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The Biggest Contract:

By building social issues into strategy, big business can recast the debate about its role, argues Ian Davis

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THE great, long-running debate about business's role in society is currently caught between two contrasting, and tired, ideological positions.

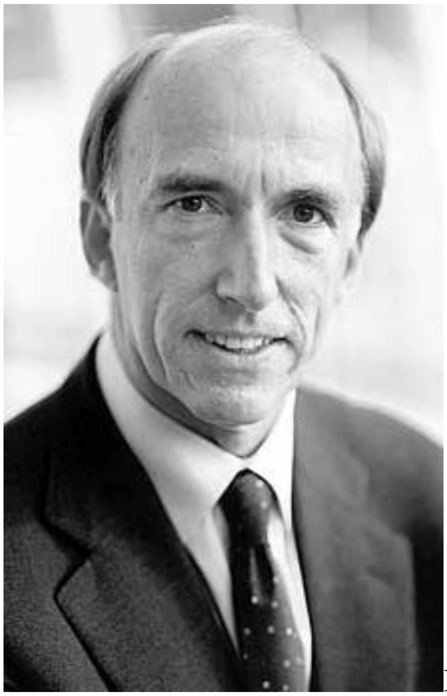
On one side of the current debate are those who argue that (to borrow Milton Friedman's phrase) the "business of business is business". This belief is most established in Anglo-Saxon economies. On this view, social issues are peripheral to the challenges of corporate management. The sole legitimate purpose of business is to create shareholder value.

On the other side are the proponents of "Corporate Social Responsibility" (CSR), a rapidly growing, rather fuzzy movement encompassing both companies which claim already to practise CSR and sceptical campaign groups arguing they need to go further in mitigating their social impacts. As other regions of the world—parts of continental and central Europe, for example—move towards the Anglo-Saxon shareholder-value model, debate between these sides has increasingly taken on global significance.

That is a pity. Both perspectives obscure in different ways the significance of social issues to business success. They also caricature unhelpfully the contribution of business to social welfare. It is time for CEOs of big companies to recast this debate and recapture the intellectual and moral high ground from their critics.

Large companies need to build social issues into strategy in a way which reflects their actual business importance. They need to articulate business's social contribution and define its ultimate purpose in a way that has more subtlety than "the business of business is business" worldview and is less defensive than most current CSR approaches. It can help to view the relationship between big business and society in this respect as an implicit "social contract": Rousseau adapted for the corporate world, you might say. This contract has obligations, opportunities and mutual advantage for both sides.

To explain the basis for such an approach, however, it may help first to pinpoint the limitations with the two current ideological poles. Start with the "business of business is business". The issue here is not primarily legal. In many countries, such as Germany, the legal obligation anyway is to stakeholders, and even in America the legal primacy of shareholders is open to very broad interpretation.

Ian Davis

The problem with “the business of business” mindset is rather that it can blind management to two important realities. The first is that social issues are not so much tangential to the business of business as fundamental to it. From a defensive point of view, companies that ignore public sentiment make themselves vulnerable to attack. But social pressures can also operate as early indicators of factors core to corporate profitability: for example, the regulations and public-policy environment in which companies must operate; the appetite of consumers for certain goods above others; and the motivation (and willingness to be hired in the first place) of employees.

Companies that treat social issues as either irritating distractions or simply unjustified vehicles for attack on business are turning a blind eye to impending forces that have the potential fundamentally to alter their strategic future. Although the effect of social pressure on these forces may not be immediate, this is not a reason for companies to delay preparing for or tackling them. Even from a strict shareholder-value perspective, most stockmarket value—typically over 80% in American and western European public markets—depends on expectations of companies' cashflow beyond the next three years.

Examples abound of the long-term business impact of social issues. These are growing fast. In the pharmaceuticals sector, a storm of social pressures over the last decade—stemming from issues such as public perceptions of excessive prices charged for HIV drugs in developing countries, for example—are now translating into a general (and sometimes seemingly indiscriminate) toughening in the regulatory environment. In the food and restaurant sector, meanwhile, the long-escalating debate about obesity is now resulting in calls for further controls on the marketing of unhealthy foods. In the case of big financial institutions, concerns over conflicts of interest and mis-selling of products have recently led to changes in core business practices and industry structure. For some big retailers, public and planning resistance to new stores is constraining growth opportunities. And all this is to say nothing of how social and political pressures have reshaped and redefined the tobacco industry, say, or the oil and mining industries over the decades.

In all such cases, billions of dollars of shareholder value have been put at stake as the result of social issues that ultimately feed into fundamental drivers of corporate performance. In many instances, a "business of business is business" outlook has blinded companies to outcomes (or shifts in their implicit "social contract") which often could have been anticipated.

