



The Business Case for Corporate Social Responsibility

by Archie B. Carroll and Kareem M. Shabana

In the last decade, in particular, empirical research has brought evidence of the measurable payoff of corporate social responsibility (CSR) initiatives to companies as well as their stakeholders. Companies have a variety of reasons for being attentive to CSR. This report documents some of the potential bottom-line benefits: reducing cost and risk, gaining competitive advantage, developing and maintaining legitimacy and reputational capital, and achieving win-win outcomes through synergistic value creation.

The term "corporate social responsibility" is still widely used even though related concepts, such as sustainability, corporate citizenship, business ethics, stakeholder management, corporate responsibility, and corporate social performance, are vying to replace it. In different ways, these expressions refer to the ensemble of policies, practices, investments, and concrete results deployed and achieved by a business corporation in the pursuit of its stakeholders' interests.

This report discusses the business case for CSR*—that is, what justifies the allocation of resources by the business community to advance a certain socially responsible cause.¹ The business case is concerned with the following question: what tangible benefits do business organizations reap from engaging in CSR initiatives? This report reviews the most notable research on the topic and provides practical examples of CSR initiatives that are also good for the business and its bottom line.

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The Search for a Business Case: A Shift in Perspective

Business management scholars have been searching for a business case for CSR since the origins of the concept in the 1960s.¹

An impetus for the research questions for this report was philosophical. It had to do with the long-standing divide between those who, like the late economist Milton Friedman, believed that the corporation should pursue only its shareholders' economic interests and those who conceive the business organization as a nexus of relations involving a variety of stakeholders (employees, suppliers, customers, and the community where the company operates) without which durable shareholder value creation is impossible. If it could be demonstrated that businesses actually benefited financially from a CSR program designed to cultivate such a range of stakeholder relations, the thinking of the latter school went, then Friedman's arguments would somewhat be neutralized.

Another impetus to research on the business case of CSR was more pragmatic. Even though CSR came about because of concerns about businesses' detrimental impacts on society, the theme of making money by improving society has also always been in the minds of early thinkers and practitioners: with the passage of time and the increase in resources being dedicated to CSR pursuits, it was only natural that questions would begin to be raised about whether CSR was making economic sense.

The socially responsible investment movement

Establishing a positive relationship between corporate social performance (CSP) and corporate financial performance (CFP) has been a long-standing pursuit of researchers. This endeavor has been described as a "30-year quest for an empirical relationship between a corporation's social initiatives and its financial performance." One comprehensive review and assessment of studies exploring the CSP-CFP relationship concludes that there is a positive relationship between CSP and CFP.

In response to this empirical evidence, in the last decade the investment community, in particular, has witnessed the growth of a cadre of socially responsible investment funds (SRI), whose dedicated investment strategy is focused on businesses with a solid track record of CSR-oriented initiatives. Today, the debate on the business case for CSR is clearly influenced by these new market trends: to raise capital, these players promote the belief of a strong correlation between social and financial performance.⁴

As the SRI movement becomes more influential, CSR theories are shifting away from an orientation on ethics (or altruistic rationale) and embracing a performance-driven orientation. In addition, analysis of the value generated by CSR has moved from the macro to the organizational level, where the effects of CSR on firm financial performance are directly experienced.⁵

The CSR of the 1960s and 1970s was motivated by social considerations, not economic ones. "While there was substantial peer pressure among corporations to become more philanthropic, no one claimed that such firms were likely to be more profitable than their less generous competitors." In contrast, the essence of the new world of CSR is "doing good to do well."

CSR is evolving into a core business function, central to the firm's overall strategy and vital to its success.⁷ Specifically, CSR addresses the question: "can companies perform better financially by addressing both their core business operations as well as their responsibilities to the broader society?" ⁸

Who Cares, Really?

Who cares about the business case for CSR?

