
REVIEW

Corporate Social Responsibility

David Henderson, *Misguided Virtue: False Notions of Corporate Social Responsibility*, New Zealand Business Roundtable, Wellington, 2001.

Reviewed by *Stephen King*

To a naïve economist, like myself, an introduction to corporate social responsibility (CSR) is similar to a first reading of *Alice in Wonderland*. It is slightly amusing, full of charm and yet clearly very silly. In some ways CSR sounds innocuous; a concept that ‘encapsulates the notion that companies have obligations that extend beyond shareholders’ (Cronin, 2001:1). But it is based on farcical ideas that would make the Mad Hatter blush. For example, a foundation principle of CSR is that business firms ‘control the financial and economic aspects of society and are possessed of monetary power far greater than the world’s governments’ (French, 1984: cited in Cronin, 2001).

CSR is a mish-mash of (sometimes contradictory) ideas. Some elements of CSR would receive general agreement — for example the idea that it should be illegal for firms to falsely represent their products. Other elements - such as the idea that firms should ignore local labour markets and differing stages of development in their hiring practices across countries - may have superficial appeal but are shown to be undesirable when subject to rigorous scrutiny.

CSR, at least in Australia, seems to boil down to little more than a call for business to donate more to charity (Duncan, 2001). This appears reasonable, although the memory that HIH was ‘an extremely generous benefactor to a wide range of worthy causes’ might lead to further thought and reflection (Brunton, 2001). However, the effects of CSR reach far further, by stating as unarguable that firms have an ‘obligation’ to communities that goes beyond the idea of mutually desirable trade and, potentially, beyond the market place. For example, banks in Australia have been castigated and threatened with government intervention for closing unprofitable rural branches. Vilification of the banks is based on the idea that the banks ‘owe’ rural communities a service, even if this takes money away from shareholders (Jones, 2001). This idea appears to be based on a wrong-headed notion that companies gain through trade but customers do not, so that companies owe their customers a return beyond profit-maximising behaviour.

Given the growth of importance of CSR and its apparent widespread acceptance, David Henderson’s short book is a timely reminder that much of CSR is both silly and dangerous. He provides an excellent critique of the arguments

propounded by CSR advocates and paints a (rather terrifying) picture of the role CSR is playing in modern corporate life.

Henderson provides a structure for analysing CSR and distinguishes between two types of related corporate behaviour. First, firms might adhere to various CSR principles because this helps to raise profits. A good corporate image can be good for business and taking account of workers, suppliers and customers almost always makes good business sense. This is nothing new. Alternatively, firms might engage in activities that lower profit under CSR even though they face no legal obligation. This response to CSR accepts the view that profit-maximising activities are not the best way for a firm to contribute to society. As Henderson states, 'the idea of maximising profits is replaced by that of achieving 'acceptable returns', while business's 'contribution to society' is explicitly — and wrongly — viewed as distinct from its profit-maximising activities' (p. 41).

It is through this second type of response that CSR can undermine the welfare of society. As Henderson notes, the response reflects a failure 'to understand the rationale of a profit-based market economy' (p. 63). In particular, it fails to recognise the role of profits as an incentive for firms and the role of mutually voluntary trade in making both buyers and sellers better off. For example, one of the key issues for CSR involves wage payments and labour laws in less developed countries. Large multinational companies based in the developed world invest in these countries and employ workers at wages and conditions that would be illegal in their home country. Such practices are abhorrent to CSR adherents and should be eliminated by the relevant companies. Under CSR, multinational companies have an obligation to support 'humane' labour practices.

But before concluding that the hiring practices of multinational companies are immoral and a source of harm to the poor, consider the effect of both the policies and their elimination. Does the hiring of poor impoverished workers in the less developed countries make those workers worse off? No! As Henderson notes 'the adults who voluntarily seek employment with foreign-connected firms, on terms that they are aware of, do so in the hope and expectation of becoming less impoverished' (p. 70). While wages and conditions of those workers might appear unacceptable to residents of the first world, they are more than acceptable to those in poor, overpopulated countries where the alternative would be even lower pay in domestic firms or greater impoverishment and starvation. But surely it would be better if those same workers received even higher pay? Not necessarily! The abundant supply of cheap labour creates the incentive for multinational firms to invest in unstable countries ruled by corrupt governments because it is profitable, despite the political risks. If well-meaning CSR advocates in developed countries forced the wages of the local workers up, foreign investment in less developed countries would dry up. It is cold comfort to a starving peasant that he or she would receive a high wage if only they had a non-existent job (Krugman, 2001).

If the problem, at least partially, is corrupt government and political instability in less developed countries, should business have a social responsibility to pressure reform in those countries? Henderson argues that such a stance is fraught with danger. Why should business be the judge of acceptable behaviour?

