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MINIMIZING CORPORATE SOCIAL IRRESPONSIBILITY TO MAXIMIZE SOCIAL WELFARE

Christina Kleinau, HHL Leipzig Graduate School of Management
Christian Kretzmann, HHL Leipzig Graduate School of Management
Henning Zülch, HHL Leipzig Graduate School of Management

ABSTRACT

This paper turns traditional ideas about the responsibility of corporations upside down by arguing that it is not conducive to aim to maximize corporate social responsibility (CSR). Instead, corporations should embrace their social responsibility by working to minimize corporate social irresponsibility (CSI). It is more straightforward to minimize tangible sources of business and/or reputational risk, such as environmental damage or child labor in the supply chain, than to maximize a construct for which a generally accepted definition is still pending. What's more, this enables a corporation to use its core business competencies and expertise to maximize social welfare by protecting those societal resources which are relevant to its own value creation process. Thereby, the demand that corporations accept responsibility for a broad range of stakeholders is met but the importance of profits as the fundamental measure of a corporation's capability to create value for society is not undermined. Failing to introduce this conception means maintaining the status-quo whereby the net societal benefit of corporations' CSR activities is questionable and the opportunity costs are high as CSI issues and the detrimental effects thereof on corporations' core business and societal stakeholders will remain unmanaged.

JEL: M14, D60, G38

KEYWORDS: Business Ethics, Corporate Mission, Corporate Social Irresponsibility, Corporate Social Responsibility, Incentives, Risk Management, Shareholder Value Principle, Sustainability

INTRODUCTION

The purpose of a corporation is defined in its corporate mission statement which summarizes how the corporation aims to create value for society and thereby, generate profits for its owners. These two goals are inextricably intertwined because, in order to generate profits, a firm must deliver products and services to the market for which consumers' willingness to pay exceeds the firm's costs of production. Hence, corporate profits do not simply represent the monetary gain that corporate owners receive. In fact, they also reflect the net value for society which a corporation has produced when the cost of inputs are subtracted from the value of the output (Sirmon et al. 2007). This reasoning has led to the old adage that "the social responsibility of business is to increase its profits" (Friedman, 1970/2007, p. 74). This adage is also reflected in the shareholder value principle which states that the purpose of a corporation is to maximize total firm market value (Jensen, 2002) as reflected by the discounted value of the sum of future profits (Brealey et al. 2006).

Nonetheless, the quote from Friedman (1970) continues on to state that a corporation ought "to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom" (Friedman 1970/2007, p. 69). Hence, the profit maximization adage contains the expectation that all the societal costs resulting from the use of input resources are accurately reflected in corporate profits. It is generally expected that corporations will be punished if they externalize costs of production by disobeying law or ethical custom, thereby making it economically unattractive to do so (e.g. Makkai and Braithwaite 1994, Greenfield 2001).

Acknowledging this assumption is integral to the correct interpretation and application of Friedman's (1970) rebuttal of the demand that corporations make some form of 'extra contribution' to societal or environmental causes. Analogously, Jensen (2002) argues that the shareholder value principle "does not maximize social welfare (…) when monopolies or externalities exist" (Jensen 2002, p. 239) and acknowledges that these problems do exist in real markets. Nonetheless, he argues that it is inefficient to request firms "to maximize something else" (Jensen 2002, p. 239) such as charitable contributions. This results from the fact that it is "impossible to maximize in more than one dimension" (Jensen 2002, p. 238) and that it is neither the responsibility, nor the core competency, of a corporation to increase the stock of social and environmental capital in an economy. This argument is supplemented by the observation that quantifying such contributions is a vague and time-consuming exercise (e.g. Vogel 2005). Instead, law making authorities are to be held responsible for resolving social issues (e.g. Jensen 2002, Tyler 2014).

In contrast to this discussion which equates corporate responsibility with shareholder value maximization, there is also an explicit discussion of corporations' responsibility to broader society. Indeed, corporations are dependent on the availability of societal resources such as environmental and social capital to create value. If these resources are not used responsibly, at some point, they will be in short supply (Swallow 1990). In this light, it is logical to argue that because corporations have social power, they, by default, have a social responsibility to use that power wisely (e.g. Dodd 1932, Davis 1960). It follows then that even if a corporation cannot find a way to make an immediate and direct profit from responsible resource use, they nonetheless have a responsibility to make a contribution to maintaining the stock of environmental and social capital over the long term (Deakin 2005). This has led to the specific discussion of corporate social responsibility (CSR) being largely dedicated to discussing how corporations can make a non-profit orientated contribution to society (e.g. Carroll and Shabana 2010, Matten and Moon 2008).

Seemingly, these two logical strands of argumentation regarding the social responsibility of corporations are at a stalemate. This article aims to contribute to creating consensus in the debate by analyzing the strengths and weaknesses of these two approaches and then proposing a reconciliatory strategy based on a two-step argumentation. Firstly, it will be put forward that, given that the assumption that 'all input costs are reflected in corporate profits' does not hold, a corporation has a responsibility to dedicate corporate resources to ensuring that all input costs are internalized so as to safeguard long-term corporate value. Given the significance of the challenge which this responsibility represents, it will be argued that a corporation does not have an additional responsibility to contribute to resolving social issues which do not relate to the corporate mission.

This approach contributes to achieving consensus in the responsibility debate because, by actively identifying and minimizing costs of corporate value creation which are borne by society and the environment, a corporation's contribution to the resolution of environmental and social issues is increased. This precisely entails the demand made by those CSR proponents who argue that a corporation has a responsibility to society extending beyond its responsibility to shareholders. At the same time, the importance of profits as the final measure of a corporation's capability to create value for society is not undermined. Essentially, it will be argued that corporate responsibility means maximizing profits whilst minimizing corporate social irresponsibility (CSI). Following the definition by Kotchen and Moon (2012), CSI "is a set of actions that increases externalized costs and/or promotes distributional conflicts" (Kotchen and Moon 2012, p. 2). CSI is therefore a direct burden on society and constitutes a risk to a corporation's future value – either because the irresponsible use of the resource will mean that it is no longer available for use in value creation processes in future or because of the negative reputational effects associated with the discovery of corporate misbehavior.

