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Strategic Leadership in Corporate Social Responsibility

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According to United Nations, "Corporate Social Responsibility (CSR) is a management concept whereby companies achieve a balance of economic, environmental, and social imperatives while at the same time addressing the expectations of shareholders and stakeholders."

Simple profit-maximizing firms face a trade-off: adapting a good CSR technology serves the common good but lowers profits.

At the 9th Annual Conference of the Asian Bureau of Finance and Economic Research (ABFER), Rui Albuquerque (Boston College) and Luís Cabral (New York University) presented their paper titled Strategic Leadership in Corporate Social Responsibility that shows how CSR can help the shareholder-value maximizing firms solve a strategic dilemma and earn higher profits by unlocking a new equilibrium that is Pareto superior.

In their paper, the authors study the optimality of the stakeholder model (the CSR model) from the perspective of agents that care about shareholder maximization.

The authors first conceptualize how profit-maximizing firms choose their technology in a one-stage game. In the usual setting, firms decide in isolation whether to stay with their legacy technology or switch to an environmentally friendly technology. The former emits more pollution, but the latter has a higher marginal production cost. A firm will lose competitiveness if other firms do not switch. Consequently, all firms prefer to stick to their legacy technology. But, this outcome is sub-optimal: because if all firms choose to switch, no single firm has a cost disadvantage, each individual firm may see profit increase while the world would actually benefit from much less pollution. This no-switching outcome is known as the Pareto sub-optimal non-cooperative equilibrium in a Prisoner's Dilemma game setting.

The authors propose a two-stage game setting. In the first stage, firms choose an objective function – to adopt CSR or not, while the second stage corresponds to the choice of some strategic variable. This setting makes the first stage a coordination game: If firms can commit to and reveal that they choose the environmentally friendly technology, no firm faces any inherent production cost disadvantage, and the world is better off. The idea then is that if a firm can move ahead of its competitors in the first stage, its CSR commitment induces its competitors to follow, which is a Pareto Superior outcome.

The key in this setting is that a market leader can commit to being environmentally friendly and make it known to its competitors. However, only if other firms also commit to adopting environmentally friendly policies would the market leader move to the second stage, in which firms implement policies. The authors bill the idea as "strategic leadership" in CSR.