time workers regulation and the 'burden of proof' regulation. However, beyond the changes made in the 2002 Employment Act, additional legislation is not on the political horizon. In the absence of new hard intervention, employers will be relied upon to go beyond legislative compliance, at least to act in the spirit as well as letter of current law. A number of soft interventions are in place to address the inequality that still exists.

In spring 2002 women accounted for 45 per cent of people in employment in the UK (Duffield 2002). The Government's own calculations are that in 2000 over her career an average 'mid-skilled' woman (with some GCSEs but not higher education) earned £250,000 less than her male counterpart and earned a further £140,000 less if she also had two children (Rake 2000).

The persistence of the pay gap can be explained by a number of factors:

- differentials in men and women's work experience, qualifications and childcare responsibilities (Anderson 2001);
- occupational segregation along gender lines (for example women accounted for 97 per cent of those in secretarial and related occupations and 91 per cent of those in caring personal services in spring 2002 and the fact that women account for the lion's share of part-time work;
- both direct and indirect discrimination by employers means that women (as well as other groups such as certain ethnic minorities) still do not receive equal pay for equal work of equal value.

The Government's review into women's employment and pay concluded that 'even the best employers are not necessarily aware of all the anomalies in their pay structures' (Kingsmill 2001 p12). Likewise, over 90 per cent of the 300 organisations interviewed by the Equal Opportunities Commission (EOC) were also confident that their pay systems are free of bias and fair to both men and women (EOC 2001).

These results reflect UK directors' attitudes set out in Table 2.1 and also indicate the scale of the challenge that faces policy-makers. Although almost three-quarters of the directors interviewed said that they had an equal opportunity policy in place, activity to promote equal opportunities appears to be relatively superficial. It does not include extending opportunities to those outside the organisation. Only one in ten said that their organisation had a policy in place to change the profile of the workforce in relation to ethnic minority groups. In addition, Table 2.2 shows that few collected the information necessary to provide a systematic evaluation of these internal policies. However, large organisations and those in the industrial sector were more likely to have a policy in place and collect the relevant information about their employees.

Although the Government has not published a target timetable for eliminating the gap, addressing discrimination in pay is an explicit aim, more specifically promoting equal pay between men and women for work of equal value. The Women's Unit was set up in 1997 and since 2001 has been operating as the Women and Equality Unit in the DTI. The Unit reports that 'the Government is determined to take first steps to help, where it can, close the pay gap further' (WEU 2002). It is here that many of the soft tools of government to narrow the pay gap are co-ordinated.

The Government commissioned a review of women's pay in 2001. The terms of reference for the Kingsmill review were to report on non-legislative ways to improve women's employment prospects and participation in the labour market. The final report endorsed the use of soft intervention by concluding that measures will be most effective where they are adopted voluntarily, clearly support the key business objectives of the organisation and have the commitment of its top management. Indeed, a central narrative of the report is that 'additional costs' will only be incurred by companies if they make 'sound business sense' (Kingsmill 2001 p17).

The Ministers for Women at the time, Patricia Hewitt and Barbara Roche, welcomed the report and outlined Government action, broadly in line with its recommendations. The measures announced were exclusively soft forms of intervention (discussed in more detail below):

- making it easier for women to get information from employers about whether they are getting equal pay;
- developing reporting requirements in large companies based on 'human capital management';
- spreading and supporting best practice through 'fair pay champions'; as well as
- recognising exemplary behaviour in the 'Castle Awards' (Cabinet Office 2001).

The 2002 Budget highlighted the Government's desire for employers to conduct pay reviews, simplifying them by promoting the Equal Opportunities Commission's (EOC) pay review model and the revision of the Equal Pay Code (HMT 2002a). Earlier in 2002 the EOC had launched its Government-funded 'pay review kit', a technical model for employers. The EOC wanted at least half of large employers to conduct an audit by the end of 2003 and called for this to become mandatory if it did not happen on a voluntary basis.

Information included in employment and pay reviews would assist companies in effectively reporting on their human capital. In January 2003 the Trade and Industry Secretary, Patricia Hewitt announced the 'Accounting for People' task force (charged with making recommendations to Government on reporting on human capital). Hewitt said 'at the heart of this project is the desire to provide solid performance benchmarks for stakeholders, particularly investors. Our task is to show how this information can be presented meaningfully in annual reports' (DTI 2003a). Similarly, in 2001 Kingsmill concluded that there was a strong case for including such information in mandatory reporting requirements.

Kingsmill's review also noted the importance of leadership at Board level, the need for equal opportunity indicators in performance appraisals for senior managers and a radical overhaul of the Investors in People (IiP) standard to reflect these issues (Kingsmill 2001). IiP is a voluntary

Table 2.3 Directors' use of the Investors in People standard

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
I have heard of Investors in People	95%	95%	96%	97%	94%
My company has actively engaged with Investors in People	44%	38%	65%	52%	39%

Base: All respondents. Column percentages. Weighted tables

national standard based on an evaluation of an organisation's workforce policies. As Table 2.3 shows this voluntary initiative enjoys extremely high levels of awareness, with 95 per cent of directors saying that they had heard of it and two-thirds of directors from large organisations and over a third from SMEs saying that their organisation had 'actively engaged' with IiP. To date the issue of equal pay is not directly referenced in the core IiP standard, although 'fairness' of recruitment and selection policies and strategies is covered in a separate IiP model.

Fair Pay Champions have been appointed by DTI to help promote and share best practice in a number of sectors. By 2003 they were working in the retail finance, food and drink, manufacturing and further education sectors. The Government also published a handbook for employers in 2003 to bring together good practice from across the EU (WEU 2003b).

The annual Castle Awards were launched by Government in 2001 to recognise and promote employers' efforts to promote equal pay and opportunities in the workplace and the first awards were presented at the end of 2002. The hope is that organisations (across public, private and voluntary sectors) will be encouraged to enter because of the benefit of government publicity, recognition at a national ceremony and the ability to use the logo as part of their corporate identity in recruitment and publicity materials (WEU 2003a).

In 2001 the Government launched 'Equality Direct' a telephone advice line funded by the DTI and delivered by ACAS to provide business advice on good practice and the benefits of effective equal opportunity strategies. In December 2001 it only received 222 enquiries; in the same period in 2002 it received almost double. Although this is a very small volume of calls, it is a good indicator of the issues that worry employers. Over 2001 and 2002, general employment good practice accounted for over a third of enquiries; discrimination law questions accounted for over a quarter of calls; equal opportunities and family friendly practice together accounted for a quarter of calls (see www.acas.org.uk). The desire to comply with good practice guidelines and deal with legal issues appears to be of primary concern.

In search of better work-life balance

The Government defines work-life balance as 'adjusting working patterns' so that 'everyone can find a rhythm to help them combine work with their other responsibilities and aspirations' (DTI 2003a). Although this vision is not just about allowing people to care for dependants, intervention has been primarily an attempt to support a family-friendly culture in business. The Government's rationale for promoting work-life balance policies set out in 1998 *Fairness at Work* White Paper is primarily couched in economic terms (DTI 1998). Family-friendly work practices are said to increase the pool of labour and therefore improve output.

In 1998 the Prime Minister's ambition was 'nothing less than to change the culture of relations in and at work – and to reflect a new relationship between work and family life.' He went on to state that 'it is often said that a change of culture cannot be brought about by a change in the framework of law. But a change in law can reflect a new culture, can enhance its understanding and support its development' (DTI 1998).

In April 2003 employers were given a new legal duty to consider applications for flexible working from employees who are parents of young or disabled children (HMSO 2002). This right was likely to affect 3.8 million parents: 2.1 million men and 1.5 million women with children under six and 200,000 parents with disabled children under 18.

There are no explicit targets for the provision or take-up of work-life balance initiatives. However, the Secretary of State for Trade and Industry during 2002-3 said repeatedly that by the end of that parliamentary term the aim was for everyone to have more choice and control over their working hours. The approach adopted by

Government was a combination of financial support for families and improved childcare provision (1.6 million places by 2004) alongside the EU imposed Directive and complemented with soft measures to work in partnership with business 'to promote the benefits of flexible working and support the take up of best practice approaches in addition to legislation to extend access to flexible work' (HMT/DTI 2003 p2).

An ageing population and the rise in dual earner families means that a growing number of employees will have to negotiate eldercare as well as childcare responsibilities (Harker and Lewis 2001). As much as half of the working age population have some caring responsibilities. Enabling those with caring responsibilities to work will be critical in lifting all children out of poverty as the Government hopes to do by 2020. In 2002 eight out of ten children living in households where no-one works were living below the poverty line (less than 60 per cent of the median national income) (HMT/DTI 2003). However, childcare responsibilities restrict people's employment options. In 2002 95 per cent of women with children under 15 who were in part-time work chose to work less than a 30-hour week. The desire for flexible work is likely to explain the sectoral concentration of women. They are more likely to work in occupations that are lower skilled and lower paid.

There are gaps in the research in relation to which employers offer flexible arrangements (and why they do so) as well as which employees benefited. Evidence suggests that part-time work is offered by over three-quarters of organisations and almost a third of workplaces offer shift work (Dex and Smith 2002). However, family-friendly policies include a wider range of flexible arrangements that aim to support employees in coping with the simultaneous pressure of being carers and employees. These include unpaid leave over school holidays (term-time working); other breaks from work; compensation for working extra hours with time off (in lieu); enabling employees to work from home (such as tele-work); and giving employees (un)paid time off for emergencies.

Research indicates that in 2000 well over half of all workplaces offered staff a flexible working arrangement other than part-time or shift work and at least a fifth of workplaces offered two or more arrangements. However, a similar proportion of workplaces offer no flexibility (Dex and Smith 2002). Between one and three in ten workplaces offer flexitime and term-time contracts. Other policies – job share, reduced hours annualised hours and compressed week – are less

Table 2.4 Directors' adoption of work-life balance policies

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Does your organisation have a policy on improving employee satisfaction with the balance between work and outside work activities?					
Yes	48%	45%	59%	49%	47%
Does your organisation collect internal information on employee satisfaction with the balance between work and outside work activities?					
Yes	46%	41%	62%	48%	44%

Base: All respondents. Column percentages. Weighted tables

popular (DfEE 2001).

The evidence presented in Table 2.4 shows that half of the UK company directors interviewed say that their organisations had policies in place improve their employees' satisfaction with their work-life balance. This is more prevalent in large organisations where six out of ten directors interviewed say that their organisation has a policy and a similar proportion say that they collect information on their employees' satisfaction with their work-life balance.

Although the results from the quantitative research show that an encouraging proportion of directors are interested in how their employees feel about their work-life balance, it is important to note that there is clear evidence of a substantial and unsatisfied demand for flexible work practices. For example, in 2000 half of lone parents not working flexitime would have liked to do so and a third would have liked to work a compressed working week (DfEE 2001a). However, this demand exists across the workforce and not just amongst groups identified as having special needs: lone parents, carers and disabled people.

In 2002 the Better Regulation Task Force highlighted the need to address the long-hours culture and work-life balance as areas in which non-regulatory options should be considered. However, the task force warned that 'employers should not assume that if the government decides to use a non-regulatory approach then they have been given a period of grace to do nothing' (BRTF 2002a p16).

By 2003 the soft intervention in place to encourage a voluntary business response was primarily:

- providing information;
- highlighting the business case for organisational change;
- promoting good practice; and using the 'Challenge fund' to support work-life consultants in selected organisations.

The Challenge Fund (2000-03) was worth £10.5 million to be awarded to organisations so that they can pay consultants to work with them to assess the business benefits of flexible working arrangements; identify the needs of employees; and find and implement solutions that meet the needs of employer, customer and employees.

In March 2000 the Prime Minister launched the Work-Life Balance campaign to oversee this work (DTI 2003b). The campaign, led by the DTI, focuses on three areas:

- tackling the long-hours culture;
- targeting sectors with acute work-life balance problems; and
- providing support and guidance.

The DTI team is working with the Small Business Service and trade organisations to develop good practice and provide advice to organisations.

Those sectors that have been identified as 'hard to reach' are those that do not generally operate flexible working practices. Surprisingly, it is not on the basis of employees' demand for such policies. For example, rather than those sectors where parents of dependent children under the age of 12 tend to work: primarily health and social work for women, the chosen sectors include IT, accountancy, advertising, construction, engineering, pharmaceuticals and hospitality. This is symptomatic of the focus within the work-life balance debate on the better-paid end of the market.

Separately to internal work within the DTI, Investors in People in conjunction with the Employers' Forum for Work-Life Balance developed an explicit model of best practice (www.employersforwork-lifebalance.org.uk). A work-life balance model was launched in May

2003 (www.iipuk.co.uk). This will not form part of the formal IiP accreditation, but will be a separate standard that organisations can choose to be checked against.

Training and education

Basic skills are defined as 'the ability to read, write and speak in English and use mathematics at a level necessary to function and progress at work and in society in general'. Research consistently suggests that one in eight people do not believe that their skills are adequate to meet the demands of everyday life (Brooks *et al* 2001). The proportion of adults without basic skills has important social and economic consequences. For example, in 2001 they were said to be up to five times more likely to be unemployed than their more qualified counterparts (Machin *et al* 2001).

In 2001, only two out of five jobs were accessible to people without level 2 qualifications (defined as five GCSEs grade A*-C or the vocational equivalent) and two-thirds of people with literacy skills at level 1 or below earned less than £9,000 a year (DfES 2001 and 2002). The Government's long-term aim is that all adults should have the opportunity to achieve a level 2 qualification (PIU 2001b). The PSA target is to reduce the number of adults who have literacy and numeracy problems by 1.5 million by 2006 with a milestone target of a reduction of 750,000 by 2004.

The Labour Force Survey (March 2001 to February 2000) shows that almost 7.5 million economically active adults in England had not achieved level 2 qualification. However, many people with low levels of education are in work. The Government's own estimates in 2001 were that half of the seven million adults in England with poor literacy and numeracy skills were in employment (DFES 2001). The 2002 Spending Review also set a separate PSA target to reduce by at least 40 per cent the number of adults in the UK workforce who lack level 2 qualifications by 2010, with one million adults already in the workforce to achieve level 2 between 2003 and 2006 (DTI 2002a). The method by which to do this was set out in the 2001 'Skills for life' strategy (DFES 2001).

As for other countries, the scale of basic skills provision in the workplace in the UK remains small (Green 2001). In 2000, just over ten per cent of employers offered opportunities to learn basic numeracy or literacy skills (TSO 2001).

In the response to the National Skills Task Force (2000) which reported to the Government on a range of education and training policies, the then Secretary of State for Education and Employment, David Blunkett, ruled out statutory measures to force employers to train their staff (National Skills Task Force 2000). Instead he promoted 'a more imaginative set of levers that help ensure employers make the right decisions about the importance of skills and developing people in their business' (DfEE 2001b). In 2002, the Treasury stated in the Pre Budget Report that in order to address basic skills problems, new ways of working with employers which go with the grain of their business needs were required (HMT 2002b).

Employer training pilots (launched in September 2002) are primarily a fiscal policy. In 2003 six pilots were operating to test new ways to improve access to training for low-skilled employees (funding was secured for them to operate at least until 2004). Firms offering low-skilled employees paid time off to train in the pilot areas are being provided with subsidies (up to 150 per cent of wage costs for small firms); free training courses up to level 2; and also information and guidance on training. However, it is too early to evaluate the pilots.