This means that in order to embrace its corporate responsibility, a corporation must identify which key inputs to the value creation process are not used in a responsible manner and work to reduce these risks; thereby reducing the prevalence of CSI. In this paper, it will be argued that this maximizes corporations' contribution to social welfare because it utilizes the 'inside' information and competencies which corporations have with regard to the social issues which are most relevant to their core business. Furthermore, it will be argued that this responsibility can be embraced in practice by corporations specifically working to define and implement minimum standards regarding the responsible use of resources. This approach is compatible both with the demand that corporate profits must not be earned at the cost of broader society and with the demand that corporations ought to maximize a single, quantitative objective function – whilst respecting "the basic rules of the society, both those embodied in law and those embodied in ethical custom" (Friedman 1970/2007, p. 69).

The remainder of the paper is structured as follows. Section two provides a brief literature review on CSR. Section three covers the debate on Shareholder Value starting from its origin in the theory of a firm by Jensen and Meckling (1976). In section four, the main proposition of this paper is set out: corporations can maximize their contribution to social welfare by minimizing CSI instead of maximizing CSR. Section five concludes.

LITERATURE REVIEW

Bowen (1953) is generally cited as the initiator of the CSR debate whereby he argued that a businessman is not only responsible for corporate financial performance but also, for other effects which the firm may have on society. Subsequently, Eells (1956) explicitly equated this responsibility to corporate giving and McGuire (1963) inferred that the responsibility of a corporation went beyond adhering to legal standards. Another early contributor to the debate, Walton (1967), emphasized the importance of voluntarily engaging in CSR – despite the difficulties which may be associated with quantifying any return on those activities.

By the 1970's, the practical implication of this discussion had come to mean that businesses were expected to make charitable contributions to society (Carroll 1999). Profit making was seen as a responsibility of business, but was deemed to be self-serving and not a service to society (e.g. Adizes and Weston 1973). It was in this context that Friedman (1970) made the aforementioned contribution to the debate by arguing for the societal value of the profit-making maxim. Nonetheless, Davis (1973) categorically re-butted Friedman's (1970) conceptualization and argued that not only is profit-making not to be considered a sign of a corporation's acceptance of social responsibility, neither is abidance to the law evidence thereof. To claim to be a responsible corporation means to contribute to the resolution of societal problems above and beyond recourse to self-interest (Davis 1973). Sethi (1975) was the first to propose the measurement of "corporate social performance" as a means of tracking corporations' progress in this field whereby social obligation, social responsibility, and social responsiveness would be explicitly measured. Nonetheless, at the conclusion of the 1970's, the CSR debate was criticized for lacking clarity and this was attributed to lack of a clear theoretical or empirical basis (Zenisek 1979).

Carroll (1979) also first presented his definition of CSR at the end of the 1970s, which still finds broad acceptance to date. This definition encompasses the points outlined above whereby the primary responsibility of a corporation is economic but to be truly responsible, the corporation must respect the law and ethical custom in its economic value creation processes – and then make some additional contribution to society which does not necessarily directly relate to economic value creation (Carroll 1979). Whilst vivid academic discussion of CSR continued throughout the 1980s and 1990s, it largely turned to the operationalization and measurement of CSR (Carroll 1999). Throughout this time, authors continually reaffirmed that profit generation could be seen as a service to society (e.g. Carroll 1999, Drucker 1984). Nonetheless, profitability was effectively excluded from the debate as economic value creation could be directly measured via profits and required no further attention. Determining how to operationalize and measure a corporation's legal adherence, ethicality and benevolence presents a far greater challenge.

To date, the search for the 'business case' for CSR is cited to be the "holy grail" (Devinney 2009) of academic research on the topic. Ironically, this equates CSR to issues which are generally considered to lie outside of corporations' profit making responsibilities - whilst at the same time acknowledging that it would be irresponsible to expect corporations to undertake activities which jeopardize their ability to make profits. After all, a corporation which is not profitable cannot possibly make any 'additional contribution' to charity. Nevertheless, Carroll and Shabana (2010) cemented the position that the core of CSR relates to non-core business issues by arguing that the ethical and philanthropic responsibilities, which were deemed to be 'expected' and 'desirable', respectively, in Carroll's (1979) definition, actually ought to be seen as "the essence of CSR" (Carroll and Shabana 2010). In this way, the CSR debate was placed firmly outside of the mainstream business discussion – despite a lack of theoretical justification for the feasibility of this argument.

The lack of suitability of this approach for maximizing social welfare is clearly evident in business practice whereby CSR departments of corporations are simply appendages – or CSR is even outsourced to an external agency – and hence, CSR activities do not make use of corporations' unique, core competencies (e.g. Bruch and Walter 2005). Furthermore, this is a problem in light of the conclusion of the previous section that corporations require guidance as to how to deal with legal and ethical responsibilities which, if not embraced, constitute a threat to their ability to continue to create value for society on the basis of their core business activities (i.e. according to their mission statement). Porter and Kramer (2011) made a significant contribution to this debate by arguing that CSR activities ought to utilize corporations' core competencies and hence, be conducive to the creation of long-term value. Nonetheless, this contribution is still constrained to the paradigm that the business case for CSR - in terms of a positive return on ethical activities - needs to be determined.

It is only recently that the CSR discussion has come to consider that the true value of embracing corporate responsibility may lie in avoiding irresponsibility in the core business (e.g. Lange and Washburn 2012, Lin-Hi and Müller 2013). Indeed, it is somewhat counter-intuitive to argue that the most effective way for a corporation to demonstrate its responsibility is simply to ensure that it is not irresponsible. Nonetheless, if major issues in regard to corporate responsibility such as the financial crisis or the Deepwater Horizon disaster are considered, it can be argued that it is, in fact, evidence of corporate irresponsibility which leads to corporations being accused of failing to fulfill their role in society (Blankenburg et al. 2010). It is argued that it is precisely because the avoidance of irresponsibility is a basic societal expectation that evidence of CSI is so damaging to corporations' societal acceptance (Brammer 2005).

