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When Principles Pay: Corporate Social Responsibility and the Bottom Line

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Geoffrey Heal, Devin T. Stewart

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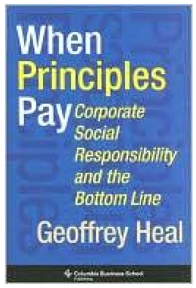

When Principles Pay: Corporate Social Responsibility and the Bottom Line

Introduction

DEVIN STEWART: Do principles pay? The title of the book today that we're talking about is *When Principles Pay: Corporate Social Responsibility and the Bottom Line*, a very hot topic.

This is a fantastic book. I'm right in the middle of it, and I am hoping that we will hear the rest so I can kind of cheat, move forward.

Related Resources:

When Principles Pay: Corporate Social Responsibility and the Bottom Line (Video)

When Principles Pay: Corporate Social Responsibility and the Bottom Line (Audio)

Geoff Heal from Columbia University's Business School has kindly come down to Carnegie Council. By way of introduction, I'm Devin Stewart from Carnegie Council. I run the Global Policy Innovations program and Policy Innovations online magazine, policyinnovations.org. We also have a quarterly luncheon workshop. So we are making our way into a more multimedia platform here.

Geoff's book is really, I think, timely. It's delightful to read it. As I was mentioning earlier, he didn't just throw everything in the world in this book. It seems very polished. It's very elegant. He starts with Adam Smith and goes all the way to Starbucks and covers everything in between. There are some nice case studies in there, which he is going to talk about. He even addresses some of the philosophical underpinnings of corporate social responsibility. He makes an argument, I think, that CSR [corporate social responsibility] does actually pay. I think one large question that we might get into later on is: What is the role of a corporation?

So, formal title here. Geoffrey Heal is the Paul Garrett Professor of Public Policy and Corporate Responsibility and Professor of Finance and Economics at the Graduate School of Business at Columbia University.

I'm just going to hand it over to Geoff, maybe about 30 minutes or so, and then we'll engage in some conversation.

Thank you very much for coming. Thank you, Geoff.

Remarks

GEOFFREY HEAL: Thanks, Devin. Thank you very much for being here and for your interest in the topic.

Let me start off by trying to explain what the issues are that led me to write

Features

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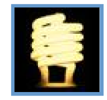

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this book and to do the research on which it is based.

All corporations have social and environmental impacts. You can't really operate as a corporation without having an environmental impact and a social impact. Every corporation produces carbon dioxide and greenhouse gases. Every corporation produces waste. Every corporation employs people. It may pay them decent wages or it may pay them bad wages. It may employ them under good conditions or bad conditions. It may employ child labor; it may not employ child labor. There is a range of parameters and possibilities here, but all corporations have impacts both in the social and the environmental fields. And that has obviously always been the case since corporations began.

However, within, I guess, the last roughly 10 or 15, maybe 20, years—probably 15 years—these environmental and social impacts have become much more a matter of concern than they used to be historically and, particularly, much more a matter of concern within the corporations.

It is probably fair to say that if you look at the Fortune 500 companies at this point, the vast majority of them have people who are responsible for monitoring and managing these social and environmental impacts, and who report either directly to the CEO or to someone who reports themselves directly to the CEO.

In other words, the corporate social and environmental impacts have become the stuff of corporate executive decision-making and of corporate policy in a way that they weren't even relatively recently—let's say 20 years ago.

So the first thing I want to try to understand is why this has happened. Why are corporations today concerned about social and environmental impacts, when 20-30 years ago they were almost certainly not? I am going to argue that there are four factors that have contributed to this and try to understand what the implications of these factors are.
One goes back to the Reagan-Thatcher era and the rhetoric of rolling back the frontiers of the state, which I'm sure many of you remember, positively or negatively. During that era, a lot of industries that were part of state-managed sectors were privatized, there was an awful lot of deregulation. If you transfer things from the state to the private sector, or you deregulate the private sector, one of the consequences of that is that standards and decisions which used to be made by the state have now come to be made by the corporation. So you are pitching in the area of corporate decision-making issues which were previously covered by state enterprises or by state regulatory bodies.

You can see that actually even during the last seven years of the current Bush Administration. Although the Bush Administration has not technically deregulated on environmental issues, it has effectively neglected the implementation of a lot of environmental laws. As a result of that, corporations have choices which they didn't used to have. They can decide whether to take advantage of the lapses in the administration of a number of the United States' principal environmental laws or not.

So corporations have more choice about setting their own standards on social and environmental matters in a world where "the frontiers of the state have been rolled backwards," deliberately or otherwise. That's one reason why corporations are facing and needing to make decisions on these issues whereas they didn't 20 or 30 years ago.

Another factor is globalization. Most major Western companies now operate all over the world. A typical Western company operates in at least a hundred countries. Many of those countries are countries in which there is either very little in the way of social and environmental legislation, or there is such legislation but it is just not implemented.

For example, if you go to China—I spent some time in China last year—if you take the trouble of looking at the environmental legislation in China and reading it, it's actually quite interesting and quite substantive, and if it were implemented it would make a huge impact. But there is absolutely no attempt at all to implement the great bulk of environmental legislation in China. So, in effect, if you are a Western company operating in China, it's up to you to decide whether to respect their legislation or not. There will be no penalties for not respecting the environmental legislation. You have a choice. You can set your own environmental standards if you are operating in China.

The same thing goes, obviously, for the standards which you apply to managing your labor force. There is minimum-wage legislation, there is some health and safety at work legislation, but again there is very little attempt to implement that. So if you are running a company in China, it is really up to you to pick your own standards.

China is one case where you actually have legislation but it's not implemented. There are other developing countries, obviously, where there simply is no legislation. If you go and set up a factory there, it is really up to you to decide what is a satisfactory health and safety situation in the workplace, what are satisfactory environmental standards. You are to pick your own standards.

In particular, Western companies have to make a choice. They have to decide: If I'm a U.S. company, should I operate to U.S. standards in China or in Vietnam, or should I operate to local standards? Should I take advantage of the fact that their standards are much lower than ours, or should I operate to the same standards as I would in the United States? That is an interesting choice that they have to face. Different companies make different decisions in that area.

There is a very interesting lawsuit going on at the moment. I'm sure some of you in the human rights area are familiar with this. It involves Chevron/Texaco. It's to do with the operations of their predecessor, Texaco, in Ecuador. Texaco drilled for oil in the Ecuadorian Amazon, in the rainforests there, and in the process polluted groundwater very extensively. It's a long, complicated story, but I'm summarizing it very briefly, and I guess probably rather poorly. But that obviously led to serious health problems for some of the indigenous peoples in the Amazonian region. Chevron is now being sued. Chevron subsequently bought Texaco, and Chevron is now being sued by a variety of entities on behalf of the people whose health was damaged.

Chevron's defense is that they complied with all appropriate legal standards in Ecuador at the time when they did this; in other words, the standards for remediation of groundwater and so on, where there were such standards in Ecuador, and Chevron complied with those standards.

The plaintiffs are saying that the standards in fact were way short of what would be customary in the United States or other Western countries, that the standards that Chevron was operating to in Ecuador were abandoned in the United States in 1932, and that in an ethical sense Chevron should be held responsible for operating for what it knew to be the appropriate standards even though they weren't legally required.

