

Total Corporate Responsibility

Achieving Sustainability and Real Prosperity

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The corporate social responsibility (CSR) movement has driven large improvements in corporate environmental and social performance. However, far more improvement is needed if human society is to become sustainable. This paper suggests a new form of CSR that is focused on promoting system change. This new approach, called Total Corporate Responsibility (TCR), recognizes that economic and political systems essentially force firms to be irresponsible and unsustainable by not holding them fully accountable for negative impacts on society. TCR encourages firms to proactively work with others to achieve system changes that hold them fully responsible. As the most difficult challenge facing management, TCR performance is an excellent indicator of management quality, the primary driver of stock market returns. Given this, it is highly likely that funds comprised of TCR leaders will outperform.

Overview

Human evolution always proceeds. Humanity appears to be on the verge of attaining a new level of awareness. Modern economic, social and political systems are based on the idea that individuals and businesses are separate from each other and the rest of the world. Yet quantum physics, systems theory and, in a different sense, even traditional religions are showing we are connected in ways that are not obvious to the five senses, but are nevertheless real. As we come to understand the interconnectedness of all things, the solutions to humanity's most pressing problems will become apparent.

Our most pressing problem is the fact that we in effect are killing ourselves by destroying our life support systems. While there have been great improvements in human rights, medicine, technology and other areas, the most important trends are strongly negative. Studies by the World Resources Institute and many others show that, with some regional exceptions, every life support system on the planet is in decline (i.e.: clean air, clean water, forests, topsoil, aquifers, fisheries, wetlands, biodiversity, etc.). Social pressure and turmoil are increasing around the world, driven by population growth, a widening gap between rich and poor and other factors. Social distress is evident even in prosperous regions. Americans, for example, medicate themselves with food (one third are obese, another third are overweight), television (six hours per day on average), and anti-depressant drugs (rapidly growing use). If human systems are not changed, the world we hand off to future generations will be much worse than today's.

At every stage in history, people of the day believed they understood the world and knew how human society should operate. Many years ago, for example, people "knew" the world was flat and believed slavery was acceptable. With a better, broader perspective, we know they were wrong. Today, many believe our capitalist system, as currently implemented, is the best way to organize business and human endeavors. Years from now, with the benefit of a better, broader perspective, people will see that we were wrong about this and many other things.

Capitalism probably could work if it were used effectively. But it isn't. Capitalism is supposed to involve sending accurate price signals so market players can make optimal purchase decisions. However, the current system sends grossly distorted signals that drive consumers to make extremely suboptimal purchase decisions.

This is completely understandable. Like a child who has not learned to walk yet, humanity does not fully understand the negative impacts of the industrial society it rapidly created over the past 150 years. As a result, the full cost of industrial activities is difficult to quantify and incorporate into prices. For example, we know that burning coal causes premature deaths, various types of illness, birth defects (from mercury), acid rain damaged forests and many other negative impacts. These are real costs paid by society that are not included in electricity prices. This creates the illusion that coal-fired electricity is cheap, when it actually may be the most expensive form of power generation. This massive subsidization of coal (and other fossil fuels) causes huge over-consumption. These failures of capitalism are a major driver of humanity's unsustainable state.

Systems Perspective

Sustainability can only be achieved if we adopt and act from a systems perspective. Every person, plant, animal and thing on this planet is part of one interconnected system. This total system is too complex for any one person to understand. So we break it down into parts (reductionism) and develop solutions to problems in one area that often become problems in other areas. As the consequences of our shortsighted actions become more obvious, firms will be compelled to take more responsibility for their negative impacts and begin acting from a systems perspective.

Adopting a systems mindset and acting from this perspective is by far the most complex challenge humanity and business will ever face. Every problem in society is a sub-element of the total system sustainability problem. Organizing human affairs in a way that places them in harmony with natural systems and ensures long-term prosperity at every level is a hugely complex, some would say impossible, challenge. Nevertheless, we have an obligation to at least try to preserve this world for our children. There are millions of brilliant people on this planet focused on making the current unsustainable system work. If we refocus our huge intellectual resources on developing and implementing sustainable solutions, we can achieve sustainability.

Doing so will require humility. Like those who thought the world was flat, we still know virtually nothing when compared to all there is to know. It would be arrogant to think we couldn't develop far more effective means of organizing human affairs. As we better understand the interconnected nature of all things, we will make huge leaps forward in technology, economics, business strategy and the means to become sustainable. Modern technology may seem impressive, but compared to that of nature it is woefully simplistic and massively inefficient. Overall it is suicidal.