What's more, the complexity of issues such as the financial crisis, climate change or child labor in the supply chain suggests that it is no mean feat to manage these issues (Prieto-Carrón 2006). As stated above, the value which a corporation creates for society is effectively measured in monetary terms by the corporate revenue. Evidence of CSI in the use of resources, such as environmental damage or the exploitation of workers, suggests that not all the societal costs of value creation are as effectively measured (Hahn and Figge 2011). This observation bears witness to the problem that adherence to the plethora of laws and ethical customs in a globalized economy simply cannot be taken for granted (Minor 2011). At the same time, it is vital that challenges in these areas are met so that corporations can maintain their ability to create value for society. Hence, avoiding CSI is a conception of CSR which can be expected to find widespread acceptance in business practice and therefore, can also be expected to effectively contribute to the ultimate aim of CSR of ensuring that corporations are responsible members of society.

Shareholder Value Debate

The theoretical foundations for the Shareholder Value Principle (SVP) were laid by Jensen and Meckling (1976) who argued that the owners of a firm (i.e. shareholders) need to ensure that managers, as shareholders' agents, do not have an incentive to exploit shareholders' inability to perfectly observe and control agents' behavior. Hence, it was concluded that managers' incentives ought to be tied to firm value. Fama (1980) extended the analysis by arguing that both managers and shareholders contribute to the firm's survival in the competitive environment - managers make decisions and shareholders bear risk. What's more, it was argued that due to the illiquidity of managers' human capital as compared to shareholders' liquid financial capital, managers have a more significant interest in the long-term survival of the firm than shareholders (Fama 1980). Accordingly, the prioritization of shareholders' interests over managers' interests does not guarantee the long-term survival of the firm, per se.

However, under the assumption of market efficiency, Fama (1980) argued that share market prices represent the best assessment of long-term firm value based on the skills of the current management. Share prices are thus an effective means of valuing management's human capital. Therefore, a decrease in share price may be interpreted as a decrease in the market value of a manager's human capital and may lead to a manager being removed from his position (Jensen and Murphy 1990). Jensen and Murphy (1990) also explicitly champion the importance of managers being rewarded for delivering more value to shareholders and punished for their inability to do so by tying their compensation to stock prices.

In culmination, these theoretical considerations suggest that the SVP is the best way to ensure that a firm fulfills its goal of investing capital in projects which generate societal value, and therefore also shareholder value - as opposed to allowing managers to expend capital on frivolous consumption or charity (e.g. Rappaport 1986, Scharfstein 1988). This theoretical conception has achieved widespread acceptance in business practice (Stout 2012). However, in the wake of the major accounting fraud scandals such as at Enron and Worldcom, criticism of the incentives set by the SVP started to emerge (e.g. Langevoort 2002). The main points of criticism include i) that it has led managers to manipulate the communication of information to the financial markets (e.g. Graham et al. 2005), ii) that it has led managers to neglect other stakeholders' interests (e.g. Charreaux and Desbriéres 2001) and iii) that it has led investment to be skewed in favor of projects which pay out sooner rather than later - contingent upon the design of managers' bonus-plans (Watts and Zimmerman 1978).

The single most significant figure in all standard equity valuation models is the most recent quarterly earnings figure (Brealey et al. 2006). Hence, managers have a strong incentive to exploit loopholes and well-founded freedom in accounting regulations to ensure that they reach quarterly earnings targets (Guidry et al. 1999). In a survey of 401 financial executives, Graham et al. (2005) find that the majority of executives believe that the earnings per share is the single most important figure for stock analysts and investors. On this basis, 78% of executives declare that they manage accounting disclosure to meet analysts' expectations and that 77% of executives believe that if they do not meet earnings expectations, it could cost them their job (Graham et al. 2005). Therefore, in the short-term, a share price rise can be induced by managing earnings figures – but in the long-term, it can be reasonably expected that the lack of real societal value creation will be exposed and the share price will decrease again (ceteris paribus).

Charreaux and Desbriéres (2001) argue that so long as shareholders alone hold the power to remove managers from their position as a consequence of unsatisfactory performance, in a difficult economic environment, managers have an incentive to re-direct rents from other stakeholders to meet shareholders' expectations. In this case, residual risk is effectively transferred to less powerful stakeholders such as lower-ranked employees (who can be made redundant) or the environment (which can be harmed via less cautious – and less expensive - waste disposal methods) (e.g. Mitchell 1997). However, these stakeholders are vital to the long-term success of a corporation. This exemplifies how promises to generate returns in the short-term can take precedence over the necessary commitments for continuing to be able to generate returns in the long-term. The strategy of using less powerful stakeholders as scapegoats is clearly unsustainable as these stakeholders - who have contributed to value creation in the past - are unlikely to be willing and able to continue to do so in future (Wheeler et al. 2003).

The point of criticism that the SVP skews a corporation's investment portfolio towards projects that pay out in the short-term refers to the fact that managers' careers with a corporation are limited. Hence, so long as the SVP dictates that their incentives are linked to share price, it is logical for them to have a preference for projects which will have the largest, immediately quantifiable effect on share price (Watts and Zimmerman 1978). In theory, share prices measure the value of a corporation as a going concern. However, it is exceedingly rare for financial valuation models to make explicit cash flow forecasts for a time period greater than 10 years in the future as uncertainty is too great. Instead, a terminal value is calculated and positive cash flows from projects with an investment horizon of more than 10 years are not explicitly reflected in the valuation. Consequently, managers are able to maximize their performance oriented bonus by neglecting investments in projects which will pay out in the long-term (i.e. >10 years) - but are reflected in current earnings as a cost (Rawls 1971, Parfit 1984, Liedekerke 2004). Graham et al (2005) find that 55% of managers are willing to sacrifice economic value and incur future costs so as to meet a short-run earnings target. Once again, this represents a disinvestment in societal value creation when the long-term horizon is considered.

The points of criticism outlined above have in common that management prioritizes short-term concerns over long-term concerns. This problem is widely discussed in business practice and has come to be known as "short-termism" (Laverty 1996). Hence, it seems that implementation issues have hindered the theoretical conception of the SVP from attaining its goal to optimize long-term value creation. What's more, the three arguments above suggest that the issues which hinder the effective realization of the SVP are legal/ethical in nature – e.g. regarding honest disclosure or the protection of important (but exploitable) stakeholders' interests.

