

Chapter 1

AN INTRODUCTION TO CORPORATE RESPONSIBILITY

Corporate responsibility (CR) is the manifestation of a corporation's social and environmental obligations to its constituencies and greater society. CR is increasingly being used by constituencies ranging from the general public to investors to analyze and critique modern-day corporate behavior.

When did society's expectations of corporations shift to include responsible and accountable behavior in addition to profit-making? As recently as two decades ago, the general public viewed such "do-gooding" as the primary domain of non-profit organizations and Good Samaritans. At the time, many considered businesses to be purely self-interested entities. Positioned in a corner directly opposite charities, the purpose of a corporation was profit maximization, with any efforts to give back to the community being limited to check-writing and philanthropy at an arm's length. Milton Friedman, a University of Chicago economist, embodied the belief that businesses should be strictly economic while governments and non-profits should handle social and environmental issues. In the 1970s, Friedman's doctrines became famous through his *New York Times Magazine* article "The Social Responsibility of Business Is to Increase its Profits," in which he declared:

What does it mean to say that "business" has responsibilities? Only people can have responsibilities. A corporation is an artificial person and in this sense may have artificial responsibilities, but "business" as a whole cannot be said to have responsibilities, even in this vague sense.¹

In the 1970s, society began to more actively question the means by which corporations generate profits, acknowledging for the first time that corporate practices and society's well-being are closely linked.² Corporations became more environmentally

aware once large-scale disasters such as Union Carbide's chemical leak in Bhopal, India, in 1984 and the Exxon Valdez oil spill in 1989 sparked widespread uproar about the irresponsibility of big business.³ In the 1990s, a series of exposés in the mainstream media revealed to many consumers for the first time the "sweatshop" labor conditions and child labor used in garment and footwear supply chains by companies such as Nike and the Kathie Lee line of clothing sold at Wal-Mart. These exposés led to consumer outrage and boycotts, which prompted corporations to adopt codes of conduct to protect workers' rights.

Today, companies are becoming increasingly aware of the effect that their operations have in their many communities and beyond. We see companies forging into unprecedented territory by tackling issues ranging from income inequality and global pandemics to climate change and access to clean water—issues previously considered to be unrelated to their organizational mission. They are implementing community programs and partnerships with nongovernmental organizations (NGOs) and, most innovatively, are adapting their own business models to be more responsible and sustainable. In this millennium, the for-profit and nonprofit sectors are no longer at odds; instead, the once-distinct lines between them are blurring.

The 2012 Edelman goodpurpose® study found that 87% of global consumers felt that "business needs to place at least equal weight on society's interests as on business interests," while only 28% believed that business was performing well in addressing societal issues. In improving CR efforts to bring them more in line with consumer expectations, corporations have an opportunity to increase profits: 73% of consumers surveyed by Edelman stated that they would switch brands if a different brand of similar quality supported a good cause.⁴

It's unsurprising, then, that many global executives today view corporate responsibility as critical to their business strategy and operations. The 2014 PricewaterhouseCoopers Global CEO Survey revealed that over three-quarters of CEOs believe that satisfying wider societal needs and protecting the interests of future generations is vital to their business.⁵ A 2013 KPMG study found that "over half of reporting companies worldwide now include CR information in their annual financial reports. This is a striking rise since 2011 (when only 20 percent did so) and 2008 (only 9 percent)." This trend shows that today's leaders understand the importance of CR and demonstrates the value and resources they are investing in CR initiatives.⁶

WHAT IS CORPORATE RESPONSIBILITY?

Corporate responsibility, corporate social responsibility, corporate citizenship, sustainability, and even conscious capitalism are some of the terms used in the news media and corporate marketing efforts as companies jockey to win the trust

and loyalty of constituents around the world.⁷ The acronym *ESG*, which stands for “environmental, social, and governance,” is also used to describe corporate responsibility initiatives. The term *triple bottom line*, popularized in 1994 by John Elkington, founder of British consulting firm SustainAbility, is also used in corporate responsibility conversations and refers to “profit, people, and planet.”

Corporate responsibility describes an organization’s respect for society’s interests, as demonstrated by its taking ownership of the effect its activities have on key constituencies, including customers, employees, shareholders, communities, and the environment, in all parts of its operations. In short, CR prompts a corporation to look beyond its traditional bottom line (economic profit or loss) to consider the greater social implications of its business.

This accountability often extends beyond baseline compliance with existing regulations to encompass voluntary and proactive efforts to improve the quality of life for employees and their families, as well as for the local community and society at large. A responsible company makes a concerted attempt to reduce the negative social and environmental footprint of its operations through a thoughtfully developed strategy implemented over the long term and not merely through temporary, stopgap measures such as monetary contributions to charitable causes.⁸ For example, ExxonMobil’s donation of \$250 million over 32 years to sponsor Masterpiece Theatre qualifies as philanthropy, but it cannot be categorized as CR, as it makes no effort to mitigate the lasting impact of the company’s operations.

In contrast, Starbucks’ efforts to minimize the negative effects of its coffee supply chain and retail operations by purchasing beans from fair trade growers and paying its employees wages higher than industry averages serve as cornerstones of its CR strategy.⁹ Many times, a company’s corporate responsibility efforts involve donations of time and expertise as opposed to cash. However, *Corporate Responsibility Magazine* observed in 2010 that the days of “checkbook philanthropy” are over and noted that contributions of in-kind products, services, and experience represented greater than 65% of corporate contributions. Additionally, 64% of global consumers felt that it was no longer enough for a company to donate only money. Instead, consumers felt that companies must incorporate good works into the fabric of their business.¹⁰

In shaping a CR strategy, a corporation ideally acknowledges and integrates the full spectrum of constituencies’ “extra-financial” concerns—social, environmental, governance, and others—into its strategy and operations. The Global Reporting Initiative (GRI), an organization that promotes sustainability reporting as a tool to help organizations become more sustainable and help with sustainable development, describes five interdependent capital asset classes: financial, human, natural, social, and technological. *The Economist* has described CR as “part of what businesses

need to do to keep up with (or, if possible, stay slightly ahead of) society's fast-changing expectations."¹¹ Developing an authentic CR strategy signals a corporation's intent to look beyond short-term financial returns and focus on long-term success and sustainability by managing those expectations. This consideration often requires the executives of public companies to fight prevailing pressures to achieve strong quarterly results at the expense of longer-term, often less tangible benefits.¹²

Despite these challenges, Harvard Business School guru Michael Porter and consultant Mark Kramer argue that CR is a strategy that, if implemented thoughtfully and thoroughly, can enhance a corporation's competitiveness. They analyze the interdependence of a company and society by using the same tools used to analyze overall competitive positioning and strategy development. In this way, CR can be used strategically to set an "affirmative [CR] agenda that produces maximum social benefit as well as gains for the business."¹³ A CR strategy should not be reactive but should proactively identify the social consequences of a company's entire value chain—the full spectrum, including all the activities it engages in when doing business—to pinpoint potential problems and opportunities wherever business and society intersect.¹⁴

In 2013, 90% of the 250 largest global companies said they used their reports on CR to highlight environmental and social changes that could affect their firm and their key stakeholders, and 70% of these companies noted that these changes have created opportunities for the innovation of new products and services.¹⁵ KPMG has identified the two principle drivers of increased value from corporate responsibility as cost-savings and improved reputation.¹⁶ A recent IBM survey found that 87% of executives were focusing on CR activities that would help them to improve efficiency, and 69% were focusing on CR activities that would help with new ideas for revenue generation.¹⁷

To help companies with strong corporate responsibility platforms gain more credibility and recognition, an American nonprofit, B Lab, has created the B Corp certification, with the "B" standing for "Benefit."¹⁸ B Corps are companies that meet "rigorous and independent standards of social and environmental performance, accountability, and transparency." Companies can apply for B Corp status much in the same way that companies can apply to certifying bodies to achieve fair trade, organic, or LEED certification. As of 2014, B Lab reported that over 1,000 companies in over 30 countries had become B Corps. These companies represent 60 industries and include investment groups and construction firms. Consumer product companies such as King Arthur Flour, Dansko, Method, Seventh Generation, Ben & Jerry's, and Patagonia have achieved B Corp status. B Lab has made significant progress since 2012, when there were only 502 certified B Corp companies. However, in 2012, the 502 companies had a combined revenue of only

\$2.5 billion, which demonstrates that the largest Fortune 500 companies are not yet part of this movement.¹⁹

On its website, B Lab lists the following reasons that companies may want to become a B Corp: “Differentiate your brand, maintain mission, save money [particularly via partnerships and discounts negotiated for members by B Lab], generate press, attract investors, improve and benchmark performance, and build a movement.”²⁰

In addition to providing its own certification, B Lab has taken its mission a step further and is working with state governments to legitimize the B corporation as a legal incorporation option. Similar to the C corporation, S corporation, LLC, and LLP, B corporation status reflects the organizational structure of a company as well as the tax laws that affect it. As of July 2014, 25 states had passed legislation recognizing B corporations, including New York, California, Massachusetts, Delaware, Illinois, and Washington, DC. B Lab is pursuing this agenda because it believes that “current corporate law makes it difficult for businesses to consider employee, community, and environmental interests when making decisions.”²¹

With more states reviewing B corporation legislation and with consumers agitating for more corporate responsibility, it seems increasingly likely that corporations that do not make an effort to carve out their own CR niche will be left trailing their competition.