So it is actually a very interesting lawsuit from a number of perspectives, and it raises precisely this issue of, if you are a Western company operating in a third world where environmental standards are a lot lower than they are here, what standards should you set? Your legal obligation is reasonably clear, but what is your ethical obligation? And what are the consequences of making one decision or another?

So that's the issue of globalization.

Another very important issue, perhaps in some ways the most important, is the rise of nongovernmental organizations—this is obviously part and parcel of the same process—and the rise of consumer activism. Nongovernmental organizations, civil society, monitor corporate actions very carefully in social and environmental fields, both in this country and in third-world countries. If they find these to be inappropriate, they are extremely vocal about this, to the extent of organizing boycotts, which can often be quite costly to the companies that are targets of those boycotts.

Consumers, at the same time, are increasingly interested in the provenance of the goods that they buy. They want to know not only what exactly am I buying, but what's the social footprint of this good that I am buying; was child labor used in making this good; what's the environmental footprint of this good; how much is its CO_2 footprint, and so on. So consumers are increasingly interested in this. I'll mention that more later on.

Nongovernmental organizations are quite aggressive in monitoring corporate behavior. And, because consumers are interested in these issues, the nongovernmental organizations, if they publicize transgressions, can have an impact on consumer choices.

There is a very clear example of that which I'm sure you are all familiar with. Back in 1997, Nike was found to be using subcontractors in China who employed child labor. It was the first, I guess, widely publicized case of a major Western corporation being responsible for child labor. There was a strong consumer reaction to this, and attempts to boycott Nike's products. If you look at Nike's quarterly income statements that are filed with the Securities and Exchange Commission, the impact on Nike's sales, on their top line, was quite sharp. Their revenues dropped by about 20 percent over a couple of quarters, at a time when their competitors' sales were increasing. So it wasn't a downturn in the market; it was a downturn in Nike's sales because of the consumer boycott. A 20 percent drop is enough to have a big impact on profits in that sort of business. So that was quite costly to them.

Nike has really sort of swung around on a dime and have now become very aggressive practitioners of socially responsible behavior in a number of respects. I'll talk a bit more about that later. So the role of NGOs is very important, indeed, and one which is increasing.

The final factor of these four is the growth of socially responsible investment funds. One of the things I'll talk about quite a lot is the role of capital markets in providing incentives for corporations to behave responsibly.

The issue here is that roughly 10 percent of all the money under professional management in the United States is managed by funds that have some explicit environmental or ethical or social objective. They want to promote responsible environmental behavior, or they want not to invest in companies that treat their employees badly, or something of the sort. Ten percent is a significant amount. That amounts to trillions of dollars.

That is a serious understatement, incidentally, because that 10 percent just includes funds which are specifically self-labeled as socially responsible investment funds. There are lots of funds that are not so labeled but nevertheless worry about social and environmental things. For example, CalPERS, the California state employees' pension fund, is not formally listed as a socially responsible investment fund, but they take quite aggressive positions when they are investing on issues like environmental performance and social performance of the companies they might invest in.

Again, university endowments. I happen to be on the Columbia University Investment Committee. We have a set of principles that we try to implement when deciding where to invest and how to invest. I think most of the private universities in this country do. A couple of weeks ago, we had a conference of the investment management groups of all the major private universities to try to coordinate policy on things like divesting from companies that operate in the Sudan, divesting from a number of other groups like that.

So there is quite a lot of money out there in foundations and in endowments and in pension funds that invests according to some sort of social or ethical considerations, even though they are not specifically labeled as social or ethical funds. So that 10 percent is probably a significant understatement. My guess is it's probably more like a quarter of the money out there going through stock markets in the United States has some sort of social and ethical concerns associated with it. That is enough money to be extremely important and quite influential.

So what are the consequences of this? Well, the consequence of this is that a lot of companies are doing what is inelegantly termed over-complying. They are doing a lot more on social and environmental issues than they are actually legally required to do. Let me give you a couple of examples of this type of over-compliance and try to talk a little bit about why they are doing that. Then we'll stop there and have a discussion.

I'll go through this one very quickly. Back in 1997, which is actually a long time back in terms of climate change issues, the then-CEO of BP, which is, I guess, the third-biggest oil company in the world, made a speech. This was actually before the Kyoto Protocol was signed. The Kyoto Protocol was signed in November of 1997. John Browne made this speech sometime, I think, in the early summer.

He made a speech in which he said two important things: one was that he accepted fully the science of climate change and believed that CO_2 emissions were generating changes in the climate; and secondly, that he accepted this was driven by fossil fuels and that oil companies were responsible for changing the climate. He made a commitment that by the year 2000 BP would reduce its CO_2 emissions by 10 percent below their 1990 levels. He also made a commitment to spend significant sums of money on developing renewable energy sources. BP in fact met both of those commitments.

Today that wouldn't be such a remarkable thing. Actually, for an oil company it would be fairly remarkable, but for companies it wouldn't be a remarkable thing to do. Back in 1997, they were two very remarkable things. It was front-page news in most newspapers. It got very aggressive criticism from Exxon and Chevron and all the other major oil companies. It put John Browne right out on the end of a very long limb as far as his colleagues in the oil industry were concerned.

The next example is actually an interesting one too. These are what are called the Equator Principles. Back in 2002-2003, the Rainforest Action Network and a number of other smallish but quite aggressive environmental groups were very concerned about the impacts of major infrastructure and oil and gas projects on the environment in developing countries. The example I mentioned a couple of minutes ago of Chevron in Ecuador was one of those examples. They wanted to try to minimize the environmental impacts of infrastructure-type projects in developing countries.

They decided that the easiest way to do this was not actually to go after the companies that were constructing the infrastructure projects, because these change from project to project, but to actually follow the money and go after the banks that were financing these, because whoever was doing the project, it was probably one of a number of major Western banks providing the cash for it. These are typically projects that involve hundreds of millions, if not billions, of dollars. The corporations typically borrow that money from a syndicate of banks in order to finance the project, then pay it back out of the revenue generated by the project.

So Rainforest Action Network started to try to organize consumer boycotts of some of the leading international banks on the grounds that these banks were financing environmentally destructive projects in developing countries. In particular, in the United States they went after Citibank, in the United Kingdom they went after Barclays, in continental Europe they went after ABN AMRO—three of the major leaders of banking syndicates in this kind of area.

The consequence of this was that, after a period of negotiations of about a year, there is a major group of Western banks, which now today includes pretty much all Western banks, which agreed to sign what are called the Equator Principles, which is a set of principles drawn up by the World Bank governing the social and environmental impact of projects financed in developing countries. They agreed that they would not finance any project that didn't comply with these principles.

The principles are actually quite interesting. They are not trivial principles at all. There is some argument. A number of NGOs, including some that I have worked with, feel that the principles aren't quite strong enough. But they are certainly a huge improvement of what came before them, which was basically nothing. They are not at all trivial.

This led to a number of major projects being rejected for funding by Western banks. Now, there are, unfortunately, some non-Western banks that are still willing to fund those projects, but it certainly makes funding more difficult to get for environmentally egregious projects.