Research conducted for this report illustrates encouraging levels of support from employers for the need encourage all their employees to reach level 2 qualifications (see Table 2.5). Half of the directors interviewed had a policy in place (and unsurprisingly over three-quarters collect information about their employees' qualifications). However,

Table 2.5 Directors' adoption of policies to promote basic skills

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Does your organisation have a policy of encouraging all employees to achieve level 2 qualifications?					
Yes	50%	48%	57%	53%	48%
Does your organisation collect internal information on employee qualifications?					
Yes	76%	73%	86%	80%	74%

Base: All respondents. Column percentages. Weighted tables

work-based training is provided by employers is unlikely to help the least skilled.

The more qualified someone is, the more likely they are to receive training. There are rational explanations as to why a person's qualifications and occupation are key predictors of their access to workplace training (PIU 2001b). There are a range of possible market failures: businesses may not be able to gain the full returns to this type of investment, and many individuals face financial barriers or are poorly informed about the value of training. Reasons such as these mean that organisations with less skilled employees have less incentive to provide training. In order to provide opportunities for those in work to develop their basic literacy and numeracy, it is necessary to both increase employer activity as well as change the pattern of this intervention.

The 'quality of life' indicator adopted in the Government's 1999 sustainable development strategy to indicate success in boosting workplace learning is the number of businesses voluntarily opting to be recognised as Investors in People (DEFRA 1999). The target was for 45 per cent of medium-sized or large organisations (employing more than 50 people) and 10,000 small organisations in England to be accredited by the end of 2002. In November 2002 the first target had almost been met (over 44 per cent of medium and large organisations were accredited) and the second was exceeded (in January 2003 over 11,500 small organisations employing 10-49 people had been accredited by IiP) (for more information see www.iipuk.co.uk).

A new 'aspirational' target was set by the Learning and Skills Council and DfES target for 45 per cent of the workforce to be covered by employers committed to or recognised by IiP, including at least 40,000 small firms (employing five to 49 people) by 2007. The Government has allocated £30 million to Learning and Skills Council to promote this activity, particularly among small and medium-sized enterprises (SU 2002). As Table 2.3 shows, IiP enjoys extremely impressive levels of recognition among directors of UK companies.

The infrastructure put in place by the DfES includes workplace basic skills advisers in each Learning and Skills Council who conduct site visits and give free advice to those organisations that request support. The Government is seeking to develop policy that helps both employers and individuals to meet their responsibilities in this area, recognising that voluntary approaches have secured increased participation in workplace training, but that they have not been sufficient given the scale of the problem (HMT 2002b). In 2002 the Chancellor announced a new employer-led taskforce to support the expansion and improvement of work-based training programmes.

In 2001-2, the Prime Minister's Strategy Unit was charged with evaluating current policies and developing a strategy for improving skills in the UK workforce. The Strategy Unit put a great deal of weight on increasing the 'demand' for basic skills, particularly among employers: promoting the business case as the means of realising latent demand. In addition to developing and promoting the commercial case for workforce development, the Unit's policy proposals included a number of soft interventions:

- sharing best practice and awarding achievement;
- gathering evidence of 'what works';
- promoting the role of skills in benchmarking indexes; and
- developing Investors in People and other awards (as also recommended by investigations into the promotion of equal opportunities and diversity).

In terms of promoting best practice, the Government already supports the 'Great places to work' initiatives in conjunction with the European Commission and Financial Times (www.greatplacestowork.co.uk).

The Secretary of State for Trade and Industry, Patricia Hewitt endorsed the view set out by the Strategy Unit and in the Kingsmill report that 'human capital accounting' is important so that private sector expenditure on training can be published as an investment (with benefits) rather than simply a cost. The suggestion is that even by promoting voluntary disclosure this can 'produce a knock-on effect in the business community, as more and more companies take a closer look at their training and development practices and compare themselves to their peers' (SU 2002). However, the implication could be that voluntary reporting will eventually be incorporated into the mandatory Operating and Financial Review (see page 96). Although Table 2.5 shows that three-quarters of organisations collect information about their employees' basic skills, few said that they made information such as this public (Joseph 2002a).

Reducing emissions of greenhouse gases

Global temperatures are rising. In the UK there has already been an increase of one degree celsius over the past century, compared to the 0.6 degree rise globally. The 1990s included seven of the ten warmest years on record, and scientists estimate that sea levels are increasing by 1.5 millimetres a year (DETR 2000). Pessimistic predictions are that by 2080 temperatures in the UK will on average be as much as five degrees higher, with the prospect of them reaching 40 degrees on some days. This change has already had serious effects. The 'thermal growing season' has increased by about one month and precipitation patterns have changed with an impact on flooding (Environment Agency 2002).

The Government ratified the Kyoto Protocol before the World Summit on Sustainable Development in Johannesburg in August 2002. The Protocol commits the UK to reducing greenhouse gas emissions by 12.5 per cent below 1990 levels between 2008 and 2012. The 2003 Energy White Paper set the Government's long-term aspiration as a 60 per cent reduction by 2050.

Although Government believes that its intervention to address environmental problems should be primarily to correct for market failures (ensuring that the 'polluter pays') it is also promoting a number of initiatives to encourage voluntary corporate action to complement fiscal incentives.

The 2000 UK Climate Change Programme was an important articulation of the Government's long-term strategy. It is clear that altering business behaviour is critical to meeting goals for greenhouse gas reduction. The Government's *Sustainable Development Strategy* states that 'voluntary improvement in business environmental performance, going beyond regulatory requirements, has an important role to play in increasing sustainability' (DEFRA 1999).

Carbon dioxide (CO_2) is the most important greenhouse gas. In 1990 CO_2 accounted for almost 80 per cent of the direct global warming potential of total emissions. The UK emitted approximately 150m tonnes of carbon dioxide in 2000 of which 55 million tonnes came from business (DEFRA 2001). The contribution of business to CO_2 emissions may be part of a slowly decreasing trend, but this ignores the impact of business travel (and the contribution of transport to emissions is increasing).

Research indicates that voluntary action is only prevalent in certain types of organisation. As Table 2.6 shows, less than a third of UK company directors collect information on their organisation's emissions of greenhouse gases or have a policy in place to reduce them. Almost half of the directors interviewed from industrial sector or large organisations said that their business had a policy in place or collected information on their emissions of greenhouse gases compared with 14 per cent of directors from the service sector.

Table 2.6 Directors' attitudes to reducing emissions of greenhouse gases

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Does your organisation have a policy on reducing emissions of CO_2 or other greenhouse gases?					
Yes	28%	23%	44%	46%	14%
Does your organisation collect internal information on emissions of carbon dioxide and other greenhouse gases?					
Yes	27%	24%	39%	45%	14%

Base: All respondents. Column percentages. Weighted tables

Many soft initiatives are in place, in particular to improve the measurement and disclosure of environmental impacts and increase the amount of information available to the market. The Government aims to give consumers better information as well as encourage purchasing initiatives which help to move the market towards products that are produced and perform in less environmentally damaging ways. Policies are in place to spread and recognise best practice; increase commitment to environmental management systems; and promote reporting and disclosure of environmental impacts.

The Carbon Trust is an independent company funded principally from recycled 'Climate Change Levy' revenues. It was established in April 2001 and works to support energy-efficiency improvements by business. Its programme includes the Energy Efficiency Best Practice programme and Environment and Energy Help line which provides business with independent information to help save energy, cut waste and reduce carbon emissions. The helpline receives 700 calls a week (www.envirowise.gov.uk).

Government also promotes the role of the most successful companies in leading by example. It specifically wants to focus on the activities of the biggest companies and collects information on the 'corporate environmental engagement' activities of the FTSE100 through the private membership organisation Business in the Environment, although no specific targets for corporate practices have been set (DEFRA 1999).

'Making a corporate commitment' (MACC2) is the challenge to individual organisations to bring their use of resources in line with Government targets (www.macc2.org.uk). However, by the end of 2002 only about 60 organisations had signed up and Table 2.7 shows that UK directors' awareness of this initiative remains low. Less than one in ten directors interviewed had heard of MACC2. In December 2002, the Chancellor, Gordon Brown launched 'Business in the Environment' award for excellence sponsored by the DTI and it continues to support the ACCA awards for environmental reporting.

The adoption of environmental management systems is promoted as a way of securing commitment to legal compliance as well as continuous improvement in environmental performance. The recognised systems are ISO 14001 and EMAS, both of which require external auditing by accredited independent third parties (www.iso.ch and www.emas.org.uk). The Government's target in 1999 was to secure over 75 per cent participation from FTSE100 companies in one of two environmental management systems (ISO 14001 and EMAS) where each had at least one certified or registered site by 2001. Again, Table 2.7 shows that recognition of these schemes appears to be concentrated among the directors of certain types of organisation. Almost a third of directors had heard of EMAS. Although there was little difference between directors representing organisations of different sizes and from different sectors, a greater proportion from industrial sector had heard of EMAS and ISO14001.

In 2000 both the Prime Minister and the Environment Minister at the time, Michael Meacher, challenged the FTSE350 to publish environmental reports by the end of 2001. Even though this challenge has remained unheeded, there is a more ambitious aim of extending voluntary reporting to the 7,000 UK businesses with more than 250 employees (DEFRA 1999). The Government recognises that increasing numbers of companies are reporting, but accepts that 'there needs to be greater take-up of hard-edged quantified measures and adoption of targets for companies to be able to demonstrate that reporting reflects real action' (DEFRA 1999). As Table 2.6 shows, on average three-quarters of organisations fail to collect information on their emissions (although this falls to six out of ten large organisations and just over half from the industrial sector).

In 2001 joint departmental guidelines on environmental reporting were published by DEFRA and DTI. They are consistent with other non-governmental reporting initiatives such as the Global Reporting Initiative and ISO14000 and are aimed at organisations of all sizes and all sectors. Although the Government's own guidelines seem to enjoy

Table 2.7 Directors' attitude to voluntary initiatives to reduce greenhouse gas emissions

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Which, if any, of the following have you heard of?					
ISO14001	61%	59%	68%	68%	56%
EU Eco-label	40%	39%	42%	42%	38%
DEFRA/DTI guidelines on environmental reporting	39%	37%	47%	44%	36%
EU Eco Management and Audit Scheme	29%	29%	30%	37%	23%
Making a Corporate Commitment campaign	7%	6%	11%	8%	7%
Has your company actively engaged with these initiatives?					
ISO14001	25%	20%	41%	37%	16%
EU Eco label	5%	4%	8%	8%	2%
DEFRA/DTI guidelines on environmental reporting	11%	8%	24%	14%	9%
EU Eco Management and Audit Scheme	4%	3%	8%	7%	1%
Making a Corporate Commitment campaign	2%	1%	2%	2%	1%

Base: All respondents. Column percentages. Weighted tables

higher levels of awareness than these non-governmental initiatives. Only 13 per cent of directors had heard of GRI compared to four out of ten who had heard of the DEFRA/DTI guidelines (Joseph 2002a).

Manufacturers and retailers are required by law to display energy efficiency ratings for certain product types covered by the EU Energy Labelling scheme including washing machines and refrigerators. Products are rated from 'A' to 'G', with 'A' being the most efficient. The Government also promotes the voluntary labelling scheme, the EU Eco-label and its flower logo. At present this is awarded to consumer products, which have the lowest environmental impact, including how much energy is consumed over their life cycle within 19 products groups (www.europa.eu.int/ecolabel).

For other environmental information, which is volunteered by business, the government introduced a 'Green Claims Code' in 1998 to raise the quality of what consumers are being told. The Code sets out principles and examples of good and bad practice in making green claims. The Code was revised in June 2000 to bring it into line with ISO standards. The 'Hi, I'm Green' leaflet was produced by DEFRA in 2000 to help consumers challenge businesses whose claims were unhelpful or misleading (www.defra.gov.uk).

Challenges for the Government

This chapter shows the extent to which the Government relies on businesses to voluntarily change their core practices in order to deliver policy objectives. Figure 2.1 uses the spectrum developed in Chapter 1 to classify the soft mechanisms adopted to engage companies in reforming their core business practices. It shows structured as well as unstructured soft initiatives are regularly employed, illustrating that similar soft tools are used to deliver this disparate range of policy goals.

Across the five issues explored, the use of 'structured' initiatives, such as voluntary guidelines for corporate conduct, is prevalent. Notably, the Investors in People scheme is used to encourage improvements in workforce practices and environment management systems are promoted to reduce pollution. However, it is far from obvious that these soft mechanisms are being used effectively. Levels of awareness as well as the extent to which companies engage with them vary widely.

Government involvement in voluntary guidelines does appear to carry weight in the business community. The evidence suggests that structured soft intervention through government-endorsed standards can encourage companies to go beyond their legislative obligations. **However, this official input should be used sparingly and be closely guided by policy aspirations.** If too many schemes are given state backing this is likely to dilute the authority that such approval brings.

From a policy perspective, it is possible that too much reliance is being placed on the Investors in People (IiP) award to improve a range of workforce practices, for example through the development of new optional 'models'. **The IiP initiative is in danger of being spread too thinly and failing to actually deliver change in all the areas in which it is active. Government's current aspiration to improve take-up of the award should be matched by a commitment to tailor it to help deliver on policy priorities.** The strength of the IiP brand means that it is an important asset to government and one which should be protected.

Lessons of the IiP success story should be considered to drive change across other core business practices. 'Investors in the Environment' could be developed and perhaps build on the 'Business in the Environment Award' launched by Gordon Brown in December 2002.

This chapter also illustrates that there are many 'unstructured' soft interventions in place. Ministers exhort company directors to implement reforms; business practices which are considered to be exemplary are publicised through award schemes and other official channels; and information is disseminated to the business community on how to reform their practices as well as the benefits of doing so.

Awareness-raising and support mechanisms include helplines and site visits. These provide free advice to organisations wishing to improve their behaviour in line with policy aspirations. These are an important element of any soft regime, if nothing else to help directors negotiate the plethora of initiatives that exist. However, at present the take-up of these government-funded services appears to be minimal. This could be because of a lack of motivation to engage in the relevant agendas, but it could also be because those in charge of organisations are not aware that this help exists.

Research should be conducted into the support required by businesses which are hoping to reform their practices in line with

public policy objectives. The resources which are allocated to providing free advice to business must be tailored in the light of this and a concerted effort must be made to increase take-up of this support. This is likely to involve both a rationalisation of current sources as well as more effective promotion of this type of help.

This chapter also describes the convergence around certain forms of soft intervention notably, improved corporate disclosure and use of structured initiatives, which also permeate a number of recent reviews of policy delivery which have either been sponsored or endorsed by the Government since 1997. Given the implied longevity of the soft approach it is essential that all steps are taken to improve its effectiveness as well make a realistic assessment of its potential.

However, given the range of tools currently in place to effect change across the areas discussed, it is extremely difficult to evaluate the success of individual Government initiatives in terms of their contribution to policy goals.

Government should build on the research presented in this chapter to explore the take-up and awareness of the entire range of soft initiatives that it currently deploys.

This reliance on a narrow range of soft tools may be inappropriate given the degree to which directors' commitment to these public objectives appears to vary.

