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Social Costs, Transparency, and Accountability through Corporate Social Reporting

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***Abstract*—**Corporate communications today take many forms, from mandatory quarterly filings with the government to hourly tweets that manage customer relationships. The two annual workhorse documents are the Annual Report and, more recently, the Corporate Social Responsibility (CSR) Report. While the former is validated by an auditor signature and relied upon by investors, the latter is relied upon only at user peril. Honest and transparent CSR should focus on properly pricing any and all of the planets' resources impacted by corporate operations, and demonstrating that full reparation has been made as appropriate. The CSR Report could be transformed into such a vital communication mechanism, but only if there is a prescribed methodology, a common platform for standardizing methodology, selecting societal parameters, and holding firms accountable, and a transparent means of disseminating information pertinent to assessing global impacts without revealing proprietary information. In a better world, such a communication apparatus would be accompanied by a formal mechanism for assuring that corporations make full restitution for all societal costs incurred in their fully appropriate and properly narrow pursuit of profit. This paper makes small inroads toward such a structure, focusing on the knotty problems for CSR posed by issues such as the "tragedy of the commons" and asymmetric information.

***Keywords*—**Corporate Social Reporting, Social Opportunity Cost, Tragedy of the Commons

I. Introduction

MODERN corporations, especially multinational enterprises (MNEs), today often focus on "corporate branding" as a critical component of their strategy to gain competitive advantage. A primary means to this end is the promotion of corporate social responsibility (CSR), and so more than 3,000 organizations worldwide have joined the Global Reporting Initiative (GRI), and more than 6,000 businesses are dues-paying members of the United Nations (U.N.) Global Compact. Capitalizing on these costly but lofty affiliations, MNEs crank out multi-colored CSR reports that unfailingly assign themselves high marks for CSR.

The affiliations are voluntary, and conformance to stated standards are non-binding. Is it any surprise that a "green-washing industry" has emerged, with MNEs misrepresenting their engagement with, and impact upon, our physical environment? Given the fees involved and the opt-out provisions in the affiliation agreements, is there any reason to trust such reports, or more generally, to expect MNEs to pursue CSR if doing so decreases corporate net present value (NPV)? Conversely, in circumstances where actions consistent with CSR also increase NPV (in which case there is no underlying need for a CSR movement), is there any reason to not expect the firm to pursue such actions?

Some environmental impacts are regulated, through laws, taxes or fines. Corporations may taut these impacts as CSR, but they are meritorious actions only to the same extent as an individual can take credit for paying taxes or not committing a felony. Among those environmental impacts that are not regulated, many indeed provide positive economic value to the firm and leave behind a positive net environmental footprint. If a firm alters its operations through a "lean production" innovation that increases throughput and decreases production time, it may be that the firm has reduced its usage of natural resources as a by-product of its pursuit of economic value. It has the right to repackage this story as one of caring for the environment, and it is not dishonest to do so, but this action should not be confused with any corporate equivalent of personal altruism. The concern here is with corporate-induced environmental impacts that harm the environment and are not regulated.

In particular, we focus on the vexing problem of corporate actions that involve: (i) non-exclusivity, such that there are no personal property rights; (ii) subtraction, such that consumption of the resource by the firm reduces the remaining supply; and (iii) information asymmetry, such that the corporation possesses information of value that is not available to others. For example, a MNE with a home office in Japan might extract water from a ground reservoir in a host country that subsidizes or undercharges for use of its reservoir. The corporation competes with local farmers in the extraction process, although on a quite different scale. The water extracted by the corporation (or farmers) is no longer available to the farmers (or corporation). Over time, as both the corporation and the farmers each act on their individual interests by extracting more water, the reservoir stock is reduced and depleted. This is the "tragedy of the commons", the failure of the "invisible hand of capitalism" to provide an outcome in the best interest of society, "the commons". A corporation adhering to any reasonable definition of CSR would include in its calculations the opportunity cost imposed

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upon society by its actions, and would make provisions to balance the scorecard. If only the corporation has access to the parameters, tradeoffs and valuations that lead to its decision to extract that water, this information asymmetry puts the corporation at an advantage in both internalizing such costs and in communicating it.

II. Perspectives

Tension between individual pursuits and collective protections have characterized capitalist economic systems for centuries. Such considerations led Adam Smith [1] to describe an "invisible hand". Nearly two hundred years later, three influential articles appeared almost simultaneously, and in various ways have shaped and molded modern considerations of "the invisible hand". Milton Friedman [2] famously challenged the corporate social responsibility movement that was then gaining steam with an essay in the New York Times entitled "The Social Responsibility of Business is to Increase Its Profits". Forty years on, the logically consistent insight of Friedman continues to elude most who advocate for some corporate form of personal altruism. Aneel Kanarni [3] recently said as much: "Corporate social responsibility (CSR) discussions often fall prey to a logical trap. If some socially desirable activity is profitable, then it is best described as "intelligent operation of the business" and thus CSR is irrelevant. If the socially desirable activity is not profitable, then companies will not voluntarily undertake it unless required to do so by law or regulation, and thus CSR will be ineffective. The concept of CSR is "intensely confused" because in both the above cases it is not a useful construct."

