Business for Social Responsibility

Fade, Integrate or Transform? The Future of CSR

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CSR is at a crossroads. After a decade of evolution, the pathway forward defies easy prognosis. Will external events and company choices relegate CSR to a passing fad, leading to its fading from corporate and public agendas? Or will CSR reach full fruition as it becomes aligned, integrated and fully institutionalized in company strategy and operations? Or, alternatively, is something more transformational on the horizon as CSR morphs into a deeper change mode, becoming a force for altering corporate purpose at the most fundamental and systemic level? These questions have profound implications for the future of all corporate enterprises. Exploring possible futures yields insight into where we find ourselves today and provides guidance about where we would like to be and how to get there.

Virtually all large companies pursue some form of scenario planning to optimize deployment of their financial and human capital. In a globalizing world where capital, technology, information and trade flow are increasing freely across borders, prudent management requires nothing less for building a healthy, competitive business in the 21st century. In an interconnected world, companies operate not as discrete, atomistic entities, but rather as elements of a global system characterized by complexity and rapid change. It is the struggle to define and manage the opportunities and risks of this new world that has fueled the emergence of CSR during the last few years, and will continue to do so in coming decades.

This paper frames three potential scenarios, intentionally designed with stark differences in content and implications for companies and their stakeholders. All scenarios are plausible, but which will — or should — materialize is not yet clear. Following the scenarios is a brief chronicle of the CSR movement and an assessment of how its history may inform its future.

THREE VISIONS

What does the future hold? To frame an answer to this question, consider three scenarios for the year 2015.

<u>Scenario 1</u>

Dateline: San Francisco, 2015

At the BSR Annual Conference, keynoters proclaim the passing of the CSR movement. A severe economic global downturn is occurring, triggered by energy shocks, over-capacity in many extractive and manufacturing sectors, withdrawal of foreign creditors from U.S. bond markets, prolonged and widespread security crises, and failures of several global financial institutions and investment funds. A wave of multinational company downsizing and consolidation is underway, affecting thousands of suppliers and workers worldwide. The obituary is grim: CSR, once viewed as irreversibly destined to become integral to corporate strategy, management and governance, has proven to be fragile and transient. Attention of business and government turns to basic economic survival and recovery from the crisis. CSR moves quietly into hibernation with an uncertain future, characterized by practices associated with its earliest phase, namely compliance and philanthropy. This is the **fad-and-fade scenario**.

The fad-and-fade scenario paints a picture of CSR falling victim to a series of developments that lead to a retreat to its earliest and most superficial form. While the hypothetical developments associated with this scenario are largely beyond the control of any one sector, company or constituency, the combination is not implausible. Certainly the last decade has seen versions of each development in some form and degree — a financial meltdown in Asia in the 1990s, fragility of hedge funds and savings and loan organizations, and an apparent inflection point in the upward surge of oil prices during 2005.

While the combination of these conditions may not be probable, the decline of CSR in this scenario is not wholly dependent on external forces. The fad-and-fade scenario would be as much a reflection of CSR's own failing to address social, environmental and governance challenges of business, most of which will persist as challenges for many years to come. Regardless of macro-economic and political trends, companies will be faced with issues of transparency, labor standards, human rights, political lobbying, climate change and many other aspects of the CSR agenda. The difference between the fad-and-fade scenario and others is that government mandates and regulation emerge as the dominant remnants of a former vibrant movement, replacing business innovation as the primary driver of best CSR practices. This, needless to say, would be a sorry outcome after years of progress toward continuous company-led innovation in creating strategies, methods and tools for advancing the CSR agenda.

Scenario 2

Dateline: San Francisco, 2015

At the BSR Annual Conference, keynoters applaud the triumph of the CSR movement and the demise of its skeptics and naysayers. In a mere two decades, CSR moved from the extraordinary to the expected, embedded in company strategy and operations. Boards of Directors, CEOs and top managers no longer ask for the business case for CSR; it has been persuasively demonstrated across a wide range of sectors and companies. Continuous enhancement of CSR practices is generally accepted, ranging from adherence to leading norms such as the Global Compact, GRI and ILO core labor standards, to internal management standards such as the new ISO CSR guidance. For large and small, public and private companies alike, CSR is the rule; the small fraction of firms that fail to grasp this find themselves increasingly at a competitive disadvantage. This is the **embed-and-integrate scenario**.

