Module 2. Corporate Social Responsibility in Historical Perspective

This Module provides historical background on the evolution of corporate social responsibility (CSR) and is not critical for case analysis.

Module 2 Outline

- Historical/Theoretical View: the enterprise as an economic institution with economic contracts with shareholders, employers, and suppliers.
- The Early Intellectual Critique: Marx and Socialist writers
- The Political Challenge: Socialism in Europe and America in the 20th century
- "Corporate Social Responsibility" (CSR) emerges as an issue focused on corporate ***irresponsibility*** in the 1960s
- CSR is debated, defined and redefined and achieves legitimacy in the West over the next half century
- 2012: CSR comes to Central and Eastern Europe
- ESG Investing

A. The Origins of Corporate Social Responsibility in the Modern Era

- Began with reexamination of the relationship between the business firm and the rest of society in the 1950s
    - power of large corporations relative to more smaller societal elements--customers, employees, shareholders, local citizens;
    - greater knowledge--technical and informational--of the large firm relative to these societal elements;
    - growing status of the business firm as a social, political, and cultural, as well as economic, institution;
    - relationship of social problems--e.g., pollution, product safety, discrimination--to business (in)action.

The CSR Challenge to US Business in the 1960s

- In the 1960s, the idea of CSR outside U.S. business widens
    - Shift from focus on corporate "social irresponsibility" to CSR
    - social movements/non-governmental organizations (NGOs) achieved significant political power and legitimacy
    - new public policy and new governmental agencies to ensure its enforcement, in areas such as equal employment opportunity (women and minorities, environmental protection, workplace safety and health.
    - the public never wavered significantly from its view of the corporation as primarily an economic institution.
    - new expectations were additions to the old economic responsibilities to employees, customers, shareholders.

- The idea of CSR <u>inside</u> U.S. business widens
  - Intellectual defense of the old economic contract: Economist Milton Friedman
  - Enlisting support from an American public that still viewed the corporation as primarily an economic institution.
  - Public is sensitive to cost of additions to the traditional corporate responsibilities to employees, customers and, most importantly, shareholders.
  - Can government be trusted to reliably and sensibly enforce new policies and rules?
  - Shift from focus on resistance to proactive policy and decisions

Social Audits in the 1970s

- **Social auditing:** communicating the social and environmental effects of organizations' economic actions to particular interest groups within society and to society at large; also known as:
  - **Social accounting**
  - **social and environmental accounting**
  - **corporate social reporting**
  - **corporate social responsibility reporting**
  - **sustainability accounting**.

Stakeholder Theory is Added in the 1980s

- Traditional view of the firm: shareholders/stockholders are the owners of the company, and the firm has a binding fiduciary duty to put their needs first
  - increase value for them in the form of share value or dividends.
- Stakeholder Theory argues that there are other parties involved with a legitimate "stake" in business decisions, including
  - Communities and their governmental bodies
  - NGOs and other community groups
  - Employees and unions
  - suppliers and customers.
- Stakeholder Theory challenges the historical US legal definition of the corporation and views it more like an enterprise in European socialism.

"Sustainability" is Added to the Enterprise's Responsibilities in the 1990s

- Sustainability in business defined: "meeting the needs of business while simultaneously contributing to the possibilities that humans and other life will flourish on the earth for a long time."
- "Natural capital "is the extension of the economic notion of capital (manufactured means of production) to the natural environment to ensure future flow of goods or services.
- "Triple Bottom Line" expands the traditional business reporting framework to account for social, environmental and financial performance, i.e., "People, planet and profit."

“Sustainability” is Broadly Embraced in the Global Political Culture in the 2000s

- Sustainable Development is defined by the United Nations: “Sustainable Development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”
- “Natural capital “is the extension of the economic notion of capital (manufactured means of production) to goods and services relating to the natural environment to ensure future flow of goods or services.
- People, planet and profit: “Triple Bottom Line” expands the traditional business reporting framework to account for social, environmental and financial performance.

Creating Shared Value (CSV) and Corporate Social Responsibility (CSR)

- CSV broadens the definition of CSR
- Environmental, social and governance (ESG) criteria are a set of standards for a company’s operations that socially conscious investors use to screen potential investments
- Rigorous CSR Tools are proposed

Module 2. Text

<u>Historical/Theoretical View of the Corporation: the enterprise as an economic institution with economic contracts with shareholders, employers, and suppliers.</u>

To understand the broad significance of “Corporate Social Responsibility,” one must go back to the origins of market society and capitalism in the late 18th century. In this early period, the behavior of the business enterprise was consistent with the theoretical model as described in Adam Smith’s 1776 book, *The Wealth of Nations*—the primary, if not exclusive, focus of the enterprise was the maximization of profits and wealth for the business owner or owners. To achieve the economic goals of the ownersin the competitive marketplace,, the business enterprise had to maximize the satisfaction of its employees, who in a perfectly competitive market would choose to work elsewhere if not satisfied with their “economic contract,” and the customers, who in a perfectly competitive market would choose to buy from a competing seller.

