Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility

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The Idea in Brief

Many firms' corporate social responsibility (CSR) efforts are counterproductive, for two reasons: They pit business against society, when the two are actually interdependent. And they pressure companies to think of CSR in generic ways, instead of crafting social initiatives appropriate to their individual strategies.

CSR can be much more than just a cost, constraint, or charitable deed. Approached strategically, it generates opportunity, innovation, and competitive advantage for corporations—while solving pressing social problems.

How to practice strategic CSR? Porter and Kramer advise pioneering innovations in your offerings and operations that create distinctive value for your company *and* society. Take Toyota. The company's early response to public concern about auto emissions gave rise to the hybrid-engine Prius. The Prius has not only significantly reduced pollutants; it's given Toyota an enviable lead over rivals in hybrid technology.

The Idea in Practice

To practice strategic CSR:

1. Identify points of intersection between your company and society.

- In what ways does your organization affect society? For example, do you provide safe working conditions and reasonable wages? Do your operations create environmental hazards?
- How does society affect your competitiveness? For instance, do countries where you operate protect intellectual property? Supply enough talented workers? Encourage outside investors?

2. Select social issues to address. Given your company's and society's impact on each other, how might you address social needs in ways that create shared value—a meaningful benefit for society that also adds to your company's bottom line?

Example:
By addressing the AIDS pandemic in Africa, a mining company such as Anglo American would not only improve the standard of living on that continent; it would also improve the productivity of the African labor force on which its success depends.

3. Mount a small number of initiatives that generate large and distinctive benefits for society and your company.

Example:
To enter the Indian market, Nestle needed to establish local sources of milk from a large, diversified base of small farmers. It received government permission to build a dairy in the district of Moga. But in Moga, farmers were impoverished, failed crops led to a high death rate in calves, and lack of refrigeration prevented farmers from shipping milk or keeping it fresh.

Nestle built refrigerated dairies as milk collection points in each Moga town and sent its trucks to the dairies to collect the milk. With the trucks went veterinarians, nutritionists, agronomists, and quality assurance experts. Farmers learned that milk quality hinged on adequate feed crop irrigation. With financing and technical assistance from Nestle, farmers dug deep-bore wells. The consequent improved irrigation reduced calves' death rate 75%, increased milk production 50-fold, and allowed Nestle to pay higher prices to farmers than those set by the government.

With steady revenues, farmers could now obtain credit. Moga's standard of living improved: More homes had electricity and telephones; more towns established primary, secondary, and high schools; and Moga had five times the number of doctors as neighboring regions. Meanwhile, Nestle gained a stable supply of high-quality commodities—without having to pay middlemen—and saw demand for its products increase in India.

Governments, activists, and the media have become adept at holding companies to account for the social consequences of their activities. Myriad organizations rank companies on the performance of their corporate social responsibility (CSR), and, despite sometimes questionable methodologies, these rankings attract considerable publicity. As a result, CSR has emerged as an inescapable priority for business leaders in every country.

Many companies have already done much to improve the social and environmental consequences of their activities, yet these efforts have not been nearly as productive as they could be—for two reasons. First, they pit business against society, when clearly the two are interdependent. Second, they pressure companies to think of corporate social responsibility in generic ways instead of in the way most appropriate to each firm's strategy.

The fact is, the prevailing approaches to CSR are so fragmented and so disconnected from business and strategy as to obscure many of the greatest opportunities for companies to benefit society. If, instead, corporations were to analyze their prospects for social responsibility using the same frameworks that guide their core business choices, they would discover that CSR can be much more than a cost, a constraint, or a charitable deed—it can be a source of opportunity, innovation, and competitive advantage.

In this article, we propose a new way to look at the relationship between business and society that does not treat corporate success and social welfare as a zero-sum game. We introduce a framework companies can use to identify all of the effects, both positive and negative, they have on society; determine which ones to address; and suggest effective ways to do so. When looked at strategically, corporate social responsibility can become a source of tremendous social progress, as the business applies its considerable resources, expertise, and insights to activities that benefit society.

The Emergence of Corporate Social Responsibility

Heightened corporate attention to CSR has not been entirely voluntary. Many companies awoke to it only after being surprised by public responses to issues they had not previously thought were part of their business responsibilities. Nike, for example, faced an extensive consumer boycott after the *New York Times* and other media outlets reported abusive labor practices at some of its Indonesian suppliers in the early 1990s. Shell Oil's decision to sink the *Brent Spar,* an obsolete oil rig, in the North Sea led to Greenpeace protests in 1995 and to international headlines. Pharmaceutical companies discovered that they were expected to respond to the AIDS pandemic in Africa even though it was far removed from their primary product lines and markets. Fast-food and packaged food companies are now being held responsible for obesity and poor nutrition.

Activist organizations of all kinds, both on the right and the left, have grown much more aggressive and effective in bringing public pressure to bear on corporations. Activists may target the most visible or successful companies merely to draw attention to an issue, even if those corporations actually have had little impact on the problem at hand. Nestlé, for example, the world's largest purveyor of bottled water, has become a major target in the global debate about access to fresh water, despite the fact that Nestlé's bottled water sales consume just 0.0008% of the world's fresh water supply. The inefficiency of agricultural irrigation, which uses 70% of the world's supply annually, is a far more pressing issue, but it offers no equally convenient multinational corporation to target.

Debates about CSR have moved all the way into corporate boardrooms. In 2005, 360 different CSR-related shareholder resolutions were filed on issues ranging from labor conditions to global warming. Government regulation increasingly mandates social responsibility reporting. Pending legislation in the UK, for example, would require every publicly listed company to disclose ethical, social, and environmental risks in its annual report. These pressures clearly demonstrate the extent to which external stakeholders are seeking to hold companies accountable for social issues and highlight the potentially large financial risks for any firm whose conduct is deemed unacceptable.

