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# TWO MODELS OF CORPORATE SOCIAL RESPONSIBILITY

*David Millon*[*]

## INTRODUCTION

There are many ways to think about the nature of business corporations. They can be seen as mere aggregations of natural persons or as entities in their own right. As entities, they have been described as either natural or artificial,[1] and the idea of the corporation as a person is itself fraught with ambiguity.[2] This Article focuses on two perspectives and traces their respective implications for notions of corporate social responsibility ("CSR"). One is familiar and has impeded efforts to argue that corporations should be managed with attention to their obligations to society. The other, less familiar perspective draws on the concept of sustainability and offers potentially more promising prospects for those concerned about CSR.

The first perspective regarding the nature of the corporation is structural. Its focus is on the corporation's constituent elements. These elements include senior management, shareholders, employees, creditors, consumers, and communities in which the corporation operates. Each of these constituencies has its own interests and these interests often conflict with those of other constituencies. For example, shareholders' desire for profit may be at odds with workers' desire for high wages. The primary normative question presented by this vision of the corporation is the amount of weight that should be given to the interests of each of these constituencies. In a particular case of conflict, whose interests should take priority?

The second approach is temporal. The focus is on the

[*] J.B. Stombock Professor of Law, Washington and Lee University. An earlier version of this Article was presented at the symposium on "The Sustainable Corporation" held at Wake Forest University School of Law in April 2011. The author is grateful to the symposium participants for their many helpful comments.

1. *See generally* David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201.

2. *See* David Millon, *The Ambiguous Significance of Corporate Personhood*, 2 STAN. AGORA: ONLINE J. LEGAL PERSP. 39 (2001); David Millon, *Personifying the Corporate Body*, 2 GRAVEN IMAGES: J. CULTURE, L. SACRED 116, 116 (1995).

corporation as an entity existing in time. Rather than an aggregation of numerous constituencies, the corporation is itself a distinct person. The primary emphasis then is on the various external relationships that determine its long-term survival. Here the key question is how the corporation should interact with its various stakeholders in order to ensure its long-run viability.

The structural approach ignores this temporal dimension and instead attends to the immediate impact of particular choices to favor the interests of one constituency over those of others. This assessment is typically made without reference to possible long-term considerations. So, for example, the possibility of economic benefits to the corporation accruing in the future will not necessarily justify expenditures that reduce profits in the short term.

These different ways of thinking about the corporation support two different ways of thinking about CSR. The first speaks in structural terms, emphasizing the broad range of interests that the corporation's management should take into account. The main challenge is balancing potentially conflicting interests implicated by particular business decisions. In particular, CSR under this view requires that management be willing to subordinate the shareholders' desire for profit maximization to the claims of nonshareholder stakeholders. Because it conceives of CSR in terms of the conflicting interests of shareholder and nonshareholder constituencies, this view might be referred to as the "constituency" model of CSR.

The second model is temporal in focus, with the key question being the corporation's success over the long run. Long-run sustainability depends crucially on the viability of the various stakeholders that determine the corporation's success. These include workers, suppliers, and customers, as well as investors, and even the environment.[3] Decisions of corporate management often affect the well-being of these stakeholders in positive or negative ways. Further, management has the ability to improve stakeholders' well-being through investment of corporate funds. If the corporation's long-run sustainability is a serious objective, management must cultivate and nurture these relationships. My main point in this Article is that a long-run orientation to corporate management will achieve many of the objectives favored by CSR advocates. This model might therefore be referred to as the "sustainability" model of CSR. Because the corporation must earn profits in order to survive, the interests of shareholders and nonshareholders do not unavoidably conflict with each other under this model. For this reason, this way of thinking about CSR can

3. For a discussion of the concept of the environment as a stakeholder, see generally Robert A. Phillips & Joel Reichart, *The Environment as a Stakeholder? A Fairness-Based Approach*, 23 J. BUS. ETHICS 185 (2000).

overcome the primary conceptual and political obstacle to the constituency model, which is the assumption that shareholder interests should predominate over those of nonshareholders.

This Article first considers the constituency model of CSR, which is the more familiar way of thinking about these issues. I discuss its status in law and practice. I then turn to the sustainability model, which offers a new and potentially fruitful perspective on CSR, and provide illustrations to highlight its contrast with the constituency model. I close with some thoughts on the prospects for a sustainability approach to CSR.

## I. THE CONSTITUENCY MODEL OF CSR

### *A. The Model*

The constituency model of CSR sees the corporation as an organization consisting of a number of different groups of people, in which the members of each group share more or less common interests. Shareholders, for example, generally seek maximal return on their investments. Employees want rewarding work, satisfactory working conditions, and good wages. Creditors expect that they will be paid according to the terms of their contracts. Often, conflicts exist among these and other constituencies' interests. High returns for shareholders can mean low wages for workers. Increased leverage may be good for shareholders but bad for bondholders. Conflicts like these mean that those in charge must make trade-off judgments. These choices are assumed to be zero-sum games.

