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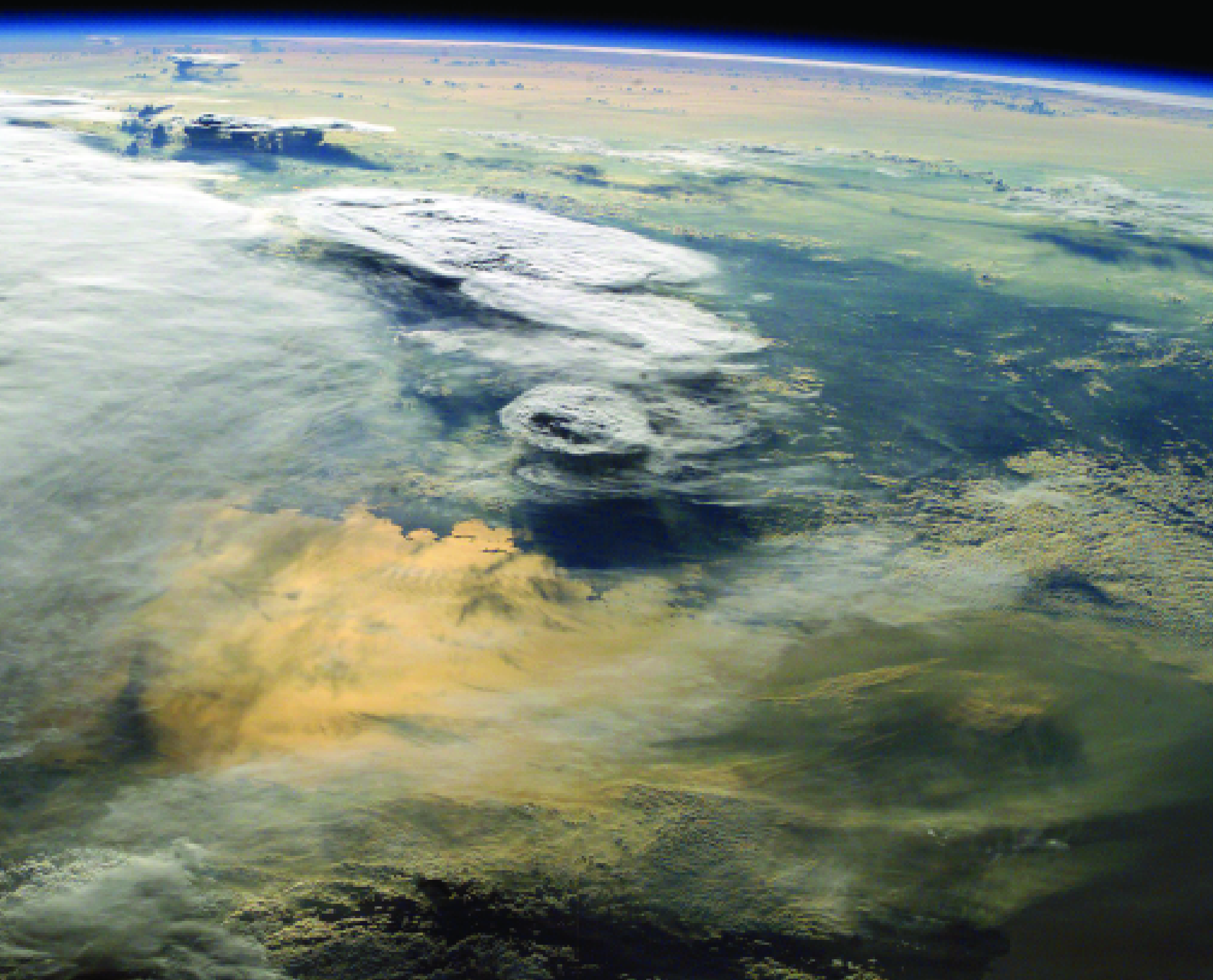

Transforming Corporations

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In March 2005, the results of a four-year study by 1,360 of the world's top scientists were announced. This comprehensive environmental analysis, the Millennium Ecosystem Assessment (MA), warns that nearly two thirds of the ecosystem services on which human society depends are being degraded or used unsustainably—a trend that could "grow significantly worse" over the next 50 years if human society does not alter its course. As the MA Board of Directors noted in its own statement when the full results were released, human activity—including economic pursuits—"is putting such strain on the natural functions of Earth that the ability of the planet's ecosystems to sustain future generations can no longer be taken for granted."[1]

The degradation of these systems does not just threaten to reduce the quality of life for humanity, it "will also profoundly affect businesses," as an MA synthesis report by industry and academic leaders noted. Ecosystem decline will intensify many of the risks and costs of doing business: it will make key resources and ecosystem services, such as fresh water and climate regulation, less available; it will heighten regulatory oversight; it will alter customer and investor preferences; and it will jeopardize the availability of capital and insurance.[2]

What the Millennium Ecosystem Assessment makes clear is that it is imperative that the business community—and especially corporations, as the dominant business institution (see Box 10–1)—takes a leading role in creating a sustainable society. While there has been a volatile and long-standing debate about whether it is corporations' duty to become more sustainable and socially responsible beyond complying with the law or whether their sole duty is to legally maximize profit, no matter the long-term societal cost, the assessment drives home the point that there is little choice: either corporations become more sustainable and responsible or the quality of life on Earth—and corporations' bottom lines—will inevitably decline. This is a reality that some corporate executives have already recognized. DuPont Chairman and CEO Charles Holliday, Jr. notes that

BOX 10–1. WHY FOCUS ON CORPORATIONS?

Corporations produce valuable goods and services and make possible a complex and highly technological social system that has extended life spans, allowed global communication and travel, and provided cheap, abundant, and diverse goods to many people around the world. They have also become the dominant form of business organization and have used their tremendous resources to exert extraordinary influence over the civic, economic, and cultural life of the societies that host them.

Today, there are more than 69,000 transnational corporations (TNCs)—those with operations in more than one country. TNCs maintain more than 690,000 foreign affiliates—business enterprises that they partially or fully control, such as subsidiaries. In 2003, the top 100 TNCs alone produced more than $5.5 trillion in sales, maintained $8 trillion in assets, and employed 14.6 million people. Together the foreign affiliates of TNCs account for one third of all world exports and one tenth of gross world product.

To create a sustainable society, all businesses—from the smallest corner shop to the largest conglomerate—will have to increase their efforts to become socially and ecologically responsible. Yet most urgent is for corporations, with their tremendous influence, resources, and impact, to exhibit leadership in responsibility efforts; this in turn will help enable and compel small and medium enterprises to follow their lead.

SOURCE: See endnote 3.