This scenario constitutes the deepening and broadening of CSR integration. Early leaders have been joined by thousands of companies worldwide in melding business values with a strong sense of moral and ethical commitment to CSR from the margins to the core of company business units and functional areas. R&D, product and service design, manufacturing, marketing, finance and accounting embrace CSR as integral to their execution and success. Corporate directors understand that CSR issues—social reporting, environmental stewardship, fair wages, consistency between company policies and lobbying practices—are not only wise business but integral to fiduciary duty.

The embed-and-integrate scenario has materialized because CSR has shed its add-on, dispensable characterization in the company and become entrenched in decision-making and culture. It has proven its worth to shareholder value, reputation and brand, and now enjoys the embrace of multiple champions throughout the ranks of executives, managers and employees. The scenario is characterized by a continuing dynamic of learning, experimentation and implementation of new ideas built on a platform of generally accepted standards of good governance, labor practices, reporting and environmental stewardship. While some of the external conditions of the fad-and-fade scenario are evident, the embed-and-integrate scenario provides CSR resilience amidst adverse conditions such as those described in Scenario 1.

<u>Scenario 3</u>

Dateline: San Francisco, 2015

At the BSR Annual Conference, keynoters reflect on the productive yet ultimately unfulfilled promise of CSR and the ascendance of a wholly different approach to corporate responsibility. While incremental progress was achieved in human rights, labor and environmental performance of corporations, intensifying ecological stresses and social inequalities spurred a fundamental rethinking of the purpose of the corporation. Frustration and disillusionment set in across a broad group of stakeholders, spurring the formation of an improbable coalition of civil society, labor and corporations into a movement in support of "corporate redesign." The notion of "shareholder value," discredited for its "short-termism" and social vacuity, has been replaced by "wealth creation" and "stakeholder governance." These concepts are rooted in the idea that all company stakeholders — employees, communities, suppliers, shareholders — are "investors" in the company and deserve to participate in its governance and benefit from its surplus. Received wisdoms such as the primacy of the shareholder, traditional fiduciary duty and limited liability remain the subjects of ongoing debates, instigating efforts to legally alter the nature and purpose of corporations to reflect a broader social function. This is the **transition-and-transformation scenario**.

Something bigger than any one company, or group of companies, is unfolding. Public confidence in the business community continues to decline amidst sharpening differences among winners and losers in the globalization process. A wave of mergers and acquisitions that benefit a limited few feed a public and civil society backlash against "churning" in the capital markets. A number of retired business leaders step forward, joined in coalition by labor and civil society groups, to challenge the prevailing wisdom concerning the rights and obligations of corporations. Spurred by proliferating initiatives at the state level,[i] a movement to redefine the purpose of the corporation gains momentum among employee groups and civil society organizations, and is fortified by a well-organized group of legal and business scholars.

By 2010, a focus on corporate purpose has moved into the political and policy arena, challenging "shareholderism" as incongruent with 21st century needs and expectations of business. But unlike earlier incremental and fragmented corporate reform efforts, this movement is attracting broad support among progressive members of the corporate community itself. Disillusionment with short-term motivation is broad and deep, and the concept of companies as "team production" entities dependent on the joint investment of employees, communities, customers, shareholders and other stakeholders has captured the public imagination.[ii]

The beacon of this movement is embodied in a new set of "design principles" that strives to foster the innovation and competitive instincts of companies while elevating social purpose as the preeminent goal of the corporation. Its six principles are: [iii]

1) **The purpose of the corporation is to harness private interests in service to the public interest.**
2) **Corporations shall accrue fair returns for shareholders, but not at the expense of the legitimate interests of other stakeholders.**
3) **Corporations shall operate sustainably, meeting the needs of the present generation without compromising the ability of future generations to meet their needs.**
4) **Corporations shall distribute their wealth equitably among those who contribute to its creation.**

5) **Corporations shall be governed in a manner that is participatory, transparent, ethical and accountable.**
6) **Corporate rights shall not infringe on the right of natural persons to govern themselves, nor infringe on other universal human rights.**

These principles diffuse quickly to major emerging economies such as Brazil, South Africa, India and China, which themselves face the dual challenges of competing internationally while addressing the acute social inequities that persist despite rapidly expanding economies. Gradually, the principles find their way into law, governance and practice, giving rise to a new vision of the role of corporations in developing societies.