While businesses have awakened to these risks, they are much less clear on what to do about them. In fact, the most common corporate response has been neither strategic nor operational but cosmetic: public relations and media campaigns, the centerpieces of which are often glossy CSR reports that showcase companies' social and environmental good deeds. Of the 250 largest multinational corporations, 64% published CSR reports in 2005, either within their annual report or, for most, in separate sustainability reports—supporting a new cottage industry of report writers.

Such publications rarely offer a coherent framework for CSR activities, let alone a strategic one. Instead, they aggregate anecdotes about uncoordinated initiatives to demonstrate a company's social sensitivity. What these reports leave out is often as telling as what they include. Reductions in pollution, waste, carbon emissions, or energy use, for example, may be documented for specific divisions or regions but not for the company as a whole. Philanthropic initiatives are typically described in terms of dollars or volunteer hours spent but almost never in terms of impact. Forward-looking commitments to reach explicit performance targets are even rarer.

This proliferation of CSR reports has been paralleled by growth in CSR ratings and rankings. While rigorous and reliable ratings might constructively influence corporate behavior, the existing cacophony of self-appointed scorekeepers does little more than add to the confusion. (See the sidebar "The Ratings Game.")

The Ratings Game

Measuring and publicizing social performance is a potentially powerful way to influence corporate behavior—assuming that the ratings are consistently measured and accurately reflect corporate social impact. Unfortunately, neither condition holds true in the current profusion of CSR checklists.

The criteria used in the rankings vary widely. The Dow Jones Sustainability Index, for example, includes aspects of economic performance in its evaluation. It weights customer service almost 50% more heavily than corporate citizenship. The equally prominent FTSE4Good Index, by contrast, contains no measures of economic performance or customer service at all. Even when criteria happen to be the same, they are invariably weighted differently in the final scoring.

Beyond the choice of criteria and their weightings lies the even more perplexing question of how to judge whether the criteria have been met. Most media, nonprofits, and investment advisory organizations have too few resources to audit a universe of complicated global corporate activities. As a result, they tend to use measures for which data are readily and inexpensively available, even though they may not be good proxies for the social or environmental effects they are intended to reflect. The Dow Jones Sustainability Index, for example, uses the size of a company's board as a measure of community involvement, even though size and involvement may be entirely unrelated.[1]

Finally, even if the measures chosen accurately reflect social impact, the data are frequently unreliable. Most ratings rely on surveys whose response rates are statistically insignificant, as well as on self-reported company data that have not been verified externally. Companies with the most to hide are the least likely to respond. The result is a jumble of largely meaningless rankings, allowing almost any company to boast that it meets some measure of social responsibility—and most do.

1. For a fuller discussion of the problem of CSR ratings, see Aaron Chatterji and David Levine, "Breaking Down the Wall of Codes: Evaluating Non-Financial Performance Measurement," *California Management Review,* Winter 2006.

In an effort to move beyond this confusion, corporate leaders have turned for advice to a growing collection of increasingly sophisticated nonprofit organizations, consulting firms, and academic experts. A rich literature on CSR has emerged, though what practical guidance it offers corporate leaders is often unclear. Examining the primary schools of thought about CSR is an essential starting point in understanding why a new approach is needed to integrating social considerations more effectively into core business operations and strategy.

Four Prevailing Justifications for CSR

Broadly speaking, proponents of CSR have used four arguments to make their case: moral obligation, sustainability, license to operate, and reputation. The moral appeal—arguing that companies have a duty to be good citizens and to "do the right thing"—is prominent in the goal of Business for Social Responsibility, the leading nonprofit CSR business association in the United States. It asks that its members "achieve commercial success in ways that honor ethical values and respect people, communities, and the natural environment." Sustainability emphasizes environmental and community stewardship. An excellent definition was developed in the 1980s by Norwegian Prime Minister Gro Harlem Brundtland and used by the World Business Council for Sustainable Development: "Meeting the needs of the present without compromising the ability of future generations to meet their own needs."

The notion of license to operate derives from the fact that every company needs tacit or explicit permission from governments, communities, and numerous other stakeholders to do business. Finally, reputation is used by many companies to justify CSR initiatives on the grounds that they will improve a company's image, strengthen its brand, enliven morale, and even raise the value of its stock. These justifications have advanced thinking in the field, but none offers sufficient guidance for the difficult choices corporate leaders must make. Consider the practical limitations of each approach.

The CSR field remains strongly imbued with a moral imperative. In some areas, such as honesty in filing financial statements and operating within the law, moral considerations are easy to understand and apply. It is the nature of moral obligations to be absolute mandates, however, while most corporate social choices involve balancing competing values, interests, and costs. Google's recent entry into China, for example, has created an irreconcilable conflict between its U.S. customers' abhorrence of censorship and the legal constraints imposed by the Chinese government. The moral calculus needed to weigh one social benefit against another, or against its financial costs, has yet to be developed. Moral principles do not tell a pharmaceutical company how to allocate its revenues among subsidizing care for the indigent today, developing cures for the future, and providing dividends to its investors.

The principle of sustainability appeals to enlightened self-interest, often invoking the so-called triple bottom line of economic, social, and environmental performance. In other words, companies should operate in ways that secure long-term economic performance by avoiding short-term behavior that is socially detrimental or environmentally wasteful. The principle works best for issues that coincide with a company's economic or regulatory interests. DuPont, for example, has saved over $2 billion from reductions in energy use since 1990. Changes to the materials McDonald's uses to wrap its food have reduced its solid waste by 30%. These were smart business decisions entirely apart from their environmental benefits. In other areas, however, the notion of sustainability can become so vague as to be meaningless. Transparency may be said to be more "sustainable" than corruption. Good employment practices are more "sustainable" than sweatshops. Philanthropy may contribute to the "sustainability" of a society. However true these assertions are, they offer little basis for balancing long-term objectives against the short-term costs they incur. The sustainability school raises questions about these trade-offs without offering a framework to answer them. Managers without a strategic understanding of CSR are prone to postpone these costs, which can lead to far greater costs when the company is later judged to have violated its social obligation.