George Akerlof [4] made a contribution to the economics community, (after three earlier rejections of the paper by leading academic journals), for which he subsequently shared the 2001 Noble Prize in Economic Sciences with Michael Spence and Joseph Stiglitz. Ackerlof focused on information asymmetry, whereby a seller frequently knows more about a product than does the buyer. Garrett Hardin [5] wrote an article in Science magazine that has been perhaps just as significant to the scientific community. Colorfully entitled "The Tragedy of the Commons", it argues that freely available resources will be harvested until destruction by the simple act of each extractor behaving in accordance with their perceived own interests. This is contrary to Adam Smith, but amply supported across many realms.

In summary, we learn from Smith that an "invisible hand" allows capitalism to thrive under many circumstances, although apparently not all. Friedman reminds us that social goals should be pursued through government policy and regulation, including that which constrains business in its proper and singular pursuit of profits. Proper justifications for government intervention and regulation include circumstances that Ackerlof describes as information asymmetries, as well as those that Hardin describes as "the commons".

III. Problem

Consider again the Japanese MNE extracting water from a reservoir in a less developed host country. Motivated to encourage infrastructure development through in-bound foreign direct investment (FDI) through Greenfield projects, the host country may offer subsidies or free and open access to the underground water reservoir. Even if it were to charge the MNE the locally competitive price for water, it is likely far less than the true market price society would place on a valued and scarce resource. The MNE can benefit from below-market water prices, extract water at will and as needed from the commons, make substantial profits on their efforts by increasing firm value – and perhaps give back some miniscule amount to the community so that it can trumpet its social responsibility.

If there were some assurance that the contributions back to the community approximated the present and future lost value from the extraction of water, the practice still would raise moral issues. However, prevailing evidence suggests MNEs routinely gain out of all proportion to what they give back voluntarily. Further, due to asymmetry of information and lack of regulation or reporting mandates, corporations present a public image through their CSR publications that suggests they give back much more than they take from the environment.

For the groundwater example, just how valued and scarce a resource is it? There are three major groups of water users: homes and businesses, agricultural interests, and industry. Water is used for many purposes, including growing crops, producing copper, generating electricity, gardening, bathing, drinking and recreation. There is a remarkable abundance of water on earth, although most is salt water that requires desalination for most uses. Less than 3% of available water does not require desalination procedures that are expensive, not readily scalable, and not yet available for all water uses. One might conclude that the limited supply of fresh water must be highly priced to reflect demand, but in fact water does not seem to command a high price. According to the 2011 Global Water Intelligence Survey [6], water and wastewater tariffs range from $10.02 per cubic meter in Aarhus, Denmark to $0.00 in several less developed cities. For the 17 cities surveyed in India, the median charge was $0.11, and half were between $0.28 and $0.05 per cubic meter.

IV. Publications

Corporations today produce at least two substantial (though not necessarily substantive) reports, the Annual Report targeting shareholders, and the CSR Report for all stakeholders. The Annual Report is subject to verification by an independent auditor that there are not substantive misrepresentations in the financial statements, nonetheless leaving considerable leeway for the firm to frame its performance, articulate its message, and otherwise massage its presentation through careful selections and more careful omissions.

The CSR Report is not subject to any audit (although sometimes corporations contract for one, such as Coca Cola did after “winning” the less-than-coveted “Corporate Greenwashing Award” [6] from the Polaris Institute); importantly, it need not conform to any standard. It is a propaganda piece, used admirably by many firms who truly are doing good, and used also by firms up to not much good. One cannot tell which is which by their covers, and usually not by their contents. There is no means to validate claims, and no audit authority. There are organizations that advocate quality CSR reporting, and that entice corporations to become members, among other reasons presumably to gain credibility through affiliation. The U.N. Global Compact and the Global Reporting Initiative are examples. Most of the Fortune 500 global corporations prominently display such affiliations on their websites and in their CSR Reports, and pay up to $10,000 in annual fees for the privilege of doing so.

What does the affiliation mean? The Olympus Corporation website featured its Global Compact affiliation throughout the unraveling of its financial improprieties. More to the point, corporations are not bound by the stated principals of either organization, and can opt-out of any onerous stated “requirement”. If this reality were made clear to stakeholders, one suspects that CSR Reports would lose much of their presumed power in brand imaging.

