Making the case for the competitive advantage of corporate social responsibility

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Companies have an obvious obligation to serve their shareholders. Owners trust firms to manage their investment and produce returns. However, stockholders are not the only party with an interest in a firm's activities. Firms affect numerous groups and individuals, both internally and externally, engendering a realm of responsibility far beyond the positive economic returns demanded by shareholders. Corporate social responsibility (CSR) defines organizational consideration of multiple stakeholders and global impact, beyond simple focus on maximization of shareholder wealth.

CSR encompasses a wide range of stakeholders. Pearce and Robinson (2005) delineated internal and external parties, including shareholders, employees, creditors, customers, suppliers, governments, unions, competitors, local communities, and the general public. Some obligations are obvious, such as the obligation of the firm to serve the financial interests of shareholders and provide employee satisfaction.

But other obligations are not as apparent, such as the firm's obligation to reduce pollution, educate consumers, or consume supplies in a timely manner. All affected parties claim some responsibility of the company, which may conflict with one another. Human and regional developments are certainly matters of CSR. Management must clearly identify, understand, and prioritize claims to plot strategic objectives. Control of resources and corporate philosophy depend upon the compromises derived from the CSR claims of various stakeholders.

Businesses do not operate independently of society and the earth; business impacts both the population and environment in which it operates. Mindful of its surroundings, a firm can control the triple-bottom-line, or the environmental, societal, and economic aspects of the firm's performance (Castka *et al.*, 2004). Ultimately, responsibility to society links with environmental protection as concern for the earth grows among the public. Such concern is reflected in governmental regulation of ecological factors. Philanthropic improvement of the quality of life requires ecological awareness.

CSR captures the ethical and legal claims to environmental protection. Any firm harming the environment in which it operates cannot sustain. Notably, in a European utility company, the Environmental Manager, outside of executive management, serves as the champion of sustainability (Schaefer, 2004); the Environmental Manager's understanding of the connection among the three bottom line components permeates strategic thought. Ecological and social welfare can affect the sustainability of a firm.

Simply speaking, a good name can enhance business in good times and protect it during a crisis. This article argues that the prolonged advantage of corporate social responsibility ensures sustainable economic advantage and should be a long-term objective of any organization.

CSR as a competitive advantage

One reason why social responsibility provides a sustainable competitive advantage is that it requires a culture that can successfully execute a combination of activities. There is literature (Black and Hartel, 2004; Hamel and Prahalad, 1994; Hout, 1999) that supports the idea that social responsibility requires a combination of activities such as deeply studying the forces that can shape the future of the industry.

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Hamel and Prahalad (1994) talked about gathering intelligence about current and potential social and political issues, involvement of stakeholders, managing stakeholder expectations, decision making, incorporating the decisions into the strategic plan and tactical activities, communicating symbols to stakeholders, and ethical business behavior. These activities have ties to aspects of some theories of strategy that are popular today such as complex adaptive systems (Wah, 1998) and strategic fit (Porter, 1979, 1981, 1991, 1996, 1998, 1999, 2001a, b).

Research propositions to support CSR research

When a company is truly committed to social responsibility, it will look to have a unique relationship with stakeholders, one that resembles a partnership with respect to the intelligence gathering and communication activities. The stakeholder is placed on equal ground with the company in these regards (Black and Hartel, 2004) such that communication is two-way, with stakeholders being able to say whatever they want without repercussion. The stakeholders can initiate communication, decide what topics should be discussed, and decide the frequency and forum and vehicle of communication. Stakeholders and the company are honest with each other, which may mean that they do not have hidden agendas and do not hold back information from each other. This requires companies to share both failures and successes in regards to social responsibility.

Companies may be reluctant to develop this type of relationship with stakeholders for a couple of reasons. First, it takes significant time on the part of the company and it takes coordination with stakeholders. Secondly, Stacey (1996) points out that people – and companies are made up of people – shy away from genuine two-way honest communication because of the conflicts that eventually arise due to differences of opinion and because of the strong emotions tied to issues of the parties involved.