The license-to-operate approach, by contrast, is far more pragmatic. It offers a concrete way for a business to identify social issues that matter to its stakeholders and make decisions about them. This approach also fosters constructive dialogue with regulators, the local citizenry, and activists—one reason, perhaps, that it is especially prevalent among companies that depend on government consent, such as those in mining and other highly regulated and extractive industries. That is also why the approach is common at companies that rely on the forbearance of their neighbors, such as those, like chemical manufacturing, whose operations are noxious or environmentally hazardous. By seeking to satisfy stakeholders, however, companies cede primary control of their CSR agendas to outsiders. Stakeholders' views are obviously important, but these groups can never fully understand a corporation's capabilities, competitive positioning, or the trade-offs it must make. Nor does the vehemence of a stakeholder group necessarily signify the importance of an issue—either to the company or to the world. A firm that views CSR as a way to placate pressure groups often finds that its approach devolves into a series of short-term defensive reactions—a never-ending public relations palliative with minimal value to society and no strategic benefit for the business.

Finally, the reputation argument seeks that strategic benefit but rarely finds it. Concerns about reputation, like license to operate, focus on satisfying external audiences. In consumer-oriented companies, it often leads to high-profile cause-related marketing campaigns. In stigmatized industries, such as chemicals and energy, a company may instead pursue social responsibility initiatives as a form of insurance, in the hope that its reputation for social consciousness will temper public criticism in the event of a crisis. This rationale once again risks confusing public relations with social and business results.

A few corporations, such as Ben & Jerry's, Newman's Own, Patagonia, and the Body Shop, have distinguished themselves through an extraordinary long-term commitment to social responsibility. But even for these companies, the social impact achieved, much less the business benefit, is hard to determine. Studies of the effect of a company's social reputation on consumer purchasing preferences or on stock market performance have been inconclusive at best. As for the concept of CSR as insurance, the connection between the good deeds and consumer attitudes is so indirect as to be impossible to measure. Having no way to quantify the benefits of these investments puts such CSR programs on shaky ground, liable to be dislodged by a change of management or a swing in the business cycle.

All four schools of thought share the same weakness: They focus on the tension between business and society rather than on their interdependence. Each creates a generic rationale that is not tied to the strategy and operations of any specific company or the places in which it operates. Consequently, none of them is sufficient to help a company identify, prioritize, and address the social issues that matter most or the ones on which it can make the biggest impact. The result is oftentimes a hodgepodge of uncoordinated CSR and philanthropic activities disconnected from the company's strategy that neither make any meaningful social impact nor strengthen the firm's long-term competitiveness. Internally, CSR practices and initiatives are often isolated from operating units—and even separated from corporate philanthropy. Externally, the company's social impact becomes diffused among numerous unrelated efforts, each responding to a different stakeholder group or corporate pressure point.

The consequence of this fragmentation is a tremendous lost opportunity. The power of corporations to create social benefit is dissipated, and so is the potential of companies to take actions that would support both their communities and their business goals.

Integrating Business and Society

To advance CSR, we must root it in a broad understanding of the interrelationship between a corporation and society while at the same time anchoring it in the strategies and activities of specific companies. To say broadly that business and society need each other might seem like a cliché, but it is also the basic truth that will pull companies out of the muddle that their current corporate-responsibility thinking has created.

Mapping Social Opportunities

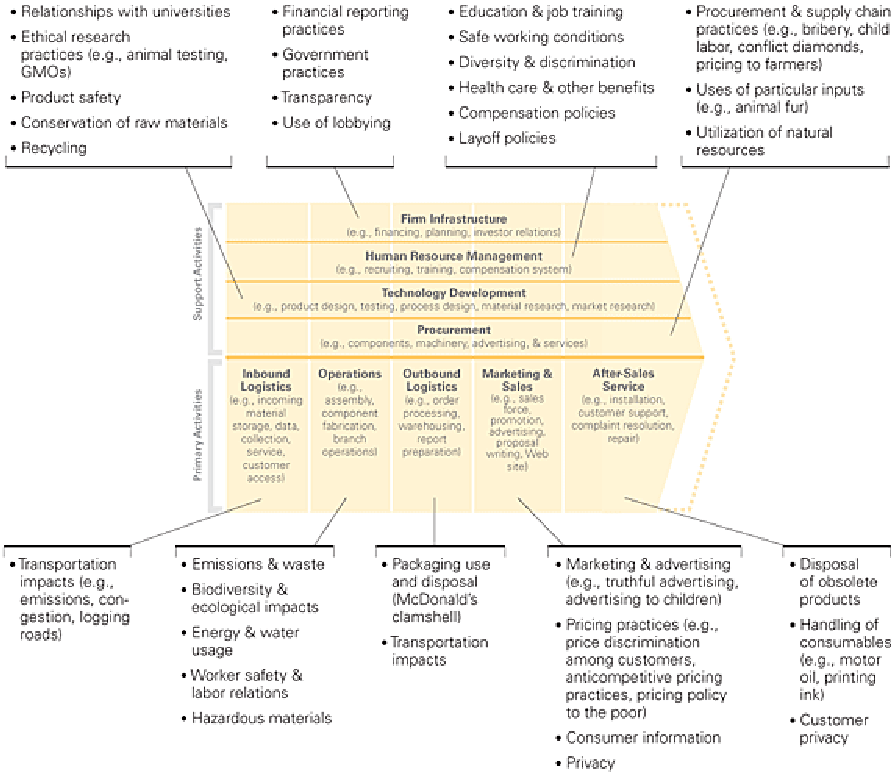
The interdependence of a company and society can be analyzed with the same tools used to analyze competitive position and develop strategy. In this way, the firm can focus its particular CSR activities to best effect. Rather than merely acting on well-intentioned impulses or reacting to outside pressure, the organization can set an affirmative CSR agenda that produces maximum social benefit as well as gains for the business.

