

**Economist.com****OPINION**

## Capitalism and ethics

### The good company

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**Companies today are exhorted to be “socially responsible”. What, exactly, does this mean?**



IT WILL no longer do for a company to go quietly about its business, telling no lies and breaking no laws, selling things that people want, and making money. That is so passé. Today, all companies, but especially big ones, are enjoined from every side to worry less about profits and be socially responsible instead. Surprisingly, perhaps, these demands have elicited a willing, not to say avid, response in enlightened boardrooms everywhere. Companies at every opportunity now pay elaborate obeisance to the principles of corporate social responsibility. They have CSR officers, CSR consultants, CSR departments, and CSR initiatives coming out of their ears. A good thing, too, you might think. About time. What kind of idiot or curmudgeon would challenge the case for businesses to behave more responsibly? Thank you for asking.

### Cynics and believers

The practices that caring, progressive CEOs mention when speaking at conferences on CSR come in all shapes and sizes. Treat your employees well; encourage loyalty among your customers and suppliers; avoid investing in “unethical” industries, or in countries where workers are paid low wages or

denied decent benefits; take care to save energy and recycle used envelopes; and so on. The range of such policies makes it hazardous to generalise. Some of them advance the interests of shareholders and of the wider world as well; others make everyone, except the office bureaucrats paid to dream them up, worse off. Motives vary too. Some CSR advocates are cynics: they pay lip service to the idea but are chuckling quietly. Others are true believers, born-again champions of a kinder, gentler capitalism (see our [survey](#) in this issue).

The one thing that all the nostrums of CSR have in common is that they are based on a faulty—and dangerously faulty—analysis of the capitalist system they are intended to redeem. Admittedly, CSR is now so well entrenched and amply funded that to complain about it may be pointless. We are concerned that it may even be a socially irresponsible use of scarce newsprint. Nonetheless, if businessmen had a clearer understanding of the CSR mindset and its defects, they would be better at their jobs and everybody else would be more prosperous.

Simply put, advocates of CSR work from the premise that unadorned capitalism fails to serve the public interest. The search for profit, they argue, may be a regrettable necessity in the modern world, a sad fact of life if there is to be any private enterprise. But the problem is that the profits of private enterprise go exclusively to shareholders. What about the public good? Only if corporations recognise their obligations to society—to “stakeholders” other than the owners of the business—will that broader social interest be advanced. Often, governments can force such obligations on companies, through taxes and regulation. But that does not fully discharge the enlightened company's debt to society. For that, one requires CSR.

This is wrong. The goal of a well-run company may be to make profits for its shareholders, but merely in doing that—provided it faces competition in its markets, behaves honestly and obeys the law—the company, without even trying, is doing good works. Its employees willingly work for the company in exchange for wages; the transaction makes them better off. Its customers willingly pay for the company's products; the transaction makes them better off also. All the while, for strictly selfish reasons, well-run companies will strive for friendly long-term relations with employees, suppliers and customers. There is no need for selfless sacrifice when it comes to stakeholders. It goes with the territory.

Thus, the selfish pursuit of profit serves a social purpose. And this is putting it mildly. The standard of living people in the West enjoy today is due to little else but the selfish pursuit of profit. It is a point that Adam Smith emphasised in “The Wealth of Nations”: “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.” This is not the fatal defect of capitalism, as CSR-advocates appear to believe; it is the very reason capitalism works.

Maybe so, those advocates might reply, but perhaps the system would work even better if there were a bit more benevolence in the boardroom and a bit less self-interest. In some cases, that might be so, but in general (as Smith

also noted) one should be wary of businessmen proclaiming their benevolence. A question to ask of all outbreaks of corporate goodness is, who is paying? Following the Indian Ocean tsunami, many companies made generous donations to charities helping the victims. There could be no worthier cause—but keep in mind that, in the case of public companies, the managers authorising those donations were giving other people's money, not their own. Philanthropy at others' expense, even in a cause as good as that one, is not quite the real thing.

### **Pernicious benevolence**

Unfortunately, tainted charity is certainly not the worst CSR can do. For instance, in the name of socially responsible conduct—also to deflect embarrassing criticism from anti-trade NGOs and to curry favour with ill-informed consumers—some multinational firms have proudly withdrawn from investments in developing countries where labour practices fall far short of western standards. This is a pernicious kind of benevolence. The policy may in fact be profit-maximising, for the reasons just noted, but as a rule it will harm the people it is supposedly intended to help: the people in the poor countries concerned, who would have benefited either from employment at higher-than-prevailing wages or from the knock-on economic effects of inward investment.

All things considered, there is much to be said for leaving social and economic policy to governments. They, at least, are accountable to voters. Managers lack the time for such endeavours, or should do. Lately they have found it a struggle even to discharge their obligations to shareholders, the people who are paying their wages. If they want to make the world a better place—a commendable aim, to be sure—let them concentrate for the time being on that.

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RESEARCH TOOLS  
SURVEYS

## The good company

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### **The movement for corporate social responsibility has won the battle of ideas. That is a pity, argues Clive Crook (interviewed [here](#))**

OVER the past ten years or so, corporate social responsibility (CSR) has blossomed as an idea, if not as a coherent practical programme. CSR commands the attention of executives everywhere—if their public statements are to be believed—and especially that of the managers of multinational companies headquartered in Europe or the United States. Today corporate social responsibility, if it is nothing else, is the tribute that capitalism everywhere pays to virtue.

It would be a challenge to find a recent annual report of any big international company that justifies the firm's existence merely in terms of profit, rather than "service to the community". Such reports often talk proudly of efforts to improve society and safeguard the environment—by restricting emissions of greenhouse gases from the staff kitchen, say, or recycling office stationery—before turning hesitantly to less important matters, such as profits. Big firms nowadays are called upon to be good corporate citizens, and they all want to show that they are.

On the face of it, this marks a significant victory in the battle of ideas. The winners are the charities, non-government organisations and other elements of what is called civil society that pushed for CSR in the first place. These well-

intentioned groups certainly did not invent the idea of good corporate citizenship, which goes back a long way. But they dressed the notion in its new CSR garb and moved it much higher up the corporate agenda.

In public-relations terms, their victory is total. In fact, their opponents never turned up. Unopposed, the CSR movement has distilled a widespread suspicion of capitalism into a set of demands for action. As its champions would say, they have held companies to account, by embarrassing the ones that especially offend against the principles of CSR, and by mobilising public sentiment and an almost universally sympathetic press against them. Intellectually, at least, the corporate world has surrendered and gone over to the other side.

The signs of the victory are not just in the speeches of top executives or the diligent reporting of CSR efforts in their published accounts. Corporate social responsibility is now an industry in its own right, and a flourishing profession as well. Consultancies have sprung up to advise companies on how to do CSR, and how to let it be known that they are doing it. The big auditing and general-practice consulting firms offer clients CSR advice (while conspicuously striving to be exemplary corporate citizens themselves).

Most multinationals now have a senior executive, often with a staff at his disposal, explicitly charged with developing and co-ordinating the CSR function. In some cases, these executives have been recruited from NGOs. There are executive-education programmes in CSR, business-school chairs in CSR, CSR professional organisations, CSR websites, CSR newsletters and much, much more.

But what does it all amount to, really? The winners, oddly enough, are disappointed. They are starting to suspect that they have been conned. Civil-society advocates of CSR increasingly accuse firms of merely paying lip-service to the idea of good corporate citizenship. Firms are still mainly interested in making money, they note disapprovingly, whatever the CEO may say in the annual report. When commercial interests and broader social welfare collide, profit comes first. Judge firms and their CSR efforts by what the companies do, charities such as Christian Aid (a CSR pioneer) now insist, not by what they say—and prepare to be unimpressed.

By all means, judge companies by their actions. And, applying that sound measure, CSR enthusiasts are bound to be disappointed. The 2004 *Giving List*, published by Britain's *Guardian* newspaper, showed that the charitable contributions of FTSE 100 companies (including gifts in kind, staff time devoted to charitable causes and related management costs) averaged just 0.97% of pre-tax profits. A few give more; many give almost nothing (though every one of them records some sort of charitable contribution). The total is not exactly startling. The figures for American corporate philanthropy are bigger, but the numbers are unlikely to impress many CSR advocates.

