



Munich Personal RePEc Archive

Effects of corporate social responsibility and irresponsibility policies

J. Scott Armstrong and Kesten C. Green

1. December 2012

Online at <http://mpra.ub.uni-muenchen.de/43007/>

MPRA Paper No. 43007, posted 4. December 2012 17:19 UTC

Effects of Corporate Social Responsibility and Irresponsibility Policies

J. Scott Armstrong, The Wharton School, University of Pennsylvania
Kesten C. Green, University of South Australia Business School

Working paper, 1 December 2012
Forthcoming in the *Journal of Business Research* in 2013

Abstract

This article reviews experimental evidence on the effects of policies intended to promote behavior by firms that is more socially responsible and less socially irresponsible. Corporate social responsibility (CSR) can provide firms with opportunities for profit, but changes are likely to increase total welfare only if firms adopt them freely and without taxpayer subsidies. Mandated CSR circumvents people's own plans and preferences, distorts the allocation of resources, and increases the likelihood of irresponsible decisions. Evidence that government policies will increase welfare and a compelling argument that proven benefits justify reductions in freedom are necessary in order to justify CSR mandates. To date, this has apparently not been achieved. Corporate social *ir*responsibility (CSI) is concerned with whether firms undertake harmful actions that managers would be unwilling to undertake acting for themselves, or that a reasonable person would expect to cause substantive net harm when all parties are considered. Markets in which stakeholders are free to make decisions in their own interests provide some protection against CSI. Tort and contract law provide additional protection. Nevertheless, managers sometimes act irresponsibly. Codes of ethics that require fair treatment of stakeholders while pursuing long-term profit reduce the risk of irresponsible decisions. Management support and stakeholder accounting are important for successful implementation. Firms may wish to consider these measures; many already have.

Keywords: accountability, affirmative action, decision making, ethics, externalities, free markets, minimum wage, paternalism, principal-agent problem, regulation, seer-sucker theory, stakeholder accounting, stakeholder theory, sustainability.

Send correspondence to J. Scott Armstrong, The Wharton School, University of Pennsylvania, Philadelphia, PA 19104, (Armstrong@wharton.upenn.edu); Kesten C. Green University of South Australia Business School, GPO Box 2471, Adelaide SA 5001, Australia (kesten.green@unisa.edu.au).

Acknowledgments: The authors are grateful for early suggestions on this paper from Kay Armstrong, Philip Booth, Tom Donaldson, Philippe Jacquart, Ed Locke, Tim McGuire, Patrick Murphy, Bodo Schlegelmilch, Paul Sherman, Fred Smith, Clifford Winston, and Arch Woodside. Rui Du, Jennifer Kwok, and Katherine Wang helped with editing. Responsibility for errors or omissions belongs to the authors.

Effects of Corporate Social Responsibility and Irresponsibility Policies

1. Introduction

In economic theory, maximizing the present value of long-term profits is the objective of a firm. Some commentators suggest that this objective is insufficient because firms should also undertake what they regard as socially responsible activities. The concept of corporate social responsibility (CSR) became prominent in the 1960s. Promoters wish to use firms as instruments for achieving various social objectives. In addition they are concerned with reducing corporate social irresponsibility (CSI).

Some advocates of CSR and of efforts to reduce CSI suggest that owners and managers lack incentives to make socially responsible decisions. As a consequence, the argument goes, corporate managers need guidance that will lead them to make responsible decisions. Guidance is likely to be insufficient, however, if following the guidance would harm profits. Therefore, government incentives and penalties may be required to ensure firms follow the guidance.

A contrasting view is that firms should be free to pursue the profit-making objectives of the owners. In doing so, firms need to develop mutually agreeable arrangements with stakeholders—those who have substantive economic interests in the activities of the firm. Stakeholders typically include owners, creditors, employees, suppliers, distributors, local communities, and customers. Prices and other arrangements adjust to reflect the preferences of individuals in each group. With each party free to end its relationships and each protective of its reputation, the system is self-monitoring and self-correcting.

The pursuit of long-term profits encourages firms to treat other parties well and to avoid misleading them. For example, firms tell customers about the limitations of their products in order to retain the benefits of good long-term relationships and to avoid the costs of dealing with disgruntled customers and with lawsuits. If managers treat owners poorly, the owners can find new managers. If firms treat other stakeholders poorly, the stakeholders can seek out firms that treat them better. Buyers seek products that best suit their needs. To do this, they can obtain independent information from others, search the Internet, use trusted suppliers, or buy well-known brands. If buyers discover that they have been misled, they can punish the seller by not buying the product in the future, demanding a refund, discouraging others from making a purchase, posting comments on the Internet, or suing. Finally, there are long-standing legal remedies in both tort and contract law if stakeholders or others are harmed or might be harmed. These remedies include compensatory damages and injunctions.