In the 19th century, the corporation form of business organization, enabling the raising of capital from shareholders that were not necessarily a part of corporate management, became widespread. But shareholding usually remained concentrated in the hands of the owner-entrepreneur in this period.

As the corporation expanded further in the 20th century and became the dominant form of business organization in market economies, there was an increasing separation between the owners, who were large in numbers with only a few holding a significant percentage of company shares, and a class of professional managers. In the late 20th century, these professional managers were often given incentive pay structures which tied their compensation to corporate performance on an annual or often quarterly basis, thus encouraging them to act in the short-term financial interests of the firm.

Shareholding in this late 20th century became increasingly concentrated in the hands of financial institutions such as pension funds and mutual funds. These funds trade large blocks of shares on an ongoing basis, often making those decisions with algorithms that were preset to buy and sell without necessarily a human hand on the "buy" or "sell" button. As a result, the long-term financial interests of the corporation can be in conflict with the short-term interests of its top management.

Public Perceptions of the Corporation through History

In the period of early Western capitalism and well into the twentieth century, the public's view of the responsibilities of business were largely consistent with those of the Western business community: as an economic institution the firm was responsible for the generation of goods and services for consumers and jobs for workers, retaining for itself the maximum profit possible when acting legally in a freely competitive market. There were exceptions to this general societal perspective, e.g., in the attacks on business in the United States and Europe in the early twentieth century, but in the United States these exceptions never represented fundamental challenges to the legitimacy of business profits or a challenge to the view of the business firm as an almost exclusively economic institution.

In Europe, the system of capitalism was challenged directly by an active socialist movement, and indirectly by the writings of Karl Marx and other communists in the late 19th century and 9into the early 20th century. As a result, European economic systems, although fundamentally structured along capitalist lines, have strong elements of socialism that involve government (and labor unions) much more directly in business activities. This pattern is also characteristic of economic systems in Asia post-World War II, beginning with Japan, and then duplicated in the "Asian Tigers" and now China, i.e., there are strong ties between government and business superimposed on what is essentially a market system.

The Evolution of "Corporate Social Responsibility" in the United States

In the United States in the 1950s, there began a reexamination of the relationship between the business firm and the rest of society that laid the foundation for the next two decades that radically after the demands of business management. This reexamination was rooted in a number of observations, including (1) the power of large business corporations relative to more atomized societal elements--customers, employees, shareholders, local citizens; (2) the greater knowledge--technical and informational--of the large firm relative to these elements; (3) the growing status of the business firm as a social, political, and cultural, as well as economic, institution; and (4) the relationship of many of the social problems then surfacing in the public consciousness--e.g., pollution, discrimination, product safety--to business action or inaction. As this reexamination occurred within the business community, business executives began reconsideration of their traditional ideology of economic responsibility narrowly defined in terms of shareholder interest in favor of a more professional ideology of "social responsibility" that emphasized responsibilities to additional "stakeholders" in the firm, including customers, employees, and local communities.

But a key feature of business's discussion of its social responsibility in the 1950s was its nonspecific nature. As a consequence, when academic writers began to explore the social responsibility idea, their attempts to analyze, define, and operationalize the concept often led them to the conclusion that "social responsibility" was more ideology than substance, more rhetoric than reality. In noting the profuse claims of responsibility by businessmen in newspaper ads and elsewhere, in 1954 Peter Drucker wrote, "You might wonder... when the managers of American business had any time for business."

What academic writers did see in the issue of social responsibility, however, was the substantive issue of business power, and the attendant question of legitimacy of that power. Corporations were clearly institutions with tremendous power. No longer able to justify that power in terms exclusively of narrow shareholder interests, corporate managers sought legitimacy in a broadened constituency. But legitimacy also means responsibility and accountability.

Business in the United States in the 1960s

The gulf between ideas of corporate social responsibility developing outside the U.S. business system and those ideas prevailing within the US business system widened considerable as the decade of social revolution in the US--1962-72--got underway. Business ideology and practice of social responsibility was slowly evolving, but not nearly fast enough to meet the rapidly-changing expectations for socially responsible conduct on the part of general public and particular interest groups. As a result, "social irresponsibility" not "social responsibility" became the thread along which public interest (and academic instruction) on the subject of corporate social responsibility grew in this period. Lurid tales of corporate misconduct began to appear regularly in the popular media, and business critics began demanding programs of minority hiring, pollution control, product safety, and numerous other activities, all in the name of corporate social responsibility.