Still, you might say, CSR was always intended to be more about how companies conduct themselves in relation to "stakeholders" (such as workers, consumers, the broader society in which firms operate and, as is often argued,

future generations) than about straightforward gifts to charity. Seen that way, donations, large or small, are not the main thing.

Setting gifts aside, then, what about the many other CSR initiatives and activities undertaken by big multinational companies? Many of these are expressly intended to help profits as well as do good. It is unclear whether this kind of CSR quite counts. Some regard it as “win-win”, and something to celebrate; others view it as a sham, the same old tainted profit motive masquerading as altruism. And, even to the most innocent observer, plenty of CSR policies smack of tokenism and political correctness more than of a genuine concern to “give back to the community”, as the *Giving List* puts it. Is CSR then mostly for show?

It is hazardous to generalise, because CSR takes many different forms and is driven by many different motives. But the short answer must be yes: for most companies, CSR does not go very deep. There are many interesting exceptions—companies that have modelled themselves in ways different from the norm; quite often, particular practices that work well enough in business terms to be genuinely embraced; charitable endeavours that happen to be doing real good, and on a meaningful scale. But for most conventionally organised public companies—which means almost all of the big ones—CSR is little more than a cosmetic treatment. The human face that CSR applies to capitalism goes on each morning, gets increasingly smeared by day and washes off at night.



Under pressure, big multinationals ask their critics to judge them by CSR criteria, and then, as the critics charge, mostly fail to follow through. Their efforts may be enough to convince the public that what they see is pretty, and in many cases this may be all they are ever intended to achieve. But by and large CSR is at best a gloss on capitalism, not the deep systemic reform that its champions deem desirable.

Does this give cause for concern? On the whole, no, for a simple reason. Capitalism does not need the fundamental reform that many CSR advocates wish for. If CSR really were altering the bones behind the face of capitalism—sawing its jaws, removing its teeth and reducing its bite—that would be bad: not just for the owners of capital, who collect the company's profits, but, as this survey will argue, also for society at large. Better that CSR be undertaken as a cosmetic exercise than as serious surgery to fix what doesn't need fixing.

### **We are an equal-opportunity employer**

But this is not the end of the matter. Particular CSR initiatives may do good, or harm, or make no difference one way or the other, but it is important to resist

the success of the CSR idea—that is, the almost universal acceptance of its premises and main lines of argument. Otherwise bones may indeed begin to snap and CSR may encroach on corporate decision-making in ways that seriously reduce welfare.

Private enterprise requires a supporting infrastructure of laws and permissions, and more generally the consent of electorates, to pursue its business goals, whatever they may be. This is something that CSR advocates emphasise—they talk of a “licence to operate”—and they are quite right. But the informed consent of electorates, and an appropriately designed economic infrastructure, in turn require an understanding of how capitalism best works to serve the public good. The thinking behind CSR gives an account of this which is muddled and, in some important ways, downright false.

There is another danger too: namely, that CSR will distract attention from genuine problems of business ethics that do need to be addressed. These are not in short supply. To say that CSR reflects a mistaken analysis of how capitalism serves society is certainly not to say that managers can be left to do as they please, nor to say that the behaviour of firms is nobody's concern but their own. There is indeed such a thing as “business ethics”: managers need to be clear about that, and to comprehend what it implies for their actions.

Also, private enterprise serves the public good only if certain stringent conditions are met. As a result, getting the most out of capitalism requires public intervention of various kinds, and a lot of it: taxes, public spending, regulation in many different areas of business activity. It also requires corporate executives to be accountable—but to the right people and in the right way.

CSR cannot be a substitute for wise policies in these areas. In several little-noticed respects, it is already a hindrance to them. If left unchallenged, it could well become more so. To improve capitalism, you first need to understand it. The thinking behind CSR does not meet that test.

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RESEARCH TOOLS  
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## The union of concerned executives

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### CSR as practised means many different things

ON THE face of it, questioning the efforts of companies to behave responsibly is an odd thing to do—unless you are accusing them of faking it, or of falling below some commonly agreed minimum standard. How could a company ever behave too responsibly? The very term “corporate social responsibility” endorses the actions to which it is applied. No doubt that is why companies fasten the label to a quite bewildering variety of supposedly enlightened, progressive or charitable corporate actions.

At one end of the broad span of CSR lie corporate policies that any well-run company ought to have in place anyway, policies that are called for on any sensible view of business ethics or good management practice. These include not lying to your employees, for instance, not paying bribes, and looking farther ahead than the next few weeks. At the other end of the range are the more ambitious and distinctive policies that differentiate between leaders and laggards in the CSR race—large expenditures of time and resources on charitable activities, for instance, or binding commitments to “ethical investment”, or spending on environmental protection beyond what regulators demand.

In other words, at the mild end of the range are practices that do not need any special CSR defence: they can perfectly well justify themselves in simpler ways, either as meeting standards of ordinary decency (of which more later), or as being necessary in any case if managers are to run a successful business. The issue here is not whether the activities themselves make sense, but whether they deserve to be dignified by the term “corporate social



responsibility”—that is, whether they deserve the special praise which this label is intended to elicit.

At the strong end of the range, many activities do deserve a special label: they go well beyond the requirements of ordinary decency or business necessity, so the term CSR is serving a useful purpose. But can the same be said of the policies?

At first sight that looks like a churlish question. What could possibly be wrong with policies such as corporate charity or careful attention to the demands of environmental protection and sustainable development? Sometimes nothing, but it depends. Many individual acts of good corporate citizenship do make sense in business terms, or as ways of advancing the public good, or both. But others do not.

Sometimes CSR policies are motivated by genuine concern for the intended beneficiaries, or by a conscientious belief that businesses must earn their “licence to operate”. There are some kindly CEOs out there, and some with a troubled conscience. But there can be other motives for CSR too. There are quite a few vain CEOs who enjoy the attention which CSR leadership brings them, and many others who, having climbed their way to the top, seem to find running a profitable company too small a test of their talents. Yet whatever the variations, one thing is constant: the weight given to specious arguments about what businesses must do to justify their existence and pay their way in society.

Putting those arguments about the duties of business to one side for the moment, setting motives aside as well and thinking only of results, one might ask two questions of any act of supposedly enlightened corporate citizenship. Does it improve the company's long-term profitability? And does it advance the broader public good?

## **Two tests**

Successful managers usually do both at once, of course: merely by running a profitable company, they are likely to be advancing the public good as well. This argument will be taken up in more detail below. Some of the business practices that are often (perhaps misleadingly) labelled as CSR do fall into this category: they raise profits and advance society's well-being at the same time. Examples include establishing a reputation for dealing honestly with employees, suppliers and customers. This is the win-win kind of CSR—the sort that fails to impress much of civil society. Perhaps it would be better to call it simply “good management”.

**Pick your permutation**  
Varieties of CSR

	Raises social welfare	Reduces social welfare
Raises profits	Good management	Pernicious CSR
Reduces profits	Borrowed virtue	Delusional CSR

Turning back to those two questions, however, note that there are three other possible answers as well. These are mapped out in the table. Some kinds of CSR reduce profits but raise social welfare (this is what civil society likes best: call it “borrowed virtue”, for reasons to be explained in a moment). There is also CSR that raises profits but reduces social welfare (“pernicious CSR”), and CSR that reduces both profits and welfare (a polite name for which might be “delusional CSR”). Consider some examples.

To begin with, win-win, or “good management”. There is a lot of it about. Many executives in the CSR movement deserve credit for testing and drawing attention to novel practices that can yield these good results. Their ideas may not be applicable in all or even most companies, but their success in particular cases is impressive.

One of the most enthusiastic and persuasive evangelists of win-win CSR is Marc Benioff, head of [salesforce.com](http://salesforce.com), a strikingly successful internet-based business-services company. In his book, “Compassionate Capitalism”, he explains, among other things, how good corporate citizenship can be used to attract, retain and motivate the best workers. His company encourages its staff to devote time, at the firm's expense, to charitable works. In complementary ways, it also provides flexibility in working hours and conditions. The character of the firm, as perceived by its employees and its customers alike, is closely associated with this commitment to good causes.

