Rebuilding Corporate Leadership:
How Directors Can Link Long-Term Performance with Public Goals

A Statement by the
Research and Policy Committee of the
Committee for Economic Development

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All CED policy recommendations must have the approval of trustees on the Research and Policy Committee. This committee is directed under the bylaws, which emphasize that “all research is to be thoroughly objective in character, and the approach in each instance is to be from the standpoint of the general welfare and not from that of any special political or economic group.” The committee is aided by a Research Advisory Board of leading social scientists and by a small permanent professional staff.

The Research and Policy Committee does not attempt to pass judgment on any pending specific legislative proposals; its purpose is to urge careful consideration of the objectives set forth in this statement and of the best means of accomplishing those objectives.

Each statement is preceded by extensive discussions, meetings, and exchange of memoranda. The research is undertaken by a subcommittee, assisted by advisors chosen for their competence in the field under study.

The full Research and Policy Committee participates in the drafting of recommendations. Likewise, the trustees on the drafting subcommittee vote to approve or disapprove a policy statement, and they share with the Research and Policy Committee the privilege of submitting individual comments for publication.

The recommendations presented herein are those of the trustee members of the Research and Policy Committee and the responsible subcommittee. They are not necessarily endorsed by other trustees or by non-trustee subcommittee members, advisors, contributors, staff members, or others associated with CED.
CED’s interest in the interaction and interdependence of business and society and the development of more socially conscious corporate leaders started with its founding in 1942. CED policy statements on corporate governance issues since 2006 have analyzed first, how corporations could regain the public’s trust in the wake of corporate scandals and compensation unrelated to performance, and second, how corporate directors could promote the long-term enduring qualities of their enterprises rather than give in to financial market “short-termism.”

This report examines how these efforts to build public trust and long-term value have coalesced to encourage many large, global corporations to pay greater attention to their longer-term interests by striking a balance between short-term commercial pursuits and such societal concerns as the environment, labor standards, and human rights. Many companies have also found ways to turn such concerns as the effects of climate change and other environmental damage into profitable commercial opportunities. This report also explores how all corporate boards could take a more active part in considering such issues and improving the reporting of financial and non-financial measures of corporate performance broadly conceived.

The recommendations of this report are offered to stimulate debate within the corporate community. Our intent is not to call for specific change but to encourage corporate leaders to contemplate our recommendations and adapt them to their unique circumstances. In accord with this purpose, companies identified in illustrative case studies in Chapters 4 and 5 were asked if they wanted to correct any factual errors or provide a short statement or comment related to the issues. ExxonMobil Corporation’s statement can be found at the end of this report (page 55) and in footnotes on pages 37-39. We are grateful to ExxonMobil for their cooperation.

This report and our two previous reports taken together give a comprehensive and up-to-date survey of the potential contributions of boards of directors to improving overall corporate performance. Empowered boards can ensure that corporate strategy builds lasting value by addressing key shareholder and societal concerns. In our view, directors could do more with their current authority to motivate managements to greater innovation, and to support managements in finding long-term value solutions to the numerous economic and societal pressures they face.

Acknowledgements

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Rebuilding Corporate Leadership: How Directors Can Link Long-Term Performance with Public Goals

Executive Summary

The financial crisis, which became evident in September 2008, transformed U.S. financial markets and provided a painful reminder of the conflict that can occur between private-sector actions and public goals. A root cause of the crisis was the excessive risk taken by almost all market participants—corporate executives, money managers, rating agencies, investment intermediaries, bankers, and investors—to achieve short-term results that temporarily benefited their businesses and themselves at the expense of their own long-term interests and those of their shareholders, employees, other linked businesses, and the nation as a whole. Of course, government regulators, some home buyers, and others who overextended credit purchases also share responsibility.

Although the crisis started in the financial services sector, our focus in this report is not on financial services or capital markets as such. Our focus is on corporate governance and the vital role directors can play in mitigating the types of pressures that created the crisis. “Rebuilding Corporate Leadership” is best understood in the context of our previous reports on regaining public trust in the wake of Enron and other scandals and how corporate directors could promote the enduring qualities of their enterprises.*

It is clear to us that the underlying patterns of behavior—rooted in short-sighted and self interested behaviors—exist across all industries. A well-functioning board can govern the corporation and its management by supporting a CEO who is doing the right thing for the sustainability of the business, while checking the excesses and other mistakes of one who is overly short sighted, self interested, or conflicted.

