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Special report:
Corporate social responsibility

The union of concerned executives

CSR as practised means many different things

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ON THE face of it, questioning the efforts of companies to behave responsibly is an odd thing to do—unless you are accusing them of faking it, or of falling below some commonly agreed minimum standard. How could a company ever behave too responsibly? The very term "corporate social responsibility" endorses the actions to which it is applied. No doubt that is why companies fasten the label to a quite bewildering variety of supposedly enlightened, progressive or charitable corporate actions.

At one end of the broad span of CSR lie corporate policies that any well-run company ought to have in place anyway, policies that are called for on any sensible view of business ethics or good management practice. These include not lying to your employees, for instance, not paying bribes, and looking farther ahead than the next few weeks. At the other end of the range are the more ambitious and distinctive policies that differentiate between leaders and laggards in the CSR race—large expenditures of time and resources on charitable activities, for instance, or binding commitments to "ethical investment", or spending on environmental protection beyond what regulators demand.

In other words, at the mild end of the range are practices that do not need any special CSR defence: they can perfectly well justify themselves in simpler ways, either as meeting standards of ordinary decency (of which more later), or as being necessary in any case if managers are to run a successful business. The issue here is not whether the activities themselves make sense, but whether they deserve to be dignified by the term "corporate social responsibility"—that is, whether they deserve the special praise which this label is intended to elicit.

At the strong end of the range, many activities do deserve a special label: they go well beyond the requirements of ordinary decency or business necessity, so the term CSR is serving a useful purpose. But can the same be said of the policies?

At first sight that looks like a churlish question. What could possibly be wrong with policies such as corporate charity or careful attention to the demands of environmental protection and sustainable development? Sometimes nothing, but it depends. Many individual acts of good corporate citizenship do make sense in business terms, or as ways of advancing the public good, or both. But others do not.

Sometimes CSR policies are motivated by genuine concern for the intended beneficiaries, or by a conscientious belief that businesses must earn their “licence to operate”. There are some kindly CEOs out there, and some with a troubled conscience. But there can be other motives for CSR too. There are quite a few vain CEOs who enjoy the attention which CSR leadership brings them, and many others who, having climbed their way to the top, seem to find running a profitable company too small a test of their talents. Yet whatever the variations, one thing is constant: the weight given to specious arguments about what businesses must do to justify their existence and pay their way in society.

Putting those arguments about the duties of business to one side for the moment, setting motives aside as well and thinking only of results, one might ask two questions of any act of supposedly enlightened corporate citizenship. Does it improve the company's long-term profitability? And does it advance the broader public good?

Two tests

Successful managers usually do both at once, of course: merely by running a profitable company, they are likely to be advancing the public good as well. This argument will be taken up in more detail below. Some of the business practices that are often (perhaps misleadingly) labelled as CSR do fall into this category: they raise profits and advance society's well-being at the same time. Examples include establishing a reputation for dealing honestly with employees, suppliers and customers. This is the win-win kind of CSR—the sort that fails to impress much of civil society. Perhaps it would be better to call it simply “good management”.

Pick your permutation

Varieties of CSR

	Raises social welfare	Reduces social welfare
Raises profits	Good management	Pernicious CSR
Reduces profits	Borrowed virtue	Delusional CSR

Turning back to those two questions, however, note that there are three other possible answers as well. These are mapped out in the table. Some kinds of CSR reduce profits but raise social welfare (this is what civil society likes best: call it “borrowed virtue”, for reasons to be explained in a moment). There is also CSR that raises profits but reduces social welfare (“pernicious CSR”), and CSR that reduces both profits and welfare (a polite name for which might be “delusional CSR”). Consider some examples.

To begin with, win-win, or “good management”. There is a lot of it about. Many executives in the CSR movement deserve credit for testing and drawing attention to novel practices that can yield these good results. Their ideas may not be applicable in all or even most companies, but their success in particular cases is impressive.