According to this view of the corporation, CSR requires management to balance shareholder and nonshareholder interests. Strict shareholder primacy—the idea that shareholder interests should enjoy priority over those of nonshareholders—is rejected because of the costs it can inflict on nonshareholders. For example, profit maximization, even when pursued within the boundaries of the law, can lead to plant closings that harm workers and local communities, environmental damage, and human rights violations in developing countries.[4] Socially responsible leadership therefore necessitates that management temper its pursuit of profit with regard for such considerations.

The constituency model of CSR largely takes for granted the trade-off or zero-sum assumption that sees benefit to nonshareholders coming at the expense of shareholders. Proponents must therefore rely on moral or ethical arguments, conceding the economic critique. Thus, for example, so-called corporate law progressives justify the balancing approach to CSR on fairness

4. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 763 (2005).

grounds, arguing that nonshareholders should not be required to rely on their own contractual bargaining capabilities to protect their interests.[5] Balancing has also been defended on efficiency grounds.[6] According to this view, management's role is to mediate among the conflicting interests of the corporation's various constituencies in order to encourage firm-specific investment and discourage opportunism. For the most part, however, the constituency model of CSR—which has long been the standard way of thinking about CSR[7]—makes no effort to appeal to shareholder interests.

### *B. Current Legal Status*

Corporate law endorses the constituency model of CSR, although only permissively. As of 2003, forty-one states had enacted "constituency statutes" that authorize management to take into consideration a range of nonshareholder interests in addition to those of shareholders.[8] Importantly, however, these statutes only permit balancing of interests rather than requiring it. Corporate boards would thus be free to pursue CSR policies but cannot be sanctioned for choosing not to do so.

Delaware—the state of incorporation for nearly two-thirds of U.S. publicly traded companies—has not enacted a constituency statute.[9] Nevertheless, Delaware law is not committed to shareholder primacy. Management's duties are owed to "the corporation and its stockholders,"[10] rather than to the shareholders alone. Delaware courts have done little to explicate the meaning of this distinction but at least this formulation must indicate that the corporation is something other than—and presumably more than—simply the shareholders alone. It could, for example, be thought of as an entity existing separately from its shareholders and other stakeholders, or perhaps as an aggregation of its various constituencies.

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5. *See, e.g.*, David Millon, *Communitarianism in Corporate Law: Foundation and Law Reform Strategies*, *in* PROGRESSIVE CORPORATE LAW 1 (Lawrence E. Mitchell ed., 1995).

6. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 280–81 (1999).

7. *See, e.g.*, E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1157 (1932) (arguing that management should have regard for the interests of workers and customers as well as those of shareholders).

8. For a description of some of these statutes, see Kathleen Hale, *Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes*, 45 ARIZ. L. REV. 823, 833 (2003). For further discussion, see, for example, David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223 (1991); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992).

9. Hale, *supra* note 8, at 833.

10. *See, e.g.*, Loft, Inc. v. Guth, 2 A.2d 225, 238 (Del. Ch. 1938), *aff'd sub nom.* Guth v. Loft, Inc., 5 A.2d 503 (Del. 1939).

Although the Delaware Chancery Court has stated that directors are obligated "to attempt, within the law, to maximize the long-run interests of the corporation's stockholders,"[11] the Delaware courts have never stated plainly that management's fiduciary responsibilities—the duties of care and loyalty—imply a general duty to maximize profits without regard to competing nonshareholder considerations. Even the quoted language, with its reference to "long-run interests," is vague enough to accommodate policies that favor nonshareholder interests as long as there may be some plausibly asserted long-run benefit to the shareholders. In any event, such pronouncements are of no practical importance, because shareholders lack the ability to challenge management policies that favor nonshareholder interests even if the result is reduction of profits. Under the business judgment rule, courts will not second-guess decisions—including decisions that appear to benefit nonshareholders at the expense of shareholders—as long as management can assert some plausible connection with the corporation's long-run best interests.[12] Further, unless a complaining shareholder can show that the decision in question was not based on adequate information or was tainted by conflict of interest, they will defer to management's claims about benefit to the corporation rather than insisting on production of evidence.[13]

In the one situation in which the Delaware Supreme Court has directly addressed management's authority to consider nonshareholder interests, the court has declined to endorse shareholder primacy. Hostile takeover bids typically present a clear conflict between the interests of shareholders (in unrestricted access to takeover premia, which are typically of substantial value) and those of nonshareholders (in defeat of an offer that threatens their well-being, for example, due to major cost-cutting initiatives).

Defining the circumstances under which a target company's management can lawfully defend against a hostile bid, the court stated in *Unocal Corp. v. Mesa Petroleum Co.* that management can take into account "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[14] The court will require

11. Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del. Ch. 1986); *see also* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010) (stating that duties of directors "include acting to promote the value of the corporation for the benefit of its stockholders").

