Social Indicators in Corporate Activities considering SDGs
- The Profit Maximization Criteria of companies and SDGs -

Shigeo Uchida, Takako Hashimoto
Chiba University of Commerce, Japan

1. Introduction

The steady growth of the advanced countries began around 1820. The driving force was the rapid development of private companies, especially corporations. Establishment of a limited liability system for stockholders in advanced countries has greatly contributed to the evolution of companies. They were able to raise huge amount of money from ordinary citizens through limited liability system.

Companies are profit making organizations that aim to maximize profits under the law. They have been leading technological and managing innovation to achieve the economic growth. However, prioritizing pursuing profits, companies have caused serious social problems such as pollution and environmental hazards. Many developed societies have emphasized on the Corporate Social Responsibility (CSR). Then they have established various laws and regulations such as the antitrust laws.

At the beginning this century, in addition to legal regulations, many global institutions have formulated various guidelines for companies. The SDGs (the Sustainable Development Goals) agreed by all member countries of the United Nations in 2015 may be the most important fruit in present society. In financial and capital markets, ESG (Environment, Social, and Governance) investments are attracting attention. Companies seem to fulfill their responsibilities.

However, the scandals of many large companies continue. Is it possible to make companies behaviors change? In this paper, we propose to use the tax system to incorporate the CSR concept into the profit maximization criteria of companies.

1. Companies brought economic growth and social problems

It becomes a consensus of economist that private companies have brought innovation and economic growth through free market competition. Angus Madison's long-term economic growth estimated that the speed of economic growth in advanced countries has been accelerated substantially since around 1820 that was half a century after the industrial revolution began in England[i].

As the main factor of growth acceleration, William J. Bernstein indicated the energy revolution by oil and the development of communication technology and a lot more[ii]. We want to emphasize the importance of the corporation system. The modern corporation system was established in advanced countries like the United States around 1820. Especially the establishment of a limited liability system for shareholders became a trigger to the growth acceleration. This system freed the shareholders from their responsibilities for the corporation's debt and enabled the corporations to raise a large amount of money from ordinary people. As the result, corporations have become large and the engine of economic activity. People work at large-scale companies to earn income and purchase goods manufactured by the companies. Thus, many people have become rich. However, companies have caused many social problems such as monopolization, environmental problems and workers' health problems. Joel Bakan stated that a corporation was a "psychopath" and a dangerous entity that has bad influence on human-being and society[iii].

2. <u>Corporate Social Responsibility(CSR)</u>

As many companies don't pay social costs such as environmental pollution, people in many countries have payed attention to Corporate Social Responsibility (CSR). What is CSR? There are two major points of views as follows:

(1) The vital duty of companies is to increase profit under law

Under the law, the company is a profit-making organization. So, it has no other purposes nothing other than maximizing profit without violating the law. The most important social contribution for the company is to pay taxes with as much profit as possible.

(2) A company is a public entity

Katsuhito Iwai argued as follows[ivv].

The company has two characteristics as "human being" under the law (legal person) and "thing". The company's assets are owned by "human being," (legal person) and the shareholders own shares of the company as "thing" (goods).

In order for the company to act as a "human being," it is essential that the society approves the company as "human." Social approval is institutionalized by law. In this way, a Company based on social approval as a public entity.

Furthermore, Iwai states that a company manager was a "fiducial trustee" who was entrusted based on expertise such as a doctor. The basis for the fiducial relationship was a principle of "ethics". It's not a contract based on a pursuit of self-interest. From this point of view, the company is expected to fulfill their social responsibilities as a public entity.

3. <u>Social costs which private companies generate and the regulations</u>

What is the CSR behavior to be expected for the company? It goes without saying that the compliance with legal regulations such as antitrust laws prepared for the purpose of repairing "market failure is required. But, that does not prevent global warming, for example.

If corporations use much cheap fossil fuels to maximize profit, societies have to pay much social costs that companies failed to pay. This is called "negative externality" on economics. Various legal regulations have been carried out to get back social costs. But still not enough, thus, in order to complement legal regulations, various business conduct guidelines have been established. The SDGs may be the most comprehensible achievement. Many governments, institutions and private companies have set SDGs goals to BE reached by 2030, and are moving toward achieving 17 common goals. In Japan, Japan Business Federation revised its Charter of Corporate Behavior in 2017, calling on member companies to take concrete action.