Starting in 2002, the CED Subcommittee on Corporate Governance and Capital Markets has met to propose ways by which to restore confidence and trust in American corporations and their leaders by encouraging enlightened statesmanship in accounting, corporate governance, other board and management practices, and, as important, the strategic thinking of corporate leaders. Public corporations are the driving force of the U.S economy. They are the core of a system unsurpassed in creating jobs, income, and wealth, and in delivering a wide choice of goods and services. Corporate leaders should understand it is in their self interest to engage responsibly with the society around them. They must find an appropriate balance between generating short-term profits and building for the future, because sustainable profits come only from long-term investment and strategy.

This statement is meant to promote discussion; its recommendations are advisory. We encourage corporate leaders to put the long-term health of their enterprises at the forefront of their numerous priorities, by paying greater attention to how their business strategies interact with the societal environment that shapes their corporations’ long-term performance and sustainability. Aligning the interests of the corporation and its shareholders with the long-term interests of society will generate vibrant and successful entities that will help to regain the public’s trust.

Our focus is on the potential contributions boards of directors can make to improve corporate strategy and long-term performance. Directors generally have been reluctant overseers of their corporations. Before the corporate scandals associated with Enron, WorldCom, and others, directors too frequently deferred to “imperial CEOs.” The Sarbanes-Oxley Act and other reforms put greater emphasis on the responsibility of independent directors to counter the CEO’s inherent power. But many directors have interpreted those reforms solely in terms of fiduciary loyalty to shareholders and, consequently, to the maximization of short-term share value, despite the diversity of shareholder interests and the transitory membership of that group. For many

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*Private Enterprise, Public Trust: The State of Corporate Governance After Sarbanes-Oxley; and Built to Last: Focusing Corporations on Long-Term Performance
directors, the daily share price has come to represent the success or failure of a board’s ability to represent shareholders’ interests. But shareholders will not prosper long when other groups linked to the health of the corporation—broadly, society—do not also thrive.

Directors have a legal obligation and duty to address the long-term performance of the corporation. Directors’ fiduciary duties include broader societal concerns that affirmatively affect the corporation’s performance and long-term sustainability. To meet that duty, directors must consider the concerns of all—not just current shareholders, managers, or other powerful constituents—who are in a position to affect a company’s long-term performance. In today’s environment, boards must know that they are empowered to reject actions that produce only short-term financial results at the expense of the long-term interests of the corporation. Compensation policies, for example, should not be designed to promote purely short-term share price enhancement.

Many corporate leaders—directors and CEOs—have found that a principled, long-term view fosters greater appreciation of the interdependence between the corporation and the society in which it operates. These individuals are leading the development of business strategies that take account of societal challenges as a means to ensure their corporations’ and society’s long-term prosperity. Although many boards remain behind the curve, a number of forward-thinking directors seem willing if not eager to consider shareholder resolutions that encourage action to abate climate change, disclose environmental risks, or incorporate human rights best practices. As important, some are speaking out to urge U.S. political leaders to repair their broken systems so they can begin to solve long-term societal problems that hamper business as well as society’s other constituents. But too few business or political leaders are following these paths, and talk about business and society interaction far outpaces action.

Our central conclusion is that corporate boards and the leaders they select must integrate relevant societal concerns, such as environmental and human rights considerations, into corporate strategy to strengthen long-term competitiveness and the sustainability of both the corporation and the society in which it exists. A successful framework requires that societal and business leaders view and treat each other as partners, not adversaries. Their actions and public communications should recognize their interdependence and shared goals.

**Recommendations**

This report is addressed primarily to America’s corporate directors. Individual directors and the boards they compose can make an enormous difference by motivating management to identify and execute long-term value solutions to the economic and social pressures their businesses face.