Research presented in this chapter shows that the size and sector in which an organisation operates has little impact upon the uptake of policies in relation to the three most popular issues (promotion of basic skills, equal opportunities and work-life balance).

However, it was the least popular policies (reducing CO_2 and promoting workforce diversity) where the size of an organisation and its sector made the most difference to the existence of a corporate policy. These are issues that seemingly have a niche interest. Unsurprisingly, policies to reduce emissions of greenhouse gases are more prevalent in large, industrial organisations. Large organisations were also far more likely to have a policy to change the profile of their workforce in relation to ethnic minority groups. Again, this is unsurprising given that heterogeneity of a workforce is unlikely to merit attention in organisations with only a handful of staff.

For some public interest issues with a niche interest such as reducing emissions of greenhouse gases, the naturally sympathetic group is also the one most able to bring about the desired outcome. For other issues, the exclusive interest of one element of the private sector is more problematic. These natural constituencies for a voluntary business response must be accounted for in policy.

A realistic assessment is required of the extent to which a voluntary corporate response will contribute to policy goals. A better understanding is required of those issues and/or sectors where soft intervention is most likely to be able to be effective and crucially whether the expected corporate response is likely to deliver policy objectives. A preoccupation with 'hard to reach' organisations in those industrial sectors which are least likely to adopt policies is an unnecessary diversion if they are not pivotal to the delivery of policy outcomes.

Transparency about corporate practices is critical for encouraging stakeholders – consumers, employees, investors – to put pressures on organisations to reform their core business operations. Disclosure is a key aspiration of many contemporary soft policies. However, the evidence shows that there is still a long way to go before the majority of businesses are open about their core social and environmental impacts.

In the five areas discussed a large proportion of company directors say that their organisations fail to collect and make public key indicators of their performance. This does not safeguard against superficial commercial response such as in relation to equal opportunity and greenhouse gas emissions.

Corporate transparency is a central element of the effective use of soft tools. Therefore, reform of the corporate governance framework and improvements in the use of soft intervention cannot be seen as distinct. Imminent reform to company law should reflect the use of policy mechanisms that are employed elsewhere and be seen as a window of opportunity to make soft tools more effective.

Having discussed voluntary action the use of soft intervention from a public policy perspective, Chapter 3 now goes on to discuss the business case for activity across these five policy issues as well as how they relate to 'corporate social responsibility'.

3. The misunderstanding of corporate social responsibility

At its most general, 'socially responsible' business behaviour is that which (beyond the creation of material output) serves the public interest. It is often discussed from the corporate perspective: how companies can reap rewards by being sensitive to social and environmental issues. Here our interest is the extent to which this private phenomenon can contribute to the fulfilment of public policy objectives.

This chapter explores the Government's interpretation and initiatives to promote corporate social responsibility (CSR): the politics and ethos that underpin policy development; the issues treated as central to being a responsible organisation; and the methods adopted to encourage this behaviour throughout the private sector.

CSR at its broadest can be understood as the reaction of business to their stakeholders' demands, for example the response to their employees' desire for flexible work and training; supporting those groups who have poor labour market prospects with effective equal opportunities policies; and protecting the environment in the interest of the whole of society.

There are two important links between corporate responsibility and soft intervention. First, to the extent that corporate responsibility is promoted or guided by government, it is itself a manifestation of soft intervention. Evidence of businesses' reaction to the Government's input can be used to guide future policy development. Second, at the very least, Government intervention in corporate responsibility must be consistent with other areas in which it promotes a voluntary private sector response. Indeed, CSR could be the co-ordinating theme behind other policies whether or not this overlap is made explicit.

Since 2000, CSR has been developed as a distinct area of policy within the Department of Trade and Industry. However, as this chapter shows, to date this agenda has been spread across core and peripheral business activities, many of which are only of tangential use in achieving policy objectives. In addition, Government involvement has focused on the benefits to be accrued by the companies involved. Indeed, there is a more explicit convergence around the notion of private gains than there is around public goals.

This chapter explores the use of the business case for corporate social responsibility in more detail. It discusses the attempts that have been made to prove that a financial rationale exists and explores the appropriate application of 'direct' and 'indirect' arguments as a policy tool. The evidence indicates that the relationship between responsible corporate behaviour and the benefits accrued are in fact rarely straightforward.

Successful soft intervention, and indeed CSR policy, should not to be constrained by areas of corporate activity that can already cite a proven business case. This restricts the Government's involvement to one of *passive* soft intervention. In order to drive improved practices across the UK's boardrooms, *active* intervention is also needed to shape the markets in which organisations operate. As it is presently constructed, it seems that the contribution made by CSR policy to achieve public goals beyond that accomplished by regulation is both marginal and muddled.

The Government's understanding of corporate social responsibility

In order to discuss the implications of corporate social responsibility from a policy perspective it is essential to know what the Government's aspirations are and critically how it interprets this amorphous concept.

The development and co-ordination of CSR policy falls within the DTI's remit and it is here that one must look to identify much of the Government's thinking. The primary means of articulating this are via an annual report published since 2001 and the DTI-managed website devoted to corporate social responsibility. From these sources it is possible to build a picture of the official understanding of CSR. It is easy to see how the reality of policy (although not necessarily the rhetoric) diverges from other issues where policy is implemented to encourage a voluntary corporate response.

This section shows that the development of CSR as a policy area in its own right is both incoherent and tentative. It is poorly incorporated as a theme into other areas of public concern, such as the issues discussed in Chapter 2 and neither has it been successfully adopted as an umbrella for policies that rely on voluntary corporate action.

However, these contradictions in policy run deeper than poor website management. They shows a failure of inter-departmental communication. Inconsistencies are symptomatic of a lack of clear and joined-up thinking. Indeed, the failure to develop a coherent story about corporate responsibility is indicative of the fact that there is no robust rationale for where, when or how to engage business in promoting social and environmental objectives. This divergence sends confusing signals to business and undermines policies to promote voluntary corporate action of all sorts.

A concept without clarity

The notion that government relies on business to achieve goals such as the protection of employees' safety at work is hardly new. However, it was only at the start of the 21st century that the Government articulated its commitment to the notion of corporate social responsibility, both by adopting this vocabulary and by giving it formal recognition in departmental responsibilities.

In 1999 a high profile group of blue-chip companies launched an influential report calling for the DTI to co-ordinate CSR activity (Committee of Inquiry 1999). Along with think tanks, other NGOs and business representative groups like Business in the Community, there was widespread acknowledgement of the need for a minister to recognise CSR activity and develop it as an explicit strand of policy. This domestic pressure to bureaucratise something that was occurring organically was compounded by a growing interest at the European level, with the Commission also taking an interest in CSR.

In March 2000, the ministerial CSR brief was created without fanfare. In fact it was effectively smuggled out as the answer to a written parliamentary question. Even so, the UK was the first country in Europe to make such a formal commitment. Following this initial burst of enthusiasm, policy development has, however, lost momentum.

CSR is a concept regularly deployed by prominent ministers as an appeal for business to engage in their areas of interest. For example:

- Chancellor of the Exchequer, Gordon Brown, said that 'it makes good business sense for business to invest and act in the most responsible manner in developing countries' as a 'smart solution for the next stage of the global economy's development' (HMT 2003a).

- Patricia Hewitt, Secretary of State for Trade and Industry, told a conference that 'increasingly businesses depend on the trust, acceptance and enthusiasm of their staff and consumers, and that social responsibility is crucial to winning that trust and thereby keeping good people and winning more business' (DTI 2001a).
- Margaret Beckett, Secretary of State for the Environment, challenged business to take greater responsibility for target setting and tackling emissions, waste, water and resource efficiency (DEFRA 2002).

However, CSR has been treated as a poisoned chalice. In the wake of the creation of a ministerial brief in March 2000, the Government shied away from defining exactly what it understood by CSR. Since then, three ministers have had this brief as part of the Department of Trade and Industry portfolio, but there appears to be little collective commitment within government to develop a robust notion of what it means to be a 'responsible' organisation. As a result, policy development is at best patchy and fragmented and at worst contradictory.

This approach is in contrast with that of the European Commission, which sees its role not exclusively as one of recognition and praise for good practice. Indeed, early in 2003 the DTI was forced to defend its commitment to CSR remaining an entirely business-led agenda in response to the Commission's Green paper. In the UK there appears to be a desire to *follow* rather than *lead* CSR activity. Indeed, research suggests that the public profile of the CSR minister is unimpressive. In 2002 only 31 per cent of UK directors were aware that there was a minister to champion this business

Table 3.1 Directors' awareness of CSR minister and leading membership organisation

Which, if any, of the following have you heard of...?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Business in the Community	73%	71%	78%	73%	72%
The Government minister for CSR	31%	28%	41%	30%	32%

Base: All respondents. Column percentages. Weighted tables

practice, less than half the proportion who were aware of Business in the Community (see Table 3.1).

Critically, until the re-shuffle of responsibilities in 2003 when energy was added to the DTI portfolio, the minister responsible for CSR was not the same minister as one of those with a remit for policy to deal with consumer affairs, company law, energy or employment relations. This has been the case since 1999 (with the exception of consumer affairs prior to 2001). This separation of the CSR agenda from the very issues that require a direct interaction with business illustrates how far the CSR agenda is considered separately to key public policy goals.

However, despite the lack of political capital used to drive corporate social responsibility, the CSR agenda has generated a disproportionate amount of interest. Support for it comes from all sectors: it emanates from consultants and practitioners who have built up an industry to support corporate endeavours to be responsible; pressure groups who want to see business engaging with their issues of concern; the business community itself with its desire to see the continuation of systematic government praise for good practice and reassurance that the voluntary agenda is worth pursuing.

Scepticism about CSR is similar in source and substance to that generated by soft intervention. The fear of members of NGOs and trades unions for example, tends to be that CSR is a business-friendly agenda used to protect corporations from harder (and more effective) regulation. It is seen as an approach which is unlikely to do more than provide a cover for the avoidance of real change in business behaviour. Because of this live and lively debate, CSR is unlikely to disappear as an issue with which Government must grapple and for the foreseeable future it will remain one on which an official line is required. This is likely to be problematic given the ethos that underpins policy development.

Ethos of business interests

A clear theme in the rhetoric which surrounds the development of CSR policy is that it should be about 'core' business competencies. The Government's statement on CSR (DTI 2002) says that it will focus firmly on mainstream business actions rather than supporting 'peripheral or philanthropic involvement'. This sentiment is encouraging as it is ostensibly in line with the requirements of policy issues such as those described in Chapter 2. Unfortunately, it has yet to permeate government involvement in CSR.

At present CSR does not provide a co-ordinating theme for encouraging companies in the voluntary delivery of public policy objectives. Indeed, as this chapter shows, CSR policy is often little more than repackaged initiatives from elsewhere. There is no clear narrative. Notably, since 2000 there have been repeated references to the commitment that corporate responsibility should remain 'primarily a business-driven agenda' and that any activity by business must be 'justifiable on commercial grounds'. Much of the Government's CSR website is devoted to examples of businesses experiencing the benefits of behaving in a socially responsible manner (www.societyandbusiness.gov.uk).

A commitment to the primacy of business interests is likely to be both a cause and effect of the placing of CSR policy within the DTI: the department whose remit it is to promote successful enterprise. Although the department does have responsibility for many of the 'hard' forms of regulation in relation to business, consumers and the workforce, in this instance the DTI's business interest seems to have constrained the sort of involvement that the Government is prepared to have. As the following section shows, not only is regulation avoided, the primary tool of intervention is promoting the financial case for voluntary action. Although 'business case' arguments are often critical for people in business hoping to engage their colleagues in the need for change within their organisation, Government intervention must do more to actually drive change.

The disquiet from business representatives about the competing demands that are placed on them by government emphasises the need to have a coherent approach for engaging companies in the voluntary delivery of public policy objectives. There must be clear boundaries to the use of such an approach. Although, the Government may hope that CSR manifests itself in changed core operations, its clear commitment to retaining this as a business-led agenda means that the focus of policy has already strayed from the production and workforce processes that are critical to the delivery of policy objectives.

Official CSR issues

At the end of 2001, the UK Government presented the European Commission with its domestic priorities for CSR activity: economic regeneration; basic literacy and numeracy skills; and international development (DTI 2001). A few months later in the Government's 2002 annual report (and more recently on the 'societyandbusiness' website) 'the environment' is added as a key theme and basic skills has been broadened to businesses' role in 'education'. However, the Government's self-imposed restriction of not defining a 'responsible' organisation means that it is near impossible to know what it would like companies to do in relation to these agendas.

With respect to regeneration, the implicit desire is to see businesses contributing to 'neighbourhood renewal' by engaging in commercial activity in deprived areas. However the key methods by which they should do so are unclear. The eclectic links on the government website cover topics such as fuel poverty, crime and business start-ups. The annual CSR reports spread the focus even wider to employee volunteering and arts funding. Furthermore, the fiscal tools adopted are largely to promote philanthropic activities which are 'peripheral' to other policy objectives: charitable donations via employee payrolls and the Community Investment Tax Credit for investment in deprived communities.

With respect to businesses' role in training and education, the focus of CSR policy is split between the notion of 'workforce development' discussed in Chapter 2 and the desire to improve the link between business and mainstream school education. Again, the latter is primarily to encourage non-core activity, such as time off for employees to volunteer in local schools.

In relation to international development, the DTI argues that 'in the UK growing public interest in the impact of business operations in developing countries has brought issues such as child labour, corruption, human rights, labour standards, environment and conflict into international trade, investment and supply chain relationships…by applying best practice in these areas, business can play an increased role in poverty reduction, sustainable development and promotion of human rights' (DTI 2002b). Although there is no doubt that these issues are important, again, this is a divergence from engaging companies in domestic policy agendas.

The justification given by the DTI for concentrating on these three issues is that it is here that the regulatory approach is less developed. Although, the department does argue that 'no approach to CSR would be complete unless it tied in with the goals of sustainable development' (DTI 2002b), it is unclear what the DTI hopes to see organisations do in order to protect the environment. The strongest steer is in fact to publish environmental reports.

The divergence of 'CSR policy' from those areas where the public interest relies on voluntary corporate action is clear. For example, in relation to the issues discussed in Chapter 2, there is no mention of family-friendly policies in core Government CSR literature and, as the following section shows, where basic skills and environmental protection are promoted as key elements of corporate responsibility there is no useful guidance on what action should be taken by responsible businesses.

Policy tools adopted to promote CSR

It is possible to identify three types of policy tool highlighted by the DTI as central to the Government's strategy for promoting CSR:

- greater levels of **transparency** partly initiated by clearer guidance on social and environmental reporting;
- defining decent **minimum levels of performance**; and
- ensuring that **regulatory and fiscal frameworks** encourage responsible corporate behaviour rather than stifle it.

The belief is that only a 'limited' programme is consistent with the preservation of the business environment required for the necessary innovation and change in corporate practices. 'Legislation is not a magic wand; it cannot force virtue, and excessive intervention risks stifling rather than fostering the innovation which has characterised CSR to date' (DTI 2002b). This means that many of the *active* soft tools discussed in Chapter 1 – such as those with a 'hard' framework – are manifestly considered to be out of bounds.