One of the most enthusiastic and persuasive evangelists of win-win CSR is Marc Benioff, head of salesforce.com (http://www.salesforce.com/) , a strikingly successful internet-based business-services company. In his book, “Compassionate Capitalism”, he explains, among other things, how good corporate citizenship can be used to attract, retain and motivate the best workers. His company encourages its staff to devote time, at the firm's expense, to charitable works. In complementary ways, it also provides flexibility in working hours and conditions. The character of the firm, as perceived by its employees and its customers alike, is closely associated with this commitment to good causes.

All this seems to pay. Mr Benioff argues that this draws the right kind of people to the firm—team players, joiners, volunteers, generous and committed colleagues with a sense of loyalty to the enterprise. This kind of corporate philanthropy, which marries good works with a clever way of sorting and motivating staff, is undoubtedly catching on.

When you press a CEO for details of a company's CSR policies, and for their business rationale, you find that every firm believes that its CSR actions fall in the win-win box. No chief executive wants to believe that the firm's various services to the community might reduce social welfare, and none seems willing to admit that his enlightened management practices might reduce profits—what would the shareholders make of that? But those other cells of the matrix are far from empty.

A clear instance of an action that reduces profits while (presumably) improving social welfare is a straightforward cash donation to charity. The donations featured in the *Giving List* fall into this category. Sums donated in this way have soared recently in response to the Asian tsunami. You might suppose that devoting profit to the public interest is CSR at its best, or at any rate its noblest. The enlightened company is surrendering some of its earnings to make the world a better place.

Philanthropy that isn't

As many CEOs point out, this is not to say that there are no business benefits. Some executives think of their charitable donations—especially gifts such as sponsoring high-profile sporting or artistic events—as a kind of advertising. Others may feel that their companies, or their industries (oil, tobacco, pharmaceuticals), have such a poor image with the public at large that generous charitable donations are needed to redress matters. But straightforward corporate philanthropy of this kind is not woven into the way the firm manages its personnel, so the commercial benefits are probably limited. Most cash donations out of profits probably do represent a net loss of profits (even if the loss is less than the gross outlay).

And what, you might ask, is wrong with that? What is wrong with a company giving part of its profits to help the victims of the disaster in Asia, for instance—a good cause if ever there was one?

Not so fast. Remember that corporate philanthropy is charity with other people's money—which is not philanthropy at all. When a company gives some of its profits away in a good cause, its managers are indulging their charitable instincts not at their own expense but at the expense of the firm's owners. That is a morally dubious transaction. When Robin Hood stole from the rich to give to the poor, he was still stealing. He might have been a good corporate citizen, but he was still a bandit—and less of one, arguably, than the vicariously charitable CEO, who is spending money taken not from strangers, but from people who have placed him in a position of trust to safeguard their property. That is why the box in the table containing “corporate philanthropy” is marked (perhaps too politely) “borrowed virtue”.

Note that the world's most spectacular philanthropists—think of the Bill & Melinda Gates Foundation, with its endowment of $27 billion—are not spending the profits of the companies they are associated with but their own private wealth. That is the real thing, true philanthropy, and is nothing but admirable, especially if the givers are taking care to ensure the money is spent wisely, as the biggest private foundations now do.

Philanthropy financed out of the profits of publicly owned companies is a quite different thing, ethically speaking. Shareholders might expect to be allowed to spend their money on good causes of their own choosing, rather than seeing the managers whose salaries they pay take that uplifting duty upon themselves.

In the case of some public companies, it is true that there are mitigating circumstances. Some companies have a tradition of generosity with shareholders' money stretching many years back. Some, for instance, are formerly private or demutualised enterprises which, on going public, created charitable foundations and undertook to keep them financed. In these cases, the shareholders knew what they were getting into when they acquired stakes in the companies. Conceivably, these policies may even be among the reasons why some shareholders acquired their stakes in the first place. At any rate, such owners have little or no reason for complaint. As for the rest, the majority, it might have been polite to ask.

Still judging acts by their effects, as opposed to motives and underlying rationale, the most harmful kinds of CSR, however, are the “pernicious” and “delusional” sorts—that is, policies and practices that actually reduce social welfare. How can that happen? All too easily.