12. *See* STEPHEN M. BAINBRIDGE, CORPORATE LAW 221–23 (2d ed. 2009).

13. *Id.*

14. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985). In a later case, the Delaware Supreme Court said that benefits for nonshareholders must be "rationally related" to shareholder interests. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 183 (Del. 1986) ("A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the

maximization of shareholder value only if management voluntarily chooses to abandon its own long-run business strategy by undertaking a transaction that will result either in change of corporate control or break-up of the corporate entity.[15] Otherwise, management may resist a hostile bid that would threaten management's plans for the corporation's future, however attractive the bid might be to the corporation's shareholders.[16] Thus, the Delaware Supreme Court has refused to embrace shareholder primacy in the one context in which it might have mattered most. In short, although it is often assumed that corporate law mandates shareholder primacy,[17] there is in fact very little doctrinal basis for such claims.[18]

### C. *Current Practice*

Although not required to do so by law, management of U.S. corporations typically pursues short-term profit maximization as measured by quarter-to-quarter earnings. The objective is enhancement of share price, which depends on a reliable stream of regular earnings; failure to meet earnings targets usually results in immediate share price decline.[19] Because the constituency model of CSR envisions expenditures—in the form of cash outlays or foregone revenues—that are designed to benefit nonshareholders, such policies would mean lower net income and therefore would conflict with management's emphasis on the currently accepted short-term conception of shareholder value. In other words, current practice generally embraces shareholder primacy and rejects CSR.

There are several explanations for current practice, which as

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stockholders."). Even so, this formulation is vague enough to provide substantial discretion. For example, management might defend a decision to protect workers by reference to long-run goodwill considerations.

15. Paramount Commc'ns, Inc. v. QVC Network Inc., 637 A.2d 34, 48 (Del. 1994).

16. Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1154 (Del. 1989). For discussion, see Lyman Johnson & David Millon, *The Case Beyond* Time, 45 BUS. LAW. 2105 (1990).

17. *See, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 419–21 (2002); ROBERT CHARLES CLARK, CORPORATE LAW 17–19, 677–81 (1986); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 23 (1991).

18. The well-known case of *Dodge v. Ford*, 170 N.W. 668 (Mich. 1919), appears to endorse shareholder primacy in strong terms but in fact this decision has had very little influence on corporate law. For discussion, see Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163 (2008).

19. *See, e.g.*, Michael C. Jensen, *Agency Costs of Overvalued Equity*, 34 FIN. MGMT. 5, 8 (2005) ("CEOs and CFOs know that the capital markets will punish the entire firm if they miss analysts' forecasts by as much as a penny.").

explained above, is not required by law. Today's shareholders typically adopt a short-term perspective that manifests itself in a strong preference for immediate results measured in terms of current share price.[20] Management thus finds itself under scrutiny to deliver results on a quarter-to-quarter basis and goes to great lengths to achieve accounting results that meet or exceed earnings targets.[21] Certain institutional investors are especially likely to exert significant pressure on corporations to generate steady profit streams. For example, in order to meet their own obligations to their beneficiaries, the California Public Employees Retirement System and other state pension funds must achieve annual returns on their investments of eight percent.[22] In the face of such demands, patience is not an option.

Management compensation also encourages concentration on current share price. Stock and stock option grants are significant elements of senior officer compensation at most U.S. corporations.[23] The justification is alignment of shareholder and management interests in order to reduce agency costs. The effect is to encourage a short-term focus on profits in order to boost the value of shares and options awarded to executives of the corporation.

Social norms shape an environment in which management tends to understand its role in terms of maximization of current share prices. Business schools, apparently misapprehending the law, preach this ethic at the expense of a richer, more complex conception of responsibility.[24] Corporate lawyers charged with

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20. *See, e.g.*, THE ASPEN INST. BUS. & SOC'Y PROGRAM, OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT 2 (2009); MATTEO TONELLO, THE CONFERENCE BD., REPORT NO. R-1386-06-RR, REVISITING STOCK MARKET SHORT-TERMISM (2006); CFA CTR. FOR FIN. MKT. INTEGRITY & BUS. ROUNDTABLE INST. FOR CORPORATE ETHICS, BREAKING THE SHORT-TERM CYCLE (2006). For a thorough analysis of the short-termism phenomenon that draws on a broad range of economic, business, and legal literature, see Lynne Dallas, *Short-Termism, the Financial Crisis and Corporate Governance* (Univ. of San Diego Sch. of Law, Research Paper No. 11-052, 2011), *available at* http://ssrn.com/abstract=1794190.