THE 21ST CENTURY’S CR SURGE

Corporations are becoming increasingly aware that as they look out for society’s best interests, they are actually looking out for their own interests too, particularly in the long run. As Charles Handy notes, “business needs a sustainable planet for its own survival, for few companies are short-term entities; they want to do business again and again, over decades.”²² Businesses do not exist in a vacuum—they inevitably intersect with society and are mutually dependent for their survival. As *Financial Times* assistant editor Michael Skapinker argues:

Companies cannot thrive in collapsing societies. Without political stability, the future of business is grim. Even in the most stable countries, companies need the community’s approval to function. Opinion can turn against them fast: witness European consumers’ distaste for genetically modified food, or the attacks on pharmaceutical companies over the pricing of AIDS drugs in Africa.²³

This argument includes corporations’ need for an environmentally stable context in which to operate. Pressing environmental and social issues today—from climate

change to income inequality—pose serious threats to “business-as-usual” operations. Sal Palmisano, former chairman of the board and former CEO of IBM, describes the new expectations corporations must meet to survive in light of these risks:

All businesses today face a new reality. Businesses now operate in an environment in which long-term societal concerns—in areas from diversity to equal opportunity, the environment and workforce policies—have been raised to the same level of public expectation as accounting practices and financial performances.²⁴

Corporations slow to adapt to this new reality pay a price. An often cited example is Wal-Mart’s 2004 discovery of a report prepared by McKinsey & Company—and subsequently made public by walmartwatch.com, a public education campaign devoted to challenging Wal-Mart to become a better corporate citizen—stating that up to 8% of Wal-Mart consumers surveyed in 2004 had ceased shopping at the chain because of its reputation, which at the time included a perceived CR deficit.²⁵ Wal-Mart’s then CEO, Lee Scott, reacted with this comment: “We thought we could sit in Bentonville, take care of customers, take care of associates—and the world would leave us alone. It doesn’t work that way anymore.”²⁶ In a published statement, Scott also admitted that Wal-Mart had been caught off-guard by its entanglement in social and environmental issues:

To be honest, most of us at Wal-Mart have been so busy minding the store that the way our critics have tried to turn us into a political symbol has taken us by surprise. But one thing we’ve learned from our critics is that Wal-Mart’s size and industry leadership mean that people expect more from us. They’re right to, and when it comes to playing our part we intend to deliver.²⁷

People today are expecting more. *The Economist* has described CR as “a do-gooding sideshow” that has now turned mainstream.²⁸ When IBM surveyed 1,700 global CEOs, they found that 72% of CEOs believe that they must improve their firm’s understanding of individual customer needs and their firm’s response time to market needs. Nearly half of all CEOs surveyed also believe they need to increase transparency, corporate accountability, and their firms’ social and environmental responsibilities.²⁹ In today’s world of heightened awareness of climate change, human rights, and scarcer resources, a corporation’s “extra-financial” behavior—how well it treats its stakeholders and the world in which it operates—contributes greatly to its trustworthiness. Trust is not an abstract notion; it can have a significant impact on a company’s bottom line. The Trust Barometer, published by the international public relations firm Edelman, revealed that 73% of people have refused to buy the products or use the services of a corporation they do not trust.³⁰

Large corporations started the new millennium on a precarious note, the effects of which still linger today. Enron and WorldCom's respective scandals shocked the world and undermined the average person's trust in the motives and operations of big business. Enron's now famous *Code of Ethics*—last published in July 2000, prior to the company's downfall—described such fundamental values as respect, integrity, communication, and excellence. Belief in the altruistic motives of big business subsequently crashed; by 2002, a *Businessweek*/Harris survey reported that 79% believed that “most corporate executives put their own personal interests ahead of employees and shareholders.”³¹ Over a decade later, the general public still demonstrates low levels of faith in corporations. In June 2014, Gallup reported that only 21% of Americans say they have a “great deal” or “quite a lot” of confidence in big business, compared to 74% for the military.³²

At the same time, widespread Internet access (an estimated 2.4 billion people were online as of June 2012³³) has redefined the notion of transparency for corporations. The Internet and social media platforms such as Twitter and Facebook now serve as powerful forums for like-minded people to educate and organize themselves. Individuals also now have a powerful tool for spreading once-proprietary company information. It is easier than ever for constituents to monitor companies and to criticize them for everything from human rights violations that take place in a distant corner of a company's supply chain to carbon emissions that are in excess of local regulatory limitations. Even traditional media is benefiting from the Internet when reporting on corporate responsibility issues. In 2010, *Corporate Responsibility Magazine* published a “black list” of the 30 companies that it rated worst in terms of transparency regarding their corporate responsibility practices, making a point of noting that the 30 black-list companies had underperformed both the S&P 500 and the magazine's list of “100 Top Corporate Citizens” based on three-year total return. This controversial list became fodder for many online blogs and websites, ultimately reaching a much wider audience than the magazine edition alone.

Further attention is being paid to corporations' CR efforts through a proliferation of socially responsible indices and rankings, such as the “Best in Social Responsibility” category on *Fortune*'s World's Most Admired Companies list. In 2009, *Newsweek* began publishing its annual Green Rankings to evaluate corporate responsibility initiatives. Many corporations today vie for inclusion on widely admired indices, including the FTSE4Good Index—an index created by benchmarking company FTSE and designed specifically to help measure the performance of companies meeting globally recognized corporate responsibility standards.³⁴ Another index of such companies is the Dow Jones Sustainability World Index, which designates the top 10% of 2,500 companies worldwide according to long-term economic, environmental, and social sustainability criteria.³⁵

These communication channels and points of engagement directly influence constituencies' impressions of a corporation. A corporation lacking a CR strategy and a clear execution plan for its CR strategy runs the risk of losing control of its reputation in today's highly networked and highly scrutinized business environment.

THE UPSIDE OF CR

Although CR is taking center stage thanks to a business environment of proliferating risks, adopting a socially responsible strategy can offer a compelling upside to corporations. Contrary to Friedman's claims, responsible business practices do not necessarily undermine a corporation's profit motive. In fact, many CEOs today describe acting responsibly as pragmatic—it makes good business sense. A well-executed CR strategy can translate into an array of benefits, including attracting and retaining customers, identifying and managing reputational risks, attracting the best-quality employees, and reducing costs.³⁶ Wal-Mart—the top company on the Fortune 100, driven by a fierce cost-cutting mantra—explains the value of CR from a strategic perspective. In former CEO Lee Scott's words:

By thinking about sustainability from our standpoint, it is really about how do you take the cost out, which is waste, whether it's through recycling, through less energy use in the store, through construction techniques we're using, through the supply chain. All of those things are simply the creation of waste.³⁷

Cutting costs allows Wal-Mart to charge even lower prices, which supports its mission of helping customers to "Save Money. Live better." General Electric (GE) has also achieved significant cost savings through eco-friendly action, such as investing in alternative energy technologies in 2002 when oil was priced at \$25 per barrel. In 2011, with oil prices six times higher and rising, GE was reaping the benefits of the demand it predicted nine years before.³⁸

The scale and nature of the benefits from CR activities for an organization can vary depending on the business and are often difficult to quantify, though increased efforts are being made to link CR initiatives directly to financial performance.³⁹ In the meantime, a strong case exists that CR makes good business sense and positively affects the bottom line.

Reputation Risk Management

Managing reputational risk is a central part of any robust corporate strategy. As Berkshire Hathaway CEO Warren Buffett once famously noted, "It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do

things differently.” Corruption scandals or environmental accidents can devastate a carefully honed corporate reputation in a matter of days. These events can also draw unwanted attention from regulators, courts, governments, and media. Building a genuine culture of “doing the right thing” within a corporation—the foundation of any genuine CR strategy—can help offset these risks.