Most CSR, in fact, is probably delusional, meaning that it reduces both profits and social welfare, even if the cost under both headings is usually small. Almost all CSR has at least some cost, after all, even if it is no more than a modest increase in the firm's bureaucratic overhead. That cost subtracts from social welfare in its own right. So the kind of CSR that merely goes through the motions, delivering no new resources to worthy causes, giving the firm's workers or customers no good reason to think more highly of it (perhaps the opposite), involves a net loss of welfare.

Or consider the current enthusiasm for recycling. No doubt there are cases where it makes good business sense to recycle. These fall under the “good management” heading: they increase profits and (mainly for that reason) social welfare as well. But the point is that recycling is not free. Effort and other resources must be expended on it. Waste must be collected, transported and processed before it can re-enter the productive process. The costs can be substantial. If those private costs exceed the private savings, profits will suffer—and so, most likely, will social welfare.

Advocates of recycling would say this is short-sighted and wrong, because it ignores the need to conserve natural resources. Shortages of materials (such as newsprint), and of the natural resources needed to produce them (trees), are not reflected in the prices paid, they argue. So a private calculation of costs and benefits will not suffice. Profit, which is private benefit minus private cost, might rule out recycling, whereas a broader social calculation of costs and benefits would show a different balance. Since society has a collective interest in conserving resources, an interest not reflected in the market prices of commodities, recycling might very well reduce profit but at the same time increase welfare—and, as with corporate philanthropy, that is what CSR is about.

The trouble is, the notion that the market prices of commodities fail to reflect their scarcity is wrong. In commodity markets, prices reflect scarcity just fine. The long-term global trend of falling commodity prices, despite growth in the world economy, is not due to the failure of markets to reflect diminishing supplies and impending shortages. Commodity markets are for the most part efficient and forward-looking. Commodity prices, measured over recent decades, have followed a downward trend because innovation has brought about ever-rising productivity in the use of those resources. In other words, supply has outstripped demand. Where, unusually, it has not, prices have indeed gone up—providing the signal that may make recycling in those cases commercially sensible.

By and large, the world is not running out of resources; where it is, prices reflect that fact. As a result, the ordinary pursuit of profits is an excellent guide to companies on whether to recycle. There is no need to anoint recycling as a kind of moral standard of responsible behaviour. And if doing so succeeds in deflecting companies from thinking hard about their costs, actual social harm results. Use of materials is an area where private and social benefits are typically well-aligned.

Consider, finally, the case of CSR that raises profits but lowers welfare—pernicious CSR. Recognising the existence of this category is especially important. Some economically literate bosses argue that if CSR raises profits then it must by the same token raise social welfare. So long as good corporate citizenship is good for the bottom line, they assume, you can rest assured that it must be win-win, and good for society as well. As a rule, this may be true. But there are some large exceptions.

Almost all CSR advocates are passionate about "sustainable development". The idea is strongly endorsed by governments everywhere, by institutions such as the World Bank and the United Nations, and indeed by anybody at all with a desire to be thought well of. It has become an organising principle for the whole CSR movement. Emphasis is laid on environmental protection and on responsible behaviour towards workers and communities in the developing countries. In order to advance those eminently worthy goals, some companies have lately devised codes of practice, or have adopted codes written by other organisations. The danger lies in the detail of these policies.

To many advocates of CSR, and to virtually all of the NGOs that have given the CSR movement its intellectual drive, responsible behaviour towards workers in the developing countries goes far beyond giving them jobs at market wages and complying with local laws and regulations on matters such as health and safety. There is a debate in CSR circles about exactly how much higher than this the standard of responsible conduct should be. Some improvement on the minimal market standard is probably win-win in any case, because rich-country multinationals operating in developing countries typically want to hire from a big pool of keen applicants and to find better-than-average workers. Rich-country multinationals do in fact pay substantially higher wages and give substantially better benefits (such as access to health care) than the local norm. But how much of an improvement on this profit-seeking market standard does good corporate citizenship require?