21. This practice is referred to as earnings management or managerial myopia. *See, e.g.*, Sanjeev Bhojraj & Robert Libby, *Capital Market Pressure, Disclosure Frequency-Induced Earnings/Cash Flow Conflict, and Managerial Myopia*, 80 ACCT. REV. 1 (2005); Daniel A. Cohen et al., *Real and Accrual-Based Earnings Management in the Pre- and Post-Sarbanes Oxley Periods*, 83 ACCT. REV. 757 (2008); David Millon, *Why is Corporate Management Obsessed with Quarterly Earnings and What Should be Done About It?*, 70 GEO. WASH. L. REV. 890, 897–900 (2002); Natalie Mizik, *The Theory and Practice of Myopic Management*, 47 J. MARKETING RES. 594 (2010).

22. Roger Lowenstein, *The Next Crisis: Public Pension Funds*, N.Y. TIMES, June 27, 2010, at MM9.

23. *See* HERBERT KRAUS, EXECUTIVE STOCK OPTIONS & STOCK APPRECIATION RIGHTS 1–2 (1994).

24. *See generally* RAKESH KHURANA, FROM HIGHER AIMS TO HIRED HANDS: THE SOCIAL TRANSFORMATION OF AMERICAN BUSINESS SCHOOLS AND THE

advising boards on their responsibilities typically take shareholder primacy for granted.[25] The business press insists on the same idea,[26] and prominent corporate law academics—most of whom tend to embrace a conservative law-and-economics agenda—likewise assume that shareholder primacy rather than CSR is legally mandated.[27]

## II. THE SUSTAINABILITY MODEL OF CSR

### A. *The Model*

The sustainability approach to CSR is based on the idea that the corporate entity should remain economically viable over the long run. The corporation must generate profits because survival requires it, but survival most emphatically does not require short-term profit maximization. In fact, a short-term time horizon may impede the corporation's long-run sustainability because it can result in policies that sacrifice future earnings for current net income.

The connection between sustainability and CSR is simply the realization that the corporation's long-run prosperity depends on the well-being of its various stakeholders, including workers, suppliers, and customers. Sustainability also requires ongoing availability of natural resources and a natural environment in which the corporation and its various constituencies can survive and flourish. Well-functioning markets and stable and supportive governments are also essential. Because the corporation itself has a significant role to play in determining the welfare of these stakeholders and in nurturing productive, reliable relations with them, a sustainability approach to business success has the potential to achieve many of the goals that CSR proponents advocate.

The sustainability model of CSR differs from the constituency model sketched above in a fundamental way. The constituency approach sees attention to nonshareholder interests as a cost that comes at the expense of profit and therefore of shareholder value. This is the trade-off or zero-sum assumption. In contrast, the sustainability perspective sees attention to nonshareholders—including investment in their well-being—as essential to the

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UNFULFILLED PROMISE OF MANAGEMENT AS A PROFESSION (2007).

25. For a recent example, see Charles M. Nathan, *A 12-Step Program to Truly Good Corporate Governance*, THE HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 18, 2011, 9:26 AM), http://blogs.law.harvard.edu/corpgov/2011/05/18/a-12-step-program-to-truly-good-corporate-governance/ (asserting that the goal of corporate governance is to enhance shareholder value).

26. *See, e.g.*, Aneel Karnani, *The Case Against Corporate Social Responsibility*, WALL ST. J., Aug. 23, 2010, http://online.wsj.com/article/SB10001424052748703338004575230112664504890.html.

27. *See, e.g.*, sources cited *supra* note 18.

viability and success of the firm and therefore also to the enhancement of shareholder value. The key difference is the relevant time horizon. Constituency CSR emphasizes the negative impact of expenditures on nonshareholders on the corporation's bottom line in the accounting period in which the costs are incurred. Sustainability CSR looks beyond the current quarter or year and factors in long-run benefit as a potential offset to short-term cost. It therefore does not necessarily pose the threat to shareholders assumed by critics of constituency CSR and may actually be in their long-run best interests.

### *B. Illustrations*

The sustainability approach to corporate management accommodates CSR expenditures because it takes into account long-term payoffs that benefit the corporation and thereby its shareholders as well. For transnational corporations doing business in developing countries, sustainability may require investment in community-level infrastructure development projects, technological innovation, education, and health care. As these investments lead to greater productivity and better product quality, workers and producers can earn higher incomes, allowing the local population to enjoy a higher standard of living. An example is Nestlé's entry into milk production in the Moga district of India.[28] Investments in refrigeration, well drilling, veterinary medicine, and training have vastly increased output; enhanced product quality has allowed Nestlé to pay higher prices to farmers.[29] The result is higher incomes for farmers and their employees, and the region now has a significantly better standard of living compared to neighboring communities.

