Why Responsibility Pays

by Ben Voyles, April 9, 2004

Virtue may be its own reward, but it appears to pay a good dividend as well. Some professors at Emory University and its Goizueta Business School say the evidence suggests that companies that try to act in socially and environmentally responsible ways actually perform better than companies that don't. One possible reason: professors say that waiting to respond to demands for reform from outside the company is often more expensive and time-consuming than acting proactively.

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Diana Robertson, a professor of organization and management who teaches ethics at Goizueta, says that most academic studies do show a correlation between corporate good deeds and economic performance. "What the data show is that for the most part, corporate social responsibility and financial performance are directly correlated, not inversely correlated, and certainly they're not negatively correlated," she says.

So why don't more companies consider the long-term benefits of taking such action? Jon Gunnemann, a professor of theology at Emory University and co-author of *The Ethical Investor*, an influential book on socially responsible investing for universities, says that it's because the focus is increasingly on short-term results. For executives whose job tenure is connected directly to short-term performance, near-future concerns tend to predominate. "One of the major constraints on any corporation that wants to be responsible in a variety of ways is the immense pressure in the last quarter of a century towards short-term thinking," Gunnemann says.

This is partly a result of the trend toward ownership through mutual funds, he says, which makes ownership more fluid and creates more distance between individual investors and the corporation. Without a relationship with the company's owners, managers are often unable to make a case for any act that doesn't serve the current stock price, according to Gunnemann. "This means there is great difficulty for managers to say, for example, 'look, we have a downturn in the market right now, instead of laying people off, let's simply cut profits for a certain period of time, retain employees and reorganize. This way we keep our employees on board and then three or four years down the road we're a healthier company and can start paying profits again.' Well, you get punished for doing that," he says.

At the same time, the increasingly global nature of business has added another kind of detachment. If a firm no longer owns factories, for instance, but subcontracts to another firm six thousand miles away, maintaining a sense of accountability for a company's acts can be more difficult than in the days when the operations of even very large companies were frequently confined to one city or region. "My sense is that with free trade…the capital flows very, very quickly, and the question of accountability is way up for grabs," Gunnemann says.

At the same time, the fact that many companies actually do engage in altruistic behaviors of some kind suggests that it must be serving a purpose, Robertson says. "In a sense, the corporations are ahead of us in that they must believe that [addressing social issues] contributes to the bottom line or they must believe that there's a reason to do it,"
Robertson observes.

William J. Carney, a professor of corporate law at Emory's School of Law, says that the reason – at least for charitable giving – may be that it serves to enhance the company's image. "The companies that engage in significant charitable giving to a large extent are consumer products companies and much of it could also be described as a form of advertising, of public relations," he says.

Shareholders don't complain, Carney says, first because it's typically not much money. Second, "shareholders may say, well, it's fine that Coca-Cola does these things because it gets its name posted someplace prominent and everybody thinks well of the product, that it's a good company, and they'll buy that rather than Pepsi."

Ironically, Robertson notes, this question of whether responsibility pays may be of less concern to companies – many of whom after all are actively engaged in various social causes – than the question of how to do it well. What are the best ways to decide what kind of causes to support, and what tactics are most effective?

Of course, one reason for that lack may be that there isn't one model for how to do good any more than there is one model for how to make money. "I'm not sure if in general one size fits all in terms of corporate social responsibility," says Robertson.

Yet some fundamentals apply. Professors say that in general being proactive often pays when it comes to questions of social and environmental responsibility. That's because the alternative – waiting for regulators or private groups to find a problem later – can be much more onerous in the long run. Steve Walton, a professor of decision and information analysis at Goizueta says an "end of pipe" solution is almost always more expensive – and less effective – than catching a problem before it develops.

One reason is that prescriptive measures sponsored by the government or by non-governmental watchdog groups are often expensive. "The reporting requirements are very extreme right now," says Walton. Sometimes, he says, companies will accept the fine just to avoid the trouble of wading through the red tape. For example, he says, "Delta paid a fine in excess of a million dollars not because they'd spilled anything or polluted, or did anything wrong, they just couldn't file and track the right paper work."

Toward that end, some companies have tried experimenting with a different way of responding to pressure groups. Instead of agreeing to disclose certain information or waiting until a crisis arises and new government forms start popping up, the company will ask an advocacy group to help it design a new product or process that will satisfy the group's environmental or social goals. By working with such an organization to help set up a business process that meets those goals, the company can avoid the burden of ongoing paperwork and at the same time help accomplish the group's goals in a more cost-effective way.

Walton cites The Home Depot, Inc., as one organization that has had good luck with this kind of arrangement. The Atlanta-based home improvement chain has worked with several environmental groups to include wood grown under sustainable conditions in their stores. "It's really risky," Walton says, "but if it works out, you've got in a sense a group that's usually not pro-business activity suddenly talking very highly of you."

But this is only effective, Walton cautions, if there's a genuine commitment within the company to do something on the issue. Some activists are quite skeptical of what's come to be known as "greenwashing" – the creation of a publicity campaign to make the company appear as if it is behaving with environmental concern when in fact it's not. This strategy may have some short-term advantage –as satirist Tom Lehrer used to say, if you can fake sincerity you've got everything - but it can increase the company's risks later on.

Another key seems to be accepting responsibility. Outsourcing, for example, might seem like a way around many concerns, but the gambit seldom works in the courts – particularly not in the court of public opinion. If something goes wrong, the public won't be concerned that a subcontractor was actually in charge, according to Walton. "You can't throw up your hands and say, oh, not my job," he warns.

In the case of the chemical disaster in Bhopal, India, for instance, Union Carbide was only one of several shareholders in the plant, "but when the accident happened, the group that got the heat was Union Carbide International," Walton says.

To ward off these kinds of disasters, some corporate responsibility advocates are encouraging executives to think about "a triple bottom line" – basically, to watch out not only for the potential for profit, but its value to the community in which the business operates and the cost to the environment. "You can't give overly strong balance to any one of the three dimensions, they've all got to balance together," explains Walton.

The advantage of the triple-bottom-line approach, Walton says, is it makes executives "think about things they usually skip right over." Done right, he says, it can be just another discipline, like a lean-supply initiative. "There are ways that you can both improve a company's environmental performance and their financial performance at the same time," he says.

But ultimately, perhaps, the issue of corporate responsibility may really be a question of executive responsibility. Robertson says that in matters of ethics, the tone tends to be set at the top. "If senior management appears to be living and breathing the code, walking the talk as they say, then people pay attention to it," she says.

Laura Rittenhouse, a New York-based corporate communications specialist who publishes an annual survey rating CEO's letters to shareholders on candor and directness, says she believes that the key to improving corporate behavior will be not through prescriptive measures such as Sarbanes-Oxley, but the emergence of a new generation of CEOs who take their role as stewards of capital very seriously. Rittenhouse cites Jeffrey Immelt of GE as one example of this emerging group who say, "I am here as a leader and what I'm focused on is not what that entitles me to, but … what has been entrusted to me," she says.

Here again, honesty also seems to be not just the best but the most lucrative policy: Rittenhouse's annual surveys have repeatedly found that companies with opaque shareholder letters tend to make less money than companies whose chiefs' write the clearest, most direct letters. For instance, the top-ranked 25 companies in 2002 gained $7.9 billion in aggregate net income from 2001 to 2002. In contrast, the 25 bottom-ranked companies lost $48.0 billion in aggregate net income, although excluding AOL Time Warner's whopping $44.5 billion loss in 2002, this loss narrows to $3.5 billion.

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