"business will not succeed in the twenty-first century if societies fail or if global ecosystems continue to deteriorate." [3]

The good news is that research and corporate experiences point to the reality that becoming a "responsible corporation" does not necessarily entail financial sacrifices but quite often improves financial performance. While there are many facets of being a responsible corporation, in essence corporate responsibility means that a corporation acts in an ecologically sustainable and socially beneficial manner—preventing ecological degradation, producing useful and healthy products, treating workers and host communities justly, and using its vast influence to improve the well-being of society and not just its bottom line. This chapter primarily focuses on the facet of sustainability, due to the urgency of safeguarding the ecosystems on which humanity depends.

The Case for Responsibility

A number of companies have already recognized the benefits of acting responsibly—investing in initiatives that reduce their environmental footprint, increase transparency of their operations, or improve the well-being of their workers and surrounding communities. Yet this number represents only a small share of the total: so far only about 1,700 transnational corporations or their affiliates have reported on social or environmental issues, usually a first step along the road to becoming a responsible firm.[4]

Managers' acceptance of corporate responsibility has been tepid at best. According to a 2004 survey by the Center for Corporate Citizenship, although 82 percent of corporate executives agree that being good corporate citizens is good for the bottom line, many believe that the lack of resources or of interest by employees or management often prevents broader adoption of corporate citizenship (responsibility) efforts.[5]

Of course, like any investment, increasing corporate responsibility does not come without cost. And with investment dollars always limited, new initiatives regularly compete based on perceived return on investment. But the evidence that corporate responsibility is worth the investment continues to grow. In 2003, researchers conducted a meta-analysis of the links between corporate social and environmental performance and corporate financial performance. They analyzed the findings of 52 studies containing more than 33,000 observations and demonstrated a positive relationship between financial performance and social and environmental performance. Moreover, the study found that many of the negative or non-significant findings of earlier studies could be explained by researcher errors.[6]

Corporate social and financial performance correlate for many reasons. First, by shrinking waste output and production inefficiencies, companies can reduce both environmental impacts and overall costs—and in the process increase competitiveness. 3M, a diverse manufacturing company, has been a pioneer in waste reduction for over 30 years. In 1975, recognizing that waste equates with industrial inefficiency, 3M started its 3P program, Pollution Prevention Pays, with the goals of cutting pollution, reducing costs, and giving employees opportunities to innovate. By 2005, it had implemented 5,600 projects that prevented an estimated million tons of pollutants and produced almost $1 billion just in first-year savings (long-term savings of new measures are not tracked). Many other companies, such as BP, DuPont, and IBM, have also cut costs by hundreds of millions of dollars by reducing waste output.[7]

Second, responsible companies often prosper because they are able to attract and retain a higher-quality workforce. According to a 2004 survey, 81 percent of Americans considered social commitment when selecting employers. Academic studies also support this. In one experiment, job applicants applied to and accepted jobs more often with firms with better social records—something that some responsible companies already experience. For example, Starbucks Coffee Company—known for its strong values and generous health benefits and ranked by *Fortune Magazine* as the eleventh best place to work in the United States in 2005—receives on average 365 applications for every job opening posted. This is a substantial number, even when compared with other large high-growth companies listed on *Fortune*'s list. Some company studies have also found that increased worker satisfaction—in part stemming from pride in social performance—actually increases productivity.[8]

Third, responsible companies benefit in the marketplace, enjoying improved reputations for being good to their workers, eco-friendly, or philanthropic. BT (British Telecom) estimates that being responsible plays a significant role in improving customer satisfaction. While research suggests that the majority of consumers do not consider responsibility their top priority when making purchasing decisions, a growing number of ethical consumers do shop according to their values. Moreover, being seen as a responsible, proactive company can reduce the risk of being attacked by activist organizations—an event that can quickly tarnish a brand or reduce customer loyalty. As Nestlé, Nike, Coca-Cola, and others have experienced firsthand, boycotts and negative publicity campaigns can have a direct impact on a company's bottom line.[9]

A fourth benefit is that responsible corporations can reduce three other forms of risk as well—being subjected to new regulations, being pressured to change policies by concerned investors, and being affected by increasing business costs. For years corporations have avoided new regulations by voluntarily improving standards—often in ways that are more industry-friendly and on a timeline easier for them to implement. Today, along with pressure from regulators, corporations also have to worry about socially responsible investors who are divesting from irresponsible companies and increasingly demanding policy changes in order to proactively respond to a threat—demanding, for example, that corporations create strategies to reduce emissions of climate-changing gases. And with a growing proportion of investment capital being held by socially responsible investors, ignoring shareholder demands can be a significant risk.[10]

Banks and insurers are also starting to pressure companies to become more responsible. With worldwide costs of storms increasing, in part because of climate change, some insurance companies are demanding that corporations provide strategies to reduce climate change. Swiss Re, for example, even alters its insurance rates depending on companies' environmental impacts and their associated risks. Banks, too, are increasing scrutiny of companies' business plans before providing loans. Thirty-one major financial institutions with holdings of trillions of dollars have adopted the Equator Principles, a set of guidelines in which banks agree to examine more closely the environmental impacts of projects they capitalize. Companies that do not attempt to minimize ecological impacts of new projects could have less access to capital.[11]

Fifth and finally, being a responsible company is providing increased access to completely new markets. As Stuart Hart, professor of management at Cornell University, notes, "few executives realize that environmental opportunities might actually become a major source of *revenue growth*." In 2004, General Electric (GE)—the world's ninth largest corporation—launched its "ecomagination" plan, which commits GE to doubling its investments in green technology research over the next five years to an annual $1.5 billion. In addition, the company will launch new green products such as diesel-electric hybrid locomotives and more-efficient jet engines. It has also promised to reduce its own greenhouse gas emissions by 1 percent by 2012 (even as the company plans to grow significantly during that time).[12]

While the environmental (not to mention the public relations) implications of this initiative are clearly beneficial, the primary motive is financial. As GE CEO Jeffrey Immelt explained at ecomagination's launch, "we are launching ecomagination not because it is trendy or moral but because it will accelerate our growth and make us more competitive." By 2010, GE hopes to post $20 billion in revenues generated from ecomagination products.[13]

At the same time that some companies are cashing in on the growing market for environmental products and services, others are making money by trying to serve the vast bottom of the economic pyramid. Many corporations sell primarily to the highest-earning 800 million people in the world and the 1.5 billion in the emerging middle class, leaving the poorest 4 billion people underserved. But more companies are starting to offer essential, economical goods and services to this group—and by doing so are becoming good corporate citizens.[14]