I mentioned Nike and other companies like Nike, Gap, and a number of others. Nike, in particular, has now become quite aggressively pro-CSR. Nike, Gap, and most of their competitors are now members of a group called the Fair Labor Association, which was formed during the last years of the Clinton Administration, which basically coordinates establishing health and safety standards, employment standards, and so on, at subcontractors in developing countries and attempts to monitor whether these standards are actually implemented or not.

I actually discuss the issue of monitoring quite a lot in the book. Monitoring employment standards in Chinese factories, for example, is not simple. It can be very difficult to find out what your subcontractors in China are truly paying their employees. It is also very difficult to find out what the health and safety standards are actually like when your inspectors are not in fact in the factory. But nevertheless they are making quite significant efforts to do this.

The final example I'll mention is Starbucks. It is an interesting company in a lot of ways from this perspective. They are obviously quite a significant buyer of coffee. They buy about 4 percent of all the coffee that is produced in the world. The really big buyers are people like Procter & Gamble and Unilever, people who sell coffee in supermarkets, but after them Starbucks is the next biggest.

I don't know how much you know about growing coffee, but the traditional way of growing coffee was to cut down tropical rainforests, clear the land completely, and then devote it to coffee plantations, which is a very environmentally harmful way of producing coffee. The loss of tropical rainforest is a major environmental problem, and coffee growing has been one of the things that has driven loss of tropical rainforests.

There are two ways of growing coffee. One is to just clear the forest and grow coffee in a plantation. The other is what is called shade growth. Shade-grown coffee is coffee where, rather than clearing the forest, you thin the forest and then plant coffee bushes in the undergrowth in the forest. So you maintain the canopy of the forest, and a lot of the biodiversity stays intact because the canopy is there, but you have coffee bushes replacing some of the undergrowth in the forest. Now, that is much less productive—you get far less coffee per hectare from that than you do from plantations—but it is obviously environmentally much less destructive.

Starbucks has been making efforts to purchase increasing amounts of its coffee from shade-grown sources. Also, they work with a group called Conservation International, a Washington-based NGO. They have agreed to a set of payments under which they rate coffee according to its environmental friendliness, and they pay more for the coffee the more environmentally friendly it is. So shade-grown coffee they will pay a significant premium for over plantation-grown coffee, and coffee that is somewhere in between the two they will pay a fraction of that premium. So they are actually deliberately providing financial incentives to coffee growers to produce coffee in an environmentally relatively friendly way.

Now, what's interesting about all of these four examples—and I could actually give you many more—is that companies are doing things that they are not being required to do legally. Nobody is requiring Starbucks legally to purchase shade-grown coffee; it is a decision they have made on their own. There is no legal requirement on Nike that it implement higher standards at its subcontractors or that it monitor those. There is no legal requirement at all on Citibank and Bank of America that they comply with the Equator Principles. Not only is there no legal requirement, but there is not even any prospect of any legal requirement, because the U.S. government couldn't, for example, legislate to govern Citibank's conduct in West Africa. They are voluntarily assuming responsibilities which could not be forced on them legally in the social and environmental area in most of these cases.

So the question is: Why do they do this? That is what I talk about principally in the book. What I argue in the book is that there are in fact a number of financial benefits to companies from this kind of over-compliance, from going beyond what is legally required of them on environmental and social issues.

One is risk management. By doing this type of thing, you can avoid lawsuits. There was actually a very interesting analysts' report produced by some equity analysts at Union Bank of Switzerland recently on the issue of pollution. This was not by an environmental group. Let me repeat, this was by some fairly hard-nosed equity analysts at UBS in their London office. They basically came up with the following argument. They said: When a company pollutes, this frequently, though not always, leads to litigation; those who are damaged by the pollution will litigate. If it doesn't lead to litigation, it often leads to political unhappiness and eventually to regulation of some sort or other.

"So, as investors," they said, "We want to know about a company's pollution record. We believe that when a company states its liabilities on its balance sheet, it should list its record of pollution, and pollution should be treated in the same way as what are called in accounting contingent liabilities."

Contingent liability is something which has the capacity to become a liability under certain circumstances. The classic example is a derivatives position of one sort or another, which are very topical at the moment. So these guys at UBS were arguing that basically pollution should be treated like a derivative, it is something which could become a liability under certain circumstances, and therefore companies need to make statements about their pollution and about the potential liabilities associated with that when they state their balance sheets. This is emphasizing the point that minimizing pollution can be seen as a way of reducing risks to which a company is exposed, reducing lawsuits or reducing regulatory risks.

There is a number of other studies which show that there are actually other benefits of various types from improved environmental performance. Both BP and Dow Chemical, which have improved their environmental performance very significantly, have reported significant cost savings there.

Interestingly, Starbucks, which not only pursues a fairly aggressive environmental policy outside of the United States but also has a fairly positive HR [Human Resources] policy within the United States, reports much, much lower employee turnover than most people in the retail food business. The standard rate of turnover for a retail food enterprise amongst its employees is roughly 200 percent a year—an amazing number, but very, very high. Starbucks reckons it pays about $1,000 to train each new employee, so a 200 percent-a-year turnover is very high.

Starbucks' turnover is about 50 percent a year—much, much lower. They reckon that one of the reasons they have significantly higher employee loyalty is partly their stance on social and environmental issues. And it has something to do with the wages they pay, which are quite decent, and the benefits they offer, which also are rather good relative to retail food operations. But there is some real payoff to Starbucks in that greatly reduced turnover. They employ several hundred thousand people in the United States. You can work out the cost of 200 percent turnover when you're paying $1,000 to train new people all the time. It's quite significant. I did it in the book, and I think it's about $65 million a year that they are saving in terms of reduced employee training costs. That obviously is attributable to some degree to their position on CSR-type issues.

Another issue, which is the last bullet point here, is that, as I said before, consumers are increasingly interested in the environmental and social problems of the goods that they buy. This is an important area.

There is actually a very interesting experiment that was carried out two years ago here in Manhattan by two guys from Harvard. I don't know how many of you know ABC Homes and Carpets, a somewhat up-market department store down on 19th Street and Broadway.

Here's the experiment that was done, just very briefly. ABC was selling two competing ranges of towels. These were both made in developing countries, as are most towels today. They were both, it happens, made of organic cotton. They were both made under fair trade conditions, which means that the labor conditions were carefully monitored and certified to be reasonable. But none of these towels were labeled that they were organic and none of them were labeled that they were fair trade. So what these two guys from Harvard did was they persuaded the management of ABC Homes and Carpets to let them carry out the following experiment: they labeled one set of towels as "organic" and "fair trade" and they didn't label the others. Then they watched what happened to sales.

The sales of the ones that were labeled "organic" and "fair trade" immediately went up by 25 percent and the sales of the others dropped. So consumers showed a very strong preference for buying the ones that were labeled as "fair trade" and "organic" as opposed to the others.

They kept that position for a month. Then they raised the prices on the ones that were labeled "fair trade" and "organic." First of all, they raised them 10 percent and kept them 10 percent up for a month. The sales didn't drop off at all. So they were now selling 25 percent more at a 10 percent higher price.

They then raised the price another 10 percent, for a total increase of 20 percent. Sales dropped off slightly, but only 1 or 2 percent. So they were actually making a lot more money because they were selling 23 percent more now at about a 20 percent higher price.

