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The Case Against Corporate Social Responsibility

The idea that companies have a duty to address social ills is not just flawed, argues Aneel Karnani. It also makes it more likely that we'll ignore the real solutions to these problems.

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But the idea that companies have a responsibility to act in the public interest and will profit from doing so is fundamentally flawed.

Large companies now routinely claim that they aren't in business just for the profits, that they're also intent on serving some larger social purpose. They trumpet their efforts to produce healthier foods or more fuel-efficient vehicles, conserve energy and other resources in their operations, or otherwise make the world a better place. Influential institutions like the Academy of Management and the United Nations, among many others, encourage companies to pursue such strategies.

It's not surprising that this idea has won over so many people—it's a very appealing proposition. You can have your cake and eat it too!

But it's an illusion, and a potentially dangerous one.

Very simply, in cases where private profits and public interests are aligned, the idea of corporate social responsibility is irrelevant: Companies that simply do everything they can to boost profits will end up increasing social welfare. In circumstances in which profits and social welfare are in direct opposition, an appeal to corporate social responsibility will almost always be ineffective, because executives are unlikely to act voluntarily in the public interest and against shareholder interests.

Irrelevant or ineffective, take your pick. But it's worse than that. The danger is that a focus on social responsibility will delay or discourage more-effective measures to enhance social welfare in those cases where profits and the public good are at odds. As society looks to companies to address these problems, the real solutions may be ignored.

Well and Good

To get a better fix on the irrelevance or ineffectiveness of corporate social responsibility efforts, let's first look at situations where profits and social welfare are in synch.

Consider the market for healthier food. Fast-food outlets have profited by expanding their offerings to include salads and other options designed to appeal to health-conscious consumers. Other companies have found new sources of revenue in low-fat, whole-grain and other types of foods that have grown in popularity. Social welfare is improved. Everybody wins.

Similarly, auto makers have profited from responding to consumer demand for more fuel-efficient vehicles, a plus for the environment. And many companies have boosted profits while enhancing social welfare by reducing their energy consumption and thus their costs.

But social welfare isn't the driving force behind these trends. Healthier foods and more fuel-efficient vehicles didn't become so common until they became profitable for their makers. Energy conservation didn't become so important to many companies until energy became more costly. These companies are benefiting society while acting in their own interests; social activists urging them to change their ways had little impact. It is the relentless maximization of profits, not a commitment to social responsibility, that has proved to be a boon to the public in these cases.

Unfortunately, not all companies take advantage of such opportunities, and in those cases both social welfare and profits suffer. These companies have one of two problems: Their executives are either incompetent or are putting their own interests ahead of the company's long-term financial interests. For instance, an executive might be averse to any risk, including the development of new products, that might jeopardize the short-term financial performance of the company and thereby affect his compensation, even if taking that risk would improve the company's longer-term prospects.

An appeal to social responsibility won't solve either of those problems. Pressure from shareholders for sustainable growth in profitability can. It can lead to incompetent managers being replaced and to a realignment of incentives for executives, so that their compensation is tied more directly to the company's long-term success.

When There's a Choice

Still, the fact is that while companies sometimes can do well by doing good, more often they can't. Because in most cases, doing what's best for society means sacrificing profits.

This is true for most of society's pervasive and persistent problems; if it weren't, those problems would have been solved long ago by companies seeking to maximize their profits. A prime example is the pollution caused by manufacturing. Reducing that pollution is costly to the manufacturers, and that eats into profits. Poverty is another obvious example. Companies could pay their workers more and charge less for their products, but their profits would suffer.

So now what? Should executives in these situations heed the call for corporate social responsibility even without the allure of profiting from it?

You can argue that they should. But you shouldn't expect that they will.