In a similar vein, the Norwegian company Yara International ASA, the world's largest chemical fertilizer company, has sponsored public/private partnerships to develop storage, transportation, and port facilities that will serve African regions with significant untapped agricultural potential.[30] The objective is to facilitate increased yields through lower-cost access to markets, which allows entry into commercial farming. This provides new jobs while also improving incomes and living standards for farmers. At the same time, Yara benefits through increased demand for its fertilizer

28. *See* Michael E. Porter & Mark R. Kramer, *Strategy & Society: The Link Between Competitive Advantage and Corporate Social Responsibility*, HARV. BUS. REV., Dec. 2006, at 11, *available at* http://www.salesforcefoundation.org/files/HBR-CompetiveAdvAndCSR.pdf.

29. *Id.*

30. For Yara's description of these initiatives, see *Agricultural Growth Corridors and African Partnerships*, YARA INTERNATIONAL ASA, http://www.yara.com/sustainability/africa_program/partnerships/index.aspx (last visited Aug. 30, 2011).

products.[31]

By spending money on projects like these, corporations incur immediate costs that reduce current profits. Longer-run benefits, however, have the potential to generate net gains in the form of enhanced productivity, greater skills and knowledge, commitment, increased consumer demand, political and social stability, and long-run viability. The corporation and its shareholders benefit—but so too do the local communities in which its workers and producers live. In contrast, a narrow, short-term orientation seeks simply to locate production in developing countries in order to take advantage of low wages and lax regulations. Current expenses are reduced, but long-run productivity and sustainability considerations are ignored.

Closer to home, many U.S. companies have invested heavily in employee health through wellness and anti-smoking initiatives.[32] Such programs are expensive and therefore stand in contrast to short-term profit enhancement strategies based on minimizing wages and benefits. Johnson & Johnson, for example, estimates that its Wellness & Prevention program has saved the company $250 million in employee health care costs over the past decade.[33] The savings represent a return of $2.71 on every dollar spent.[34] There also appears to be a connection between employer-sponsored wellness programs and employee loyalty; companies with effective programs experience significantly lower voluntary attrition.[35] Greater productivity and higher morale may also result.[36]

Investment in research and development ("R&D") is another example of an upfront cost with potential longer-term payoffs. Despite the crucial importance of R&D for corporate sustainability, corporations have been reducing expenditures in order to maintain short-term earnings.[37] A reversal of this trend would be socially beneficial because it would facilitate the development of new products and services, including those that address consumer demand for environmentally responsible offerings.[38] Proctor &

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31. *Id.*

32. Leonard L. Berry et al., *What's the Hard Return on Employee Wellness Programs?*, HARV. BUS. REV., Dec. 2010, at 104, 105.

33. *Id.* at 105.

34. *Id*; *see also* Rachel M. Henke et al., *Recent Experience in Health Promotion at Johnson & Johnson: Lower Health Spending, Strong Return on Investment*, 30 HEALTH AFF. 490 (2011).

35. Berry et al., *supra* note 32, at 106.

36. *Id.* at 112.

37. *See, e.g.*, William R. Baber et al., *The Effect of Concern About Reported Income on Discretionary Spending Decisions: The Case of Research and Development*, 66 ACCT. REV. 818, 818 (1991) (finding significantly lower R&D spending where it would affect reported earnings).

38. Ram Nidumolu et al., *Why Sustainability is Now the Key Driver of Innovation*, HARV. BUS. REV., Sept. 2009, at 57, 61–62.

Gamble's development of cold-water clothes-washing detergents is one example.[39] Toyota's invention of hybrid gasoline/electric automobiles is another; the failure of U.S. automakers to make similar R&D investments has left them at a competitive disadvantage, forced to license Toyota's technology.[40] Similarly, GE has invested billions in order to develop its "ecomagination" line of energy efficient products and now predicts that revenues from these products will grow at twice the rate of total company revenues over the next five years.[41] All of these are examples of products that will provide social benefits as well as profits to the corporation and its shareholders, but such results are only achieved if companies are willing to spend money on projects that will earn returns in the future, if at all.

### *C. "Strategic" versus "Philanthropic" CSR*

The examples sketched above share a strategic emphasis on investments that serve the interests of key stakeholders in order to bolster the corporation's long-term sustainability. As a result, nonshareholder constituencies can benefit in important ways. However, because such policies are justified in economic terms—in terms of the corporation's long-run profitability—there is no need to resort to moral or ethical arguments, as is the case with the constituency model of CSR. The whole point is to generate net gains in the future from expenditures incurred in the present—benefits to nonshareholders come not at the expense of shareholders but rather are deployed for their ultimate advantage.