Perhaps it appears strange that these very things that scare people, and thus companies, are the things that are necessary to be innovative, to think outside our normal ruts, to get us to shift our paradigm. As online information and customer relationship management related (CRM) technologies and their corresponding infrastructure continue to diffuse through the social fabric of global business society, stakeholders demanding quality information exchanges drive the future for CSR strategies. The basic research propositions that are suggested for further empirical study, but for the basis of the discussion of this article, include the following:

P1. The future for CSR strategies will grow proportionally by quality information exchanges associated with the development of strategic intangible assets supported by the resource-based view theory of the firm, such as company and product reputation, employee know-how, and company culture.

P2. The future for CSR strategies will be based on management's ability to mediate the negative arguments against social responsibility; namely reducing the agency theory dilemmas of aversive selection and moral hazard. Management must counter the negative image that most companies are not sincere with their efforts to be socially responsible and that evil ulterior motives of pure profit and market share lay beneath the surface.

P3. The future for CSR strategies will be based on management's ability to promote the concept of corporate sustainability through the application of triple bottom-line thinking (the simultaneous integration of economic, environmental, and social criteria in to strategy in order to create long-term shareholder value, spite its initial costs involved in the implications associated with green designs).

Porter (1996, 2001a, b), perhaps the most cited author on the subject of strategy, has determined that the fit of these types of long-term activities provides a sustainable competitive advantage because it is much more difficult for a competitor to imitate multiple activities than just one activity. Social responsibility involves combining activities involving people inside and outside the company. The ability to successfully fit outside stakeholders into an effective combination of business processes adds even greater complexity to the strategic fit, making it even more sustainable as a competitive advantage.

Besides engaging with stakeholders, companies can utilize other resources to gather information about current and future social and political issues. One resource companies can utilize is academia. Professors, undergraduates, and graduate students are willing at times to do research on a topic such as social responsibility and provide the results of such research to companies. Another resource that companies could utilize to obtain information on social responsibility issues and trends are think tanks. Gathering information from a number of stakeholders and others and turning that into decisions that change the direction and activities of a company is not easy to pull off, and could be considered complex. The fact that the company makes changes based on the information gathered makes it adaptive. Finally, that this involves multiple people and groups within the company as well as multiple stakeholder groups shows that it requires a system and processes to gather the information through the engagement of stakeholders.

Granted, this process requires oversight on the part of management in the decision-making process, but the rest of the activities are very similar to a complex adaptive system (CAS) (Wah, 1998). Allowing people to gain information from a number of sources and to use that information to adapt to changes that are occurring or will occur is what a complex adaptive system is about.

For companies to have a reputation as socially responsible, they must be proactive in their efforts and not reactive to political regulations and stakeholder sanctions. If a company does not act proactively, stakeholders may respond by creating awareness among other stakeholders for counter action or even to encourage other stakeholders to withhold important resources (Bryan and Smith, 2005; Maignan and Ferrell, 2004; Smith, 2004a, b; Smith and Rupp, 2004; Smith *et al.*, 2004).

Historically, a concentration on improved operational effectiveness and overcapacity created a temporary economic advantage accompanied by increased profit and firm value. Such an advantage is short-lived; investors may be satisfied, but competing companies will eventually mimic technological and material improvements. Hence, physical technologies can quickly become obsolete or re-engineered by competitors, negating any strategic value such an asset may have possessed (Michalisin *et al.*, 1997, 2000). As competing ideas converge, operating competencies serve little or no competitive advantage. Material advantages focused on profit also generally ignore CSR.

This short-lived economic advantage is in direct contrast to CSR, which produces a sustainable competitive advantage attributable to positive organizational reputation. The socially perceived image of the company depends upon the marketing of strategies like the four Es; namely, make it easy for the consumer to be green, empower the consumers with solutions, enlist the support of the customer, and establish credibility with all publics and help to avoid a backlash (Pearce and Robinson, 2005).

