

## **Toward a New Meaning of CSR: Corporate Shareholder Responsibility**

The Corporate Social Responsibility (CSR) movement has become mainstream in the last twenty years. Thanks to a successful campaign to the press, policy-makers, and the public, the parlance of CSR can be read, seen, and heard on corporate websites, in business schools, and in the speeches of political leaders. Furthermore, CSR theorists have devoted significant attention to develop measurement and evaluation, fostering concepts such as venture philanthropy and social return on investment. However, every social and economic transition entails externality, and CSR has created unintended consequences, which this essay will address.

To solve the challenges of the developing world, a host of actors come together: individuals, governments, corporations, and non-governmental organizations. Of these, two emerge as the most important and effective, as they are income generators: business and individuals, or more appropriately, shareholders. These actors in the present knowledge economy in general, and the role of information and communications technology (ICT) companies in particular are the focus of this essay. Publicly-traded companies in the U.S. and Europe as well as emerging ICT firms in India, the world's new knowledge and technology powerhouse, provide the bulk of examples. As befits a discussion of CSR, the shareholder vs. stakeholder debate for creating social change will be revisited.

Though the world's economy has changed, the responsibilities of business have not. Business exists only to make a profit, but its shareholders, enriched from the largesse of capital gain, have a responsibility to address the world's challenges. Fortunately, the transition to a knowledge economy has drastically decreased the cost of technology, enabling business to turn problems into profits. Peter Drucker who coined the term "knowledge economy" in his book *The Age of Discontinuity: Guidelines to our Changing Society*<sup>1</sup> notes that at a minimum, the corporation must ensure its own resources, or it will go out of business. At the same time, the firm has the capacity to "turn a social problem into economic opportunity and economic benefit, into productive capacity, into human competence, into well-paid jobs, and into wealth."<sup>2</sup>

The world can enjoy a double benefit as shareholders with their capital gains invest their dividends in social improvement. Thus, these two actors, ICT businesses and shareholders, emerge as the key change agents.

### **The Unintended Consequence of CSR**

Though proponents of CSR may have their hearts in the right place seeking to solve the world's problems, they are unwittingly undermining the very corporations they seek to strengthen. The CSR movement has been emboldened by the stakeholder theory of the firm that emerged after high profile corporate scandals in the 1980s. The theory posits that a corporation needs to serve the interests not just of shareholders, but also employees, suppliers, customers, and communities.<sup>3</sup>

This benevolent idea rests on some important false assumptions: (1) that corporations have responsibilities; (2) that corporations are responsible for the world's problems; and (3) that making corporations accountable to "stakeholders" will solve the world's problems.

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<sup>1</sup> Harper & Row, 2002.

<sup>2</sup> Drucker, Peter. *Frontiers of Management: How Tomorrow Is Shaped Today*. Plume, 1999.

<sup>3</sup> Marcoux, Alexei. "Business Ethics Gone Wrong". *Cato Policy Report*. May/June 2000.  
[http://www.cato.org/pubs/policy\\_report/v22n3/cpr-22n3.html](http://www.cato.org/pubs/policy_report/v22n3/cpr-22n3.html)

A corporation is an “artificial person”, and therefore cannot have responsibilities. Only Individuals, such shareholders and managers, can have responsibilities.<sup>4</sup> The notion that corporation must “give back” assumes that business has some unfair advantage, ignoring the fact that the corporation paid wages and benefits to its employees; provided goods and services to its customers; and paid taxes to the government.<sup>5</sup>

While the media can be thanked for bringing corporate misdeeds to light, sensational reporting obscures the real picture that corporations, for the most part, operate ethically. Of the 17,500 publicly-traded companies in America, less than 100 firms are responsible for the majority of fraud. By comparison, the rate of failed U.S. Presidents and jailed American Congressmen is ten times higher, and public opinion polls routinely rate corporate leaders above politicians—and journalists.<sup>6</sup> The facts weigh against legislation as an effective means of preventing fraud. The past thirty years have seen ever-increasing regulation, none of which succeeded to prevent the scandals of WorldCom, Tyco, Adelphia, and others. The Enron debacle, in fact, was facilitated by rules-based accounting. As the court cases against these firms illustrated, it was the individual directors and managers who committed fraud, not the whole corporation.