Brand Differentiation

In crowded marketplaces, companies strive for a unique selling proposition that can separate them from the competition in consumers’ minds. Corporate responsibility can help build customer loyalty based on distinctive ethical values. Several major brands, such as Stonyfield, Seventh Generation, TOMS shoes, and The Body Shop, are built on such ethical values. GE CEO Jeffrey Immelt emphasized the importance of brand differentiation by staying ahead of issues and evolving with ever-changing constituency concerns:

When society changes its mind, you better be in front of it and not behind it, and [sustainability] is an issue on which society has changed its mind. As CEO, my job is to get out in front of it because if you’re not out in front of it, you’re going to get [plowed] under.⁴⁰

Talent Attraction and Retention

As we will discuss in more detail later in the chapter, a CR program can aid in employee recruitment and retention. It can also help improve the image of a company among employees, particularly when they become involved through fundraising activities, community volunteering, or helping to shape the company’s CR strategy itself. Using these tactics to strengthen goodwill and trust among present and future employees can translate into reduced costs and greater worker productivity.⁴¹ In 2010, an estimated 34% of employees said they would take a pay cut to work for a socially responsible firm.⁴²

Once a company decides to implement corporate responsibility practices, it should be sure to communicate them to its employees and other key constituencies to maximize the return on its efforts. That same 2010 study found that a full 53% of employees were not sure if their company had any CR practices in place.

License to Operate

Corporations want to avoid interference in their business through taxation or regulations. By taking substantive voluntary steps, they may be able to persuade governments and the wider public that they are taking current issues like health

and safety, diversity, and the environment seriously and thus avoid intervention. Expenses today can result in future cost-savings or increased revenue streams from new, socially responsible products and services. Consider DuPont, which has saved more than \$2 billion from energy use reductions since 1990—an upfront investment that, years later, continues to pay dividends.⁴³

CR Critics

Despite mounting evidence in support of CR's benefits, followers of Milton Friedman and others continue to argue that there is no place for social responsibility in business. These critics rail against CR as detracting from a corporation's commercial purpose and effectiveness, thereby inhibiting free markets. In this view, responsibility and profitability constitute a zero-sum game; corporations are for-profit institutions whose primary purpose is profit, and they lose competitiveness through altruistic, profit-diminishing behavior.⁴⁴ Some critics claim that CR is little more than a public relations strategy, in which companies cherry-pick their good activities to showcase and ignore the others, creating an inaccurate image of a socially or environmentally responsible company. Others contest that CR programs are often undertaken in an effort to distract the public from the ethical questions posed by their core operations. In general, however, constituencies are increasingly calling for more corporate responsibility and demanding that companies rise to the occasion.

RESPONSIBILITY INSIDE AND OUT: EMPLOYEE INVOLVEMENT IN CR

Employees play an essential role as brand ambassadors for a corporation. This is especially true in the implementation of a CR strategy. The next generation of corporate leaders is actively searching for responsible practices in corporate track records as they recruit and pick a place to start their careers.

In 2011, *Harvard Business Review* shared research findings that 88.3% of MBA graduates from top programs would take a pay cut to work for an ethically responsible company and would be willing to forgo an average of \$8,087 in compensation.⁴⁵ Top business schools around the world are offering a greater number of corporate responsibility, values-based leadership, and sustainable enterprise courses and programs, addressing business students' desire not just to work hard but to do some good at the same time.⁴⁶ Net Impact, an association of more than 40,000 business professionals working to improve corporate responsibility, reports that 98% of the top 50 MBA programs have active chapters.⁴⁷

Once a corporation has attracted top talent, engaging those employees from all levels of the organization in a company's CR efforts is imperative. Employees are often the primary spokespeople for a corporation, responsible for much word-of-mouth information shared and impressions formed. Furthermore, making employees central to a CR strategy can boost employee goodwill and morale, decrease turnover, and increase operational efficiencies by encouraging employees to identify opportunities for sustainability and cost-savings.⁴⁸ Many corporations are missing out on this upside: though more than three-quarters of executives say corporate citizenship fits their companies' traditions and values, only 36% report talking to their employees about corporate citizenship.⁴⁹

IBM serves as an example of a company successfully engaging its employees in CR issues, as it hosts regular brainstorming sessions focusing on corporate responsibility and sustainability. It often refers to its now-famous, and still largest, first "InnovationJam" held in 2006.⁵⁰ During this InnovationJam, more than 150,000 IBM employees, family members, clients, and partners in 104 countries joined in on an online conversation on IBM's global intranet. Driven primarily by IBM employees, more than 46,000 observations and ideas were posted on how to translate IBM's technologies into economic and broader societal value. IBM allocated \$100 million to explore 10 promising business opportunities suggested, including creating access to branchless banking for the underprivileged masses around the world and working with utility companies to increase power grid and infrastructure efficiency.⁵¹

Stanley Litow, IBM's vice president of corporate citizenship and corporate affairs and president of IBM's Foundation, further explains IBM's approach to corporate responsibility:

In the *Harvard Business Review*, Rosabeth M. Kanter described the IBM approach as going from "spare change to real change." With the spare change approach, the company makes X amount of dollars and they give their spare change back to the community, with the goal being generosity. But with the real change approach, you take what is most valuable to the company—in our case, our innovation technology, and the skill and talent of our people—and contribute it into the community. The real change approach is strategic, it's a systemic part of the way we operate as a company, and that is the case for tie-in to business strategy. In the end, it's even more generous to do it that way.⁵²

Strong evidence exists that the general public now views genuinely responsible behavior as starting inside the four walls of an organization. As FleishmanHillard posted on its website following the 2011 Fortune Green Brainstorming Conference, "a company cannot meet its sustainability or reputation goals without a smart

strategy that incorporates employees.”⁵³ After conducting research with FleishmanHillard, the National Consumers League reports that 76% of American consumers agree that for a company to be socially responsible, it should prioritize salary and wage increases for employees over making charitable contributions.⁵⁴ Observers credit Google’s workplace environment for its strong social responsibility reputation, because the company does not traditionally score in the top five for its environmental or community cause involvement on the major rankings.⁵⁵ As Robert Fronk of Harris Interactive explains, “corporate responsibility, in the minds of consumers, starts with your own employees first.”⁵⁶

Corporations have an excellent opportunity to differentiate themselves based on such internally responsible behavior. There is a sharp contrast today between executive talk and action pertaining to the treatment of employees. While four out of five senior executives “see the importance of valuing employees and treating them well,” only half of companies surveyed offer health insurance to employees, and less than one-third provide either training or career development to low-wage employees.⁵⁷

BUILDING A VALUES-BASED CULTURE

A critical element of valuing employees is codifying corporate beliefs—including those pertaining to employees and other constituencies—in a set of corporate values for each employee to embody. A clear and prominent set of values or code of ethics instilled in employees should ideally serve as a navigational compass for everyday work activities. Employees who live and breathe their company’s values are far less likely to engage in legal or ethical breaches. A strong, values-based culture can also contribute to an organization’s competitive edge, increasing employee pride, loyalty, and willingness to go the extra mile for the sake of the corporation’s mission.⁵⁸ Former IBM chairman Thomas J. Watson described the importance of corporate values and strong employee faith in them this way:

Consider any great organization—one that has lasted over the years—and I think you will find that it owes its resiliency, not to its form of organization or administrative skills, but to the power of what we call beliefs and the appeal these beliefs have for its people. This, then, is my thesis: I firmly believe that any organization, in order to survive and achieve success, must have a sound set of beliefs on which it premises all its policies and actions. Next, I believe that the most important single factor in corporate success is faithful adherence to those beliefs. And finally, I believe that, if an organization is to meet the challenges of a changing world, it must be prepared to change everything about itself except those beliefs as it moves through corporate life.⁵⁹

For a values-based corporate culture to take root and thrive, the tone must be set from the top. Warren Buffett, CEO of Berkshire Hathaway and noted philanthropist, is adamant about this, taking an active role in clearly communicating his ethical expectations to his employees. Using blunt, everyday language—and analogies that any employee can easily identify with—he explicitly states intolerance for ethical wrongdoing, citing it as more important than profits. Most important, Buffett creates a clear connection between the individual actions of employees and corporate culture, in turn shaping the organization's overall reputation. Buffett emphasized this personal accountability in a now legendary September 2006 memo to Berkshire Hathaway employees (see Figure 1.1):

Your attitude on such matters, expressed by behavior as well as words, will be the most important factor in how the culture of your business develops. And culture, more than rule books, determines how an organization behaves. Thanks for your help on this. Berkshire's reputation is in your hands.⁶⁰

Research underscores the enormous impact corporate leaders have on the atmosphere of a workplace and the values and behavior encouraged within it. Deloitte has found that 75% of employees identify either their senior or middle management as the primary source of pressure they feel to compromise the standards of their organizations.⁶¹ In 2010, Deloitte found that 31% of employees believed that their colleagues were more likely to behave unethically as a result of the challenging economic conditions.