This is hardly surprising given that the globalized nature of the modern business environment has meant that the setting of legal boundaries for business has become increasingly challenging – as has defining reasonable ethical expectations (Basu and Palazzo 2008). However, these issues were simply not perceived as such significant potential problems by the original advocates of the SVP. Nonetheless, discussion of 'environmental risks' such as climate change or 'reputational risks' such as the exposure of child labor in the supply chain suggests that, in a globalized economy, corporations may indeed need to invest in managing social and environmental problems in order to protect their ability to generate profits in the long-term. Such issues are generally considered to be constituents of the CSR debate and hence, the following section reviews the development of this debate so as to analyze what theoretical insights are available as to how corporations may deal with social and environmental issues.

MINIMIZING CORPORATE SOCIAL IRRESPONSIBILITY

The above analysis of the two, seemingly contradictory, discussions of corporate responsibility (whereby the former discussion emphasized the responsibility of corporations to broader society whereas the latter discussion emphasized the responsibility of the corporation to its shareholders) has shown that, in fact, they share a strong degree of commonality (see also Husted and Salazar 2006). In a globalized economy, corporations can earn short-term gains by externalizing costs to the environment or other stakeholders who lack bargaining power but who, nonetheless, do make an important contribution to long-term value creation. Given the global nature of these sorts of issues, the call on behalf of non-governmental organizations and society at large for corporations to play a role in mitigating these issues has been loud - but it lacks direction. Hence, its importance has not been systematically embraced by the corporate actors who are in a position to take action (e.g. Archel et al. 2011, Cooper and Owen 2007). Instead, corporations attempting to appease these calls have been led to try to embrace CSR by making charitable donations – whilst simultaneously struggling with CSI issues in their core business. Over the last decade, progress in regards to resolving global, social issues has been negligible (Dyllic and Hockerts 2002) and the economic turmoil of the latter half of the past decade has seriously tested the sustainability of the economic progress witnessed in the early 2000s (Hall 2010).

To further clarify the distinction between 'maximizing CSR' and 'minimizing CSI', doing good and avoiding bad will be differentiated (see also Lin-Hi and Müller 2013). Doing good ("dG") can be defined as actions which surpass legitimate legal and ethical expectations (i.e. over-fulfillment). Such actions are easily communicable to external stakeholders (such as customers) because they are presented openly as a means of signaling. Signaling originates from contract theory and deals with the information transmission among two parties to resolve the issue of asymmetric information (Spence 1973). Generally, dG takes the form of charitable donations to a good cause such as the construction of basic infrastructure in developing nations. By doing so, the firm sends a signal that reveals potentially useful information to the customer (e.g. "We care for others"). Given that piece of additional information that the customer might otherwise not have, the purchasing habits can be altered (Luo and Battachrya 2006). For this reason, dG is oftentimes closely connected to a firm's advertising strategy (Varadarajan and Menon 1999). Ceteris paribus, a new signal of trustworthiness and benevolence to customers can be expected to increase sales or the willingness to accept higher prices (Bhattacharya and Sen 2004).

Avoiding bad ("aB") can be defined as corporate actions dedicated to improving corporate behavior in areas in which legitimate legal and ethical expectations are not met. aB cannot be used effectively as a signal as it is generally taken for granted by stakeholders (Lin-Hi and Müller 2013). In this case, if communicated, it may well awaken suspicions which stakeholders did not originally have – e.g. consider the slogan: "Our sales staff do not pay bribes to politicians". What's more, the corporation may well suffer negative consequences of honest communication. E.g. launching a campaign with the slogan "Our sales staff no longer pay bribes to politicians" would likely attract a legal investigation and subsequent punishment if it were proven that the corporation had indeed paid bribes in the past. Nonetheless, in contrast to dG, aB deals with immediate consequences of a firm's core business. 'Bad' can, by definition, only be avoided where it has previously been caused in the revenue generation process of a corporation – and thus, aB addresses issues which, in time, are increasingly likely to threaten a corporation's core value creation processes. What's more, aB requires a firm to actively reflect on which aspects of its core business are not in harmony with societal expectations and values. The 'status-quo' of legal and ethical standards effectively defines what society values.

This paper argues that finding a way to implement the minimization of CSI into a corporation's core business processes is vital to ensure that corporations' contribution to societal value creation is maximized. Corporations evidently must use resources in order to create value but the use of resources can occur in a responsible or an irresponsible manner. Using resources irresponsibly constitutes a risk to the profitability of a corporation's core business and is detrimental to society and/or the environment. Hence, in the following, it will be argued that avoiding CSI resolves the contention in the SVP versus CSR debate by first exemplifying why corporations ought to concentrate their 'CSR efforts' on detecting and minimizing CSI in their core business and then discussing how this strategy can be realized in practice.

<u>Why – Optimal Use of Resources</u>

Based on the fundamental production theory in economics, the goal of corporations and individuals is to make use of resources in an optimal way in order to increase their utility (e.g. by means of consumption or profit generation). As resources are limited, allocation decisions need to be made. McWilliams and Siegel (2001) address the issue of coping with scarce resources for CSR in the context of the theory of a firm. They hypothesize that, given the specifications of a firm and the structure of the environment under which it operates (e.g. size, labor market conditions), there is an ideal level of CSR and this level is derived by means of a cost-benefit analysis (ibid.). The additional costs which occur due to the corporation's societal commitment must be exceeded by an increase in revenue (ibid.). However, this approach of determining optimality is incomplete because 'avoiding bad' by adhering to the law is taken as being self-evident and not incorporated into the analysis. In reality, particularly large corporations that devote substantial amounts of money to go "beyond obeying the law" are found not to comply with basic standards (e.g. Chatterji and Listokin 2007, Lange and Washburn 2012). Strike et al. (2006) put forward that it is common for large firms to be socially responsible and irresponsible at the same time. Hardly any corporation is entirely good or entirely bad. Additionally, it is found that this coexistence is strongly related to the degree of international diversification (Strike et al. 2006).