They then took the labels away completely, left the towels for a number of months, and then completely reversed the experiment and put the labels on the other set of towels. They found exactly the same thing happened again.

That was a very interesting experiment. It shows that consumers, at least some consumers, are willing to pay a significant amount extra for goods that they believe are produced in an environmentally and socially benign fashion.

You can see that actually with the sales of the Toyota Prius. The Toyota Prius costs significantly more than any equivalent car in terms of the number of seats, performance, and so on, probably $5,000 or $6,000 more than equivalent non-hybrid cars. But it is now the sixth-best-selling vehicle in the United States, which is actually quite remarkable. That was in the first quarter of this year. That shows that people are willing to pay a significant amount extra for something which they believe to be environmentally benign in that case.

Now let me finish off with some brief remarks on the way the stock market sees some of these issues.

There was a very interesting study, actually quite old now. There have been many since then. I'll just mention this one, and if you're interested in more I can talk about them later on. The study was carried out in 1995.

I don't know how much you know about this, but every year the U.S. Environmental Protection Agency (EPA) publishes what is called the TRI. TRI stands for Toxics Release Inventory. The Toxics Release Inventory is data that applies to every firm in the United States, so every establishment, which is a branch of a firm technically, in the United States employing more than 10 people. So it is very comprehensive. What it does is list every one of 630 toxic pollutants that that establishment employing more than 10 people produces, how much of it it produces and what happens to it.

In particular, it lists for every establishment employing more than 10 people the amount of each of 630 toxic chemicals that they release into the air, they release into the water, they dump in dumps for disposal, or they leave on the ground, or whatever. So it's a fairly detailed profile of toxic pollution produced by everything other than very, very small companies in the United States. That is available on the U.S. EPA's website. It's public domain information. Most of you probably haven't looked at it, but it's right there. You can Google it.

Now, what this study did was to look at the impacts of this information on the prices of the shares of the companies that feature on the TRI list. This information is typically released in October, so, say, on October 5th this year the EPA will post on its website the latest Toxics Release Inventory, and it will list all the companies in the United States producing and disposing of these 630 different toxic chemicals and how much goes into the air, how much goes into the water, and so on.

What a guy called Hamilton did was he published an article published in the *Journal of Environmental Economics and Management*. What he did was study the impact of this data on share prices. To cut a longish statistical story short, what he found was that as soon as this data is released, the share prices of companies featured on this list fall. The more pollution they produce, the more the share price falls. The more different types of pollution they produce, the more the share prices fall.

And the share prices can be marked down quite significantly. So if on a Monday the EPA posts data showing that your company produces a lot of pollutants, Tuesday your share prices are marked down 5-10 percent. So there is a real cost to companies of pollution in this context.

For example, this matters to management because most managers have stock options, so they actually feel this directly personally. If their shares of the company are marked down 10 percent, that's 10 percent off some aspect of their wealth. If you've got an option, the value of an option may fall much more than 10 percent if the value of the underlying share falls by 10 percent. The value of an option can crash 50 percent if the underlying share goes down by 10 percent.

Also, it raises the cost of capital. It means you have to issue more shares to raise any given amount of money if the value of your shares falls. Companies don't like the cost of capital to go up.

So it's interesting. This is a fact which is not very widely known. People don't understand. Most people don't appreciate that the stock markets actually have this position on pollution.

This study has been repeated many times in the United States. I've done some work on this type of thing myself just last year. And it has been repeated in many other countries as well, with the same sort of results. So there is a real sense in which stock markets are concerned about environmental behavior and penalize it.

It is also true to some degree of social behavior as well. The thing here is that environmental behavior is relatively easy to measure. Environmental behavior is measured by pollution. In most industrial countries, something like the EPA keeps a fairly tight record on pollution.

It is public domain information. So if you want to know about the pollution record of an American company or a British company or a French company or a German company, or a Japanese company for that matter, you can go and look it up and you can get a pretty good fix on whether it is a clean or a dirty company without having to do too much research. That is good objective, measurable data.

Rating companies by their social performance is somewhat harder and it is rather more subjective. There are actually a couple of companies that sell ratings of other companies by their social and environmental performance. There is a group here in Manhattan, called Innovest, down on Third Avenue in the forties. There is another group in Boston, called KLD Research & Analytics. What they do is they sell assessments of companies' social and environmental performance. They sell that to fund managers who are managing SRI [Socially Responsible Investing] funds. If you are managing a green fund, you need to know which companies are green. If you are managing a social fund, you need to know which companies are social. That's not always easy to find out, so these guys sell you that information. They have ratings on these things.

You can actually do studies. If you get hold of their ratings, which I and some colleagues have done, you can use these ratings as a way of measuring their social performance, how they treat their workers and things of that sort, and do similar studies to the one I just mentioned, and find some impact also of social performance on a company's stock price.

I think that's probably a good place for me to stop.

Questions and Answers

DEVIN STEWART:

Thank you very much, Geoff.

By the way, you might have seen Geoff Heal was mentioned recently in *The Economist* magazine special report on CSR that they did. It's great to have one of the leading voices on CSR at the Carnegie Council.

Just going back to a couple of those last technical points, one is that the stock markets penalize pollution. How exactly does that work? You mentioned you had done some work on that. How do you observe the causality there?

GEOFFREY HEAL: Well, that actually depends on the particular study. What's interesting about this study I mentioned of the release of the Toxics Release Inventory data is that you can see very clearly what's happening here. I mean the Toxics Release Inventory data is posted on the EPA Web site on Monday afternoon, and Tuesday's share prices are marked down. So it's very clear that it's the release of the information about pollution that is generating the movement in share prices there.

There are a number of other studies which are I think interesting but less tight statistically, which basically correlate what's called the market-to-book ratio for a company, which is the value the stock market places on the company, the total value, all of its outstanding shares, divided by the book value of its assets, which is essentially a measure of how well the stock market thinks of a company and how productive it thinks the management is and so on.

What people have done is correlate this market-to-book ratio with various aspects of environmental and social performance. There is actually a fairly robust positive correlation between this market-to-book ratio and, for example, the position on the TRI database. The companies that are featured as releasing a lot of pollution in the TRI database tend to have a lower market-to-book ratio than those that don't feature in the TRI database at all. In general, companies with good environmental records tend to have a higher market-to-book ratio and higher capitalization than others.

Now, that correlation between stock market valuation and environmental performance is fairly robust. But if you have done any statistics, you will know that correlation doesn't mean causation. A and B may be correlated, but it doesn't mean that A causes B. B could cause A or they could both be caused by some third factor. So the fact that there is a correlation between stock market valuation and environmental performance doesn't prove that environmental performance causes the stock market valuation to be high. It is equally plausible it goes the other way, right, that rich, successful companies decide that they can spend money on environmental issues.

Another possibility is that neither causes either, but that there is some third factor driving them both, the kind of management. One possibility that I think many people entertain quite seriously is that the kinds of managers who run a company successfully are also the kinds of managers who will be concerned about environmental problems and about social problems and don't want to see their company in the headlines for negative reasons, for whatever, whether they're social or environmental.