These two tools should be used in different ways. When a company uses the value chain to chart all the social consequences of its activities, it has, in effect, created an inventory of problems and opportunities—mostly operational issues—that need to be investigated, prioritized, and addressed. In general, companies should attempt to clear away as many negative value-chain social impacts as possible. Some company activities will prove to offer opportunities for social and strategic distinction.

In addressing competitive context, companies cannot take on every area in the diamond. Therefore, the task is to identify those areas of social context with the greatest strategic value. A company should carefully choose from this menu one or a few social initiatives that will have the greatest shared value: benefit for both society and its own competitiveness.

Looking Inside Out: Mapping the Social Impact of the Value Chain

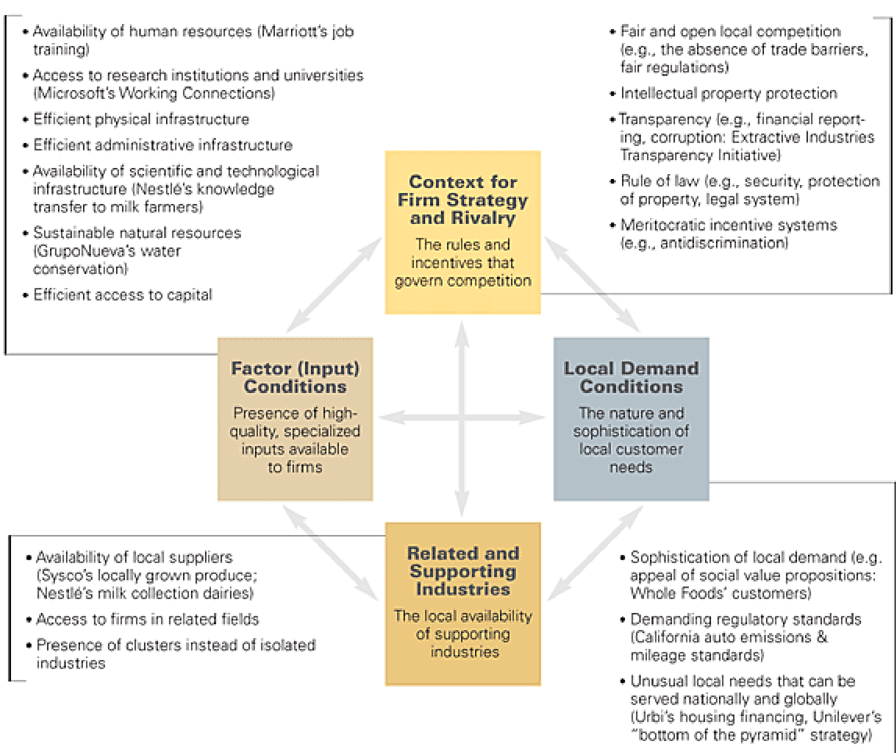
The *value chain* depicts all the activities a company engages in while doing business. It can be used as a framework to identify the positive and negative social impact of those activities. These "inside-out" linkages may range from hiring and layoff policies to greenhouse gas emissions, as the partial list of examples illustrated here demonstrates.



Source: Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance*, 1985

Looking Outside In: Social Influences on Competitiveness

In addition to understanding the social ramifications of the value chain, effective CSR requires an understanding of the social dimensions of the company's competitive context—the "outside-in" linkages that affect its ability to improve productivity and execute strategy. These can be understood using the *diamond framework,* which shows how the conditions at a company's locations (such as transportation infrastructure and honestly enforced regulatory policy) affect its ability to compete.



Source: Michael E. Porter, *The Competitive Advantage of Nations*, 1990

Successful corporations need a healthy society. Education, health care, and equal opportunity are essential to a productive workforce. Safe products and working conditions not only attract customers but lower the internal costs of accidents. Efficient utilization of land, water, energy, and other natural resources makes business more productive. Good government, the rule of law, and property rights are essential for efficiency and innovation. Strong regulatory standards protect both consumers and competitive companies from exploitation. Ultimately, a healthy society creates expanding demand for business, as more human needs are met and aspirations grow. Any business that pursues its ends at the expense of the society in which it operates will find its success to be illusory and ultimately temporary.

At the same time, a healthy society needs successful companies. No social program can rival the business sector when it comes to creating the jobs, wealth, and innovation that improve standards of living and social conditions over time. If governments, NGOs, and other participants in civil society weaken the ability of business to operate productively, they may win battles but will lose the war, as corporate and regional competitiveness fade, wages stagnate, jobs disappear, and the wealth that pays taxes and supports nonprofit contributions evaporates.

Leaders in both business and civil society have focused too much on the friction between them and not enough on the points of intersection. The mutual dependence of corporations and society implies that both business decisions and social policies must follow the principle of *shared value*. That is, choices must benefit both sides. If either a business or a society pursues policies that benefit its interests at the expense of the other, it will find itself on a dangerous path. A temporary gain to one will undermine the long-term prosperity of both.[1]

To put these broad principles into practice, a company must integrate a social perspective into the core frameworks it already uses to understand competition and guide its business strategy.

Identifying the points of intersection.

The interdependence between a company and society takes two forms. First, a company impinges upon society through its operations in the normal course of business: These are *inside-out linkages*.

Virtually every activity in a company's value chain touches on the communities in which the firm operates, creating either positive or negative social consequences. (For an example of this process, see the exhibit "Looking Inside Out: Mapping the Social Impact of the Value Chain.") While companies are increasingly aware of the social impact of their activities (such as hiring practices, emissions, and waste disposal), these impacts can be more subtle and variable than many managers realize. For one thing, they depend on location. The same manufacturing operation will have very different social consequences in China than in the United States.