In terms of promoting transparency, the most concerted effort recently made by the DTI under the auspices of its CSR policy was to fight the European Commission in order to ensure that reporting on social and environmental issues remains voluntary. In terms of hard regulation, the key development is the proposed mandatory Operating and Financial Review (OFR) for large companies (explained in Chapter 4). The DEFRA/DTI guidelines on environmental reporting are the primary voluntary initiative applicable to organisations of all sizes. However, at present they seem unlikely to drive change.

As discussed in Chapter 2, the Prime Minister's challenge to the FTSE350 to issue environmental reports in line with departmental guidance has gone unheeded. There will also be plenty of room to circumvent the obligation to provide information on social and environmental impacts even within the thousand organisations to which the proposed Operating and Financial Review regulations will apply. Although social and environmental reporting is increasing, as Chapter 2 discusses, it will often fail to contain robust indicators of performance and varying formats also hinder comparability between reports. The voluntary approach does not seem to have been successful, but further direct regulation in addition to the OFR does not seem to be on the Government's agenda.

In relation to some issues which are seen to be particularly important – health and safety/equal opportunities - there is a recognition of the need to have decent minimum levels of performance. However, in contrast to the rhetoric about CSR, these standards for behaviour are limited to (new) regulation rather than concrete suggestions of how to go beyond legislative obligations, such as ambitious targets to which organisations should aspire.

The policy mechanisms used to encourage CSR do not adequately reflect policy in place across other areas of activity, such as those discussed in Chapter 2. Neither does CSR policy reflect the three types of intervention promoted by the DTI to be central to its strategy. Rather than ensuring transparency, defining minimum standards for performance and using regulatory and fiscal frameworks, a great deal of emphasis is in fact placed on researching and promoting the business case, alongside a focus on publicising and endorsing 'real life' examples of good practice.

Contradictions between the rhetoric and reality of CSR policy could be shown in relation to initiatives to promote international development and regeneration, but are illustrated below by the action taken to encourage workplace learning and reforms to protect the environment.

The CSR website suggests that the contribution that business might make is to 'advise on and support the training and development needs of low-skilled, low-paid employees, particularly those with poor literacy and numeracy skills'. The annual statement on CSR highlights the Basic Skills Agency's Employers' Toolkit for practical help for companies on how to tackle basic skills needs (www.toolkit.org) and says that the Small Business Service will also provide relevant information to companies seeking to address this problem. However, the clearest *direct* advice that the Government gives to companies about what it expects them to do in order to be socially responsible is to work towards the Investors in People standard 'ensuring that the development needs of all of their employees are reflected in their training and development plans' (www.societyandbusiness.gov.uk).

Although there is significant overlap between the soft initiatives that are promoted within the CSR strategy and those that are relied upon to promote employees' basic skills (set out in Chapter 2), any organisation seeking advice about its responsibilities in this regard would find the attempt at co-ordinating policy is sorely lacking. For example, an employer searching CSR publications worried that he/she did not have adequate policies in place would not find a mention of the 'free workplace basic skills advisers' provided by DfES. Neither would they be made aware of organisations which have been awarded for their exemplary record as 'Great places to work'.

In terms of the initiatives in place to help companies protect the environment – and reduce their emissions of greenhouse gases in particular – there is also substantial but incomplete overlap between CSR initiatives and the soft forms of intervention set out in Chapter 2. Most weight is given to the joint departmental guidelines on reporting and two environmental management systems (namely ISO14001 and EMAS). Links are also made to the official challenge to organisations to set improvement targets and report progress (Making a Corporate Commitment or 'MACC2') and information is provided about the Green Claims Code and the sectoral sustainability strategies adopted in some industries such as the Society of Motor Manufactures and Traders, British Retail Consortium. The Soap and Detergent industry association; the photo-processing industry; and the chemical industries association have all linked their codes of practice to the Government's sustainability website (www.sustainable-development.gov.uk).

However, there are also notable exceptions to the initiatives that are helpfully highlighted within official CSR sources, for example, the Association of Certified Chartered Accountants (ACCA) awards for environmental reporting and the EU Eco-label. Most importantly, there is no obvious link to 'Action Energy' the Government-backed initiative from the Carbon Trust which provides a free 'Environment and Energy Helpline' as well as free site visits through 'Envirowise'. In the same way as training and education, any organisation seeking practical advice on how to improve its practices would be left searching.

The business case for responsible corporate action

The political commitment to CSR rests heavily on the ability of responsible organisations to benefit financially. Much public (and private) energy is being expended on trying to substantiate this Holy Grail. The DTI has commissioned work to explore the private benefits; it publicises those experienced by 'real life' organisations; and praises research of this genre emanating from non-governmental sources. For example, the Secretary of State for Trade and Industry, Patricia Hewitt, welcomed a study published by the Institute of Business Ethics in April 2003 providing evidence that companies with established codes of ethics were generally better at risk management and outperformed those organisations without a commitment to ethical conduct (IBE 2003). Prior to that, the membership organisation Business in the Community's 2000 report from its 'Business Impact Task Force' was influential (BITC 2000).

In contrast to this research activity, it is often implicit in government rhetoric that such a link between ethics and profits has already been proven. Although the following section shows that such proof has been elusive, this should not discourage policy-makers. In contrast to the view espoused by organisations such as BITC, *passive* policy to alert companies to issues with a mutual public/private benefit may have only a limited use. However, the 'indirect' business case has a wider relevance and, as the following chapter discusses, *active* soft tools have the ability to improve the commercial rationale for being 'responsible' by manipulating the environment in which companies operate.

The elusive business case

The 'business case' for CSR is used as shorthand for the collection of arguments that responsible action has a positive effect on company profits. Many attempts have been made to measure the extent to which financial performance is enhanced as a result of being socially responsible. Of the numerous quantitative studies undertaken to prove a link, one of the most pre-eminent was published by Graves and Waddock (1999).

Overall, Graves and Waddock as well as the scores of less well known studies imply that there is a positive correlation between ethics and profits and importantly none have found a negative relationship.

However, the methodology adopted in such studies undermines the application of these attempts to uncover the business case in a number of ways. This body of research often fails to distinguish between different aspects of responsible corporate activity, instead referring to 'responsible firms', such as those selected by ethical stock exchange indices or those organisations with a published code of conduct. This renders it impossible to say which aspects of responsible behaviour have led to the benefits accrued.

As importantly, this research fails to prove the direction of causation: whether responsible organisations are more profitable as a result of CSR activities or whether it is the most successful organisations that are able to dedicate resources to socially and environmentally beneficial behaviour.

Research to explore the benefits of environmentally or socially-minded activity often fails to acknowledge the costs to a business in adopting these practices. For example, research undertaken by the Co-operative bank showed that in 2002, almost a quarter of the bank's profits were attributed to customers who cited ethics as an 'important' factor. However, the bank also calculated the *cost* of factoring in ethical considerations (for example, the additional cost associated with the purchase of green electricity and the opportunity cost of foregoing certain corporate business) (Co-operative Bank 2003).

A pragmatic 'business case' will be based on a cost-benefit analysis for taking a certain course of action as well as comparative analysis of investing the resources elsewhere. As this example shows, general research is often too far removed from the reality of corporate decision-making to have a useful application.

Finally, the circumstances within which companies operate vary so widely that any research which looks across a heterogeneous sample will hide many contradictory results (which are likely to be influenced by the size and sector of the organisation). Studies which show a positive link may prove that on the whole organisations that take all their stakeholders' concerns seriously, are more likely to be well run and perform better than their less scrupulous counterparts. However, they pick up too much 'noise' to make a strong case for changing specific practices in individual organisations.

For reasons such as these it is extremely difficult to rely on the business case to excite organisations to deliver individual policy goals. For example, as Chapter 2 explains, the Government relies on the commercial argument to encourage employers to help improve basic literacy and numeracy levels in their workforce. It is true that a series of Employers Skills Surveys show that on average a quarter of employers agree that a significant proportion of their staff are less than fully proficient and that they have an internal skills gap (over half of these employers specifically mention problems in staff's communication skills) (Hillage *et al* 2002). However, the evidence is less clear that employers actually believe that this lack of skills is impeding their business objectives and undermine profits (Brooks *et al* 2001).

In this instance the problems that do exist seem to be concentrated in certain sectors: transport and communications; wholesale; retail and hospitality (Hillage *et al* 2002). However, sectors, which report problems with employees' skills, are not necessarily where unskilled people tend to work. Men with poor basic skills are overwhelmingly in manual work. Women tend to work in 'personal services' (for example in care homes and hairdressers) as well as in packing and low-level factory work (Basic Skills Agency). If the aim of policy is to improve people's life chances then it is actually where the business case is less obvious that voluntary action by employers is most acutely required.

Problems with the data and research relating to the business case make it of dubious use as a policy tool. However, even if these methodological difficulties were to be overcome, such attempts to measure are a financial rationale based on a 'snap shot' or inherently static view of the commercial environment in which companies operate.

Limited application of the direct case

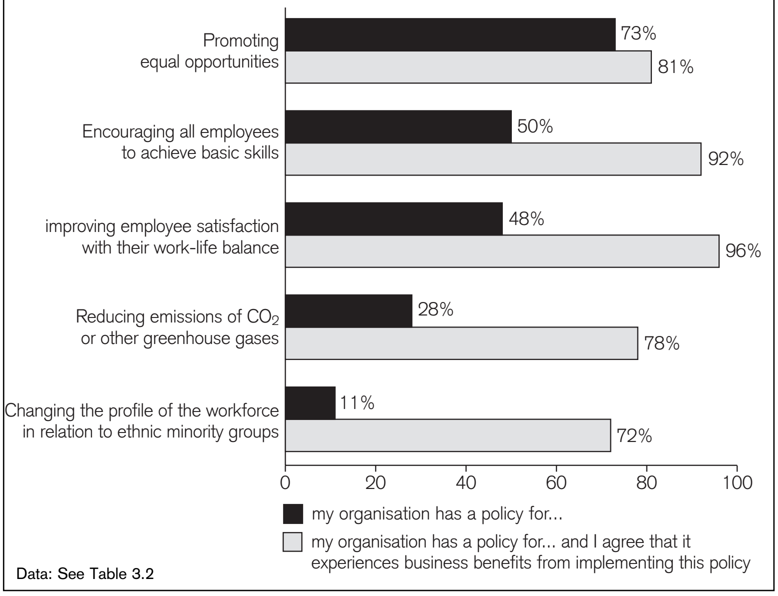
Commercial benefits that are gained from responsible corporate action can be classified as direct or indirect. The 'static' business case is relevant if direct benefits occur and CSR activity is precisely a money saving/making initiative. Evidence of this is easiest to locate in relation to eco-efficiency, where cost saving is achieved through environmentally driven action (Kemp 2001). Further examples from the policy areas discussed in Chapter 2 are arguably reductions in the costs of absenteeism from providing a crèche or improving the access of non-English speaking customers by employing a linguistically-diverse workforce.

Where such a direct business case exists there will be a direct overlap between public policy objectives and business objectives. Companies should behave in ways that are socially desirable (beyond simply creating material output), because it is also beneficial to the company. The argument follows that in these circumstances there is no need for policy intervention at all. The convergence of public and private interests arises naturally.

However, as Chapter 2 discusses, there is plenty of scope for business to raise its game and for Government to exploit these naturally occurring overlaps of interest. As previously discussed in this chapter, the promotion of a commercial rationale is a significant part of domestic strategy to increase CSR activity as well as ensure a corporate response to other targeted soft initiatives. The assumption is that companies, which are made aware of the private 'wins' to be gained from responsible corporate activity, will follow the example set by their 'successful' peers. Related soft government activity is therefore to research the relationship between responsible conduct and financial returns, disseminate the evidence, and exhort companies to adopt a more enlightened approach. Exploiting these natural overlaps in the public/private interest can be characterised as 'passive' policy-making.

Unfortunately, however, the direct business case is unlikely to be relevant to many public policy objectives. Indeed, this may explain why directors of organisations that are active in certain issues do not necessarily say that their organisations benefit from doing so. As Figure 3.1 shows, over three-quarters of directors say that they do experience business benefits from promoting equal opportunities, work-life balance

Figure 3.1 The benefit experienced from implementing policies across five core CSR issues



Data: See Table 3.2

Table 3.2 The benefit experienced from implementing policies across five core CSR issues

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Do you agree or disagree that your organisation experiences business benefits from implementing policies to promote equal opportunities?					
Sample size	367	270	98	176	192
Agree	81%	78%	91%	78%	85%
Disagree	15%	18%	7%	19%	11%

Base: All respondents who have a policy on equal opportunities. Column percentages. Weighted tables

	Total	*SMEs*	*large*	*industrial*	*services*
Do you agree or disagree that your organisation experiences business benefits from implementing policies to encourage all employees to achieve Level Two qualifications or the equivalent?					
Sample size	249	186	63	113	137
Agree	92%	93%	89%	91%	93%
Disagree	6%	6%	6%	7%	7%

Base: All respondents who have a policy on encouraging all employees to achieve Level Two qualifications or equivalent. Column percentages. Weighted tables

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Do you agree or disagree that your organisation experiences business benefits from implementing policies to improve employee satisfaction with the balance between work and outside work?					
Sample size	239	175	65	106	134
Agree	96%	94%	100%	94%	97%
Disagree	3%	5%	0%	5%	2%
Base: All respondents who have a policy on improving employee satisfaction with the balance between work and outside work. Column percentages. Weighted tables					
Do you agree or disagree that your organisation experiences business benefits from implementing policies to reduce emissions of carbon dioxide or other greenhouse gases?					
Sample size	138	89	48	98	40
Agree	78%	76%	79%	76%	80%
Disagree	17%	20%	10%	19%	8%
Base: All respondents who have a policy on reducing emissions of carbon dioxide or other greenhouse gases. Column percentages. Weighted tables					
Do you agree or disagree that your organisation experiences business benefits from implementing policies to change the profile of its workforce in relation to minority ethnic groups?					
Sample size	53	26	27	22	31
Agree	72%	73%	70%	64%	77%
Disagree	23%	23%	22%	32%	13%
Base: All respondents who have a policy on the profile of its workforce in relation to minority ethnic groups. Column percentages. Weighted tables					

and basic skills within their workforce, the fact that all directors do not say that they benefit suggests that straightforward financial gain may not adequately explain activity in individual companies.

The sample sizes are small, but a greater proportion of directors seem to think that there are benefits in encouraging employees to achieve basic skills and improve their satisfaction with their work-life balance than those that think that there are benefits from changing the profile of their workforce in relation to ethnic minority groups. This pattern is the same for small and medium sized enterprises as well as large organisations and across the industrial and service sectors. Indeed,

Table 3.3 The benefits that directors think they get from giving to charity

Do you agree or disagree that your organisation experiences business benefits from making donations to charity?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	278	205	73	125	153
Agree	45%	40%	59%	44%	46%
Disagree	51%	56%	38%	49%	54%

Base: All respondents who have a policy on charity donations. Column percentages. Weighted tables

Table 3.3 confirms that 'benefits' are not always the driving force behind corporate philanthropy.

Limits to the direct business case, and therefore the use of passive tools, is exacerbated by the fact that public objectives are likely to concern a longer time frame and broader set of issues than those considered to be relevant to commercial decisions. Family-friendly working practices can help to reduce child poverty and occupational segregation along gender lines, the benefits of which will not necessarily be reflected in the advantage to each organisation of increasing its pool of potential recruits (although there may well be a commercial rationale for doing so).

