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Bryan W. Husted and David Bruce Allen
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1 Introduction

Everywhere business creates wealth, there is a chorus imploring firms to respond to community needs, large and small. The most urgent, at times strident, calls are addressed to multinational enterprises (MNEs). CEOs of multinationals are told repeatedly that they have a special obligation to society to use their firms' assets, global reach, and unique skills to address the challenges of poverty, illness, and human rights violations in innovative ways. They are also reminded with equal fervor that if the satisfaction of helping to make the world a better place were not sufficient incentive, that their firms' commitment to social action will be rewarded by lasting customer loyalty and profits.

For the most part, CEOs agree. Moreover, given the magnitude of the world's ills and pandemic dissatisfaction with government, they understand, and may even feel honored that governments, NGOs, and other civil society groups turn to the business community for resources and solutions. Not surprisingly, social action and CSR[1] are embraced by all – investors, management, employees, governments, NGOs, the press, and academics like ourselves.

Dramatic events, such as the Hurricane Katrina disaster, provide strong evidence for this new role of business in society. As the perception that government could not provide relief grew, firms announced a battery of employee, philanthropic, and relief aid projects. Wal-Mart, frequently portrayed as a villain in the mass media, and whose expansion has been subject to numerous "stop Wal-Mart" campaigns in cities throughout the US, announced it was relocating thousands of its employees to jobs at other Wal-Marts and opened its warehouses

[1] The term CSR stands for corporate social responsibility and is sometimes employed to cover all actions by the firm that are deemed ethical and/or benefit society, and are pursued altruistically. Later on, we will have a good deal more to say about the institution of CSR.

for aid relief, leveraging its logistics expertise. Wal-Mart's actions were reported widely on television and in the press. Wal-Mart was not alone in pitching in. *The New York Times* picked up on the widespread corporate efforts in a Sept. 14, 2005 article entitled "Storm and Crisis: The Helping Hands; When Good Will Is Also Good Business," which began "Corporate good will in the aftermath of Hurricane Katrina has been anything but run-of-the-mill. Amgen, the biotechnology company, is donating $2.5 million to relief efforts, focusing on dialysis and cancer patients. On top of millions of dollars in cash and equipment, General Electric donated a mobile power plant" (Hafner *et al.* 2005).

Following Katrina, Americans expected firms to help. As firms responded, the media publicized their efforts, and firms earned goodwill that might later be translated into profits.

The logic, as such, is simple, direct, impeccable, and promulgated in every developed country in the world. Good deeds lead to a reputation advantage and, hence, profits. But this is not the whole of the argument in favor of corporate social action. Strategy gurus Kanter, Porter, and Prahalad have all written *Harvard Business Review* articles explaining how some of the best innovation and new market opportunities come out of social action projects and social entrepreneurship. As *The New York Times* reported recently, "Perhaps for less altruistic reasons, but often with positive results for the poor, corporations have made India a laboratory for extending modern technological conveniences to those long deprived. Nokia, for instance, develops many of its ultralow-cost cell phones here. Citibank first experimented here with a special ATM that recognizes thumbprints – to help slum dwellers who struggle with PINs" (Giriharadis, 2007).

Competitive advantage and fortune apparently await those who can provide products and services to "the bottom of the pyramid." As firms address environmental and social problems via social action projects, the message of business opportunity and reputation building appears to be unbeatable; who would not want to do well by doing good and reap praise for it?

But is it true that firms that engage in social action will be rewarded with a good name, competitive advantage, superior profits, and corporate sustainability? What if it is true for some firms and not for others? How do positive social activities get weighed against less positive actions by the same company? To what extent are home market and foreign market activities compatible? Are there situations in which corporate social action has a positive financial impact and others when it does not? Are there specific management processes involved with achieving financial reward through corporate social action? Are there significant risks in engaging in corporate social action? Ought firms to have a corporate social strategy? Do we need a new theory of the firm that moves beyond both the traditional economic efficiency model and the emergent stakeholder model? Does corporate social responsibility (CSR) require that firms engage in disinterested or altruistic actions divorced from thoughts of profit? And finally, are the rules for social strategy different in different countries?

In a decade of research into these questions, we have found that firms will do a far better job at creating economic value and social value if they include social action programs in the strategic decision-making process.