A company's impact on society also changes over time, as social standards evolve and science progresses. Asbestos, now understood as a serious health risk, was thought to be safe in the early 1900s, given the scientific knowledge then available. Evidence of its risks gradually mounted for more than 50 years before any company was held liable for the harms it can cause. Many firms that failed to anticipate the consequences of this evolving body of research have been bankrupted by the results. No longer can companies be content to monitor only the obvious social impacts of today. Without a careful process for identifying evolving social effects of tomorrow, firms may risk their very survival.

Not only does corporate activity affect society, but external social conditions also influence corporations, for better and for worse. These are *outside-in linkages*.

Every company operates within a competitive context, which significantly affects its ability to carry out its strategy, especially in the long run. Social conditions form a key part of this context. Competitive context garners far less attention than value chain impacts but can have far greater strategic importance for both companies and societies. Ensuring the health of the competitive context benefits both the company and the community.

Competitive context can be divided into four broad areas: first, the quantity and quality of available business inputs—human resources, for example, or transportation infrastructure; second, the rules and incentives that govern competition—such as policies that protect intellectual property, ensure transparency, safeguard against corruption, and encourage investment; third, the size and sophistication of local demand, influenced by such things as standards for product quality and safety, consumer rights, and fairness in government purchasing; fourth, the local availability of supporting industries, such as service providers and machinery producers. Any and all of these aspects of context can be opportunities for CSR initiatives. (See the exhibit "Looking Outside In: Social Influences on Competitiveness.") The ability to recruit appropriate human resources, for example, may depend on a number of social factors that companies can influence, such as the local educational system, the availability of housing, the existence of discrimination (which limits the pool of workers), and the adequacy of the public health infrastructure.[2]

Choosing which social issues to address.

No business can solve all of society's problems or bear the cost of doing so. Instead, each company must select issues that intersect with its particular business. Other social agendas are best left to those companies in other industries, NGOs, or government institutions that are better positioned to address them. The essential test that should guide CSR is not whether a cause is worthy but whether it presents an opportunity to create shared value—that is, a meaningful benefit for society that is also valuable to the business.

Our framework suggests that the social issues affecting a company fall into three categories, which distinguish between the many worthy causes and the narrower set of social issues that are both important and strategic for the business.

Generic social issues may be important to society but are neither significantly affected by the company's operations nor influence the company's long-term competitiveness. *Value chain social impacts* are those that are significantly affected by the company's activities in the ordinary course of business. *Social dimensions of competitive context* are factors in the external environment that significantly affect the underlying drivers of competitiveness in those places where the company operates. (See the exhibit "Prioritizing Social Issues.")

Prioritizing Social Issues

Generic Social Issues	Value Chain Social Impacts	Social Dimensions of Competitive Context
Social issues that are not significantly affected by a company's operations nor materially affect its long-term competitiveness.	Social issues that are significantly affected by a company's activities in the ordinary course of business.	Social issues in the external environment that significantly affect the underlying drivers of a company's competitiveness in the locations where it operates.

Every company will need to sort social issues into these three categories for each of its business units and primary locations, then rank them in terms of potential impact. Into which category a given social issue falls will vary from business unit to business unit, industry to industry, and place to place.

Supporting a dance company may be a generic social issue for a utility like Southern California Edison but an important part of the competitive context for a corporation like American Express, which depends on the high-end entertainment, hospitality, and tourism cluster. Carbon emissions may be a generic social issue for a financial services firm like Bank of America, a negative value chain impact for a transportation-based company like UPS, or both a value chain impact and a competitive context issue for a car manufacturer like Toyota. The AIDS pandemic in Africa may be a generic social issue for a U.S. retailer like Home Depot, a value chain impact for a pharmaceutical company like GlaxoSmithKline, and a competitive context issue for a mining company like Anglo American that depends on local labor in Africa for its operations.

Even issues that apply widely in the economy, such as diversity in hiring or conservation of energy, can have greater significance for some industries than for others. Health care benefits, for example, will present fewer challenges for software development or biotechnology firms, where workforces tend to be small and well compensated, than for companies in a field like retailing, which is heavily dependent on large numbers of lower-wage workers.

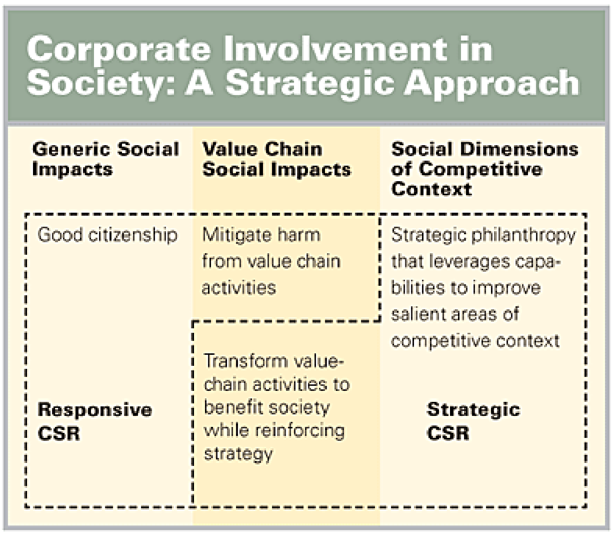
Within an industry, a given social issue may cut differently for different companies, owing to differences in competitive positioning. In the auto industry, for example, Volvo has chosen to make safety a central element of its competitive positioning, while Toyota has built a competitive advantage from the environmental benefits of its hybrid technology. For an individual company, some issues will prove to be important for many of its business units and locations, offering opportunities for strategic corporatewide CSR initiatives.