All this seems to pay. Mr Benioff argues that this draws the right kind of people to the firm—team players, joiners, volunteers, generous and committed colleagues with a sense of loyalty to the enterprise. This kind of corporate philanthropy, which marries good works with a clever way of sorting and motivating staff, is undoubtedly catching on.

When you press a CEO for details of a company's CSR policies, and for their business rationale, you find that every firm believes that its CSR actions fall in the win-win box. No chief executive wants to believe that the firm's various services to the community might reduce social welfare, and none seems willing to admit that his enlightened management practices might reduce profits—what would the shareholders make of that? But those other cells of the matrix are far from empty.

A clear instance of an action that reduces profits while (presumably) improving

social welfare is a straightforward cash donation to charity. The donations featured in the *Giving List* fall into this category. Sums donated in this way have soared recently in response to the Asian tsunami. You might suppose that devoting profit to the public interest is CSR at its best, or at any rate its noblest. The enlightened company is surrendering some of its earnings to make the world a better place.

### **Philanthropy that isn't**

As many CEOs point out, this is not to say that there are no business benefits. Some executives think of their charitable donations—especially gifts such as sponsoring high-profile sporting or artistic events—as a kind of advertising. Others may feel that their companies, or their industries (oil, tobacco, pharmaceuticals), have such a poor image with the public at large that generous charitable donations are needed to redress matters. But straightforward corporate philanthropy of this kind is not woven into the way the firm manages its personnel, so the commercial benefits are probably limited. Most cash donations out of profits probably do represent a net loss of profits (even if the loss is less than the gross outlay).

And what, you might ask, is wrong with that? What is wrong with a company giving part of its profits to help the victims of the disaster in Asia, for instance—a good cause if ever there was one?

Not so fast. Remember that corporate philanthropy is charity with other people's money—which is not philanthropy at all. When a company gives some of its profits away in a good cause, its managers are indulging their charitable instincts not at their own expense but at the expense of the firm's owners. That is a morally dubious transaction. When Robin Hood stole from the rich to give to the poor, he was still stealing. He might have been a good corporate citizen, but he was still a bandit—and less of one, arguably, than the vicariously charitable CEO, who is spending money taken not from strangers, but from people who have placed him in a position of trust to safeguard their property. That is why the box in the table containing “corporate philanthropy” is marked (perhaps too politely) “borrowed virtue”.

Note that the world's most spectacular philanthropists—think of the Bill & Melinda Gates Foundation, with its endowment of \$27 billion—are not spending the profits of the companies they are associated with but their own private wealth. That is the real thing, true philanthropy, and is nothing but admirable, especially if the givers are taking care to ensure the money is spent wisely, as the biggest private foundations now do.

Philanthropy financed out of the profits of publicly owned companies is a quite different thing, ethically speaking. Shareholders might expect to be allowed to spend their money on good causes of their own choosing, rather than seeing the managers whose salaries they pay take that uplifting duty upon themselves.

In the case of some public companies, it is true that there are mitigating circumstances. Some companies have a tradition of generosity with shareholders' money stretching many years back. Some, for instance, are formerly private or demutualised enterprises which, on going public, created charitable foundations and undertook to keep them financed. In these cases, the shareholders knew what they were getting into when they acquired stakes in the companies. Conceivably, these policies may even be among the reasons why some shareholders acquired their stakes in the first place. At any rate, such owners have little or no reason for complaint. As for the rest, the majority, it might have been polite to ask.



Still judging acts by their effects, as opposed to motives and underlying rationale, the most harmful kinds of CSR, however, are the “pernicious” and “delusional” sorts—that is, policies and practices that actually reduce social welfare. How can that happen? All too easily.

Most CSR, in fact, is probably delusional, meaning that it reduces both profits and social welfare, even if the cost under both headings is usually small. Almost all CSR has at least some cost, after all, even if it is no more than a modest increase in the firm's bureaucratic overhead. That cost subtracts from social welfare in its own right. So the kind of CSR that merely goes through the motions, delivering no new resources to worthy causes, giving the firm's workers or customers no good reason to think more highly of it (perhaps the opposite), involves a net loss of welfare.

Or consider the current enthusiasm for recycling. No doubt there are cases where it makes good business sense to recycle. These fall under the “good management” heading: they increase profits and (mainly for that reason) social welfare as well. But the point is that recycling is not free. Effort and other resources must be expended on it. Waste must be collected, transported and processed before it can re-enter the productive process. The costs can be substantial. If those private costs exceed the private savings, profits will suffer—and so, most likely, will social welfare.

Advocates of recycling would say this is short-sighted and wrong, because it ignores the need to conserve natural resources. Shortages of materials (such as newsprint), and of the natural resources needed to produce them (trees), are not reflected in the prices paid, they argue. So a private calculation of costs and benefits will not suffice. Profit, which is private benefit minus private cost, might rule out recycling, whereas a broader social calculation of costs and benefits would show a different balance. Since society has a collective interest in conserving resources, an interest not reflected in the market prices of commodities, recycling might very well reduce profit but at the same time increase welfare—and, as with corporate philanthropy, that is what CSR is

about.

The trouble is, the notion that the market prices of commodities fail to reflect their scarcity is wrong. In commodity markets, prices reflect scarcity just fine. The long-term global trend of falling commodity prices, despite growth in the world economy, is not due to the failure of markets to reflect diminishing supplies and impending shortages. Commodity markets are for the most part efficient and forward-looking. Commodity prices, measured over recent decades, have followed a downward trend because innovation has brought about ever-rising productivity in the use of those resources. In other words, supply has outstripped demand. Where, unusually, it has not, prices have indeed gone up—providing the signal that may make recycling in those cases commercially sensible.

By and large, the world is not running out of resources; where it is, prices reflect that fact. As a result, the ordinary pursuit of profits is an excellent guide to companies on whether to recycle. There is no need to anoint recycling as a kind of moral standard of responsible behaviour. And if doing so succeeds in deflecting companies from thinking hard about their costs, actual social harm results. Use of materials is an area where private and social benefits are typically well-aligned.

Consider, finally, the case of CSR that raises profits but lowers welfare—pernicious CSR. Recognising the existence of this category is especially important. Some economically literate bosses argue that if CSR raises profits then it must by the same token raise social welfare. So long as good corporate citizenship is good for the bottom line, they assume, you can rest assured that it must be win-win, and good for society as well. As a rule, this may be true. But there are some large exceptions.

Almost all CSR advocates are passionate about “sustainable development”. The idea is strongly endorsed by governments everywhere, by institutions such as the World Bank and the United Nations, and indeed by anybody at all with a desire to be thought well of. It has become an organising principle for the whole CSR movement. Emphasis is laid on environmental protection and on responsible behaviour towards workers and communities in the developing countries. In order to advance those eminently worthy goals, some companies have lately devised codes of practice, or have adopted codes written by other organisations. The danger lies in the detail of these policies.

To many advocates of CSR, and to virtually all of the NGOs that have given the CSR movement its intellectual drive, responsible behaviour towards workers in the developing countries goes far beyond giving them jobs at market wages and complying with local laws and regulations on matters such as health and safety. There is a debate in CSR circles about exactly how much higher than this the standard of responsible conduct should be. Some improvement on the minimal market standard is probably win-win in any case, because rich-country multinationals operating in developing countries typically want to hire from a big pool of keen applicants and to find better-than-average workers. Rich-country multinationals do in fact pay substantially higher wages and give

substantially better benefits (such as access to health care) than the local norm. But how much of an improvement on this profit-seeking market standard does good corporate citizenship require?

Some CSR advocates have aligned themselves with those in the NGO movement who regard it as wrong—exploitative, or “unfair”—to hire workers in the developing countries on any terms that are significantly less generous than those granted to their rich-country workers. Companies under NGO scrutiny have been dissuaded from investing in manufacturing operations in developing countries such as India or Bangladesh, or have decided to end such operations, faced with charges that they are employing “sweatshop labour”. As good corporate citizens, they say with arms twisted behind their back, they no longer do that. Many development NGOs are pushing for labour standards that would mandate this kind of “best practice”, and want these standards written into future trade agreements.

