The Multi-stakeholder Operating System and CSR

by
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Traditional metrics for conducting socially responsible investment analysis have become inadequate. Investors need both more and different kinds of information than in the past to balance risk with potential gain.

The recently construed "triple bottom line" performance analysis construct is a big complicating factor. The triple bottom line serves as a report card on three categories of corporate performance: *people, planet, and profits* – or the "Three P's" of investment analysis. Each category is separately analyzed, then integrated with the others to create a single holistic picture of a company's performance profile now, and prospectively.

Getting a credible picture from Three P's performance analysis is a formidable challenge. No broadly accepted standards exist to guide the process. Linking a company's performance in the people and planet categories to its profitability performance has involved more subjectivity than traditional investment analysis would normally tolerate.

For instance, consider a company that enjoys a strong positive reputation for being a good corporate citizen. A legitimate question from an investor's perspective is, "How much does this contribute to growth and profitability?" Advocates for the company might *feel* that its corporate citizenship practices account for some increment of growth and profitability. However, unless a company has bothered to build a causal model and communicate the output from the model, the reality is that no one really *knows.* Thus, the task of linking companies' social responsibility profiles to their financial performance tends to be more subjectively determined than the product of statistically rigorous analysis.

We see little value to investors in analyzing company performance based on the tenets of "corporate social responsibility" (CSR) as they are now widely discussed and debated. In our view, CSR has worked against the development of generally accepted standards for assessing Three P's performance. The reason is CSR has its roots in moral philosophy, an unsuitable platform for investment analysis.

Too many conflicting opinions exist concerning right and wrong in corporate behavior to make moral profiles a mainstay of investment analysis. What one person might feel is unfit corporate behavior, another might justify as a fully legal and ethical practical response to real world conditions.

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> *– R. Edward Freeman, Professor of Business Administration* at The Darden School, UVA

Edward Freeman, Darden Business School professor of ethics at the University of Virginia has come out solidly against CSR. Freeman, who can be rightly called the intellectual father of the multi-stakeholder operating system, has written:

> "The idea of corporate social responsibility has failed to help create the good society. Long seen by academics and managers alike as the missing link in capitalism, the concept of corporate social responsibility has not delivered on its promise. Furthermore, it has become a barrier to meaningful conversations about corporations and the good life. Corporate social responsibility, in all of its many masks, has outlived its rather limited useful life, and we call for its immediate demise."

Where socially responsible investing fits into the picture

The *socially responsible investment* (SRI) movement is an ideological companion of CSR. The SRI movement grew out of the market for investment opportunities that allowed people to avoid owning shares directly or indirectly in companies they viewed as poor corporate citizens. These more moralistic investors naturally want good returns on their investments. However, SRI has a mixed record on that score. Some funds generally do quite well, while others underperform index funds.

By comparison, the list of companies that lack enviable corporate citizenship reputations, but have done exceedingly well by investors is long. Take Altria for an example. It's ownership of cigarette maker Phillip Morris has made it off limits in the SRI community. Yet, Altria has a solid history of rewarding shareholders well. Notably, Phillip Morris was one of the 11 companies Jim Collins used to make his points in *Good to Great*, the best selling business book of the past decade.

As a matter of deeply engrained principle, we do not take our investors into companies that we deem socially irresponsible. However, the decision to invest in a company is not based on its moral profile. A blemished CSR reputation may bar a company from consideration, but a sterling record in CSR does not guarantee inclusion in our candidate universe. The biggest influences on our screening decisions are the extent to which a company embraces the multi-stakeholder operating system. A platform based on the subjective nature of moral beliefs affords a less steady foundation for a company's operation than a pragmatic operating system that ultimately reflects moral sensibilities. In this view, moral results become side effect outcomes, not objectives.

Getting beyond the fallacy of balancing stakeholders' interests

Supporters of multi-stakeholder operating systems often extol the virtue of *balancing* stakeholder interests. They believe companies should operate in such ways that one stakeholder group does not gain at the expense of other stakeholder groups. But that is unrealistic. Further, it would be counterproductive to meeting growth and profit objectives.