Firms advertise their affection to public claims to enhance their corporate image. Advertisement of the adoption of CSR provides a sustainable advantage amongst competitors through improved appearance. The advantage is intangible and difficult to duplicate. Competitors seeking to match the CSR competency of a firm will find themselves slow to capture the consumer loyalty or governmental trust of the first. The organizational impacts of a positive public image compound; not only can the firm expect increased sales and revenue, but also greater employee satisfaction, the attraction of new investors, and tax exemptions. CSR benefits manifest an enduring competitive advantage.

How to measure CSR?

Theoretically, increased corporate value results from adoption of CSR, although the relationship does not easily lend itself to objective analysis. How is CSR measured? Response to stakeholder obligations is not as clearly quantifiable as a firm's quarterly income or operating expenses. Financial statistics measure a firm's economic performance.

As CSR translates into sustainability, the superior economic performance of the Dow Jones Sustainability Group Index highlights the advantage of embracing CSR (Castka *et al.*, 2004). Globally, the FTSE 350 represents the largest 350 companies of the London stock market. Among the FTSE 350, ten of the most financially successful applied innovative CSR techniques as strategic objectives (Cumming *et al.*, 2005). Throughout the global economy, strategic implementation of CSR links to improved monetary returns, despite CSR's inherent avoidance of quantification.

Effects of regulation on CSR

Difficulty in the measurement of CSR, along with the power controlled by multinational corporations, complicates regulation. The amassed resources of global corporations surpass those of national governments, making enforcement of corporate legislation difficult. Since the 1940s, international dispute barred the development of international business regulation. From the failure of the proposed International Trade Organization (ITO) in the 1940s to the global expansion of business in the 1990s, the foundations of decreasing governmental advantage over businesses appears (Florini, 2003).

It was not until the late 1970s that non-governmental agencies applied significant pressure, resulting in the US Foreign Corrupt Practices Act in 1977 and the CSR movement of the 1990s. Non-governmental agencies, such as civil society groups, fight to fill ''the governance gap'' through protest.

Avoiding measurable commitments with vague codes or statements

Some civil groups urge the application of controversial corporate codes of conduct and CSR inclusion in corporate mission statements. Many business leaders attempt to avoid measurable commitments with vague codes or statements, but others comply with independent external auditing. Such auditing is voluntary, and many companies argue that standards should be set by industry.

Auditing of self-inflicted standards conducted internally or by hired auditors lends itself to bias. Public scrutiny often incites public reporting, but the standards for public reporting still require some advancement. Of those standards that do currently exist, some of the more popular standards include the Malcolm Baldridge National Quality Award (MBNQA) (see www.isixsigma.com/ca/baldridge/), the European Quality Award (EQA) and ISO 14001. These standards do consider results and not just policies (Kok *et al.*, 2001).

Implications for small to mid-size enterprises (SMEs)

Various stakeholders may appreciate standard measurement and reporting of CSR, but inflicting governance of such an issue presents some complexity for small and mid-size enterprises (SMEs). Firms both large and small must consider strategy and, hence, CSR; however, SMEs respond to a confined set of shareholders and have a smaller effect on society.

While SMEs may share the human and ecological concerns of larger corporations, a fear of the bureaucracy and investment associated with CSR bars its growth. SMEs do not posses the mass of resources of large international firms. With fewer consumers, smaller firms have less interest in the response of society. Impending European legislation may soon force all businesses, including SMEs, to adopt a CSR agenda involving mandatory reporting, stakeholder dialogue and director consideration of global issues (Castka *et al.*, 2004).

Perhaps companies should be left to adopt CSR independently, but without pressure from shareholders and consumers, what drives small businesses to act ethically? CSR adoption is economically beneficial, but regulation may be an impediment to smaller firms without the necessary resources for standard enforcement.