For example, GrameenPhone, a for-profit partnership between four companies, provides telecommunications services to villagers in Bangladesh. Along with earning GrameenPhone $74 million on revenues of about $300 million in 2004, the company supplied phone access to more than 50 million people and provided jobs to 75,000 village women, who in turn earn on average $1,000 a year (compared with the average per capita income of $286 in Bangladesh). Much of this increased personal revenue went to children's education and health care, improving the development of villages. Finally, the phone service helped save users money as well, reducing unnecessary travel to cities, which has helped reduce environmental impacts. With about 3 billion people worldwide lacking reliable access to telecommunications services, this is just one of the many business opportunities waiting to be realized.[15]

Of course, being more responsible does not always increase profits. Some pollution control measures add costs, as does increasing wages and benefits to workers. Moreover, corporations may have to forgo some irresponsible business opportunities that competitors would be willing to snap up. In the long run, however, being more responsible can help corporations outcompete rivals by staying ahead of tightening regulations, reducing usage of increasingly costly inputs, and attracting the dollars of concerned investors and consumers.[16]

In today's environmentally constrained world, with stakeholders taking an ever more active role, not becoming more responsible will be an increasingly risky choice. Indeed, whether companies should become more responsible is essentially moot. Rather, the pertinent questions are, How should companies increase responsibility? And why aren't more of them doing so?

Some Early Leaders

Currently, most corporations making an effort to become more responsible are primarily focused on reducing impacts, whether on consumers, communities, workers, or the environment. (See Table 10–1.) Reducing environmental and social impacts is an impor-

Table 10–1. Selected Corporate Leaders in Reducing Environmental Impacts

Sector	Company	Country	Achievements and Plans
Air transport	Iberia	Spain	Reduced fuel consumption per flight 6 percent between 2002 and 2004. Plans to reduce fuel usage by 19 percent from 2001 levels by 2006.
Banking	HSBC	United Kingdom	Taking a leading role in creating and strengthening environmental screens for lending.
Chemical products	Henkel KGaA	Germany	Between 2000 and 2004, reduced the amount of water and energy used and several pollutants released per ton of output.
Electronics	Philips Electronics	Netherlands	Established an EcoDesign Process to produce efficient, recyclable, low-weight, low-toxicity products.
Health care products	Johnson & Johnson	United States	Acquires 24 percent of electricity from renewable sources, making the company the biggest U.S. corporate purchaser of renewable energy.
Insurance	Swiss Re	Switzerland	Sector leader in pushing for stricter climate regulation. Has internal goal of being carbon-neutral by 2013.
Paper	Svenska Cellulosa	Sweden	Largest collector and user of recycled paper in Europe. Plants three times as many trees as it harvests each year.
Vehicles	Toyota	Japan	Sector leader in operational efficiency and in producing low-emission, fuel-efficient, and hybrid cars.

SOURCE: See endnote 17.

tant short-term step. With growing environmental constraints, however, simply polluting less (that is, increasing "eco-efficiency") will not be enough. Instead, business practices will have to strive to become "eco-effective."[17]

Eco-effectiveness, as industrial design experts William McDonough and Michael Braungart explain, means redesigning goods and production processes to follow the laws of nature. Almost everything that companies produce is toxic at one level or another—whether because of dependence on fossil fuels for energy, petrochemicals for inputs, or pesticides and chemical fertilizers for cultivation. An eco-effective product would be designed so as to produce no waste—being either perpetually recyclable or compostable, a model known as "cradle-to-cradle."[18]

Swiss textile maker Röhner's effort to create an eco-effective fabric offers a good example of the complicated reformulation needed. In the early 1990s, the Swiss government classified the company's fabric trimmings as hazardous waste because of the toxic chemicals in the dyes, which prevented disposal or incineration within Switzerland. Exporting the trimmings would be too expensive, so Röhner had to find an alternative. The company called in McDonough and Braungart to find a way to create an eco-effective fabric. After testing 8,000 chemicals, they found 38 non-toxic ones that could produce the needed colors. Today this fabric, which uses only organic ramie, pesticide-free wool, and the non-toxic dyes, produces no pollution during production and at the end of its life is fully compostable.[19]

To be successful in the long term, corporations will have to create similar plans to redesign products and services to be eco-effective. This will of course be challenging, considering the amount of infrastructure large corporations have. Yet this transition will be possible if companies make deliberate efforts to create a transparent long-term plan with specific stepping stones that transform their production processes gradually. At present this sort of long-term vision is rare, though a few innovative companies have started down this path.

In 1993, the Fuji Xerox Company (a joint venture between Fuji Photo Film and Xerox) realized that simply recycling old photocopiers would not be sufficient to reduce natural resource use successfully, so the company started designing a photocopier with components that could be reused in future models. While it has taken much effort to create durable parts that would be effective in new models, by 2003 Fuji Xerox was reusing 54 percent of components in new copiers. Moreover, by recycling the other parts the company has been able to generate very little waste.[20]

Other companies, too, are testing the bounds of innovation. Nike is trying to create a non-toxic, recyclable sneaker, while Fetzer Wines (a subsidiary of conglomerate Brown-Forman) is striving to use only organic grapes by 2010. So far it has hit the 11 percent mark, while at the same time switching to 100 percent renewable energy and reducing waste output by 97 percent since 1990.[21]

Perhaps the best-known corporation with a mission to become eco-effective is Interface Carpet. In 1994, Interface Founder and Board Chairman Ray Anderson—after an epiphany that the current business system was wreaking ecological havoc on the planet—committed Interface to becoming a sustainable company by 2020. Since 1996, Interface has cut energy usage by 28 percent, greenhouse gases by 46 percent, and solid waste by 63 percent and has invented a series of recyclable and compostable fabrics. While still far from its goal, over the next 10 years Interface plans to reduce energy usage by half (and obtain half of the remaining energy it needs from renewable sources), cut waste in half, and get half of its materials from post-consumer materials.[22]

Yet these are companies that have much to gain by transforming—reduced pollution, materials usage, and improved reputation, for example. And since there are alternative methods to create their products, they do not have so much to lose if they can find a way to make the transition cheaply. Other companies whose businesses are at the very root unsustainable, such as those in oil production or mining, have a much larger challenge ahead: namely, reinventing their business models. Their profits come from an infrastructure that they have already invested in—oil wells and pipelines, for instance. Even if they wanted to, managers could not shut down these operations tomorrow without risking financial ruin. Yet oil supplies will decline and carbon taxes will increase, so by not starting to invest in a new renewable energy infrastructure, these companies risk being deposed by start-up renewable energy firms. As Stuart Hart of Cornell notes, "for these firms, continued blind adherence to yesterday's technology could spell doom, not just a missed opportunity."[23]

Barriers to Responsibility

Unfortunately, most corporations face significant barriers to becoming more socially and ecologically responsible. Indeed, the vast majority still struggle with simple legal compliance. Between 1975 and 1984, for example, 62 percent of Fortune 500 companies in the United States committed illegal actions. And in many countries—including major developing economies like China and India—the discussion of corporate responsibility has only just started. (See Box 10–2.)[24]