Meanwhile, multinationals, drawn to the emerging South for its labor (skilled and unskilled) and burgeoning consumer markets, find themselves held to these corporate design principles alongside the suite of other prevailing international norms (e.g. Global Compact, GRI, ILO Core Labor Standards) as conditions for doing business.

How plausible is this post-CSR, transformational scenario? For some, no doubt, it stretches credulity given its departure from the prevailing norm of shareholder-driven corporate law and practice. But in historical perspective, major shifts of this magnitude -- including the modern environmental, women's and civil rights movements -- have occurred with regularity, spurred by grievance, galvanized by a handful of visionaries, and driven by the intersection of crisis and opportunity.

The contemporary pace of social change is certainly not diminishing and is arguably accelerating, owing to the forces of globalization. Revisiting the historical roots of the corporation and the trajectory of CSR is important for framing where we have come from, and for thinking about where we are headed.

GENESIS OF THE MODERN CORPORATION

A glimpse of the origins of the modern corporation is helpful for understanding CSR in the late 20th and early 21st centuries. Imagining the next phase of CSR invites consideration of the birth of the corporation as we know it. Therefore, an understanding of what has come before provides insight into the range of possibilities for the corporation.

From its genesis in the early Industrial Revolution, the joint-stock corporation took root as the heir to the private-partnership organization, wherein close owner-capitalists maintained high levels of familiarity with the workings of the companies that they partially owned. As the scale of companies grew, so did the need for capital well beyond what the original entrepreneur and close partners could provide. Thus, the idea of passive investors purchasing equity shares emerged, and by the end of the 19th century this would come to dominate the industrial landscape and become a central driving force of the economic expansion of Western nations.

This development was not warmly embraced by all. Indeed, as early as the late 18th century, Adam Smith harbored doubts about the social repercussions of the joint-stock company. Notwithstanding his seminal observation that individuals working to advance their self-interests is the surest route to aggregate societal well-being, Smith understood the threat of business monopoly, privilege and protection to societal interests. His concern with business power to "intimidate the legislature" was a premonition of contemporary corporate political influence, the future scale of which he could not have possibly imagined.

U.S. court decisions in the late 19th century fueled the rise of shareholder supremacy, a notion built on the premise that shareholding entitles shareholders to be the dominant recipients of surplus generated by corporate wealth creation. This view, while upheld in the courts, met with opposition, even among business leaders. Henry Ford and Owen D. Young, GE's chairman in the 1920s, questioned the supremacy of shareholders relative to other parties that contribute to wealth creation.[iv] Ford was sued by two shareholders for suspending dividends in favor of plant expansion. When asked what is the purpose of his corporation, Ford responded: "To do as much good as we can, everywhere, for everybody concerned … and incidentally to make money." Ford lost his case in a Michigan court. A few years later, Young rhetorically asked: "To whom do I owe my obligations?" His answer: the company owes "a fair rate of return to shareholders" at the same time as it serves the interests of employees, customers and the public.

Notwithstanding this ubiquitous view of corporate purpose, shareholderism intensified during the ensuing decades, subject only to slight modifications by subsequent court rulings.[v] Reinforced by "stock market capitalism" — the unwavering focus on short-term share price at the expense of other performance indicators — shareholder primacy reached its pinnacle after the 1980s. This was evidenced during the wave of mergers and acquisitions (M&As) that swept the business community in the name of maximizing short-term shareholder value. Though the magnitude of long-term benefits — even to shareholders — of the 1980s and subsequent waves of M&As remain contested, the period solidified the supremacy of shareholder rights vis-à-vis the rights of other stakeholders.

Today, the received wisdom of shareholder value as the central purpose of business poses a continuing challenge to CSR. The conflict begins with management education and is entrenched deeply as to be the core driver of board and executive decision-making. Such is the case even though, as Sumantra Ghoshal observes: "If the value creation is achieved by combining the resources of both employees and shareholders, why should the value distribution favor on the latter? Why must the mainstream of our theory be premised on maximizing the returns to just one of these various contributors?"[vi]

In a fundamental sense, the emergence of CSR may be viewed as a modest corrective mechanism to shareholderism. Its emphasis on stakeholder rights and participation opposes the unrelenting focus on shareholder interests, especially those that place short-term share price above all other goals.