Fear of the unknown and failure to recognize our interconnectedness are probably our greatest barriers to progress. Many feel they are ultimately alone in the world. To provide a sense of security in an otherwise threatening world, they cling to beliefs that are often illogical and unsustainable. These might include the idea that economic growth should be the primary goal of society, or that new technology will allow us to cost-effectively clean a polluted atmosphere, oceans and groundwater, or that making millions of species extinct won't matter as long as humans survive.

Human progress is usually prompted by pain or by a courageous pioneering spirit that challenges conventional wisdom. To become sustainable, we must develop the willingness and open-mindedness to question the structure of our economic, social and political systems. The task is daunting. It requires that we have the courage to live with uncertainty as we explore new, uncharted waters. If out of fear we opt for certainty by sticking with our current, familiar systems, change will be forced upon us. It is inevitable that human pain and suffering will increase if we do not hold companies fully responsible for their actions and fail to remedy our unsustainable systems.

Throughout history, people have demonstrated great capacity to rise up, sacrifice and fight against injustice. The founders of the United States understood the importance of sacrificing for future generations. During World War II, the Allies sacrificed greatly to vanquish an enemy of humanity. Now we must find the strength and courage to fight the greatest enemy humanity (and all life on this planet) has ever faced – our own shortsightedness – our inability to see our interconnectedness – our inability to see that we are in this together and will rise or fall together.

The Role of Business in Sustainability

While business obviously provides great benefits to society, it also has large negative impacts, both directly through manufacturing and indirectly through consumption of its products and services. Negative impacts are tangible (pollution, inefficient use of resources, destruction of natural habitat and biodiversity, unsafe products, layoffs, etc.) and intangible (disruption of indigenous cultures, degradation of cultural values and public spirit by overemphasizing materialism, etc.).

In the same way that government holds individuals accountable for their negative impacts on society, only government can hold business accountable. However, as noted above with the coal example, business is not held responsible for many of its negative impacts. This occurs partly because it is difficult to quantify impacts and because business and its owners are often allowed to provide large amounts of funding for political campaigns. This system gives a small segment of society overwhelming influence over government and strongly suppresses the voice of anyone not wealthy enough to buy influence. Because business often dominates government, short of a catastrophe, government will not be able to hold business fully responsible unless business asks to be held responsible.

However, business usually asks (and pays) for the opposite – to be held less or not responsible. Regulations are intended to hold companies responsible for their negative impacts on society. When companies lobby for less regulation, and give money to politicians who vote in favor of their position, they are asking to not be held responsible. This is the same as an individual giving money to a judge and asking to not be held responsible for murder or robbery.

As reprehensible as this business action sounds, it would be incorrect to ascribe negative motives to business. Business simply does what it is designed to do – maximize short-term profits. Expecting business to focus primarily on taking care of the environment, for example, would be like expecting an automobile to wash clothes. Businesses spend billions of dollars on mitigating environmental and social impacts. Many CEO's have made sustainability a key element of corporate philosophy and strategy. There is no shortage of good intentions among business leaders. No CEO wants to hurt children or leave a legacy of environmental destruction. The problem is not bad intentions. In nearly all cases, the situation is good business leaders wanting to do the right thing in a system that often forces them to do the wrong thing. We have a system problem, not a people problem.

Economic, social and political systems that do not hold firms fully accountable essentially force companies to be irresponsible and unsustainable. This occurs because any firm attempting to fully mitigate impacts in a competitive market would probably put itself out of business (costs would become too high relative to competitors). Many well-intentioned firms make huge strides in the right direction, but can only go so far in a system that does not hold them fully responsible.

Sustainability can only be achieved through the coordinated action of many different stakeholder groups. Business cannot do it alone. However, since business is such a large part of the problem, it must be a large part of the solution. To achieve sustainability, business leadership must rise to a new level. Visionary, proactive leaders must work aggressively with others to remedy system flaws.

System Flaws - Economic

System flaws abound in the economic, political and social areas. Probably the greatest flaws in the economic area are failure to incorporate externalities into prices, failure to consider limits to growth, inaccurate measurement of social well being and the discount rate. When external costs, such as those described in the coal example, are not incorporated into prices, firms do not have incentives to develop lower impact, sustainable alternatives. From society's perspective, it is grossly inefficient to not incorporate externalities into prices. For example, it is vastly more expensive to clean up pollution than to prevent it (assuming clean up is even possible).