One might reasonably ask whether regulators are as strongly and clearly motivated to do good, whether they possess the requisite knowledge to do so, and whether they can do so in practice? Moreover, when a government policy is harmful, the harm is greater in extent than when a firm's policy is harmful, there is not the same opportunity for those who are harmed to exit the relationship, and ambiguous feedback, interest group lobbying, and inertia are more likely to delay its reversal than would be the case for a firm.

Despite explanations by Adam Smith, Friedrich von Hayek, Milton Friedman and others, the idea that people should be free to make contracts as they see fit (the so-called "invisible hand" of the market) is counter-intuitive for many people. They cannot believe such a system can work because it lacks a coordinator and, they argue, the parties are motivated by greed.

Adam Smith addressed this concern: “It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest” (Smith 1776/2008, p. 25). In contrast, mandates and subsidies aimed at promoting CSR and reducing CSI are based on the belief that people need the guiding hand of government.

2. CSR and CSI as Government Regulation

Regulators face a complex problem if they are to improve on the welfare outcomes that arise from free-market interactions. In order to do so, they must meet basic conditions to help ensure that regulation will make the situation better than market solutions. In particular, welfare is likely to be reduced by a CSR or CSI regulation if the regulator fails to meet any of the following common-sense conditions:

1. Know stakeholder’s endowments, relationships, and preferences
2. Describe in detail how the situation could be changed to the benefit of those affected
3. Design rules that will produce the intended changes
4. Design rules that will not produce unintended changes
5. Resist pressures to modify the rules in ways that would reduce the total benefit
6. Ensure those affected by the rules know and understand them
7. Establish rewards and punishments to ensure the rules are followed
8. Establish fair procedures for resolving disputes arising from enforcement of the rules
9. Change rules (see 1–8) when the situation changes, as with inventions or scarcities
10. Keep the administrative costs of the rules below the value of the benefits.

Learning how many existing regulations meet these ten conditions would be interesting: The answer should already be known. In the case of the first condition, for example, stakeholders themselves do not know their preferences until faced with specific choices. Consider the case of a consumer buying a product. Nisbett and Wilson’s review of the literature on making decisions concludes, “the accuracy of subjective reports is so poor as to suggest that any introspective access that may exist is not sufficient to produce generally correct or reliable reports” (1977, p. 233). Customers know what they like, even if they are not sure why. But how could a regulator know their preferences? The question was raised by Jeremy Bentham in the late-1700s, “It is a standing topic of complaint, that a man knows too little of himself. Be it so: but is it so certain that the legislator must know more? It is plain, that of individuals the legislator can know nothing: concerning those points of conduct which depend upon the particular circumstances of each individual, it is plain, therefore, that he can determine nothing to advantage” (Bentham 1789, 1823, p. 379, 1789/1907).

And might the ability to choose for oneself add to one’s enjoyment of life? A study of data from 46 nations leads to the conclusion that choice *is* important to happiness (Veenhoven, 2000). Moreover, regulation dulls the connection between the preferences of buyers and sellers’ production decisions and innovations.

Rizzo and Whitman (2009) ask a similar question to the one asked in this article, in their case about new paternalist or so-called libertarian paternalist policies. Do policymakers know enough to improve the situation? They propose that government policy makers must pass six

knowledge tests in order to be confident of improving welfare. They conclude that success is unlikely.

Regulation is a forecasting problem. Legislators, regulators, and courts appear to depend on expert judgment to forecast whether a proposed regulation will lead to desired outcomes. The question that then arises is, are such forecasts valid? An early review of the experimental evidence on forecasting for complex and uncertain situations concluded that experts with accurate information are unable to make predictions that are better than those made by non-experts (Armstrong 1980). That conclusion was reinforced by a study of more than 82,000 judgmental forecasts made over 20 years by 284 experts in politics and economics (Tetlock, 2005). The experts' unaided forecasts were little more accurate than those made by non-experts, and they were less accurate than forecasts from simple models. Despite the evidence, most people believe that they and their favorite experts are exceptions. The disconnection between evidence and belief about expert forecasting is described by the Seer-sucker Theory: "No matter how much evidence exists that seers do not exist, suckers will pay for the existence of seers" (Armstrong, 1980).

Despite the widespread belief that regulation is useful, the authors were unable to find scientific studies that established that regulation was superior to non-regulation in any specific case. To the contrary, the effects are typically harmful (e.g., Winston, 2006). For example, mandated disclosure and disclaimer regulations, which are intended to provide potential buyers and other stakeholders with important information, are examples of regulations that seem obviously beneficial. U.S. courts have upheld such restrictions on free speech for nearly seven decades on the basis of their intuitive appeal: how can more information be harmful? Would not people be protected by guidance and warnings? In light of these commonsense beliefs, it is remarkable that all experimental evidence has shown that buyers and sellers have been *harmed* by mandated disclosures (Ben-Shahar and Schneider, 2011; Winston, 2008). The same applies to mandated disclaimers (Green and Armstrong, 2012).