Outside the Anglo-American business culture, questions about the nature and purpose of the corporation are heard with some frequency. In Germany, for example, where labor is represented on corporate boards, equity ownership is traditionally far more concentrated than in the U.S. and UK. Market dominance rather than share price is viewed as the core performance indicator. The distaste for shareholderism was expressed recently by the chairman of the German Social Democratic party, referring to the failed effort of Deutche Borse to buy the London Stock Exchange: "Financial investors … have no face; they descend upon companies like locusts, destroy everything [for short-term gain] and move on."

In India, South Africa and Brazil, skepticism of shareholderism has cast CSR as an antidote or preemptive mechanism. In India, the Ghandian model of voluntary commitment to public welfare and social needs is at least as influential in shaping attitudes toward corporate purpose as are imported doctrines associated with Friedman and other Western thought leaders that equate corporate purpose with private gain.[vii]

Many multinationals, of course, are well aware of these differences as they navigate relationships with host governments and business partners who may hold different views on such critical issues as labor standards, transparency and engagement of indigenous peoples. But with the globalization of business likely to continue unabated, the challenges of understanding and reconciling different CSR cultures will persist for many years to come.

CSR EMERGENCE

No single historical event marks the birth of CSR. Some observers date its origins to the early environmentalism of the 1960s, when the first serious regulations were put in place in North America and Europe. At the same time, the long tradition of corporate philanthropy in the U.S. has remained a standard component and expectation of "responsible business" since the early days of the large American industrial firm.

Juxtaposed with the ascendance of shareholder value as the core purpose of business were the early precursors of CSR that took root some 25 years ago. Distilled to its basics, the CSR story is a chronicle of gradual redefinition and expansion ranging from "must do" legal compliance blended with traditional philanthropy, to "should do" based on traditional benefit/cost analysis, to "ought to do" based on emerging global norms of integrity, ethics and justice.[viii] These phases form a continuum, implying a process of building toward a more complex and nuanced framework for defining CSR in concept and practice.

Despite its uneven and disjointed evolution, it is fair to say that one identifiable thread in CSR history is a three-fold shift in focus from what is legally required and charitable to what is financially justified and, most recently, to what is morally expected. Each step along this continuum mirrors an evolving definition of the parties to whom corporations are responsible and accountable.[ix]

Since 2000, CSR has entered yet another phase often called "integration." This stage reflects a maturation of the CSR idea and recognition of the inherent limits of distancing CSR from core business strategy and operations. The leading edge is now characterized by the idea of seamlessness — identifying and implementing actions that make CSR everyone's business and ending its isolation as a useful but dispensable add-on to "real" business activities. Paradoxically, companies pursuing integration see CSR becoming less visible as it penetrates not only strategy and operations, but corporate governance.

What is emerging in the integration phase is actually multifaceted, comprising:[x]

- *Alignment* with business objectives within overall company strategy
- *Integration* across business entities and functional areas
- *Institutionalization* by embedding strategies, policies, processes and systems into the fabric of the organization

Though integration is far from the norm, it is clearly moving to a level of best practice among companies who understand the rich opportunities of shifting CSR from the margins to the core of business practice.

The bastions of mainstream business such as *The Wall Street Journal* and *Fortune* now often report on a range of CSR issues such as sweatshops, climate change and fair trade. Another barometer of integration is the extent to which leading companies are blending financial and CSR reporting.[xi] Recent reports by Novo Nordisk, Novartis, Dofasco and BC Hydro (Canada), GSK (UK), SAS, Natura (Brazil) and DSM (Netherlands) illustrate this trend. Reading the Novo Nordisk report, for example, one is hard-pressed to distinguish a CSR issue from a business strategy issue. Sections in the Novo Nordisk publication include Defeating Diabetes, Innovation, Business Ethics, and People and Industry Under Fire. In a sector under intense scrutiny for its drug trials, transparency, pricing and post-commercial safety assessment, Novo takes a direct, unflinching approach to reporting. The topics that it grapples with are of no less interest to investors than they are to civil society groups, medical professionals and consumer groups. In the contemporary phase of CSR, integration of this nature is likely to intensify as the confluence of CSR and standard business practices continues to make headway in corporate strategy and operations.