Wider relevance of the indirect case

Of greater relevance to public policy is the 'indirect' business case for corporate responsibility. The indirect case rests on exogenous factors, namely the reaction to corporate conduct from a range of stakeholders; the media, NGOs, consumers, investors and employees. Importantly, therefore it is not just the government's desire for changes in corporate behaviour that is being internalised in reformed business practices, so too are the demands of a range of civil and market actors. Businesses' reaction to these pressures is often discussed in terms of protecting the 'legitimacy' of the operations both of individual organisations, and of the private sector as a whole.

It is important to stress that the processes involved here are dynamic. For example, it may be in companies' own interests to improve their standards of conduct in line with public pressures, when there would otherwise be adverse financial consequences for them for failing to defend their reputation. If the range of issues that concern stakeholders broadens, or the intensity of the pressure these groups are able to exert increases, then companies will need to react correspondingly to protect their profitability.

It should be noted that commercial environments change naturally *and* deliberately. For example, tackling labour market disadvantage for certain ethnic minority groups is likely to become more of a business imperative as the ethnic minority population of the UK is projected to account for over half of the growth in the working age population between 2001-2011 (PIU 2002a). As the following chapter discusses, commercial pressure can be reinforced and directed, for example by increasing the accountability of management to shareholders, by facilitating more effective shareholder monitoring of corporate social and environmental performance through broader disclosure. Shareholder self-interest may in this way be harnessed for a wider social purpose.

It does not follow, in other words, that because companies are expected to behave in line with their long-term financial interests, there is a pre-determined limit to what can be achieved in terms of improved behaviour. However, as the following examples show, it is hard to quantify this in terms of the risk that companies face if they do not behave responsibly.

The indirect business case for choosing to pollute less can be presented in terms of developing the capacity necessary to respond to government and market pressure. For example, by demonstrating to regulators that an organisation is raising standards it can avert more stringent regulation. This process of innovation can also enable it to develop the technology to meet future legislative or fiscal requirements. Leading technological changes in an industry can result in competitive advantages as well as meeting requirements that may be introduced in overseas markets. As importantly, by improving environmental performance, an organisation can strengthen its reputation and credibility with consumers and with other business partners.

With regards to the business case that the Government promotes for voluntarily addressing pay gaps within an organisation, it cites improvements to productivity and efficiency that equal pay policies bring. In particular, fair and transparent pay systems are said to improve staff morale (WEU 2003a). Likewise a workforce with improved basic skills is said to allow organisations to 'increase profitability, efficiency of existing processes, developing new products and enabling growth into new markets' (SU 2002 p11). Beyond helping families, a good work-life balance also has implications for improving employees' health (Acheson 1998). There is accumulating evidence that long hours are linked with stress-related symptoms that affect people inside and outside work (Sparks *et al* 1997). This also has financial consequences. The International Labour Organisation has estimated that stress accounts for 14 per cent of sickness leave and the annual cost of stress to UK is £5.3 billion (ILO 2000).

The coincidence of corporate and societal interests is far from complete and CSR is not the answer to every public policy question. Nevertheless, market and civil society pressures for improved standards of conduct can, to an extent, narrow the gap between private and public interests by altering the pay-offs for socially approved or disapproved conduct. Consumers, for example, may reward companies that adopt high standards of social or environmental performance, and penalise those with low standards if they are presented the relevant information.

The extent to which this, *dynamic* version of the business case can be utilised to bring about significant changes in corporate behaviour depends in large measure on the scope and intensity of the pressures that companies face. It is important, therefore, to take a closer look at these. Indeed, this injects a degree of realism into discussions of CSR and soft intervention and helps to identify the limits to what this approach is likely to achieve.

As the next chapter explains, active soft tools can be designed to stimulate and strengthen the pressures themselves. Government should not be preoccupied with proving a static business case for corporate action, choosing passive policies at the expense of more active ones. The following chapter will discuss the market and civil drivers of the business case, the extent to which company directors respond to these pressures as well as how they can be strengthened by active forms of soft intervention.

Challenges for the Government

The process of policy-making in order to encourage corporate responsibility is tentative and at times inconsistent across government. This chapter suggests that Government intervention has not 'led' CSR activity, nor has CSR been developed as a co-ordinating theme behind other policies that rely on voluntary corporate action.

There is clearly a limit to what corporate social responsibility can achieve. However, at present policy to promote this type of activity is undermined. Inter-departmental administration and communication has failed to present a joined-up approach to business, although this is indicative of a broader failure to develop a coherent story about the role of companies in delivering policy objectives.

A thorough account must be developed of the need and priorities for the private delivery of public goals. At the very least this will protect Government from the charge of business representatives that CSR is used as a cover for any demand which Government chooses to place on it (for help in cash or in kind). Instead a sustainable CSR policy should be a targeted and transparent way for engaging organisations in those policy objectives which cannot be achieved without support from business.

Government must develop a robust rationale for where and when to rely on voluntary corporate action. A cross-government agenda for engaging companies in the delivery of public policy would need to move away from promoting the primacy of business interests. Instead, the starting point should be the achievement of public objectives.

Therefore, Government's involvement in and promotion of CSR must in reality (as well as rhetorically) focus on 'core' business activities rather than those which are 'peripheral' to policy objectives as well as how organisations operate.

The present departmental structure of government is based on the assumption that DTI can simultaneously be the champion of business interests as well as take the lead on much of corporate regulation. Even without a discussion of the validity of this premise, it is unclear how best to deal with CSR if, as proposed, it is adopted as a soft policy tool.

There is an outstanding question about how best to develop and co-ordinate CSR policy in Government. The present situation of a ministerial brief for CSR separate from those whose responsibilities

depend on effective voluntary corporate action is unsatisfactory. Corporate responsibility must be 'mainstreamed' into all ministerial portfolios that have a remit to change business practices.

The achievement of many policy objectives does not rely on hard regulation alone and the articulation of soft CSR policy cannot necessarily be left up to a DTI minister of state of whom few company directors are aware. However, even if responsibility for CSR is taken out of the DTI, one department, perhaps the Cabinet Office will need to co-ordinate other department's use of soft mechanisms to engage companies in their individual departmental agendas and act as a 'clearing house' for demands made on the corporate sector.

Corporate 'responsibility' is a term abused by ministers. There has to be collective ministerial responsibility to decide on the priorities for corporate action. This would have to be based on a realistic assessment of what companies are likely to contribute as discussed in Chapter 2.

The Government's strategy to 'define minimum levels of performance' across key CSR issues is commendable. However, unless this goes beyond present demands to be law-abiding, it will not drive change. Similarly, the official desire in recent Government publications to see CSR focused on 'core' business practices is unlikely to be effective without additional guidance or structured policies to promote best practice. As Chapter 2 shows, many organisations with policies currently in place are not able to systematically evaluate their effect.

Structured soft intervention, which defines aspirational levels of performance, could benefit a range of policy issues. However, in order to avoid a superficial reponse in companies, it is essential that organisations also collect information about the impact of their internal practices.

It is essential that all such initiatives are accurately incorporated into any cross-government moves to engage 'businessandsociety' for example, through the DTI-managed website by this name. Businesses are interested in CSR. Any organisation motivated to research what the Government thinks about CSR should be provided with the advice that they require. As we have already discussed in Chapter 2, Government promotional material should include signposts to state-funded support for reforming workforce and production processes in line with policy objectives.

There is a need for better administrative joining-up across departments with an interest in CSR, for example in the

promotion of soft initiatives to companies, such as free advice on how to improve corporate practices.

There is also plenty of scope to put the business case arguments to better use. Although case studies of 'good news' stories may have a public relations role, in order to have direct relevance to other companies, methodological failings in research would need to be overcome. Better quality research would also be of use in gauging a potential corporate response to soft intervention. However, as this chapter argues a static, 'snap shot' view of the world will constrain the use of the business case to *passive* types of soft government intervention.

The following chapter now goes on to discuss a more *active* approach to soft intervention reinforcing the role of stakeholders in corporate governance and the promotion of social and environmental objectives.

4. The effective promotion of voluntarism

The evidence presented in this chapter indicates that more UK company directors consider *non-governmental* pressures to be important in encouraging their organisations to think about its social and environmental impact than the proportion who think that the *Government* itself is important. Although the research concerns the impact of stakeholders on how organisations *think* rather than the effect that they have on what organisations actually *do* in response to pressure, the clear suggestion is that a widespread change in boardroom practices is unlikely to occur in the absence of 'market' forces.

This has significant implications for CSR policy as well as the more general use of soft intervention. Alongside moving away from a preoccupation with promoting the *direct* business case and the *passive* use of soft tools, policy-makers should instead make a concerted effort to influence civil and market actors who are already shown to exert strong pressure over responsible corporate behaviour.

It is clearly in the Government's power to facilitate and manipulate this *indirect* pressure on companies, altering the commercial environment in which they operate. *Active* forms of soft intervention have the potential to prompt wide-ranging corporate action in support of public interest objectives such as environmental sustainability and equality.

As this chapter explains, for the foreseeable future the UK company law framework will place shareholders at the centre of corporate governance. This is in contrast with the more 'pluralist' position adopted elsewhere in Europe, which gives other stakeholders such as employees an influential role in governing the company. This continued emphasis on maximising shareholder value also highlights the importance of state intervention that aims to reinforce market pressures. This chapter concludes with recommendations to the Government for a more active approach to soft intervention.

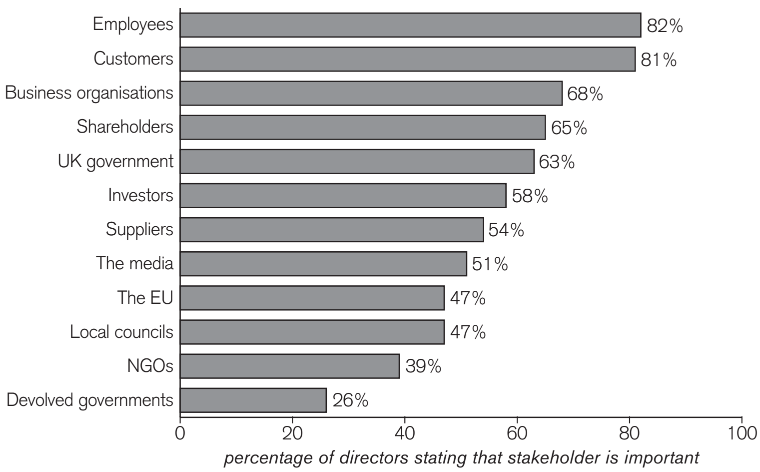
Drivers of a dynamic business case

A genuine and visible commitment on the part of company directors to responsible business practices is essential if such an approach is to be embraced throughout the organisation. The attitudes of directors to their stakeholders' social and environmental concerns will determine how their organisation responds and the extent to which resources and energy are deployed to innovate and reform core commercial practices.

A number of different factors may account for the extent to which directors are pre-disposed to respond to the social and environmental agendas of their stakeholders. The makeup of the board itself is likely to offer a partial explanation. For example, it will be important that the board can draw on a diversity of skills, experience, and outlook if it is to be in tune with public expectations about the non-financial performance of the business as well as to have a sufficiently long-term view to consider this important (Higgs 2003).

As Figure 4.1 illustrates, UK directors are most likely to think that market actors – employees, customers, business representative groups and shareholders – are encouraging their organisation to think about their social and environmental impacts. Central government is seen as important by fewer directors. Civil actors such as NGOs and the media are deemed to be important by an even smaller proportion of directors, but devolved government is considered to be the least influential force in encouraging directors to think about their organisation's impact. It is important to note that these results are not indicative of the *impact* of these stakeholders on corporate behaviour, obviously 'hard' government regulation will be an important source of pressure on more than the

Figure 4.1 Which stakeholders are important in encouraging your organisation to think about its social and environmental impacts?



Data: see Tables 4.1,2,4,5,6 and 8

two-thirds of organisations whose directors say that the Government is an important *influence* on how they think.

This section discusses these drivers of a business case; the sources of pressure which can influence directors to improve the impact that their organisation has on society and the environment. It explores the limits to what these pressures are likely to contribute to the achievement of policy goals.

As Chapter 3 explains, a discussion of the 'indirect' business case for CSR is often couched in terms of a company's relationship with stakeholders. In this section we discuss the evidence of this relationship. However, it should be considered with the same health warning as other attempts to prove or measure the business case explored in Chapter 3.

Employees

Without resorting to industrial action, employees can put pressure on their employers to change how their organisation operates, as well as help to develop and implement reformed practices. As Figure 4.1 shows, the research conducted for this report uncovered the fact that employee pressure is in fact most widely cited by directors as an influence which 'encourages their organisation to think about how it impacts upon society and the environment'. Eight out of ten directors think that employees are an important influence (and Table 4.1 indicates that this proportion is slightly greater for large and industrial organisations).

The strength of this pressure for change can be enhanced with effective consultation mechanisms. However, the degree to which employers are likely to be predisposed to take employees' views into

Table 4.1 Employees' influence on organisations' social and environmental policies

How important are employees in encouraging your organisation to think about its environmental and social impact?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Important	82%	81%	85%	85%	79%

Base: All respondents. Column percentages. Weighted tables

account will broadly depend on whether directors take a long-term approach, for example recognising the benefits of measures that do more than improve short-term productivity and profitability.

The commercial rationale for taking account of employees' demands include improving morale and loyalty. In addition, the business case for broader CSR activity is often defined in relation to recruitment of *potential* employees. Some evidence suggests that businesses with a poor reputation find it more difficult to attract and retain good quality personnel. In a survey conducted by the Industrial Society, for example, 82 per cent of staff in higher skilled occupations claimed that they would not work for an organisation whose values they did not share, and 72 per cent would take social and ethical considerations into account in selecting an employer (Draper 2000).

Customers and suppliers

There is a growing trend towards 'ethical purchasing' behaviour. It encompasses the selection of explicitly ethical products, such as 'fair trade' coffee, but perhaps more significantly, the practice of avoiding mainstream suppliers on reputational grounds, or actively seeking out those with a positive reputation. In a recent survey only five per cent of consumers claimed to make active and informed choices on ethical grounds in most of their purchase decisions. A further 18 per cent said that they frequently bought or avoided products according to the manufacturer's reputation for socially responsible conduct. Research suggests that around a half of the population have at some time chosen products because of the manufacturer's positive reputation or rejected them because of its poor reputation (Cowe and Williams 2000).

While these statistics suggest that many consumers have views about the non-financial implications of their purchases and are prepared to vote with their wallets, they need to be viewed with caution. The same survey shows that conventional product attributes, namely quality, value for money, and service were far more important determinants of purchasing behaviour than perception of the company's social performance.

This suggests that ethical considerations are often quite easily displaced by other more tangible aspects of the good or service. Further, because a given consumer takes account of some ethical considerations, it does not inevitably follow that he or she will be concerned about a company's social performance across a broad range of issues.

The issues that are commonly considered to attract high levels of consumer interest tend to be limited in scope, and include child labour and animal welfare. There is a vast range of ways in which companies affect employees, communities and the environment that, at present, evoke little in the way of a consumer response. A distinction should also be drawn between avoidance of products which consumers believe may be harmful to themselves and boycotting products to alter company behaviour for the benefit of third parties or society generally. As regards the latter, there is evidence that consumers are conscious of the collective action problems involved, which make such behaviour of questionable rationality. The research published by Cowe and Williams in 2000 indicated that only 11 per cent of consumers strongly believe their shopping choices will make a significant difference, though a further 40 per cent believe they have some influence.