Opinions of experts tend to lag decades behind the evidence, and the opinions of the general public tend to lag those of the experts. In the early 1900s, economists and the general public saw a need for regulation of businesses. This viewpoint persisted in university economics textbooks. For example, Paul Samuelson's *Economics* advocated central planning. By his 13th edition (1989) Samuelson claimed, "The Soviet economy is proof to the contrary to what many skeptics had earlier believed, a socialist command economy can function and even thrive" (quoted in Skousen 1997, p. 148). However, as Winston (1993) documents, empirical evidence on the failures of regulation began to affect economists' views on regulations. By the late 1970s, for example, 97% of economists agreed that "tariffs and import quotas reduce general economic welfare" and 90% agreed that, "a minimum wage increases unemployment among young and unskilled workers" (Kearl, Pope, Whiting and Wimmer, 1979, p. 30). For a summary of the state of economic knowledge of minimum wage policies, see Gorman (2008). Judging by government policies around the world, public opinion and political leadership have yet to catch up with evidence on these issues.

An appeal to the economic concept of externalities is another way the argument is made for government intervention. Externalities occur when there are benefits or costs to third parties that are not reflected in the price of a product. As a consequence, the theory goes, such products are under or over produced relative to the socially optimal quantity. In practice, third parties typically propose that a particular externality exists, and that government action is needed in

order for the market to provide the correct quantity of the product. This argument is another way of saying that sellers and buyers are not being sufficiently socially responsible, or are being socially irresponsible. Alternatively, sellers or buyers sometimes lobby for a subsidy, arguing that this would lead to greater social responsibility as a result of more of a socially desirable product being produced and consumed. Given that there is no agreement of what social responsibility is or how much it is worth relative other desiderata—nor is it plausible that free people would agree—it is not clear how any government or political process could determine the optimal quantity of the product. Because firms are guided by prices in their search for profits, they have stronger incentives and better means than do regulators to provide the optimal social quantity of a product: the quantity and kind for which buyers and other stakeholders are willing and able to pay for with their own money.

The belief that regulation is desirable persists despite the lack of experimental evidence to support regulation. Indeed, natural experiments whereby heavily regulated countries such as North Korea are comparable with less regulated countries that were previously similar, such as South Korea, provide scant evidence of superior social outcomes. South Korea's 2012 Index of Economic Freedom is 69.9 and its 2010 per capita GDP adjusted for purchasing power is \$28,600. The equivalent figures for North Korea are 1.0 and \$1,100 (Miller, Holmes, Feulner, et al., 2012). For further evidence from natural experiments, see the statistics provided on Wikipedia in the entry titled "Eastern Bloc economies."

Government regulations are expected to harm stakeholders because they ignore prices and restrict the rights of consenting adults to make contracts with one another. Might it be fair to suggest, then, that accepting government subsidies and exploiting protective regulations are examples of corporate social irresponsibility? The findings of a study of the deregulation of nine U.S. industries (including airlines, railroads, brokerage, telecommunications, and natural gas) were consistent with economists' predictions that consumers would benefit. The general public expected the opposite outcome for some industries, such as airlines. Even after deregulation, the general public perceives that airline customers were harmed (Winston, 1993). De Soto (1989) shows how government regulations lead to socially irresponsible results in poorer countries.

The authors' review of the evidence on government regulation supports the *Iron Law of Regulation*: "There is no form of market failure, however egregious, which is not eventually made worse by the political interventions intended to fix it" (original source unknown).

3. CSR and CSI Regulations in Practice

Because agreeing on a definition of CSR is hard, if not impossible, firms may be told or forced to take actions that seem socially responsible to some people, but which are regarded as socially irresponsible by others. For example, should managers of corporations divert money from stockholders to charities of their own choosing without the agreement of all of the owners? Should managers support social causes that are objectionable to many of the firm's stakeholders? Should firms be forced to discriminate on the basis of race and gender in their hiring and promotion decisions? Should managers support programs that the firm's owners expect will harm welfare? For example, according to a National Center for Public Policy Research 2012 press release, at their annual shareholder meeting in Chicago executives from

Target Corporation refused to answer stockholder requests for cost-benefit information on the various environmental sustainability programs listed in the corporation's 2011 Corporate Responsibility Report (Target Corporation 2012).

Major disagreements over what constitutes socially responsible behavior are common. Discrimination based on race, sex, or ethnicity is believed by many to be responsible behavior and is endorsed and sometimes enforced by governments. Since the early 1960s, the U.S. government has supported present-day discrimination to redress historical disadvantages. For example, elite universities discriminate against Asians and southern white males under the name of affirmative action. To have the same opportunity for acceptance at America's elite colleges, Asians must score 450 points higher out of 1600 on the SAT tests than people with dark skin (Espenshade and Radford, 2009, p. 92). It is not immediately obvious how this helps to redress previous disadvantages. Moreover, the majority of people in the U.S. do not support such discrimination. A May 26-June 2009 Quinnipiac University nationwide survey of 3,097 registered voters asked "Do you think affirmative action programs that give preferences to blacks and other minorities in hiring, promotions and college admissions should be continued, or do you think these affirmative action programs should be abolished?" Their responses were: Continued 36%; Abolished 55%; Unsure 9%.