Obviously, corporate boards, CEOs, CFOs, and upper echelon business executives care. They are the guardians of companies' financial well-being and, ultimately, must bear responsibility for the impact of CSR on the bottom line. At multiple levels, executives need to justify that CSR is consistent with the firm's strategies and that it is financially sustainable.^a

However, other groups care as well. Shareholders are acutely concerned with financial performance and sensitive to possible threats to management's priorities. Social activists care because it is in their long-term best interests if companies can sustain the types of social initiatives that they are advocating. Governmental bodies care because they desire to see whether companies can deliver social and environmental benefits more cost effectively than they can through regulatory approaches. Consumers care as well, as they want to pass on a better world to their children, and many want their purchasing to reflect their values.

^a K. O'Sullivan, "Virtue rewarded: companies are suddenly discovering the profit potential of social responsibility." CFO, October 2006, pp. 47–52.

Simon Zadek. Doing Good and Doing Well: Making the Business Case for Corporate Citizenship. New York: The Conference Board Research Report, 2000, 1282-00-RR.

One Business Case Just Won't Do

There is no single CSR business case—no single rationalization for how CSR improves the bottom line. Over the years, researchers have developed many arguments. In general, these arguments can be grouped based on approach, topics addressed, and underlying assumptions about how value is created and defined. According to this categorization, CSR is a viable business choice as it is a tool to:

- implement cost and risk reductions;
- gain competitive advantage;
- develop corporate reputation and legitimacy; and
- seek win-win outcomes through synergistic value creation.⁹

Other widely accepted approaches substantiating the business case include focusing on the empirical research linking CSR with corporate social performance (CSP) and identifying values brought to different stakeholder groups that directly or indirectly benefit the company's bottom lines.

Broad versus narrow views Some researchers have examined the integration of CSR considerations in the day-to-day business agenda of organizations. The "mainstreaming" of CSR follows from one of three rationales:

- the social values-led model, in which organizations adopt CSR initiatives regarding specific issues for non-economic reasons;
- the business-case model, in which CSR initiatives are primarily assessed in an economic manner and pursued only when there is a clear link to firm financial performance¹⁰; and
- the syncretic stewardship model, which combines the social values-led and the business-case models.

The business case model and the syncretic models may be seen as two perspectives of the business case for CSR: one narrow and one broad. The business case model represents the narrow view: CSR is only recognized when there is a clear link to firm financial performance. The syncretic model is broad because it recognizes both direct and indirect relationships between CSR and firm financial performance. The advantage of the broad view is that it enables the firm to identify and exploit opportunities beyond the financial, opportunities that the narrow view would not be able to recognize or justify.

Another advantage of the broad view of the business case, which is illustrated by the syncretic model, is its recognition of the interdependence between business and society.¹¹

The failure to recognize such interdependence in favor of pitting business against society leads to reducing the productivity of CSR initiatives. "The prevailing approaches to CSR are so fragmented and so disconnected from business and strategy as to obscure many of the greatest opportunities for companies to benefit society." The adoption of CSR practices, their integration with firm strategy, and their mainstreaming in the day-to-day business agenda should not be done in a generic manner. Rather, they should be pursued "in the way most appropriate to each firm's strategy." 13

In support of the business case for CSR, the next sections of the report discuss examples of the effect of CSR on firm performance. The discussion is organized according to the framework referenced earlier, which identifies four categories of benefits that firms may attain from engaging in CSR activities.¹⁴

Reducing Costs and Risks

Cost and risk reduction justifications contend that engaging in certain CSR activities will reduce the firm's inefficient capital expenditures and exposure to risks. "[T]he primary view is that the demands of stakeholders present potential threats to the viability of the organization, and that corporate economic interests are served by mitigating the threats through a threshold level of social or environmental performance." ¹¹⁵

Equal employment opportunity policies and practices CSR activities in the form of equal employment opportunity (EEO) policies and practices enhance long-term shareholder value by reducing costs and risks. The argument is that explicit EEO statements are necessary to illustrate an inclusive policy that reduces employee turnover through improving morale. This argument is consistent with those who observe that "[l]ack of diversity may cause higher turnover and absenteeism from disgruntled employees." 17