In the following, it will be argued that the traditional approach of rewarding firms for (voluntary) pro-social behavior mis-incentivizes corporations and needs to be replaced by a conception of CSR that punishes anti-social behavior. It will be exemplified that corporations' are able to generate a more significant long-term benefit from their 'CSR activities' if they aim to minimize CSI in their core business. This approach is superior to the traditional conception of CSR whereby corporations make some non-core business related charitable contributions because it protects key inputs to corporate value creation activities. From a societal point of view, corporate knowledge, time and monetary resources are used more efficiently as the unique value creation structures which corporations possess can be effectively channeled towards the resolution of social issues. Furthermore, minimizing CSI is optimal from an individual corporation's point of view because it mitigates the conflict between maximizing profit and making a positive contribution to society. As discussed above, CSR as 'doing good' has encouraged corporations to undertake flagship projects which have little or nothing to do with their core business (Van Rekom et al 2013). Meanwhile, as emphasized in the discussion of the SVP, corporations are currently being criticized for 'short-termism' whereby managers are considered to succumb to incentives to prioritize short-term financial interests at the expense of societal or environmental stakeholders - who may well be important for long-term value creation (Snyder 2010).

In this context, the case of Nike Inc. can be considered as a prominent example. As a leading global producer of sports equipment and apparel, Nike was among the first targets of public campaigns against corporate irresponsibility (Business Insider 2013). In the 1990s, Nike had one of the world's largest advertising budgets and engaged in social projects such as supporting adolescent girls in developing countries (Nike 2008). Despite these activities and the aggressive promotion of Nike's image as the global leader in sports equipment and apparel, civil society continued to criticize Nike's poor labor standards (e.g. using sweatshops to produce their goods) (The Guardian 2011) and environmental irresponsibility (BBC 2011). None of the charitable causes which Nike supported were related to their core business or the impact which conducting their core business had on society (e.g. their sub-contractors' employees) or the environment where they operated. Until the end of the twentieth century, Nike refrained from undertaking progressive organizational changes but nowadays, Nike's strategy is to turn these threats into opportunities (Nike 2013). The company aims to differentiate itself by designing its products such that the use of materials is minimized – thereby creating less waste (ibid.). The materials themselves are also chosen to be more environmentally friendly (ibid.). Whilst Nike arguably still has a long way to go to appease the expectations of all societal stakeholders, the understanding that no amount of dG can make up for the externalization of costs resulting from irresponsible resource use seems to have been strategically embraced.

In an academic context, Van Rekom et al. (2013) argue that CSR initiatives do not have a noteworthy long-term impact if they are not directly related to the core business of a firm. This represents a loss of opportunity because a corporation that engages in peripheral (i.e. non-core business related) activities does not make use of its core competencies and expertise (Coombs 1996). If corporations embrace the aim of 'avoiding bad' rather than supporting miscellaneous 'good causes', the scope of actions that a corporation can undertake in order to embrace its social responsibility is focused. The expectation is that thereby, the corporation does not engage in peripheral activities which might be outsourced to CSR departments but rather, focusses on activities that are linked to their core business. At first glance, this appears to be a reduction of opportunities for a firm to do good and use this as a means of marketing – and indeed, it is. However, research has proven that the credibility of CSR initiatives is higher for those projects that are closely linked to a firm's products, geographical location and operations (e.g. Du et al 2011). In relation to the Nike Inc. example above, it is reasonable to assume that Nike is well informed about the quantity and quality of materials needed to produce sporting goods and apparel. It is less intuitive to expect that Nike can create value for adolescent girls in developing countries.

All in all, in a world in which governments are not able to ensure that corporations internalize all negative externalities and where they are not examined in CSR assessments (because the focus is placed on voluntary beneficial actions rather than on non-compliance with self-evident regulations), corporations have incentives to maximize their profit at the expense of their stakeholders. However, this cannot occur on a sustainable basis – i.e. externalizing costs has negative implications for social welfare and therefore, is detrimental to long-term value creation (Demsetz 1967). Hence, we argue that firms should focus on detecting and avoiding negative effects of their core business (i.e. their key areas of revenue creation) rather than focusing on areas that are peripheral to their daily business. This enables firms to use their expertise and core competencies and is an important investment in their long-term profitability.Based on this argument that aB is the more effective way for an individual corporation to maximize its welfare than by pursuing dG, this section addresses the optimality of the strategy from a societal point of view. It will be shown that the conception of CSR that prioritizes 'doing good' provokes simultaneous over- and under-fulfillment of legal and ethical requirements. This, in turn, leads to an inefficient allocation of corporate resources and produces a sub-optimal state of social welfare.

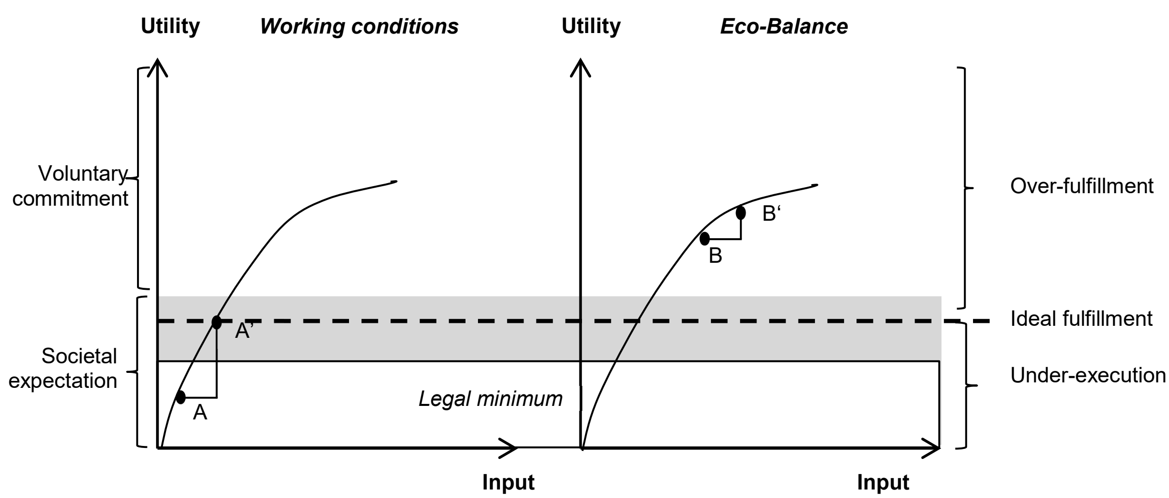
As mentioned above, it is not uncommon for firms to fail to comply with legitimate legal and ethical expectations in certain areas whilst simultaneously over-fulfilling expectations in other areas. Moreover, cases are documented in which firms consciously decide to act highly benevolent in some field in order to create a buffer for future misconduct in other areas (Minor 2011). Corporations that are conscious about their public image face two options - they can either minimize CSI (in line with our suggestion) or they can use CSR to compensate for anti-social actions which leads to the coexistence of over- and under-fulfillment (Kotchen and Moon 2012). Unfortunately, this practice of offsetting leads to a state in which aspects that are highly visible to the public are over-fulfilled and widely promoted whilst other important investments in the maintenance of societal resources are neglected - and this is intentionally kept out of the public eye (Wagner 2008). If the concept of minimizing CSI is embraced, corporations are no longer incentivized to misuse their CSR commitment to cover up or offset irresponsible behavior. This meets the cry for increased acceptance of social responsibility expressed in the academic debate on CSR.