Integration in its various forms will continue unabated. The blurring of CSR with issues of corporate strategy, management and governance seems destined to continue in the next few years to include issues like corporate lobbying, business taxes paid to government, and product stewardship issues that are only now emerging.

In the coming years, will a steady state emerge in which CSR is effectively absorbed into the business mainstream, interwoven with most or all aspects of strategy, management and governance? For many practitioners, this would be the most satisfying of outcomes.

Seeing a dramatic shift in relatively few years from the narrowness of philanthropy to the point of seamless invisibility within the corporation would be nothing short of remarkable. For companies that have embraced CSR, this future would vindicate their efforts. At the same time, this trend would challenge the skeptics who continue to dismiss CSR as a costly, unjustified deviation from business' principal purpose of creating shareholder value.[xii] For those who have resisted CSR, it would lay bare the foolishness of coloring CSR as diversionary and immaterial to core business concerns.

Of course, it is premature to judge exactly when -- or if -- this full integration will occur across a broad band of companies or, alternatively, whether the field will become increasingly stratified among firms that strive for continuously deeper integration and those that remain stuck in the business-case and philanthropic mindsets. Pondering this question logically leads to an even longer-term one: Even if integration does shift from an extraordinary practice to the exceptional and eventually the expected, will such mainstreaming end the evolution of CSR as we know it?

WHY ASK "WHAT'S NEXT?"

Envisioning the future of CSR presents both a challenge and opportunity for companies seeking to maintain prosperity in an increasingly complex business environment that is fraught with risk and rich in opportunity. We are in a moment when we are cognizant of CSR's impressive progress in relatively few years, yet uncertain about its future. It's time to question how the vast resources and unparalleled ingenuity of corporations can be harnessed to build maximum long-term wealth for all stakeholders.

What, specifically, underlies this moment? Three conditions come to mind. The first is **scale**. The reach of the largest multinationals is unprecedented. We already have witnessed companies — Wal-Mart, ExxonMobil, BP, Shell — with revenues in excess of a quarter *trillion* dollars (US), a turnover inconceivable even a decade ago. In the case of Wal-Mart, for example, scale of this magnitude is associated with domination of vast networks of suppliers, over a million U.S. workers, and enormous influence on product pricing, labor practices and community impacts. Inevitably, scale at this level gives rise to questions as to whether such corporate influence is matched by commensurate standards of corporate responsibility.

Transience is a second condition. The pace of change in the global economy is exemplified by waves of mergers and acquisitions, fleeting ownership enabled by new investment instruments such as hedge funds, and dislocation associated with frenetic restructuring of where and how goods and services are produced. Large segments of the shareholder population are immune to the repercussions of these rapidly shifting tides. But for workers and communities, the uncertainty is unsettling at minimum and ruinous at worst. For shareholders, transience is simply the modern manifestation of "creative destruction," enabling the market to relentlessly drive toward near-term shareholder returns often, though not always, in the name of efficiency and competitiveness. For workers and communities, however, transience is the embodiment of the amorality of business and the market economy in general, bowing to near-term returns at the expense of broader long-term, non-shareholder interests.

Finally, **disparities** constitute a third condition that contributes to the anxiety over the direction of global companies. Disparities come in many forms — the ratio of executive pay to average wages; the inequalities between shareholder returns and non-shareholder (employee, community, environment) returns; and imbalances between how corporations are governed and who is affected by such governance. Disparities are also present in significant segments of capital markets, exemplified by investment banking firms that accrue extraordinary profits while shifting the risks to other parties. This has been termed the "Heads we win, tails you lose" strategy.[xiii] Lastly, disparities are evident in the flat or declining real wages of workers versus the steady, sometimes dramatic increases of the wealth of CEOs.

Scale, transience and disparities -- these conditions conspire to infect the public perception of business and to prompt questions about what the corporate future holds. The erosion of the safety net that corporations once provided in terms of health coverage, pension funds and job tenure further feeds unease that the business-society social contract is unraveling. These developments, combined with the sense that CSR may be approaching its limits, cloud the corporate future. But clouds need not lead to paralysis. Indeed, all signals point to a moment of opportunity for companies to shape -- not just react to -- the future of CSR.

