

**Aligning CSR with Power: Two Pragmatic Strategies for Transformational Change  
A Panel Discussion**

Jane Hickie, Ellen Konar, and Steven Tomlinson

This panel proceeds from the observation that the CSR movement has not yet articulated a coherent strategy for aligning social responsibility with the core objectives of corporate management. We argue for a more pragmatic approach that proceeds from the motivations and limitations of corporate leaders, legislators, customers and investors to the design of strategic initiatives that could force managers to integrate CSR concerns into their basic business decisions. Rather than antagonizing corporate management, we believe that CSR advocates will accelerate the transformations they seek by offering more “carrots” – that is, if their efforts directly advance the interests of the people at the top. We will lay out our approach, offer two examples, and discuss the implications for social and environmental performance metrics.

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### **Introduction**

As efforts proliferate to entice, exhort or even coerce corporations into environmental and social responsibility, internal and external advocates of CSR become increasingly frustrated with the rate of progress. Despite extensive data collection, colorful reports, showcase projects, the current state of CSR ominously resembles earlier efforts to reform the corporation – diversity, “quality” – that have failed to deliver fundamental changes.

This panel proceeds from the observation that the CSR movement has not yet articulated a coherent strategy for aligning social responsibility with the core objectives of corporate management. We argue for a more pragmatic approach that proceeds from the motivations and limitations of corporate leaders, legislators, customers and investors to the design of strategic initiatives that could force managers to integrate CSR concerns into their basic business decisions. Rather than antagonizing corporate management, we believe that CSR advocates will accelerate the transformations they seek by offering more “carrots” – that is, if their efforts directly advance the interests of the people at the top. We will lay out our approach, offer two examples, and discuss the implications for social and environmental performance metrics.

### **A Focus on “How?”**

In order to have a coherent strategy, a movement must have a well-articulated goal and a way to measure progress. Our panel will sidestep the question of CSR’s “What?” except to offer that the best goals for public policy reform involve priorities determined on the basis of science and consensus among the interested (or “issue”) publics. We will assume for the purpose of this discussion that goals can and will be prioritized and appropriate metrics selected.

We will focus primarily on the “How?” of CSR – a pragmatic assessment of how CSR can sell business and political leaders, customers and investors on the triple bottom line. In reality, business leaders cannot justify decisions that adversely impact the company’s margins. In reality, business leaders care more about their own personal tax burdens than they do about the taxes their companies pay. In reality, political leaders are preoccupied with reelection and most attentive to the opinions of those who can deliver campaign contributions and votes. In reality, consumers pay attention to information that is relevant to their purchasing decisions, simple, and meaningful to them and their peers. In reality, investors judge their companies relative to the performance of competitors. We insist that strategies for social transformation take seriously these realities.

By contrast, most CSR efforts approach “How?” with the naïve assumption – a sort of “faith-based initiative” – that somehow disclosure itself will catalyze social transformation. On its own, however, disclosure only increases the noise level for decision-makers who are in many cases already overloaded with information and focused on other priorities.

### **Externalities and Business Margins**

Consider CSR’s drive to hold businesses accountable for their environmental impact. Economists don’t expect a free market to efficiently regulate pollution. Property rights for clean air and water are not defined. Businesses externalize the cost of pollution and pass the savings on to customers and investors.

For instance, suppose two companies, Toxicorp and Clean Inc., produce similar chairs that sell for \$100 for each. Clean Inc. uses expensive paints without toxic fumes and can produce chairs for \$40 each. Its margin per chair is \$60.

Toxicorp spends only \$20 to produce each chair (per unit margin of \$80) using less expensive paints that pollute the air. The pollution created by each chair, however, imposes \$30 worth of costs – respiratory ailments, water clean up costs, etc. – on society at large. The true social cost of production (\$20 private costs plus \$30 environmental cost equals \$50 per chair) is higher for Toxicorp, and the true social profit margin is only \$50.

Because Toxicorp can earn \$80 per chair by externalizing costs, it gains an edge in attracting capital. Clean Inc.’s survival depends on finding investors who will settle for smaller economic returns or customers who will pay higher prices in exchange for supporting a business with a better “environmental return.” Where economic return is the priority for investors and customers, socially inefficient Toxicorp becomes the norm.