In the following, the efficient allocation of resources for the purpose of maximizing social welfare will be discussed whereby social welfare refers to the aggregate utility of a society. In this way, different states of economies that result from a variation in the supply or allocation of resources can be compared (Bergson 1938). For the purpose of this analysis, we assume that a firm can create a bundle of actions to increase welfare that consists of the two components: doing good (dG) and avoiding bad (aB). Accordingly, we define a firm's effort to be allocated efficiently if substituting dG and aB cannot increase the total social welfare any further.

Under the current conception of CSR, certain aspects which are mostly unrelated to the core business are voluntarily over-fulfilled such that legitimate legal and ethical expectations are exceeded. However, as revealed in the fundamental economic principle, utility and thereby social welfare as the sum of all individuals' utility, increases with each additional input unit but the marginal utility diminishes (Mankiw 2011). While the first unit of input yields the highest gain in utility, the second leads to a smaller, yet positive, change that is followed by a continuing reduction.

It is sometimes argued that any effort of 'doing good' made by a corporation, (regardless of how small the incremental benefit is) is good. However, this point of view does not take account of the opportunity costs of dG. Resources which are dedicated to dG cannot be dedicated to aB. If a corporation is completely compliant and fulfills legitimate legal and ethical expectations in all areas, CSI would not exist and the opportunity costs of dG would be non-existent. In any other case, a more significant benefit for society could be generated by aB instead of dG and hence, there is an opportunity cost associated with dG so it is not simply good, per se. Figure 1 provides an illustrative example of the impact on societal utility which an increase in working conditions has versus an improvement of a firm's eco-balance. Relevant thresholds for judgements are in the order of the level of potential fulfillment: legal minimum, societal expectation, and voluntary commitment. These thresholds correspond to a utility-based evaluation as either under-execution, ideal fulfillment, and over-fulfillment. Based on the fundamental economic utility function, one can see that, in this example, increasing working conditions, which are still under-executed in terms of not yet fulfilling societal expectations, corresponds to much a higher incremental utility than in the area of eco-balance where the company has already achieved a state of over-fulfillment which exceeds societal expectations. However, as argued above, if maximizing CSR is the basis for the evaluation of firms, they are more likely to choose the smaller gain in utility which corresponds to higher public attention.

Figure 1: Illustration of Societal Utility Generation Relative to the 'Ideal Fulfilment' of Legal and Ethical Expectations



To continue the example: Let us assume that Firm X desires to be regarded as socially responsible and is evaluating its investment opportunities. Further, assume that Firm X has to decide whether to increase the stringency of its controls on the working conditions of its international sub-contractors or whether to improve the eco-efficiency of its flagship office in its home country. For the same investment sum, a shift from point A to A' (in terms of working conditions) or a shift from B to B' (in terms of eco-balance) would be feasible. Firm X suspects that many of their international sub-contractors bribe the local auditors who are employed to ensure that Firm X's ethical labor standards are maintained and hence, social welfare could be significantly increased by an investment in monitoring laborers' working conditions more closely. It is widely acknowledged that many laborers in developing nations are poorly treated and that corruption is highly detrimental for economic development (Theobald 1990). However, there is no obvious evidence of mishandling in Firm X's supply chain and the firm expects that no stakeholder will investigate the issue. Meanwhile, the illustration of the eco-balance curve suggests that the potential for Firm X to increase social welfare by improving the eco-balance is limited. This can be interpreted such that Firm X's core business already has a relatively minimal impact on the environment. Yet, the investment in eco-efficiency is readily communicable to stakeholders and likely to be valued in CSR rankings.

The question now is: What is optimal from a societal perspective? As one can deduce from the illustration, the marginal societal utility gain (that is, the first derivative of the concave utility function) is much higher for the investment in closely monitoring working conditions. However, Firm X aims to generate signals of their responsibility. As stated above, aB is far more challenging to communicate and under the current, widespread understanding of CSR, it is not covered in CSR rankings. Hence, given that dG has a higher visibility and aB is taken for granted and offers little or no opportunities for positive publicity (Consider: "Since the beginning of this year, we have actually ensured that all our production facilities comply with our ethical labor standards!"), the firm is likely to invest even further in their eco-balance. Thereby, the potential societal gain of enforcing higher labor standards is foregone. What's more, this occurs unbeknownst to shareholders with a long-term orientation who bear the consequences if, at some future date, the corporate misbehavior is exposed.

Concluding, corporations' attempts to embrace their social responsibility are oftentimes not driven by what is the management's fundamental intention (e.g. derived from their corporate mission) but rather aligned to the current public perception of what is good. The current perception in turn leads to a sub-optimal state in which corporations strive for voluntary over-fulfillment (dG) in some areas whilst neglecting negative consequences of their actions in other areas (not aB).