However, contrary to this, Figure 4.1 suggests that eight out of ten UK company directors believe that customer pressure is an important influence within their organisation across a range of social and environmental issues. Increasing the availability of information about company behaviour is likely to have a positive effect on this pressure, but it is likely to remain the case that many causes will lack a meaningful consumer constituency to advance them. This means that there are limits to the effectiveness of interventions designed to harness consumer pressure, where the policy objectives in question have little popular appeal. However, connections can be made between issues, for example, between the treatment of staff in third world suppliers' factories and employees in the UK; or environmentally friendly projects and the producer's own pollution record.

The companies most likely to be affected by consumer pressure are clearly those that sell directly into consumer markets, with large, household-names that are regularly exposed to media scrutiny being the most susceptible. Although the accepted wisdom is that smaller organisations and those without a consumer market presence are much less vulnerable, the difference in the survey results between different sized organisations and sectors appears to be minimal (see Table 4.2).

Indeed businesses may be influenced by consumers' ethical preferences in a more indirect way. Retailers and sellers of branded consumer goods, which are themselves subject to consumer scrutiny, may transmit this pressure to companies in their supply chains, as has been the case, for example, with regard to employment conditions in overseas factories in the sports goods and clothing sectors.

At a domestic level, in a recent survey of managing directors of small and medium sized enterprise, 43 per cent said they had to satisfy a large commercial customer about their environmental management policies and 60 per cent did so in relation to health and safety (DTI 2002g). Consumer and other market pressures on purchaser companies to have 'clean' supply chains is likely to be part of the explanation. Commercial purchasers may also regard a good environmental and safety record as a proxy indicator of quality and reliability.

This is reflected in the research conducted for this report. As Tables 4.2 and 4.3 show, supplier pressure was in fact felt by over half of directors and six in ten said that social and environmental issues were important when dealing with suppliers and customers. Overall, however, this pressure was most prevalent in relation to the environment.

As well as applying pressure in the supply chain in an upwards direction, for example, through contracts with more vigorous environmental criteria, companies concerned about their reputation may also take steps to ensure the responsible use of their products by downstream purchasers, as, for example, with the 'product stewardship' programme in the chemicals industry. This involves manufacturers 'taking responsibility for the health, safety and environmental

Table 4.2 Customer and supplier influence on organisations' social and environmental policies

How important are each of the following in encouraging your organisation to think about its environmental and social impact?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Customers are important	81%	78%	88%	86%	77%
Suppliers are important	54%	54%	55%	62%	48%

Base: All respondents. Column percentages. Weighted tables

Table 4.3 Supply-chain pressure

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
In your organisation's dealings with other organisations, either as suppliers or customers, how important is it to know about how they treat their employees?					
Important	67%	66%	72%	66%	68%
Not important	28%	30%	25%	29%	28%
In your organisation's dealings with other organisations, either as suppliers or customers, how important is it to know about their environmental impact?					
Important	62%	61%	69%	74%	53%
Not important	33%	35%	25%	20%	42%
In your organisation's dealings with other organisations, either as suppliers or customers, how important is it to know about their social impact?					
Important	49%	47%	55%	51%	47%
Not important	45%	48%	36%	41%	48%

Base: All respondents. Column percentages. Weighted tables

implications of a product from inception through to final disposition' (Gunningham and Grabosky 1998 p235).

Sectoral pressure from peers

The quantitative research presented in this report was conducted with members of the Institute of Directors, so it is perhaps unsurprising that seven out of ten said that business representative groups encourage their organisation to think about its social and environmental impacts (see Table 4.4).

However, this is indicative of a trend towards the development of a sectoral response to many CSR issues. For example, the financial services sector has developed 'FORGE II' which covers both social and environmental impacts (www.bba.org.uk). The Government promotes a number of such strategies, for example in relation to sectors' endeavours to be environmentally sustainable (see page 64).

Table 4.4 Business representative groups' influence on organisations' social and environmental policies

How important are organisations that represent business (such as IoD or trade associations) in encouraging your organisation to think about its environmental and social impact?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Important	68%	68%	67%	71%	66%

Base: All respondents. Column percentages. Weighted tables

In the past business representative organisations have been exclusively set up to lobby for the interests of their industry. This new development shows a widespread understanding that it is in the self-interest of different sectors to have a policy for how to deal with various CSR issues in order to protect the legitimacy of their own industry.

Civil action: NGOs and the media

In theory, NGOs play an important role in informing and shaping public opinion about corporate behaviour, as well as stimulating and co-ordinating market responses to this. The most visible way in which NGOs have attempted to influence corporate policies is by targeting companies with a high public profile, which exemplify particular forms of offending behaviour, such as Greenpeace and Friends of the Earth's campaign 'StopEsso' (www.stopesso.com).

In mounting a campaign NGOs seek maximum media attention in an attempt to undermine the reputation of the company involved and to make demands for public commitments for change. The internet has led to an enormous expansion of the opportunities for NGOs to organise public pressure resulting in organisations such as 'Corporate Watch' (www.corporate watch.org.uk).

Of course NGOs may also try to change company policies indirectly, by lobbying companies' major institutional shareholders (Secrett 2002). The indirect effect that NGOs and the media have on companies (via other stakeholders) may explain directors' perceptions of their influence (illustrated in Figure 4.1). Indeed, the evidence presented probably under-estimates the importance they have in shaping public opinion and stakeholder pressure.

In addition to 'aggressive', including sometimes unlawful, behaviour, a number of NGOs are now also involved in more collaborative forms of engagement. While some are implacably anti-capitalist, others have entered into partnerships with companies in order to make available their expertise in addressing social and environmental problems. In some cases this has included endorsement of corporate social policies, for example, through involvement in monitoring or auditing activities, or participation in product labelling schemes, adding valuable credibility to such arrangements (Zadek 2001).

The media gives credence to campaigns from whatever source. NGOs and Government alike rely on media exposure. The desire to avoid the negative publicity associated with failing to qualify for the FTSE4Good index focused corporate minds on meeting the criteria (FT 2001). A media policy of naming and shaming poor performers, for example in relation to charitable giving (Guardian 2001) may help to explain the disproportionate interest in certain initiatives.

NGOs and the media both lead and follow wider public interest in corporate practices. However, the scale of the resources which can be deployed to rally public pressure is likely to constrain the effect that civil organisations can have or the extent to which they can be relied upon to articulate improvements in business activity, for example by

Table 4.5 The media and NGOs influence on organisations' social and environmental policies

How important are each of the following in encouraging your organisation to think about its environmental and social impact?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
The media is important	51%	47%	65%	53%	50%
Non-governmental bodies or interest groups are important	39%	35%	52%	44%	35%

Base: All respondents. Column percentages. Weighted tables

comparing information on company impacts in order to name and shame poor performers.

Government at all levels

Directors in our survey were asked for their views on the European Union; national government; devolved government (Northern Ireland Executive, Scottish Parliament and Welsh Assembly); as well as local government. In terms of encouraging their organisation to think about its environmental or social impacts, national government came out strongest: almost two thirds (63 per cent) of directors said that it did encourage their organisation to think about these issues.

As Figure 4.1 shows, the other levels of government that directors were asked about were three of the four least likely sources of effective pressure to think about non-financial impacts. Of the three, local government and the EU fared best: almost half of directors (47 per cent) said that they encouraged their organisation to think. Only a quarter (26 per cent) agreed that devolved government was important in this regard.

This pattern is reflected to some extent in the level of knowledge of various voluntary initiatives that directors were asked about. The voluntary initiatives that were created at the European level enjoy a similar level of awareness to those developed domestically. Four out of

Table 4.6 Government's influence on directors social and environmental policies

How important are each of the following in encouraging your organisation to think about its environmental and social impact?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
The Government is important	63%	60%	73%	68%	58%
The European Union is important	47%	46%	53%	56%	41%
Local councils are important	47%	44%	56%	58%	39%
Devolved Governments (eg Northern Ireland Executive, Scottish Parliament, Welsh Assembly) are important	26%	23%	37%	30%	24%

Base: All respondents. Column percentages. Weighted tables

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ten directors (39 per cent) had heard of the recent European Commission Green Paper on CSR (CEC 2001a). (Since the survey was completed, the Green Paper and related documents have formed the basis of the European Commission's 2002 Communication on business contribution to sustainable development.)

Shareholders and investors

The Government clearly puts the onus of maintaining standards for corporate governance on shareholders (described in more detail in the following section). This sentiment was endorsed by the Company Law Review which stated that its 'proposals on transparency and the controlling power of shareholders are fundamentally dependent on the responsible, diligent and active exercise of their powers by these fiduciary investors' (CLR Steering Group 2001 para 3.52).

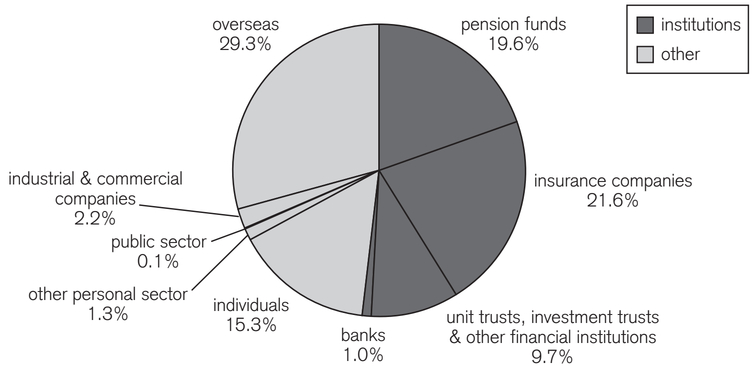
Shareholders are more usually regarded as a source of pressure on management to pursue a narrow goal of maximising financial returns, than to take an expanded view of corporate responsibilities. The desire to maximise share prices and dividends should however lead to an interest in the improved social and environmental performance of the companies in which they invest, to the extent that they are satisfied that a business case exists. This suggests that shareholders can be expected to play a role in reinforcing, and possibly anticipating, pressures that companies already face to be more socially responsible from other market or civil actors, such as customers or employees. Although they may respond to this risk, they are unlikely, on the other hand, to push the frontier of responsibility further by encouraging companies to behave in ways that might jeopardise share values of organisations in their portfolio.

This 'sensitising' role is an important one and should help organisations to improve their analysis and management of the risks and opportunities that they face. However, this narrow view of shareholders' contribution to commercial pressure in line with wider public interests is inadequate. As Figure 4.2 shows, shareholders are primarily institutions rather than individuals and increasingly there are moves within the institutional world to move towards 'socially responsible investment' (SRI).

Individual shareholders or the beneficiaries of institutional portfolios (such as pensioners) are not necessarily only interested in their own narrow financial improvement. This is also true for the trustees of pension funds, for example those who are also members of trades unions (TUC 2002b). Investors themselves have interests in the health of society and the environment. In particular those with large, diversified portfolios can be understood as owning a 'slice' of the economy and have interests in reducing negative externalities of the organisations they own. Or at least it is not in these 'universal' investors' interests to increase the externalities on society (Hawley and Williams 2002). This may explain why institutional investors are increasingly active and why Table 4.8 shows that shareholders and investors are successfully encouraging all sorts of organisations to think about their corporate social and environmental impacts.

Institutional investors, primarily pension funds, dominate the stock market. They invest funds on behalf of others and are under a fiduciary duty to maximise the value of the assets under their control. It seems likely that taking an active interest in the social and environmental performance of the companies in which they invest will be broadly in line with the preferences of most of the institutions' ultimate beneficiaries (as long as it is not detrimental to the value of the fund). There is survey evidence to suggest, for example, that a majority of pension scheme members would like their funds to use

Figure 4.2 Equity ownership in the UK



Source: Myners P (2001) Review of the Institutional Investment Industry Final Report March 2001 p27 their voting rights to put pressure on companies to improve their social performance (Simpson 2002). However, there is little reason to think that they would wish this to be at the expense of their own financial security.

However, the growth in the adoption by mainstream institutional investors of socially responsible investment ('SRI') policies gives some reason to think that the institutions are beginning to use their muscle in this area (see Ethical Investment Research Service www.eiris.org). SRI policies may relate to the selection and retention of investments (as part of an 'ethical screening' process) and/or to active engagement with the management of companies whose social, environmental, or ethical performance is poor. The influence of institutional investors is said to be one of either 'voice' (argument and voting) or 'exit' (severing connections and selling shares). Recent amendments to the Pensions Act 1995, which since 2000 require pension fund trustees to disclose both types of policy, if they have them, have given a boost to SRI (HMSO 1999).

The Association of British Insurers' *Disclosure Guidelines on Social Responsibility*, issued in 2001, are similarly intended to encourage involvement in corporate responsibility issues on the part of the insurance industry. The implementation of SRI policies has been facilitated by the development of ethical indices. Tracking the FTSE4Good in the UK and the Dow Jones Sustainability Group Index in the US, provides a non-resource intensive option for SRI. Investment management firms also now offer SRI funds, and there are a number of consultancies that monitor and benchmark corporate social performance on behalf of investor clients, and sometimes co-ordinate investor engagement (Simpson 2002).

Indeed, as Table 4.7 shows, a significant minority of directors are aware of these developments which have been given a great deal of publicity. Half of all directors have heard of the ABI guidelines and a fifth have heard of FTSE4Good (and these proportions increase to six out of ten and a quarter respectively for large organisations). Table 4.7 also indicates that these guidelines may attract a level of 'engagement'. Fifteen per cent of all directors (and a quarter of those from large organisations) say that they 'actively engage' with the ABI guidelines.

A survey conducted shortly after the introduction of the Pensions Act disclosure requirement indicates that 48 per cent of the two hundred

Table 4.7 Directors awareness of initiatives to promote ethical investment

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Which, if any, of the following have you heard of...?					
Association of British Insurers guidelines on CSR	48%	45%	59%	47%	49%
FTSE4Good	19%	17%	23%	19%	19%
Has your company actively engaged with Association of British Insurers guidelines on CSR?					
Yes	15%	13%	25%	18%	13%

Base: All respondents. Column percentages. Weighted tables

funds that responded had requested their fund manager to take account of SRI considerations in the management of their portfolios (Mathieu 2000). Four out of ten funds mentioned engagement in their statement of investment principles. A more recent survey suggests that these figures are now higher, with over two-thirds of respondents having investment policies which take account of social, ethical and environmental issues, and virtually all mentioning engagement strategies in their statement of principles (Just Pensions 2003).

While these figures are encouraging, there is evidence to suggest that in many cases the SRI policies adopted are vague and hence difficult to put into effect. They are also often unsupported by monitoring or other accountability mechanisms for ensuring that external fund managers are in compliance, nor are manager reward systems generally geared to compliance (Coles and Green 2002). No doubt as a reflection of this, only very limited resources are devoted by the bulk of fund management firms to SRI activity (Deloitte and Touche 2002).

Weak accountability is particularly significant given uncertainties about the commitment more generally of fund managers, to whom investment decisions and voting rights are often delegated. The majority view of a panel of investment advisers questioned on the issue, for example, was that the relationship between financial performance and social, ethical and environmental responsibility was ‘close to zero’, though some were convinced of the benefits of good environmental management (Gribben and Wilson 2000). As against this, a recent survey of attitudes of fund managers indicates more positively that 42 per cent agree (though in the main not strongly) that companies exhibiting good environmental or social performance will outperform their peers (Deloitte and Touche 2002).