The transition to enduring advantage through CSR requires the dismissal of traditional operational goals and the development of innovative strategy. Creative strategies stretch the effects of a firm's operation and increase stakeholder awareness (Hout, 1999).

New partnerships or alternative processes are a few approaches to CSR. For example, a study of the cement industry showed a necessity for product and process innovation with environmental and social consideration. In a nearly homogeneous industry with high competition, a conglomeration of competing companies considered the path to sustainability, plotted with ideals like emissions reduction, ecological stewardship, and cooperation (Placet *et al.*, 2005). Such a partnership is unique. Even more unique, Tesco, a grocery retailer, teamed up with deprived neighborhoods in a saturated market to provide education, jobs, and a new façade through ''regeneration-partnership stores'' (Cumming *et al.*, 2005). Multiple industries employ socially responsible unique strategy and reap the benefits, from telecommunications to utilities to health and beauty products.

The economic fruit of CSR is not limited to a specific industry. Firms apply innovative socially responsible management or process improvements, which develop a competitive advantage. Incremental transformation through partnerships, technology and business practices typically support the firms' strategies. Such companies have grasped the notion that the risk of staying the same or ignorant of CSR in a complex business environment is greater than the risk of changing (Cumming *et al.*, 2005).

Profitability and market share

Through a study of company stock prices from 1995 to 2003 (Derwall *et al.*, 2005), it was shown that companies that are rated highly in social responsibility significantly outperform companies who are rated low in social responsibility. Their study eliminated or adjusted for factors that can influence stock prices. The factors they controlled were volatility/market risk, size, value versus growth companies, and momentum effects (Derwall *et al.*, 2005).

A couple of things can be concluded from this study. First, investors value companies that are rated highly in social responsibility. When investors do not value a company, that company's stock price will fall and the stock will not perform well, i.e. stock performance is a good, albeit not perfect, measure of company value. Investors are typically interested in stocks that will perform well over a period of time, say five to ten years or longer, so the results of the aforementioned study tell us that investors think that stocks of socially responsible companies will outperform companies that are not socially responsible. The second conclusion from the study is that the financial advantage, at least from a stock performance perspective, of being socially responsible is sustainable, since the study covered an eight-year period. A third conclusion that can be reached is that reputation is sustainable competitive advantage because the reputation of a socially responsible company has a significant positive impact on the stock performance.

Cautions

It would be difficult to find someone who views socially responsible behavior as a negative. However, social responsibility is not without its skeptics. Most arguments against social responsibility boil down to two points. The first argument has its foundation in the agency theory dilemma. The second point is centered on the fact that companies are not sincere

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with their efforts to be socially responsible, and that evil ulterior motives lie beneath the surface (Coors and Winegarden, 2005).

Companies should not allow social responsibility to divert their attention from the main goal, which is to maximize shareholder value or to shed accountability for poor financial performance. Behind the pressure to adopt social responsibility is the profit motive. Putting people before profits is the wrong tactic. Doing the opposite will force competitive businesses to find new markets and make better use of current resources. By doing this, companies provide benefits to customers, employees and the community (Kerr, 2004; Smith, 2005, 2006; Wulfson, 2001).

Companies that choose to be socially responsible may be perceived to engage in what is called unprofitable corporate responsible action by critics of CSR. In the end, companies' behaviors change when consumer preferences change. Social responsibility will exist to the extent that the consumer is willing to pay for it.

According to Coors and Winegarden (2005), the market gives us precisely what we ask of it. An example of this concept is the production of biomass fuel. The claim is that many consumers may prefer to use an environmentally friendly product, but they are not willing to pay a premium for it. If there were a demand for biomass fuel, gas stations would start selling it tomorrow. Government can intervene and give incentives for businesses and consumers to be socially responsible, but the extra cost to do this has the same impact as a tax (Coors and Winegarden, 2005).