So the regression studies which find these correlations between stock market performance and environmental performance are interesting, but they don't give you a clear fix on what is causing what. The interesting thing about that sort of study of the release of the TRI data is that it gives you a fairly clear fix.

DEVIN STEWART: Have there been interview-based studies, interviewing stock market actors or fund managers?

GEOFFREY HEAL: Yes, absolutely. It's interesting. I actually teach a course on this sort of stuff at the Business School at Columbia. This semester I had a guy from Goldman Sachs who runs part of their portfolio operation come and talk about the value of information about a company's social and environmental performance in stock picking. They actually are now very big on this. Goldman Sachs believes strongly that there is a lot of value, just from a strictly stock-picking perspective, a portfolio management perspective, in knowing which companies have good environmental records and which companies have bad environmental records, other things being equal. So there's a correlation between their social and environmental performance and financial performance. So yes, absolutely.

DEVIN STEWART: How are these people, such as the researchers at Innovest—do you know what's inside their model? Do you have any idea?

GEOFFREY HEAL: Yes, I have a lot of idea what's underneath. There are about 15 Columbia graduates working at Innovest. I know a lot about that.

What they do is they take a lot of information about a company's social and environmental performance and try to summarize it into a typical agency rating. They give it a triple-A or a quadruple-A or a triple-B or whatever.

On the environmental side, as I indicated, it's relatively easy to do that. You can get data on how much CO_2 a company emits, its position in the Toxics Release Inventory, what penalties, if any, environmental agencies have levied on it. So you can get data on a company's environmental performance fairly easily.

The social performance is tougher. They measure things like the degree of unionization, the company's attitude towards unionization, whether they permit unionization. They look at issues like turnover, on the assumption that companies that treat their employees well have lower rates of turnover. They look at employee-related lawsuits. They look at things like accidents at work, so what's the rate of workers' compensation claims. And again, the assumption is that if you are treating workers well there will be low turnover, there will be low rates of accidents at work, and issues of that sort.

They pull together all that type of data and they condense it all into a single number. There's a lot of subjectivity that goes into that, but I think they do it as well as they can.

The thing which is hard for them to do is to get, as I indicated earlier, data on companies' subcontractors overseas. So if you want to evaluate Nike—I mean Nike has no production facilities in this country. Everything is technically done overseas. Everything is subcontracted out. It is hard to get really good data on how well Nike's subcontractors treat their employees, what wages they pay, and so on. Nike makes some data available, but how accurate that is—I'm not saying Nike is deliberately distorting; I don't think they are—but how accurate that data is is hard to tell.

There are some really horrifying stories about attempts to monitor wage payments and working conditions at subcontractors in China. It's extraordinarily difficult to do that. There is a lot of evidence that, for example, most Chinese companies that subcontract to Western entities maintain at least two sets of books. They have one set of books which is the real books, which have the accurate numbers in them and show the wages they actually pay and the hours that are actually worked, and another set of books which they show to Western investigators, which have a different set of wages and a different set of hours worked on them, which comply with Western standards—very, very different indeed from the first set of books. If you send an accountant over there to check and they have any suspicion at all that that accountant comes from a Western company, they show him the appropriate set of books. There is a third set of books, of course, which goes to the tax authorities. So there are at least three sets of books. And it goes beyond that.

There have been a number of cases. This has been very clearly established. It is actually very hard, given the best will in the world, to monitor employment conditions at subcontractors in a number of areas.

DEVIN STEWART: You talked about some really fundamental philosophical principles at the beginning of the book. I'd like to touch on a couple of those fairly briefly so we can throw it out to the audience here.

One is the principle of fairness, which is very important here at Carnegie Council, one of our pillars of how we understand ethics. Just going to the last wage example, how do you calculate fair wage? How does that come about?

GEOFFREY HEAL: I actually don't do that in the book, but what I do say in the book is that there are two—Adam Smith came up with an argument, a beautiful argument actually in many ways, that the market is an efficient way of allocating resources. But there are two big shortcomings in the market mechanism. I think that the issues that we are talking about here, and CSI issues in general actually, are very directly related to these big shortcomings in the market mechanism.

One shortcoming in the market mechanism is the existence of external costs, costs that are associated with a transaction that don't fall on either party to the transaction but fall on third parties. Pollution is the classic example, and so is climate change. The Stern Review on the Economics of Climate Change, which came out the year before last, described climate change as the biggest external cost in the history of the world. It actually is very accurate.

If I purchase fossil fuels from you, then there is a transaction between us. But when I burn those fossil fuels, the costs fall on everybody else, but not significantly on either of us. They fall on everybody else through pollution generated and the climate change generated. So that is an example of externalization of a cost. Markets don't work at all well in situations where you've got externalized costs like that. That's why you have a lot of environmental problems with the operation of markets.

The other weakness of markets obviously is that even if they are efficient, they are not necessarily fair. The distribution of income that is generated by a competitive market may be grossly unfair. That's just the way markets work. Now, they reflect the underlying distribution of endowments, and if that's skewed, then the income distribution that comes out will be skewed too.

I think a lot of the issues that we have been talking about are actually closely related to one of these two issues. So almost every environmental problem we talked about, every culprit environmental issue, is connected with externalization of costs, with pollution of one sort or another.

And just about every social issue is concerned at some level with fairness and with the fact that market solutions are not necessarily fair. So, for example, the market solution to employment in third-world countries is very low wages. In the third-world countries you've got excess supply of labor, not much employment, not much in the way of skills, and the market-clearing wage rate is going to be very, very low, a dollar a day or less. A lot of people feel that's not fair, that to have people work 10 hours a day seven days a week for a dollar a day is grotesquely unreasonable, even though it happens to be the market-clearing wage. So there is a conflict between what is economically efficient and what is fair in cases like that.

A lot of these issues we've been talking about, like the Fair Labor Association and a lot of the social dimensions of CSR, really have to do with trying to remedy the inherent unfairness of certain market outcomes.

That's as far as I'll venture into the philosophical—

DEVIN STEWART: I'm glad. You actually did a lot more. I'll remind you about the "invisible hand," which is another topic we might touch upon. Just talking about fairness, this may seem far removed from classical economics, but keep in mind—and you brought this up in the book—that insider trading and other examples of bad behavior that are sanctioned negatively in global economics have fairness ingrained in the origins of these basic principles.

GEOFFREY HEAL: Yes.

DEVIN STEWART: Where do they come from? They come from a sense of fairness, not efficiency necessarily. Interesting.

Going back to the "invisible hand," Adam Smith says if we all act in our own interest, then the overall effect will be beneficial to society. Geoff, you and I were talking about this beforehand. Now, that's to say that the brewer, the baker, and the butcher—those are the three that he uses—if they all just pursue their own interests in feeding their families and keeping a roof over their head, we'll all benefit because we'll get what we need to have a nice meal and be happy. That part of the equation looks at, in my opinion, more at profit maximization. But the other half of that sentence is "it benefits all of society."

Can we analyze corporations by whether or not they are living up to their duty to benefit all of society, that these endeavors shouldn't just necessarily maximize wealth in an isolation chamber, that they are related to society, and whether or not we can ask companies to reexamine the role of a corporation? You had an elegant answer that I'd like you to explain.