Ensuring that employees are striking a healthy balance in their lives is another important piece of building an ethical culture. Deloitte's Ethics & Workplace Survey also found that an overwhelming 91% of employed adults polled claimed they were more likely to behave ethically in the workplace when they maintained a good work-life balance.⁶² A positive working environment reduces stress and frustration levels, thereby diminishing the likelihood of cutting corners to meet unrealistic demands. It is disturbing to consider research by the corporate trend-tracking service DYG SCAN pointing to a pattern of employees no longer believing in employer loyalty, concern, and personal commitment.⁶³ Investing in employees to foster a sense of mutual accountability and encouraging the free airing of issues without fear of reprimand or retaliation can go a long way toward strengthening an ethical culture.⁶⁴ Taking another step to provide employees with resources—such as ethics training to prepare them for dilemmas or a hotline to call if one occurs—can be critical to keeping a corporate culture aligned with the strong values that must underpin all successful corporate citizenship efforts.

Figure 1.1 Berkshire memorandum

Memorandum

To: Berkshire Hathaway Managers (“The All-Stars”)

From: Warren E. Buffett

Date: September 27, 2006

The five most dangerous words in business may be “Everybody else is doing it.” A lot of banks and insurance companies have suffered earnings disasters after relying on that rationale.

Even worse have been the consequences from using that phrase to justify the morality of proposed actions. More than 100 companies so far have been drawn into the stock option backdating scandal and the number is sure to go higher. My guess is that a great many of the people involved would not have behaved in the manner they did except for the fact that they felt others were doing so as well. The same goes for all of the accounting gimmicks to manipulate earnings—and deceive investors—that has [*sic*] taken place in recent years. You would have been happy to have as an executor of your will or your son-in-law most of the people who engaged in these ill-conceived activities. But somewhere along the line they picked up the notion—perhaps suggested to them by their auditor or consultant—that a number of well-respected managers were engaging in such practices and therefore it must be OK to do so. It’s a seductive argument. But it couldn’t be more wrong. In fact, every time you hear the phrase “Everybody else is doing it” it should raise a huge red flag. Why would somebody offer such a rationale for an act if there were a good reason available? Clearly the advocate harbors at least a small doubt about the act if he utilizes this verbal crutch. So, at Berkshire, let’s start with what is legal, but always go on to what we would feel comfortable about being printed on the front page of our local paper, and never proceed forward simply on the basis of the fact that other people are doing it.

A final note: Somebody is doing something today at Berkshire that you and I would be unhappy about if we knew of it. That’s inevitable: We now employ well over 200,000 people and the chances of that number getting through the day without any bad behavior occurring is nil. But we can have a huge effect in minimizing such activities by jumping on anything immediately when there is the slightest odor of impropriety. Your attitude on such matters, expressed by behavior as well as words, will be the most important factor in how the culture of your business develops. And culture, more than rule books, determines how an organization behaves. Thanks for your help on this. Berkshire’s reputation is in your hands.

Source: Full text of Warren Buffett’s memorandum. FT.com. <http://www.ft.com/cms/s/0/48312832-57d4-11db-be9f-0000779e2340.html#axzz21NuYXyCz>. Accessed 7/12/2014.

THE EVOLUTION OF CR

As discussed earlier in the chapter, the past couple of decades have seen a shift in societal expectations of corporate behavior. In adapting to these changing expectations, companies have shifted their approach to corporate responsibility from viewing CR initiatives as an obligation to embracing CR as an important component of business strategy. Accordingly, companies have adjusted their CR operations to suit a more visionary approach. Some of the ways they have demonstrated this change in thinking include making long-term commitments to specific social issues and initiatives, providing more than monetary support to causes, sourcing funds from business units as well as philanthropic budgets, and forming strategic alliances—and doing all of this in a way that advances business goals.⁶⁵ Table 1.1 outlines the differences between a first- or second-generation CR program and a third-generation CR program, with a first- or second-generation program engaging all stakeholders but being structured as a separate division, and a third-generation program being woven into the fabric of the company, its culture, and guiding business principles.

How did this change come about? While CR has been a major topic of discussion for only the past couple of decades, its origins date back to much earlier. One early example of CR is the 1830 boycott of slave-produced goods led by the National Negro Convention, which spurred shifts in corporate behavior across the

Table 1.1 Strategic shifts between first- and second-generation CR and third-generation CR, according to Dave Stangis, president of the Campbell Soup Foundation

First- and Second-Generation CR Strategies	Third-Generation CR Strategies
<ul style="list-style-type: none"> • Risk management or mitigation • Commitment to reporting • Environmental, health, and safety measures • Annual performance targets • Community relations strategy • Transparency surrounding workplace and ethics • CSR and sustainability governance • Materiality assessment • Stakeholder engagement • Branding and marketplace programs 	<ul style="list-style-type: none"> • Integrated into culture • Integrated into innovation cycle • Integrated into recruitment and leadership development • Integrated into performance management and compensation • Differentiating and identifiable to employees, customers, suppliers, and consumers • Integral to mission, values, and strategies • Provide operational focus • Leverage unique strengths

Source: Net Impact Issues in Depth call with Dave Stangis, president of the Campbell Soup Foundation, June 28, 2010.

United States.⁶⁶ More recently, a 1950s U.S. Supreme Court decision removed legal restrictions and unwritten codes which up to that point had restricted or limited corporate contributions and involvement in social issues, paving the way for companies to rethink their approach to corporate responsibility. Consequently, by the 1960s, most companies felt pressure to demonstrate social responsibility and had established foundations and giving programs.

In the decades following the Supreme Court's actions, other events have resulted in increased corporate scrutiny and greater importance of CR initiatives. The Rainforest Action Network established its influence as an NGO by orchestrating a 1987 boycott of Burger King for importing beef from countries where rainforests are destroyed to provide pasture for cattle.⁶⁷ Burger King's sales subsequently declined by 12%, prompting the company to cancel \$35 million worth of beef contracts in Central America and announce an end to rainforest beef imports.⁶⁸

A milestone in the world of corporate responsibility was the 1989 Exxon Valdez oil spill, an event which called into question the philanthropic approach seen in the 1970s and 1980s, in which companies gave money to social issues irrespective of such issues' relationship to corporate missions. Rather than funneling its corporate giving into preventative measures against such disasters, Exxon's philanthropic efforts had revolved around Masterpiece Theatre—a noble cause, but not one related to Exxon's core business or its corporate mission.

In the 1990s, new models arose suggesting that not only should a company's philanthropic arm support philanthropic initiatives but also that business units should provide support for philanthropic activities with corporate resources such as expertise.⁶⁹ Similar to the 19th-century boycott and the Burger King incident discussed above, Shell faced consequences in the mid-1990s stemming from its 1995 decision to dispose of an oil storage platform that it no longer needed, the Brent Spar, by sinking it in the Atlantic Ocean. Environmental NGO Greenpeace staged protests, using vivid and emotional language, prompting a widespread boycott of Shell stations in northern Europe, with sales volumes in Germany dropping up to 40% in June 1995.⁷⁰ As seen from the examples above, NGOs have played a tremendous role in bringing corporate errors in judgment to the attention of the public.

In the 21st century, increased globalization of business as well as major advancements in information technology have increased corporate accountability.⁷¹ As companies focus on organizing and prioritizing their CR efforts, they are increasingly connecting with other organizations to develop guidelines and standards. As of June 2014, over 12,000 businesses in 145 countries around the world had signaled their commitment to sustainability of human and environmental resources by participating in the United Nations Global Compact, which was launched in July 2000 and is the largest sustainability/corporate responsibility policy initiative in the world.

To help guide companies in their corporate responsibility efforts, the United Nations Global Compact drew upon several diplomatic human rights and sustainability documents when crafting its list of “Ten Principles” (see Figure 1.2). Companies can use this list to guide their corporate responsibility initiatives.⁷²

According to the UN, the Global Compact offers a unique strategic platform for participants to advance their commitment to sustainability and corporate citizenship. Structured as a public–private initiative, the Global Compact is a policy framework for the development, implementation, and disclosure of sustainability principles and practices, offering participants a wide spectrum of specialized workstreams, management tools and resources, and topical programs and projects. The purpose of the Global Compact is to advance sustainable business models and markets, with the goal of contributing to the initiative’s overarching mission of helping to build a more sustainable and inclusive global economy.⁷³

Figure 1.2 The United Nations Global Compact: Ten principles

Human Rights

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and

Principle 2: make sure that they are not complicit in human rights abuses.

Labour

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labour;

Principle 5: the effective abolition of child labour; and

Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

Principle 7: Businesses should support a precautionary approach to environmental challenges;

Principle 8: undertake initiatives to promote greater environmental responsibility; and

Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

Source: “United Nations Global Compact,” <http://www.unglobalcompact.org>. (Accessed 7/13/14).