Whether or not fund managers are convinced of the connection between social responsibility and profits in principle, the general reluctance of the institutions to intervene in the affairs of investee companies needs also to be taken into account in assessing the part played by shareholders in improving corporate social performance. The problem of collective action together with agency problems, imperfect information and conflicts of interest affecting shareholder and external fund manager relationships, mean that institutional investors tend to be slow to intervene when companies are performing poorly even by reference to conventional financial criteria (Stapledon 1996 and CLR Steering Group 2001).

In the words of the influential Myners Review of the institutional investment industry, there is a 'general reluctance to tackle corporate under-performance in investee companies, particularly pre-emptive action to prevent troubled companies developing serious problems' (Myners 2001 p10). Although Myners did not seek to give investors a public interest responsibility to invest in certain ways, he hoped to uncover factors distorting decision-making in these institutions. He concluded that the trustees of pension funds lack the expertise, time and resources to be able to exert pressure on their agents in any sort of meaningful way, nor are their internal mechanisms giving them a mandate to act. For reasons such as these, their 'voice' is limited and instead they tend to (sell their shares) 'exit'.

In response to the threat that followed the Review of legislation to make voting by institutions mandatory, an industry body, the Institutional Shareholders' Committee (ISC), drew up a statement of principles designed to encourage intervention in appropriate cases by undertaking to produce a clear public statement of policy on monitoring the performance of companies (ISC 2002). The signatories represent the majority of the UK's institutional investors. As one of the signatories explained it's aim is to put in place 'some process around the whole shareholder activism debate' and to create a climate where 'it is no longer defensible for somebody to say 'I do not like the company' and sell their shares' (Investment Management Association 2002). How effective this will be remains to be seen.

Critically, whilst the ISC encourages greater engagement by institutional investors with companies, it emphasises that the resources devoted to this task should be commensurate with the benefits to their client/customers. In spite of these developments there are fears that exit rather than voice will remain the norm for institutional investors. The use of tracker funds and the 'herd' mentality that Myners identified will reinforce this. Indeed, where pressure to reform is felt by companies, it is likely to be concentrated in or near the FTSE250 (Trade and Industry Committee 2003).

In 2003 the Trade and Industry Select Committee concluded that 'ultimately, the primary concern of institutional investors is to maximise the return on their investments. Whilst this may bring with it some pressure on companies hoping to attract funds from institutional investors to ensure that they have adequate corporate governance systems in place, there is a limit to the extent to which the institutional investors are willing or able to police the probity of the UK's companies' (Trade and Industry Committee 2003 para 120).

Nevertheless, it is clear that some institutional investors practice active engagement policies. What may differentiate them from the bulk of the investment industry is that they do not view the obligation to maximise the value of the fund as their sole objective. This appears to be the position of a number of local authority and other public sector pension funds especially (such as the Universities Superannuation Scheme www.usshq.co.uk) which have adopted a campaigning stance on a variety of issues, for example, climate change and human rights (Cowe 2002 and Coles and Green 2002). Whether improved standards of corporate responsibility will result in increased financial returns, or the returns will exceed the cost of intervention is highly uncertain, and so whether engagement is cost-effective must necessarily be a matter of judgement. It appears that investors in this 'committed' group are more readily disposed to exercise their judgement in favour of intervention than those that are purely financially motivated.

So far there is little more than anecdotal evidence about the extent to which active investors have actually made a difference to company behaviour. In a survey of the views of fund managers there was general agreement that only a few companies demonstrated any significant

Table 4.8 Shareholders' and investors' influence on directors social and environmental policies

How important are each of the following in encouraging your organisation to think about its environmental and social impact?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Shareholders are important	65%	62%	76%	73%	59%
Investors are important	58%	55%	69%	61%	55%

Base: All respondents. Column percentages. Weighted tables

change following engagement. This may under-estimate the effects, however, improvements in social and environmental performance may be gradual and investor engagement is one of a number of cumulative sources of pressure that put these issues onto the strategic agenda (Dresner 2002). Indeed, as Table 4.8 shows, six out of ten directors interviewed for this report say that investors are important in encouraging their organisation to think about its social and environmental impact and two-thirds say that shareholders are important in this regard (ten per cent more directors from large organisations agree).

The force of markets in corporate governance

This section highlights the importance of market forces in constraining and driving changes in business behaviour by describing the UK corporate governance framework which is to underpin business activity in the UK for the foreseeable future.

The future of company law

Company law in the UK is shareholder-centred insofar as it is the duty of directors to further the interests of the shareholders. The right to appoint and remove the board is ultimately vested in those who own shares. These 'interests' are usually couched in straightforward financial terms: maximising share price and dividend income.

Whether such a paradigm should continue to underpin UK statute was the central issue in the independent review of company law commissioned by the DTI in 1998. This was the most wide-ranging review in UK corporate history, and was charged with answering the fundamental question ‘in whose interests should companies operate?’ It culminated in a report and recommendations in 2001 (CLR Steering Group 2001). The Government’s response to this Review and the subsequent legislation expected within this parliamentary term is likely to frame policy for at least the next half a century.

The Review’s conclusion was that while there should not be a radical departure from the current position of shareholder primacy, the law should be reformulated and extended to promote greater ‘inclusivity’. That is, the law should be used to emphasise the dependence of commercial success for the company on its cultivating and maintaining positive relationships with employees, customers, and suppliers, and paying attention to the business’s broader social and environmental effects. These are the relationships that will be at the heart of any ‘enlightened shareholder value’ (ESV) approach in support of wider public policy objectives.

Endorsing this inclusive approach meant a rejection of the alternative, ‘pluralist’ model of the company (often referred to as a ‘stakeholder’ model). In a pluralist framework the overriding obligation of the directors to act in the interests of the shareholders is replaced with a duty to balance the interests of all the participants in the business and society more generally. Directors are under a duty to achieve what they consider to be the best overall outcome. While the Review was sympathetic to the aims of pluralism, an important factor that led to its rejection was the difficulty of enforcing pluralist duties.

As the House of Commons Trade and Industry Select Committee noted, the most significant disagreements in the Review centred on the controversial proposals for establishing minimum standards for corporate governance. ‘Those supporting ESV do so basically because they because they believe that company law exists to promote the long-term success of companies, which in their view, requires the management of companies to have regard to factors such as goodwill that involve interest groups other than shareholders. The pluralists, on the other hand, while also believing that companies will benefit from taking account of wider interest groups, regard company law as an instrument for forcing companies to behave in particular ways, for example requiring companies to follow good environmental, employment and social practice' (Trade and Industry Committee 2003).

The Company Law Review Steering Group argued that it would not be sensible to ask the courts to police the trade-offs between conflicting interests that enforcing pluarlist duties would entail. Rendered unenforceable, pluralist duties would be unlikely to change behaviour. Furthermore, the broadened managerial discretion that would result might make holding directors legally accountable for their decisions even more difficult than it is currently. Although more fundamental, institutional changes, such as mandatory employee representation on the board, might well have a more significant impact on company decision-making, such changes are not currently on the political agenda.

The Government's White Paper *Modernising Company Law* (TSO 2002a), sets out proposals for a new Companies Act that will give effect to the inclusive approach. Although a Companies Bill was not included in the 2002 Queen's Speech, the Act was widely expected to be on the statute book before the end of the current parliamentary term. This was seen to be the likely timetable not least because a third of the forthcoming Bill has already been published alongside the White Paper and the majority of the new and technically complex ideas are now in the public domain. These issues are discussed in the following section, although as the Committee noted, the White Paper is not in itself a complete legislative proposal and it is 'concerned about the delay in the Government's production of a Companies Bill' (Trade and Industry Committee 2003 para 20).

Active soft intervention to implement an inclusive approach

The chosen inclusive approach is not a straightforward endorsement of the status quo. In order to put this approach into practice, the forthcoming Companies Act will make two important changes. It will set out a statutory statement of directors' duties and provide for more extensive disclosure via an 'operating and financial review' (OFR) a narrative report covering the main factors underlining the company's performance and prospects which is intended to give a broader view of companies' operations than purely financial reports (see Table 4.9). However, the final detail of the rules that are enacted will be critical to

Table 4.9 Proposed contents of the Operating and Financial Review

Compulsory content of the OFR

- a statement of the company's business;
- a fair review of performance during that financial year and of the position of the company at the end of that year; and
- a fair projection of the prospects for the company's business and of events which will, or are likely to, substantially affect that business.

Duty to consider other matters in OFR

- the management structure of the company;
- information on the purchase and sale of shares by members of the company;
- the company's employment policies;
- the company's policies on environmental issues relevant to the company's business;
- the company's policies on social and community issues relevant to the company's business;
- the company's performance, in carrying out its employment, environmental and social and community policies; and
- any other matters which affect, or may affect, the company's reputation.

Based on TSO (2002b) draft clauses 74 and 75.

how effective they are in aligning public and private interests, as will reaction of managements, investors, employees and other stakeholders to these innovations. There is a divergence over the extent to which change should be expected given the scope for interpreting the legislation as it is currently drafted (Trade and Industry Committee 2003).

The proposed statement of duties makes explicit the obligation of directors to take account of the long-term, as well as the short-term consequences of their decisions, in promoting the success of the company for the benefit of the shareholders. It also refers to an obligation to have regard to the need to foster relationships with employees, suppliers and customers, to the community and environmental effects of the company's behaviour, and the need to protect its reputation. In putting the duty into statutory form, the aim is to clarify the currently obscure common law making it more accessible, as well as to counter apparently common misconceptions, for example, that the law requires directors to maximise short-term financial returns (IOD 1999).

The statement is also intended to change the decision-making culture of the boardroom, by setting out, and thereby legitimating, standards for the internal and external assessment of company policies that are not exclusively shareholder-focused. ‘A director of a company must in any given case act in the way he decides, in good faith, would be the most likely to promote the success of the company for the benefit of its members as a whole…and in deciding what would be most likely to promote that success, take account of all the material factors that it is practicable in the circumstances for him to identify’ (TSO 2002b pp112-3).

In a similar vein, proposals for the OFR are a response to criticisms across the public and private sectors that current corporate reporting is too narrowly financial and backward looking ‘failing to take account of less tangible factors, and therefore not recognising the full value of the company to either its owners or other stakeholders’ (ICAEW 2002). At present companies have the option to produce an OFR as part of their financial reporting and accounts, but comparatively few do so voluntarily. It is proposed that the new requirements will apply to around 1,000 of the biggest companies, those which meet two or more of the following three criteria: a turnover of at least £500m; a balance sheet total of at least £250m; and at least 5,000 employees (TSO 2002a para 4.36).

The formal objective of the OFR is to permit members of the company to make an informed assessment of its operations, financial position, future strategy and prospects. It should also make more transparent the extent to which directors are complying with the obligations set out in the statement of duties, facilitating, for example, an evaluation of the company’s performance in dealing with the social and environmental challenges that it faces. This innovation is in line with the voluntary reporting guidelines, which have since been published by influential market actors such as the Association of British Insurers (ABI 2002). While the OFR is primarily aimed at shareholders, it should provide an opportunity for all stakeholders to assess how well the company is addressing these issues and facilitate non-governmental pressure to change corporate behaviour. Indeed, the White Paper 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…The Government…sees the OFR as the opportunity for directors to demonstrate their response to this business case' (TSO 2002a para 4.36). However, some fear that in practice the information provided will be of use only to shareholders concerned with the financial value of the company (CORE 2003).

Controversially, the current proposals distinguish between matters which must always be reported on, and those which must be reported only when the directors consider them 'material' to fulfilling the review's objective: an understanding of the business and its prospects (see Table 4.9). Importantly, workforce, social and environmental issues come within the latter discretionary category with the inherent risk that this approach will lead to under-reporting in these areas. Within these broad categories, the proposed Standards Board will develop rules about how, if disclosure is required, it should be made. Guidance on how to apply the 'materiality test' has already been proposed (DTI 2003e). However, the decision not to have any more detailed requirements in statute will not encourage directors to 'integrate environmental, social and employment factors into their consideration of company policy as a whole: in the jargon to "embed" such areas in all their policy decisions rather than leaving them in a corporate social responsibility ghetto' (Trade and Industry Committee 2003 para 60).

Importantly, the auditors' report on the OFR will be concerned only with the adequacy of the process of preparing the report and not its content unless the content is 'inconsistent with the financial statements or other information they are aware of as a result of the audit' (TSO 2002a para 4.40).

Table 4.10 Directors' commitment to publishing social and environmental reports

Does your organisation produce a report available to the public on its...?

	Total	*Sizes*		*Sector*	
		SMEs	*large*	*industrial*	*services*
Sample size	500	390	110	215	285
Social impact	9%	6%	21%	13%	7%
Environmental impact	16%	10%	36%	24%	9%
Neither of the above	81%	88%	56%	74%	87%

Base: All respondents. Column percentages. Weighted tables

Although the Government already promotes voluntary reporting on social and environmental indicators, Chapter 2 shows that many organisations do not collect information on their performance across some key issues and Table 4.10 shows that few publish reports. As the only regulatory reform on the horizon aimed at improving disclosure, it is critical that the OFR is effective.

It should be noted, however, that although OFR obligations apply to large companies, supply-chain pressure illustrated in Table 4.2 is likely to spread the impact to organisations in commercial relationships with companies with an OFR obligation. A far greater number of organisations are likely to see these new priorities affect the decisions made in their own business than the 1,000 to which the law applies.

The importance of market pressure

The company law White Paper recommendations do not amount to a fundamental redefinition of the operational priorities of the company in favour of society and the environment. The aims of the inclusive approach are the more modest ones of encouraging management to take maximum advantage of the overlap between corporate and broader societal interests and of increasing companies' responsiveness to external pressures, for example, from consumers and NGOs, for higher standards. As such it is an important example of 'active' soft intervention (in the terminology of Chapter 1 it is a 'hard framework' with a 'soft impact').

The OFR is intended to play a key role, by enabling shareholders to factor such issues as the effectiveness of the company's policies on social and environmental issues and its management of reputational risk into their investment appraisals. At least in theory, companies that fail to satisfy investor expectations in these, as in more conventional areas of financial performance, should suffer adverse share price effects or be subjected to more direct forms of shareholder intervention. Increasing accountability to shareholders is, therefore, viewed in these proposals as a way of inducing directors to pay greater attention to social and environmental issues. Pressure exerted by institutional investors to end executive 'rewards for failure' has recently exemplified the potential success of such an approach to change company policy.

The extent to which this approach is likely to result in significant improvements in corporate social and environmental performance depends on two principal factors. The first is whether shareholders (in effect, institutional investors) become an effective source of internal accountability and pressure to reform behaviour.

The second factor concerns the extent and the intensity of the pressures that market and civil society actors are able to impose on companies for improved standards of conduct. A public policy objective of aligning company behaviour with outside pressure presupposes the effectiveness of that pressure which itself drives the financial imperative. The important role played by market and civil society actors within the inclusive approach highlights the case for exploring the possibilities of government intervention that is designed to strengthen the ability of these groups to influence corporate conduct and to explore the possibility of harnessing this pressure for public ends. In this light, recommendations are set out below.