When the government imposes policies in the name of social responsibility, they tend to persist for long periods. This is partly because the costs tend to be dispersed and the benefits concentrated. In contrast, participants in free markets are punished if their idea of what is socially responsible fails to provide a net benefit. For example, a manager might consider the skin tone of a potential employee an important consideration for modeling a range of clothes to the advantage of the firm and its customers. If a manager were to adopt an "affirmative action" policy that led the firm to hire a web designer based on skin color, on the other hand, this would put them at a disadvantage to firms that did not discriminate in this way. Firms in South Africa were leaders in rejecting racial policies: they openly disobeyed apartheid laws. Managers regarded those actions as good for their firms.

Some proponents of CSR argue that firms will ultimately earn higher profits if they do good deeds. Without an agreed-upon and unambiguous definition of CSR, however, such claims cannot be tested. Even if a testable general claim were forthcoming, other variables—including subsidies, tax breaks, and special treatment—and causal ambiguity would require experiments for proper testing (Armstrong, 2012). Furthermore, investment returns are contingent on circumstances and must be evaluated each on its own merits.

Despite the questionable value of analyzing non-experimental data, many researchers have published such analyses to assess the value of CSR. Margolis and Walsh (2003) list 127 such papers published between 1972 and 2002. About half (50.5 percent) of the 109 studies that treated corporate social performance as an independent variable failed to find a positive relationship with financial performance. In their review, they found that the 13 previous reviewers since 1978 had identified "problems of all kinds in this research... sampling problems, concerns about reliability and validity... omission of controls... and [of] moderating conditions" (p. 278). No doubt the number of similar studies has grown substantially since the Margolis and Walsh review.

Where corporate social responsibility decisions conflict with the market by asking or forcing managers to obey rules that are harmful for their firms, CSR is likely to lead to socially irresponsible decisions in the form of penalties imposed on people who have done no harm and

in the form of distortions in the allocation of resources. Moreover, governments forcing firms to allocate resources in particular ways, for example in response to the lobbying of the sustainability movement, amounts to a confiscation of property rights.

4. CSR and CSI as Voluntary Policies

Firms might adopt policies in order to encourage their employees to act responsibly and to avoid acting irresponsibly. These practices are informed by the stakeholder theory of the firm. For an excellent review of the history and literature on the stakeholder theory, see Donaldson and Preston's (1995), one of the most frequently cited academic papers on social responsibility. They approach the problem by looking at whether firms use the stakeholder theory (many do), the normative issue (is the stakeholder theory justified on moral grounds?), and the instrumental issue (are firms more profitable if they follow stakeholder theory?). They conclude that there is a lack of evidence on the instrumental value of stakeholder theory. Partly, they write, this lack of evidence is due to the lack of explicit descriptions in the use of the stakeholder theory.

One view of stakeholder theory is that it requires a change in the objectives of the firm. Instead of simply maximizing the net present value (NPV) of profits, the stakeholder-theory objective of the firm is to maximize NPV subject to treating other stakeholders fairly. This view is consistent with Donaldson and Preston's (1995) argument that the property rights of stakeholders provide the moral justification for using stakeholder theory as the basis of the management of firms. It is also consistent with beliefs held by managers; for example, in Baumhart's (1968) survey of subscribers to the *Harvard Business Review*, 83% of the respondents agreed that, "for corporation executives to act in the interests of shareholders alone... is unethical". However, to be effective, a firm's objectives must be explicit and measurable. Support for this conclusion is drawn from hundreds of lab and field experiments on objective setting (Locke and Latham, 2002).

5. Evidence on Voluntary CSR

The authors conducted searches for experimental and quasi-experimental research findings that could provide evidence on the effects of voluntary corporate social responsibility and corporate social irresponsibility initiatives. Searches included the Internet and examining references in key papers. The authors attempted to contact all those whose findings they had referred to in order to ask whether they had accurately summarized the findings, and to ask whether evidence had been overlooked. They received replies from most of those they had attempted to contact and made extensive changes in response to the replies.

Many firms have responded to CSR in a rational way by looking for profit opportunities. For example, if people are willing to pay three times as much for eggs laid by "free-range" chickens, it may be possible for the seller to increase profits. Customers who buy them are happier even if they have little idea of what it means for chickens to be raised free-range, if there is no objective difference in the taste of the eggs, or health effects, and if there is no knowledge about the happiness of the chickens. The key is that decisions do not lead to net harm. Hence, a firm may find opportunities to increase profits by satisfying customers who hold strong beliefs on the lifestyles of chickens.