The evidence clearly shows that policies of this kind (especially if they come to be required of all companies as part of future trade pacts) are not in the interests of the workers they purport to help. Foreign direct investment in the third world is known to be one of the best spurs to economic development: just look at China. Even when the wages and other terms offered to local workers are much less generous than those offered to their western counterparts, they are typically much better than the local economy can provide, which is why jobs with foreign multinationals are nearly always in great demand in poor countries.

Attitudes that discourage such investment by making it less profitable, or by exposing companies that have made such investments to ridicule or censure, undoubtedly hold poor countries back. They also keep in poverty the very workers who would otherwise have got those jobs. To withdraw from such investments, as good corporate citizens are frequently enjoined to, may well be profitable for the companies concerned because staying put would impose heavy costs on their reputation. Capitulating to the ill-judged demands of the NGOs may be rational, profit-seeking behaviour on their part. But in this case, what is good for profits is bad for welfare.

This danger is compounded when CSR leaders campaign for the introduction of codes that impose such standards on all firms. This too may be fine for profits, which is why so many companies have begun to endorse this policy. It is a good idea for a business to hobble its competition if possible—which is what mandatory labour standards of the sort demanded of the WTO tend to do. How much better if grasping this commercial advantage can be disguised as acting the good corporate citizen. But hobbling the competition is bad for the public at large. Again, by depriving them of investment, such perverted virtue especially harms the economic prospects of developing countries.

All this underlines a broader worry. Companies do operate in a climate of opinion. To be successful and profitable, they must take account of how they are perceived. Big, successful businesses, which often find themselves in the public view, strive constantly to improve and protect their reputation. This is



just as it should be: concern for the way they are judged by customers, suppliers and the world at large is a useful discipline. If it were absent, there would be no economic pressure on companies to behave decently. If nobody is paying attention, why worry about dealing honestly with people, or honouring a contract? This pressure of outsiders' perceptions is an indispensable force. Without it, companies in a private-enterprise system would be nasty, brutish and very short-lived.

## **Need to know**

However, it is important that this pressure should be well-informed, or at least not utterly misguided. In particular, it needs to embody some basic economic understanding. Unwarranted, misguided or contradictory public demands on companies, especially if these demands emerge in due course as government mandates, can affect decisions in such a way as to detach profitable business conduct from the public good.

If the public decides to punish banks and other service companies that move their call-centres offshore by withholding its custom, the profit-seeking company will respond by ending the practice. Whether that response advances the broader social good then depends on the circumstances. If consumers reject outsourcing of this kind because it provides a lower quality of service, fine: that is the market working as it should. If the public rejects outsourcing because it falsely believes that workers in foreign call-centres are being exploited, that is not fine: that is the market, through popular misconception, getting it wrong.

In a way, this is to concede an important point to the advocates of CSR. Capitalism does function on top of, and one way or another is moulded by, prevailing popular opinion. As noted earlier, the conditions that must be satisfied if capitalism is to serve the public good are not trivial. A comprehending and supportive climate of opinion must be added to the list. That is why the battle of ideas matters so much.

CSR comes in a wide variety of forms. Judged by results, it may be win-win, borrowed virtue, delusional or pernicious. Judged by motives, it may be done in good faith or bad faith, out of conviction, boredom or vanity, by genuinely well-intentioned business leaders or by cynical bosses looking to dupe their consumers. But invariably, and dangerously, it is underpinned by mixed-up economics.

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## The world according to CSR

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From The Economist print edition



### **Good corporate citizens believe that capitalism is wicked but redeemable**

OVER the past century or so, and especially in the past 50 years, the western industrial democracies have experienced what can only be described as an economic miracle. Living standards and the quality of life have risen at a pace, and to a level, that would have been impossible to imagine in earlier times.

This improvement in people's lives, staggering by any historical standard, is not measured solely in terms of material consumption—important though it is, for instance, to have enough to eat, to keep warm in winter, to be entertained and educated and to be able to travel. In addition to material gains such as these, and to all the other blessings of western “consumer society”, broader measures of well-being have raced upward as well: infant mortality has plummeted, life expectancy has soared, and the quality of those extended years of life, in terms of freedom from chronic sickness and pain, is better than earlier generations ever dreamed it could be.

All this has been bestowed not just on an elite, but on the broad mass of people. In the West today the poor live better lives than all but the nobility enjoyed throughout the course of modern history before capitalism. Capitalism, plainly, has been the driving force behind this unparalleled economic and social progress. Yet today it is suspected, feared and deplored—and not just by the kind of energetic anti-capitalists who now and then put bricks through the

windows of McDonald's.

According even to middle-of-the-road popular opinion, capitalism is at best a regrettable necessity, a useful monster that needs to be bound, drugged and muzzled if it is not to go on the rampage. Stranger still, this view seems to be shared by a good proportion of business leaders. Capitalism, if guided by nothing but their own unchecked intentions, would be wicked, destructive and exploitative, they apparently believe—bent on raping the planet and intent on keeping the poor outside the capitalist West in poverty.

In a much-discussed recent book, "The Corporation: The Pathological Pursuit of Profit and Power", Joel Bakan, a law professor at the University of British Columbia, lays bare the danger. His themes were further developed and illustrated in a film of the same title, which was also successful and well reviewed.

The corporation's legally defined mandate is to pursue relentlessly and without exception its own economic self-interest, regardless of the harmful consequences it might cause to others...Today, corporations govern our lives. They determine what we eat, what we watch, what we wear, where we work and what we do. We are inescapably surrounded by their culture, iconography and ideology. And, like the church and the monarchy in other times, they posture as infallible and omnipotent, glorifying themselves in imposing buildings and elaborate displays. Increasingly, corporations dictate the decisions of their supposed overseers in government and control domains of society once firmly embedded in the public sphere. Corporations now govern society, perhaps more than governments themselves do; yet ironically it is their very power, much of which they have gained through economic globalisation, that makes them vulnerable. As is true of any ruling institution, the corporation now attracts mistrust, fear and demands for accountability from an increasingly anxious public. Today's corporate leaders understand, as did their predecessors, that work is needed to regain and maintain the public's trust. And they, like their predecessors, are seeking to soften the corporation's image by presenting it as human, benevolent and socially responsible.

In Mr Bakan's view, CSR is mostly a fraud. Companies, after all, are in "pathological pursuit of profit and power". CSR is merely a means to those ends, a way to ingratiate capitalism to a rightly suspecting public. The book's jacket has blurbs of generous praise not just, as you might expect, from Noam Chomsky but also from an investment-fund manager and a CEO, who says it is holding up "a mirror for [corporations] to see their destructive selves as others see them".

Many businessmen do seem to recognise themselves in that mirror. And popular culture has the corporate psycho in plain view—which is remarkable, given the corporation's suffocating grip on all thoughts and deeds. What is the capitalist ethos according to Hollywood? "Greed is good," as Gordon Gekko

explained in "Wall Street". From "RoboCop" (the military-industrial complex) to "Super Size Me" (fast-food tyrants) and back again, the brave unequal war against corporate dominion is waged.

This paranoid fear of capitalism, shared by so many of its leading practitioners, boils down to two main ideas. First, profit in its own right has nothing to do with the public good. A company in pursuit of profit is seeking a purely private gain. If the pursuit of profit is to yield an advance in social welfare, then something else, acting with deliberation and intelligence from outside the corporation, must intervene. Second, in their mad pursuit of private gain, companies are driven by the logic of their quest to place crippling burdens on society and on the environment.

So far as society at large is concerned, in other words, the untrammelled pursuit of profit yields nothing, but costs plenty. Unless it is checked either by CSR or (as Mr Bakan would prefer, if only as a first step) by double-strength government regulation, private enterprise makes losers of everyone but itself.



### **Private profit, public interest**

The perceived tension between private profit and public interest pervades the CSR literature. Yet the idea is never examined. It is always regarded as self-evident.