Energy-saving and other environmentally sound production practices Cost and risk reduction may also be achieved through CSR activities directed at the natural environment. Empirical research shows that being environmentally proactive results in cost and risk reduction. Specifically, data shows hat "being proactive on environmental issues can lower the costs of complying with present and future environmental regulations ... [and] ... enhance firm efficiencies and drive down operating costs." ¹⁸

Community relations management Finally, CSR activities directed at managing community relations may also result in cost and risk reductions.¹⁹ For example, building positive community relationships may contribute to the firm's attaining tax advantages offered by city and county governments to further local investments. In addition, positive community relationships decrease the number of regulations imposed on the firm because the firm is perceived as a sanctioned member of society.

Cost and risk reduction arguments for CSR have been gaining wide acceptance among managers and executives. In a survey of business executives by PricewaterhouseCoopers, 73 percent of the respondents indicated that "cost savings" was one of the top three reasons companies are becoming more socially responsible.²⁰

Gaining Competitive Advantage

As used in this section of the report, the term "competitive advantage" is best understood in the context of a differentiation strategy; in other words, the focus is on how firms may use CSR practices to set themselves apart from their competitors. The previous section, which focused on cost and risk reduction, illustrated how CSR practices may be thought of in terms of building a competitive advantage through a cost management strategy. "Competitive advantages" was cited as one of the top two justifications for CSR in a survey of business executives reported in a Fortune survey.²¹ In this context, stakeholder demands are seen as opportunities rather than constraints. Firms strategically manage their resources to meet these demands and exploit the opportunities associated with them for the benefit of the firm.²² This approach to CSR requires firms to integrate their social responsibility initiatives with their broader business strategies.

EEO policies Companies that build their competitive advantage through unique CSR strategies may have a superior advantage, as the uniqueness of their CSR strategies may serve as a basis for setting the firm apart from its competitors.²³ For example, an explicit statement of EEO policies would have additional benefits to the cost and risk reduction discussed earlier in this report. Such policies would provide the firm with a competitive advantage because "[c]ompanies without inclusive policies may be at a competitive disadvantage in recruiting and retaining employees from the widest talent pool."²⁴

Customer and investor relations programs CSR initiatives can contribute to strengthening a firm's competitive advantage, its brand loyalty, and its consumer patronage. CSR initiatives also have a positive impact on attracting investment. Many institutional investors "avoid companies or industries that violate their organizational mission, values, or principles... [They also] seek companies with good records on employee relations, environmental stewardship, community involvement, and corporate governance."²⁵

Corporate philanthropy Companies may align their philanthropic activities with their capabilities and core competencies. "In so doing, they avoid distractions from the core business, enhance the efficiency of their charitable activities and assure unique value creation for the beneficiaries." For example, McKinsey & Co. offers free consulting services to nonprofit organizations in social, cultural, and educational fields. Beneficiaries include public art galleries, colleges, and charitable institutions. Home Depot Inc. provided rebuilding knowhow to the communities victimized by Hurricane Katrina. Strategic philanthropy helps companies gain a competitive advantage and in turn boosts its bottom line. ²⁸

The Business Case in Practice

The following CSR initiatives offer practical example of the business value generated by the allocation of resources in socially responsible pursuits.

Reducing costs and risks

- Equal employment opportunity policies and practices
- Energy-saving and other environmentally sound production practices
- Community relations management

Gaining competitive advantage

- EEO policies
- Customer relations program
- Corporate philanthropy

Developing reputation and legitimacy

- Corporate philanthropy
- Corporate disclosure and transparency practices

Seeking win-win outcomes through synergistic value creation

- Charitable giving to education
- Stakeholder engagement

CSR initiatives enhance a firm's competitive advantage to the extent that they influence the decisions of the firm's stakeholders in its favor. Stakeholders may prefer a firm over its competitors specifically due to the firm's engagement in such CSR initiatives.