As active thinkers and writers inside and outside the business community wrestled with the philosophical and practical questions surrounding the corporate social responsibility debate, the social movements of the 1960s were taking shape. In short order, the country moved rapidly toward a public agenda on many key social responsibility issues, including discrimination in employment, pollution control and product and workplace safety. By the early 1970s, these social movements structured around new Non-governmental organizations (NGOs), had achieved significant changes in public policy which would impose upon business a whole range of responsibilities which were unheard of a few short years before. What's more, this new public policy carried with it the creation of a number of new US governmental bodies to ensure its enforcement, including the Equal Employment Opportunity Commission (EEOC), Environmental Protection Agency (EPA), and Occupational Safety and Health Administration (OSHA).

Despite the revolution in expectations on corporate conduct, the public never wavered significantly from its view of the corporation as primarily an economic institution. Rather, the bulk of these new expectations represented either additions to, or constraints on, the traditional corporate economic responsibilities to employees, customers and, most importantly, shareholders.

The Multinational Corporation (MNC) and Social Responsibility in the 1960s

The challenge to the legitimacy and practices of multinational corporations (MNCs) dates to the early overseas activities of Western corporations. The majority of the challenge was to companies in extractive industries, where they were accused of despoiling the natural environment or corrupting local political systems, as with the tropical fruit companies in Latin America. This history also includes the activities of the numerous European companies who, with the support of their home governments, operated throughout Asia during the period of colonialism, but principally dating to the 19th century.

Concern in developed countries about the activities of U.S. multinational firms was heightened in the 1960s with the publication of Jacques Servan-Schreiber's The American Challenge and Raymond Vernon's Sovereignty at Bay. These books asserted that multinational corporations in general and US MNCs in particular were a direct threat to national governments and their capacity to control their own economic destiny. This challenge was presented in a somewhat altered form by President Mahathir of Malaysia, where the culprit was not international corporations but international financial traders and institutions.

As with the domestic corporation, the question the firm must confront is the balance between its economic interests and the social, political and other interests where it operates, a question that is framed in this course as, "What is the social contract?"

The idea of CSR inside U.S. business widens in the 1970s

Business resistance to an expanded definition of its corporate social responsibility was bolstered by an intellectual defense from conservative economists like Nobel-prize winning economist Milton Friedman. Business also enlisting support from an American public that still viewed the corporation as primarily an economic institution. The American public was sensitive to the cost of additions to the traditional corporate responsibilities to employees, customers and, most importantly, shareholders. The American public also was not convinced that government could be trusted to reliably and sensibly enforce new policies and rules. Nevertheless, business community began a gradual shift in focus on resistance to proactive policy and decisions. What came to be referred to as “enlightened self-interest.”

Social Audits in the 1970s

One of the early responses of some businesses to demands for more responsible behavior was the preparation of “**social audits**.”

Social auditing can be defined **as** communicating the social and environmental effects of organizations' economic actions to particular interest groups within society and to society at large. It is also known by other names, such as:

- **Social accounting**
- **social and environmental accounting**
- **corporate social reporting**
- **corporate social responsibility reporting**
- **sustainability accounting**.

While many companies report what might be called their CSR activities, few do so in separate documents. Rather, they include this information as part of their annual report to shareholders.

Stakeholder Theory is Added in the 1980s

As noted above, the traditional view of the firm confirms the shareholders/stockholders are the owners of the company, and emphasizes the firm’s binding fiduciary duty to put their needs first. This has meant increasing the value of their investment through increasing share value and/or the payout of dividends.

Stakeholder Theory argues that there are other parties involved with a legitimate "stake" in business decisions, including:

- Local communities impacted by company operations and the governmental bodies of those communities
- NGOs and other community groups that represent "stakeholder groups that might not otherwise have their interests represented
- Employees and unions
- suppliers and customers with a strong dependent relationship to the firm.

In effect, Stakeholder Theory challenges the historical US legal definition of the corporation and views it more like an enterprise in European socialism. To date, this idea of a broadened legal definition of the corporation has not seen any acceptance in American jurisprudence.

"Sustainability" is Added to The Enterprise's Responsibilities in the 1990s

In the 1990s, "Sustainability" became a popular term, but one with multiple meanings. When applied to business, it meant "meeting the needs of business while simultaneously contributing to the possibilities that humans and other life will flourish on the earth for a long time." Quite explicit in this definition is the primacy of business needs, i.e., one could say that it implies that the business must be "sustainable" as an economic entity.