The top executives at Royal Dutch/Shell have lately been acting as CSR thought-leaders—and they are CSR champions in other ways as well (through the activities of the generously supported charitable activities of the Shell Foundation, for instance). Shell has a lot of popular suspicion to live down, following the scandal over its operations in Nigeria, for instance, and the controversy surrounding its plans for the disposal of the Brent Spar oil-drilling platform in the North Sea. Its senior executives have done their best. In a leaflet explaining why the company had embraced CSR, Sir Mark Moody-Stuart, who was chairman between 1998 and 2001, and before that managing director, wrote:

[M]y colleagues and I on the committee of managing directors are totally committed to a business strategy that generates profits while contributing to the well-being of the planet and its people.

That seems entirely unobjectionable, you might think: a commitment to motherhood and apple pie. But the clear implication—and Sir Mark, to judge by other speeches and articles, buys it wholesale—is that if Shell simply made profits for its owners, that would in itself contribute nothing to “the planet and its people”. From this it follows that if Shell is to justify its activities to society at large, it has to do more than just make money for its owners. Therein lies the case for CSR. But is the premise actually true? True or false, it is never challenged.

One of the world's foremost CSR networks and organisations is the World Business Council for Sustainable Development. Its membership is made up of 175 big multinationals, including Shell, alongside firms such as ABB, Dow Chemical, Ford, General Motors, Procter & Gamble, Time Warner and so on. One of the council's publications begins:

Although the rationale for the very existence of business at law and in other respects is to generate acceptable returns for its shareholders and investors, business and business leaders have, over the centuries, made significant contributions to the societies of which they form part.

Why yes. If you compare people's lives in the West today with those of people living, say, a century ago, or two centuries ago, it would be right, if perhaps a little miserly, to concede that business has made some “significant contributions”. But in the council's opinion these moderately important benefits did not arise because businesses generated acceptable returns for their owners; they arose despite that fact. Profit, unfortunately, is necessary, as the council sadly notes: otherwise you cannot have business, along with the possibility of those quite useful contributions. But those contributions have to be separately willed. It is simply not in the nature of business as such to contribute. That is an add-on, a responsibility that business may choose to discharge or not discharge, as it sees fit.

So, anti-capitalists believe this; angry law-school professors (whose own significant contributions cannot be in doubt) believe it; and the leaders of international big business believe it. For good measure, many industrial-country governments, acting singly or in concert, believe it as well. Britain is just one of many countries to have designated a minister responsible for encouraging CSR initiatives. In 2001 the European Commission published a consultative paper entitled, “Promoting a European Framework for Corporate Social Responsibility”. The aim is “to launch a wide debate on how the European Union could promote corporate social responsibility at both the European and international level”. Values, it says, “need to be translated into action”.

Leading international institutions such as the World Bank, the United Nations,

the Organisation of Economic Co-operation and Development, and indeed more or less any outfit of that sort you care to name, endorse the view that profit serves an exclusively private interest, and that blind pursuit of profit is therefore likely to prove socially harmful.

The United Nations is especially keen on CSR, as part of a broad new approach to global governance. It continues to promote its "Global Compact", launched at the World Economic Forum in 1999. This initiative aims to draw together businesses and business organisations, NGOs, and UN and other international agencies. The goal of this new "tripartism"—an ongoing discussion among governments, companies and civil society (which is how the UN refers to NGOs)—is to find ways to "underpin the free and open market system with stable and just societies".

It is one thing to believe that profit-seeking serves no public interest directly. It is another to believe that profit-seeking, unless tempered and channelled by CSR or in some other way, actually works against the public interest. This second idea, already noted, is an extension of the first. And this is where "sustainable development" comes in.

The concept of sustainable development puts flesh on the idea that business left to its own devices is dangerous. Untamed profit-seeking, it is argued, puts strain on the environment and exploits workers. At the same time the goal of sustainable development points to a more concrete agenda for CSR: while pursuing profit, enlightened companies should take care to protect the environment and uphold the rights of workers (and others) as well. Hence the "triple bottom line" which thought-leaders on CSR (including the United Nations and the European Commission) want companies to monitor and report: don't just aim to make money, but protect the environment and fight for social justice as well.

## **Unsustainable**

One problem with the triple bottom line is quickly apparent. Measuring profits is fairly straightforward; measuring environmental protection and social justice is not. The difficulty is partly that there is no single yardstick for measuring progress in those areas. How is any given success for environmental action to be weighed against any given advance in social justice—or, for that matter, against any given change in profits? And how are the three to be traded off against each other? (CSR advocates who emphasise sustainable development implicitly insist that there must be such a trade-off, at least when it comes to weighing profit against either of the other two.) Measuring profits—the good old single bottom line—offers a pretty clear test of business success. The triple bottom line does not.

The problem is not just that there is no one yardstick allowing the three measures to be compared with each other. It is also that there is no agreement on what progress on the environment, or progress in the social sphere, actually mean—not, at least, if you are trying to be precise about it. In other words,



there are no yardsticks by which different aspects of environmental protection can be compared even with each other, let alone with other criteria. And the same goes for social justice.

One company reduces its emissions of greenhouse gases. One increases its spending on recycling. Another provides free child-care facilities for its workers. Another raises the wages of its lowest-paid workers. All of these things cost money: suppose, for the sake of argument, that all four have reduced profit by the same amount. Which company has done most to protect the environment? Which has done most to advance social progress? Overall, how far has each company improved its triple bottom line? Bearing in mind the cost, can you even say that any of them have done so?

The great virtue of the single bottom line is that it holds managers to account for something. The triple bottom line does not. It is not so much a licence to operate as a licence to obfuscate.

CSR advocates could reply that this misses the point. The idea of the triple bottom line is not that the three-dimensional performance of business can ever be judged as precisely as its orthodox one-dimensional performance. The triple bottom line is just shorthand for saying: take other things into account, acknowledge that profit isn't everything, and don't pursue profit relentlessly, as you would otherwise be inclined to, even at the expense of damage to the environment and infringements of the rights of workers and other stakeholders. You cannot be precise about these things, but at least you can recognise the social and environmental peril of too narrow a focus on profit.

That is a perfectly reasonable line of argument—or it would be, if a narrow focus on profit really did endanger the environment, systematically infringe the rights of workers and stakeholders, and in general fail to serve the public interest. That is the world according to CSR, but is the world really like that? The short answer is no. For a slightly longer answer, read on.

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RESEARCH TOOLS  
**SURVEYS****Profit and the public good**

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From The Economist print edition

**Companies that merely compete and prosper make society better off**

ADAM SMITH, you might say, wrote the book on corporate social responsibility. It is entitled, "Wealth of Nations".

Every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it...he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good.

It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.

Smith did not worship selfishness. He regarded benevolence as admirable, as a great virtue, and he saw the instinct for sympathy towards one's fellow man as the foundation on which civilised conduct is built (he wrote another book about

this: "The Theory of Moral Sentiments"). But his greatest economic insight—and indeed the greatest single insight yielded by the discipline of economics—was that benevolence was not in fact necessary to advance the public interest, so long as people were free to engage with each other in voluntary economic interaction. That is fortunate, he pointed out, since benevolence is often in short supply. Self-interest, on the other hand, is not.

If self-interest, guided as though by an invisible hand, inadvertently serves the public good, then it is easy to see why society can prosper even if people are not always driven by benevolence. It is because Smith was right about self-interest and the public interest that communism failed and capitalism worked.

Most advocates of CSR, especially those who run giant international corporations, have probably read some economics in their time. Many of the officials at the United Nations, World Bank and OECD who argue in favour of CSR have advanced degrees in the subject from the best universities. Yet they have apparently failed to grasp this most basic and necessary insight of the entire discipline. Through the action of Smith's invisible hand, the private search for profit does advance the public interest. There is no need for thought-leaders in CSR armed with initiatives and compacts to bring this about.