As private companies are the leading actors in economic activities, they must be the engines for achieving the SDGs as well. Although we are aware that it is not easy.

In2001, Enron, the global energy trading company, suddenly went bankrupt. The Chapter 11 of the Federal Bankruptcy Law was applied for Enron in December 2001. Until then, Enron had been known as an excellent company that published annual reports ahead of other companies, calling on the importance of human rights, environment, business transparency, etc., but President Bush criticized the greedy managers of Enron as "bad apples."

In the wake of the Enron case, the SOX Act (Public Company Accounting Reform and Investor Protection Act of 2002:Sarbens-Oxley Act) was enacted in the United States in 2002 to strengthen internal control of companies and improve credibility of corporate accounting. This movement spread to Japan. The Financial Securities and Exchange Law was amended in 2006. Under this law, the listed companies WERE required to submit internal control report with audit certification.

But, there is no end to the scandals of big companies. The "Panama Papers"[vi] published in 2016 reveals the facts that lots of world famous companies use skillfully "tax haven" to avoid the duty to pay taxes, which is the most important CSR. If the top executives don't have high ethics, the business behavior of companies doesn't change. In addition, consumers who buy company products, investors who provide money also should be ethical and public-minded. Otherwise, the behavior of companies whose main mission is to increase profits will not change.

4. <u>Incorporate the CSR concept into the Profit Maximization Criteria</u>

What should we do? Recently, we pay attention to the following new tides:

(1) Some contributions to SDGs have brought the chances of profit making to companies. For example, the cost of producing renewable energy such as solar power dropped sharply and lead to greater profitability.

(2) The movement to select the destination of investments, and finance according to the degree of contribution to CSR and SDGs is going to be a new normal.

In December 2015, the Financial Stability Board (FSB), which consists of ministries of finance, central banks, financial regulators in 25 major countries, established the Climate Change Related Financial Information Disclosure Task Force. In August 2017, this institution submitted the final report. The report states that it was important for investors to make decision according to the degree of the weather-related risk in the future.

These trends are desirable, but not enough. Companies will accept these trends as long as they make profits. Companies cannot make actions to damage profit. Therefore, it is essential to incorporate the CSR concept into the Profit Maximization Criteria. For that purpose, we believe that it's effective to use the tax system as follows:

(1) Government-certified agencies should rate companies according to SDGs and CSR evaluation criteria.

(2) Rating agencies should be based on companies' public information.

(3) The tax authorities should reflect the rating on the corporate tax rates. The tax rate for high rating companies will be lower than that of low rating companies.

(4) Companies listed on the stock exchanges should be obliged to take rating for their CSR and SDGs activity.

The above methods are expected to cause companies to bear the social cost which they bring.

Actually, the rating for companies has been established in the bond market. CSR-related ratings are also implemented for the purpose of constructing portfolio of ESG investment. The number of listed companies is limited, and they disclose lots of information. About 3200 companies are listed on Tokyo Stock Exchange. These listed companies account for 0.1 % of all Japanese companies, but they accounted for 45 % of total corporate sales in Japan, 60% of profit. Under these circumstances, using tax system for achieving SDGs seems be effective.

5. Conclusion

For promoting SDGs, this paper proposed to use a tax system to incorporate the CSR concept into the profit maximization criteria of companies. Basically, companies are profit making organizations that aim to maximize profits. Therefore, it is not easy that they make actions for SDGs/CSR, if they cannot make profits. To incorporate the CSR concept into the Profit Maximization Criteria, we need new criteria. One of criteria, we propose a new tax system that rates companies according to SDGs and CSR evaluation criteria. We believe our proposed system contributes to SDGs/CSR.

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[iii] Bakan, Joel, "The Corporation," The pathological pursuit of profit and power. Hachette UK, 2012.
[iv] 岩井克人, "会社はこれからどうなるのか," 平凡社, 2003. (in Japanese)
[v] 岩井克人, "株式会社の本質: その法律的構造と経済的機能," 現代経済学の潮流 73 (2002). (in Japanese)
[vi] https://panamapapers.icij.org/20160403-panama-papers-global-overview.html.