For this reason, this approach to CSR objectives can be labeled "strategic."[42] In contrast, the notion that CSR requires firms to forego profits—and therefore reduce shareholder wealth—in order to spend corporate funds to benefit nonshareholder constituencies might be termed "philanthropic" CSR. An example would be refusal to immediately close a plant generating subnormal returns because of concerns about the harsh impact the closure would have on the labor force, the local community, and perhaps also on the company's reputation among consumers, investors, and the general public. Such a decision could be characterized as "philanthropic" in the sense that corporate management has chosen voluntarily to forego profits in order to benefit nonshareholder constituencies. These benefits come at the expense of the shareholders. From that

39. *Id.* at 62.
40. Porter & Kramer, *supra* note 28, at 88–89.
41. Michael E. Porter & Mark R. Kramer, *Creating Shared Value: How to Reinvent Capitalism—and Unleash a Wave of Innovation and Growth*, HARV. BUS. REV., Jan.–Feb. 2011, at 62, 67. For GE's description of the "ecomagination" initiatives, see *Ecomagination*, GENERAL ELECTRIC, http://www.ecomagination.com/ (last visited Aug. 30, 2011).
42. *See* Porter & Kramer, *supra* note 28, at 88.

perspective, the decision is analogous to a charitable donation to a nonprofit organization.

Typically no serious effort is made to defend philanthropic CSR in economic terms. There may be assertions of long-run goodwill or reputational advantages but such claims are virtually impossible to document and the evidence of actual positive effects of CSR policies on worker, consumer, or investor attitudes is uncertain.[43] Indeed, the key idea is not economic at all. It is instead based on a claimed moral or ethical imperative requiring that corporations perform good works regardless of their possible negative impact on profits. This is why this notion of CSR has made only limited headway beyond left-leaning academics and political activists for whom the profit motive may be suspect at best and shareholders are to be tolerated but no more than that.

Because sustainability CSR insists on corporate profitability over the long run, and benefits to key nonshareholder constituencies are designed ultimately to generate payoffs to the corporation and its shareholders, it need not rely on moral or ethical argument alone. Instead, strategic CSR should be understood as promoting the corporation's financial interest and therefore those of the shareholders too. This approach avoids objections to the effect that management is "spending someone else's money"[44] when it uses corporate funds to improve the well-being of nonshareholder stakeholders. For this reason, strategic CSR ought to have significantly broader appeal than the constituency or philanthropic model has had.

While sustainability CSR has the potential to benefit nonshareholders substantially, it is important to note that it is not a complete solution to the problem of the social responsibilities of business. Because it is driven by strategic business considerations, this approach to CSR includes built-in limitations on what corporations are likely to do. Specifically, they cannot be expected to engage social issues unless they have the potential to improve the long-run bottom line. Thus, for example, a corporation may decline to address environmental impacts or labor-force problems, even though doing so could serve the corporation's business interests, if in management's view the long-run benefits to the corporation do not justify the short-term costs.

Further, pressure from shareholders for immediate returns is likely to skew the cost-benefit calculus. Management's awareness that shareholders prefer current earnings may lead it to discount the value of future payoffs more heavily than it otherwise would. In other words, management may assume that a higher rate of return

43. *Id.* at 83.

44. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970 (Magazine), at 33, 33.

is necessary to justify current expenditures designed to benefit nonshareholders. This would discourage some investments that might be endorsed if shareholders were more patient than they typically are today.

Seen solely through a cost-benefit lens, CSR initiatives are not likely to go as far as some would advocate. The moral or ethical case for, say, environmentally responsible policies, or attention to human rights issues, may therefore continue to provide justification for business policies that cannot be defended solely in economic terms. CSR may require attention to nonshareholder interests even when doing so is not in the long-run interests of the shareholders.

Further, if CSR is limited solely to strategic considerations, corporations will not contribute to efforts to solve social problems that are unrelated to their long-run economic interests. Purely charitable expenditures therefore would require justification on other grounds, and moral or ethical arguments for CSR would be relevant here too. Large corporations make significant cash and noncash contributions to a range of educational, health, community development, environmental, and cultural organizations. One survey found that the median total giving amount for sixty-one Fortune 100 companies exceeded $56 million in 2009.[45] These gifts often have no direct connection to the donor's business and are made for essentially philanthropic reasons.[46] They provide needed financial support for worthy causes that otherwise might not receive sufficient funds to be effective. Attractive as the argument for sustainability CSR may appear to be, a philanthropic conception of CSR, unmotivated by business considerations, therefore continues to be important in its own right. Sustainability CSR is not a complete substitute.

## III. THE PROSPECTS FOR SUSTAINABILITY CSR

The economic argument for sustainability CSR ought to have broad appeal. Because it is not based on purely moral or ethical considerations, it avoids standard objections raised against the constituency CSR model based on the interests of shareholders and their claims of privilege vis-à-vis the corporation's various nonshareholder groups. Further, unless blinded by short-term myopia, corporate executives should appreciate the importance of the corporation's long-run viability. They therefore should be receptive to the idea that investment in the well-being of key stakeholders can generate significant financial returns. Indeed, the examples sketched above—and there are many others that illustrate

45. COMM. ENCOURAGING CORP. PHILANTHROPY, GIVING IN NUMBERS 2010 EDITION 7, *available at* http://www.corporatephilanthropy.org/pdfs/giving_in_numbers/GivinginNumbers2010.pdf.
46. *Id.*

the same idea[47]—indicate that many executives understand this point and are incorporating it into their business strategy. Because these developments are driven by economic self-interest, there may be no need for law to encourage it further. Even acknowledging, however, that acceptance of the sustainability model would not fully discharge a corporation's social responsibilities, there are significant impediments to its widespread adoption as a basic element of corporate strategy.