Smith was a genius because this harmony of private interest and public interest is not at all obvious—and yet, at the same time, once it is pointed out, the idea is instantly simple and plausible. This is especially so if you think not about self-interested individuals but about profit-seeking companies. The value that people attach to the goods and services they buy from companies is shown by what they are willing to pay for them. The costs of producing those goods and services are a measure of what society has to surrender to consume those things. If what people pay exceeds the cost, society has gained—and the company has turned a profit. The bigger the gain for society, the bigger the profit. So profits are a guide (by no means a perfect one, but a guide nonetheless) to the value that companies create for society.

Does this mean that Gordon Gekko, the odious protagonist of the movie, "Wall Street", was right to say that "greed is good"? No: greed and self-interest are not the same thing, as Mr Gekko discovered in that movie. Greed, in the ordinary meaning of the word, is not rational or calculating. Freely indulged, it makes you fat and drives you into bankruptcy. The kind of self-interest that advances the public good is rational and enlightened. Rational, calculating self-interest makes a person, or a firm, worry about its reputation for honesty and fair dealing, for paying debts and honouring agreements. It looks beyond the short term and plans ahead. It considers sacrifices today for the sake of gains tomorrow, or five years from now. It makes good neighbours.

Morally, also, there is a world of difference between greed and self-interest. The first, even if it were not self-defeating, would still be a gross perversion of the second. Failing to see this distinction, and thus concluding without further thought that private enterprise is tainted, is a kind of ethical stupidity. Greed is ugly. There is nothing ignoble, in contrast, about a calm and moderate desire

to advance one's own welfare, married (as it is in most people) to a sympathetic regard for the well-being of others. And, as Smith pointed out, rational self-interest also happens to make the world go round.

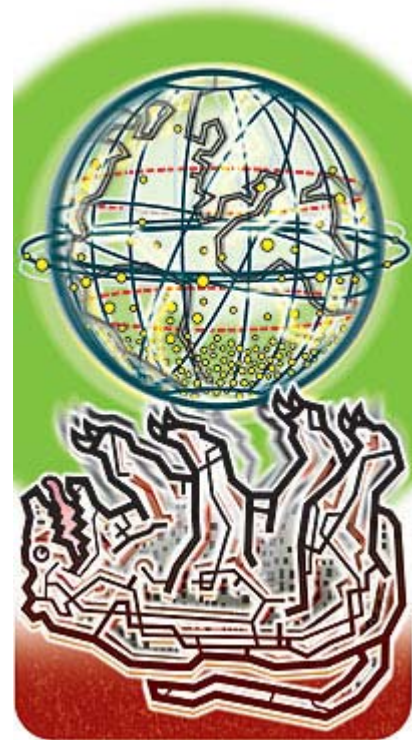
## Faulty premise

The premise that CSR advocates never question is in fact wrong. It is an error to suppose that profit-seeking, as such, fails to advance the public good, and that special efforts to give something back to society are needed to redeem it.

However, as already noted, profit succeeds as an indicator of value creation, and as a signal that draws new investment to socially useful purposes, only under certain circumstances. It cannot be taken for granted that these conditions will always be satisfied.

One main requirement is that firms are in competition with each other. The profits that a monopoly can extract from the economy are a measure of market power, not social gain. And monopoly profits may not serve as an effective signal for new investment if economic barriers of one kind or another hamper competition by keeping new entrants off the monopolist's turf.

Oddly enough, business leaders who voice their commitment to good corporate citizenship rarely demand the removal of barriers to competition in their industries—a measure that would almost invariably serve the public interest. Manufacturers are far more likely to call for import barriers to be raised against their foreign competitors than they are to call for existing tariffs or other barriers to come down. Producers of all manner of goods and services are more likely to call for the introduction of licences and controls to protect their existing positions in their markets than to demand that newcomers should be permitted and even encouraged to contest those markets.



And CSR often helps them in this. Although it is true that many business leaders mean what they say about good corporate citizenship, and speak up for CSR in good faith, CSR is nonetheless far more often invoked as a rationale for anti-competitive practices than as a reason to bolster competition. Incumbent firms or professions seem to find it easier to comply with burdensome regulations if they know that those rules are deterring new entrants. That is why, often in the name of CSR, incumbent businesses are so given to calling for rules and standards to be harmonised and extended, both at home and abroad.

For the good of the public, you understand, barristers are opposed to reforms

that would allow solicitors to appear more often as advocates in English courts (their training just isn't up to it). For the safety of the consumer, American pharmaceutical companies insist, extraordinary precautions must be taken before drugs can be imported from Canada (heaven knows what the Canadians, a devil-may-care sort of people, put into those pills). For the good of the world's poor, industrial-country manufacturers believe, goods should not be imported from countries where employees have to work long hours for low pay and without statutory vacations (that is unfair trade).

A great deal of economic regulation makes sense for one reason or another. But it is striking that business leaders—especially, it seems, those who speak up most enthusiastically for CSR—call for regulation that restricts competition far more often than they call for regulation that strengthens it. This prompts the thought that the design of economic regulation is best left to governments, rather than to corporate citizens, however enlightened.

## **Social prices**

A second condition must be met before one can be sure that private enterprise in competitive markets is advancing the public good. Prices need to reflect true social costs and benefits. Many transactions, however, have side-effects—externalities, as they are called. Where they do, private costs and benefits diverge from public costs and benefits. Sometimes externalities are positive. If your neighbour repaints his house, that may increase the value of yours; since he fails to capture all the gains created by his spending, he may repaint his house less frequently than would be best for society at large—or, in this case, for your end of the street. Markets tend to undersupply goods that involve positive externalities.

Externalities can also be negative. The classic instance is a polluting factory. The owners of the factory and the customers for its goods do not have to bear the full costs of the pollution that comes out of its smokestacks. Failing to take that into account, the market sets the price of the factory's goods too low. Demand for the product is stronger than it should be. Goods that involve negative externalities tend to be oversupplied.

This kind of argument is invoked to make sense of “sustainable development” and the claims pressed on business by that idea. Prices are wrong, the argument goes, so markets are failing. Pollution, including the accumulation of greenhouse gases, is not priced into the market, so there is too much of it. Impending shortages of natural resources are not priced into the market, so those resources are consumed too rapidly. The value of wilderness, either for its beauty or for its stocks of endangered species, is not priced into the market, so too much of it gets cemented over.

Whether the pattern of consumption based on these false prices is sustainable is really beside the point. Some patterns of consumption could be indefinitely sustained but still be wrong, causing mounting damage as far ahead as one can see. Others might indeed be unsustainable, meaning bound to be halted at

some point, yet not be wrong, as when the approaching exhaustion of a raw material leads to the invention of a substitute. "Sustainability" has a nice ring to it, but it is not the issue. The question is whether false prices are causing big economic mistakes—and, if so, what might be done about that.

Many market prices do diverge from the corresponding "shadow prices" that would direct resources to their socially best uses. In many cases, the divergence is big enough to warrant government action—a point which all governments have taken on board, sometimes to a fault. All industrial-country governments intervene in their economies. In principle, much of this intervention aims to mitigate the misallocation of resources caused by externalities and other kinds of market failure. But it is important to keep a sense of proportion about the supposed unreliability of market signals.

So far as environmental externalities are concerned, most leading advocates of CSR seem to be in the grip of a grossly exaggerated environmental pessimism. The claim that economic growth is necessarily bad for the environment is an article of faith in the CSR movement. But this idea is simply wrong.

Natural resources are not running out, if you measure effective supply in relation to demand. The reason is that scarcity raises prices, which spurs innovation: new sources are found, the efficiency of extraction goes up, existing supplies are used more economically, and substitutes are invented. In 1970, global reserves of copper were estimated at 280m tonnes; during the next 30 years about 270m tonnes were consumed. Where did estimated reserves of copper stand at the turn of the century? Not at 10m tonnes, but at 340m. Available supplies have surged, and, it so happens, demand per unit of economic activity has been falling: copper is being replaced in many of its main industrial applications by other materials (notably, fibre-optic cable instead of copper wire for telecommunications).

Copper, therefore, is unlikely ever to run out—and if it did, in some very distant future, it would be unlikely by then to matter. The same is true for other key minerals. Reserves of bauxite in 1970 were 5.3 billion tonnes; the amount consumed between 1970 and 2000 was around 3 billion tonnes; reserves by the end of the century stood at 25 billion tonnes. Or take energy. Oil reserves in 1970: 580 billion barrels. Oil consumed between 1970 and the turn of the century: 690 billion barrels. Oil reserves in 2000: 1,050 billion barrels. And so on.