Unlike the old view of corporate responsibility, in which companies largely engaged in hands-off philanthropic activities unrelated to their core businesses, the new approach to CR hinges on the idea that a corporation's social initiatives should be in line with overall corporate objectives. Increasingly, companies aim both to do well and to do good, selecting strategic areas of CR focus that fit with their corporate values.⁷⁴ Some ways that corporations have integrated CR into their overall strategy include identifying issues related to their core products and markets, seeking out issues that offer opportunities to meet marketing objectives, and identifying the issues most important to their constituencies, including the community, customers, and employees.⁷⁵ Corporations have also become increasingly visionary in their approach to CR, looking at longer-term commitments to social programs. Meanwhile, the development of corporate responsibility as a core strategy has manifested itself in myriad ways, including in-kind contributions of a company's products, volunteering employee time, and integrating CR initiatives into departments beyond the CR niche.⁷⁶ Indeed, at the 2011 Net Impact Conference, an overarching theme was the ultimate goal of doing away with CR departments, with even CR professionals stating their vision for the elimination of distinct CR arms and the incorporation of CR functions into primary business units and CR principles into companies' core strategies.

Why should corporations embrace CR's infiltration of traditional departments? In his book *Social Innovation, Inc.*, Jason Saul explains that organizations that have failed to realize the business potential of CR initiatives are leaving money on the table. He identifies the unrealized market potential as "social arbitrage," noting that:

Embracing the business potential of issues like the environment, education, health care, hunger relief, discrimination, and economic development could earn companies tens of billions of dollars, open up new markets, attract new customers, prompt new innovations, and dramatically lower costs.⁷⁷

CR has undergone a shift from pure philanthropy to a strategy embedded in a company's values involving action. There is a difference between doing good and doing less bad, and good CR policy should result in positive returns for a company.⁷⁸

Beyond the monetary benefits of effective CR policy, corporations have come to understand CR as a means of enhancing corporate reputation. To hedge against reputational risk, Seventh Generation co-founder Jeffrey Hollender emphasizes the importance of transparency about a company's weaknesses as well as communicating where it has done well in CR, citing the need for corporations to embrace their faults and try to improve upon them to move forward. He states that being an authentically good company means building every aspect of your business strategy around responsibility.⁷⁹

Effective CR strategy must come from the top of an organization. The results of the 2012 Global Chief Executive Officer Study, conducted by IBM and including 1,700 business leaders, offer some key insights, suggesting that CEOs must find a balance between control and openness to be successful. CEOs that focus on ethics and values, build a collaborative environment, and define a purpose and mission for their firms will have the most successful workforce.⁸⁰ The world is changing rapidly and increasing in complexity at a pace faster than that at which companies are able to adapt. To keep up, leaders must empower their employees through the values of their company, engage customers as individuals, and promote innovation through a variety of partnerships.⁸¹

Because of technological advances, the world is not only becoming increasingly complex but also increasingly connected. It is no surprise that the IBM study identifies communication with consumers as a key component of creating a successful corporate strategy, and the same is true of CR. Businesses must take stakeholders into account with every decision that is made, “uncover patterns and answer questions they never thought to ask.”⁸² As globalization continues and grows stronger, many CEOs believe that the business world will be increasingly influenced by governmental bodies.

In a rapidly changing world, business has taken on a new role in society. Business plays a larger role because of unprecedented levels of disparity between economic situations in different countries.⁸³ With weakened governments and a stronger private sector but no one in control, CR has the potential to become the most important issue of the modern era.⁸⁴ The nature of governance is changing, with national governments having less power because of globalization. There is no governance at the global level. Governments must pick their battles and are unable to deal with every social issue that arises. For this reason, CR has immense potential to be a response to globalization.⁸⁵ While the problems that CR addresses are not all the result of globalization, globalization makes things faster, larger, and more visible, and therefore has increased the pressure on corporations to behave responsibly. Globalization, therefore, has created a new interdependence between corporations and governments.⁸⁶

HOW TO THINK ABOUT CR: FRAMEWORKS AND IMPLEMENTATION

According to Jeffrey Hollender, co-founder of Seventh Generation, CR must be holistic and systemic. It must be embedded into strategic planning as a key driver.⁸⁷ Three frameworks have emerged as the dominant way to organize and categorize the broad array of issues related to corporate responsibility.

Three Key Frameworks

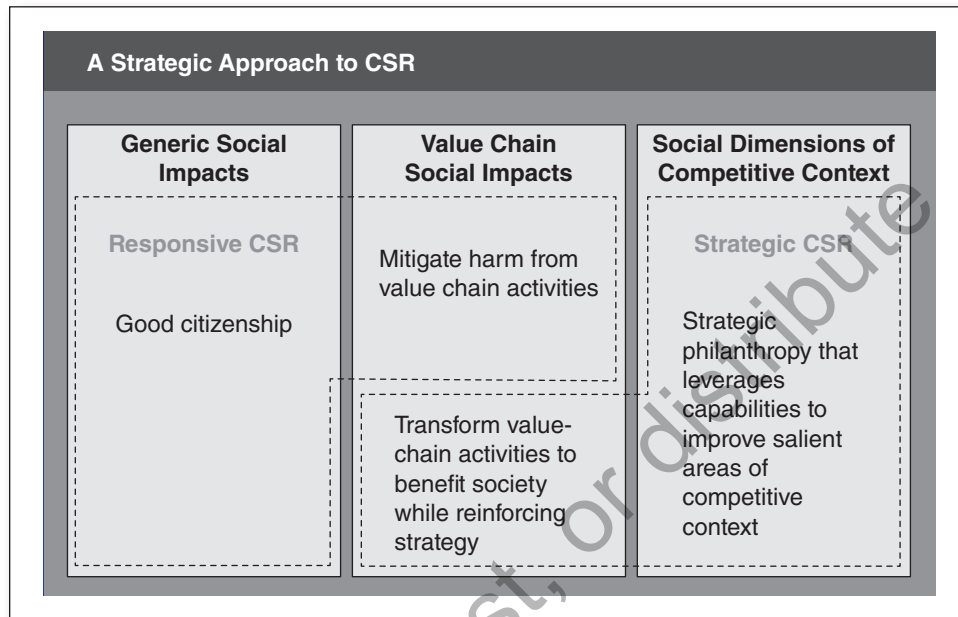
Triple bottom line. The triple bottom line framework incorporates the addition of social and environmental values into the traditional economic measures of a corporation or organization's success.⁸⁸ The triple bottom line concept looks beyond profits to incorporate the impact of a company's behavior on people and the planet.

In advocating the triple bottom line approach, John Elkington argued that a corporation should account for its impact beyond the traditional financial profit-and-loss bottom line.⁸⁹ A corporation should also measure the bottom line of its "people account"—in other words, corporations must assess how socially responsible they have been throughout their operations. Additionally, a corporation should look at its "planet account," analyzing its efforts to be environmentally responsible. The triple bottom line framework looks at the whole picture of corporate behavior, assessing a corporation's financial, social, and environmental performance, with the idea that a corporation must look at all three Ps to fully account for the cost of doing business.⁹⁰

Responsive vs. strategic CR. In developing the responsive vs. strategic CR framework, Michael Porter and Mark Kramer identified three ways in which businesses are involved in society. The first is *generic social issues*, which are important to society but neither are significantly affected by a company's operations nor influence a company's long-term competitiveness. The second is *value chain social impact*, which includes issues affected by the company in its ordinary course of business. The third is *social dimensions of competitive context*, which are factors in the environment that affect underlying drivers of competitiveness where a company operates.⁹¹ How companies approach these three elements constitutes *responsive CSR* vs. *strategic CSR* (see Figure 1.3).

Responsive CSR includes corporate behaviors such as being a good corporate citizen, paying attention to evolving social concerns of stakeholders, and mitigating existing or anticipated risks from business activities. An example of responsive CR is GE's program in which it "adopts" underperforming high schools near several major U.S. facilities. This program creates goodwill in the immediate communities in which GE operates, improves the company's governmental relations, and contributes to employee pride. At the same time, it is incidental to GE's business, and the effects of the program in terms of recruitment and retention are small.

Strategic CSR, on the other hand, moves beyond good corporate citizenship and risk mitigation, seeking instead to identify strategic CR initiatives with sizable social and business benefits. Unlike responsive CR, strategic CR creates the

Figure 1.3 A strategic approach to CSR

Source: Porter, M. E., & Kramer, M. R. (2006, December). "Strategy and society: The link between competitive advantage and corporate responsibility." *Harvard Business Review*. <https://hbr.org/2006/12/strategy-and-society-the-link-between-competitive-advantage-and-corporate-social-responsibility>.

opportunity for shared value. An example of strategic CR in practice is the launch of the Toyota Prius. In introducing the Prius to the market, Toyota had a competitive business advantage by offering the first hybrid engine mass-produced worldwide while touting the environmental benefits from fewer emissions and less reliance on gasoline.⁹²

ESG. The ESG framework takes into account environmental, social, and governance issues and is a catchall term for criteria used in socially responsible investing. According to Peter Kinder, former president of KLD Research and Analytics:

ESG came largely from the institutional side, which has been uncomfortable with terms like "socially" and "responsible." They wanted an acronym that stripped away the moral aspects of what we do and made it a function of data and information.⁹³

Investment firms and their decision-makers apply ESG criteria in their own way. KLD looks at the following in thinking about ESG:

- *Environmental*: climate change, product/services (beneficial vs. harmful), operations and management
- *Social*: community involvement, diversity, employee relations, human rights, products (i.e., benefits to the economically disadvantaged)
- *Governance*: reporting, structure

Goldman Sachs takes a slightly different approach to the same set of concerns:⁹⁴

- *Environmental*: inputs (energy/water); outputs (climate change, emissions, waste)
- *Social*: leadership (accountability, reporting, development); employees (diversity, training, labor relations); customers (product safety, responsible marketing); communities (human rights, social investments, transparency)
- *Governance*: transparency, independence, compensation, shareholder rights

This book will look at corporate responsibility through the lens of all three frameworks, starting with the business case for CR, and will then examine environmental, social, and governance issues that affect businesses today.

