By Robert N. Stavins

Some Straight Talk Needed About CSR

The time is ripe for critical thinking about corporate social responsibility, because there are few topics where discussions feature greater ratios of heat to light. With this in mind, two of my Harvard colleagues — law professor Bruce Hay and business school professor Richard Vietor — and I co-edited a book published in 2005, *Environmental Protection and the Social Responsibility of Firms: Perspectives from Law, Economics, and Business.*

At issue is the appropriate role of business with regard to environmental protection. Everyone agrees that firms should obey the law. But beyond the law — beyond compliance with regulations — do firms have additional responsibilities to commit resources to environmental protection? How should we think about the notion of firms sacrificing profits in the social interest?

Much of what has been written on this question has been both confused and confusing. Advocates, as well as academics, have entangled what ought to be four distinct questions about corporate social responsibility: may they, can they, should they, and do they.

First, may firms sacrifice profits in the social interest — given their fiduciary responsibilities to shareholders? Does management have a fiduciary duty to maximize corporate profits in the interest of shareholders, or can it sacrifice profits by voluntarily exceeding the requirements of environmental law? Einer Elhauge, a professor at Harvard Law School, challenges the conventional wisdom that managers have a simple legal duty to maximize corporate profits. He argues that managers have freedom to diverge from the goal of profit maximization, because their legal duties to shareholders are governed by the "business judgment rule," which gives them broad discretion to use corporate resources as they see fit.

If a company's managers decide, for example, to use "green" inputs, devise cleaner production technologies, or dispose of their waste more safely, courts will not stop them from doing so, no matter how disgruntled shareholders may be at such acts of public charity. The reason is that for all a judge knows, such measures — particularly when they are well publicized — will add to the firm's bottom line in the long run by increasing public goodwill. But this line of argument contradicts the very premise, since it is based upon the notion that the actions are not sacrificing profits, but contributing to them.

This leads directly to the second question. Can firms sacrifice profits in the social interest on a sustainable basis, or will the forces of a competitive market render such efforts transient at best? Paul Portney, Dean of the Eller College of Management at the University of Arizona, notes that for firms that enjoy monopoly positions or produce products for well-defined niche markets, such extra costs can well be passed on to customers. But for the majority of firms in competitive industries — particularly firms that produce commodities — it is difficult or impossible to pass on such voluntarily incurred costs to customers. Such firms have to absorb those extra costs in the form of reduced profits, reduced shareholder dividends, and/or reduced compensation, suggesting that, in the face of competition, such behavior is not sustainable.

This leads to the third question of CSR: even if firms may carry out such profit-sacrificing activities, and can do so, should they — from society's perspective? Is this likely to lead to an efficient use of social resources? To be more specific, under what conditions are firms' CSR activities likely to be welfare-enhancing? Portney finds that this is most likely to be the case if firms pursuing CSR strategies are doing so because it is good business — that is, profitable. Once again, a positive response violates the premise of the question. But for more costly CSR investments, concern exists about the opportunity costs that will be involved for firms. Further, in the case of companies that behave strategically with CSR to anticipate and shape future regulations, welfare may be reduced if the result is less stringent standards (that would have been justified).

Finally, do firms behave this way? Do some firms reduce their earnings by voluntarily engaging in environmental stewardship? Forest Reinhardt of the Harvard Business School addresses this question by surveying the performance of a broad cross-section of firms, and finds that only rarely does it pay to be green. That said, situations do exist in which it does pay. Where one can increase customers' willingness to pay, reduce one's costs, manage future risk, or anticipate and defer costly governmental regulation, then it may pay to be green. Overall, Reinhardt acknowledges the existence of these opportunities for some firms — examples such as Patagonia and DuPont stand out — but the empirical evidence does not support broad claims of pervasive opportunities.

So, where does this leave us? May firms engage in CSR, beyond the law? An affirmative though conditional answer seems appropriate. Can firms do so on a sustainable basis? Outside of monopolies and limited niche markets, the answer is probably negative. Should they carry out such beyond-compliance efforts, even when doing so is not profitable? Here — if the alternative is sound and effective government policy — the answer may not be encouraging. And the last question — do firms generally carry out such activities — seems to lead to a negative assessment, at least if we restrict our attention to real cases of "sacrificing profits in the social interest."

But definitive answers to these questions await the results of rigorous, empirical research. In the meantime, we ought to prevent muddled thinking by keeping separate these four questions of corporation social responsibility.

[A review of *Environmental Protection and the Social Responsibility of Firms* appears In The Literature, page 4 — Ed.]

Robert N. Stavins is the Albert Pratt Professor of Business and Government at the John F. Kennedy School of Government and Director of the Environmental Economics Program at Harvard University. He can be reached at robert_stavins@harvard.edu.