Causes might help advertisers establish a link with customers who might otherwise resist their appeals. Causes can be of a general nature, such as donations to charities, or firms can show how purchasing the product contributes to a social good. An advertisement can inform people that the firm is aligned with a popular cause, such as “This ad was printed on recycled bio-degradable paper.” To show their support for causes, sellers use phrases such as “Fair trade certified,” “Fairly traded,” “Certifiably sustainable,” and “Local.” The terms sometimes indicate support by a third party, such as “Rainforest Alliance Certified.”

Causes can be tied to purchases. In 1983, in what is reputed to be one of the earliest examples of tying sales to charitable donations, American Express advertised that they would donate a penny to the renovation of the Statue of Liberty for each use of its credit card. Compared with the same period in the prior year, it claimed a 28 percent increase in credit card usage, a huge increase for such a small offer. For a description on how to use causes to improve profits, see Armstrong (2010, pp. 140–141).

Sainsbury’s, the British supermarket chain, sold “fair trade” bananas at four times the price of conventional bananas (Stecklow and White, 2004). In an experimental study of coffee-buying behavior, the price of cups of coffee advertised as “fair trade” and the price of cups of the top selling variety were varied with discounts, which were advertised. Nearly 500 buyers were observed and interviewed. Demand for the fair trade variety was much less sensitive to price changes (Arnot, Boxall, and Cash, 2006). The Fair Trade approach should not be regarded as a CSR panacea, however. While it does some good and little harm as a niche brand, the anti-free trade approach of its promoters would be harmful if it became more prevalent (Mohan, 2010).

Surveys found that 83 percent of U.S. respondents would have a more positive image of a firm if it supported a cause that they respect. And 86 percent of U.K. respondents said they would be more likely to purchase from a company associated with a cause (Ellen, Mohr, and Webb, 2000).

In summary, it is possible for stakeholders to gain from applications of the CSR concept without harming others if the initiatives are voluntary and are not subsidized by taxpayers. Failing this, there are strong a priori reasons to expect that actions taken in the name of CSR will be socially irresponsible, as defined in the next section. This conclusion is not new.

6. Evidence on Methods to Reduce CSI

This paper uses a definition that Armstrong (1977) proposes: “A decision can be considered as irresponsible if it is (1) inferior to other options when all effects upon all parties are considered, or (2) a decision that the decision maker would consider unethical in a personal capacity.”

Corporate social irresponsibility is a long-standing problem. In a survey of 1,800 subscribers to the *Harvard Business Review*, 82 percent of the respondents indicated that their industries were likely to have engaged in “unethical practices.” The primary influence in making these unethical decisions was reported to be the behavior of the respondent’s boss (Baumhart 1968).

One source of social irresponsibility is that people working for firms might employ unethical procedures to increase their personal wealth at the expense of the firm (e.g., embezzlement). Owners of firms endeavor to exclude such behavior because it harms profitability. The

penalties for irresponsible actions by corporate managers can be huge (Karpoff and Lott, 1993; Lott, 1992). A related problem occurs when managers or boards of directors deceive the owners. Here again the penalties are high. A study of 585 firms that were targeted by the SEC for financial misrepresentations from 1978–2002 found that while legal actions led to legal penalties of around \$24 million, the reputational losses were more than seven times larger (Karpoff, Lee, and Martin, 2008).

Perhaps the major source of irresponsible behavior in firms is people following the dictates of their roles even when doing so causes harm. This issue of people following instructions in contravention of their own ethical beliefs was examined in Milgram's (1974) "blind obedience" studies on learning. It was unsurprising that he found that people submit to authority. What was surprising was the size of the effect. Many "teacher" subjects in Milgram's experiments on learning continued to administer electric shocks to their "learner" subjects even though they thought their actions as a teacher were leading the learner to suffer considerable pain and, in some cases, death. In another experiment, subjects were given the role of either lawyer for the plaintiff or lawyer for the defendant in a dispute over damages arising from an automobile accident (Babcock et. al 1995). The subjects then read the evidence on the case and were asked to estimate what dollar amount a fair judge would award in damages. The two groups of "lawyers" found different parts aspects the evidence important and the difference between the estimates of fair damages were large. Such biased estimates would not be in the interest of clients, as they would reduce the chances of an out-of-court settlement.

The studies suggest that one way to help reduce the chances that managers will make irresponsible decisions is to give them roles that are consistent with responsible behavior. Developing explicit and measurable objectives should help firms to achieve this. For example, "The role of our managers is to maximize long-term profits subject to the fair treatment of our stakeholders. To that end, managers are expected to report on the effects of the firm's actions on stakeholders in addition to the usual financial reporting requirements."

While codes of ethics have long been suggested as a way to reduce irresponsible corporate behavior, many codes are neither clear nor operational. A laboratory experiment by Brief, et al. (1996) found that a code of ethics for financial reporting failed to reduce a high rate of fraudulent accounting because it was vague. Also, it did not involve an attempt to change the roles of the participants. Codes might be effective if they reinforce the role of long-term profit making subject to satisfactory treatment of the other stakeholders and if they are supported with stakeholder accounting. Nothing further should be added, as this would cause confusion.