In summary, our major recommendations are as follows:

- The board of directors has ultimate responsibility for the performance of the corporation. Directors have an obligation to act as stewards of the corporation’s long-term economic health. They should widen the purview of their deliberations to give weight to societal issues that impact the firm’s longer-term performance. (p. 26)

- Our basic recommendation with regard to societal issues is not a “one-size-fits-all” solution. As each corporation is unique, each will have unique societal issues that may impact its performance. These should be the board’s concern. Our recommendation is simply that boards should play an active role in encouraging company management to evaluate the options available and to decide explicitly what it ought to do, based on sound business grounds that incorporate a longer-term view. Once a decision has been made and justified, the board should monitor implementation and continue to evaluate the company’s strategy on the basis of long-term costs and long-term benefits. (p. 32)

- Directors regularly should consider how the company plans, manages, and communicates its interaction with society. The board should insist that management report regularly to it and to the public on non-financial performance, including social performance. To institutionalize the process, the board may want to establish a special committee or empower its governance committee to take responsibility for oversight. That committee should report to the full board and appear regularly on its agenda. (p. 28)
• Directors should recognize the value of corporate communication with shareholders and the public on issues that bear on the company’s reputation and brand value, even when such communication may not be required by regulation or fit neatly into financial disclosure formats. Boards that have a non-executive chair or lead director may want to consider a communications role for that person on such issues and topics. (p. 32)

• Directors should promote honesty in reporting not only on financial results and other non-financial aspects of their company’s operations, but also on the risks, opportunities and results of its social interactions. Such reporting should show how the company evaluates the long-term impact of potential costs and benefits. But aside from mandated environmental and labor reporting to government regulatory agencies, corporate “sustainability” reporting should remain within the purview and at the discretion of individual companies (as they exercise their responsibility for honest and full communication with shareholders). Directors should use their authority to help their companies find a firm-specific way to communicate effectively with shareholders and the public—through the regular annual report to shareholders, in a separate public report, or in some other way. (pp. 33-34)

• The CEO is mainly responsible for carrying out the board’s directions. When choosing a CEO, the board’s selection committee should be mindful of the role that person will play in setting the tone and direction of the company with regard to ethics, integrity, and engagement with shareholders and other interested parties. Boards should tie a portion of CEO and senior management’s performance compensation to metrics based on the corporation’s performance on such concerns. (pp. 28 and 29)

Interdependence of Business and Society

The current paradigm that shapes the way that many business and political leaders and the general public think about the relationship between business and society is overly narrow and oppositional. This convention views the role of business solely as the maximization of profits. While those engaged in business understand the good that comes from the profit motive, many in the public and in politics see the pursuit of profit as feeding individual greed at the expense of society. They perceive private and public interests to be engaged in a zero-sum contest for resources and power. The recent turmoil and government intervention in financial markets has exacerbated these perceptions.

Our preferred framework recognizes that the interests of society and business are not mutually exclusive: they are interdependent; their goals are linked; and they should be seen in positive-sum terms. Our society depends on corporations to innovate and invest, thereby improving living standards, creating jobs and wealth, and providing social goods. Corporations, too, depend on society. At the most fundamental level, society establishes and secures property rights and provides the environment in which businesses can exist. An excellent and equitable education system is needed to provide a productive and innovative workforce. Intelligent policies towards land, water, energy, transportation, communication, health care, and other concerns are needed to sustain the environment, improve commerce, and maintain a vibrant society. An effective and equitable system of justice keeps all parties productively engaged in the pursuit of the common good and protects property and other economic rights. It is without question in each corporation’s interest to sustain the society in which it operates.

We recognize that there are practical limits to any corporation’s ability to fulfill societal needs—individual companies cannot do everything. Neither can they ignore their profit-making responsibilities. Surely government must play a prominent role in setting the public agenda and rules of fair competition that support, rather than undermine, far-sighted business statesmanship (as discussed below).

Yet, failure of corporations to shift to an approach—based on substance, not image—that recognizes their interdependence with the societies around them will further increase public cynicism toward business, erode society’s already diminished trust in, and support of, corporations and their leadership, and invite more burdensome regulation. Such results are in the interests of

* Of course, these need not be the same reports, but public reporting must be truthful and easily understood.
neither business nor society. Society overall is already poorer and less able to address its needs because business has not been sufficiently engaged in helping to find solutions to problems culminating in the late-2008 financial crisis. Business risks losing its “license to operate,” imperils its access to needed physical, human, and financial resources, and invites ever greater scrutiny and more stringent regulation through excessive attention to short-term self interest.

The Role of the Board of Directors

Boards should spend more productive time considering long-term sustainability, which means finding practical ways—through production, research and development, investment, marketing, communications, human resources development, and other processes—of carrying out a strategy that includes the interaction between the corporation and society.