Another concern created by the stakeholder model is the complication of the agency problem. Agency theory has to do with the competing interests of corporate actors as well as the costs of trustees to oversee managers. Being made to serve the interests of both stakeholders and shareholders, we have created legions of schizophrenic managers, two-headed beasts trying to maximize profits *and* solve the world’s problems at the same time, with neither interest being satisfied. Notes one business ethicist, “A manager told to serve two masters [a little for the equity holders, a little for the community] has been freed of both and is answerable to neither. Faced with a demand from either group, the manager can appeal to the interests of the other.”<sup>7</sup>

Sometimes CSR amounts to nothing more than a corporation opening its checkbook to placate a particular stakeholder. In the worst cases, misdoing directors and officers commit crimes while they hid behind the cloak of CSR. And certifying a company as a good corporate citizen is no guarantee of integrity; the Great Place to Work Institute’s annual CSR employee questionnaire named Enron as one of the Best 100 Companies to Work for in America for years.<sup>8</sup>

Another danger that CSR creates is the degradation of equity capital. As shareholders’ power declines relative to stakeholders, the lessened control of financial performance is reflected in stock price, and the value of the stock falls. This forces corporations to fund expansion with debt rather than equity. On top of that, the firm faces the

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<sup>4</sup> Friedman, Milton. “The Corporate Responsibility of Business to Increase Profits”. 13 September 1970. *New York Times Magazine*. <http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>

<sup>5</sup> Marcoux.

<sup>6</sup> Rodgers, T.J. “Rethinking the Social Responsibility of Business”. *Reason*. October 2005. <http://www.reason.com/0510/fe.mf.rethinking.shtml>

<sup>7</sup> Marcoux (quoting Easterbrook and Fischel’s *The Economic Structure of Corporate Law*, Harvard University Press, 1996)

<sup>8</sup>“Enron Named #22 of “100 Best Companies to Work for in America”. CSR Wire. 18 December 2000. <http://www.csrwire.com/article.cgi/525.html>

twin burden of not only having to borrow money, but to do so at a higher rate because its stock price and performance are depressed.<sup>9</sup>

### **Who is more effective: Shareholder or Stakeholder?**

CSR might have broad appeal because it allows a convenient way for individuals to relinquish their own responsibilities. For example, we can blame car manufacturers for causing global warming while we gleefully drive our gas-guzzling vehicles. Or we can sue McDonald's for poisoning us with saturated fat when we don't have enough will power to make a salad. Putting the onus on "the evil corporations" is a lot easier than changing our own behavior.

Such personal responsibility for social improvement is part and parcel of Milton Friedman's philosophy of economic freedom. He presented this elegant argument and defined the role of the corporation in his seminal 1970 essay "The Corporate Responsibility of Business Is to Increase Profits". He explained further, "There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."<sup>10</sup>

A corporation exists simply to make a profit. While this statement smacks of soullessness in today's rhetoric of CSR, embraced by enlightened shareholders, its spirit can have tremendous benefits for social good.

When a corporation maximizes its profits, shareholders make more money, and thus have more money to spend on social improvement. It is exactly Friedman's shareholder model that has made Bill Gates and Warren Buffet the greatest philanthropists of all time. Demanding accountability and results, Gates and his foundation have addressed AIDS with more money, speed, and effectiveness than scores of other actors combined. The stakeholder model, on the other hand, in which corporate resources are diverted to various stakeholder interests, is in essence a charge on the unwitting shareholder, customer, and employee. Allowed to operate freely, the shareholder model also benefits government, for as revenues are maximized, so are taxes.