Failing to hold firms responsible places society at risk since firms are not encouraged to adopt a precautionary approach. Firms are hugely creative. Survival is a great motivator. If firms are held responsible for their negative impacts, they will find ways to be sustainable and responsible.

Genetically engineered (GE) foods provide an excellent example of how failing to hold firms responsible places society at great risk and violates the precautionary principle. Traditional plant hybridization techniques mimic natural evolutionary processes that have evolved over billions of years. Modern GE techniques produce seeds that could never be produced in nature. Given the nearly infinite complexity of genetic structures, it is impossible to know how a gene from one substance inserted into the DNA of another will affect the billions of DNA components, especially over multiple generations. These new, unnatural life forms cannot be recalled once released into nature. It is hubris to think GE crops can be used with impunity. GE crops potentially pose the greatest environmental threat since, unlike any other environmental problem, there is no remedy. They could become self-replicating toxins. If GE seed manufacturers were held fully responsible for potential negative impacts, these seeds would not be produced.

Failure to consider limits to growth illustrates the bluntly simplistic and unsophisticated nature of our economic theories and systems. We are surrounded by infinitely more sophisticated systems and technologies. Modeling our economic system after nature would make humanity sustainable. In nature, systems such as forests grow then level off, forming a sustainable balance with other systems. The idea that a business or national economy should grow indefinitely in a finite world is unrealistic. A more sophisticated economic system would recognize that firms also have optimal sizes. Companies would be rewarded for achieving and maintaining optimal size. Growth beyond this would be penalized.

In addition, a more sophisticated economic system would implement a much better means of assessing the well being of society. Our current system of using economic growth as the measure of social prosperity is simplistic in the extreme. In fact, it is increasingly negatively correlated with social well being. To illustrate, gross domestic product, the primary means of measuring prosperity in the US, rises when medical costs, environmental damage, anti-depressant sales and incarceration increase. These are measures of social degradation, not prosperity.

The discount rate is based on the idea that money is more valuable today than in the future. This is of course true in the sense that today's money can be invested and earn a return. However, this concept also says that tangible assets (forests, clean air, clean water, etc.) are well as intangible assets (human life, quality of life, etc) have lower value as time goes on. In other words, the discount rate says people today are worth more than those in the future. Beyond fifty years or so, the discount rate says most people and things are nearly worthless. As a result, when making economic decisions at the firm and national level, business and political leaders are often compelled to act as if their grandchildren are nearly worthless.

System Flaws - Political

Political system flaws include the ability of companies to financially influence politicians (a process known as bribery in developing countries, but called campaign finance in the US). When politicians must rely on funding from corporations to get elected, the government becomes primarily focused on serving short-term corporate ends. This results in corporate welfare, which is essentially a massive transfer of national wealth to the small group that owns most corporate assets.

In the US, for example, firms have lobbied and provided funding to politicians who vote to maintain an 1872 mining law that allows companies to buy rights to minerals on Federal lands for five dollars an acre. Under this law, Chevron paid \$10,000 for rights to platinum and palladium worth an estimated \$30 billion on 2,000 acres near Yellowstone Park. The government is supposed to act as a responsible steward on behalf of current and future generations, rather than squander our wealth for the benefit of those providing large political contributions.

Ending the ability of anyone to financially influence politicians and implementing complete public funding of political campaigns would make it much more difficult for companies to avoid being held responsible. It would also reduce taxes by orders of magnitude more than any other tax reduction activity. For example, ending the thousands of corporate welfare abuses, such as the Chevron example above, would reduce taxes by hundreds of billions, perhaps trillions, of dollars.

Another major political/legal system flaw is the limited liability corporate structure. This structure is intended to facilitate corporate investment by not holding firms and their owners fully responsible for negative impacts on society. As a result, taxpayers often must pay to remedy environmental and social problems caused by firms. As noted above, this process is grossly inefficient since remediation is virtually always far more expensive than prevention. When companies are not held fully responsible for their actions, they are not motivated to prevent problems. In fact, they are compelled to cause them.