Many directors are uncertain about the validity of societal and other non-shareholder concerns and how such concerns interact with corporate performance. But recent research indicates that how a corporation engages societal issues is a significant factor in a company’s performance. Investors and analysts are increasingly using such evaluations to allocate capital. That does not mean that other corporate constituents any more than shareholders should determine company policies; that social considerations should trump hard-headed business analysis; or that the corporation should be viewed as an arm of government or an instrument of social policy. It does mean, however, that boards must pay greater attention to how societal concerns affect the corporation while continuing to keep an eye on traditional financial criteria.

Boards are uniquely positioned to make sure that the long-term interests of the corporation are not lost or sacrificed to the pressures of daily business activity. Successful boards will help the CEO to balance short-term and long-term goals. Boards can serve as a buffer between the CEO and market forces that make unhealthy short-term practices difficult to resist. They should support—and protect—CEOs and other senior managers who take the long-term view.

Because each corporation has a stake in the health and welfare of the society in which it operates, its directors cannot afford to ignore that social environment. Nor can they ignore the welfare of key groups, such as employees, whose interests bear on the wealth-creating potential of the corporation.

Additional Considerations

In the course of our deliberations, we examined several related critical issues.

First, we examined some practical cases where corporations have had to confront directly environmental and human rights issues. The examples we analyze, in the oil industry with respect to climate change and in internet technologies with respect to human rights, illustrate the difficult problems companies face and the types of responses they have developed. These examples demonstrate that companies cannot avoid confronting hard questions regarding environmental, human rights, and other societal concerns, and that no one answer fits every circumstance. Whether decisions are made after considerable deliberation or in the heat of a moment, business decisions that intersect with societal interests can reverberate in unexpected ways. The importance of such decisions both to the society in which a business operates and to the business itself should command the attention of corporate directors.

Next, we addressed the question of whether privately held corporations that are owned by private equity companies face the same societal pressures as their publicly held counterparts. We found, unsurprisingly, that the actions of private firms are subject to the same market forces and bound by the same social considerations (including government regulation) as large, public corporations. Of course, private-equity-owned firms differ from public corporations on a number of accounts: disclosures, access to funding, executive compensation, shareholder/ownership rights, and investors’ liquidity, to name a few. But these differences neither protect private firms from market competition nor free them from exposure to societal concerns. In fact, like their public counterparts, market forces, pressure from non-governmental organizations, and “enlightened self interest” work to nudge some of these private firms toward a more operational and sustained integration of social issues with company strategy. Others, of course, remain resistant to change or fly under the radar of social monitors.
We conclude that both publicly held and private-equity-owned businesses must become more adept at incorporating societal concerns into strategic frameworks and business plans. For private firms, which currently are not compelled to disclose as much information as public firms, greater voluntary disclosure of their activities might serve as a starting point.

Finally, what is the proper division of responsibility between business and government? Shouldn’t governments take primary responsibility for addressing societal concerns?

Government plays many economic roles in market capitalist systems. Among them are: promotion of macroeconomic growth and stability; maintenance of social equity in the distribution of income; and regulation of market competition. Most relevant to the issues addressed in this report, governments generally supplement markets by providing public goods and compelling private entities to account for the costs they impose on society—the two primary concerns that corporations are increasingly called upon to address.

Clearly, government must establish and enforce social policies in these areas. Normally, the business role is to obey local laws and regulations. But laws and regulations typically set minimum standards. Many businesses, especially global corporations, often exceed these minimum standards. In advanced economies, like the United States, the pressure to exceed regulatory minimums is strongest when it appears that government policies lag behind societal attitudes. For example, U.S. environmental policy, to many observers, has not caught up with societal concerns about the risks of climate change.

In the U.S. context, a lack of trust in political institutions undermines social progress and shifts public demands from political leaders to business leaders. A better outcome would be one where political institutions could be relied upon to address intelligently public concerns and close the gap between social expectations and government policies. Elsewhere, CED has addressed the problem of Washington’s broken policy process. Our conclusion and recommendation, adapted from that analysis, is that political leaders should understand the costs they impose on business and society at large if they do not take action to improve political governance and policymaking. They need seriously to address reforms in ethics, lobbying, redistricting, earmarks, and other legislative procedures and executive practices to break the logjam holding back policy reforms in substantive areas such as global climate change.