In this period, a second phrase related to sustainability enjoyed a measure of popularity--"Natural capital." "Natural capital" was the extension of the economic notion of "capital" (manufactured means of production) to the natural environment to ensure future flow of goods or services.

The "**Triple Bottom Line**" was another sustainability-related phrase that emerged in the effort to redirect business to CSR. The Triple Bottom Line, like natural capital, expands the traditional business reporting framework to account for social, environmental and financial performance., or as someone called it, balancing "People, planet and profit."

Quite clearly, these various definitions brought the idea of CSR further into focus. In effect, business was being asked to report what it was doing to "sustain" not just itself, but the societies in which it operated ("people") and the environment (local ecosystems and "the planet").

"Sustainability" is Broadly Embraced in the Global Political Culture in the 21st Century

The idea of sustainability was being introduced into business, it was also being introduced into the broader public arena in the form of a call for "sustainable development." Sustainable Development is defined by the United Nations: "Sustainable Development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs." Governments both national, regional and local began to talk about sustainable development within the framework of their boundaries, with a strong emphasis on issues related to employment, resource depletion, and public health. Further, the CSR activities of businesses, or lack thereof, operating within political entities came to be one of the foci of sustainable development concerns.

CSR and Sustainability Today

This half century of CSR development has clearly seen an evolution in terminology and a broadening of attention given to it. There has been significant progress within the business community in developed economies in eliminating the corporate irresponsibility that helped foster the CSR movement, if it can be described as a kind of social movement. However, for any single issue within the scope of CSR, and for CSR itself, there remains considerable ambiguity as to how a firm or manager should respond to particular decision making challenges when social, environmental and political issues are raises. It is not the intention of this course to resolve those ambiguities and tell prospective how they should resolve those dilemmas. Rather it is to draw into clear focus the underlying issues, and equip prospective mangers with the professional perspective and analytical tools to resolve their dilemmas once they occur.

Creating Shared Value (CSV) and Corporate Social Responsibility (CSR)

Creating shared value (CSV) is a business concept first introduced in *Harvard Business Review* article *Strategy & Society: The Link between Competitive Advantage and Corporate Social Responsibility*. It is explained in Module 4.

Evolving Metrics for Measuring Corporate Social Performance.

In the last decade, there has been a growing effort to develop universal metrics for measuring corporate social performance. While these metrics are developed by organizations with some business participation, they are primarily a product of NGOs seeking to urge corporations toward more social responsibility using their prescribed metrics. For examples, see:

Global Social Compliance Programme (ww.gscpnet.com)
Global GAP (good agricultural practice) (www.globalgap.org)
Global Gap Risk Assessment on Social Practices (also globalgap.org)
Business Social Compliance Initiative (bsci-intl.org)
Global Reporting Initiative https://www.globalreporting.org/

Environmental, Social, and Governance (ESG) Investment

Environmental, social and governance (ESG) criteria are a set of standards for a company's operations that socially conscious investors use to screen potential investments. Environmental criteria consider how a company performs as a steward of nature. Social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates. Governance deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights. ESG criteria are an increasingly popular way for investors to evaluate companies in which they might want to invest. ESG criteria can also help investors avoid companies that might pose a greater financial risk due to their environmental or other practices.

Environmental criteria may include a company's energy use, waste, pollution, natural resource conservation, and treatment of animals. The criteria can also be used in evaluating any environmental risks a company might face and how the company is managing those risks. For example, are there issues related to its ownership of contaminated land, its disposal of hazardous waste, its management of toxic emissions, or its compliance with government environmental regulations?

Social criteria look at the company's business relationships. Does it work with suppliers that hold the same values as it claims to hold? Does the company donate a percentage of its profits to the local community or encourage employees to perform volunteer work there? Do the company's working conditions show a high regard for its employees' health and safety? Are other stakeholders' interests taken into account?

With regard to **governance**, investors may want to know that a company uses accurate and transparent accounting methods, and that stockholders are given an opportunity to vote on important issues. They may also want assurances that companies avoid conflicts of interest in their choice of board members, don't use political contributions to obtain unduly favorable treatment and, of course, don't engage in illegal practices.

CSR Tools

CSR4U TOOL is a web tool dedicated especially to SMEs (small and medium-sized enterprises) to approach CSR and business ethics principles. It is a result of an European funded research project called LOIEs. CSR4U TOOL let your organization to test your social, environmental and financial performances in an easy way. (See Module 4)

CSR and Climate Change

Climate change presents a major challenge to corporations and executives as **Reading 0. "Business Perspectives on Climate Change,"** in the Homework Vault makes clear. It will impact different industries in dramatically different ways. The cases in this course are designed to represent the range of impacts across a wide spectrum of industries.