Three main barriers to greater corporate responsibility can be identified. First and foremost, there is a perception that shareholders expect consistent and ever-increasing short-term financial gains. To suggest that corporations alone are at fault for their continuing shortsighted behavior would be naive. Shareholders do exert pressure on corporations—often in ways that encourage maximization of profit. Investors often punish companies by selling off stock if quarterly profits do not reach expected levels. Thus companies often feel pressure to maximize returns even at the expense of societal or environmental well-being (and sometimes even at the expense of the obeying the law).[25]

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Perhaps surprisingly, in the United States—where this pressure is often most pronounced—the law defends the judgment of corporate managers in choosing what to spend revenue on—that is, it is their prerogative to sacrifice profit to improve environmental performance, raise wages, or increase philanthropic contributions. But pressure from shareholders, analysts, and boards of directors to maximize profit can easily overwhelm this legal freedom; one look at the effects on a company's stock price if it announces it will not meet this quarter's expected earning shows how limited company managers actually are. A new type of stakeholder pressure is needed to counter current shareholder pressure. Mobilizing consumer groups, nongovernmental organizations (NGOs), and socially responsible investors can help create a better balance.[26]

Second, true environmental and social costs are not captured in current accounting methods or are distorted by perverse subsi-

BOX 10–2. CORPORATE RESPONSIBILITY IN INDIA AND CHINA

In 2003, according to AccountAbility's National Corporate Responsibility (NCR) Index, India ranked thirty-fifth, and China ranked forty-fifth out of 50 countries measured. (The top five spots were dominated by Scandinavian countries.) India received a score of 53.4 out of 100 while China earned a 47.8. Both countries, like most other developing nations on the list, are laggards in corporate responsibility performance. Few domestic corporations in India and China are voluntarily increasing responsibility: in 2004, only 5 Indian and 11 Chinese companies even filed reports that disclose aspects of their environmental and social performance, which is often a first step in increasing responsibility.

Yet there are a few corporate responsibility leaders in these two countries. The Tata Group—an Indian conglomerate consisting of 91 companies in seven sectors—has approached responsibility in a unique way. Over the past century, the company has created four cities that provide housing and essential services to Tata employees and their families (as well as other city residents). In Jamshedpur, where most of Tata Steel's operations are based, the company spends $30 million a year on maintaining residents' health. Education is also a priority there: at 75 percent, the city's literacy rate is significantly higher than surrounding cities.

In China, companies are so far primarily focused on environmental compliance and eco-efficiency improvements. One fertilizer company, Fuyang Chemical Works, was able to reduce annual ammonia losses by almost 5,000 tons and to increase annual production by 3 percent.

While China and India score within a few points of each other on most of the NCR Index indicators, on one—corporate engagement with civil society—India scored 59, which was 30 points higher than China. In part this divergence stems from national differences in degree of civic freedom, but it also reflects differences in public trust in business and the strength of consumer activism. In India, activists have been successful in recent years in increasing corporate responsibility—including holding the Indian Coca-Cola subsidiary accountable for its depletion of groundwater sources and the contamination of its sodas with pesticides. The mobilization of Indian consumers, environmental activists, and government officials contributed to the closure of a Coca-Cola production facility in Plachimada, Kerala, and to a 14-percent decline in sales in the second quarter of 2005, usually the peak sales season. This Indian activity (along with long-standing bad publicity due to labor abuses by the Colombian Coca-Cola affiliate) is helping to push Coca-Cola to increase its focus on corporate responsibility initiatives, both in India and globally.

In China, however, corporations often have stronger influence on the government or are sometimes state-owned. This, combined with a less developed civil society sector (see Chapter 9), is inhibiting increased societal actions against corporations while slowing the growth of corporate responsibility. Accelerating the development of civil society activities will be essential in increasing corporate responsibility there.

SOURCE: See endnote 24.

dies and taxes. According to an analysis by Ralph Estes, a former business professor at American University, if U.S. corporations had to pay all of the externalized costs that their business activities generate—such as workplace injuries, medical care required by the failure of unsafe products, and health costs from pollution—they would have owed $3.5 trillion in 1995, four times more than the $822 billion they earned in profits that year. A more recent analysis found that if the companies in the FTSE 100 had to pay the externalized economic costs of their carbon emissions—estimated at about $36 per ton by the British government—they would lose 12 percent of their earnings.[27]

This sort of externalization toll is routinely evident in hazy skies, injured consumers, and impoverished workers in the United States and elsewhere. For example, a 2004 report released by U.S. Representative George Miller found that one 200-employee Wal-Mart store may cost U.S. taxpayers $420,000 per year because of the need for federal aid (such as housing assistance, tax credits, and health insurance assistance) for Wal-Mart's low-wage employees. Moreover, many corporations fill their labor needs offshore in order to exploit unorganized workers in low-cost countries. More than 40 million people now work in export-processing or "free trade" zones around the world. These areas, often exempt from national legislation, allow manufacturers to demand long hours, pay lower wages, and ignore health and safety regulations.[28]

Real costs of doing business are skewed even further by the more than $1 trillion in subsidies that businesses receive worldwide each year. These subsidies, which account for roughly 4 percent of the gross world product, support some of the more environmentally destructive sectors, including agriculture, energy, road transportation, mining, and manufacturing. While not all of these go to corporations, most do—including the majority of the $93 billion handed out by the U.S. government in 2002. Many of these subsidies stimulate overproduction, lock in existing technologies, and thus have adverse effects on the environment. A World Bank study found that removing global energy subsidies could reduce world carbon output by 21 percent.[29]

Between the failure to price goods accurately and skewing prices by giving away free government dollars, corporations are insulated from market forces. If fossil fuels were priced more accurately, corporations' choices would change; certain sectors would fade while others would bloom. Instead, artificial prices encourage unsustainable business practices and prop up certain sectors.

If the revenues of governments and the largest corporations are compared, 77 of the top 100 are corporations.