A good example of this involves the recent dismissal by the Bush Administration of Clinton-era lawsuits against electric utilities for allegedly failing to install pollution control equipment in violation of the Clean Air Act. Many utilities felt they could not afford to reduce emissions in a competitive market. As a result, they successfully lobbied to have the lawsuits dismissed. While this obviously lowers costs to firms, the total cost to society of failing to reduce emissions (premature deaths, illness, birth defects, etc.) is much higher.

Failing to hold corporations fully responsible also places small firms that are held responsible at an unfair disadvantage. Developing and implementing a more sophisticated corporate structure that serves society better than the limited liability corporation will be difficult, but not impossible. The idea that the economy can only prosper if firms are allowed to damage the environmental and social realms is absurd.

System Flaws - Social

System flaws in the social area include the largely unregulated ability of firms to influence public opinion and values through advertising and media. Being focused on maximizing sales and earnings, companies view citizens primarily as consumers of goods and services. Advertising is used to create a perceived need and prompt a purchase. This is frequently done by taking advantage of human needs for self esteem, love and connection to others. Advertisements often use strong emotional appeals to imply purchasing a product will meet these non-material needs.

A common and intended consequence of advertising is that consumers feel inadequate without the product. Widespread use of this type of advertising creates a pervasive sense of emptiness and low self

esteem in society. Emotionally false advertising does not tell consumers that non-material needs are met through activities such as being a good spouse, parent and neighbor, doing fulfilling work or being in nature, since firms don't make money on this. Conventional advertising is one of the most destructive influences in society. It is a root cause of increasing compulsive behavior and depression. (The destructiveness of advertising is not obvious to many because, from childhood, we are steeped in an advertising culture that equates success with material prosperity.)

With overwhelming financial resources, relative to other stakeholder groups, and control of many media outlets, firms have the ability to unfairly influence and mislead public opinion. The founders of the United States were concerned about this abuse of power. They often spoke of the evils of democracy. The Founders were concerned that the uninformed public could be whipsawed by sound bites. As a result, they structured the country to be a republic, where politicians study complex issues and make expert decisions on behalf of current and future generations, rather than a democracy, where the uninformed majority rules, often through opinion polls.

Because politicians are often seen as serving corporate interests rather than the public good, they do not receive the public trust and support needed to make tough decisions. In this environment, public opinion is highly vulnerable to corporate misinformation campaigns. In pursuit of profit maximization, some firms seek to confuse the public about key issues in an effort to avoid being held responsible for their negative impacts. A good example is when oil companies publish ads questioning the reality of climate change, even though nearly all scientists not receiving funding from firms agree climate change is largely induced by human activities and will have significant negative impacts on society.

Defining and Rating Total Corporate Responsibility Performance

The traditional CSR movement has been focused on improving corporate environmental and social performance (i.e.: reducing pollution, making safe products, taking good care of employees, acting responsibly in developing countries, etc.). This has prompted great improvement, but much more is needed to achieve sustainability. The missing element of sustainability is system change. The TCR model takes CSR to the next level by shifting the focus to system change. TCR encourages firms to continue traditional CSR activities. However, the emphasis is placed on working proactively with others to promote system changes that hold firms fully responsible.

TCR suggests a new mindset for business. Rather than seeing itself as one entity operating independently from the rest of society, business would see itself as being part of one interconnected system. It would give priority to the good of the overall system, and in so doing ensure its own prosperity. The TCR approach recognizes the realities of today's marketplace. It suggests that firms take practical, incremental, profit-enhancing actions that improve internal CSR performance and promote system change.

The TCR model is based on three concepts – Interconnectedness, Actualization and Posterity. The model includes many different metrics that are used to assess performance in each area. Weightings are assigned to each metric based on financial and strategic relevance, data quality and other factors. Weighted scores are added to produce best-in-class ratings of TCR performance.

Interconnectedness means that business is part of one interconnected system. Recognizing this, firms strive to mitigate all primary and extended negative impacts on society. Performance assessment in this area considers internal and external activities. Internal metric categories include risk mitigation, product development, stakeholder relations and developing country impacts. External metric categories include industrial ecology, government relations, and dialogue and action in support of system change.

In the interconnectedness area, performance rating focuses on campaign finance, lobbying and other system change activities. Favorable ratings are given to firms that seek to be held more responsible for their negative impacts on society, rather than less. Examples of proactive strategies include BP's decision to not provide funding to political action committees in the US and lobbying by the electric utility PSEG for more stringent restrictions on air emissions.