Developing Reputation and Legitimacy

Companies may also justify their CSR initiatives on the basis of creating, defending, and sustaining their legitimacy and strong reputations. A business is perceived as legitimate when its activities are congruent with the goals and values of the society in which the business operates. In other words, a business is perceived as legitimate when it fulfills its social responsibilities.²⁹

As firms demonstrate their ability to fit in with the communities and cultures in which they operate, they are able to build mutually beneficial relationships with stakeholders. Firms "focus on value creation by leveraging gains in reputation and legitimacy made through aligning stakeholder interests."30 Strong reputation and legitimacy sanction the firm to operate in society. CSR activities enhance the ability of a firm to be seen as legitimate in the eyes of consumers, investors, and employees. Time and again, consumers, employees, and investors have shown a distinct preference for companies that take their social responsibilities seriously. A Center for Corporate Citizenship study found that 66 percent of executives thought their social responsibility strategies resulted in improving corporate reputation and saw this as a business benefit.31

Corporate philanthropy Corporate philanthropy may be a tool of legitimization. Firms that have negative social performance in the areas of environmental issues and product safety use charitable contributions as a means for building their legitimacy.³²

Corporate disclosure and transparency practices

Corporations have also enhanced their legitimacy and reputation through the disclosure of information regarding their performance on different social and environmental issues, sometimes referred to as sustainability reporting. Corporate social reporting refers to stand-alone reports that provide information regarding a company's economic, environmental, and social performance. The practice of corporate social reporting has been encouraged by the launch of the Global Reporting Initiative (GRI) in 1997-1998 and the introduction of the United Nations Global Compact in 1999. Through social reporting, firms can document that their operations are consistent with social norms and expectations, and, therefore, are perceived as legitimate.

Seeking Win-Win Outcomes through Synergistic Value Creation

Synergistic value creation arguments focus on exploiting opportunities that reconcile differing stakeholder demands. Firms do this by "connecting stakeholder interests, and creating pluralistic definitions of value for multiple stakeholders simultaneously."33 In other words, with a cause big enough, they can unite many potential interest groups.

Charitable giving to education When companies get the "where" and the "how" right, philanthropic activities and competitive advantage become mutually reinforcing and create a virtuous circle. Corporate philanthropy may be used to influence the competitive context of an organization, which allows the organization to improve its competitiveness and at the same time fulfill the needs of some of its stakeholders. For example, in the long run, charitable giving to education improves the quality of human resources available to the firm. Similarly, charitable contributions to community causes eventually result in the creation and preservation of a higher quality of life, which may sustain "sophisticated and demanding local customers."34

The notion of creating win-win outcomes through CSR activities has been raised before. Management expert Peter Drucker argues that "the proper 'social responsibility' of business is to ... turn a social problem into economic opportunity and economic benefit, into productive capacity, into human competence, into well-paid jobs, and into wealth."35 It has been argued that, "it will not be too long before we can begin to assert that the business of business is the creation of sustainable value—economic, social and ecological."36

An example: the win-win perspective adopted by the life sciences firm Novo Group allowed it to pursue its business "[which] is deeply involved in genetic modification and yet maintains highly interactive and constructive relationships with stakeholders and publishes a highly rated environmental and social report each year."37

Stakeholder engagement The win-win perspective on CSR practices aims to satisfy stakeholders' demands while allowing the firm to pursue financial success. By engaging its stakeholders and satisfying their demands, the firm finds opportunities for profit with the consent and support of its stakeholder environment.

Conclusion

The business case for corporate social responsibility can be made. While it is valuable for a company to engage in CSR for altruistic and ethical justifications, the highly competitive business world in which we live requires that, in allocating resources to socially responsible initiatives, firms continue to consider their own business needs. In the last decade, in particular, empirical research has brought evidence of the measurable payoff of CSR initiatives on firms as well as their stakeholders. Firms have a variety of reasons for being CSR-attentive. But beyond the many bottom-line benefits outlined here, businesses that adopt CSR practices also benefit our society at large.

Endnotes

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- 25 Ibid., 64.
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- 34 Porter and Kramer, 60-65.
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