### *A. Sustainability CSR's Problematic Appeal*

As discussed above, today's shareholders—particularly the large institutions that increasingly dominate the stock markets—typically prefer immediate maximization of share value over a more patient approach that is willing to wait for potentially greater returns in the future. This preference leads management to prioritize short-term profits over longer-run considerations. This approach obviously discourages constituency CSR because, under this model, benefits to nonshareholders reduce short-term profits and therefore have a negative impact on current share price. Management's catering to shareholder preferences also impedes thinking about long-run objectives because the corporation's future performance depends in part on expenditures that are made today. The impact on short-term earnings tends to overwhelm considerations based on future returns. Accordingly, CSR policies based on a commitment to sustainable profits are also a casualty of the current obsession with short-termism embraced by shareholders and management.

As explained above, management compensation practices that typically include stock and stock options also encourage a short-term focus. So too do social norms that encourage concentration on quarterly earnings as the relevant metric by which management is to be evaluated. As long as corporate executives prioritize short-term results over long-run value, sustainability considerations will be of only secondary importance. So too will be the idea that CSR policies can contribute importantly to a corporation's long-run viability.

Even if corporate management appreciates the importance of sustainability as a business strategy, it will not necessarily appreciate the potential strategic benefits of CSR policies. Initiatives that require significant investments in the well-being of nonshareholders may be suspect because of their perceived association with constituency CSR policies, which are assumed to come at the expense of corporate profits and not to benefit the corporation. Among executives who assume that shareholder primacy is the relevant metric, there may therefore be a strong

47. *See, e.g.*, Porter & Kramer, *supra* note 41; Porter & Kramer, *supra* note 28.

tendency to bridle even at CSR policies that are based on strategic, rather than philanthropic, motivations.

### *B. Accounting Conventions*

Current accounting conventions generally do not express the future value of strategic investments in the well-being of nonshareholder constituencies.[48] This does not explain why shareholders generally focus on current earnings without regard to longer-term considerations; as explained above, there are other reasons for that phenomenon. Nor does it explain why corporate management remains focused primarily on short-term earnings. The point instead is that an investor who seeks information about the potential future payoffs of current expenditures that are designed to generate sustainable profits by promoting the interests of nonshareholders will find it difficult to obtain that information from the corporation's financial disclosure. Similarly, corporate executives who approve expenditures benefiting nonshareholders may be frustrated at their inability to express the future value of those expenditures in the corporation's financial statements.

According to Generally Accepted Accounting Principles, expenditures designed to benefit nonshareholders so as to create future value typically must be reported as expenses that reduce net income in the accounting period in which they are paid.[49] The fact that they are supposed to generate future profits potentially extending over many years is not reflected on the income statement or balance sheet—instead they are accounted for as current expenses just as are, say, rent or salary or interest payments.[50] So, for example, a corporation that spends money training farmers in more productive, less environmentally damaging agricultural practices or encouraging its employees to pursue healthier life choices will have to account for those costs on its income statement when the expenditures are made, reducing net income by the amount of the expenditure, even though the goal is to produce value in the future. Although these might better be thought of as investments rather than expenses, their value is not expressed on the balance sheet.

Compare in this regard expenditures made to acquire fixed assets, that is, assets that are expected to contribute value to the corporation over a number of years. The cost of these assets is allocated over their useful lives, rather than treated as an expense to be assigned entirely to the period in which they are purchased.[51]

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48. *See Generally Accepted Accounting Principles in the United States*, U.S. GAAP, http://cpaclass.com/gaap/gaap-us-01a.htm (last visited Aug. 30, 2011).
49. *See id.*
50. *See id.*
51. *See* STANLEY SIEGEL & DAVID A. SEIGEL, ACCOUNTING AND FINANCIAL DISCLOSURE: A GUIDE TO BASIC CONCEPTS 50–51 (1983).