The “Sins of Green-washing” movement lists seven misleading sins common to CSR Reports. Although perhaps whimsical labels, their analyses conclude that virtually all CSR Reports commit one (or more, many more) of these misrepresentations, and that less than 5% of products examined were “sin-free” – notwithstanding that many of the corporations were proud affiliates of the U.N. Global Compact and/or the Global Reporting Initiative.

Members of the U.N. Global Compact also are eligible to join the CEO Water Mandate, which purports to be a platform for enlightened global water stewardship. It also is a voluntary and non-binding initiative, currently listing 85 corporations as members – including Coca Cola. The Polaris Institute [7] counters that: “…the real agenda of the CEO Water Mandate is to facilitate greater control over water sources and services by for-profit corporations. This is a prime example of an international institution helping corporations green-wash socially and environmentally damaging practices. Only signatories of the UN Global Compact can endorse the CEO Water Mandate… The Mandate – like the Global Compact itself – is voluntary and non-binding.”

Fortunately, these two platforms for unverifiable but sanctimonious claims of environmental compassion, stewardship and corporate altruism may also have planted the “seeds of their own construction”, a means to transform corporate communications into a vehicle for accounting and transparency in CSR. We conclude by developing a blueprint for action.

V. PROPOSAL

Large Corporate social responsibility (CSR) is a perhaps noble, possibly misguided, and assuredly ill-defined concept. For our purposes, it is helpful to set aside actions that lie outside the value-chain of the organization. However beneficial contributions may be to local charities or neighborhood picnics, they are peripheral to the fundamental operations of the business – and undoubtedly the result of a careful benefit-cost calculus onto itself. Neither are we searching for or advocating corporate adoption of value-deprecation projects, with net present value negative (NPV < 0) after properly considering and pricing all relevant benefits and costs over time and properly adjusting for risk. Acceptance of such projects would imply a corporate altruism properly cautioned against by Friedman, as it would imply a violation of the principal-agent agreement whereby management is steward, but not an independent consumer, of shareholder funds.

The challenge is to assure that corporations are considering all costs in their calculations (including community costs associated with usage of non-excludable resources) and not disregarding some categories and applying below-market rates to others, to inject societal lost opportunities on resource extractions, and to find a mechanism by which proprietary corporate information is shielded while decision process transparency is communicated to stakeholders. Let’s begin by attaching numbers to our running example.

The Japanese MNE builds a new plant this year that extracts water from a reservoir in rural Georgia as an essential ingredient in its bottling process. The average cost of water per cubic meter is $2.00 globally, and about the same back in Japan, but only $0.10 in Georgia. The plant costs $50 million now, but should generate $20 million annually at nominal cost levels. To meet production targets, the plant will extract 100,000 cubic meters of water annually. For projects like this, the MNE uses a weighted-average cost of capital (WACC) of 8%. The corporate value (CorpNPV) of this project therefore equals $84.2 million using standard discounting techniques, and so the corporation decides to proceed. However, the corporation has considered neither the possibility that the local price of water does not fully reflect the value society places on it, especially given this is a non-renewable subtraction from the global water supply (at least over an intermediate timeframe of several decades).

At the local market price of $0.10, the extraction of 100,000 cubic meters costs the firm $10,000 annually. At either the global average rate or the home country rate, the market price of $2.00 would entail an additional $190,000 cost annually. If these implied costs are treated as non-renewable, then the cost-stream to society is represented by a perpetuity discounted at the societal opportunity cost, or proxy for a WACC. Assuming a 3% social cost of capital, the “GapNPV” not priced by the firm equals $190,000 * 10 / 0.03 = -$63.3 million. This represents an estimate of the cost to society of removing a million cubic meters of valued freshwater from our scarce earthly supply, and should be added to the "CorpNPV" to arrive at a "Societal Net Present Value" (SNPV) of ($84.2 - $63.3 =) $20.9 million. Since SNPV > 0, the multinational corporation has an obligation to shareholders to increase firm value by undertaking the project, even if it must pay a $63.3 million fee to do so.

VI. Conclusion

Of course, reasonable folks may disagree over many details, including the proper market price for current and foregone future usage of water and the proper societal discount rate. The essential argument is that CSR Reports can serve as a constructive and meaningful communications vehicle, at once providing corporations with a credible vehicle to communicate honest and realistic social responsibility to its public, and a means to hold corporations fully accountable for transparent communication of analyses underlying their most important decisions, including those involving such thorny problems as the "tragedy of the commons". While preserving proprietary corporate information, a properly constructed methodology could overcome much of the information asymmetry that characterizes most present interactions between corporations and the public. Given the extraordinary stakes involving our shared planet and its future, citizens interested in corporate activities deserve the kind of (mostly) reliable and transparent corporate communications that financial investors currently receive from audited financial reports. Providing such on a voluntary basis would require true acts of corporate social responsibility; rather than wait for such an unlikely turn, and absent any prospect of global government regulation, pressure for voluntary regulation is the next best solution.

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