When we say "the decision-making process" we mean just that: firms must decide yes or no – a great deal, some, or even none – on social action programs. Social action, like all corporate activities, may be strategic or not, beneficial or harmful to the bottom line. However, as our research has also shown, to date few firms truly understand what this means. Too often, social action is an expense. Corporate communications informs stakeholders of the firm's good deeds; praise is expected in return. On occasion, a reputation advantage seems to be attached to the good works. Sometimes, in an unpleasant turn of events, the same company that benefited from engaging in social action is accused of not adequately sharing these benefits with its customers and the community; another firm is criticized as "unethical" or "uncaring" when it abandons a social action project or defends a policy a stakeholder considers wrong. Doing good, management finds out, is not quite as simple as it first appears.

At the very least, all firms subject to stakeholder demands for CSR need to consider their social action projects as part of their strategy. Those firms that believe social action can also be a vital part of their competitive advantage require a well-developed *corporate social strategy* that is fully integrated with business strategy. CEOs and top management need to know the full story on how business can positively engage stakeholders and satisfy their legitimate needs, while maintaining, and even improving, competitive advantage. Telling that story is largely what this book is about.

Surprisingly, management research has just begun to consider the issues carefully. Over the last two decades, research has mostly been stuck on developing a theory of the firm that incorporates stakeholder aspirations, and links corporate profitability to corporate social responsibility without saying very much about either how to decide what to do or how to actually get it done. One recent effort, the July 2007 *Academy of Management Review* Special Topic Forum on "Business As Social Change Agents" set out to explain the strategic benefits of social action, but was judged even by the editors themselves to fall far short of offering much in the way of examples of social action entrepreneurship and leadership, instead, "Most of the papers address factors that affect whether firms will undertake socially responsible action" (Bies *et al.*, 2007: 791). Whether is, of course, important, but without the how, and the who, the prospects for social change will be unaffected. Part of the problem is that researchers must finally come to acknowledge that demonstrating a causal relationship between positive CSR spending and firm financial performance is a dead end. Even Michael Barnett's "Stakeholder Influence Capacity and the Variability of Financial Returns to Corporate Social Responsibility" (2007) and Mackey *et al.*'s "Corporate Social Responsibility and Firm Performance: Investor Preferences and Corporate Strategies" (2007), both in the same Special Topic Forum, recognize the consistent failures of previous CSR and stakeholder research in which financial performance is the dependent variable, but nonetheless, despite efforts to dissect CSR and stakeholder influence, run smack into the same problem.

The reason for this was explained with exquisite preciseness and tact by James March and Robert Sutton (1997) in "Organizational Performance as a Dependent Variable" over a decade ago.

> Most studies of organizational performance define performance as a dependent variable and seek to identify variables that produce variations in performance. Researchers who study organizational performance in this way typically devote little attention to the complications of using such a formulation to characterize the causal structure of performance phenomena. These complications include the ways in which performance advantage is competitively unstable, the causal complexity surrounding performance, and the limitations of using data based on retrospective recall of informants. Since these complications are well-known and routinely taught, a pattern of acknowledging the difficulties but continuing the practice cannot be

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attributed exclusively to poor training, lack of intelligence, or low standards. Most researchers understand the difficulties of inferring causal order from the correlations generated by organizational histories, particularly when those correlations may be implicit in the measurement procedures used. We suggest that the persistence of this pattern is due, in part, to the context of organizational research. Organizational researchers live in two worlds. The first demands and rewards speculations about how to improve performance. The second demands and rewards adherence to rigorous standards of scholarship. (March and Sutton, 1997)

Accordingly, one of our goals is to help shift the conversation away from performance outcomes and back on to the variables, the concrete behaviors, that go into creating competitive advantage itself and value creation. Over the last decade we have worked to come up with alternative approaches to understanding how corporate social action functions. When this work has sufficient weight and empirical evidence, then it makes sense to talk about economic and social value creation and, in turn, corporate performance.

The corporate performance dependent variable is not the only stumbling block we face in offering corporate social strategy as a possible alternative to current practice. Some researchers have concluded that the lack of a clear correlation (positive or negative) between corporate social performance and corporate financial performance supports the ethical argument that doing good is good in itself and that rewards for doing good are irrelevant. If this is correct, then the only thing firms must do is decide what is right and behave accordingly; unfortunately, as we will discuss later on, management may not always be in a position to be ethical arbiters.

Another group of researchers, among them C. K. Prahalad (2005) and Stuart Hart (2007), argue persuasively that doing good is the task of social entrepreneurs who will change the world and get rich providing goods and services for the base of the pyramid.

Though both these arguments have considerable merit, we believe that neither responds to the questions we raise nor provides established firms, particularly multinationals, with much needed strategic tools for deciding on and managing social action programs effectively. For their part, academic researchers face the challenge of investigating the strategic opportunities inherent in social action programs that may either supplement or displace traditional strategic options.