The third barrier involves corporate influence in society. Corporations have exerted influence over institutions of governance, academia, civil society, and the media in order to increase short-term gains rather than to push for a more sustainable, more responsible business system. Because of their size and wealth, they have significant power over these other societal institutions. Indeed, if the revenues of governments and the largest corporations are compared, 77 of the top 100 are corporations. They direct portions of this revenue toward lobbying the government, supporting universities or NGOs, even creating their own advocacy groups—primarily for initiatives that benefit their short-term interests. Although they could use some of this influence to push for measures that would maintain the natural systems on which they depend, the pressure to profit in the short term causes the overwhelming majority to use their influence for short-term benefits, such as increased subsidies, weakened regulations, and tax breaks.[30]

Recent examples abound: Bayer AG spent the past five years trying to delay the U.S. government from banning its antibiotic Baytril for use in chicken farming, even after research showed that the drug's use is a threat to human health. Food companies regularly lobby to weaken nutritional recommendations, such as attempting to suppress a 2003 report by the World Health Organization that recommended that refined sugar make up no more than 10 percent of daily food intake and successfully helping to water down the new U.S. dietary guidelines released in 2004. And this is only the tip of the iceberg. In 2004, businesses spent about $1 billion in the United States on political contributions and another $2 billion on lobbying.[31]

Corporations' influence often extends much further than simply lobbying governments. Whether it is by affecting what the media publishes (such as through threatening to withdraw advertising dollars), funding academic research programs, setting up advocacy groups with misleading names like the Global Climate Coalition to skew the debate on climate change, or simply spending billions in advertising to convince consumers that they need certain products (which are often unhealthy or even dangerous), corporations exert a strong influence over society and have for the most part used it to improve their own interests, not those of the larger society.[32]

Engaging Stakeholders

To strengthen corporations' ability to focus on the future—especially redesigning their operations to be sustainable in the long term—it is essential that the mix of pressures corporations feel from stakeholders is altered. Until the clamoring for perpetually increasing short-term profits is eclipsed by demands for sustainable long-term value, corporations' capacity to change will remain limited. Stakeholders, including investors, NGOs, and activists, as well as communities, labor, and consumers, are playing an increasingly important role in changing this balance.

As shareholders recognize that the lasting value of their investments depends on how companies address long-term risks like climate change and toxic chemical releases, they are becoming a powerful force for change. More investors—from mutual fund companies to big institutional investors like the pension fund systems of New York City and the state of California—are increasingly engaging with companies to encourage them to adopt policies that address long-term risks.[33]

Investors have the right to "dialogue" with management, express their concerns, and ask the corporation to take action. Just putting issues on the table is sometimes enough to trigger a response. In 2002, Calvert Asset Management Company, a socially responsible investment (SRI) mutual fund, sent letters to 154 corporations listed in their Calvert Social Index that had no women or minority members on their boards of directors and asked them to consider diversifying as they hired new board members. Since then, 48 of these companies have added at least one minority member or woman to their boards and another 39 have adopted language that promotes increased diversity.[34]

But when such requests fail, investors can increase pressure further by filing shareholder resolutions—motions that demand specific corporate policy changes. While resolutions are non-binding, companies often agree to policy changes in order to maintain good relationships with shareholders and avoid bad publicity. Indeed, the most successful resolutions are not those that actually come to a vote (since most shares are held by non-voting institutions, and the resolutions are non-binding anyway), but the ones withdrawn by those who filed them because management has agreed to act on the issue.

In 2004, according to the Investor Responsibility Research Center, investors filed 327 resolutions regarding social or environmental issues with U.S. companies—22 percent more than in the previous year. They subsequently withdrew 81 of these after companies agreed to address the issues raised, ranging from animal welfare and climate change to political contributions and global labor standards.[35]

Religious groups are one of the most active filers of resolutions. The lead filer of over 20 percent of the 351 resolutions filed in the first half of 2005 had a religious affiliation. The Interfaith Center on Corporate Responsibility is just one of these groups. Consisting of 275 faith-based institutional investors, this organization has a portfolio of over $110 billion and participates in more than 100 resolutions a year.[36]

Perhaps the most impressive investor initiative was a recent show of force in May 2005 at the United Nations. Hundreds of major investors, collectively controlling assets of $3.2 trillion ($600 billion more than the total funds invested globally in actual SRI funds), gathered there to discuss how to press companies to address climate change and its associated financial risks. At the end of the day, the Investor Network on Climate Risk pledged not only to invest $1 billion in clean energy companies but to step up pressure on companies to disclose their climate impacts and how they are dealing with them.[37]

To become an even more effective force for change, SRI will have to go mainstream. Although most major investors, such as universities and pension funds, do not consider social responsibility criteria when choosing investments, in some countries this is starting to change. In the United Kingdom, for example, pension funds have been required since 2000 to disclose the extent to which their investment portfolios take into account environmental and social concerns—a law that has triggered similar initiatives in Belgium, France, Germany, the Netherlands, Sweden, and Switzerland. These simple law changes have started to mainstream SRI in Europe and could greatly enhance investors' role in improving corporate behavior.[38]

In the short term, the power of SRI continues to come from shareholder advocacy. But as more dollars, euros, yen, and yuan are directed toward sustainable companies, this will pressure unsustainable companies to improve their records in order to compete for capital, in turn helping to transform the role of the corporation in society. But even with a significant increase in socially responsible investing, shareholders alone cannot change the current trajectory; in the United States, the country with the most developed SRI community, socially responsible investors represent one ninth of all investment dollars. To succeed, other stakeholders will need to play key roles as well.[39]

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Nongovernmental organizations will be one of these stakeholders. Over the past 25 years, NGOs, which now total some 26,000 organizations globally, have become an increasingly powerful force. As with socially responsible investors, some NGOs are engaging gently, through partnerships that support corporate efforts to increase responsibility, while others are using more aggressive methods—organizing massive activist campaigns to force corporations to change their priorities.[40]

Environmental Defense is an example of the former, seeking out companies to help them to reduce their environmental impacts often while also reducing their costs. In 2000, Environmental Defense approached FedEx with an offer to help lower the emissions of its delivery fleet. After realizing that this would provide a triple win—cost savings, good publicity, and less pollution—FedEx agreed. By the end of 2002, a new hybrid truck design was selected and 18 prototypes were put into service in Sacramento, New York City, Tampa, and Washington, D.C. Seventy-five more trucks will be on the roads in 2006. Each truck reduces emissions of soot by 96 percent and of nitrogen oxides (NO_X) by 65 percent and improves fuel efficiency by 57 percent. As FedEx converts its 30,000-strong fleet over the coming years, the company will lower its environmental impacts considerably. Moreover, the benefits do not stop at FedEx. As Elizabeth Sturcken of Environmental Defense points out, "This project is serving as a catalyst for the entire shipping industry to convert their fleets."[41]

Sometimes companies are the ones that seek out the NGOs. In the 1990s, Chiquita Banana suffered through a major labor strike, a bout of terrible publicity for its labor and environmental practices, and the destruction of a significant portion of its banana crops by Hurricane Mitch. The company realized that it needed to rebuild its brand and sought out a partnership with the Rainforest Alliance, an NGO that worked with the company to certify the health, labor, and environmental practices on its farms. By 2002, all Chiquita's farms, covering 25,000 hectares, were certified by the Rainforest Alliance, as were 75 percent of the bananas sold by the company in Europe and the United States.[42]

More often than not, though, improving social and environmental records are not generally the highest priorities of corporate managers. Yet this can quickly change when their companies suddenly become the targets of bad publicity from a coordinated group of activists. With corporations spending a half trillion dollars each year to create positive images through advertising, a sudden storm of negative publicity from the actions of thousands of coordinated activists can swiftly raise environmental issues to the top of managers' action-item lists.[43]

This fear of public shaming—and the connected loss of profit and stock value—are what makes these "corporate campaigns" so successful. Unlike traditional campaigns against companies, such as boycotts, labor strikes, and litigation (which remain important but often have limited objectives), corporate campaigns treat the targeted company more as a lever of change than as an end in itself.

