Response: The Meaning of Corporate Social Responsibility Variations on a Theme of Edwin M. Epstein

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Practitioners, students, teachers, and writers on the law of corporations will be grateful to Professor Epstein for his comprehensive survey and analysis of the problems customarily discussed under the headings of "corporate social responsibility." His collection and analysis of commentaries permit us to find in a single essay nearly all the ideas that have been expressed on the subject.

If one needed convincing, one could no longer doubt after reading Professor Epstein's article that the power of megacorporations inevitably carries with it responsibility for the total effects of corporate activities on the socioeconomic order. One would probably appreciate much more sharply than ever before the twofold character of responsibility—both for effects and for means. Professor Epstein illuminates with considerable originality the differences between responsibility for the effects of corporate behavior ("product responsibility") and responsibility for listening to employees, consumers, and environmentalists in the course of decision-making ("process responsibility").

Having accepted Professor Epstein's theses, we are led irresistibly to questions that lie beyond them. In particular, what does "corporate social responsibility" (which I will abbreviate as CSR) mean to the many people who use the term?

On the basic level, CSR is urged as a justification for the regulation of products of corporations—the goods they produce, the pollution they emit, and the wages they pay. The meaning of CSR in this context may be characterized as the "regulatory justification" meaning. Hardly anyone would challenge the validity of the concept in this sense; even Milton Friedman concedes that competition should be carried out
"within the rules of the game." All that remains in dispute is the balance of benefit, in particular instances, between regulation and freedom.

On a slightly more advanced level, CSR implies the duty of corporations to comply with the regulations that the government makes. This formulation may be called the "regulatory compliance" meaning. The idea is that a corporation should obey the state's regulations of its economic activity, even though the prohibited acts are not inherently evil, and may even be, in the executives' view, beneficial to the community. Corporations should not, for instance, dump mercury unlawfully into streams even if the amounts seem harmless and are probably undetectable; they should not install in cars required antipollution devices that are easily disconnected. This conception is also one to which no one would want to dissent openly, although many businessmen believe privately that some regulatory provisions (especially in the area of competition law) are more honored in the breach than in observance.

A third possible meaning of CSR relates to the roles of corporation executives in relation to the regulations that produce the "rules of the game." It may be called the "regulatory leadership" meaning. It may be illustrated by the activity of a number of insurance companies in relation to "no-fault" automobile accident insurance. In the short run, no-fault insurance appeared to be disadvantageous to insurers. It reduced premiums, and thereby reduced the volume of money on which the insurance companies could expect to make a profit. More seriously, it was often accompanied by governmental orders for premium cuts that greatly exceeded the economies that insurers expected to realize. Moreover, the no-fault system is one that appears to lend itself more readily to replacement by government-administered programs of health and disability insurance. Nevertheless, a considerable number of companies decided to support the system. They may have had some long-term advantages in mind, but these were problematical.

An interesting comparison with the role of insurance companies in no-fault legislation is supplied by the actions of the Ford Motor Company, which decided in the mid-fifties that safety devices like padded dashboards and seat belts would be appropriate, and actively promoted them as extra-price options. After one or two poor selling seasons, the officers concluded that the public was not ready for safety devices, and stopped actively promoting them (although retaining them as options). Under the "regulatory leadership" conception of CSR, they might rather have proceeded to advocate legislation requiring all manufacturers to provide these devices, thus freeing themselves from a competitive
disadvantage and extending the benefits of the devices. Probably there are scores of details every year about which automobile executives are aware of possible improvements in the public interest, but refrain from suggesting governmental action to impose them.

This meaning of CSR is one that many corporate executives seem to find unacceptable. Newspaper reports present a picture of automobile manufacturers opposing nearly every step in safety and antipollution legislation. The picture may be false, because only conflicts make news, and because when manufacturers do favor a regulation they find it politically wiser to keep their faces in the background. In addition, many probably believe in all sincerity that governmental controls are so inevitably clumsy that they do more harm than good, even when the conduct mandated is beneficial. On the other hand, executives in highly regulated industries, such as railroads and trucking lines have come to regard regulation as a security blanket in whose production they are eager to join.

A fourth possible meaning of CSR—and definitely the most controversial—involves the idea that corporate managers should voluntarily reduce profits in order to pay more to employees, or charge less to customers, or emit less pollution into the biosphere. This definition may be called the “relocation” meaning. The classic example of this conception can be illustrated by the declaration in 1916 by Henry Ford that Ford Motor Company had made more than enough profits, and would share future profits with workers and consumers by simultaneously raising wages and cutting prices. The Supreme Court of Michigan ruled that Henry should not divert profits from shareholders to employees and consumers; many recent commentators have concluded that Henry’s view was preferable to the court’s.

Whether Henry’s actual motives were as altruistic as his professions has been questioned, in view of certain historical facts. Two of Ford’s principal shareholders, the Dodge brothers, had recently decided to graduate from making parts for Ford to making whole automobiles for themselves. Henry’s dividend reduction cut the subsidy that Ford dividends were providing to the Dodges, and his price reduction made it more difficult for the Dodges to meet Ford’s competition. But since we are studying the meaning of CSR, rather than the psyche of Henry Ford, let us consider the implications of the principles that Henry avowed.

The situation of Ford Motor Company in 1916, which makes the

CSR question of that date so easy for commentators, was very unusual. The company was paying dividends of over $10,000,000 a year to original investors who had contributed no more than $100,000 in initial capital. Clearly, their dividends could be cut without imperilling the company's ability to finance itself. In fact, Henry's modest proposal was to cut the annual dividends to $1,200,000, or 1200% of the original investment.