Several researchers have made promising advances, in particular linking social outcomes with stakeholder theory. The aim has been to identify which stakeholders matter and under what circumstances. For example, Hillman and Keim's (2001) work on primary and secondary stakeholders and social benefits found that different market and nonmarket participants have varying impacts on firm competitive advantage. Such targeted research has helped to introduce academic rigor and realistic expectations to the CSR domain.

Nonetheless, CSR research has lagged far behind the demands of businesses, NGOs, and other civil society and government organizations that seek a clearer understanding of the firm's contribution to social welfare. Accordingly, one of our key objectives is to develop a theory of firm strategic behavior that explains how firms can integrate business strategy and social strategy to increase overall economic and social value creation.

Hence, in seeking to explain firm financial and social performance, we respond to key strategy questions regarding investment in corporate social action. Not all social issues should claim the attention of managers and be invested in; and even worthy social action projects may be rejected by specific stakeholder groups, exposing the firm to new, perhaps debilitating demands. Addressing such strategy formulation questions is essential to understanding how firms may employ social activities to achieve competitive advantage and, hence, superior returns.

We believe that this book will provide new directions for studying the role of social action programs within the firm's corporate strategy. While there are energetic calls for a more strategic CSR and several efforts to explain how it might work, there has been neither sustained theory development nor a meaningful discussion of how to put corporate social strategy into practice. We intend to do both. The book examines both the why of corporate social strategy – that is, it analyzes why and under what conditions social action programs create value for the firm – as well as the how of social strategy. In addition, we provide several examples of firms that are on the road to doing so.

In summary, we believe this book is the first to set out a fully developed strategy for corporate social action. In this introductory chapter, we begin by examining current research in the area and then explore the potential role of corporate social action in the search for competitive advantage. This discussion leads us to propose and define the concept of corporate social strategy; we dedicate much of the chapter to locating social strategy within the field of strategic management. Additionally, we lay out the road map for the rest of this book.

The road to corporate social strategy

One of the most vexing research questions in management is the ambiguous relationship between corporate social responsibility and financial performance (Griffin and Mahon, 1997; Preston and O'Bannon, 1997; Russo and Fouts, 1997; Waddock and Graves, 1997; Hillman and Keim, 2001; Margolis and Walsh, 2001, 2003; Orlitzky *et al.*, 2003). Though initially of concern principally to researchers in social issues management, the emergence of stakeholder theory as an alternative to restrictive economic theories of the firm (Freeman, 1984) has pushed the question of CSR's impacts on corporate performance to the forefront of a reinvigorated debate over the theory of the firm.

As a result, two Academy of Management journals have dedicated special issues to stakeholder management and CSR. The 1995 *Academy of Management Review* "Shifting Paradigms: Societal Expectations and Corporate Performance," held the consensus view that firms must meet the demands of both shareholders and other stakeholders. A framework for stakeholder theory was proposed based on the distinction between normative, descriptive, and instrumental stakeholder approaches (Donaldson and Preston, 1995); among the key research questions that emerged was how to move beyond the normative belief that CSR is good for stakeholders and shareholders, and to demonstrate the instrumental value of CSR for firms.

Four years later, in the *Academy of Management Journal* (1999), the special research forum on "Stakeholders, Social Responsibility and Performance" reviewed the results of recent empirical research. The verdict was, at best, neutral. Particularly telling were the findings of Berman *et al.* (1999). Only two of five stakeholder groups (employees and customers), both directly related to the firm's value chain, were shown to have a positive influence on firm performance. None of the nonmarket stakeholders were found to have any effect. Disappointing results have long been the bane of CSR and stakeholder research. Continuing research has sought to disentangle the moderating and mediating variables muddying the relationship between social action and firm performance as we seek to explain how nonmarket factors impact corporate performance (Hillman and Keim, 2001; McWilliams and Siegel, 2001). These recent studies have been careful to take into account previous work and have rigorously employed statistical modeling (Orlitzky *et al.*, 2003), but they have not significantly changed the landscape (Margolis and Walsh, 2003).

During the last decade there has been little advance in research methodology, though slowly we have come to understand that the complexity of corporate behavior precludes demonstrating that corporate social action (or any other firm activity, for that matter) is positively correlated with financial performance. Nor have we advanced appreciably in the practical task of providing good working models for managers of how to create competitive advantage and economic and social value through social action.