Where a social issue is salient for many companies across multiple industries, it can often be addressed most effectively through cooperative models. The Extractive Industries Transparency Initiative, for example, includes 19 major oil, gas, and mining companies that have agreed to discourage corruption through full public disclosure and verification of all corporate payments to governments in the countries in which they operate. Collective action by all major corporations in these industries prevents corrupt governments from undermining social benefit by simply choosing not to deal with the firms that disclose their payments.

Creating a corporate social agenda.

Categorizing and ranking social issues is just the means to an end, which is to create an explicit and affirmative corporate social agenda. A corporate social agenda looks beyond community expectations to opportunities to achieve social and economic benefits simultaneously. It moves from mitigating harm to finding ways to reinforce corporate strategy by advancing social conditions.

Such a social agenda must be responsive to stakeholders, but it cannot stop there. A substantial portion of corporate resources and attention must migrate to truly strategic CSR. (See the exhibit “Corporate Involvement in Society: A Strategic Approach.”) It is through strategic CSR that the company will make the most significant social impact and reap the greatest business benefits.



Responsive CSR.

Responsive CSR comprises two elements: acting as a good corporate citizen, attuned to the evolving social concerns of stakeholders, and mitigating existing or anticipated adverse effects from business activities.

Good citizenship is a sine qua non of CSR, and companies need to do it well. Many worthy local organizations rely on corporate contributions, while employees derive justifiable pride from their company’s positive involvement in the community.

The best corporate citizenship initiatives involve far more than writing a check: They specify clear, measurable goals and track results over time. A good example is GE’s program to adopt underperforming public high schools near several of its major U.S. facilities. The company contributes between $250,000 and $1 million over a five-year period to each school and makes in-kind donations as well. GE managers and employees take an active role by working with school administrators to assess needs and mentor or tutor students. In an independent study of ten schools in the program between 1989 and 1999, nearly all showed significant improvement, while the graduation rate in four of the five worst-performing schools doubled from an average of 30% to 60%.

Effective corporate citizenship initiatives such as this one create goodwill and improve relations with local governments and other important constituencies. What’s more, GE’s employees feel great pride in their participation. Their effect is inherently limited, however. No matter how beneficial the program is, it remains incidental to the company’s business, and the direct effect on GE’s recruiting and retention is modest.

The second part of responsive CSR—mitigating the harm arising from a firm’s value chain activities—is essentially an operational challenge. Because there are a myriad of possible value chain impacts for each business unit, many companies have adopted a checklist approach to CSR, using standardized sets of social and environmental risks. The Global Reporting Initiative, which is rapidly becoming a standard for CSR reporting, has enumerated a list of 141 CSR issues, supplemented by auxiliary lists for different industries.

These lists make for an excellent starting point, but companies need a more proactive and tailored internal process. Managers at each business unit can use the value chain as a tool to identify systematically the social impacts of the unit's activities in each location. Here operating management, which is closest to the work actually being done, is particularly helpful. Most challenging is to anticipate impacts that are not yet well recognized. Consider B&Q, an international chain of home supply centers based in England. The company has begun to analyze systematically tens of thousands of products in its hundreds of stores against a list of a dozen social issues—from climate change to working conditions at its suppliers' factories—to determine which products pose potential social responsibility risks and how the company might take action before any external pressure is brought to bear.

For most value chain impacts, there is no need to reinvent the wheel. The company should identify best practices for dealing with each one, with an eye toward how those practices are changing. Some companies will be more proactive and effective in mitigating the wide array of social problems that the value chain can create. These companies will gain an edge, but—just as for procurement and other operational improvements—any advantage is likely to be temporary.

Strategic CSR.

For any company, strategy must go beyond best practices. It is about choosing a unique position—doing things differently from competitors in a way that lowers costs or better serves a particular set of customer needs. These principles apply to a company's relationship to society as readily as to its relationship to its customers and rivals.

Strategic CSR moves beyond good corporate citizenship and mitigating harmful value chain impacts to mount a small number of initiatives whose social and business benefits are large and distinctive. Strategic CSR involves both inside-out and outside-in dimensions working in tandem. It is here that the opportunities for shared value truly lie.

Many opportunities to pioneer innovations to benefit both society and a company's own competitiveness can arise in the product offering and the value chain. Toyota's response to concerns over automobile emissions is an example. Toyota's Prius, the hybrid electric/gasoline vehicle, is the first in a series of innovative car models that have produced competitive advantage and environmental benefits. Hybrid engines emit as little as 10% of the harmful pollutants conventional vehicles produce while consuming only half as much gas. Voted 2004 Car of the Year by *Motor Trend* magazine, Prius has given Toyota a lead so substantial that Ford and other car companies are licensing the technology. Toyota has created a unique position with customers and is well on its way to establishing its technology as the world standard.

Urbi, a Mexican construction company, has prospered by building housing for disadvantaged buyers using novel financing vehicles such as flexible mortgage payments made through payroll deductions. Crédit Agricole, France's largest bank, has differentiated itself by offering specialized financial products related to the environment, such as financing packages for energy-saving home improvements and for audits to certify farms as organic.

Strategic CSR also unlocks shared value by investing in social aspects of context that strengthen company competitiveness. A symbiotic relationship develops: The success of the company and the success of the community become mutually reinforcing. Typically, the more closely tied a social issue is to the company's business, the greater the opportunity to leverage the firm's resources and capabilities, and benefit society.

Microsoft's Working Connections partnership with the American Association of Community Colleges (AACC) is a good example of a shared-value opportunity arising from investments in context. The shortage of information technology workers is a significant constraint on Microsoft's growth; currently, there are more than 450,000 unfilled IT positions in the United States alone. Community colleges, with an enrollment of 11.6 million students, representing 45% of all U.S. undergraduates, could be a major solution. Microsoft recognizes, however, that community colleges face special challenges: IT curricula are not standardized, technology used in classrooms is often outdated, and there are no systematic professional development programs to keep faculty up to date.