If it was laudable in 1916 to sacrifice dividends in the interests of employees and consumers, the question arises whether it would be equally laudable in 1979 to cut the dividends of present-day Ford shareholders for similar purposes. The current shares are derived through splits, share dividends, and recapitalizations from those issued in 1903; each one represents an original contribution of about one tenth of a cent. But most present shareholders got their shares directly or indirectly from the Ford Foundation, which sold them at various prices (adjusted for splits) from about $25 to about $40. At the end of 1978, the market price was about $40, and the total invested capital per share (including reinvested profits) was about $80. If the managers would be justified in diverting excessive profits from shareholders, do profits become excessive when they surpass a fair return on $.001, on $25, on $40, or on $80?

A more rational approach might be to ask, "What degree of diversion would impair the company's ability to raise the funds that it needs in order to discharge efficiently its responsibilities to employees, consumers, and the biosphere?" This question is much like that asked and answered daily (and very diversely) in the regulation of public utility companies. Companies constantly need to increase their investment, partly because rising requirements of safety and pollution control and increasing scarcity of materials require more expensive equipment and processes. Companies can increase their assets by borrowing money, but only if their equity increases proportionately. In order to increase their equity, they have to have enough earnings to plow in some profits, or to pay dividends that will attract new equity investments.

Although the need for profits is commonly explained (in a capitalist system) as a means of inducing investment, the need is just as inexorable in noncapitalist economies. In the socialist countries of Eastern Europe, it appears that established enterprises are expected not only to finance themselves, but also to produce a surplus that the banks can then lend to the new and failing enterprises. As a consequence, the demand for profits (under some other name) is probably at least as great as under the capitalist system.
Whatever may be the profit level needed to maintain operations, there will be some companies above it (as was Ford Motor Company in 1916). By the excess-profits test, these companies could afford voluntarily to reduce prices, raise wages, or reduce pollution. They would still be faced with difficult problems in deciding which of these objectives should have priority.

Many other companies operate at a profit level below that which would permit them to continue operations indefinitely without raising prices, lowering wages, increasing pollution, or impairing still further their financial viability. In the automobile industry, American Motors and Chrysler may be in this position. In the steel industry, most or all of the American major producers may be in it, too; on the representation that they cannot otherwise fulfill their other obligations, they have persuaded the U. S. government to raise domestic prices by means of import “trigger prices.”

Considering the severe effects that rising steel prices have on the inflationary spiral, should steel companies reduce their prices at the expense of investors? Considering the oppressive pollution of the atmosphere in the area of Gary, Indiana, should steel companies further reduce their emissions at the expense of investors? If investor interests are to be sacrificed, who are the worthiest beneficiaries—the consumers (through reduced prices), the employees (through increased wages), or the inhabitants of the county (through reduced pollution)?

These questions are largely academic, so long as directors are elected by shareholders. Although shareholders have been notoriously indifferent to management maneuvers, they would probably react vigorously against a professed policy of sacrificing their interests for the benefit of consumers, employees or neighbors. Consequently, if the “reallocation” theory of CSR is to be followed, a radical change must be made in the composition of governing boards. In addition to investor representatives, boards would have employee, consumer, and environmental representatives, who would presumably trade off their respective interests, perhaps in the same way that senators from Maine and Arizona trade-off reclamation expenditures for harbor improvements. A key determinant of the results would be the number of representatives awarded to each constituency. Of course the present legal rules on fiduciary responsibility of directors “to the corporation” would have to be rewritten.

These considerations point toward the conclusion that one cannot realistically expect to see a massive reallocation of the benefits of enterprise from investors to other constituencies, and that an attempt at mas-
sive reallocation would be likely to prove unproductive eventually, even for those whom it sought to benefit. But this does not mean that a recognition of CSR cannot make substantial changes in the social product of enterprise. A change in the attitudes of enterprise leaders toward safety and environmental regulation would probably lead to considerable social gains, even without changes in voluntary "reallocation."

In the area of "reallocation," there are possible improvements that are feasible without being massive. For example, a major safety improvement in door locks was made by automobile manufacturers in the 1950's. Safety engineers discovered that the car door lock then in use—resembling the door lock on a house—tended to spring open when the car rolled over, thereby spilling the passengers, who were then crushed by the rolling car. The lock was redesigned so that it would not open under these conditions, and all the manufacturers quickly adopted the improvement, even though the change involved costs. Admittedly there were potential savings in liability for accidents, but the choice was probably made because the change was good for customers, and the expense was so small that neither customers nor investors would be conscious of paying for it.

There are of course thousands of similar actions taken by corporate managers in the interests of consumers, employees, or the biosphere that were not compelled by law, but involved some reallocation of benefits from investors to other constituencies. Although managers like to trumpet these good works in TV commercials, they generally evade admitting that any profits were diverted. Thus, reallocation flourishes, like executive perquisites, in a clandestine atmosphere in which nearly everyone agrees it is a pretty good thing so long as it does not become perceptible in financial statements.

Professor Epstein's exposition of CSR, together with the numerous others that he cites, will contribute to bringing CSR out of the closet, and to the conscious and avowed balancing of investor interests against other interests that have legitimate claims on the enterprise. But we should not expect CSR—however openly it may be avowed—to solve the problems of personnel, pollution, and prices in the steel industry or in other industries in which the gap between current and ideal performance is very wide. With this understanding, nearly everyone should feel safe in praising and promoting Corporate Social Responsibility.