Where we ought to go from here is a significant challenge, given the pressures on business firms to increase profits, increase corporate social action, and help fix the world's problems. We argue that social action is a strategic tool that managers need to learn how to employ. Academic researchers must investigate the strategic choices generated by treating social action as a set of business opportunities that may also interact with traditional strategic options. Our challenge is to develop a theory of the firm in which we contribute to solving the world's ills while maintaining or increasing firm profitability. Understood in terms of joint financial and social performance, we are asked to answer questions of strategy formulation including: (1) how much to invest in social action?; (2) what social activities should be invested in?; (3) will these investments satisfy stakeholders or, on the contrary, may the firm open itself up to new, perhaps debilitating, demands from stakeholders?; (4) should the firm invest in projects that management judges to be financially and socially beneficial, or should investment decisions be left to external NGO and civil society professionals? Answering such questions involves explaining how firms may employ social activities to achieve competitive advantage and, hence, superior returns.

As we have indicated briefly above, the relationship between CSR and financial performance has taken on special relevance as non-business organizations, including the United Nations (Global Compact), and ethical investment funds (Calvert Social Index Fund, Domini Social Equity Fund) insist that there is a positive relationship between CSR and economic performance – despite the mixed empirical evidence! In an environment in which social action is a requisite of doing business, figuring out how to do it and under what circumstances is fundamental. One of our key objectives in this book is to formulate a model of corporate social strategy that more clearly sets out the conditions under which engaging in social change programs can create competitive advantage and lead to superior financial as well as social performance.[2]

In developing our model, we draw on the most relevant recent efforts to link CSR activities to superior financial performance and incorporate CSR into the theory of the firm (Burke and Logsdon, 1996; Berman *et al.*, 1999; Reinhardt, 1999; Rowley and Berman, 2000; Aragón-Correa and Sharma, 2003). As discussed previously, there is no necessary link between CSR and profitability, nor could there be. Only after considering a specific firm activity or group of activities as part of a defined strategy will it make sense to analyze whether the firm has a competitive advantage and, hence, the possibility of creating wealth (Porter, 1996).

For example, in looking at the relationship of response to categories of stakeholders and firm performance, Berman *et al.* (1999) find that only market stakeholders are linked to improved financial performance. However, as we will argue more fully later on in Chapter 4, we believe that a social strategy formulation model based on the commitment of the firm to the strategic use of social action in seeking competitive advantage can incorporate both market and nonmarket stakeholders. With respect to the theory of the firm, Aragón-Correa and Sharma (2003) detail a model of proactive environmental strategy that parallels our work. While quite useful, especially in drawing a strong relationship between the general business environment and a proactive environmental strategy, the model focuses specifically on environmental strategy and improvements in product performance and reduction of environmental damage. Here, the link is between a specific set of easily identifiable firm activities that are part of core operations. Social action programs are a more difficult challenge precisely because they are much more difficult to link to

[2] The terms "social action" and "social change" are used synonymously throughout this chapter. We may assume that firms that engage in social action pretend to achieve some positive social change.

specific firm operations and the route to obtaining benefits much more complex. Social strategy embraces both environment and social action. In this book, we focus principally on social action because the strategic opportunities are as large and complex as the demands being placed on firms. In sum, despite having gotten bogged down in the often sterile debate over profitability, previous research has provided evidence that when linked to competitive advantage, CSR may entail either reduced costs (e.g., environmental savings), product or service improvement (e.g., social product attributes that add value) or improved reputation (e.g., buyers prefer products sold by socially responsible firms) (Fombrun and Shanley, 1990; Reinhardt, 1999). While reminding us that some firms have created competitive advantage in certain situations, research has yet to address two key questions: how can firms manage social action to create competitive advantage as well as achieve its social objectives? What do managers need to know about social action and competitive advantage if they are to integrate social change activities into core firm processes?

In answering these questions, we position CSR and social action within the mainstream of the management literature. CSR traditionally refers to activities that "further some social good, beyond the interests of the firm and that which is required by law" (McWilliams and Siegel, 2001). We juxtapose CSR with social action as a way to emphasize the broad range of social activities in which a firm may become involved. In principle, we agree with Marquis *et al.* (2007: 926) who define corporate social action as "behaviors and practices that extend beyond immediate profit maximization goals and are intended to increase social benefits or mitigate social problems for constituencies external to the firm." This approach is similar to prior attempts to define CSR in terms of welfare economics in which corporate social responsibility is defined as the firm's obligation to respond to the externalities created by market action (Sethi, 1978). Externalities are positive or negative impacts of a firm's production on the utility or production of a third party. For example, a negative externality is created when the firm emits noxious gases that affect the health of its neighbors (Sethi, 1978). A positive externality occurs when a company opens operations in the inner city and its presence drives down crime in the area (Keim, 1978).

To this argument, we add the proviso that social action is more likely to lead to both positive financial and positive social performance