### **The colour of gloom**

What about pollution? On the whole, rich countries are less polluted than poor countries, not more. The reason is that wealth increases both the demand for a healthier environment and the means to bring it about. Environmental regulation has been necessary to achieve this, to be sure, because pollution is indeed an externality. But it is not true that the problem has been left unattended in the rich world, that things are therefore getting worse, and that CSR initiatives have to rise to the challenge of dealing with this neglect.



Strong environmental protection is already in place in Europe and the United States. In some cases, no doubt, it needs to be strengthened further. In some other cases, most likely, it is already too strong. Overall, the evidence fails to show systematic neglect, or any tendency, once government regulation is taken into account, for economic growth to make things worse.

How much of an exception to this is global warming? Potentially, as many CSR advocates say, a very important one. Emissions of greenhouse gases are causing stocks of carbon in the atmosphere to grow rapidly. Almost all climate scientists expect this to raise temperatures to some unknown extent during the coming decades. If temperatures rise towards the upper end of current projections, the environmental damage will be great.

Yet the world still lacks an effective regime for global carbon abatement. This is not so much because the United States has refused to support the Kyoto agreement as because that agreement is deeply flawed in any case—but this is beside the point. Global warming is a potentially very significant externality that governments up to now have failed to address properly.

Another such case is excessive encroachment on wilderness areas. Once a wilderness has been lost, it cannot be replaced—and, unlike for copper or oil, there will never be a substitute. Governments in many rich and poor countries are neglecting this issue.

But on questions such as these, where governments are, it seems, leaving significant market failures unaddressed, the question for businesses is whether CSR can do anything useful to bridge the gap. Many companies at the forefront of the CSR movement have embarked on initiatives of their own, aimed, for example, at reducing greenhouse-gas emissions or at protecting wilderness areas.

These would need to be judged case by case, to see whether particular policies were instances of “good management” (as when an oil company invests profitably in alternative fuels, anticipating both shifts in consumer demand and forthcoming taxes on carbon), “borrowed virtue”, (for example, creating private wilderness reserves at shareholders' expense), “pernicious CSR” (blocking competition in the name of specious environmental goals) or “delusional CSR” (increasing emissions of greenhouse gases in order to conserve raw materials that are not in diminishing supply).

There will be good and bad. As a general rule, however, correcting market failures is best left to government. Businesses cannot be trusted to get it right, partly because they lack the wherewithal to frame intelligent policy in these areas. Aside from the implausibility of expecting the unco-ordinated actions of thousands of private firms to yield a coherent optimising policy on global warming, say, there is also what you might call the constitutional issue. The right policy on global warming is not clear-cut even at the global level, to say nothing of the national level or the level of the individual firm or consumer. Devising such a policy, and sharing the costs equitably, is a political challenge of the first order. Settling such questions exceeds both the competence and

the proper remit of private enterprise.

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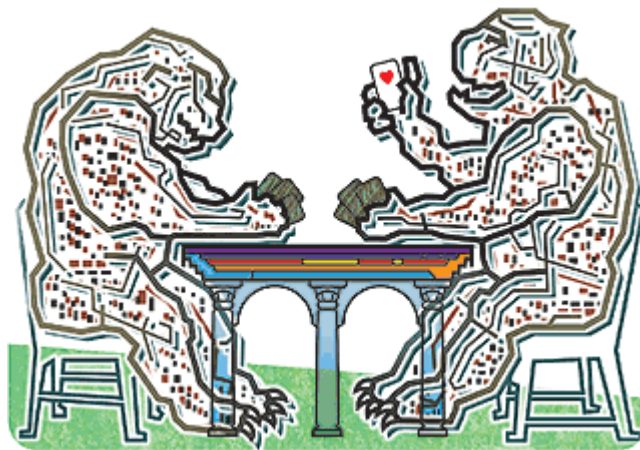
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RESEARCH TOOLS  
**SURVEYS**

## The ethics of business

Jan 20th 2005

From The Economist print edition



### **Good corporate citizens, and wise governments, should be wary of CSR**

RECALL that Joel Bakan, the angry law-school professor and scourge of modern corporations, argued that CSR is usually a scam. It is for governments, he says, not firms, to decide questions of social, environmental and industrial policy—and governments should know that if they fail in that duty, the psychotic corporation, quite likely hiding behind CSR, will continue to rape and pillage.

Mr Bakan and those who share his morbid fear of capitalism are wrong about that second point. Not only is competitive private enterprise already heavily regulated; it also comes with a great deal of built-in additional self-interested self-regulation, as it were. But they are quite right about the first point. It is indeed desirable to establish a clear division of duties between business and government. Governments, which are accountable to their electorates, should decide matters of public policy. Managers, who are accountable to their shareholders, should run their businesses.

Does this mean that managers need not concern themselves with ethics? Just the opposite. Managers should think much harder about business ethics than they appear to at present. It is lack of clarity about business ethics that gives rise to confusion over what managers' responsibilities are, and over where the limits of those responsibilities lie.

The crucial point is that managers of public companies do not own the

businesses they run. They are employed by the firms' owners to maximise the long-term value of the owners' assets. Putting those assets to any other use is cheating the owners, and that is unethical. If a manager believes that the business he is working for is causing harm to society at large, the right thing to do is not to work for that business in the first place. Nothing obliges someone who believes that the tobacco industry is evil to work in that industry. But if someone accepts a salary to manage a tobacco business in the interests of its owners, he has an obligation to those owners. To flout that obligation is unethical.

In addition, of course, managers ought to behave ethically as they pursue the proper business goal of maximising owner value—and that puts real constraints on their actions. In most cases, acting within these constraints advances the aim of the business, just as individuals find that enlightened self-interest and ethical conduct usually sit well together. But, for firms as for people, this will not always be true. Sometimes the aims of the business and rational self-interest will clash with ethics, and when they do, those aims and interests must give way.

Much the same goes for acting within the law. In democratic societies where the rule of law is upheld, businesses and individuals should work under a strong presumption that they will obey those societies' laws. This will generally be good for business, and usually will be ethical as well—but, again, not always. Now and then, depending on the circumstances, it is wrong to obey the law. And merely following the law does not exhaust a firm's ethical responsibilities, any more than it does an individual's. Some things that are legal are unethical; and many things required by ethics are not required by law.

Managers of companies must confront these questions in running their businesses, just as individuals must in leading their everyday lives. Business ethics, in short, is not an empty box. But what exactly is in the box?

Elaine Sternberg, an academic philosopher and business consultant (and a former investment banker), persuasively argues in her book, "Just Business", that there are two main things: "ordinary decency" and "distributive justice". These need to be understood in relation to the proper goal of the firm. Without these basic values, business would not be possible.

### **Be decent, be just**

If owner value, and ownership itself, are to mean anything, there must be respect for property rights. This excludes, Ms Sternberg points out, "lying, cheating, stealing, killing, coercion, physical violence and most illegality"; it calls instead for "honesty and fairness". Taken together, in her formulation, these constraints reflect the demands of "ordinary decency".

Some businessmen appear to believe that anything which is not outright illegal, however unethical, can be regarded as proper business conduct. But without

ordinary decency (which goes a long way beyond what the law requires of firms), business could not be carried on.

Firms that lie and cheat cannot expect to stay in business very long, even if their actions are allowed by law. Dishonest companies will be unable to borrow, to obtain working capital, or to form stable business relationships with suppliers and customers. Decency in this sense is not just good for business, it is essential. When it comes to maximising long-term owner value, honesty is not just the best policy, it is the only feasible policy.

### **Crime doesn't pay**

What about organised crime, you might ask? The mafia lasted pretty well as a profit-maximising business, did it not? Yes, but organised crime nonetheless proves the point. See what a criminal or "indecent" enterprise has to do to grow and survive: it must corrupt and intimidate, and thoroughly subvert both politics and the criminal-justice system. Some sick jurisdictions have let that happen. Where the rule of law prevails, however, those methods do not work outside a highly circumscribed and perpetually beleaguered criminal domain. Inside this zone, enterprises are small, always in hiding, and in pathological conflict with each other. Outside it, in the light, honesty and fair dealing are required if business enterprises are to prosper and survive.