Some experimentation has been done to assess the effectiveness of changing the roles of managers. Armstrong (1977) conducted an extension of the Milgram experiment by using an actual case faced by Upjohn, a pharmaceutical company. The company was facing the potential ban of one of its drugs, Panalba, by the U.S. Food and Drug Administration (FDA). After much study, a scientific panel concluded unanimously that the drug had serious side effects that led to unnecessary deaths. The benefits of Panalba were available from other drugs that did not cause fatalities. The Upjohn board of directors decided to use available legal means to delay a ban and to continue selling Panalba. This description was drawn from Mintz (1969).

In the original experiments, participants played the role of one of seven Upjohn board members. After receiving background information on the case, the role players were asked to choose from one of five responses to the potential banning of the drug by the FDA. The five

possible responses ranged from immediately removing the drug from the market to taking steps to keep the drug on the market.

Thirty-three faculty members conducted this experiment with 319 groups of subjects from ten countries between 1972 and 1977. The 57 control groups received no information on responsibilities. None of the control groups decided to remove Panalba from the market and 79 percent took the same action as Upjohn: “Continue efforts to most effectively market Panalba and take legal, political, and other necessary actions to prevent the authorities from banning Panalba.” This decision was classified as irresponsible by 97 percent of a convenience sample of 71 respondents similar to the subjects who had participated in the experiments. Interestingly, subjects in the control group were bothered by their decisions, as had occurred in the Milgram experiments, yet in the follow-up questionnaire 90% of the subjects were unaware that the experiment dealt with irresponsible behavior.

Because roles exert powerful influences on decision-making, a treatment was devised as an attempt to modify subjects’ perceptions of their roles so that they would feel responsible to all of the firm’s stakeholders. To that end, some subjects were told that Upjohn’s board had passed a stakeholder-role resolution in 1950 stating,

The Board’s duty was to recognize the interests of each and every one of its ‘interest groups’ or ‘stakeholders’. The stakeholders are those groups that make specific contributions to the firm. Thus, the board is to consider the effects of decisions upon employees, creditors, stockholders, customers, suppliers, distributors and the local community. Furthermore, the board should consider only its own stakeholders in making decisions. It shall not attempt to serve the common good or society in general. (All of the current board members are well aware of this policy statement.)

In another treatment designed to further emphasize the stakeholder role, the above description was provided to a Board that was comprised of three representatives of stockholders and one representative each of the local community, suppliers, consumers, and employees (stakeholders). The stakeholder roles were provided to the subjects before they read the materials, so that they would read the materials in-role.

The effects of the two stakeholder treatments were modest. This was expected due to the fact that profit was the only criterion measured. Decision-makers pay little attention to unmeasured criteria (see, e.g., Slovic and MacPhillamy, 1974). To reinforce the stakeholder roles, another experimental treatment was introduced, this time with “stakeholder accounting.” The subjects received information on the impact of the decisions upon stockholders, employees, and customers. Under the stakeholder accounting treatment, the percentage of highly irresponsible decisions was reduced to 23 percent when the participants were told that the Board agreed with the stakeholder role for directors, and to 22 percent when the Board was composed of stakeholder representatives. The socially responsible decisions went from none under the control condition to 12 percent when the board adopted the stakeholder view to 29 percent when the board was composed of stakeholder representatives (Armstrong, 1977).

In an extension of the Panalba experiment by King et al. (2010), subjects first considered the situation and reported the decision they would make as private individuals. They were then assigned to stockholder roles. The proportion of socially irresponsible decisions by stockholders was lower when they had made the individual out-of-role decision first.

Computer, rather than face-to-face, interactions also reduced the proportion of socially irresponsible decisions, presumably by reducing group pressure to conform to traditional roles.

A widely studied quasi-experiment on stakeholder management of companies has been going on since 1956. It involves more than 250 companies employing almost 100,000 people in the Mondragon cooperative in Spain. Employees own the firm, although not all employees are owners. The board of directors represents all stakeholders. Statistical analyses by industrial economists conclude that these cooperatives perform well in comparison to other Spanish companies that produce similar goods (Arando et al. 2010).

International welding business Lincoln Electric promotes the stakeholder role in the firm's Code of Conduct. The 52-page code includes a non-retaliation policy in order to encourage reporting of ethical issues, and the firm provides Compliance Hotlines in 24 countries and an Internet page for reporting. The code includes the following questions for employees:

Question Three: How would it be perceived?

This question brings into focus the consequences of your decision for both you and for Lincoln. It is worth asking: How will this decision affect my reputation and that of the Company? How would I feel about my decision if it were reported on the front page of the newspaper? Would I be comfortable if my family and friends knew I made this decision?

Question Four: Is it fair to all stakeholders?