The economist argues that the efficient outcome follows when the parties to the transaction “internalize” the externality – that is, factor into their trades the costs they impose on others. In this case, the market would get the efficient, Clean Inc. outcome if

- Manufacturers paid a \$30 surcharge for each toxic chair they produce, thereby internalizing the pollution costs.
- Customers would pay an addition \$30 per non-toxic table to reflect the benefit they are getting from reduced pollution.
- Investors would reckon the \$30 environmental “profit” as part of their return and reduce their expectation of financial profit accordingly.

In order to promote such internalization of social costs, CSR advocates have attempted to influence businesses, customers and investors on two fronts – policy and public relations.

With the current Administration, however, CSR advocates have found it difficult to gain support for any policy that imposes additional regulation on business. Moreover, while public relations efforts have created some buzz in which clean companies get a small market advantage among a small pool of potential customers, CSR needs a strategy that can deliver profits in the mass market.

As with all economic progress, learning-by-doing fuels advances in productivity; the conversation between customers and businesses leads to better, smarter ways of delivering high-quality products at lower prices and often with less pollution. The challenge for CSR is to accelerate this progress by choosing the policy and organizing initiatives and marketing strategies that most rapidly increase rate of innovation and reform. We now consider two possibilities.

## **Tax Reform**

Consider three realities governing the pursuit of tax reform in Washington's current political climate: First, it is not feasible to significantly reduce federal taxes. Second, it is feasible to rebalance the federal tax burden between corporations and families/individuals. Third, it is feasible to build a coalition for passing tax legislation that encourages social responsibility.

### *Taxes Are Inevitable*

The entitlement programs that make up the largest part of the federal budget are extremely difficult to reduce. Social Security, Medicare, Medicaid are resilient, and have defeated the efforts of the most intrepid "reformers." Both defense spending and "off budget" spending has dramatically increased with this Administration and this Congress. Non-defense, discretionary or domestic spending is only a small fraction of the budget. As a consequence, in spite of rhetoric to the contrary, spending continues even as tax cuts are enacted, and the resulting deficits will inevitably require new taxes on future generations of US citizens.

### *The Tax Burden is Out of Balance*

In 1953, corporations contributed 60% of federal revenues while individuals and families contributed only 40% (Christensen and Murphy 2004). Today, corporations contribute only about 10% of the total. Individuals and families bear 90% of the burden. Of these families and individuals, 47% of federal tax revenues are now paid by only 10% of the taxpayers (CBO 2004). As corporations pay a shrinking share of federal government spending, the burden of remediating corporate externalities shifts from the company to the executive's own pocketbook.

### *A Powerful Coalition Supporting CSR Tax Legislation Can be Built*

The key to activating this coalition is to organize those wealthy individuals who already contact Members of Congress on their own behalf. Consider the prospects for passing higher taxes on corporate polluters: First, executives would need to be persuaded to act in

their own self interest: “Why should individuals foot the bill for corporate pollution? Make the polluters pay, and reduce my personal taxes.”

Also important are those advocacy organizations that will contact members of Congress on behalf of their members and whose support the Representative values for his or her reelection. In the case of Democrats and moderate Republicans, it is traditional environmental environmentalist groups like the Sierra Club. In the case of conservative Republicans, it is a group of newly-awakened leaders among Evangelical Christians who may have roots in the “What Would Jesus Drive” movement.

Corporate Social Responsibility advocates could help organize and unify these disparate groups around the idea that the U.S. tax system should charge corporations more if they pollute, and less if they are good citizens.

The legislation should:

- shift the taxes associated with remediating corporate externalities from individuals to businesses, thereby reducing the personal tax liabilities of wealthy individuals and families;
- clearly link in the voter’s mind corporate taxes with the externalized costs of corporate activity so that it is politically feasible to set tax rates that reflect the costs of cleaning up pollution;
- rebate taxes to corporations that can demonstrate that they are not externalizing costs, so that as “cleaner” companies signal themselves out of the general risk pool, the taxes paid by the average corporation remaining in the pool increases, This “selection” dynamic puts greater pressure on these businesses to reduce pollution.

In economic terms, taxing individuals to clean up a company’s environmental damage promotes inefficiency by separating the decision to use a polluting technology from accountability to cover its social costs. Rebalancing the tax burden in this context gives Congress an opening to clearly link corporate taxes to the cost of remediating corporate externalities. CSR advocates should align with corporate management as advocates for tax breaks for companies with clean environmental records. As clean producers gain exemption from externality taxes – leaving dirtier producers to shoulder a greater burden – the financial incentive to improve environmental performance intensifies. Tax policy thereby acquires real power to impel socially responsible corporate behavior.

