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the inside track #18

Highlighting CSR Issues of the moment

Sadly, regulations don't stop for a recession - or even an election!

Recent discussions with clients suggest that many decisions are being put on hold until after the election, and because of the uncertain economic position.

But, whilst it is clear that recession changes many things, one that does not change is the onset of new regulations. Over the next few months, several new regulations will either become law or take effect.

First to take effect is the Carbon Reduction Energy Efficiency Scheme (CRC). After lengthy public consultation, it finally starts from 1st April 2010. It requires qualifying UK organisations (private and public companies as well as governmental bodies and those in the voluntary sector) to measure and report carbon emissions from their UK property portfolio. Perhaps more importantly, also it requires these organisations to actively manage energy efficiency to reduce emissions.

Given the previously long lead time, it might be reasonable to assume that organisations had all aspects of the CRC well under control. Yet there seems to be an implicit assumption that the need to register between 1st April and 30th September means key actions can wait until the physical act of registration. They cannot!

Also in April 2010, The Bribery Bill introduces a new criminal offence of corporate negligence, requiring companies to **demonstrate and report** that effective systems to prevent bribery are in place for both employees and agents. Bribery related legislation has been around for several years. The Anti - Terrorism Crime and Security Act of 2001 was introduced to deter UK companies from acts of bribery overseas and also extended UK law to cover facilitation payments. But whilst consolidating all existing legislation, the Bribery Bill will also strengthen corporate accountability for bribery. The Serious Fraud Office has issued guidance which sets out the 'adequate procedures' that a company should have in place to show that it has done everything possible to prevent individuals making or receiving bribes. These procedures represent good business practice, but for some companies, demonstrating that they are in effect - and operate effectively - may be a bigger challenge.

Next comes the Equality Bill, the eventual existence of which may be affected due to the general election, but is likely to see its way into the Statute book if the current Government is re-elected. It includes requirements on the public reporting of gender pay differentials, meaning companies would have to have reporting mechanisms in place, and explain and potentially address any significant anomalies. It also includes a clause requiring organisations to avoid using recruitment questionnaires with requests for medical information if the job being recruited for does not require any specific health (mental or physical) attributes.

Another set of “regulations” is the proposed revisions to the UK Corporate Governance Code. A remarkably short period of consultation has just closed and we expect the final form to be published in the next few weeks, which will be effective for financial years starting after 29th June 2010. It requires listed companies to provide a more comprehensive description of the business model in Business Reviews as well as requiring criteria for performance based remuneration for executive directors/senior management to include non-financial performance metrics. As importantly, there is an increased focus on risk management processes within the Code reinforcing the link with the Directors' duty to “promote the long term success of the company”.

These four sets of new regulatory procedures will have a significant impact on the way businesses are managed - but from our experience, whilst some companies recognise these are to take effect, only a few are building them into their business processes.

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These "regulations" emphasise the constantly changing pressures of corporate responsibility. Whilst economic recession may put a damper on some corporate responsibility activities, the challenge is to maintain a watch and be aware of developments covering a wide range of activities to determine changed priorities.

The challenge is to ensure corporate responsibility remains aligned to the business strategy and contributes to the business drivers. The message from all these new regulations is that, even more than previously, CR should be integral to business decision making, particularly risk and reputation management.

Taking each regulation in turn shows how corporate responsibility practitioners can better contribute to risk and reputation management.

Looking at CRC on behalf of clients, our experience shows the financial amounts at risk may be relatively minor, certainly when compared to bottom line profits of UK operations. The real issue for companies is the risk of under performing in performance tables against peers, resulting in reputation issues with key stakeholders. This will be due to the tables being publicly available - and capable of being benchmarked by third parties.

Considering the Bribery Bill, the key issue will be to ensure monitoring programmes introduced to safeguard the company against prosecution include both input and output KPIs to enable a company to demonstrate systems are both in effect - and effective. This necessitates companies considering how to report effectiveness of their bribery compliance procedures - either in their annual report or in CR reporting.

The issue relating to the Equality Bill is similar to the CRC. Assuming it becomes law, the risk for an individual company lies in comparison of gender pay performance, given publication will be in the public domain. Managing stakeholders' interests on this topic will be vital for corporate responsibility practitioners from day one.

The new Corporate Governance Code will focus Board attention on the key drivers for the business, many of which will be non financial. The question will be which corporate responsibility activities contribute to these business drivers, and what are relevant non financial metrics as the basis for the executive remuneration incentive packages. The commonplace approach of putting corporate responsibility in the annual report as a standalone will need to change into deciding which parts of the corporate responsibility agenda truly contribute to the company's business drivers and enable the successful delivery of the business strategy.

Ultimately, the corporate responsibility practitioner needs to demonstrate activities contribute to company performance. In this respect, a case study we researched as part of our contribution to a recent investor focused book* highlights links between environmental, social and governance practices to share performance. The Director of Quantitative Research for New Amsterdam Partners (NAP) - a New York fund managing around $4billion - researched the time horizons affecting environmental and governance practices of companies. The findings indicated better governance practices are reflected in share out-performance in the nearer term, whereas better environmental practices result in share out-performance in the longer term. This study reinforced the findings of other research by NAP.

Even in recessionary times, the challenge for corporate responsibility practitioners is to focus on how corporate responsibility activities contribute to the overall business strategy, ensuring directors "promote the success of the company in the long term". This means reviewing both the relevance of the activities currently in place, and also reviewing the latest regulatory and stakeholder developments to identify changing priorities.

If you would like an objective and impartial view on the new requirements described in the is newsletter, contact Tony Hoskins - thoskins@thevirtuouscircle.co.uk or Ian Redington - iredington@thevirtuouscircle.co.uk

** Environmental Alpha - Institutional Investors and Climate Change - Angelo A Calvello, John Wiley 2010*