Ethical decision-making demands that you take into account the effects of your decision on customers, suppliers, employees, shareholders and the wider community. It is important to widen your ethical lens and think about whether the situation or action is consistent with our ethical commitments and if it is fair for everyone concerned. Who has an interest at stake in the situation, and how significant is it compared to others? Who will be helped or hurt by your decision? (Lincoln Electric 2009, p.7-8.)

Other successful companies, such as BB&T, Southwest Airlines, WalMart, and Whole Foods Corporation, base their conduct on stakeholder theory as well.

7. Conclusions

No agreed definition of corporate social responsibility exists, and such agreement may be impossible to achieve. Social responsibility to some people is irresponsible to others. Views on what is socially responsible change over time. It is not enough that some people think today that some firms should behave in ways that they regard as more socially responsible. It is necessary to provide evidence that proposed changes would increase welfare in practice, and to provide a compelling argument that proven benefits justify any reduction in freedom. To date, this appears not to have been done. Actions promoted as socially responsible that are forced or subsidized suppress the free expression of the needs and concerns of buyers and the efforts of sellers to satisfy them. Suppression of free market activity tends to reduce the total welfare of society. With economic theory, experimental evidence, and individuals' preference for freedom of choice all against government regulation, there is no obvious need for further research on regulation in the name of social responsibility.

Voluntary CSR initiatives, on the other hand, can increase welfare. When buyers and sellers are free to make their own decisions, the CSR movement can help firms identify opportunities for increasing profits by providing benefits to customer and other stakeholders. Many firms recognize the marketing opportunities associated with CSR. Experimental research might help to choose CSR initiatives that would be effective for firms and their stakeholders.

Corporate social *ir*responsibility occurs when a manager makes a decision that is either (1) unethical in terms of a manager's personal values, or (2) inferior to other options when considering the effects upon all parties. Avoiding such decisions will likely be consistent with the values of most owners and with their objective of long-term profit maximization. As a consequence, owners and their managers are likely to welcome methods that can help them to prevent social irresponsibility.

Based on experimental research to date, one method that could help to prevent irresponsibility is to change the roles of firms' managers in such a way that they strive to maximize long-term profitability subject to fair treatment of their stakeholders. Stakeholder accounting and management support seem important for the success of such initiatives. Descriptions of socially responsible roles could be used as the basis of a firm's code of ethics. While there is a need for more experimental studies to learn about the costs and benefits of these proposals for reducing corporate social irresponsibility, many firms have already implemented some of these proposals with apparent success.

References

- Arando, S., Freundlich, F., Gago, M., Jones, D. C., & Kato, T. (2010). Assessing Mondragon: stability and managed change in the face of globalization. William Davidson Institute Working Paper Number 1003. [Available from <http://wdi.umich.edu/files/publications/workingpapers/wp1003.pdf>]
- Armstrong, J. S. (1977). Social irresponsibility in management. *Journal of Business Research*, 5, 185–213.
- Armstrong, J. S. (1980). The seer-sucker theory: The value of experts in forecasting. *Technology Review*, 83, 16–24.
- Armstrong, J. S. (2010). *Persuasive advertising*. London: Palgrave Macmillan.
- Armstrong, J. S. (2012). Illusions in regression analysis. *International Journal of Forecasting*, 26, 689–694.
- Arnot, C., Boxall, P. C., & Cash, S. B. (2006). Do ethical consumers care about price? A revealed preference analysis of fair trade coffee purchases. *Canadian Journal of Agricultural Economics*, 54, 555–565.
- Babcock, L., Loewenstein, G., Issacharoff, S., & Camerer, C. (1995). Biased judgments of fairness in bargaining. *The American Economic Review*, 85, 1337–1343.
- Baumhart, R. (1968). *Ethics in business*. New York: Holt, Rinehart and Winston.
- Ben-Shahar, O., & Schneider, C. E. (2010). The failure of mandated disclosure. *University of Pennsylvania Law Review*, 159, 647–749.
- Bentham, J. (1780, 1823). *An introduction to the principles of morals and legislation*. Oxford: Clarendon.
- Brief, A. P., Dukerich, J. M., Brown, P. R., & Brett, J. F. (1996). What's wrong with the Treadway Commission report? Experimental analyses of the effects of personal values and codes of conduct on fraudulent financial reporting. *Journal of Business Ethics*, 15, 183–198.
- de Soto, H. (1989). *The Other Path*. New York: Harper & Row Publishers.
- Donaldson, T., & Preston, L. E. (1995). The stakeholder theory of the corporation: Concepts, evidence and implications. *Academy of Management Review*, 20, 65–91.
- Ellen, P. S., Mohr, L. A., & Webb, D. J. (2000). Charitable programs and the retailer: Do they mix? *Journal of Retailing*, 76, 395–406.
- Espenshade, T. J. & Radford, A. W. (2009). *No longer separate, not yet equal: Race and Class in elite college admission and campus life*. Princeton: Princeton University Press.
- Gorman, L. (2008). Minimum wages. In D. R. Henderson (ed.), *The Concise Encyclopedia of Economics*, 2nd Ed. Library of Economics and Liberty. Retrieved September 10, 2012 from the World Wide Web: <http://www.econlib.org/library/Enc/MinimumWages.html#>