Actualization means that the primary purpose of business is to help society achieve its highest potential. Over time, this implies that the primary focus of business would shift from maximizing short-term profits to maximizing the well being of society. Ironically, shifting the focus away from profits probably would increase earnings as firms are rewarded for being of greater service to society. Performance metrics in this area also focus on internal and external activities. Internal metric categories include employee development and training, benefits and compensation, health and safety, leadership performance and development, and organization learning. External metric categories include advertising and media campaigns.

In the actualization area, performance rating focuses on activities that influence social values and public opinions. Emphasis is placed on analyzing the implicit messages contained in advertising. For example, assessment would determine whether or not advertisements use emotional appeals to imply that purchases will fulfill non-material needs for love, acceptance by peers and self worth. Emphasis is also placed on media campaigns that mislead the public for the purpose of holding firms less responsible.

Examples of proactive, socially-responsible advertising include ads that focus on favorable product characteristics (reliability, quality, performance, price, etc.) and describe a firm's responsible business practices (treating employees well, working to improve communities, etc.). Responsible ads would not imply in any way that purchasing a product would enhance ones status in society or increase ones popularity. This issue is subtle and difficult to analyze. However, it is critical for the well being of society that firms realize it is not appropriate to take advantage of emotional needs to sell products. This type of advertising reduces social well being by distracting the public from the real sources of satisfaction in life. It also promotes environmentally destructive and wasteful lifestyles.

Posterity means that the primary obligation of this generation is to preserve and enhance society for future generations. Every other goal should be subordinate to this. In practice, this means priority would be given to the well being of future generations to the greatest extent possible when making business decisions. Performance metric categories include conservation and wildlife preservation programs as well as business strategies intended to enhance the quality of life for the most needy. Examples of proactive strategies include providing low cost products and services intended to meet basic human needs in developing countries.

Performance Potential of TCR Funds

CSR performance is an excellent indicator of management quality (the primary driver of stock returns) because CSR is one of the most complex challenges facing management. In the CSR area, there are high levels of technical, regulatory and market uncertainty as well as many different stakeholders and complex issues to address. Success in this highly complex area strongly implies management has the ability to succeed in other areas, and thereby earn superior returns.

TCR is orders of magnitude more complex than CSR. In fact, it is probably the most complex challenge management will ever face. Complexity stems from the fact that it is difficult, if not impossible, for any one firm to change the systems within which it operates. Success requires working with other stakeholders to achieve system change. TCR is also complex because firms may have to abandon effective, but destructive, practices such as conventional advertising. Finding responsible alternatives to

irresponsible business practices will be difficult in some cases. But this is exactly why TCR is the best indicator of management quality. Smart firms will welcome the complexity involved in figuring out how to prosper in a responsible manner. Less sophisticated firms may not be able to rise to the challenge.

Since 1995, socially responsible investing (SRI) assets have grown 40 percent faster than all professionally managed investment assets in the US (to \$2.2 trillion). A major driver of this growth has been the superior financial performance of SRI funds. Traditional SRI approaches use negative screening (i.e.: avoiding sectors for ethical reasons). This can reduce fund diversity and lead to lower returns. Newer positive screening approaches maintain fund diversity but shift investments toward CSR leaders. These funds frequently outperform mainstream funds because they do a better job of measuring management quality and addressing financially relevant CSR issues. With TCR being an even better indicator of management quality than CSR, it is likely that funds comprised of TCR leaders will outperform mainstream funds to an even greater degree.

Frank Dixon advises businesses, governments and other organizations on sustainability, system change and enhancing financial performance through increased corporate responsibility. For seven years, he was the Managing Director of Research for Innovest Strategic Value Advisors, the largest corporate sustainability research firm in the world. At Innovest, he developed financially-focused models and methods for assessing corporate environmental and social performance and helped institutional investors develop high-performing socially-responsible investing products. His work overseeing the sustainability analysis of more than 2,000 firms made it clear that systemic issues compel all firms to operate unsustainably by making full impact mitigation impossible. To engage business and investors in driving the system changes needed to achieve sustainability, he developed a new sustainability approach focused on system change, called Total Corporate Responsibility. He is advising Wal-Mart and other firms on sustainability. He has an MBA from the Harvard Business School. Frank Dixon can be contacted at fdixon@GlobalSystemChange.com.

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