Executives are hired to maximize profits; that is their responsibility to their company's shareholders. Even if executives wanted to forgo some profit to benefit society, they could expect to lose their jobs if they tried—and be replaced by managers who would restore profit as the top priority. The movement for corporate social responsibility is in direct opposition, in such cases, to the movement for better corporate governance, which demands that managers fulfill their fiduciary duty to act in the shareholders' interest or be relieved of their responsibilities. That's one reason so many companies talk a great deal about social responsibility but do nothing—a tactic known as greenwashing.

Managers who sacrifice profit for the common good also are in effect imposing a tax on their shareholders and arbitrarily deciding how that money should be spent. In that sense they are usurping the role of elected government officials, if only on a small scale.

Privately owned companies are a different story. If an owner-operated business chooses to accept diminished profit in order to enhance social welfare, that decision isn't being imposed on shareholders. And, of course, it is admirable and desirable for the leaders of successful public companies to use some of their personal fortune for charitable purposes, as many have throughout history and many do now. But those leaders shouldn't presume to pursue their philanthropic goals with shareholder money. Indeed, many shareholders themselves use significant amounts of the money they make from their investments to help fund charities or otherwise improve social welfare.

This is not to say, of course, that companies should be left free to pursue the greatest possible profits without regard for the social consequences. But, appeals to corporate social responsibility are not an effective way to strike a balance between profits and the public good.

The Power of Regulation

So how can that balance best be struck?

The ultimate solution is government regulation. Its greatest appeal is that it is binding. Government has the power to enforce regulation. No need to rely on anyone's best intentions.

But government regulation isn't perfect, and it can even end up reducing public welfare because of its cost or inefficiency. The government also may lack the resources and competence to design and administer appropriate regulations, particularly for complex industries requiring much specialized knowledge. And industry groups might find ways to influence regulation to the point where it is ineffective or even ends up benefiting the industry at the expense of the general population.

Outright corruption can make the situation even worse. What's more, all the problems of government failure are exacerbated in developing countries with weak and often corrupt governments.

Still, with all their faults, governments are a far more effective protector of the public good than any campaign for corporate social responsibility.

Watchdogs and Advocates

Civil society also plays a role in constraining corporate behavior that reduces social welfare, acting as a watchdog and advocate. Various nonprofit organizations and movements provide a voice for a wide variety of social, political, environmental, ethnic, cultural and community interests.

The Rainforest Action Network, for example, is an organization that agitates, often quite effectively, for environmental protection and sustainability. Its website states, "Our campaigns leverage public opinion and consumer pressure to turn the public stigma of environmental destruction into a business nightmare for any American company that refuses to adopt responsible environmental policies." That's quite a different approach from trying to convince executives that they should do what's best for society because it's the right thing to do and won't hurt their bottom line.

Overall, though, such activism has a mixed track record, and it can't be relied on as the primary mechanism for imposing constraints on corporate behavior—especially in most developing countries, where civil society lacks adequate resources to exert much influence and there is insufficient awareness of public issues among the population.

Self-Control

Self-regulation is another alternative, but it suffers from the same drawback as the concept of corporate social responsibility: Companies are unlikely to voluntarily act in the public interest at the expense of shareholder interests.

But self-regulation can be useful. It tends to promote good practices and target specific problems within industries, impose lower compliance costs on businesses than government regulation, and offer quick, low-cost dispute-resolution procedures. Self-regulation can also be more flexible than government regulation, allowing it to respond more effectively to changing circumstances.

The challenge is to design self-regulation in a manner that emphasizes transparency and accountability, consistent with what the public expects from government regulation. It is up to the government to ensure that any self-regulation meets that standard. And the government must be prepared to step in and impose its own regulations if the industry fails to police itself effectively.

Financial Calculation

In the end, social responsibility is a financial calculation for executives, just like any other aspect of their business. The only sure way to influence corporate decision making is to impose an unacceptable cost—regulatory mandates, taxes, punitive fines, public embarrassment—on socially unacceptable behavior.

Pleas for corporate social responsibility will be truly embraced only by those executives who are smart enough to see that doing the right thing is a byproduct of their pursuit of profit. And that renders such pleas pointless.

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