HOW TO THINK ABOUT CR: FRAMEWORKS AND IMPLEMENTATION

With a record number of companies devoting significant budgets and human capital to CR efforts, there is more CR chatter to compete with, which makes it difficult to differentiate a company as responsible. By July 2008, an article in *Environmental Leader* had dubbed this effect “green fatigue” or “green noise.”⁹⁵ In this environment, responsibility is no longer an option; it is a necessary condition that a corporation must meet to maintain positive relationships with its constituents and ensure its ongoing survival. The following list of key takeaways can ensure that a thoughtful communication strategy is properly integrated to fuel the success of a corporation’s CR program.

1. It Starts on the Inside

Throughout the chapter, we have emphasized the importance of engaging employees in a CR strategy. Wal-Mart cites employee engagement in its CR efforts as a critical part of its green plan’s success. Each employee is encouraged to make voluntary changes in his or her life to make a positive individual contribution to the environment—from using compact fluorescent lights to riding a bike to work—which helps employees rally more personally around Wal-Mart’s corporate

environmental efforts and share those messages in-store with consumers.⁹⁶ At Wal-Mart Canada, vice presidents drew from the lower ranks of the company's 75,000-employee pool (as of 2008; the employee pool is about 91,500 as of February 2014)⁹⁷ to pull together 14 "Sustainability Value Networks," teams that submit proposals and action plans on topics including greenhouse gas reduction and operational waste reduction.⁹⁸ Ensuring that a CR strategy resonates strongly with employees can help drive greater efficiencies and positive feelings of ownership and membership in a company that stands for something greater than profits alone.

2. Collaborate With Friends and Foes

The old adage holds true in CR communications: Keep your friends close and your enemies even closer. The continued influence of NGOs presents an opportunity for corporations to forge partnerships to defend against attacks and build credibility with the millions of consumers who hold these cause-driven organizations in high regard. McDonald's, for example, worked closely with the Environmental Defense Fund in the early 1990s to change from plastic and foam packaging to paper through a collaborative effort.

3. Present the Bad With the Good

The importance of transparency cannot be overstated in the implementation of a CR strategy. Companies that do not disclose or downplay the negative attributes or effects of their operations do so at their own peril. Given the sophistication and vigilance of NGOs and the accessibility of the Internet today, a company's constituents will likely find out the truth whether or not the company proactively tells them.

Being transparent means being clear in CR communication and not clouding realities with vague or verbose prose. Admitting mistakes and missteps is the first, and perhaps most crucial, step to correcting them. Constituents will be more forgiving and trustful of a company that openly discusses its challenges in implementing CR initiatives than they will be of companies that attempt to mask or misrepresent shortcomings. Clarity also means using metrics and quantifying CR efforts wherever possible and, just as important, explaining the methodology. Constituencies will appreciate and engage with a company's CR strategy only if they are able to understand what it is and how the results are being measured.

4. Stay One Step Ahead of Antagonists

Corporations should keep a finger on the pulse of influencers, critics, and all constituents to gauge existing opinions and spot potential trouble brewing well in advance of a CR crisis erupting. This monitoring will enable a company to tell its own story and maintain a strong grasp on its reputation. In the words of Mary Jane Klocke, former director of North American Shareholder Marketing at BP:

Engagement raises brand awareness, offers valuable insights and perspectives from key stakeholders and gives us avenues of influence and opportunity to get the facts out rather than have the [socially responsible investment or SRI] community receive its information from the media or other third parties.⁹⁹

5. Match Rhetoric With Action

Constituencies today have little patience for self-aggrandizing corporations that inaccurately inflate their CR efforts or do not deliver on promises made. The greater the number of corporations that vie to win approval through CR efforts, the more savvy and discerning constituencies will be in separating hollow rhetoric from bona fide results. Companies should also be careful to never express complacency in their efforts to be responsible. Just as the business environment—and a corporation's intersection with social, environmental, and governance issues—is constantly in flux, a CR strategy must also be continually reshaped.¹⁰⁰ David Douglas, former vice president of eco-responsibility at Sun Microsystems, explains:

A big mistake is to send the message that your company believes it has done all it can do. There is always room for improvement when it comes to developing business practices that create social and business value. To indicate otherwise brings the credibility of your company's entire [CR] program into question.¹⁰¹

CONCLUSION

Corporate responsibility is increasing in importance because of increased globalization and complexity, as well as the ease of the spread of information facilitated by technological advancements. Corporations must seek to define the role of CR in their businesses and move to the third-generation understanding of CR, which is integrated into a company's strategy and culture and based on the notion of doing good to do well.

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STARBUCKS COFFEE COMPANY

On an overcast February afternoon in 2000, Starbucks CEO Orin Smith gazed out his office window in Seattle and contemplated what had just occurred at his company's annual shareholder meeting. In prior years, the meeting had always been a fun, all-day affair where shareholders from around the country gathered to celebrate the company's success. This year, however, Smith and other senior Starbucks executives heard an earful from the activist group Global Exchange. A human rights organization dedicated to promoting environmental, political, and social justice around the world, Global Exchange criticized Starbucks for profiting at farmers' expense by paying low prices and not buying "fair trade" coffee beans. Not only did the activists disrupt the company's annual meeting to the point that the convention hall security police asked the activists to leave, but they also threatened a national boycott if the company refused to sell and promote fair trade coffee. Although Smith strongly disagreed with using the shareholders meeting as a public forum, he knew there was a strong likelihood his company could face serious reprisals if it did not address the issues raised by Global Exchange.

FAIR TRADE

Fair trade began after World War II as religiously affiliated, nonprofit organizations purchased handmade products for resale from European producers. Fair trade coffees were coffees purchased directly from cooperatives of small farmers at a guaranteed floor price. Fair trade coffee focused on the worker's economic sustainability by attempting to cut out or limit middlemen and providing much-needed credit to small farmers so that they could end their poverty cycle. Licensing organizations in individual importing countries certified fair trade coffee from farmers listed on the Fair Trade Registry. Consequently, there were a host of different certifying agencies, and fair trade coffee accounted for a different market share in each country.¹

By the late 1990s, the fair trade movement had gained a foothold in the United States, and in early 1999, TransFair USA, a third-party certification agency, launched its Fair Trade Certified coffee label. During that summer, Global Exchange began a campaign to educate consumers and the media about labor conditions in the coffee industry, focusing on getting the message out to specialty coffee consumers. Although the activists were successful in educating pockets of consumers, they knew their effectiveness was limited unless they directed blame for the farmers' woes. Global Exchange decided to take an anti-corporation stance and focused their attention on the most visible brand in specialty coffee: Starbucks.

Source: This case was sponsored by the Allwin Initiative for Corporate Citizenship and prepared by Alison Stanley, T'02, under the direction of Professor Paul A. Argenti, with the cooperation of Starbucks Coffee Company.

Starbucks Coffee Company had grown from a small, regional business into the undisputed leader in the specialty coffee industry by buying only the best-quality coffee and providing an unmatched store experience. The company's coffee buyers had built long-standing relationships with farmers and believed it paid the highest prices in the industry for top-quality beans. Adopting the fair trade model would cause serious concerns for Starbucks, as fair trade paid a floor price of \$1.26 regardless of bean quality. Starbucks coffee buyers had to admit that while they paid high prices, they didn't always know whether farmers got their fair share. It was virtually impossible to track the flow of money from the importers and exporters back through the supply chain to the individual farmer. By dealing only with cooperatives, TransFair USA bypassed most of these problems and added value by producing financial transparency. Yet being a socially responsive corporation was a key tenet of Starbucks' mission statement. The intent of fair trade advocates to raise small-farmer incomes was consistent with the company's values. Treating partners (Starbucks employees), customers, and suppliers with dignity and respect was essential to the company. In fact, it came as a shock to many at Starbucks that activist groups were criticizing their company for unfair practices. As he watched the sky darken outside his window, Orin Smith asked himself just how socially responsive his company could be without affecting the fundamental business practices that had been the foundation of its great success.