This strategy builds on the “Environmental Tax Reform” that has been enacted in a number of European countries. The results indicate that in Germany for example, increased taxes on petroleum products were combined with reductions in other, distorting taxes with positive economic outcomes for both employment and GDP. At the same time, Germany also adopted new tax incentives to promote clean energy technologies in its Environmental Tax Reform package. As a consequence, Environmental Tax Reform is said to yield a “double dividend”...both environmental and economic. (Bosquet and Hoerner 2001)

To build momentum for Environmental Tax Reform, CSR advocates should document the extent to which the government is currently paying ameliorative costs and the extent to which various corporations are contributing to those costs. The effort will also require clear standards by which a corporation can win exemption from the new “pollution taxes,” criteria that are clear and simple enough to survive political wrangling.

## **Strategic Marketing**

The imperative to increase revenues drives corporate strategy. Customers – businesses and households – by deciding what products to buy and what prices to pay, are the ultimate arbiters of corporate revenues. If the CSR movement can effectively reach and influence the purchasing decisions of a critical mass of customers, it can make socially responsible business practices profitable – and even essential – for corporations.

CSR advocates’ approach to customers has not always aligned with the interests of mainstream businesses. CSR advocates have helped organize boycotts, lawsuits, and lobbying against corporate offenders. In many highly visible cases – Shell, Nike, etc. – these efforts have made direct hits on companies’ margins and market shares and forced changes in policies and strategy and sent warnings to others.

Although the greatest leverage is the promise of increased market share and revenues, external CSR proponents too often focus on niche players devoted to principles, workers, and communities whether or not their products and business strategies make economic sense. Internal CSR advocates focus on corporate processes and communication independent of products and margins. Neither approach is likely to catalyze the transformation of business that CSR seeks.

In this section, we argue that CSR is more likely to become integral to business if its external advocates pursue a less antagonistic approach and join forces within corporations to solve a challenging marketing problem: How can business leverage customers’ growing concern about environmental protection or corporate behavior to increase their willingness to pay for healthier products? We believe that a smart and concerted effort on the part of CSR proponents could move social responsibility into the mass market.

## **The Markets**

A growing body of research identifies a core market of affluent consumers who want their spending and investing to support CSR principles. The funds that manage “socially responsible investing” already account for over \$2.16 trillion or more than 11% of investments under professional management (Social Investment Forum, 2003) and their share of total investment is increasing, growing 40% faster than all professionally-managed investment assets in the U.S.

Numerous studies demonstrate that between 10% and 15% of American consumers, generally the more affluent, are strongly sympathetic to environmental and social issues. Lipke (2001) found that 11% of consumers exhibit deeply-held environmental concerns. These “true naturals” as Lipke calls them, attempt to tailor their actions (and, critically, their purchases) to these beliefs. An additional 17% say they alter their actions and purchases, but only when it is convenient. Another 25%, although interested, tend not be willing to trade convenience, price, and product quality for CSR benefits. Another study, reviewed by Public Agenda, found that 70% of all consumers had purchased a product or brand because it was better for the environment.

How then do we account for the narrow appeal of Tom’s of Maine toothpaste and eco-friendly toilet paper? These products, from obscure companies with minimal investment in marketing, made it onto retail shelves, into our “consideration sets” and even into our homes on a trial basis. They managed to establish themselves in highly mature, cluttered markets with no “unmet” functional need, and in which new products from new companies almost never make it to market, much less trial. The notoriety of these almost “cult products” proves the existence and the persistence of a market force. Knowing that often less than 10% and certainly less than 70% of purchases, even premium purchases, seem to reflect an environmental or social agenda, however, we can assume that “shopping green” currently costs more in time, money or quality compromises than consumers are ready to spend.

So how can CSR make its agenda less costly and more compelling to the masses that drive corporate decisions? How can CSR make optimal use of marketing’s key elements of product, price, place, promotion and packaging as it seeks to expand the appeal of products? For unless the market expands beyond “true naturals” to include many of the incremental 60% of customers, “mainstream pragmatists,” who have on occasion included products in their “consideration sets” based on environmental factors; CSR cannot become central to business decision making.