### **Global Challenges: AIDS, Malaria, and Malnutrition**

In the knowledge economy, there is no shortage of information, and fortunately, much of it is useful. For a list of global challenges to address, one need not look further than the Copenhagen Consensus.<sup>11</sup> Brainchild of Danish statistician Bjorn Lomborg, this bi-annual meeting of the world's top economists has the explicit goal to assist decision makers by prioritizing the world's problems with costs and benefits. The meeting's proceedings are explained in depth online and in Lomborg's recent book *How to Spend \$50 Billion to Make the World a Better Place*.<sup>12</sup>

The group's top issues are communicable diseases, water/sanitation, education, malnutrition/hunger, and subsidies/trade. The best investment of all focuses on AIDS prevention. An investment of €22 billion could prevent 28 million cases of AIDS by 2010 while

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<sup>9</sup> Marcoux.

<sup>10</sup> Friedman.

<sup>11</sup> [www.copenhagenconsensus.com](http://www.copenhagenconsensus.com)

<sup>12</sup> Copenhagen Consensus Center, 2006.

the benefits of this are forty times as high.<sup>13</sup> With this list, it is possible then for the world's leaders and individuals to take concerted action.

Malaria has eradicated in the developed world, but it, along with AIDS and tuberculosis, are still the leading causes of death in the developing world. The incidence of communicable diseases is 90% preventable, yet it represents 7 of the top 10 causes of child deaths in developing countries and accounts for around 60% of all such deaths: more than 6 million deaths annually.<sup>14</sup>

The developed world has the tools and resources to address these challenges. It is not a coincidence that the Bill and Melinda Gates Foundation has targeted this area, the single best investment to help the greatest number of people. The link between the health of a people and their economy is clear. As the working papers of the Copenhagen Consensus note, "... up to 1.7% of annual economic growth in East Asia between 1965 and 1990 (about half the total GDP increase for the period) has been attributed to massive improvements in public health."<sup>15</sup>

Malnutrition is another scourge of the developing world, of which 17 percent remains undernourished. Needless to say, a reliable source of food can address this challenge. Given many agricultural challenges in the developing world, the Copenhagen Consensus recommends biotechnology as the best means providing sustainable nourishment.

*... This is not just a case of subsistence farmers growing more to eat: rather it is a question of more productive farming which gives farmers a better return on their investment, increases demand for the labour of landless people and reduces the price of food to make it more accessible to both rural and urban populations. The "green revolution" of the 1960s and 70s is a clear example of how modern plant breeding advances can be widely employed for the benefit of the poor.... Similar advances could be derived using the best technologies available now, including biotechnological advances."<sup>16</sup>*

Fortunately, this is an area where ICT businesses can play a role.

### How the ICT Speeds Solving Problems

With increased access to media and information, the world's poor want the many benefits of the developed world. It is estimated that the informal economy is responsible for up to 60% of economic activity in the least developed countries. This area is ripe for technological investment allowing it to leapfrog the economic revolutions of the past, particularly in the areas of tele-education, telemedicine, microbanking, and agricultural

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<sup>13</sup> Ibid.

<sup>14</sup> Mills, Anne and Sam Shillcutt. "Challenge Paper on Communicable Diseases". London School of Hygiene and Tropical Medicine. February 2004.  
[http://www.copenhagenconsensus.com/Admin/Public/Download.aspx?file=files/filer/cc/papers/communicable\\_diseases\\_160404.pdf](http://www.copenhagenconsensus.com/Admin/Public/Download.aspx?file=files/filer/cc/papers/communicable_diseases_160404.pdf)

<sup>15</sup> Ibid.