Just as important, these outcomes have posed not just risks to companies, but also have generated value-creation opportunities. In the case of the pharmaceuticals sector, for example, in the growing market for generic (ie, non-patent-protected) drugs; in the case of fast-food restaurants, in providing healthier meals; and in the case of the energy industry, in meeting fast-growing demand (as well as regulatory pressure) for cleaner fuels such as natural gas. Social pressures often indicate the existence of unmet social needs or consumer preferences. Businesses can gain advantage by spotting and supplying these before their competitors.

Value judgments

Paradoxically, the language of shareholder value may hinder companies from maximising shareholder value in this respect. Practised as an unthinking mantra, it can lead managers to focus excessively on improving the short-term performance of their business, neglecting important longer-term opportunities and issues. The latter would include not just societal pressures, but also the trust of customers, investment in innovation and other growth prospects.

The second point that the "business of business is business" outlook obscures for many companies is related to the first: the need to address questions around their ethics and legitimacy. For reasons of integrity and enlightened self-interest, big firms need to tackle such issues, in both words and actions.

It is neither sufficient nor wise to say that it is up to governments to set laws, and for companies simply to operate within these rules. Nor is it enough, even if it is often valid, to point out that many criticisms of businesses are unmerited, or that those throwing the mud ought also to examine their own practices and social responsibility. Irrespective of whether the criticisms are valid or not, their cumulative effect can shape the strategic context for companies. It is imperative for business to seek to lead rather than react to these debates.

Moreover, in some parts of the world, particularly in some poor developing countries, the rule of law as well as provision of basic public services is notable by its absence. This can render the "business of business is business" positively unhelpful as a guide for corporate action. If companies operating in such environments focus too narrowly on ill-defined local laws or shy from broad debates about their alleged behaviour, they are likely to face mounting criticism over their activities, and face a greater risk of becoming embroiled in local political tensions.

CSagghhh!

Is CSR the answer? If only it were. This is not to criticise the many laudable CSR initiatives by individual companies, nor to dispute the obvious need for businesses (as for any other social entity) to be responsible. It is rather to examine the broad prescriptions set for companies by groups and activists involved in CSR. These commonly include "stakeholder dialogue", "social and environmental reports" and corporate policies on ethical issues. This approach is too limited, too defensive and too disconnected from corporate strategy.

The defensive posture of CSR springs from its genesis

The defensive posture of CSR springs from its genesis. Its popularity as a set of tactics among companies was driven in large part by a series of anti-corporate campaigns in the late 1990s. These were given impetus in turn by the anti-globalisation protests around the same time. Since then companies have been drawn to CSR, attracted by nice-sounding, if vague notions such as the "triple bottom line" (the idea that companies can simultaneously serve social and environmental goals as well as profits). They have seen it as a means to avoid NGO and reputational flak, and to mitigate the rougher edges and consequences of capitalism.

This defensiveness starts the argument on the wrong foot, certainly as far as business leaders should be concerned. Big business provides huge and critical contributions to modern society. These are insufficiently articulated, acknowledged or understood. Among these are productivity gains, innovation and research, employment, large-scale investments, human-capital development and organisation. All of these are, and will be, essential for future national and global economic welfare. Big business also provides a vehicle for investment that is likely to be central to the provision of pensions in the ageing OECD. In poorer developing countries, meanwhile, the entry of multinational companies (through foreign direct investment) has often contributed critical capital, technology, skills and other poverty-reducing economic spillovers. It is no coincidence that developing countries place such emphasis on attracting big businesses and the investment it can bring to their economies.

Such a thing as society?

CSR is limited as an agenda for corporate action because it fails to capture the potential importance of social issues for corporate strategy. Admittedly companies undertaking "stakeholder dialogue" with NGOs will be more aware in advance of potential issues. But tracking NGO opinion is only a part of understanding the range of social pressures which ultimately can affect core business drivers such as regulations, consumption patterns and the like.

An obvious next step for companies, having understood the possible evolution of these broad social pressures, is to map long-term options and responses to them. This process clearly needs to be rooted in strategic development. Yet typical CSR initiatives—a new ethical policy here, for example, or a glossy sustainability report there—are often tangential to this. It is perfectly possible for a firm to follow many of the prescriptions of CSR and still to be caught short by seismic shifts in its socially-driven business environment.

One of the compounding problems is that many companies have chosen to root their CSR functions too narrowly within their public- or corporate-affairs departments. Though playing an important tactical role, such departments are often geared towards rebutting criticism, and tend to operate at a distance from strategic decision-making within the company.

In the limitations of both CSR and of the "business of business is business" thinking lie the outlines of a new approach for business (as relevant for Chinese, Indian and German companies as for American and British businesses). Three main strands stand out.