I always think that in human history the corporation manifested itself and then sort of forgot what its purpose was and we have to keep reminding it, sort of like Nagarjuna or Thomas Aquinas and the religious studies. But you had a much more nuanced answer, so please.

GEOFFREY HEAL: Well, they are interesting and complicated issues that you are raising there. I mean you certainly could, in principle, carry out what you might think of as a sort of social audit to the corporation, which is rather like a private audit, in that a private audit is an attempt to calculate its true profitability and its true value. The social audit would be to attempt to calculate its true social impact on all the various groups in society.

Corporations have at different points in history interpreted their roles differently in this respect. One that I mention a bit in the book is that if you go back to the 19th century, while there was a lot of very aggressive and very cruel capitalism, there was a small number of quite influential, very enlightened capitalists, Carnegie amongst them, who felt that it was fundamentally important to treat their employees well. That attitude lasted into the 20th century but died fairly quickly in the 20th century.

I guess the last major proponent of that attitude was Henry Ford, who famously wanted to pay all of his workers five dollars a day, which by the standards of the time would have been enough to allow them to buy one of his cars. So Henry Ford's idea was that anybody who worked for him should be able to purchase a Model T Ford—any color, as long as it's black, of course. He was actually sued by some of his shareholders on the grounds that he was paying his employees too much. He was pursued by the Dodge brothers, who went on to found Dodge, on the grounds that he was paying his employees too much. They actually won that lawsuit. It is a very famous lawsuit in the annals of corporate governance. I give some quotes from the judgment on that in the book.

Anyway, there was a period in the 19th and maybe the very early 20th century when there were a number of prominent capitalists who saw it as part of their duty to go as far as they possibly could to improve the working conditions of their employees.

That attitude died away, I think. I haven't really studied this in detail, but my guess is that Ford was the last guy to really embody that attitude. It died away significantly. That was not obviously the attitude in the 1920s and 1930s, and it was not the postwar attitude either.

Big corporations are beginning to go back in that direction a bit for different reasons. Not because it's something they feel ethically they want to do necessarily. I'm not saying that there isn't an ethical element to their decisions, but I think primarily it's because they see it in their own interest to do this. They see that a narrow definition of corporate interest in the long run is probably bad for them and that a broader interpretation—so it's kind of enlightened self-interest, I think is the right term here. They are coming to see that a broad definition of the corporate interest is appropriate.

Someone—I forget who it was, someone I actually invited to talk to my students this semester from one of the corporations based in New York—made the following remark, which I thought was really nice. I don't know whether it was originally his or not. He said, "A company can't succeed in a society that fails." So you need to worry about the conditions you are creating in society if you are running a company.

DEVIN STEWART: I wasn't going to bring up Francis Fukiyama, but I guess I have to now. Just joking. But there is a Hegelian aspect here. Can you view this as a historical phenomenon, where the individual is emerging, where the value is laid, or is it simply, as you put it, enlightened self-interest, where people are realizing it's in their interest?

GEOFFREY HEAL: One of the things which is driving this is the increasing recognition of interdependence. I mean externalities, externalization of costs, is a form of interdependence. Climate change is a manifestation of global interdependence. I think that a recognition that in various ways we all affect each other and all, to some degree at least, depend on each other is one of the things that's behind this, yes.

DEVIN STEWART: Thank you very much Geoff, for taking those tough questions. I'll throw it open to the audience.

QUESTION: I have actually come here from India. What I noticed in your presentation was that a lot of the examples you gave were those of major corporations. This is a question we have always dealt with in the past as well, that it takes the luxury of the rich. Do you find something like this being followed by smaller organizations? In India we have very similar issues, where we have large organizations. They have foundations and they practice ethics. In fact, there are cases of over-compliance.

I myself am involved with a few corporations, good ones registered on Nasdaq as well, like Infosys, et cetera. We have had cases of over-compliance there. But when I am working with the very small organizations which employ 20 or 50 people in their company, the same kind of concern is not expressed very openly. They do their own bit of altruistic activity. But when it comes to environmental concerns and issues, I do find that it is much less than what is articulated openly by the larger corporations.

GEOFFREY HEAL: Yes, it's interesting. I was actually in Mumbai in January at a conference on exactly these sorts of issues, which was sponsored by the Confederation of Indian Industry. There were some interesting speakers talking about CSR-type issues in India.

Obviously, Indian industry has a very strong charitable tradition. A lot of the big, older, established Indian companies have very significant foundations attached to them which do a lot of charitable giving.
On the issue of size, all of the examples I've spoken about are big companies simply because you'll know who I'm talking about. If I talk about some company in Wisconsin that employs 15 people but nevertheless has a great social and environmental record, it's not that interesting. You wouldn't know who I'm talking about. So I focus on big companies because they are the household names, everybody knows them.

All the evidence is this is not a phenomenon that's related to size, that small companies, maybe possibly for slightly different reasons, take these issues seriously as well.

The difference here is not so much size. The principal difference that we find actually in the research that we have done on this is whether companies sell directly to consumers or not. Companies that sell to consumers are much more concerned about social and environmental issues than companies that are in the business-to-business field.

The consumers tend to be worried about the social and environmental impact of a company. They are worried about the company's image. If you are selling to consumers, your brand image matters. It's companies that are selling to consumers that tend to invest most heavily in over-compliance and in CSR-type issues. But within that context they can be small, medium, or large. But that's the main difference we found, business-to-business versus business-to-consumer markets.

DEVIN STEWART: Is it the luxury of the rich, I think was the question, right?

GEOFFREY HEAL: Yes, I think there is some evidence for that. The example I told you about, the case of ABC Homes and Carpets downtown here, that's a shop that caters to relatively rich people. I don't suppose anybody shops in there who has an income of much less than $100,000 a year or something of that sort.

All of the examples I can think of of situations where consumers are obviously willing to pay more for socially and environmentally benign goods are fairly upscale markets. I can give you a lot of examples. They are all markets where you are dealing with relatively affluent consumers.

Now, interestingly enough, one thing which has happened recently is that

Wal-Mart, which is not typically selling to upscale consumers, has decided that it will sell, for example, only certified sustainably caught fish. Wal-Mart has announced that within a couple of years it will sell only fish which is certified as sustainably caught by the Marine Stewardship Council, which is actually quite a serious entity. That will have a huge impact on the fishing business in the United States because Wal-Mart is the largest retailer of fish certainly in the United States and, I presume, therefore in the world.

They have also announced they are going to start selling organic food. Organic food, again, has typically been the preserve of the relatively affluent.

I don't know why they are doing this exactly. I don't think their consumers, their customers, are pressing for sustainably caught fish or for organic food. So I'm not totally clear what is driving Wal-Mart in these moves, but I'm sure it is not a charitable move on their part. I assume they calculated there is some payoff to them from these moves. I'm not quite clear what it is. But anyway, that is an example of a retail operation that is selling to the less affluent which has decided to push ahead on organic and on certified issues. I think that's interesting. I find that an interesting development, if a slightly puzzling one.

DEVIN STEWART: Is Wal-Mart perhaps anticipating that the market will grow?