Businesses need to be especially cautious when using social responsibility as an advertising campaign. Alsop (2004) declares that corporate reputation has never been more valuable or vulnerable than today. The public has been slow to forgive business for scandals such as Enron. Companies also have to be careful that their promises to be socially responsible are not self-serving or contain hollow promises.

Before companies begin launching new social responsibility programs, they need to recognize that the law of diminishing returns applies. This means that the reward of doing something decreases as the doing of it increases, an example of the law of diminishing returns. Companies do not need to spend endless amounts of money on social responsibility because the rewards for doing so do not exist. The trick is to determine how much money to spend on social responsibility to stay ahead of the competition and to maintain a strong reputation as a socially responsible company.

Simply speaking, a good name can enhance business in good times and protect it during a crisis (Alsop, 2004). This means that companies need to continuously promote a good reputation rather than trying to enhance it only in good times and to do this, they need to realize the importance of a good reputation and socially responsible behavior.

Resource-based view (RBV) and its implications to CSR

Corporate social responsibility is inherently attuned with the resource-based view (RBV) of a firm. RBV asserts that owning or controlling strategic assets leads to a sustainable competitive advantage and superior firm performance (Michalisin *et al.*, 1997, 2000). A strategic asset is defined in the business world as having the ability to be simultaneously valuable, rare, imperfectly imitable and non-substitutable. This definition obviously shows that any tangible asset could not meet this strict definition. For that reason we will focus on the strategic assets associated with firms becoming more adept at CSR.

CSR can take the form of taking care of employees, taking care of the environment, or even extending the interconnectedness of the company with the outside community. A good example of a company significantly benefiting from a successful CSR strategy that paid off with huge RBV benefits is Lincoln Electric (Hastings, 1999). The interconnectedness of the firm with the surrounding community and also the company's superior reputation can be noted through the banks' willingness to renegotiate loan covenants and even extend the existing line of credit. This extension of the line of credit allowed the company to meet payroll and remain a going concern.

It was also the employees who were willing to sacrifice personal time for the benefit of the company, which kept the company in business. In fact, Lincoln Electric even had 450 employees forfeit a combined 614 weeks of vacation! It was the social responsible policy of Lincoln Electric to take care of their employees, which fostered a true connection of the employees with the company. The employees' connection with the company along with the openness of management (two key attributes of RBV) allowed the company to increase per day sales from $1.8 million to $3.1 million. Lincoln Electric was able to capitalize on its culture and employee loyalty to bring all of the necessary components together to save the organization (Hastings, 1999).

From this example we can discern that without the positive culture of the organization, Lincoln Electric surely would have been doomed. The positive culture at Lincoln Electric (developed through years of a successful CSR strategy) still remains their most valuable asset.

Dean (2003/2004) also addressed this by identifying that corporate culture can also be applied as part of the reason for a consumer's perception of a firm's trustworthiness. The corporate values, behaviors and guiding principles are what makes up a firm as part of the RBV, and if those values are strong and community minded as well, the consumer's perception of a firm will be greater than if the corporate culture were lacking.

Corporate trustworthiness is how much a consumer believes in a firm and their actions. If consumers do not perceive firms to have a strong corporate culture, reputation and sense of social responsibility, the trustworthiness of that firm from the consumer's perspective will be decreased. Trustworthiness can be seen as a competitive advantage for firms and it would be in their best interest to gain the trust of consumers. Companies also need to make sure their employees are aware of how their behavior affects the reputation of the organization. In general, stakeholders are waiting to see companies demonstrate more goodwill toward their customers, employees, and local communities (Alsop, 2004; Smith and Lias, 2005). Enhanced reputation is inherently a core attribute of RBV. Being named on of the nation's top 100 companies to work for and the reduction of employee injuries is indicative of a company with highly valued strategic assets (Quinn and Norton, 2004).

