

The grand misapprehension: A response to Aneel Karnani's "'Doing well by doing good': The grand illusion"

Authors: Pietra Rivoli, Sandra A. Waddock

Persistent link: <http://hdl.handle.net/2345/2535>

This work is posted on [eScholarship@BC](#),
Boston College University Libraries.

Published in *California Management Review*, vol. 53, no. 2, pp. 112-116, winter 2011

These materials are made available for use in research, teaching and private study, pursuant to U.S. Copyright Law. The user must assume full responsibility for any use of the materials, including but not limited to, infringement of copyright and publication rights of reproduced materials. Any materials used for academic research or otherwise should be fully credited with the source. The publisher or original authors may retain copyright to the materials.

The Grand Misapprehension

A RESPONSE TO ANEEL KARNANI'S "DOING WELL BY DOING GOOD': THE GRAND ILLUSION"

Pietra Rivoli
Sandra Waddock

Karnani's article "Doing Well by Doing Good: The Grand Illusion" and our article on the "Time-Context Dynamic of Corporate Responsibility" present two fundamentally different worldviews and associated sets of assumptions. His comments on our article highlight these differences. Karnani's view is based on a standard (and static) competitive market framework and set of assumptions. While we do not deny the importance—indeed the centrality—of competitive markets in explaining firm behavior, we also incorporate the time dynamic of social change and its effects on firm behavior.

More than 40 years ago, Milton Friedman argued that "the social responsibility of the firm is to increase its profits." Karnani agrees with this early assessment and argues that regulations, not CR, should influence firm behavior. Yet if the competitive market framework embedded in a regulatory structure had exclusive explanatory power for firm behavior, then it would not seem plausible or even possible that corporate responsibility (CR) could remain such a force in business activity—and such a pre-occupation of management—for nearly half a century. The "Grand Illusion" seems to have considerable staying power—suggesting that it is in fact not such an illusion. If CR is an illusory bubble of some sort, it is certainly one of the longest bubbles in business history.

The Business Case for CR

The discussion is convoluted because Karnani attempts to simply define away the existence of corporate (social) responsibility by claiming that if "some socially desirable activity is profitable, then it is best described as 'intelligent operation of the business.'" It is certainly helpful to companies when there is a so-called business case to be made for being responsible beyond the narrow

conception of fiduciary duty to shareholders and conforming to laws—and norms—of society. While we support the “good management” hypothesis, which argues that being responsible to stakeholders and the natural environment is simply good management,¹ it is exactly the shifting ground of social norms and the pressures that companies feel from these changes that (as our article argues) creates the opportunities and incentives for companies to go beyond immediate profit maximizing toward corporate responsibility.

The statement in Karnani’s paper that managers who “run the company in a socially responsible manner will penalize the shareholders” is not supported by the evidence. Corporate responsibility is not the same thing as give-aways or philanthropy, which in at least some of this article seems to be Karnani’s assumption (and which might simply be a cost). Further, the evidence suggests that the relationship between CR and shareholder returns is neither positive nor negative, but is a rather a neutral one, albeit one with significant measurement challenges.²

The core of our argument is that when social norms change, public expectations rise, and it is exactly at that time that progressive companies engage in what we can define as pro-social activities or corporate (social) responsibility beyond the current set of good management expectations. No sophisticated observer of corporate responsibility today would claim that there is *always* a business case for CR, nor do we argue so in our article. In fact, one of the leading advocates of CSR, Klaus Leisinger, head of the Novartis Foundation for Sustainable Development, stated at the UN Global Compact Leaders Summit in June 2010 that it was nonsense (he actually used somewhat more colorful language) to think that there was always a business case for CSR. When corporate *social* responsibility (CSR) is conceived of as philanthropy, there is, in fact, not always (nor necessarily often) a business case—nor is there necessarily an expected return beyond hoped-for social benefit. In some ways, it is this concept of philanthropy by corporations that Karnani is really discussing. He objects to business people making decisions about using corporate dollars for social good, which he notes is the rightful role of governments (despite the reality that courts in the U.S. have explicitly allowed such contributions) and acting as corporate political citizens (though the 2010 U.S. Supreme Court *Citizens United* decision also gives companies the right to influence elections and to participate in pro-social activities.)

When we are talking about corporate responsibility, however, a different logic applies. CR is not necessary about the explicit pro-social activities of the firm; rather, it involves the inherent *relationships* that companies have with their multiple stakeholders (and the natural environment) and how companies treat those stakeholders. Thus it is integrally bound to *how* a company is managed. In this sense, CR is a strategic approach to management that understands the centrality of stakeholders and nature to the long-term success of the firm and builds

Pietra Rivoli is a Professor at the McDonough School of Business at Georgetown University.

Sandra Waddock is the Galligan Chair of Strategy and Professor of Management at Boston College and writes extensively on corporate responsibility.

on that understanding.³ Following this logic, many firms today do practice CR behaviors as they engage with their stakeholders—employees, customers, investors, suppliers, governments, and communities—as a strategic choice, and they do so in advance of regulatory requirements.