GEOFFREY HEAL: My theory on that is actually quite a complicated and maybe slightly Machiavellian one. Wal-Mart started as a supermarket in small towns, relatively small towns. That was the whole Sam Walton strategy, was to open up Wal-Mart branches in towns that were thought to be too small to support a supermarket. If you look at their geographic distribution, you will find they are all over the rural parts of the United States but they are not in most of the big metropolitan urban areas. So there is no Wal-Mart in the New York metropolitan area, there is one in the Chicago area, there is none in the San Francisco area, I think there's one in the L.A. area these days. They have been trying very hard to get into those areas because that's where the growth in the market is. The market they are in now is pretty much saturated with them, so if they want to grow, they've got to grow in the metropolitan areas where they don't have a presence.

So they need to do something which will make them more politically acceptable in those metropolitan areas, where to date they have basically been blocked. There was a proposal to open a Wal-Mart in Brooklyn recently. That was blocked basically by Democrats and trade unions on various councils here in the United States. Wal-Mart has a very strongly anti-union position, so that's not surprising.

I think what they are trying to do is do an end-run around that type of opposition by becoming environmentally very friendly and trying to cater to a rather different type of market in the hope that some of the opposition to them will be weakened by that. I'm not absolutely sure. They didn't tell me that. It's just a guess. It's a reasonable guess.

DEVIN STEWART: Sounds pretty reasonable.We have a couple more questions.

QUESTION: I'd like to ask you two questions relating to the United Nations. The first is: In your research on this issue, have you evaluated the United Nations Global Compact, which was set up by Kofi Annan to enable companies to participate in support of four principles: environment, labor, human rights, and non-corruption? That is the first question.

The second question: Tomorrow at the United Nations they are going to be issuing the second anniversary of a Global Peace Index, which has been created by someone called Steve Killelea, who is working very hard now to make the business case for peace as comparable to environmental and social responsibility. I just would be very interested in your comments on that.

GEOFFREY HEAL: The UN Global Compact I think is an interesting development. It's a very positive development.

The issue, I guess, with the UN Global Compact and all sorts of agreements like that is that there is—and I'm not saying this is unique to the Global Compact—that there is very little in the way of enforcement. Technically, there is nothing in the way of enforcement. So it's a group of companies that come together and say, "We will agree to abide by certain principles in our dealings." The principles are so obviously appealing that it would be very difficult to say that you won't abide by those principles.

The question, which I think it is too early to really answer very much, is whether specifically coming out in public and saying, "We will agree to abide by these principles," actually has any impact in the long run on the behavior of the companies. I don't know. I'm not aware of any studies of that, and I suspect that it is probably too early to really be able to call the case on that.

The Peace Index—the business case for peace is enormously strong. As I said before, business can't succeed in a society that fails. That goes for society that is at war too. Certain types of business maybe can thrive. Lockheed Martins and Grummans and so on can do very well out of the Iraq war, but in general disturbances of the peace are enormously damaging to businesses.

But precisely what role businesses can play in that I'm not quite certain. Businesses do have clear social and environmental impacts. The thing which is interesting about the stuff I've talked about is that businesses do have social and environmental impacts and they can take measures to improve those. A business can decide to go carbon-neutral. A business can decide to pay reasonable wages. A business can decide not to pay its CEO too much money. Those are all decisions within its own scope, and they can make those decisions. They are in-house decisions.

Decisions that affect peace I suspect are less directly under the control of businesses. I don't know—maybe I'm wrong on that. I haven't thought about that issue very much, I'm afraid.

The key thing here is to define issues that businesses can control. Businesses do drive environmental pollution. Most pollution is produced by businesses. Some of it is produced by individuals, obviously, but a very substantial proportion is driven by businesses. That's something businesses can control. Wages are paid by businesses, so that's something that businesses can control again. Inequality is under the control of businesses. It's something that we can ask them to look at reasonably. I'm not quite certain that peace is to the same degree.

QUESTION: I have a question about DVDs that are corporate socially responsible in their focus, like *The Corporation* and *Sicko* by Michael Moore. Do you foresee a role in the future for that kind of DVD?

GEOFFREY HEAL: Yes, I do. I mentioned I think the role of NGOs has been very important. I think that what NGOs do is they bring information to light, basically. As I said, you and I as consumers are interested in knowing more about the social and environmental impact of the products that we buy or the services that we buy. It's very hard to find that out. You know, if I go into a shop and I'm thinking of buying something, I typically can't ask the salesperson, "What's the carbon footprint of this?" or, "Where was this made?" or, "Under what employment conditions?" They just genuinely don't know, and it's hard to find that information.

So what NGOs do—their principal role, I think, is as sources of information for consumers who want to be conscientious consumers. I think that Michael Moore and people like Michael Moore can play that same sort of role, do play that same sort of role. Michael Moore goes somewhat beyond that, in the sense that he is critiquing—in that *Sicko* movie you mentioned he is critiquing the entire health-care system and to some degree suggesting alternatives. That is perhaps rather beyond what the typical NGO is doing.

But nevertheless, I think that it is important for people to know what the alternatives are. I think that type of thing is important in that context, yes. I am a tremendous believer in the cleansing power of transparency and information. I think if people are concerned about issues and if they are given enough information about those issues, then I think it puts a lot of pressure on the actors ultimately to behave well. Transparency is a great disinfectant.

DEVIN STEWART: I am going to ask you if you have any prognosis of any effects of some of the financial events going on. The reason is, if you go back to the Equator Principles, as you mentioned, the big signers were Citi, ABN, and Barclays, and there were some non-signers who were still active. Of course, since then Barclays, ABN, and Citi have all taken huge hits on some of our shenanigans, and I'm going to guess that some of the people not playing were related to, let's say, China, who is now very aware of the trillion dollars of reserves and has great interest in African resources and not so much interest in how African countries may govern themselves, and, not only that, but declined in one case to invest in Citi. This week's *Economist* references some expression of disdain for Western financial institutions by some of them.

The scary thought is that the progress of social principles and environmental principles maybe is tied to financial firepower and standing, and now that the shoe is on the other foot, are we facing a shift in paradigm or a real hazard to this? I don't know if you have any thoughts or prognosis or insight at this point, but this is a principle question.

GEOFFREY HEAL: It's a very good question, and I talk about it a bit in the book without actually really answering it, to be quite honest. Yes, that's a big issue.

I mentioned when I talk about the Equator Principles that most major Western banks have now subscribed to them either explicitly or, even if they haven't subscribed explicitly, they follow them. But if you want to carry out an environmentally destructive mining project in Africa, you can get money from a Chinese bank and the Chinese bank will not be too concerned.

It's actually very striking that if you look at Sudan, there are no Western oil companies operating in Sudan now. But there is significant oil production going on there, and that is what is funding the Sudanese government. That is entirely being funded by a couple of Chinese companies and by ONG, which is an Indian oil company. So the Chinese are major investors in Sudan. And of course the companies that are investing there are state-owned companies. There is no real SRI route to having an influence on those companies.

There are a couple of things that are interesting. One is that the Chinese government has shown some sensitivity to that issue in the last few months. I guess that's a result of the Olympics. They have shown some interest in curtailing their activities in Sudan to some degree.