- Green, K. & Armstrong, J. S. (2012). Evidence on the Effects of Mandatory Disclaimers in Advertising. *Journal of Public Policy & Marketing*, 31, 293-304.
- Karpoff, J. M., Lee, D. S., & Martin, G. S. (2008). The cost to the firm of cooking the books. *Journal of Financial and Quantitative Analysis*, 43, 581–612.
- Karpoff, J. M., & Lott, Jr., J. R. (1993). The reputational penalty firms bear from committing criminal fraud. *Journal of Law and Economics*, 46, 757–802.
- Kearl, J. R., Pope, C. L., Whiting, G. C. & Wimmer, L. T. (1979). A confusion of economists? *The American Economic Review*, 69 (2), 28–37.
- King, R. C., Hartzel, K. S., Schilhavy, R. A. M., Melone, N. P & McGuire. T. W. (2010). Social responsibility and stakeholder influence: Does technology matter during stakeholder deliberation with high-impact decisions? *Decision Support Systems*, 48, 536-547.
- Lincoln Electric (2009). Lincoln Electric Code of Corporate Conduct and Ethics. Cleveland, OH: The Lincoln Electric Company [Available from <http://www.lincolnelectric.com/en-us/company/investor-relations/Pages/code-corporate-conduct.aspx>]
- Locke, E. A. & Latham. G. P. (2002). Building a practically useful theory of goal setting and task motivation: A 35 year odyssey. *American Psychologist*. 57, 705–717.
- Lott, J. R., Jr. (1992). Do we punish high-income criminals too heavily? *Economic Inquiry*, 30, 583–608.
- Margolis, J. D. & Walsh, J. P. (2003). Misery loves companies: Rethinking social initiatives by business *Administrative Science Quarterly*, 48, 268–305.
- Milgram, S. (1974). *Obedience to authority*. New York: Harper & Row.
- Miller, T., Holmes, K. R. Feulner, E. J., Kim, A. B., Riley, B., & Roberts, J. M. (2012). 2012 Index of Economic Freedom. Washington & New York: The Heritage Foundation & The Wall Street Journal.
- Mintz, M. (1969). FDA and Panalba: A conflict of commercial, therapeutic goals? *Science*, 165 (August), 875–881.
- Mohan, S. (2010). Fair trade without the froth. *The Institute of Economic Affairs Monographs*, Hobart Paper, No. 170.
- Nisbett, R. E. & Wilson, T. D. (1977). Telling more than we can know: Verbal reports on mental processes. *Psychological Review*, 84, 231–259.
- Rizzo, M. J., & Whitman, D G. (2009). The knowledge problem of new paternalism. *Brigham Young University Law Review*, 905–968.
- Skousen, M. (1997). The perseverance of Paul Samuelson's economics. *Journal of Economic Perspectives*, 11(2): 137–152.
- Slovic, P. & MacPhillamy, D. J. (1974). Dimensional commensurability and cue utilization in comparative judgment. *Organizational Behavior and Human Performance*, 11, 172–194.

- Smith, A. (1776, 2008). *An inquiry into the nature and causes of the wealth of nations*. Hamburg, Germany: Management Laboratory.
- Stecklow, S., & White, E. (2004). What price virtue? At some retailers, 'fair trade' carries a very high cost. *The Wall Street Journal*, 8 June. [Available from <http://online.wsj.com/article/0,,SB108664921254731069,00.html>]
- Target Corporation (2012). 2011 Corporate social responsibility report. online: Target.com. [Available from https://corporate.target.com/_media/TargetCorp/csr/pdf/2011-Target-Corporate-Responsibility-Report.pdf]
- Tetlock, P. E. (2005). *Expert political judgment: How good is it? How can we know?* Princeton: Princeton University Press.
- The National Center for Public Policy Research (2012). Target executives grilled over company's costly "sustainability" programs. Washington, D.C.: The National Center for Public Policy Research. [Available from http://www.nationalcenter.org/PR-Target_061312.html]
- Veenhoven, R. (2000). Freedom and happiness. in Diener, E. and Suh, E.M., *Culture and subjective wellbeing*, Cambridge, MA: MIT Press, 257–288.
- Winston, C. (1993). Economic deregulation: days of reckoning for microeconomists. *Journal of Economic Literature*, 31, 1263-1289.
- Winston, C. (2006). *Government failure versus market failure: Microeconomics policy research and government performance*. Washington, D.C.: AEI-Brookings Joint Center for Regulatory Studies. [Available from <http://www.brookings.edu/press/Books/2006/governmentfailurevsmarketfailure.aspx>]
- Winston, C. (2008). The efficacy of information policy: A review of Archeron Fung, Mary Graham, and David Weil's full disclosure: The perils and promise of transparency. *Journal of Economic Literature*, 46, 704–717.