<sup>16</sup> Behrman, Jere R., Harold Alderman and John Hoddinott. "Malnutrition and Hunger". Copenhagen Consensus. February 2004.  
[http://www.copenhagenconsensus.com/Admin/Public/Download.aspx?file=Files/Filer/CC/Papers/Hunger\\_and\\_Malnutrition\\_070504.pdf](http://www.copenhagenconsensus.com/Admin/Public/Download.aspx?file=Files/Filer/CC/Papers/Hunger_and_Malnutrition_070504.pdf)

extension services. This multi-trillion euro opportunity is explained by visionary C.K. Prahalad in his book *The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits*.<sup>17</sup>

Prahalad's support of economic freedom echoes of Friedman, who in 1980 visited the luxurious City Palace in Jaipur, the capital of the Indian state of Rajasthan. Friedman reflected upon the gross inequalities of India, not only the vestiges of the British empire, but also the excess of the Maharajas. Friedman observed that life is unfair; some are born rich; others, poor. Nevertheless, the best path out of poverty is the free market: "Nowhere are the rich richer and the poor poorer than in those societies that do not permit the free market to operate, whether they be feudal societies where status determines position, or modern, centrally-planned economies where access to government determines position."<sup>18</sup>

Prahalad gives special mention to ICT when discussing the eradication of poverty as it serves as a means to lower dramatically the costs associated with access to products and services, distribution, and credit management. For example computerization allows firms such as Grameen Bank, operating at 30-40% less overhead than traditional banks, to provide microlending to 40,000 villages.<sup>19</sup> When the price of a transistor has fallen from the equivalent of \$3 in 1960 to 3 millionths of a dollar today, widespread adoption of technology by the developing world is a distinct possibility.

ICT companies can also help by speeding the development of vaccines and biotechnology for the developing world, which to date has focused mainly on the developed world. The proposals of Harvard University development economist Michael Kremer seek to remedy this. His book *Strong Medicine: Creating Incentives for Pharmaceutical Research on Neglected Diseases* describes how "pull mechanisms" can incentivise corporations to undertake research and development of drugs as well as bio-agriculture for the benefit of the developing world.<sup>20</sup> Kremer notes that R & D is a global public good with social benefits that outweigh private returns. As opposed to push programs in which companies receive grants in advance, with pull programs, policy makers/donors pay only for results—providing a true market test.<sup>21</sup> Pull programs force focus on specific research projects and viable products.

### **To Be Optimized, a Knowledge Economy Demands Economic Freedom**

The cost of government regulation hinders drug development, creating a process that takes twelve years and minimum of €800 million, €100 million alone in compliance costs. Only the largest pharmaceutical companies can afford such expenditures, and as such, smaller players are prohibited from participating.

The negative effects of government regulation are not confined to health care industry. Removing subsidies and trade barriers from all industries is a key to improving the standard of living in the developing world, and as such, is another Consensus Consensus priority. Evidence gathered during the second half of the twentieth century shows that the countries that liberalised their trade have enjoyed an average 1.5% increase in annual GDP growth

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<sup>17</sup> Wharton School Publishing, 2004. For a précis, the website of Eric Brewer, another leading thinker in the field. <http://www.cs.berkeley.edu/~brewer/ict4b/Fortune-BoP.pdf>

<sup>18</sup> Friedman, Milton. *Free to Choose*. Harcourt Brace Jovanovich. 1980. <http://www.freetochoose.com/>

<sup>19</sup> Prahalad

<sup>20</sup> Princeton University Press, 2004.

<sup>21</sup> Kremer, Michael and Zwane, Alix Peterson. "Encouraging Private Sector Research in Tropical Medicine". *World Development*. Vol. 33. 2005.

compared with the pre-reform rate. Free trade has a direct effect on reducing poverty, as well as indirect effect on lessening other challenges in the developing world. An optimistic assumption of 50% across-the-board cuts to tariffs and farm subsidies leads to predicted benefits of approximately €150 billion to €800 billion a year.<sup>22</sup>

As free trade is so important to social improvement, it is demoralizing to see the breakdown of the recent talks of the World Trade Organization. Countries lobby for an advantage while billions of lives are at stake. Furthermore, discussions are conducted without full information of the subsidy spending of each nation—both because of the high cost measurement as well as attempts by governments to conceal the full story. Here is a perfect example of the agency problem and imperfect information negatively impacting social good. Clearly it is time for leadership on the part of governments and corporations to surrender their protectionist policies.