When a coalition of NGOs and investors led by the Rainforest Action Network (RAN) targeted Citigroup (the largest bank holding company in the United States), the goal was to reduce overall exploitation of natural resources. But RAN did not go after mining and logging companies—which are not in the public eye and depend on continued extraction to survive. They focused instead on the financial institutions that capitalize the mining and logging companies. Banks spend billions of dollars to maintain strong brands and customer bases. These assets are essential, and thus exploitable, vulnerabilities. In 2000, RAN asked Citigroup to adopt a green lending policy. Although the company initially refused, after more than three years of protests, shareholder actions, and various irritating tactics, Citigroup finally recognized that lending to unsustainable industries would be more costly than profitable and agreed to implement a new set of environmental lending standards.[44]

Once Citigroup yielded, its antagonistic relationship with RAN evolved into a collaboration to ensure adherence to its new standards—a partnership that provided free beneficial publicity to Citigroup. Meanwhile, RAN quietly drafted a letter to the second largest bank in the United States, Bank of America, asking managers to adopt a similar policy. Bank of America, having witnessed the disruption that committed activists can cause by chaining themselves to bank doors, quickly realized that it was better to join the ranks of ecofriendly banks. Bank of America's capitulation left JPMorgan Chase as the next target, and it also soon followed suit. Considering that together these three banks hold assets of almost $4 trillion, this is a significant victory, especially since each new agreement has been stronger than the last. For instance, JPMorgan Chase agreed to stop financing projects in environmentally sensitive ecosystems and to require environmental impact assessments for all loans over $50 million—two provisions not in earlier agreements.[45]

RAN's strategic choices—including effective partnering with investors and corporate insiders, sequentially targeting intermediary companies, and providing the companies with easy ways to cooperate—have leveraged its successes. For example, after Home Depot yielded to RAN's demand to change its wood-buying practices in August 1999, it only took a month for Lowes to agree to a similar policy. Within nine months, 8 of the 10 largest do-it-yourself stores in the United States had developed similar policies.[46]

This "rank 'em and spank 'em" strategy—in which one company after the next is brought to the negotiating table—has proved to be incredibly effective. Already, it has changed the practices of many banks and do-it-yourself stores, as well as office supply stores and computer retailers. Now it is being applied to jewelry stores in order to clean up gold production, to coffee roasters to make coffee farming more equitable and sustainable, and to cosmetics companies to force them to purchase less toxic chemicals for their makeup.[47]

Beyond merely triggering defensive reactions, these campaigns can sometimes lead to real leadership. Staples, once a target of a corporate campaign for its unsustainable paper purchasing practices, is now part of a coalition of businesses helping to design a comprehensive paper-purchasing guideline that it hopes corporations around the world will adopt.[48]

Perhaps stakeholder engagement, over time, will be enough to transform corporations. Right now, however, it is not. In fact, some major corporations seem exceptionally uninterested in changing, even when aggressively targeted by NGOs, investors, and consumers. For years ExxonMobil, the largest oil company in the world, has been subjected to pressure. Yet the company has been reluctant to make even minor investments in renewable energies and, unlike other oil companies, still refuses to admit to the dangers of climate change. In 2005, the NGO and investor community renewed its efforts: staging protests, filing resolutions, and waging boycotts. While ExxonMobil may continue to refuse to change, this stance will not come without cost—losing the company potential customers, employees, and societal good will.[49]

With the power of civil society growing, corporate managers must recognize that either they seek out genuine partnerships with stakeholders to support their efforts toward being more sustainable or they risk the very real possibility that stakeholders will come knocking on their doors, brandishing picket signs and shareholder resolutions and demanding immediate and sometimes difficult change.

Leveling the Playing Field

Since the first corporations were established in the 1600s, governments have been essential in ensuring that these business entities behave responsibly. Governments create regulations that dictate all aspects of corporate activities—from how much waste they can release to how much control they have over markets. Yet with corporations' influence over governmental bodies becoming ever more entrenched and the growing complexity of the technological age, policymakers need to broaden their approach to remain effective. In addition to writing laws that respond to specific problems, such as the amount of mercury that power plants can discharge, governments need to establish the right market signals so that responsible companies can start competing with their less responsible rivals.

Without the right market signals, the ability of a corporation to increase its responsibility is constrained—even when confronted by adamant stakeholders. For example, if a company pushes hard to switch to 100 percent renewable energy and the price of oil continues to be subsidized while the social and environmental costs of using oil are externalized, the company will have difficulty competing. Thus it will be essential for policymakers to level the playing field by creating more accurate price signals through measures like reducing subsidies and taxing pollution and finite resources.

This is already happening to some extent. In 2001, governments in the European Union gave 6.3 billion euros to coal producers—about 162 euros per ton of coal (compared with an international market price of 47 euros per ton). This artificially supports the coal industry and hinders the transition to better technologies. Recognizing the environmental costs of coal, the EU passed legislation in 2003 to reduce these subsidies gradually. Some countries, such as the United Kingdom, have already made great progress in phasing them out. Others, however, still prop up their coal industries. Germany, for example, doled out 4.7 billion euros in coal subsidies in 2001.[50]

As the removal of subsidies clearly damages certain sectors, affected industries are likely to resist, making it difficult to phase out subsidies. Governments may find it easier to pass broader tax reforms that internalize externalized costs but are either revenue-neutral or affect a broader group of industries.