We also reiterate conclusions and recommendations from CED’s previous policy statement on government regulation. That analysis pointed to what some now term “smart regulation,” which draws from an array of ideas linked to performance-and principles-based regulation. Smart regulation seeks to strike an appropriate balance between flexibility and efficiency, relying more on markets than on commands.

Conclusion

CED was founded by a group of business statesmen who had strong views on the direction of public policy and the role of the business community in helping to advance our society as a whole. A key, if not critical, contribution of the business community to overcoming societal problems may lie not only in individual corporate policies but in business statesmanship—the willingness of business leaders to speak out on pressing public concerns, such as unsustainable cost increases in federal entitlement programs, the lack of universal health care, environmental damage from climate change, and the threat to human rights.

It is not an either-or choice. U.S. business leaders should consider both how their business strategies interact with societal issues and how they personally can make a difference by supporting sound public policies that address society’s key concerns.

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* “Washington Is Broken” So What Are You Going To Do About It?
† Modernizing Government Regulation: The Need for Action
Public, for-profit corporations perform a highly important societal function—they create jobs that provide income and wealth to elevate living standards better than any other known mechanism. But CEOs and corporate directors increasingly face myriad additional demands to extend their success to other areas of societal concern. Shareholders, regulators, government agencies of all types, consumers, employees, non-profit organizations, ratings agencies, and other constituencies expect CEOs and directors to do much more than take (prudent) risks to grow profits and act within legal constraints. Rather, they expect ethical behavior and transparent operations that respect environmental, societal and corporate governance concerns, and a host of other financial and non-financial objectives. Balancing these expectations has never been easy. In recent years, excessive compensation, exorbitant severance payments, and other forms of short-sighted and self-interested behavior have poisoned the public’s opinion of business and business leaders. The financial crisis of 2008 has further lowered the public’s regard of business.

One of the great strengths of the corporation and of successful corporate leaders has been the ability to adapt to ever-changing circumstances. Today, as corporations become more global and increasingly operate in geographic areas with different, often conflicting legal regimes and social norms, demands of corporate constituencies—transmitted through resource (capital and labor) and final-product markets, government regulation, and public forums—motivate more than ever corporate leaders to consider these pressures and embrace public goals to bring the forces of corporate enterprise to bear on public problems.

The problems faced by society—whether local, national, or global—also necessarily confront businesses, which exist within and are part of society. Environmental problems throughout the world affect living standards and constrain activities once taken for granted. The increasing scarcity of critical resources, such as clean water and energy, limit choices for both consumers and producers. Producers face greater legal and market constraints because consumers and citizens are more sensitive to how things are produced—the conditions under which workers labor, the types of chemicals and materials used, and even the method of production. As important, the seeming inability of political systems, in the United States and virtually everywhere else, to address these concerns meaningfully creates social conditions that impede economic growth generally and make business decisions much more difficult for individual firms.

This study examines:

• How these conditions, as reflected by the various demands of shareholders and others, affect corporate strategy;

• What actions corporate directors could take to promote the identification and inclusion of societal concerns into core business strategies, consistent with the goal of maximizing long-term value;

• Whether constituency demands and societal concerns affect public and private corporations differently; and

• Where the limits may be between private, voluntary actions of corporations and the responsibilities of governments.

The Context of Recent Events

In fall 2008, financial markets in the United States and other parts of the world fell into a crisis that saw in quick succession the collapse of some of the nation’s top financial institutions and an unprecedented $700 billion appropriation designed to stabilize credit markets and recapitalize remaining financial institutions.

The crisis is a painful reminder of the conflict that can occur between private-sector actions and public goals. A root cause of the financial crisis was the excessive risk...
taken by almost all market participants—corporate executives, money managers, rating agencies, investment intermediaries, bankers, and investors—to achieve short-term results that temporarily benefited their businesses and themselves at the expense of their own long-term interests and those of their shareholders, employees, other linked businesses, and the nation as a whole. Actions by public officials charged with regulating private-sector conduct, particularly in the financial sector, also played a significant role in the crisis.