Microsoft's $50 million five-year initiative was aimed at all three problems. In addition to contributing money and products, Microsoft sent employee volunteers to colleges to assess needs, contribute to curriculum development, and create faculty development institutes. Note that in this case, volunteers and assigned staff were able to use their core professional skills to address a social need, a far cry from typical volunteer programs. Microsoft has achieved results that have benefited many communities while having a direct—and potentially significant—impact on the company.

Integrating inside-out and outside-in practices.

Pioneering value chain innovations and addressing social constraints to competitiveness are each powerful tools for creating economic and social value. However, as our examples illustrate, the impact is even greater if they work together. Activities in the value chain can be performed in ways that reinforce improvements in the social dimensions of context. At the same time, investments in competitive context have the potential to reduce constraints on a company's value chain activities. Marriott, for example, provides 180 hours of paid classroom and on-the-job training to chronically unemployed job candidates. The company has combined this with support for local community service organizations, which identify, screen, and refer the candidates to Marriott. The net result is both a major benefit to communities and a reduction in Marriott's cost of recruiting entry-level employees. Ninety percent of those in the training program take jobs with Marriott. One year later, more than 65% are still in their jobs, a substantially higher retention rate than the norm.

When value chain practices and investments in competitive context are fully integrated, CSR becomes hard to distinguish from the day-to-day business of the company. Nestlé, for example, works directly with small farmers in developing countries to source the basic commodities, such as milk, coffee, and cocoa, on which much of its global business depends. (See the sidebar "Integrating Company Practice and Context: Nestlé's Milk District.") The company's investment in local infrastructure and its transfer of world-class knowledge and technology over decades has produced enormous social benefits through improved health care, better education, and economic development, while giving Nestlé direct and reliable access to the commodities it needs to maintain a profitable global business. Nestlé's distinctive strategy is inseparable from its social impact.

Integrating Company Practice and Context: Nestlé's Milk District

Nestlé's approach to working with small farmers exemplifies the symbiotic relationship between social progress and competitive advantage. Ironically, while the company's reputation remains marred by a 30-year-old controversy surrounding sales of infant formula in Africa, the corporation's impact in developing countries has often been profoundly positive.

Consider the history of Nestlé's milk business in India. In 1962, the company wanted to enter the Indian market, and it received government permission to build a dairy in the northern district of Moga. Poverty in the region was severe; people were without electricity, transportation, telephones, or medical care. A farmer typically owned less than five acres of poorly irrigated and infertile soil. Many kept a single buffalo cow that produced just enough milk for their own consumption. Sixty percent of calves died newborn. Because farmers lacked refrigeration, transportation, or any way to test for quality, milk could not travel far and was frequently contaminated or diluted.

Nestlé came to Moga to build a business, not to engage in CSR. But Nestlé's value chain, derived from the company's origins in Switzerland, depended on establishing local sources of milk from a large, diversified base of small farmers. Establishing that value chain in Moga required Nestlé to transform the competitive context in ways that created tremendous shared value for both the company and the region.

Nestlé built refrigerated dairies as collection points for milk in each town and sent its trucks out to the dairies to collect the milk. With the trucks went veterinarians, nutritionists, agronomists, and quality assurance experts. Medicines and nutritional supplements were provided for sick animals, and monthly training sessions were held for local farmers. Farmers learned that the milk quality depended on the cows' diet, which in turn depended on adequate feed crop irrigation. With financing and technical assistance from Nestlé, farmers began to dig previously unaffordable deep-bore wells. Improved irrigation not only fed cows but increased crop yields, producing surplus wheat and rice and raising the standard of living.

When Nestlé's milk factory first opened, only 180 local farmers supplied milk. Today, Nestlé buys milk from more than 75,000 farmers in the region, collecting it twice daily from more than 650 village dairies. The death rate of calves has dropped by 75%. Milk production has increased 50-fold. As the quality has improved, Nestlé has been able to pay higher prices to farmers than those set by the government, and its steady biweekly payments have enabled farmers to obtain credit. Competing dairies and milk factories have opened, and an industry cluster is beginning to develop.

Today, Moga has a significantly higher standard of living than other regions in the vicinity. Ninety percent of the homes have electricity, and most have telephones; all villages have primary schools, and many have secondary schools. Moga has five times the number of doctors as neighboring regions. The increased purchasing power of local farmers has also greatly expanded the market for Nestlé's products, further supporting the firm's economic success.

Nestlé's commitment to working with small farmers is central to its strategy. It enables the company to obtain a stable supply of high-quality commodities without paying middlemen. The corporation's other core products—coffee and cocoa—are often grown by small farmers in developing countries under similar conditions. Nestlé's experience in setting up collection points, training farmers, and introducing better technology in Moga has been repeated in Brazil, Thailand, and a dozen other countries, including, most recently, China. In each case, as Nestlé has prospered, so has the community.

Creating a social dimension to the value proposition.

At the heart of any strategy is a unique value proposition: a set of needs a company can meet for its chosen customers that others cannot. The most strategic CSR occurs when a company adds a social dimension to its value proposition, making social impact integral to the overall strategy.

Consider Whole Foods Market, whose value proposition is to sell organic, natural, and healthy food products to customers who are passionate about food and the environment. Social issues are fundamental to what makes Whole Foods unique in food retailing and to its ability to command premium prices. The company's sourcing emphasizes purchases from local farmers through each store's procurement process. Buyers screen out foods containing any of nearly 100 common ingredients that the company considers unhealthy or environmentally damaging. The same standards apply to products made internally. Whole Foods' baked goods, for example, use only unbleached and unbromated flour.