The theory is that the cost of these assets should be accounted for over the entire period during which they generate value.[52] Further, the value of fixed assets is included on the balance sheet, expressed in terms of historical cost.[53]

For an investment community obsessed with quarterly earnings, these accounting conventions arguably fail to capture accurately the worth of the expenditures designed to produce sustainable future benefits. They therefore overstate the expenditures' cost to the corporation. A thoughtful analyst could no doubt distinguish costs that generate immediate value—rent and wages, for example—from the kinds of expenditures that are designed to produce future value. He or she could then discount the latter category of expense accordingly, thus reducing the impact on the corporation's net income. Instead, however, shareholders' current focus on earnings—on the "bottom line"—without regard for whether the corporation's expenses may create possible longer-term value amounts to an uncritical acceptance of the validity of current accounting conventions as the basis for valuation of a corporation's stock. Even if management wished to do so, it may be reluctant to correct, through its financial disclosure, misleading information based on these conventions.[54]

## CONCLUSION

The orthodox model of CSR—which I have termed in this Article the "constituency" model—envisions the corporation as composed of a number of constituencies whose interests often conflict. Policies that are designed to benefit a nonshareholder constituency are assumed to reduce profits and therefore affect shareholder interests adversely. Similarly, strict adherence to profit maximization, while in the shareholders' interest, can impose costs on nonshareholders. As management attempts to mediate among these conflicting interests, zero-sum trade-offs are assumed to be inevitable. So, for example, faced with an underperforming plant, management must

52. *See id.* Fixed assets include machinery, buildings, and vehicles. *Id.* at 50. The process by which the cost of such assets is allocated over their useful lives is termed "depreciation." *Id.* A similar process is applied to assets that are actually consumed over time, such as oil reserves or timber, and is referred to as "depletion" rather than depreciation. *Id.* at 50–51. For certain intangible assets like patents, the allocation process is termed "amortization." *Id.* at 51.

53. *See id.* at 52.

54. In particular, concerns about uncertainty or materiality may discourage inclusion of forward-looking assertions in the Management's Discussion and Analysis ("MD&A") section of the corporation's annual report. *See generally* SEC FOCUS ON MD&A DISCLOSURE, FENWICK & WEST LLP 1 (2002) (discussing heightened scrutiny of MD&A disclosures of public companies), *available at* http://www.fenwick.com/publications/indices.asp?request=SEC+Focus+on+MD%26A+Disclosures&cmd=search&SearchForm=%25%25SearchForm%25%25&Fuzzy=Yes&Fuzziness=2&corp=1&ip=1&lit=1&emp=1.

decide whether to shut it down or continue operations for the sake of workers and the local community. Seen in this light, CSR has enjoyed limited traction among business leaders, academics, lawyers, and policymakers because it is widely taken for granted that shareholder primacy is the relevant benchmark.[55] In fact there is no legal warrant for that assumption, but its widespread acceptance renders the constituency model of CSR fundamentally problematic in the eyes of many.

The "sustainability" model of CSR sketched in this Article rejects the zero-sum trade-off assumption of the constituency model and instead embraces the idea that the corporation's long-run sustainability depends in part on the long-run viability of key stakeholders. The corporation has a role to play in ensuring that viability. Examples mentioned above include infrastructure investments in developing countries that will enhance the productivity of local farmers, benefiting the corporation as buyer of their produce and the farmers themselves and their local communities. Many U.S. companies have spent significant sums on wellness and anti-smoking initiatives for their employees, resulting in a healthier workforce as well as improved loyalty and productivity. The point is that investment in the well-being of key nonshareholder constituencies—even though costly in the short run—can generate payoffs in the future that justify those expenditures. Indeed, failure to attend to such considerations may threaten the corporation's long-run competitiveness. Seen in this light, a commitment to sustainability has the potential to accomplish significant objectives favored by CSR proponents.

The sustainability model of CSR avoids the standard objections to the constituency model based on shareholder primacy. Long-run sustainability requires economic success over time. Strategic investments beneficial to nonshareholders are thus designed ultimately to enhance profits. The long-run perspective facilitates appreciation of the relevance of future returns on current investments and their potential to promote shareholder value.

Conceived in this way, CSR grounded in sustainability concerns can produce real benefits for nonshareholders. It is nevertheless important to bear in mind that it still may not do enough to satisfy fully the corporation's responsibilities to society. Because it is grounded on cost-benefit analysis, the arguably legitimate interests of nonshareholders will not be served unless, in the long run at least, the corporation will profit from current expenditures. Furthermore, an approach to CSR that is limited to the corporation's strategic concerns will not justify philanthropy that cannot be firmly linked to the corporation's own economic interests. Accordingly,

55. *See, e.g.*, D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 277–78 (1998).

depending on one's views about the extent of the business corporation's social responsibilities, sustainability CSR may not go far enough.

Even accepting these possible shortcomings, there is reason to doubt whether corporate self-interest can be sufficient to generate significant investment in CSR initiatives motivated by sustainability concerns. The contemporary preference of most shareholders for current returns means that they are likely to be unreceptive to expenditures that reduce quarterly earnings for the sake of potential future payoffs. In addition to possible questions of speculativeness, this impatience means that investors will discount heavily the value of any such future returns. This will discourage potentially profitable CSR investments that might otherwise have been made.