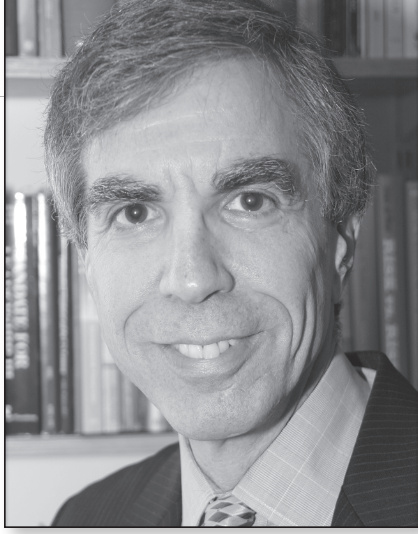

By Robert N. Stavins

CSR Through an Economic Lens

Business leaders, government officials, and academics continue to talk about corporate social responsibility. A considerable challenge is simply identifying a sensible definition of CSR from among a bewildering range that have been proposed. In a recent article in the *Review of Environmental Economics and Policy,* "Corporate Social Responsibility through an Economic Lens," Harvard Business School professors Forest Reinhardt and Richard Vietor and I adopt a definition originally offered by Einer Elhauge, a professor at Harvard Law School: sacrificing profits in the social interest.

Of course, questions regarding sacrificing profits in the social interest apply beyond the environmental sphere. Indeed, the debate over the legality of sacrificing profits in the public interest may be said to have begun in 1932 with opposing articles in a *Harvard Law Review* symposium. The debate in economics began much more recently, with Milton Friedman's 1970 article "The Social Responsibility of Business Is to Increase Its Profits," in the *New York Times Magazine.* Since then, the debate has continued, particularly in the environmental realm.

In our recent article, Reinhardt, Vietor, and I address four key questions which I first raised in my January/February 2006 column in this magazine. May firms sacrifice profits in the social interest within the scope of their fiduciary responsibilities to their shareholders? Can they do so on a sustainable basis, or will the forces of a competitive marketplace render such efforts and their impacts transient at best? Do firms, in fact, frequently or at least sometimes behave this way, reducing their earnings by voluntarily engaging in environmental stewardship? And finally, should firms carry out such profit-sacrificing activities — in other words, is this an efficient use of social resources?

Our starting point for examining the first question — may they — is the prevailing view that corporate directors have a fiduciary duty to maximize profits for shareholders. Surprisingly, the legal basis for this view is not very strong. Although the judicial record is supportive of a duty to maximize profits for shareholders, it leaves abundant room for firms to sacrifice profits in the public interest. The "business judgment rule" effectively protects many public-minded managerial actions from successful legal challenge. Indeed, as long as managers can claim some plausible connection to future profitability, the business judgment rule grants them sufficient leeway to commit corporate resources where they wish.

Just because the legal system may allow firms to sacrifice profits in the social interest does not mean that firms can do so on a sustainable basis in the face of competitive pressures. Typically, firms that participate in costly CSR activities will have to raise prices, reduce wages and other costs, accept smaller profits, or pay smaller dividends — and accept the economic consequences, which may include loss of market share, increased insurance costs, increased borrowing costs, and loss of reputation. In the long term, the firm may face shareholder litigation, corporate takeover, or even closure.

This process of economic survival of the fittest suggests that firms that engage in unsustainable CSR may find themselves being pushed out of business. Given the seemingly inevitable outcome of this process, why would any firms choose to participate in unsustainable CSR activities? First, the firms that engage (or say they engage) in CSR are often active in markets that are imperfect or distorted by government intervention, so that they are protected from Friedman's evolutionary imperatives. Second, managers can make decisions that commit the firm to short-term CSR actions, even if those activities will not be continued in the long run.

Evidence of firms actually sacrificing profits in the social interest is sorely lacking. Most firms view socially responsible actions in the same way that they view more traditional business activities. Instead of altruistically sacrificing profits, they engage in a more limited — but more profitable — set of socially beneficial activities that contributes to their financial goals. Although proponents may argue that being environmentally responsible will inevitably lead to higher profits in the long term, the relationship between socially responsible activities and profitability may be best characterized as some firms will generate long-term profits from some socially responsible activities some of the time.

Evidence of firms actually sacrificing profits in the social interest is sorely lacking

Finally, is it in the social interest for firms to engage in CSR? Indeed, should governments allow such activity? To the extent that existing regulations require an insufficient level of environmental protection, additional corporate investment in CSR activities may increase social welfare. But this suggests that CSR should be viewed as a complement to, rather than a substitute for, increasingly effective government regulation.

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