STARBUCKS CULTURE

In 1990, Starbucks' senior executive team had drafted a mission statement laying out the guiding principles behind the company. The team hoped that the principles included in this mission statement would help partners gauge the appropriateness of their decisions and actions. As Orin Smith explained, "Those guidelines are part of our culture, and we try to live by them every day."² After drafting the mission statement, the executive team asked all Starbucks partners to review and comment on the document. Based on their feedback, the final statement (see Exhibit 1.1) put "people first and profits last."³ In fact, the number one guiding principle in Starbucks' mission statement was to "provide a great work environment and treat each other with respect and dignity."⁴

Going forward, Starbucks did three things to keep the mission and guiding principles alive: First, it provided all new partners with a copy of the mission statement and comment cards during orientation. Second, when making presentations, Starbucks leadership continually related decisions back to the appropriate guiding principle or principles they supported. And third, the company developed a "Mission Review" system through which any partner could comment on a decision or action relative to its consistency with one of the six principles. The partner most knowledgeable on the comment had to respond directly to such a submission within two weeks or, if the comment was anonymous, the

response appeared in a monthly report.⁵ As a result of this continual emphasis, the guiding principles and their underlying values had become the cornerstones of a very strong culture.

After buying Starbucks, Howard Schultz had worked to develop a benefits program that would attract top people who were eager to work for the company and committed to excellence. One of Schultz's key philosophies was to "treat people like family, and they will be loyal and give their all." Accordingly, Starbucks paid more than the going wage in the restaurant and retail industries, granted stock options to both full- and part-time partners in proportion to their level of base pay, and offered health benefits for both full- and part-time partners.⁶ In return, Starbucks had a partner turnover rate of 60% compared to the restaurant industry average of 200%.⁷ Furthermore, when asked by outside agencies, 82% of the partners reported being "very satisfied" and 15% as being "satisfied" with their jobs. While such a high satisfaction rate could be found in many small, privately held companies, it was virtually unheard of for a large, publicly traded corporation of over 55,000 employees.⁸ All of this had fostered a strong culture that employed a predominately young and educated workforce who were extremely proud to work for Starbucks. Their pride came from working for a very visible and successful company that tried to act in accordance with their shared values. According to Smith, "it's extremely valuable to have people proud to work for Starbucks, and we make decisions that are consistent with what our partners expect of us."⁹

CORPORATE RESPONSIBILITY AT STARBUCKS

Just as treating partners well was one of the pillars of Starbucks' culture, so was contributing positively to the communities it served and to the environment.¹⁰ Starbucks had made this commitment not only because it was the right thing to do, but also because its workforce was aware and concerned with global environmental and poverty issues. In addition to sustaining and growing its business, Starbucks supported causes "in both the communities where Starbucks stores were located and the countries where Starbucks coffee was grown."¹¹

On the local level, store managers were granted discretion to donate to local causes and provide coffee for local fundraisers. One Seattle store donated more than \$500,000 to Zion Preparatory Academy, an African-American school for inner-city youth.¹² In 1998, Starbucks and Erwin "Magic" Johnson's company, Johnson Development Corporation, formed a joint partnership and created the Urban Coffee Opportunities. Subsequently, 28 stores opened in urban communities, providing new employment and revitalization opportunities in several U.S. cities.¹³

Internationally, in 1991, Starbucks began contributing to CARE, a worldwide relief and development foundation, as a way to give back to coffee-origin countries. By 1995,

Starbucks was CARE's largest corporate donor, pledging more than \$100,000 a year and specifying that its support go to coffee-producing countries.¹⁴ The company's donations helped with projects like clean-water systems, health and sanitation training, and literacy efforts.¹⁵ Over the years, Starbucks has contributed more than \$1.8 million to CARE.¹⁶

In 1998, Starbucks partnered with Conservation International (CI), a nonprofit organization that helped promote biodiversity in coffee-growing regions, to support producers of shade-grown coffee. The coffee came from cooperatives in Chiapas, Mexico, and was introduced as a limited edition in 1999. The cooperatives' land bordered the El Triunfo Biosphere Reserve, an area designated by CI as one of the 25 "hot spots" that were home to over half the world's known plants and animals.¹⁷ Since 1999, Starbucks had funded seasonal promotions of the coffee every year, with the hope of adding it to its lineup of year-round offerings. The partnership had proven positive for both the environment and the Mexican farmers. Shade acreage increased by 220%, while farmers received a price premium of 65% above the market price and increased exports by 50%. Since the beginning of the partnership, Starbucks had made loan guarantees that helped provide over \$750,000 in loans to farmers.¹⁸ This financial support enabled these farmers to nearly double their income.

In 1992, Starbucks developed an environmental mission statement to articulate more clearly how the company interacted with its environment, eventually creating an Environmental Affairs team tasked with developing environmentally responsible policies and minimizing the company's "footprint."¹⁹ Additionally, Starbucks actively used environmental purchasing guidelines, reducing waste through recycling and energy conservation and continually educating partners through the company's "Green Team" initiatives. In 1994, Starbucks hired Sue Mecklenburg as the first director of environmental affairs.

Although Starbucks had supported responsible business practices virtually since its inception, as the company itself had grown, so had the importance of defending its image. It was Mecklenburg who developed the idea of using paper sleeves instead of double cupping.²⁰ At the end of 1999, Starbucks created a Corporate Social Responsibility department, and Dave Olsen was named the department's first senior vice president. According to Sue Mecklenburg, "Dave really is the heart and soul of the company and is acknowledged by others as a leader. By having Dave be the first Corporate Responsibility SVP, the department had instant credibility within the company."²¹ Between 1994 and 2001, Starbucks' CSR department grew from only one person to 14.

THE ECONOMICS OF COFFEE

After oil, coffee is the second most traded commodity on worldwide markets. Coffee is grown in more than 80 tropical and subtropical countries, employs an estimated 20 million rural farmers, and is the principal source of foreign exchange in many countries.²²

In 2001, coffee farmers and plantations produced 15.5 billion pounds of coffee while the world market bought only 13 billion pounds. Overproduction was not unusual in the coffee industry and was one of the major reasons why historically prices had traveled a boom-to-bust cycle.

From Bean to Export

Coffee beans begin at the farm on coffee trees. After trees are planted, it takes between one and three years for the trees to bear coffee “cherries,” which typically contain two beans. Each tree produces 2,000 to 4,000 beans a year—approximately one pound of roasted coffee. However, yields alternate with a good crop one year and a poor crop the next.

Farm sizes range from 5 acres (traditional farms) to large plantations covering thousands of acres. Farming and harvesting methods differ greatly between traditional and large coffee farms. Traditional farms, called *fincas* in Latin America, usually have many non-coffee trees that shade the coffee plants from the glaring tropical sun. These farms are integrated agricultural systems that provide additional crops, protection from soil erosion, and homes to insects that act as natural pest control. Farmers on these smaller plots handpick cherries when it’s time to harvest the trees. In contrast, large coffee plantations, *fazendas* (estates) in Brazil, use little to no shade, plant trees more densely in rows, and harvest the cherries mechanically.

By 2001, between 50% and 70% of the global coffee supply was coming from small-scale farms.²³ These small producers usually did not own the *beneficios* (mills) that were used to process the product from cherry to bean. While some did operate as part of a cooperative that collectively owned the mills, not all small-scale farmers had this option. Often mills were owned and operated by the large farms, and consequently small farmers had little leverage when negotiating prices with these much larger owners. Coffee must be processed, and it was common for small farmers to accept a considerably lower price to be able to get their coffee to market. Often, these small producers had difficulties financing their operations throughout the year and would sell their crop to middlemen known as “coyotes” prior to harvest to receive a cash advance. These middlemen provided small farmers with credit at high interest rates in exchange for bringing their beans to market. Small-scale farmers were often caught in a perpetual cycle of poverty: small production levels limited their access to cash, which in turn hindered their potential for increasing output. For many producing countries, coffee was tightly connected to the social and political power structures that had existed for hundreds of years.²⁴

From Export to Cup

The coffee export process varied greatly depending on country of origin and buyer. In some countries, beans were exported through government coffee boards, while other

countries used private exporters only. After they were shipped to the import country, coffee beans were visually inspected and taste-tested for quality through a process called “cupping.” After passing inspection, coffee was stored in warehouses until it was shipped to roasters. Large roasters often had their own coffee buyers and procured green beans directly from producers. Large roasters also stockpiled green coffee at the import warehouses to help decrease their exposure to market conditions. Conversely, smaller roasters bought coffee from independent brokers and importers who might have amassed beans at warehouses and thus were exposed to a much larger risk of price fluctuations.