Business case for social responsibility

Many companies cite the expenses associated with social responsibility and green design efforts. More progressive thinkers are using terminology such as ''corporate sustainability'' and ''triple bottom-line.'' Corporate sustainability is defined by Wade (2005) as the idea of integrating economic, environmental and social criteria into strategy and management to create long-term shareholder value. The concept has been slow to catch on due to the costs involved in green design.

However, some recent examples highlight the payback or triple-bottom-line thinking. In a comparison of the Dow Jones Sustainability Index and the Dow Jones Global Index, the sustainability index was found to have a 15.8 percent return as compared to 12.5 percent for the global index over a six-year period starting in August 1996. This provides evidence that that socially responsible behavior can lead to long-term profitability (Wade, 2005).

Management can also have short-term profits. West Bend Mutual reduced its electricity costs by approximately 40 percent from $2.16 to 1.32 per square foot by using a green-designed headquarters where individual employees were given control of their own temperature and airflow.

As an added benefit, productivity also increased 16 percent. Boeing experienced similar benefits when they implemented energy efficient ''Green Lights'' in their facility. Lighting electricity has been reduced by 90 percent and will pay for itself in less than two years. Again, another positive side effect included the reduction of production errors due to the improved lighting (Wade, 2005).

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Local ‘‘green’’ scene

Medrad, Inc. (see www.medrad.com/) announced in November 2005 that they would build a new Corporate Center in the Tech 21 Research Park in Marshall Township. The new corporate center will utilize green design. Medrad acknowledges the extra upfront costs associated with green design, but feels the benefits far outweigh the costs. A study was performed by Ellis (2005) to look into the cost-benefit of constructing a green corporate center. The results showed that green buildings seek solutions that maximize overall human, economic, and environmental health and productivity benefits. Green building design strives to balance environmental responsibility, resource efficiency, occupant comfort, and well-being and community sensitivity. Analyzed over 20-year NPV calculations, financial benefits range from $48 to 67 per square foot, which include 25 to 30 percent energy efficiency gains, and productivity gains of up to 15 percent, including reductions in absenteeism and improved work quality. Minimal upfront investment of about 2 percent of construction costs typically yields life cycle savings of over ten times the initial investment (Ellis, 2005).

For example, the Greater Pittsburgh Building Industry has generated more certified green projects than its counterparts throughout the country. Pittsburgh has the world’s first green Convention Center, the first MS in Sustainable Design (Carnegie Mellon University) and the first MS in Green Construction (University of Pittsburgh). The Greater Pittsburgh region has over 2.7 milloion square feet of Leadership in Energy and Environmental Design (LEED) Certified Buildings, and Pennsylvania is second only to California in the number of certified projects. Currently, there are over 40 projects in the LEED system in the state of Pennsylvania.

Other local examples include the PNC Firstside Center. Some benefits included two business units having turnover decrease by 83 and 57 percent compared to a decrease of just 11 percent during the same period for a similar business unit in another building. The features of the Regional Learning Alliance (RLA) at Cranberry Woods include waterless urinals, purchase of green power, non-toxic cleaning products, sunscreens, construction waste recycling and an air quality plan (Ellis, 2005).

General conclusions and implications

An increasing number of studies, both in the practitioner and academic press, show that firms locally are becoming more conscientious of the effects of their socially responsible behavior. Innovative responsible strategy, exceeding government requirements and considering multiple stakeholders, is a long-term objective.

Initially, adoption of CSR burdens a company financially. But, investing resources in charity, environmental protection, and education pays dividends in corporate reputation. Distribution of short-term gains increases the reliability of long-term returns through CSR. A relationship with employees, competitors, consumers, and suppliers is invaluable. Educated owners understand the importance of CSR. Increasingly, investors seek socially responsible firms and not just the highest current financial returns. Sustainability is important to investors, shown through portfolio screens for and mutual funds of CSR adopting companies. The prolonged advantage of CSR ensures sustainable economic advantage and should be a long-term objective of any organization.

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