The challenges for the Government to reinforce market pressure

Company Law reform

The current review of company law began in 1998, culminating in the 2002 White Paper. As this report describes, these imminent reforms in corporate governance are critical to realising a much broader social and environmental agenda.

The new Companies Bill should be put before Parliament as soon as possible. Its introduction in the Queen's speech should make an explicit reference to the Government's desire to see the proposed changes in corporate governance 'further align public and private interests'.

An explicit reference to the need to alter business behaviour in the public interest, would send a clear signal that the option is being left open to introduce more stringent hard regulation if this active soft approach does not bring the change required to achieve social and environmental objectives.

Disclosure and the Operating and Financial Review

The Trade and Industry Select Committee makes a clear distinction between the aims of company law, namely to 'promote the long term health of companies, taking into account both the interests of shareholders and broader corporate social and environmental responsibilities', and the objectives of other legislation, which sets out 'the specific duties of care required of companies to their employees and society at large in areas such as employment law' (Trade and Industry Committee 2003 para 22).

Making such a clear distinction is unhelpful. Disclosure is the cornerstone for corporate governance reforms and without an effective strategy to reduce information asymmetries, other soft forms of Government intervention will also be set to fail. Whilst it is clearly the case that reporting requirements will reflect the ultimate aim of the legislation (Joseph 2002b), the window of opportunity opened by the OFR to enhance civil and market activism should not be missed.

Statutory disclosure requirements must take into account other policy objectives that rely upon voluntary corporate action and the disclosure likely to underpin effective soft intervention.

This subtle change of emphasis of the aim of modernising company law would have a direct bearing on the response deemed appropriate to the issues raised by proposals for an OFR. The Select Committee understands some aspects of the OFR are contentious as they stand in the White Paper. Particular questions raised are:

- Whether more companies should be made subject to the OFR regime
- Whether too much discretion is being given to directors as to what they put in OFRs
- What value OFRs will have given the limited check on their accuracy
- What redress there will be (and from whom) if OFRs are inaccurate (Trade and Industry Committee 2003 para 54)

The Trade and Industry Committee is content with the proposed thresholds for producing an OFR and a 'gradualist' approach 'so that details of what is required can be worked out with the largest companies and the key aspects extended to smaller companies' (Trade and Industry Committee 2003 para 75). However, the aspiration of enhanced transparency beyond the 1,000 large organisations to which the regulation applies must be made articulated.

Government must be explicit about its aspirations for more extensive corporate disclosure beyond that demanded by OFR proposals in the 2002 White Paper.

The distinction between 'core' subjects and 'other matters' is widely interpreted as a division between the mandatory and discretionary elements of the OFR, where discretionary elements include social and environmental issues. Discretion is based on whether issues in the latter category are *material* to an assessment of the organisation. Although many of the UK's biggest organisations should find it difficult to show that these issues are immaterial, discretion could affect the quality of reporting and it sends the wrong signals to directors about the relative importance of these issues in comparison to those which are more directly financial.

All elements of the OFR, financial, social and environmental should be classified as core (mandatory). A second best option would be for all issues covered by the OFR to be non-core (mandatory only if deemed material). At least then they would be on the same legal footing. **A split between the two categories as proposed in the White Paper undermines the importance of social and environmental issues.**

The proposed Standards Board has a vital role in providing guidance on the detail of reporting, giving substance to the high-level statements expected in the Companies Act.

It is essential that the Standards Board include people with a broader range of expertise than financial accounting. The inclusion of a wider range of interests than that of the shareholding community, will help to ensure that appropriate weight is given to social and environmental issues; and that reports are made accessible to a range of stakeholders.

The Government describes the audit of an OFR as essentially concerned with the adequacy of the *process* of preparation, not on its detailed *content*. However, auditors will also have the duty of reporting on whether the OFR complied with the rules produced by the Standard Board (which cover both the content and process of reports). Although proposals for a wider role for auditors should be treated with caution, there are still outstanding questions about the verification of the information provided.

Government must publish best practice guidance on the verification of reports as well as the ability of stakeholders to seek redress for inaccuracies.

The Trade and Industry Committee agreed that company law cannot alone be expected to change corporate culture: without active shareholders and other interest groups, unwilling or incapable directors would be able to nullify the effects of even statutory obligations'. Indeed, the success of the OFR will largely be determined by the degree to which there is market pressure to 'comply' with legislation or 'explain' why obligations have not been met. The Committee seems confident that investors and bodies such as the Pensions Investment Research Consultants (PIRC) will play a leading role in this process (Trade and Industry Committee 2003 para 70).

An explicit reliance on pressure from the investment community to drive change in the boardroom must be matched by proposals to reinforce this interest.

Investors

A great deal of weight has been placed on shareholder activism driving change, more specifically, on the role of institutional investors. As set out in this chapter, Government has already commissioned a review of the industry and legislative reforms have already encouraged investor pressure. However, this cannot be seen to be the end of the story. There is plenty of scope for Government to do more to build on these reforms:

- **As Myners recommended in 2001 there should be a review of the extent to which his recommendations, such as increased disclosure by pension funds, have actually bought about changed behaviour. Further legislative obligations to disclose should be implemented if the voluntary approach has not been sufficiently adopted.**
- **Myners' influential review should be replicated for the insurance industry.**
- **Amendments to the 1995 Pension Act should be improved upon. In particular, trustees should report to members on how their fund 'statements of investment principles' have**

actually been put into action. Pension fund managers should report to trustees on how they voted and provide better disclosure about the effect that their engagement policies have had (this information should also be passed on to members).

- **If further research is conclusive that fiduciary duties are seen by fund managers and trustees as an obstacle to acting in the wider public interest, then further clarity of investor duties must be produced as a priority.**

Beyond these changes, more should be done to promote both activism and accountability in the investment community, building on the momentum spurred by the current debate over executive pay. However, the limits to what investors are likely to achieve must also be recognised. As the Trade and Industry Committee noted, although there have been moves such as the ISC statement of principles, 'exit' (disinvestment) rather than 'voice' (engagement) will remain the norm for institutional investors. This is compounded by a general 'herd' mentaility reinforced by developments such as tracker funds (2003 para 119; Myners 2001 p2). Exit strategies are unlikely to drive change in the way that engagement can by permeating company decision-making processes and raising issues on boardroom agendas.

The Government must engage in a debate on how to further address short-termism in the investment community. This is a key obstacle to more wide-ranging corporate response to stakeholder demands and soft government intervention. A commitment to addressing the short-termist tendencies in the investment community will undoubtedly involve more wide-ranging reform.

Company directors

The commitment of those running an organisation to work in the public interest is critical to reforming practices (ensuring that the necessary resources are put in place) as well as ensuring that social and environmental issues are at the heart of decision-making rather than left to 'specialised' but separate bits of an organisation.

Women hold only six per cent of non-executive posts and only one per cent of non-executives are from black and ethnic minority groups

(Higgs 2003). The homogeneity of non-executive directors are likely to prevent a balanced assessment of the need to alter corporate practices in the public interest. The Government-endorsed proposals which stand to broaden the pool from which non-executives are recruited are therefore welcome (DTI 2003d). However, Government needs to send a clear message on its desire for diversity.

As a first step, the Government should commit itself to improving the diversity of people holding the position of non-executive director.

Customers

The research conducted for this report dispels the myth that customers are only an important source of pressure in consumer-facing or large companies. On average eight out of ten directors say that customers are an important influence in their organisation with regards to its thinking about its social and environmental impacts.

Accessible information is critical in influencing spending decisions on the high street. However, companies themselves cannot be relied upon to tell customers what they want to know and neither can NGOs and the media be relied upon to distil information provided in company reports into an easily digestible format. Even with an effectively implemented OFR there is a significant role for Government in addressing information aimed at consumers. Disclosure and accessible information are key to active consumerism.

Information presented at the time of purchase will usually take the form of labels. As the current guidance on product labelling describes, Government can be involved and support labelling schemes in a number of ways from providing publicity to actually implementing a mandatory scheme (DTI 2002c).

Unsurprisingly, research conducted for the DTI stated that 'people must be aware that there is an issue that is covered by product labelling and they must be sympathetic to the message before they will respond' (DTI 2002d p7). Government must develop a strategy to improve consumer recognition of those labels which have state backing, particularly where the issues involved are complex.

Additional research must be done to understand the impact of labels on consumer decisions and whether more can be done to

reinforce consumer pressure in support of social and environmental agendas.

Only a handful of causes will dramatically shift spending decisions. For example, some research shows almost two-thirds of people say that seeing a logo on a product 'makes no difference' (MAFF 2000). Therefore, it may be preferable to develop Government-recognised standards which group together those issues which are of a primary concern (genetic modification, child labour) with those issues which are of critical importance to achieving broader social and environmental objectives (environmental sustainability, treatment of employees).

The effect of standards can be indirect. For example, the European energy efficiency label may only have had a limited direct effect on purchasing decisions: saving energy was only the seventh most important factor in buying a fridge and energy use is considered important primarily to 'save money' rather than 'save the environment'. However, the 'A-G' rating has had a significant indirect impact for example with some retailers now only stocking appliances with better ratings (Environmental Change Unit 1998).

There is a clear role for Consumer Direct to enhance consumer action. This telephone helpline and website for consumers was supported in the 1999 White Paper (DTI 1999) and will be rolled-out nationally in 2007 after pilots in 2004. It was a response to the need to answer a range of questions from consumers and empower them to solve problems themselves (DTI 2003b). Although, this helpline will not provide product specific information (except in relation to safety advice), it will provide information on codes of practice.

Where codes of practice and/or logos are supported by Government, these must be a central element of initiatives aimed to facilitate active consumerism. In particular this should be reflected by Consumer Direct.

Commercial relationships

Commercial relationships are important in encouraging organisations to think about their social and environmental impacts. Suppliers are seen as important in this regard by over half of directors. Two thirds of directors say that in their dealings with other organisations, as suppliers or customers, it is important to know about how they treat their employees and only slightly fewer say that these organisations' environmental impact is important. These results are fairly consistent across directors representing organisations of different sizes and sectors, except environmental impacts are clearly more relevant to industrial sector. Again, Government should seek to reinforce this pressure in support of public interest objectives.

All Government-supported reporting and labelling initiatives should include disclosure about standards within other organisations in the supply-chain.

This is one way to encourage more organisations in a supply chain to take stock of their own impacts (and disclose them). Another way is through business representative groups such as trade associations.

All business representative groups should be encouraged to publish a strategy for responding to the various 'soft' demands from Government; a code of practice for voluntary action in their sector.

This would go beyond a statement of principles and instead guide a sectoral response to public (policy) demands. These tailored sectoral approaches provide both an effective in-road into reinforcing pressure on member organisations as well as improve understanding of the contribution of each sector is likely to make to public policy objectives. This is particularly important given the different propensity of sectors to respond to aspects of the public agenda (as well as their differing ability to effect change).

Public procurement

Government and all its public agencies should aspire to lead best practice across all 'corporate social responsibility' issues. Other than leading by example however, Government can influence corporate behaviour using its own market weight. It should ensure high social and environmental standards in its supply chain by acting as an 'intelligent' client and in constructing other service delivery arrangements such as public private partnerships.

A higher priority needs to be given to develop this policy tool. More work is particularly required in relation to social issues. An interdepartmental group on sustainable procurement was established in 2001 'in order to consider how Government bodies could carry out the procurement of goods and services in a manner that supports the

Government's policy and objectives for sustainable development' (DTI 2002e).

The Government's own social and environmental objectives should be at the heart of all public expenditure.

There is scope to include non-financial 'community aims' in public contracts (JRF 2002). This is not prohibited by European public procurement legislation or the local authority 'Best Value' regime as long as certain procedures are complied with (ODPM 2003 and CEC 2001b). Importantly, any social or environmental goals must be specified as a core purpose of the contract; contracts must not discriminate against certain contractors; and these specifications must benefit the public authority at award stage. This latter criterion means that contracts must be in support of other policy statements such as a local authority's Community Strategy.

Government must provide better guidance to public agencies on how to take advantage of the scope to use their buying power to enhance corporate practices, but beyond this Government should actually encourage agencies to do so.

In 2000 the Cabinet Office called on the Office of Government Commerce and other departments to develop guidance on the use of production process requirements in procurement specifications which were 'user-friendly and supported by a proactive strategy to raise awareness and understanding about the potential role of procurement in addressing social, health and environmental issues' (PIU 2000 p205).

The recommendation to produce user friendly guidance and raise awareness should be met for both social and environmental issues as an important step to promoting a debate on how to use the Government's buying power in a more sustainable way.

Employees

In response to the interviews conducted to inform this report, over eight in ten directors said that employees were important in encouraging their organisation to think about its social and environmental impacts. The input of employees into decision-making within their organisation should be facilitated as an *end* in itself as well as a *means* to encourage corporate support of public interest objectives.

Providing information to employees will be key to this process. Government should encourage the spread of best practice in human capital accounting. However, there are issues which are relevant to *all* organisations, such as equal opportunity policies and the treatment of 'non-core' staff such as cleaners. These issues should not be considered to be optional, not least because the disclosure of these *core* social impacts is unlikely to require the expenditure of extra time and resources.

There should be a clear timetable for Equal Pay Reviews after which these requirements should be made mandatory.

Ideally there would be a two-way flow of information between employees and employers within all organisations. The Government should support improvements in employee consultation. This is already recognised as an important part of handling sensitively any issues seen as 'direct interest' to employees, such as industrial change which involves redundancies (DTI 2002f). However, the implementation of the European Directive to establish a framework for informing and consulting employees provides an ideal opportunity to set in train wider reform (OJEC 2002). The Government expects this to come into force by Spring 2005.

As for corporate governance reforms, the need for effective consultation should not be separated from public agendas that rely on soft forms of intervention. A 'general duty' on employers to carry out the procedures required by the European directive alongside a code of practice to specify the subjects on which consultation should take place should extend the right of consultation into areas such as those discussed in Chapter 2 (equal opportunities, training and workforce developments, flexible working arrangements and environmental issues) (TUC 2002a).

Government guidelines on employee consultation must also cover the reform of social and environmental policies in addition to those issues of 'direct' interest to employees.

There are numerous other commercial reasons as to why it is important to inform and consult employees about any changes to an organisation's policies: employees will actually implement reform; encouraging 'ownership' of new proposals will only set to improve the quality of employees' input; and employees are likely to have superior knowledge of how to best manage reform.

In industries where there is competition for skilled staff, pressure from prospective employees (graduates) can be enhanced, for example by 'tightening' criteria for the Investors in People award. Students are likely to be interested in equal opportunities, diversity as well as training. They should have accessible information on how their prospective employees fare in relation to their competitors across a range of such issues. For example, 'naming and shaming' employers should be encouraged in further and higher education establishments.

Although soft forms of Government intervention are not a panacea, this chapter sets out numerous ways in which its use as a complement to hard regulation can be improved. The opportunity to reinforce pressure exerted by investors, customers, employees as well as from Government itself will be critical in shaping the commercial environment in which companies operate. These 'active' reforms, alongside improved disclosure of corporate social and environmental impacts, will enhance the alignment of public and private interests. Those with a long-term perspective will understand that the benefits of this to society will improve the environment in which all businesses operate.

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