After roasters buy green coffee, the beans are shipped to roasting facilities where the beans are roasted until they receive their characteristic color and aroma and then cooled. Once the beans are cooled, roasters blend beans from different countries to balance the flavors and strengths. Roasters then package, market, and distribute coffee through a variety of methods.

FAIR TRADE COFFEE

In 1997, an umbrella group called the Fairtrade Labelling Organizations International (FLO) was formed to coordinate the monitoring and certification processes for fair trade coffee. There were 277 cooperatives from 24 countries representing 550,000 farmers that produced coffee on the Fair Trade Registry in 2001.²⁵ FLO estimated that in 2000, farmers produced 165 million pounds of coffee, but only 29.1 million were actually sold as fair trade coffee, with a retail value of \$393 million.²⁶

Four main criteria for fair trade coffee greatly affected the number of farmers this system could influence. The criteria were that roasters and importers:

- Must purchase directly from small farmers who cultivated less than 3 hectares of land. These farmers had to be organized into democratically run cooperatives.
- Must pay a guaranteed price of \$1.26 for arabica, \$1.06 for robusta, and \$1.41 for organic beans. If the market price was above these levels, farmers received a \$.05 premium over market.
- Must offer farmers advanced financing to help cover costs.
- Must develop long-term relationships with cooperatives.

Unlike organic certification, roasters and importers signed a licensing agreement to sell fair trade beans with the fair trade certification agency. The licensing fee paid for some of the certification and monitoring costs.²⁷ Thus, roasters and importers paid a floor price and a licensing fee for fair trade beans.

On the whole, fair trade coffee was a small fraction of the overall coffee market in 2001 in both producing and consuming countries. An estimated 75% of coffee farmers

worldwide are smallholder farmers who harvest approximately 1,000 to 3,000 pounds of coffee a year.²⁸ Farmers working with fair trade cooperatives are typically such smallholder farmers. However, many smallholder farmers could not join cooperatives due to such factors as their isolated location. And without a cooperative, individual farmers could never amass the quantity necessary to export directly to consuming countries.²⁹ The 165 million pounds produced in 2001 was 1.2% of the total global output and influenced only 2.2% of the farmers and workers in coffee-producing countries. This model effectively ignored the plight of workers on large coffee estates.³⁰ However, coffee insiders said there was a long backlog of cooperatives asking for certification but that FLO was hesitant to add more farmers since much of the fair trade coffee was not bought at fair trade prices.³¹ Although consumer knowledge of fair trade coffee had continued to grow in the 1990s, purchasing patterns did not always reflect this. European countries developed fair trade labels well before the United States and Canada, but fair trade coffee market share had flattened out by 2001. Holland, which introduced the fair trade label in 1988, had a 2.7% fair trade market share and was one of the higher percentages in Europe.³² Adoption was somewhat sporadic and depended greatly on consumer sentiment. In 1992, Germany, France, and Switzerland all adopted the label but had a 1%, 0.1%, and 3% market share, respectively, in 2001.³³

STARBUCKS AND FAIR TRADE COFFEE

For Starbucks, the real issues were brand and consumer proposition. Starbucks hesitated to sign a fair trade license, not wanting to commit until it had carefully weighed all the implications.³⁴ According to Starbucks executives, their chief concern with fair trade coffee was finding top-quality beans from cooperatives that had not demonstrated an ability to produce quality beans to Starbucks standards. From earlier cupping analyses, Starbucks had little evidence that fair trade coffee met its quality standards. Starbucks was beginning to move toward purchasing more of its coffee through direct relationships with exporters or farmers and negotiated a price based on quality. The company was willing to pay higher prices for great-quality beans and had developed long-term contracts with many of its suppliers.

Mary Williams, senior vice president of the Coffee department, was known throughout the coffee industry as a “tough cupper” who would not settle for anything less than top-quality beans. She explained:

The relationships I have with farmers were built over the last 20 years. It’s taken some of them years before I would use their beans consistently and pay them \$1.26 or more. Now I was being asked to use another farmer who I didn’t know and pay him the same price without the same quality standards?³⁵

On average, farmers sent samples and met with Starbucks coffee buyers at their farms for at least two years before Starbucks accepted their beans. In weighing the fair trade coffee issue, Williams had secondary concerns with how the farmers she worked with would react when they discovered that other farmers received the same price without being held to Starbucks quality standards. This was not a trivial issue, because it was more expensive to grow high-quality beans. Further, Williams feared that the smaller cooperatives would not be able to guarantee that they could take back a low-quality shipment and replace it based on Starbucks' volume and quality needs.

Starbucks was also concerned about its brand exposure if the quality of fair trade coffee turned out to be very different from the rest of its whole-bean coffee line. Coffee quality was a critical component of the Starbucks brand, and if it was compromised the value of the brand could be seriously diminished. "Honestly, we didn't want to put our brand at risk," said Tom Ehlers, vice president of the Whole Bean department. "This was an uncharted category, and as marketers we were concerned about endorsing a product that didn't meet our quality standards."³⁶ The Whole Bean department would face several challenges in introducing fair trade coffee to 3,200 stores in the U.S. First, it would have to come up with a good story for fair trade coffee. As Tim Kern, Whole Bean product manager, explained:

A lot of our business is about the romance of coffee—where it comes from and how to make it come alive for the customer. We weren't really sure where fair trade beans would be coming from because of the quality.³⁷

In addition to confirming the marketing message and being able to communicate it effectively to both employees and customers, Kern wasn't sure Starbucks could change its product offerings as quickly as outsiders thought the company could. "It's not that easy to make changes to over 3,000 stores. We have a calendar set with coffee promotions and it takes time to create new materials and distribute them to all of our stores."³⁸

And how would fair trade coffee be priced? Starbucks coffee was a high-margin business, but if the company were to charge a premium for fair trade, how would customers perceive this? While pricing was a secondary issue to consider, it was not a reason for Starbucks to abandon fair trade coffee. Orin Smith recalled:

In fact, a number of people believed that the sale of low-quality fair trade coffee undermined their entire business proposition with customers: Starbucks and other specialty coffee companies had persuaded customers to pay high prices for quality coffee. This enabled roasters to pay the highest prices in the industry to coffee sellers.³⁹

If quality were reduced, specialty coffee would be no different than mass-market coffee and the consumer would be unwilling to pay premium prices. This would destroy the industry's ability to pay price premiums to producers. According to Smith:

The best way to improve the standard of living for farmers is to expand the specialty coffee industry by persuading more consumers to buy quality coffee. While some consumers are persuaded to pay premium prices to help farmers, most are not willing to pay high prices regardless of quality.⁴⁰

THE FAIR TRADE DECISION

Starbucks defined being a socially responsible corporation “as conducting our business in ways that produce social, environmental and economic benefits to the communities in which we operate.”⁴¹ Not only were consumers demanding more than just a “product,” but also employees were increasingly electing to work for companies with strong values. In a 1999 survey by Cone Communications, 62% of respondents said they would switch brands or retailers to support causes they cared about.⁴² Another survey conducted in 2001 showed that 75% to 80% of consumers were likely to reward companies for being “good corporate citizens,” while 20% said they’d punish those who weren’t.⁴³ The company cared about being a responsible corporation for a variety of reasons: increasing employee satisfaction, maintaining quality supply sources, obtaining a competitive advantage through a strong reputation, and increasing shareholder value.⁴⁴

As he looked out over the busy port in Seattle’s South of Downtown district, Orin Smith pondered all these issues. At 5 p.m., he was to meet with his executive team to hear their concerns and issues before making his decision.

Although offering fair trade coffee was a good objective and consistent with the company’s aims of being a socially responsible organization, Smith knew he could not base his decision on this factor alone. He drummed his fingers on the desk and asked himself how Starbucks could support fair trade coffee given that the company had limited resources, a strong image to protect, and shareholders who were willing to support causes only so much.

Case Questions

1. What are the key corporate responsibility issues for Starbucks?
2. How does the Global Exchange situation present an opportunity for Starbucks to create shared value?
3. How should Starbucks’ culture and mission statement (see Exhibit 1.1) inform the company’s approach to corporate responsibility?

Exhibit 1.1 Starbucks Mission Statement

Establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles as we grow. The following six guiding principles will help us measure the appropriateness of our decisions:

1. Provide a great work environment and treat each other with respect and dignity.
2. Embrace diversity as an essential component in the way we do business.
3. Apply the highest standards of excellence to the purchasing, roasting and fresh delivery of our coffee.
4. Develop enthusiastically satisfied customers all the time.
5. Contribute positively to our communities and our environment.
6. Recognize that profitability is essential to our future success.

Source: Porter, M. E., & Kramer, M. R. (2006, December). "Strategy and society: The link between competitive advantage and corporate responsibility." *Harvard Business Review*. Retrieved March 1, 2015, from <https://hbr.org/2006/12/strategy-and-society-the-link-between-competitive-advantage-and-corporate-social-responsibility>.

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