### **“Crossing the Chasm”**

To achieve success in the mass market, CSR marketing has to move beyond PR campaigns and into product-marketing strategies and tactics. Looking at the successes and failures of the technology industry during the last decade, Moore (2002) dubbed the central issue and its solution “Crossing the Chasm.” In the 1990’s many initially successful companies with hot products failed to thrive or even survive: by catering to core customers exclusively and for too long, their products failed to “Cross the Chasm” from niche to mass market. Successful technology companies on the other hand, saw their markets and revenues take off by developing an entry strategy around the core market, but then quickly simplifying the products and their communications, increasing accessibility and convenience in purchase and use, and driving down prices through R&D and manufacturing innovation. Personal computers for example, went from user- assembled kits to user-friendly, all-in-one turnkey systems; from feature list ads in computer magazines to 30-second “Dell dude” single-message ads on TV; from specialized retail stores like CompUSA to mass retailers like Circuit City and Best buy; and from \$4000 hardware boxes to \$500 systems with preloaded applications. In the process, consumers benefited and many companies thrived.

CSR's current efforts to "sell" social responsibility to consumers are still in the early stages with very basic products, fragmented and confusing messages and marketing, high prices and specialized retailers. Marketing CSR relies heavily on lengthy reports from manufacturers or organizations, unlikely to reach beyond even the most dedicated "true naturals. A proliferation of warnings and campaigns overload consumers with conflicting and confusing messages. The result is ignorance and indifference. Which store do I go to purchase safe, healthy home products? To understand how little is known about products or manufacturers compare consumer rankings of corporate environmental performance with that of any expert or empirical ranking. Whereas Interface and S.C Johnson appear to have an extraordinary record of product and manufacturing innovation in support of environmental and social performance, neither appear among the consumer list of top CSR or environmental brands. The list of companies consumers believe are strong environmental supporters are ones which are strong stock performers (e.g. high tech in late '80's) or are in desirable product categories (e.g. Johnson and Johnson). Most readers can cite compelling evidence of what Datamonitor politely calls a "need for consumer education."

There are some early success stories, which indicate the promise of product development and marketing for CSR. On the corporate, product side, consider the hybrid business. Over the past two years, we've moved beyond the spartan two-seat Honda Insight to the next generation Toyota Prius. Now reasonably sized and powered, with more mainstream options like leather seats and some basic advertising, the market has begun to turn the corner. With year-on-year growth of 120% in February 2005, the Prius has captured a sizable segment of the "true naturals" and even some buyers from the next tier, despite its \$4000 premium and three month waiting list. Although sales are still below that of the established Camry or Corolla models, they far outsell the lower-priced Scion models, and their more traditional competition. What if Toyota went beyond their custom-built model, eliminating the wait, and extended the system to cars which suit families and those wanting the psychic and safety benefits of larger, SUV type models?

The other seemingly successful CSR story is "Energy Star". As a government-backed program, it has impacted the availability and notoriety of energy-efficient products in 40 product categories, making it easy for consumers to identify and purchase products in keeping with their own self interest, values and social identification. If you believe the government's statistics, the program has an estimated cost savings of \$8 billion per year, and is equivalent in value to taking 15 million cars off the road this past year.

In both instances, a niche interest is showing signs of a transition to mass market. Critical to this process was a competitive product that had a relevant message (less consumption, equal performance) simple indicator (e.g. expected MPG on the sticker), with credibility (Toyota branded and substantive proof), that was actionable (widely available product).

These early success stories can be the beginnings of a much larger, broader effort to rally the consumer. The resources of Energy Star are far from that required to make it front and center for many consumers in the array of product categories in which it is meaningful. Successfully launching and developing a visible imprimatur or labeling program, be it "fair trade", "organic" or "energy star" requires intense focus and resources. Advertising revenues and a singular focus ("pure foods") made the "Good Housekeeping Seal of Approval" powerful. Insurance

investment and a focus on safety made Underwriters Laboratory's testing and labeling program viable. Can the core of CSR find a single flag around which to rally and generate the resources? The requirement is to garner the full attention of a broad set of even second-tier manufacturers, retailers or consumers who by their investment and focus begin a virtuous cycle. It is then that consumer buying habits will make CSR profitable and even a requirement for corporations.

## **Conclusion**

In opposing the interests of corporate executives, CSR has made its job too difficult and its long-term impact doubtful. A powerfully effective strategic initiative is more likely to come from CSR's aligning itself with the core interests of business leaders. Like all of us, the people at the helm of corporations would like to pay less in taxes – and certainly to avoid paying for the costs imposed on society by others. Like all of us, these executives are looking for help in reaching bigger crowds with clearer messages. To the extent that CSR can help powerful people solve pressing problems, it positions itself to wield wider influence.

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