Whole Foods' commitment to natural and environmentally friendly operating practices extends well beyond sourcing. Stores are constructed using a minimum of virgin raw materials. Recently, the company purchased renewable wind energy credits equal to 100% of its electricity use in all of its stores and facilities, the only *Fortune* 500 company to offset its electricity consumption entirely. Spoiled produce and biodegradable waste are trucked to regional centers for composting. Whole Foods' vehicles are being converted to run on biofuels. Even the cleaning products used in its stores are environmentally friendly. And through its philanthropy, the company has created the Animal Compassion Foundation to develop more natural and humane ways of raising farm animals. In short, nearly every aspect of the company's value chain reinforces the social dimensions of its value proposition, distinguishing Whole Foods from its competitors.

Not every company can build its entire value proposition around social issues as Whole Foods does, but adding a social dimension to the value proposition offers a new frontier in competitive positioning. Government regulation, exposure to criticism and liability, and consumers' attention to social issues are all persistently increasing. As a result, the number of industries and companies whose competitive advantage can involve social value propositions is constantly growing. Sysco, for example, the largest distributor of food products to restaurants and institutions in North America, has begun an initiative to preserve small, family-owned farms and offer locally grown produce to its customers as a source of competitive differentiation. Even large global multinationals—such as General Electric, with its "ecomagination" initiative that focuses on developing water purification technology and other "green" businesses, and Unilever, through its efforts to pioneer new products, packaging, and distribution systems to meet the needs of the poorest populations—have decided that major business opportunities lie in integrating business and society.

Organizing for CSR

Integrating business and social needs takes more than good intentions and strong leadership. It requires adjustments in organization, reporting relationships, and incentives. Few companies have engaged operating management in processes that identify and prioritize social issues based on their salience to business operations and their importance to the company's competitive context. Even fewer have unified their philanthropy with the management of their CSR efforts, much less sought to embed a social dimension into their core value proposition. Doing these things requires a far different approach to both CSR and philanthropy than the one prevalent today. Companies must shift from a fragmented, defensive posture to an integrated, affirmative approach. The focus must move away from an emphasis on image to an emphasis on substance.

The current preoccupation with measuring stakeholder satisfaction has it backwards. What needs to be measured is social impact. Operating managers must understand the importance of the outside-in influence of competitive context, while people with responsibility for CSR initiatives must have a granular understanding of every activity in the value chain. Value chain and competitive-context investments in CSR need to be incorporated into the performance measures of managers with P&L responsibility. These transformations require more than a broadening of job definition; they require overcoming a number of long-standing prejudices. Many operating managers have developed an ingrained us-versus-them mind-set that responds defensively to the discussion of any social issue, just as many NGOs view askance the pursuit of social value for profit. These attitudes must change if companies want to leverage the social dimension of corporate strategy.

Strategy is always about making choices, and success in corporate social responsibility is no different. It is about choosing which social issues to focus on. The short-term performance pressures companies face rule out indiscriminate investments in social value creation. They suggest, instead, that creating shared value should be viewed like research and development, as a long-term investment in a company's future competitiveness. The billions of dollars already being spent on CSR and corporate philanthropy would generate far more benefit to both business and society if consistently invested using the principles we have outlined.

While responsive CSR depends on being a good corporate citizen and addressing every social harm the business creates, strategic CSR is far more selective. Companies are called on to address hundreds of social issues, but only a few represent opportunities to make a real difference to society or to confer a competitive advantage. Organizations that make the right choices and build focused, proactive, and integrated social initiatives in concert with their core strategies will increasingly distance themselves from the pack.

The Moral Purpose of Business

By providing jobs, investing capital, purchasing goods, and doing business every day, corporations have a profound and positive influence on society. The most important thing a corporation can do for society, and for any community, is contribute to a prosperous economy. Governments and NGOs often forget this basic truth. When developing countries distort rules and incentives for business, for example, they penalize productive companies. Such countries are doomed to poverty, low wages, and selling off their natural resources. Corporations have the know-how and resources to change this state of affairs, not only in the developing world but also in economically disadvantaged communities in advanced economies.

This cannot excuse businesses that seek short-term profits deceptively or shirk the social and environmental consequences of their actions. But CSR should not be only about what businesses have done that is wrong—important as that is. Nor should it be only about making philanthropic contributions to local charities, lending a hand in time of disaster, or providing relief to society's needy—worthy though these contributions may be. Efforts to find shared value in operating practices and in the social dimensions of competitive context have the potential not only to foster economic and social development but to change the way companies and society think about each other. NGOs, governments, and companies must stop thinking in terms of "corporate social responsibility" and start thinking in terms of "corporate social integration."

Perceiving social responsibility as building shared value rather than as damage control or as a PR campaign will require dramatically different thinking in business. We are convinced, however, that CSR will become increasingly important to competitive success.

Corporations are not responsible for all the world's problems, nor do they have the resources to solve them all. Each company can identify the particular set of societal problems that it is best equipped to help resolve and from which it can gain the greatest competitive benefit. Addressing social issues by creating shared value will lead to self-sustaining solutions that do not depend on private or government subsidies. When a well-run business applies its vast resources, expertise, and management talent to problems that it understands and in which it has a stake, it can have a greater impact on social good than any other institution or philanthropic organization.

1. An early discussion of the idea of CSR as an opportunity rather than a cost can be found in David Grayson and Adrian Hodges, *Corporate Social Opportunity* (Greenleaf, 2004).

2. For a more complete discussion of the importance of competitive context and the diamond model, see Michael E. Porter and Mark R. Kramer, "The Competitive Advantage of Corporate Philanthropy," HBR December 2002. See also Michael Porter's book *The Competitive Advantage of Nations* (The Free Press, 1990) and his article "Locations, Clusters, and Company Strategy," in *The Oxford Handbook of Economic Geography,* edited by Gordon L. Clark, Maryann P. Feldman, and Meric S. Gertler (Oxford University Press, 2000).

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