Some CSR advocates have aligned themselves with those in the NGO movement who regard it as wrong—exploitative, or "unfair"—to hire workers in the developing countries on any terms that are significantly less generous than those granted to their rich-country workers. Companies under NGO scrutiny have been dissuaded from investing in manufacturing operations in developing countries such as India or Bangladesh, or have decided to end such operations, faced with charges that they are employing "sweatshop labour". As good corporate citizens, they say with arms twisted behind their back, they no longer do that. Many development NGOs are pushing for labour standards that would mandate this kind of "best practice", and want these standards written into future trade agreements.

The evidence clearly shows that policies of this kind (especially if they come to be required of all companies as part of future trade pacts) are not in the interests of the workers they purport to help. Foreign direct investment in the third world is known to be one of the best spurs to economic development: just look at China. Even when the wages and other terms offered to local workers are much less generous than those offered to their western counterparts, they are typically much better than the local economy can provide, which is why jobs with foreign multinationals are nearly always in great demand in poor countries.

Attitudes that discourage such investment by making it less profitable, or by exposing companies that have made such investments to ridicule or censure, undoubtedly hold poor countries back.

They also keep in poverty the very workers who would otherwise have got those jobs. To withdraw from such investments, as good corporate citizens are frequently enjoined to, may well be profitable for the companies concerned because staying put would impose heavy costs on their reputation. Capitulating to the ill-judged demands of the NGOs may be rational, profit-seeking behaviour on their part. But in this case, what is good for profits is bad for welfare.

This danger is compounded when CSR leaders campaign for the introduction of codes that impose such standards on all firms. This too may be fine for profits, which is why so many companies have begun to endorse this policy. It is a good idea for a business to hobble its competition if possible—which is what mandatory labour standards of the sort demanded of the WTO tend to do. How much better if grasping this commercial advantage can be disguised as acting the good corporate citizen. But hobbling the competition is bad for the public at large. Again, by depriving them of investment, such perverted virtue especially harms the economic prospects of developing countries.

All this underlines a broader worry. Companies do operate in a climate of opinion. To be successful and profitable, they must take account of how they are perceived. Big, successful businesses, which often find themselves in the public view, strive constantly to improve and protect their reputation. This is just as it should be: concern for the way they are judged by customers, suppliers and the world at large is a useful discipline. If it were absent, there would be no economic pressure on companies to behave decently. If nobody is paying attention, why worry about dealing honestly with people, or honouring a contract? This pressure of outsiders' perceptions is an indispensable force. Without it, companies in a private-enterprise system would be nasty, brutish and very short-lived.

Need to know

However, it is important that this pressure should be well-informed, or at least not utterly misguided. In particular, it needs to embody some basic economic understanding. Unwarranted, misguided or contradictory public demands on companies, especially if these demands emerge in due course as government mandates, can affect decisions in such a way as to detach profitable business conduct from the public good.

If the public decides to punish banks and other service companies that move their call-centres offshore by withholding its custom, the profit-seeking company will respond by ending the practice. Whether that response advances the broader social good then depends on the circumstances. If consumers reject outsourcing of this kind because it provides a lower quality of service, fine: that is the market working as it should. If the public rejects outsourcing because it falsely believes that workers in foreign call-centres are being exploited, that is not fine: that is the market, through popular misconception, getting it wrong.

In a way, this is to concede an important point to the advocates of CSR. Capitalism does function on top of, and one way or another is moulded by, prevailing popular opinion. As noted earlier, the conditions that must be satisfied if capitalism is to serve the public good are not trivial. A comprehending and supportive climate of opinion must be added to the list. That is why the battle of ideas matters so much.

CSR comes in a wide variety of forms. Judged by results, it may be win-win, borrowed virtue, delusional or pernicious. Judged by motives, it may be done in good faith or bad faith, out of conviction, boredom or vanity, by genuinely well-intentioned business leaders or by cynical bosses looking to dupe their consumers. But invariably, and dangerously, it is underpinned by mixed-up economics.

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