REFLECTIONS

Few would doubt that the global future is inextricably linked to the corporate future. As such, CSR is not an option; it is a reality. The sheer weight of the corporate role in wealth creation and the footprint associated with this creative process makes responsibility inevitable. We may argue about the degree and proper responses associated with such responsibility, but there can be little argument about the fact itself.

The core question facing companies is how to harness the full potential of business to serve the public interest while preserving and enhancing core assets — creativity, innovation and competitive drive. In some sense, this has always been the central challenge of CSR. We see more than ever that the opportunities for individual, company and collective action are plentiful. Companies coming together — often prodded by external parties — to tackle climate change is a living example of this.

But for every opportunity realized, dozens remain untapped. Why, for example, do we not see U.S. companies rallying for universal health care in the face of the enormous cost burdens that threaten their financial future? Or, in the case of the airline and transport services industry, both buffeted by petroleum price hikes and uncertainties, why do we not see collective action to vastly accelerate alternative fuels research? Why is there a paucity of initiatives like Nike's challenge to apparel makers to create common standards and audits for contract manufacturers? Is it a question of political will? Legal impediments? Or just blind competitiveness that obscures the potential payoffs?

Two centuries ago, social purpose was central to the charter of U.S. corporations. One hundred years ago, well into the era of the large, investor-owned companies, industrialists like Ford and Young understood the concept of harnessing the private interest to serve a broader public purpose. With the right mix of wisdom and will, the next decades may well witness a turn away from the deleterious effects of single-minded shareholderism toward next-generation CSR that meets the dual goals of prosperous corporations and prosperous societies.

ENDNOTES

[i] Current examples of state initiatives to redefine directors' duties and/or establish special charters for responsible companies have occurred in California, Minnesota and Maine.

[ii] Blair, Margaret M. and Stout, Lynn A., "A Team Production Theory of Corporate Law." Virginia Law Review, Vol. 85, No. 2, pp. 248-328, March 1999, http://ssrn.com/abstract=425500.

[iii] These principles, in draft at this writing, reflect the collective thinking of a forum of individuals in law, business, labor, civil society, government and journalism, who have begun an initiative to advance corporate redesign. See www.corporate2020.org.

[iv] Michael Skapinker, "Only the Strong Survive," *Financial Times*, June 11-12, 2005, W1.

[v] The courts tended to dodge the question of the distinction between long-term profit maximization and short-term profit and share price maximization, generally upholding the right of companies to take non-maximizing actions in the short term as long as they would achieve long-term maximization.

[vi] Sumantra Ghoshal, "Bad Management theories are destroying good management practices," *Academy of Management Learning & Education,* 2005, Vol. 4, No. 1, 75-91.

[vii] N.K. Balasubramanian, et al, "Emerging Opportunities or Traditions Reinforced: An Analysis of the Attitudes Towards CSR and Trends of Thinking About CSR in India," *Journal of Corporate Citizenship* 17 (Spring 2005) 79-92.

[viii] Another characterization of CSR's evolution is its transition from public relations to managing reputations, and operational risk to strategic differentiator. Simon Zadek, *Third Generation Corporate Citizenship: Public Policy and Business in Society*, The Foreign Policy Center, 2001.

[ix] This framework is a variant on Lynne Sharpe Paine, *Value Shift.* New York, McGraw Hill, 2003, 123.

[x] Boston College Center for Corporate Citizenship, *Integration: Critical Link for Corporate Citizenship -- Strategies and Real Cases from 8 Companies.* 2005. For an alternative but compatible framework of the transition from pre-compliance to post-strategic, see also Simon Zadek, "The Path to Corporate Responsibility," *Harvard Business Review,* Dec. 2004, 125-132.

[xi] Allen White, "New Wine, New Bottles: The Rise of Non-Financial Reporting," June 20, 2005, http://www.bsr.org/Meta/200506_BSR_Allen-White_Essay.pdf

[xii] The recent *Economist* piece, and the furor it triggered, attests to the durability of this view. "The Good Company," *Economist*, January 22, 2005, 3-22.

[xiii] Philip Augar, *The Greed Merchants.* Cambridge, England: Portfolio, 2005.