The first is a helpfully simple prescription. Businesses need to introduce explicit processes to make sure that social issues and emerging social forces are discussed at the highest levels as part of overall strategic planning. This means executive managers must educate and engage their boards of directors. It also means they need to develop broad metrics or summaries that usefully describe the relevant issues, in much the same way that most firms analyse customer trends today. The risk that stakeholders—including governments, consumer groups, lawyers and the media—will mobilise around particular issues can be roughly estimated based on the known agendas and interests of these groups. For example, that the obesity debate would rebound before long on the food companies was partly predictable from the growing spending by governments on obesity-related health problems, inevitable media focus on the issue, plus the interest of some lawyers in finding fresh corporate targets for litigation. By the time business seriously engaged with the issue, however, it was in a defensive posture, struggling to catch up with the public debate. In future, companies need to be much better at understanding and anticipating such issues.

Big, not so easy

The second and third strands both relate to the idea that there is an implicit contract between big business and society, or indeed between whole economic sectors and society—the contract that is the subject of this article. Detractors have often successfully portrayed the contract as a one-way bargain that benefits business at society's expense. Reality is much more complex. The activities undertaken by business have clearly brought social benefits as well as costs. Similarly, however, there are two sides to a contract—and business must acknowledge that in return for the ability to function it is subject to rules and constraints. At times the contract can come under obvious strain. The recent backlash against big business in America can be seen as society seeking to shift the terms of the contract, based on popular perceptions that business has abused its role. Similarly in Germany at present, business is struggling to defend itself against charges that its contract with society is fundamentally unbalanced.

The second strand requires companies not just to understand their individual "contracts", but actively to manage them. To do this they can choose from a range of potential tactics such as: more transparent reporting; shifts in R&D or asset reorganisation to capture expected future opportunities or to shed perceived liabilities; changes in regulatory approach; and, at an industry level, development and deployment of voluntary standards of behaviour.

Some companies and sectors are already experimenting with such approaches—witness General Electric's recent announcement of a doubling of its research spending on environmentally-friendlier technologies. Nonetheless, there is scope for much more activity, provided it is aligned with corporate strategic goals. Reshaping conduct on an industry-wide and increasingly global basis may be particularly important given that the perceived misdeeds of one company can rebound on its sector as a whole.

An important point is that companies will have quite different tactical responses depending on their circumstances, so off-the-shelf, or simply nice-sounding, solutions may not always be appropriate. Transparency offers a good example. It is easy, but wrong, to say that there can never be enough of it. What might be good for a pharmaceutical firm trying to restore consumers' trust could be damaging for a hedge-fund manager. And a voluntary code of practice for a retailer naturally would read very differently from that of a copper-mining company.

This leads me to the third strand of a new approach for business leaders. They need to shape the debates on social issues much more consciously. This means establishing ever higher standards of integrity and transparency within their own companies. It also means becoming much more actively involved in external debates and in the media on social issues that shape their business context.

A starting point may be for CEOs to articulate publicly the purpose of business in less dry terms than shareholder value. Shareholder value should continue to be seen as the critical measure of business success. However, it may be more accurate, more motivating—and indeed more beneficial to shareholder value over the long term—to describe business's ultimate purpose as the efficient provision of goods and services that society wants.

This is a hugely valuable, even noble, purpose. It is the fundamental basis of the contract between business and society, and forms the basis of most people's real interactions with business. CEOs could point out that profits should not be seen as an end in themselves, but rather as a signal from society that their company is succeeding in its mission of providing something people want—and doing it in a way that uses resources efficiently relative to other possible uses. From this perspective, shareholder-value creation or profits are the measure, and the reward, of success in delivering to society the more fundamental business purpose. The measures and rewards reflect the predominant values of the relevant society.

By moving away from a rigid linguistic focus on shareholder value, big business can also make clear to a broad audience that it understands the trade-offs that are inherent in its social contract. The debate between business and society is essentially one over the management of, and agreement over, those trade-offs.

Debatable issues

What might this mean specifically? There is no shortage of big social issues today that directly affect many big businesses and that require new debate. These include: ensuring aid and trade regimes successfully promote the development of Africa and other poor regions (the economic lift-off of such regions would present a major potential boon to global markets as well as international security); promoting a more sophisticated and sensitive approach from both companies and governments to balancing the societal risks and rewards from new technologies; spearheading dialogue on the health-care and pension challenges in many developed countries; and supporting efforts to resolve regional conflicts.

Obviously the relevant issue needs to be matched to the specific business. Some companies and business organisations have taken strong public stances on these and similar issues. But in general high-level, concerted corporate activism is more notable by its absence.

Business leaders should not fear their greater advocacy of the contract between business and society. Public receptiveness to active business leadership on issues such as these may be a lot better than some might be inclined to think. Despite the poor image and bad press of big business in recent times, polls suggest that people retain a belief in the ability of business to provide a positive contribution to society.

More than two centuries ago, Rousseau's social contract helped to seed the idea among political leaders that they must serve the public good, lest their own legitimacy be threatened. The CEOs of today's big corporations should take the opportunity to restate and reinforce their own social contracts in order to help secure, for the long term, the invested billions of their shareholders.