Sweden, for example, enacted a law in 1992 that charges utilities about 5 euros per kilogram of nitrogen oxide emissions they release. To minimize the resistance by utilities, the law specified that all levies received would be returned to utilities in accordance with how much energy they produced. As a result, the facilities that generated the most energy while producing the least NO_X benefited doubly—earning additional revenue while siphoning off profits from their dirtier competitors. By 1999, this law had helped reduce NO_X emissions at originally targeted facilities by 37 percent.[51]

Altering tax structures can also help make prices more accurate and can do so in ways that actually create new opportunities for proactive businesses. Germany's ecological tax, for example, introduced in 1999, has been successful both in reducing pollution and in creating new jobs, while for the most part being revenue-neutral. In essence, the German government raised taxes on most fossil fuels while lowering pension contributions by 0.8 percent. Thus while companies and citizens paid more on gas, electricity, and heating, they paid fewer taxes on wages. This reform had the benefit of rebalancing the labor versus resource equation, making workers relatively less expensive. In 2004, a German government report estimated that this tax reform led to a 2-percent reduction in carbon emissions and created up to 250,000 new jobs. Companies that proactively reduce energy usage will register even larger savings with lower spending on fuel and taxes.[52]

The European Union has also set up a new pollution tax on carbon emissions. With the Kyoto Protocol coming into force in early 2005, the EU has to reduce carbon and other emissions that contribute to climate change by a total of 8 percent below 1990 levels by

2012. To facilitate this, the EU created an Emission Trading Scheme for industries with significant carbon emissions. Some 13,000 industrial facilities and utilities will now have to reduce their emissions below their allotted level, trade credits with those that have already done so, or pay a fine of 40 euros per ton (a fine that will increase to 100 euros starting in 2008). This has already led to significant carbon trading between companies, at a price of about 17 euros per ton. While the price is still low, and the allowances are excessively generous, over time this trading scheme will reward companies that reduce carbon emissions while punishing those that do not.[53]

Without proactive government efforts to regulate corporate behavior—at local, national, and, through the creation of treaties, international levels—and to create market signals that reward corporate responsibility, corporations' ability to become more responsible will be slowed. But when governments build frameworks that internalize external costs, not only will the market become more efficient, but the public will gain a safer, cleaner, and healthier society. Moreover, as noted in the *Responsible Competitiveness Index 2003,* as stakeholders increasingly demand corporate responsibility, countries that nurture a responsible business climate may gain economic advantages, while those with "responsibility deficits," like the United States, may see their competitive edge blunted.[54]

Redirecting Corporate Influence

Today, trust in companies remains low in many countries. While trust levels are slightly higher than in 2000, when several major corporate scandals surfaced, many people remain wary of corporate motivations—seeing companies as driven primarily by greed and willing to exploit workers and the environment for their own short-term gain. This, of course, compromises corporations' "license to operate" and makes them ready targets for activists. Indeed, some organizations advocate not just for corporate reform but, through the repeal of corporate charters, the actual end of the corporate system.[55]

If corporations plan to maintain their place as a dominant institution in society, they will need to be perceived as beneficial on the whole. This demands that they use their influence to improve society and not just their bottom lines. Of course, with the current economic structure that externalizes many of the social and environmental costs of doing business, these two often conflict. The goal is to tie societal well-being with corporate well-being. This is not a new idea; experts on corporations have advocated this stance for decades. In *Concept of the Corporation*, his 1946 classic analysis, Peter Drucker argued that while corporations should be allowed to profit from their activities—as profit is essential to their survival—"this does not mean that the corporation should be free from social obligations. On the contrary it should be so organized as to fulfill automatically its social obligations in the very act of seeking its own best self-interest."[56]

If corporations plan to maintain their place as a dominant institution, they will need to use their influence to improve society and not just their bottom lines.

Some corporations already recognize that improving society is in their interest and are backing up these beliefs with their resources—a development that is often furthered when managers are personally committed to creating a responsible business, as can be seen in the evolution of companies such as Interface, S. C. Johnson and Son, Seventh Generation, and Green Mountain Coffee Roasters. However, proactive sustainable business leaders are currently few and far between. To hasten the growth in corporate responsibility, a new generation of sustainable business leaders will need to be trained and placed into positions of responsibility—a trend that is accelerating thanks to the growth in sustainable business school programs. (See Box 10–3.)[57]

While some corporations are trailblazers, the overwhelming majority are still dragging their feet. Accelerating this transition will depend on the best companies pushing their competitors to follow their lead. As momentum increases, the laggards will feel compelled to jump on the bandwagon (but unfortunately for these latecomers, they will have lost out on the financial and reputational benefits of being the first to act). Strategies that these proactive corporations are starting to use are various, but some of the common ones include increasing transparency through increased reporting, lobbying for policy changes that improve society (as opposed to lobbying for laws that just improve their bottom line), and creating voluntary company or industry initiatives that raise the bar for entire sectors.

At the most basic level, it is essential that corporate transparency increases. Beyond the crises that a lack of transparency can trigger—Enron, Anderson, and Parmalat come to mind—a lack of transparency hinders proactive change. Declaring long-term goals and a strategy to achieve them pushes companies to work toward these changes. Corporate responsibility reporting is central to achieving this. As the Chairman of Royal Dutch Shell, Jeroen van der Veer, explains "we have seen how, if done honestly, reporting forces companies to publicly take stock of their environmental and social performance, to decide improvement priorities, and deliver through clear targets." By reporting, corporations admittedly expose their operations to more public scrutiny, yet they also increase trust among stakeholders (as long as they are actually working toward

BOX 10–3. TRAINING THE NEXT GENERATION OF RESPONSIBLE BUSINESS LEADERS

Traditionally, studies of sustainable development and business management have rarely been housed in the same academic program. Yet around the world—from Brazil and Finland to North Carolina and South Korea—more business schools are starting to integrate sustainability into their curricula. Moreover, Presidio World College and Bainbridge Graduate Institute—two business schools uniquely dedicated to teaching "sustainable business"—were recently established in the United States and have started graduating their first classes of sustainable business managers. More universities, such as the University of Oregon, are also starting to launch professional development programs to help train current executives in sustainability management.

Business school students are starting to take the lead in training themselves in sustainability. In 1993, students established a network of individuals interested in using business to improve the world. By 2004, this organization—Net Impact—had grown to more than 11,000 members and 100 chapters around the world. Members often volunteer their business skills and time to community organizations or charities. As these individuals, and others trained in sustainable business, enter the workforce and take positions of leadership, they can help the business sector play an increasingly positive role in society.