Granted, some critics of business regard "the big multinationals" as little more than outposts of a mafia-like empire. In the world according to Michael Moore, such companies do systematically lie and cheat, and get away with it by corrupting and intimidating, and subverting both politics and the criminal-justice system. There is indeed little to choose, on this view, between Halliburton (or IBM, for that matter, or General Motors or GlaxoSmithKline) and the *cosa nostra*. Now and then executives do commit crimes, of course. Usually, they are found out and punished. That aside, if you believe that "the big multinationals" are essentially criminal enterprises getting away with murder (perhaps literally), you are beyond the reach of an article about business ethics.

What about the second component of business ethics, distributive justice? In the business context, this simply means aligning benefits within the organisation to the contribution made to achieving the aims of the firm. Pay linked to performance and promotion on merit are instances of distributive justice within the company.

Much of what was said about the role of ordinary decency applies here too. Again, these notions of what is fair are widely accepted; on the other hand, they are not, for the most part, required by law; as a practical matter, they are needed if the business is to do as well as it can; and they are also questions of

ethics, and hence part of the ethics of business. To promote a friend rather than the best person for the job, or to reward a manager for incompetence or wrongdoing, is a bad way to run a business—and is also unethical.

Many writers on business ethics, and just about all advocates of CSR, argue that this way of thinking mistakes the proper purpose of the enterprise. Making money for the owners is too narrow a view of what a corporation is for. It raises ownership—“mere ownership”, as they would say—too high. Owners are just one group among many kinds of different “stakeholders” in a business. It is wrong to run a business in the interest of one kind of stakeholder, ignoring the legitimate interests of all the others. Is this correct?



There is a lot of unnecessary confusion about “stakeholders”. Businesses certainly need to take account of other interested parties if they are to succeed as businesses: they must satisfy their customers, get on with their suppliers, motivate their workers, and so forth. In that sense, these different groups of stakeholders will have their say and exercise their influence. But “taking account of” is not the same as “being held accountable to”. Accountability refers to a much more formal and direct set of rights and obligations.

Of course it is always possible, as a matter of law, to create forms of managerial accountability to non-owners. Through the courts, you might say, managers are held accountable to society at large. Public policy can make managers accountable to regulators. Managerial accountability to workers can also be required by law: worker representation on company boards is mandated in Germany, for instance. (Whether this serves the interests of German workers, or of Germany's citizens in general, is nowadays in doubt.) But all such lines of accountability recognise owners as primary. You cannot deem stakeholders to be equal co-owners of a business without repudiating the very idea of ownership. And where the law does not create accountability to non-owners, there is none.

In many of the corporate scandals of recent years, it has seemed that managers have acted as though they were accountable to nobody—not even, and in some cases least of all, to the firms' owners. This has been rightly recognised as a problem, and a lot of time and effort has been spent on trying to make accountability to shareholders—on matters such as executive pay—more effective.

Muddled thinking on CSR, and on supposed accountability to non-owners, only makes it harder to put this right. Advocates of CSR ought to reflect on the fact that the “triple bottom line” and the bogus pay scheme which rewards bad performance with riches have something important in common: the idea that the interests of “mere owners” should not be allowed to come between



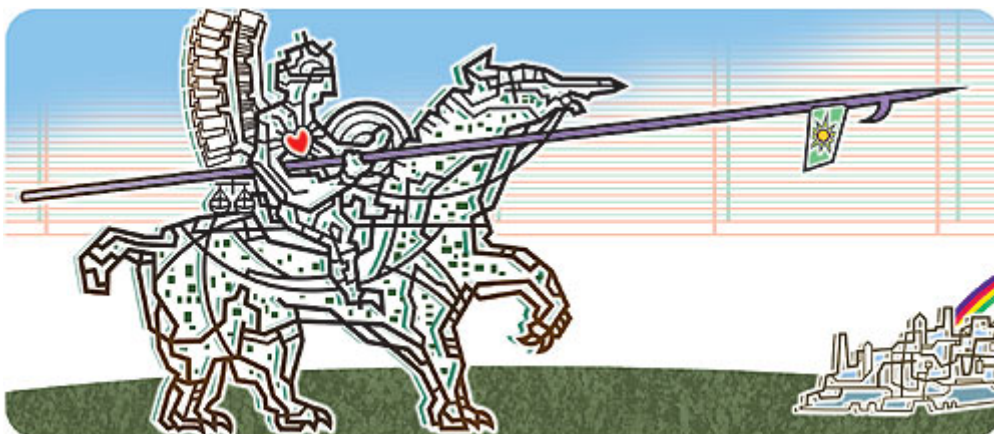
managers and their personal objectives. Broken corporate governance and CSR are close relations. You often see them together.

### Good companies, good government

An earlier section of this article sketched out a four-way classification of CSR: good management, borrowed virtue, pernicious CSR and delusional CSR. Does business ethics shed any more light on those categories? It does, though some of the results are a little troubling at first sight.

Good management and delusional CSR raise no new difficulties from an ethical point of view: the first, which increases profits and improves social welfare, is plainly a good thing and the second, which reduces both, is plainly not. Borrowed virtue has already been criticised on ethical grounds, even though it is assumed to advance social welfare. That verdict stands, as you would expect. A proper understanding of business ethics makes the reasoning clearer, but the main thing is still that the profits of a publicly owned company are not the managers' to give away. The remaining category is pernicious CSR, the kind that raises profits but reduces social welfare.

Is pernicious CSR also unethical? Often, paradoxically, the answer will be no. Managers cannot be criticised on ethical grounds for aiming to increase long-term owner-value: that is their job. Assuming that they have also acted within the law, the next question is whether they have violated the standards of ordinary decency and distributive justice within the organisation. If they have—if they have lied, or bribed, or coerced, for instance—then they have behaved unethically. But if they have acted in accordance with those two standards of business conduct, they are ethically in the right, even though they have acted against the public interest.



This is not as strange as it seems. Consider the case of monopoly. Managers are not to be criticised on ethical grounds for striving to drive their competitors out of business—provided that they do this by selling a better product, for instance, rather than by deception or coercion or through unlawful anti-competitive practices. And if they succeed in establishing a monopoly, it is not unethical to set a price that maximises the company's profits, or even (to the

extent that the law allows it) to create business barriers to the entry of new competitors (for instance, by spending heavily on advertising). For that matter, it is not unethical for a company to lobby the government for protection from foreign competition, citing its concerns, as a good corporate citizen, for the well-being of its workers. All of these things may well be ethical—even when, from the point of view of society as a whole, they are likely to be undesirable.

This seeming paradox only underlines the point that businesses should not try to do the work of governments, just as governments should not try to do the work of businesses. The goals of business and the goals of government are different—or should be. That, by the way, is why “partnership” between those two should always arouse intense suspicion. Managers, acting in their professional capacity, ought not to concern themselves with the public good: they are not competent to do it, they lack the democratic credentials for it, and their day jobs should leave them no time even to think about it. If they merely concentrate on discharging their responsibility to the owners of their firms, acting ethically as they do so, they will usually serve the public good in any case.

The proper guardians of the public interest are governments, which are accountable to all citizens. It is the job of elected politicians to set goals for regulators, to deal with externalities, to mediate among different interests, to attend to the demands of social justice, to provide public goods and collect the taxes to pay for them, to establish collective priorities where that is necessary and appropriate, and to organise resources accordingly.

The proper business of business is business. No apology required.

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RESEARCH TOOLS  
**SURVEYS**

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This survey owes a lot to "Misguided Virtue" by David Henderson, published by the Institute of Economic Affairs in London; "A Poverty of Reason" by Wilfred Beckerman, published by the Independent Institute; and "Just Business" by Elaine Sternberg, published by Oxford University Press. This is not to say that these authors would agree with each other, or with this survey, about all of the issues discussed.

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