This is the role of government. Implicitly, the CSR position elevates business to a role in determining socially desirable policies.

The CSR process involves forcing business to lead government. By sacrificing profits to attain an inflexible CSR position (for example, see Henderson, page 65, for the principles of ‘eco-efficiency’), firms harm their customers — through higher costs and prices — and make themselves less competitive. This in turn harms their suppliers, their workers and their shareholders. As these ‘socially responsible’ firms lose market share, capital and labour to their ‘less responsible’ competitors, they will be forced to either abandon their CSR position or get their rivals to adopt it. The latter will involve corporations who adopt CSR lobbying for government intervention on their competitive rivals. Henderson captures this nicely (p. 79) with a conversation between two executives of rival mining companies: ‘My organization is run by Greenpeace today, and it is my job to ensure that Greenpeace is running yours tomorrow’.

While Henderson provides an excellent overview of CSR and effectively critiques many aspects of CSR, I have two reservations about his book. The first relates to style. In my opinion, the book takes a long time to ‘get going’. The first thirty pages (of a ninety-four page book) did little to convince me that CSR really was a problem. In these pages, Henderson defines and categorises CSR and discusses its emergence and growth. But these first three chapters do not create a sense of the importance of Henderson’s topic. It is not until Henderson starts to quote business and political leaders, particularly from page 29 on, that the true extent of CSR and its potential dangers become clear.

My second reservation is about the nature of Henderson’s critique. In many ways, I think that Henderson gives CSR more than its due. While Henderson mentions the issues of mutually beneficial trade and the nature of firms as voluntary groupings of disparate individuals, he does not emphasise that these issues are the key factors in understanding why CSR is flawed. Firms only make abnormal profits by helping people in extraordinary ways through the market place. And those very profits, in the absence of government intervention, contain the seeds of their own destruction, as they lure in new firms who drive down prices, raise service and compete away the abnormal profits. This is how firms benefit society. There is not a conflict between profits and social welfare. Rather it is the lure of profit, in a free market, that creates social welfare.

Further, before calling for corporate social responsibility, it is necessary to ask what a corporation actually is. A firm, no matter how large, is simply a group of individuals who voluntarily join together through contractual arrangements. These individuals are part of society. To talk of corporate responsibility to society as separate from the corporation as part of society is nonsense.

By considering the corporation as part of society, the true nature of CSR becomes clear. CSR policies fall into two groupings. First, many CSR policies simply aim at redistributing society’s wealth from those who act within corporations (and particularly those who participate in corporations by providing funds as shareholders) to those who do not participate in corporations. Such

redistribution might be worthwhile. There is no reason why a market-based economy will lead to an equitable division of wealth. However, such redistribution policy is up to government, not company managers, to decide.

Second, CSR policies often involve using corporations to impose on society particular principles that are not endorsed by most of the population. If most people supported CSR policies then firms would find it profitable to adopt those policies. Consumers would be willing to pay more for products from a firm that does not 'exploit' cheap labour or that adopts certain environmental practices. Similarly investors would be willing to forgo some return to fund CSR compliant firms and employees would be willing to receive lower wages to support those firms. That CSR policy must be imposed through high-level lobbying and government pressure reflects that most people in society do not support those policies. When faced by a 'responsible' product at a high price and a cheaper 'irresponsible' product, most people prefer the cheaper product. CSR is an attempt by a minority who support certain policies to use corporations to impose those policies on the majority of the population who do not accept them.

Henderson has written an important, timely book. However, I see the risk of CSR differently to Henderson. Over time, CSR is unlikely to survive through voluntary corporate compliance that reduces firm's profits. CSR thrived in the economically buoyant 1990s. In tighter economic times, CSR will lose much of its gloss and senior executives that support it are likely to be replaced by hard-nosed realists. The real long-term risk of CSR will be misguided government policy. If CSR leads governments to pass laws where the social benefit is outweighed by the cost to business and the community, then CSR will create significant loss.

References

- Brunton, R. (2001), 'Profit the Primary Corporate Responsibility', Courier Mail, 9 June. Reprinted at www.ipa.org.au/media.
- Cronin, C. (2001), 'Corporate Social Responsibility in Australia: A Select Review of the Literature', Background Paper Number 3, Research and Social Policy Team, The Smith Family.
- Duncan, T. (2001), speech to The Brisbane Institute, June 6.
- French, P. (1984), *Collective and Corporate Responsibility*, Columbia University Press, New York.
- Jones, A. (2001), 'Transcript of radio interview of the Prime Minister' 2UE, May 14, <http://www.pm.gov.au/news/interviews/2001/interview1037.htm>.
- Krugman, P. (1997), 'In Praise of Cheap Labor', <http://web.mit.edu/krugman/www/smokey.html>.

Stephen King is Professor of Economics at the Melbourne Business School.