Also, the CNPC [China National Petroleum Corporation] was going to float on the New York Stock Exchange in the late 1990s—and I might be wrong. There are three major Chinese oil companies and they are all a bunch of initials —CNPC, CNO, OOC, and one more—and I forget which is which now. One of the three, the largest, was going to float on the New York Stock Exchange in the late 1990s. Because of its poor environmental record in Africa, because of its record in Sudan, there was strong opposition from Western NGOs. Goldman Sachs, who was underwriting that IPO, actually pulled it completely.

What they then did was create a subsidiary, a wholly owned subsidiary, which was responsible only for their operations in certain parts of the world which were not controversial, and then float that subsidiary. That raised about a quarter of the capital that the original flotation was intended to raise.

There are good and bad aspects of that. The good aspect of that is that it shows that even a Chinese company was subject to a certain amount of discipline for social and environmental reasons by Western capital markets. The bad aspect of it obviously is that they essentially got around this. They raised less money than they originally intended to, but they still did raise quite a lot of money by what amounts in the end to a subterfuge, because clearly the subsidiary is effectively part of the same company from an operational perspective.

I think that is a big issue. I think that as long as these Chinese companies are substantially state-owned and there are no really effective NGOs in China, there will be no way of disciplining them unless they feel increasingly a need to come to Western capital markets. China has so much money that the chances of that I think are fairly small.

So yes, I think that's a real issue. I think one of the frontiers in this whole area now is to get companies from countries like China—and China is the most obvious one, but it is not unique in this respect—to buy into the sort of CSR paradigm more seriously, and that is going to take some doing.

QUESTION: I got here just as you were talking about contingent liability. It seems like the bulk of your talk, although focused on image and reputation—50 percent focused on that I'll say—looks only at reputational risk, of what I've heard. Do you consider the other side, the up-side, the increase in stock value due to some of these environmental and social principles and practices?

GEOFFREY HEAL: I do, yes. There are a number of different aspects of the mechanisms through which companies gain in this area.

One is reduction of the risk of lawsuits. The one you just mentioned is increase in brand value, the value of an image, brand image. I think that's important in the consumer business in particular.

But there are actually quite interesting studies. I mentioned just briefly that one study of the impact of the Toxics Release Inventory data on stock price, but there are actually several other studies.

There is actually quite an interesting study by a couple of guys at Princeton of the impact of SRI funds on pricing of equity. What they do is they take what they call "sin stocks." These are the stocks that just about every SRI fund agrees not to invest in. Those are basically alcohol, gambling, and tobacco stocks. Whatever your particular ethical flavor, you probably don't want to invest in alcohol, tobacco, and gambling. So those are probably the most widely boycotted stocks of all.

What they do is they try to study whether the fact that there are so many SRI-type funds boycotting these stocks has an impact on their prices. It's a long and complicated study, but the answer is yes, they find that those stocks are very significantly undervalued relative to what you might expect based on their profitability, the variants of profits, the covariants of profits, with the rest of the market, and a bunch of things like that.

They also find, interestingly, that in the corporate debt market there is no such effect, that SRI funds operate in equity markets but not in debt markets. So the corporate debts of these companies are not undervalued. Consequently, it is much cheaper for them to raise money as debt rather than equity, and they are all very highly leveraged, which is really quite interesting. So that is an interesting study of the impact.

I found that, talking to chief financial officers of big corporations, they are actually very conscious of the impact of these issues on their share prices. It's something that seems to worry them a lot. For example, a lot of big corporations go to considerable lengths to be listed in the Dow Jones Sustainability Index or the FTSE 4 Good Index. If you ask them why they do that, they are actually quite convinced, although they have great difficulty providing real hard evidence on this, that it is good for their share price and it reduces the cost of capital to them, and good for the share price makes it less likely they'll be bought out by opponents, bought out by private equity, easier to raise money, and all that sort of stuff. So there's a whole bunch of reasons why they're interested in that.

DEVIN STEWART: Carol, I have to plug your piece. Carol Holding actually wrote a great piece for Policy Innovations on this very topic, and I recommend you check it out, the impact of CSR on brands.

QUESTION: I'm interested if you found differences between environmental and social behaviors. Dave Vogel wrote a book, called *The Market for Virtue*, and he argues the elasticity for doing good things is really thin; you get really banged for doing bad things, but you don't get a lot of bang for your buck for doing good things.

The environmental argument is easy because, as you argue in your book, if Wal-Mart increases the fuel efficiency of its 7,000 trucks, that goes right to the bottom line. But on the social side, if Wal-Mart allows unionization to occur, that's also going to go to the bottom line but not the side that they prefer.

GEOFFREY HEAL: Right.

QUESTIONER: So it seems to me like there is a very different instrumental issue when you look at social versus environmental actions by firms. I was wondering if you saw that.

GEOFFREY HEAL: I think that's correct. One of the things a couple of colleagues and I did, was we took this data from the companies I mentioned earlier, Innovest and KLD Research Analytics, and for each company that they deal with, which is I guess about 5,000 or 6,000 listed companies that are in the universe of both, we constructed an environmental performance index, what we called a labor performance index, which dealt with how they treat employees, labor turnover, unionization, stuff like that; and a community index, which deals with support for community events and community systems in one way or another. Then we looked at the correlation between these indices across companies.

It was actually very low indeed. So a company can be great on environmental issues and appalling on labor or social issues, or great on social issues and appalling on environmental issues. Wal-Mart obviously is a good example. It scores rather high—actually, I think some group rather recently voted Wal-Mart the greenest company in the United States—so it scores quite high on environmental performance, but it scores low obviously on labor-related issues.

That was actually something that quite surprised us. We had this vision of companies being sort of uniformly benign across these things. But obviously companies in fact don't operate like that. They consciously or unconsciously are making a choice to decide that social or environmental issues are more important to them and responding on those.

As you say, it's easy to measure the impact of environmental performance. Social performance is much tougher to measure itself in the first place, and it's harder to measure its impact.

I have done some work with colleagues on the impact of social performance on market-to-book. We do find a positive impact there, but only for companies that have a very high ratio of advertising-to-sales spending. So in other words, companies which advertise heavily tend to benefit in terms of valuation from having good social performance, which I think really emphasizes the point about the value of brand and the fact that CSR is playing into the value of a brand.

Indeed, you look at this, and one of the things that does I think come out of some of the studies is that CSR, a company's social and environmental performance, is an important determinant of its brand, the value of its brand, and how consumers see it. I think for Starbucks, for example, this is part of its branding strategy quite consciously. I think Starbucks deliberately tries to build its brand image around this. I think other companies are increasingly doing that too. I think Toyota has to some degree done that in the hybrid area and within the green vehicle space. So yes, I think that is important.

I can send you, if you give me a card, a statistical paper, what we got on this social stuff. It's much harder to deal with than the environmental because it's so squishy and so subjective to get these measures together. But I'd be interested in your comments on it.

DEVIN STEWART: I think this is a success. We have actually forged some relationships here and continuing work to do. That's great.

I want to thank Geoffrey Heal for coming by. Again, the book is *When Principles Pay*. Last but not least, this event was in cooperation with Columbia Business School, and we hope to cooperate further.

Thank you very much.

Related Resources:

- When Principles Pay: Corporate Social Responsibility and the Bottom Line (Video)
- When Principles Pay: Corporate Social Responsibility and the Bottom Line (Audio)

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