How – Establish Minimum Standards

It was argued above that the key difference between 'doing good' and 'avoiding bad' is whether the legitimate legal and ethical expectations are under- or over-fulfilled. Hence, it begs the question how 'legitimate expectations' ought to be defined (see also Suchanek 2012). The technical definition of 'minimum standards' can be conceptualized as the point where the utility curve stops increasing so dramatically (i.e. where the second derivative of the utility curve is 0), as indicated in Figure 1. In a society with well-defined laws and effective enforcement mechanisms, legal standards effectively constitute the minimum standards regarding what is irrefutably valued in that society (Rawls 1971). E.g. nations with a legally defined minimum wage can be said to have a higher 'minimum standard' for equality, i.e. equality is valued more highly than in nations without a legally defined minimum wage. Thus, legal standards are a first, inviolable reference point for defining 'legitimate expectations'.

In this way, CSR can be conceptualized as corporate governance or compliance (e.g. Aguilera et al. 2006, Jamali et al. 2008). Under the assumption that legal standards are indeed effectively enforced, the costs of the sanctions associated with non-adherence ensures that profits, and thereby shareholder value, are maximized when corporations maintain these standards (Greenfield 2001). Diverse corporate governance instruments exist to ensure that managers and employees abide by legal standards (Harjoto and Jo 2010). However, in today's globalized economy, adhering to legal standards is not sufficient to ensure that a corporation's ability to create value for itself, and for society, is protected (e.g. Jensen 2002, Strike et al. 2006). In many countries, legal standards are either not defined or not enforced (Low and Yeats 1992). Therefore, corporate governance mechanisms have developed to include such instruments as codes of ethics or voluntary commitments to soft law initiatives such as the UN Guiding Principles on Business and Human Rights (Berglöf and von Thadden 1999).

Nonetheless, as argued above, this approach of standards being 'inflicted' on corporations has been insufficient to guarantee compliance and thereby, the achievement of societal goals. Violation of soft law initiatives such as the UN Guiding Principles on Business and Human Rights is an example of the possibility for a corporation to exploit societal resources – without having to take full account of the cost of the use of that resource in monetary terms (Campbell 2007). It is vital that the issue of corporate responsibility is not limited to the compliance discourse so as to account for the fact that if a corporation's international operations do not comply with the ethical expectations of its main sales market, it can and, likely, will be held responsible for this (Epstein and Roy 2003). Hence, corporations are not simply 'expected' to comply with ethical expectations. They also have a long-term strategic interest in doing so.

A large portion of society considers it to be ethically unjustifiable to take advantage of the lack of an effective legal system in overseas markets to externalize production costs to societal stakeholders and this portion of society will expect corporations to act accordingly (e.g. Freeman et al. 2004). In terms of the graphs in Figure 1, this means that the standard of 'ideal fulfilment' according to societal expectations is above the legal minimum. However, there is no universally defined societal utility curve of which the second derivative could be found so as to determine the universally ideal minimum standard. This means that harmonizing the SVP and CSR discussions as this paper proposes, is vital for clarifying and implementing the insight that adhering to minimum standards protects a firm's ability to create value long-term. The likelihood that a firm will be held accountable for violating legitimate expectations can be increased if, instead of making contradictory demands on corporations as is to the case if the traditional conception of maximizing CSR is relied on to define corporate responsibility, the focus is laid on minimizing CSI. This will increase the incentive for corporations to consider their ethical responsibilities from a core business perspective and dedicate their unique resources to resolving these issues – thereby managing potential threats to their value creation activities.

In this context, King (2007) argues for the value of dialogue between corporations and social interest groups in order to develop a strategy for dealing with social issues in the absence of a governmental authority. Though King (2007) emphasizes the productive benefit of this form of stakeholder interaction, we wish to emphasize the reduction of the risk of significant negative effects. This approach adds a certain - as we argue, vital - focal point regarding which issues corporations ought to concentrate their efforts on. In regards to the aforementioned issue of labor standards, those corporations which are exposed to the greatest risk of negative consequences from the issue have the highest responsibility to campaign for the implementation of effective minimum standards. In this case, societal scrutiny on labor issues is likely to be directed at a discount clothing manufacturer (whereby the business model entails an intense pressure to reduce costs) or a well-known, worldwide brand such as Nike (whereby the publicity scandal is assumed to be greatest). These corporations not only have a social responsibility to manage this particular risk, but also a responsibility to their shareholders to do so.

In an academic context, McWilliams et al. (2002) also emphasize the potential for corporations to generate and protect a competitive advantage by lobbying for the implementation of certain regulatory standards which competitors do not yet have the capability to comply with. Those corporations for which a social issue poses the biggest threat to their core business ought to be the 'market leaders' in managing that issue. In this way, corporations which are best informed about societal problems, e.g. where current laws and standards are either set too low or are not enforced, can contribute most constructively to minimizing the threat to their core business. Similarly, Brammer et al. (2012) observe the importance of introducing institutional theory to the 'mainstream' CSR discussion given that institutions evolve to embody and enforce the 'status quo' of society's expectations of corporate ethics. Douglas North, a core proponent of institutional theory, defines institutions as "the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction" (North 2006). Explicitly defined and enforced minimum standards are a prominent example of an institution.

Currently, examples of negative externalities abound and the societal costs of corporate value creation are, unfortunately, widely observable. Hence, it is vital that institutions are introduced to manage problems of human interaction which create externalities. However, this evolution will not occur by chance. It requires investment such as in targeted dialogues and indeed, 'investment' is the key word. Given that the payoff of specific investments to remedy observable negative effects of corporate value creation processes is uncertain, corporations which endeavor to do so initially suffer a competitive disadvantage due to the cost of the investment (Pies et al. 2009). Yet, if a corporation fails to embrace its responsibility, this means that important business risks will not be managed and this can also be expected to be associated with significant costs in the future. Thus, whilst the strategy of minimizing CSI requires the use of resources, it is indeed an investment. There is a business case for risk management. By contrast, dedicating resources to societal causes which are unrelated to corporate value creation activities is difficult to conceptualize as an investment. It is for this reason that evidence of a firm's quantifiable benefit as a result of its social commitment is referred to as the (mythical) "holy grail" (Devinney 2009) of CSR research. Hence, corporations do not have a responsibility to make charitable contributions.