### **People, the Ultimate Resource, Ensured through Education and Employment**

If free trade can exist, then technology can reach the developing world that much faster. Not only does technology bring lower costs and efficiency, it can create the economies of scale necessary to provide the equitable distribution of education and employment. Using satellite technology and cheap computers (a €75 laptop now under development from AMD), it is possible to achieve the physical expansion of education that the Copenhagen Consensus recommends.

ICT companies are realizing that the developing world is a market not only for goods and services, but for skilled labor as well. While the top multi-national corporations of the world produce 30% of all economic output, they employ less than 1% of the world's population.<sup>23</sup> Tackling the challenges of the world's problems requires tremendous leadership on the part of management, not just the implementation of hardware and software. These managers are best chosen and trained in the developing world. Cisco Systems with its Networking Academy to train technology leaders and Hewlett-Packard with its Microenterprise Acceleration Program to foster entrepreneurs are seeding the leaders of the developing world.

Also encouraging is the burgeoning of home-grown technology companies in the developing world, particularly India. Prahalad describes further, "The new MNCs like Wipro, Infosys, or TCS ...will not only emerge as a major force, but they will have the opportunity to rewrite the book on how to manage global operations. They will show us how to create low cost, highly effective, real-time systems."<sup>24</sup>

In addition to these Indian MNCs, there is a crop of smaller Indian contract research organizations (CRO) which are working to fast-track the drugs needed by the developing world. Pharmaceutical companies can outsource costly, time-consuming clinical trials to these organizations. With lower infrastructure and labor costs, a typical CRO can operate with 75 percent lower costs, shaving upwards of half of the cost of clinical trials. The huge demand for

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<sup>22</sup> Anderson, Kim. "Subsidies and Trade Barriers". Centre for International Economic Studies; University of Adelaide. Copenhagen Consensus, 2004.  
[http://www.copenhagenconsensus.com/Admin/Public/Download.aspx?file=Files/Filer/CC/Papers/Subsidies\\_and\\_Trade\\_Barriers\\_140504.pdf](http://www.copenhagenconsensus.com/Admin/Public/Download.aspx?file=Files/Filer/CC/Papers/Subsidies_and_Trade_Barriers_140504.pdf)

<sup>23</sup> Prahalad

<sup>24</sup> Mahanta, Vinod. Interview with C.K. Prahalad. *Economic Times/India Times*. 19 December 2003.  
<http://economictimes.indiatimes.com/articleshow/msid-367787,prtpage-1.cms>

these important services is allowing Indian CROs to grow at 80% annually, outpacing the global rate of 15%.<sup>25</sup>

Finally, there is something necessary and valuable for people in the developing world to learn the skills to solve their own problems. As Nobel economist Julian Simon noted in his book *The Ultimate Resource: People, Material, and the Environment*, "Human beings are not just more mouths to feed, but are productive and inventive minds that help find creative solutions to man's problems, thus leaving us better off over the long run."<sup>26</sup>

### **Profits, not Public Relations**

The CSR movement was right that responsibility in the world needs to expand, but not on the part of the amorphous "corporation", making boardrooms the bastion of special interest politicking and muddled mission statements. Instead, let's put responsibility where it belongs: on the shareholder. With the profits achieved in an economically free knowledge economy, enterprising ICT companies, and enlightened shareholders, we can realize a world in which disease, poverty, inequality can be eradicated.

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<sup>25</sup> Tata Consultancy Services. "Accelerating Development: The TCS CRO Report". 26 July 2005. [www.tcs.com](http://www.tcs.com)

<sup>26</sup> Princeton University, 1996. [http://www.juliansimon.com/writings/Ultimate\\_Resource/](http://www.juliansimon.com/writings/Ultimate_Resource/)