Let us take the example of Nike’s current progressive set of activities related to sweatshops, which includes active monitoring of suppliers and a host of other activities. Nike was one of the companies caught in the sweatshop controversies that exploded in the late 1990s when apparel companies considered what was going on in their supply chains to be beyond the scope of their interests. However, social norms shifted and, as they did, Nike and many other companies with extended supply chains got caught in the midst of controversies that threatened their reputations—and their brands. The more progressive of these companies, including Nike, acted reasonably quickly to try to repair their reputations by instituting various practices, such as supply chain monitoring and reporting, including external audits, which were viewed as more socially responsible than simply ignoring the problem of sweatshops. Consistent with the time dynamic discussed in our article, the regulatory responses—for example, the inclusion of labor standards in U.S. trade agreements—followed the adoption of CR practices by firms such as Nike. CR behavior by some firms changes what is profitable for other firms, and changing norms of firm behavior can and do affect public policy.

Nike ultimately benefitted reputationally from such activities, but it adopted them largely as a response to changing social mores, incurring the costs of doing so, despite the lack of an immediate business case. Other progressive companies, observing Nike’s woes and perhaps wishing to avoid them, adopted similar practices. The gap between current practice and changing social expectations is where we find what is typically labeled CSR. These activities cannot be assumed away by competitive market theory.

Misapprehensions of the “Grand Illusion”

The “orthodox view among free market economists,” which Karnani advocates, “is that the only social responsibility a law-abiding business has is to maximize profits for the shareholders, and this will lead to maximizing social welfare.”⁴ Claiming that the invisible hand that Adam Smith wrote about is “empirically true,” Karnani goes further, stating, “In an efficient market, every profitable firm is doing good.”⁵

CR advocates would argue that “good” goes beyond economics to encompass wellbeing, health, equity, and sustainability, to name a few “goods.” That is, the societal perspective argues that things beyond (but including) economics are important *goods* for a wide variety of stakeholders, many of whom contribute to the wealth creation potential of firms (e.g., employees, customers, suppliers, and communities—in addition to investors).

Further, there is much that can be said from the societal perspective about the arguments in Karnani’s article as well as in his response to our article. Below

are points of contention between what we have argued and what Karnani argues. We disagree, for example, with his premises:

- That markets are efficient. There is considerable evidence that financial markets as well as oligopolistic, marketing-driven “real” goods markets are not efficient.
- That the “business case” is the only reason for CR. In some cases, there is a business case for CR—thought of as “do good” activities. However, the real meaning of corporate responsibility is not philanthropy, but can be found in the business model and the ways that companies engage their stakeholders.
- That managers who “run the company in a socially responsible manner will penalize shareholders.” Again, the evidence to date does not support this claim. Further, it is not reasonable to argue that CR management practices can persist (and indeed flourish) for half a century if they systematically penalized shareholders.
- That regulation is always the answer. We agree that regulations must govern firm behavior. However, Karnani offers no explanation regarding how regulations originate. We argue that regulations evolve partly in response to changing norms and expectations—including norms of corporate behavior, or CR. CR often facilitates effective public policy; this relationship is often one of complements and sequencing, not one of substitutes.

Business as Usual?

Even if Karnani were correct about his definitions of CR/CSR, even if markets were efficient, even if the political system were effective in regulating firm behavior, and even if there were *never* a business case for CSR, there are good reasons to reject his arguments in the world we live in today. The scale of challenges facing our global society requires positive engagement by global corporations with all of their stakeholders.

Fortunately, history clearly displays an ever-increasing bar for corporate behavior. From labor standards to child labor, from environmental protection to fire safety, from affirmative action to product safety testing, the world today has higher standards for corporate behavior than it did a century or even a decade ago. How did—and do—these changes happen? Corporations are embedded in society, and social expectations change over time. Corporations adapt their behavior in response to these changes, and public policies change as well. This makes corporate responsibility not an illusion, but an integral part of human progress.

Notes

1. See Sandra Waddock and Samuel B. Graves, “The corporate social performance--financial performance link,” *Strategic Management Journal*, 18/4 (1997): 303-319.
2. For example, Margolis et al. studied more than 160 research papers to come to this conclusion. Joshua D. Margolis, Hilary Anger Elfenbein, and James P. Walsh, “Does It Pay To Be

Good...And Does It Matter? A Meta-Analysis Of The Relationship Between Corporate Social And Financial Performance," Harvard Business School and University of Michigan Working Paper, 2009. See also Joshua D. Margolis and Hillary Anger Elfenbein, "Do Well by Doing Good? Don't Count on It," *Harvard Business Review*, 86/1 (January 2008): 19-20; Joshua D. Margolis and James P. Walsh, "Misery Loves Companies: Rethinking Social Initiatives By Business," *Administrative Science Quarterly*, 48 (2003): 268-305. Sam Graves, Jegoo Lee, and Sandra Waddock have also completed a 15-year study of the corporate responsibility-financial performance link using a risk-adjusted measure (still unpublished) and come to a similar conclusion about the neutrality of the relationship.

3. Indeed is highly consistent with stakeholder thinking, as developed by R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Boston, MA: Pitman, 1984).
4. Aneel Karnani, "Doing Well by Doing Good': The Grand Illusion," *California Management Review*, 53/2 (Winter 2011): 70.
5. *Ibid.*, p. 71.