SOURCE: See endnote 57.

stated goals and not just making empty claims or "greenwashing.")[58]

In 2004 some 1,700 corporations or their affiliates filed reports on issues of responsibility, up from virtually none in the early 1990s. (See Figure 10–1.) These reports detail everything from labor standards and impacts on local communities to toxic releases and greenhouse gas emissions. Yet if 1,700 transnational corporations or their affiliates are filing reports, that means hundreds of thousands are not. Moreover, of the 1,700 reports filed, many are below par—lacking in details, transparency, or inclusion of long-term goals. In 2003, less than 40 percent of the reports received any sort of third-party verification.[59]

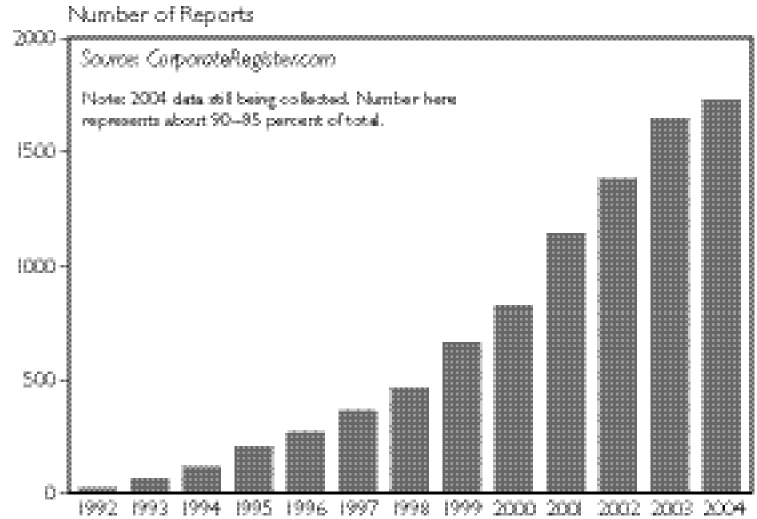

Figure 10–1. Corporate Social and Environmental Reports, 1992–2004

Still, there are some leaders in reporting. CorporateRegister.com categorized about a quarter of the 1,700 reports published in 2004 as full sustainability reports, highlighting companies' efforts on environmental, social, economic, and community issues. Many of the largest companies are also filing some type of responsibility report. About 80 percent of the FTSE 100 filed a significant environmental or social report. While growth in reporting continues, its pace is starting to slow. Essential to maintaining the rate of growth will be to mandate corporate responsibility reporting for companies listed on national stock exchanges—a measure that France has already passed.[60]

Some companies are using these reports not just as ways to declare immediate impacts, but to state long-term goals and their progress toward achieving them. For example, in 1998 BP set the goal of cutting its greenhouse gas emissions to 10 percent below 1990 levels by 2010 and started publishing its annual releases. By 2001, BP had reached its goal, and in the process the company saved $650 million. Starbucks, too, has used its annual reports to declare its commitment to reduce its environmental and social impact through the creation of a sustainable coffee supply. In 2004, 19.7 million kilograms of its coffee (14.5 percent) followed its rigorous Coffee and Farmer Equity (C.A.F.E.) standards, up from 6 million kilograms the year before. These standards, verified by an external auditor, award points for 28 key sustainability indicators, such as the amount of water, energy, and pesticides used and how equitably the profits are distributed among workers. Starbucks' goal is to increase the share of C.A.F.E. standard coffee to 60 percent by 2007.[61]

While some progress has been made in increasing transparency in long-term goals and their implementation, very few corporations disclose the efforts they make to influence government, such as political contributions and lobbying expenditures. According to a 2005 report by the Center for Political Accountability, of 120 companies investigated, only one—Morgan-Stanley—merited a passing grade for disclosing the political contributions it makes and the system to control where these political contributions go. Since then, two other companies have joined Morgan-Stanley: Johnson & Johnson and Schering-Plough (though all three only made this change after shareholders filed a resolution). Johnson & Johnson took the additional step of agreeing to declare the rationale for contributions along with disclosure of the amount.[62]

In England, several large companies are pushing the government to increase U.K. efforts to reduce carbon emissions.

This is not to say that all political influence by corporations is necessarily problematic. In reality, if responsible companies simply bow out of politics the debate will still be controlled by irresponsible companies. Rather, by disclosing political contributions and lobbying expenses and what they are directed to, corporations could be actively engaged in the political debate in a way that will improve society (and their own interests if they choose their causes right) while actually improving their records on responsibility.

Although asking corporations to redirect scant resources toward lobbying initiatives that benefit society more broadly may seem naive, if done effectively these efforts can improve the well-being of both society and companies—a lesson that many corporations have already learned. Back in the late 1980s, DuPont—at the time a leading producer of chlorofluorocarbons (CFCs)—pushed hard for a global ban on CFCs. Yet they also invented a CFC substitute, which, when the ban went into effect, allowed them to dominate the substitute market. More recently, many companies are starting to get involved in climate change politics. For example, Duke Energy Corp., a leading U.S. coal company, announced in mid-2005 that it would start lobbying for a carbon tax. Recognizing that climate change poses a significant threat and that there would inevitably be regulation on carbon emissions, Duke Energy realized that it was in its own interest to proactively help shape a national policy. As Duke CEO Paul Anderson noted, "The worst scenario would be if all 50 states took separate actions and we have to comply with 50 different laws."[63]

In England, where climate change responses are much farther along than in the United States, several large companies are pushing the government to increase U.K. efforts to reduce carbon emissions, including creating targets for emissions trading beyond 2012, and eliminating "the policy inconsistencies and perverse incentives that undermine the effectiveness of climate policy." These examples foreshadow a potential future where corporate lobbying is not feared but celebrated. To achieve this, however, it will be essential to create a fully transparent lobbying system, reward companies that lobby for laws that benefit society, and punish companies that vie for laws that benefit them at the expense of society.[64]

Along with redirecting political influence toward a better agenda, corporations need to push each other to improve. Leaders in different sectors will have to set the bar high and push others to live up to it. Nike, once attacked for being one of the biggest exploiters of sweatshop labor, now is trying to lead the footwear and apparel sector in improving labor standards. In 2005, for the first time, the company disclosed all of its active factories in order to both increase the transparency of its supply chain and help encourage collaboration with others in the sector to improve the conditions of all factories.[65]

Some companies are working with peers to create new standards that they hope will be implemented across their industries. In 2002, for example, 10 of the world's leading cement companies, responsible for one third of global cement production, established the Cement Sustainability Initiative (CSI), creating a plan to measure and reduce toxic emissions, greenhouse gases, waste production, and impacts on land and communities. In 2005, this group (which by then had expanded to 16 companies) released its first progress report. The first three years of the CSI focused primarily on measuring current releases and designing uniform protocols for future activities (including reporting, community engagement, and energy and material usage).This complemented members' individual efforts on reducing impacts, as well as setting the stage for more aggressive future collaboration.[66]

With ecological threats growing ever more urgent, the time to ask whether corporations should increase responsibility has passed. The business sector must become more responsible and lead the drive to make society sustainable. But without the right incentives and pressures, corporations will not do this quickly enough. Consumers, citizens, and employees must support corporate leaders who step up to the challenge and punish those who do not. Such basic actions as deciding which bank to have a savings account in, which shoes to buy, which companies to work for, and which political efforts and candidates to support will help reshape the market. But to succeed, these incremental efforts will need to be supported by aggressive actions by NGOs, policymakers, and savvy business leaders—actions that will make all corporations recognize that their long-term financial success depends not just on pursuing the bottom line, but on doing so in a socially and environmentally responsible way.

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