The idea of “balancing” stakeholders’ interests is a moral precept. It’s totally lacking in strategic value, not to mention practicality. Stakeholders’ interests cannot be balanced because stakeholders are not all equal. Both their contributions to a company’s success and the benefits they derive from a company are wide-ranging variables that resist the neat quantification and equalization implicit in the idea of balancing interests.

We view the practice of *aligning stakeholders’* interests quite differently. Aligning stakeholder interests means getting stakeholders working together in pursuit of their own and the company’s objectives. Alignment enables stakeholders to leverage their relationship with other stakeholders to gain the greatest possible advantage from their relationship with the company. Alignment shifts the supply/demand equation from the classic win-lose construct in stakeholder relationships to a double win construct.

A lesson in stakeholder alignment

The remarkable story of 30-year-old Blake Mycoskie illustrates the win-win advantages derived from aligning stakeholder interests.

On a visit to Argentina in 2005, Mycoskie took to wearing *alpargatas* – resilient, lightweight slip-on shoes with a breathable canvas top and soft leather insole traditionally worn by Argentine workers. He liked the shoes so much he decided to set up a new shoe business based on the *alpargatas* style. He would call the new company Toms.

Toms was to be a different kind of shoe company. Mycoskie says, “Inspired by a traditional Argentine shoe and challenged by the continent’s poverty and health issues, I created Toms with a singular mission: To make life more comfortable. Toms accomplishes this through its unique shoe and my commitment to match every pair purchased with a donated pair to a child in need…no complicated formulas, it’s simple…you buy a pair of Toms and I give a pair to a child on your behalf.”

In business only since June 2006, Toms has placed shoes in hundreds of stores across the U.S. including Nordstrom, Urban Outfitters and Bloomingdale’s.

How does this story illustrate the principle of aligning stakeholders' interests? Let's start with the stakeholder that most interested Mycoskie—poor children in Argentina. He could have helped them the old fashioned way by allocating some of his profits to outfitting poor kids with shoes. Instead, he leveraged his relationship with shoe customers who would get more satisfaction from buying a pair of Toms shoes than just from the shoes themselves.

Consumer trend surveys have reported a significant up tick in altruistic behaviors in all age groups since around the mid-1990s. Toms taps into that phenomenon. Giving shoe-buying consumers the opportunity to serve others in the course of serving themselves is an example of aligning stakeholder interests. Mycoskie has aligned the interests of poor children with those of customers wanting to add meaning to their lives by helping others.

Mycoskie's business model results in lower marketing costs than experienced by competitors. (AT&T has featured Toms in its advertisements.) Customers embrace Toms almost as a cult. Their enthusiasm prompts them to tell Toms' story everywhere. Retailers like Nordstrom, Urban Outfitters and Bloomingdale's have signed up for Tom's mission. They benefit by having a more human face on their retail operations. Toms has brought their interests into alignment with those of shoe customers and poor kids in the slums of Argentina.

One might laud Mycoskie for his socially responsible approach to business, but Tom's success owes more to the alignment of stakeholders' interests than to expressions of corporately moral behavior. Mycoskie created a company, endowed it with a particular culture and began creating a community around the culture. He has now enlisted thousands of people to help make Toms a success.

Four months after opening for business in June 2006, Mycoskie headed for Argentina with a couple of dozen volunteers to make his first delivery of 10,000 pairs of shoes. Since then, many customers have expressed an interest in volunteering for future shoe give-away missions. So Mycoskie set up a travel service to accommodate them. For $2,000 volunteers can sign up for two days of sightseeing and four days of giving shoes away.

The secret of Toms success ultimately lies in the successful creation of communities of stakeholders. The more tightly bound together stakeholders are, the stronger their loyalties to the sponsoring company. This loyalty in turn is a strong indicator of a company's future performance capacity.