The business case for minimizing CSI lies in the fact that using key resources irresponsibly is a risk to a corporation's value creation activities. Nonetheless, inherent to the concept of risk is the fact that the benefit of averting a crisis effectively remains immeasurable. The cost of a crisis is only quantified when that crisis occurs. Even so, in crisis situations, costs are, by definition, immense and shareholder value is significantly negatively affected. For example, in hindsight, BP's decision to save costs by compromising on technical safety standards at the Deep Water Horizon oil rig did not maximize shareholder value (Lin-Hi and Blumberg 2011). Though indeed, the probable costs of such 'ethical risks' materializing is often not explicitly calculated as this is an exceedingly challenging undertaking (Skogdalenn and Vinnem 2011).

The difficulty of quantifying the uncertain cost of ethical risks explains why it is important to draw on insights and combine both the SVP and CSR discussions. As emphasized above, the SVP (which is very quantitatively oriented) has led to short-termism and neglect of the long-term cost of externalities and ethical risks to (future) shareholders. Simultaneously, the CSR discussion has become detached from the 'survival condition' of profitability for all corporations. Aiming to minimize the sources of CSI which pose the biggest threat to a corporation's core business via the establishment of minimum standards synthesizes the strengths and overcomes the weaknesses evident in the two (competing) approaches to corporate responsibility.

CONCLUDING COMMENTS

Turning the traditional approach to CSR upside down, as this paper seeks to do, makes corporate responsibility a core business issue which is relevant for all stages of corporate value creation. This means that corporate responsibility is not simply a task which can be outsourced to a specialized department or consultancy firm as it requires intimate knowledge of the risks associated with the core business. What's more, it implies that, unlike the approach of maximizing CSR, minimizing CSI is systematically compatible with the long-term profit maximization principle. In the words of Rupp et al. (2011) who argue for a synthesis of the responsibility-profitability discussion due to the positive motivational effects, CSR ought to stop "being a set of practices organizations feel pressured by external groups to carry out and starts becoming a set of practices that represent a manifestation of the organization's and stakeholders' shared values" (Rupp et al. 2011, p. 5).

Aiming to minimize CSI reduces the complexity of potential managerial actions with regard to embracing corporate responsibility as it provides a distinct focus as to how resources can be used most efficiently. It is more straightforward to minimize tangible sources of business and/or reputational risk, such as environmental damage or child labor in the supply chain, than to maximize the construct of CSR which "can mean anything to anybody" (Frankenthal 2001, p. 20). What's more, reflecting on reducing CSI eliminates the temptation to misuse CSR to generate quick (reputational) wins – whilst failing to manage long-term threats to the profitability of the core business. By interacting with stakeholders to establish realistic minimum standards, the most important social issues which the corporation has the power – and the incentive – to influence can be identified and dealt with.To be sure, the idea of minimizing CSI still faces significant head wind. As mentioned, corporations are understandably disinclined to bring attention to those issues whereby societal resources are used most irresponsibly. In this way, it is vital that it is not only corporations who embrace the strategy of minimizing CSI – but also broader society (Sethi 2003).

Governmental and non-governmental organizations need to be prepared to discuss and show understanding for the challenges which corporations face in attempting to embrace their corporate responsibility on a global scale. At the same time, civil society needs to develop the strong expectation that corporations are prepared to discuss these issues and cease to expect that corporations make some, easily communicable contribution to resolving diverse social issues.

Similarly, in this conception, shareholders are expected to see the strategy of minimizing CSI as an investment in maintaining and maximizing long-term value creation. This means that those corporations who have a high proportion of shareholders with a short-term orientation are less likely to be able to successfully implement the strategy. This challenge is also mirrored on an individual level. Those employees who are best informed about social issues are likely to have the highest disincentive to approach the issue. For example, a supply chain manager will obviously be reticent to approach their seniors to discuss the high number of child laborers which they are responsible for. So long as an employee does not expect negative consequences to result from a social issue whilst they are responsible for it, their ethical incentive to draw attention to the issue will be weighed against the need to consider the negative consequences of doing so, which may even be so extreme as to involve legal repercussions or job loss.

Nonetheless, the significance of these challenges decreases as the level of understanding and acceptance for the strategy of minimizing CSI increases. In this vein, this paper has sought to exemplify the desirability of the conception from the perspective of an individual firm and society. This conception of minimizing CSI enables a corporation to use its unique resources to maximize social welfare by protecting societal resources - and this simultaneously enhances its ability to generate profits over the long-term. Failing to introduce this conception means maintaining the status-quo whereby the net societal benefit of corporations' CSR activities is questionable and the opportunity costs thereof are high as CSI issues will continue to plague corporations' core business and societal stakeholders.

Abbreviations

aB	avoiding bad
dG	doing good
CSI	Corporate social irresponsibility
CSR	corporate social responsibility
SVP	shareholder value principle

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BIOGRAPHY

HHL Leipzig Graduate School of Management
Jahnallee 59
04109 Leipzig, Germany
Phone ++49-341-9851701

Christina Kleinau, christina.kleinau@hhl.de. Christina Kleinau is a Research Associate at the Dr Werner Jackstädt Chair of Economic and Business Ethics at HHL Leipzig Graduate School of Management in Leipzig, Germany. Her core research interest is ethics in finance but she also works on the broader topic of corporate responsibility in any industry as well as more specific issues such as the implications of agricultural commodity speculation for sustainable resource use.

Christian Kretzmann (corresponding author), christian.kretzmann@hhl.de. Doctoral candidate and research associate at the Chair of Accounting and Auditing, HHL Leipzig Graduate School of Management, Germany. His primary field of interest is information processing in equity markets with a focus on financial communication.

Prof. Dr. Henning Zülch, henning.zuelch@hhl.de. Chair of Accounting and Auditing, HHL Leipzig Graduate School of Management, Germany and Visiting Professor at the University of Vienna, Austria. His research is focused on Financial Accounting based on International Financial Reporting Standards (IFRS) and Corporate Governance.