This “short-termism” took different forms in different parts of the economy, but it was pervasive. In financial services, excessive leverage and a classic mismatch between short-term liabilities and long-term investments were at the core of problems obscured by a blizzard of complex financial paper. In housing, myopic greed of borrowers and lenders created bad loans that could be justified only by looking beyond the very short-term through rose-colored glasses. Elsewhere, in manufacturing for example, many firms focused more on their quarterly earnings-per-share number than they did on investing in research and development (R&D) and worker training, which underlie long-term performance.

Although the crisis has been centered in financial services, our focus in this report is not on that sector or on capital markets as such. Our focus is on corporate governance and the vital role directors can play in mitigating the types of pressures that created the crisis. It is clear to us that the underlying patterns—rooted in short-sighted and self-interested behaviors—exist across all industries. A well-functioning board can govern the corporation and its management by supporting and protecting a CEO who is doing the right thing for the sustainability of the business, while checking the excesses and other mistakes of one who is overly short-sighted, self-interested, or conflicted.

Recovery from this crisis will continue to dominate economic decision making for some period of years. We do not, however, want to lose sight of longer-term forces that also will shape the business environment. It is vitally important that as a society, and as business leaders, we work to fix both short-term and long-term problems.

### The Corporation and Society are Interdependent

Historically, corporations were privately organized and publicly chartered to both grow the value of shareholders’ investments and advance the public good. In the 16th and 17th centuries, “chartered companies” were created by monarchs largely to explore and open the resources of the New World. And the early American colonies empowered chartered corporations to build critical infrastructure, including roads, canals, and banks. It wasn’t until 1830 that the state of Massachusetts first allowed companies the privilege of limited liability, a hallmark of the corporate form, without being engaged in public works. And, in 1837 Connecticut became the first to allow companies to be incorporated without a special legislative act. Even then, legislatures often revoked charters from corporations that failed to fulfill their public responsibilities.

But the conventional view of the modern corporation is that it must operate primarily (some would say solely) in the interests of its shareholders. Nearly a half century ago Milton Friedman claimed “there is but one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game.” More recently, that view has been challenged by scholars and practitioners who have examined the role of the board with regard to a broader set of corporate constituents and concluded that they too merit consideration. We take up this issue in more detail in discussing the role of boards of directors in Chapter 3.

Recent turmoil in financial markets and the downturn in business generally have soured public perceptions of business and business leaders. Corporations are under increased pressure to rebalance public and private goals, as the public demands tangible results beyond the corporations’ direct (though temporarily declining) contributions to personal income and wealth. Some shareholders are among those demanding “more,” by agitating for greater consideration of environmental, human rights, and other societal issues. Although such demands have been greatest on large, global corporations, the underlying trends make it likely that even relatively smaller-sized companies, and non-corporate businesses, will feel the same pressures if they have not yet.
Various constituencies, often working through non-profits or non-governmental organizations (NGOs), make similar demands. Many NGOs actively advocate higher standards of corporate behavior with respect to environmental and human rights issues. Other NGOs attempt to hold corporations accountable by leveraging the Internet and other media sources to expose what they see as sub-standard labor practices, abuses of human rights, pollution of local waterways, violations of government health and safety standards, and the like.

Of course, governments—local, state, and national—have their say, too. Governments everywhere require disclosure and reporting of the corporation’s effects on society. Government laws and regulations often mandate the achievement of certain societal objectives running the gamut from standard financial disclosures to employment practices to environmental standards. Other times, governments may impact businesses by doing too little to meet societal goals directly, thereby increasing public pressure on, and often the commercial need for, corporations to fill the gap. In some less developed countries, where governmental authority exists in name only, multinational corporations frequently carry the burden of providing basic services usually supplied by governments. Even in the United States, corporations often must provide workers with remedial education services, roads for transportation, and other infrastructure improvements.

At the same time, other voices, mostly from the business community, are questioning how much of the corporation’s resources it can afford to devote to societal issues that, however worthy, do not add to this quarter’s or even this year’s bottom line. Where is the line between private and public responsibilities? And what calculus can guide the corporation’s decision making?

To an extent, how the public and business think about each other and their relationship has consequences for the achievement of their separate and mutual goals. The conventional (Friedman) framework, cited above, strongly implies that society and business stand opposed to one another; any benefit to business comes at the expense of society and vice versa. It reflects a zero-sum game where private and public interests are understood to be mutually exclusive ends. Often politicians, NGO leaders, the media, and others adopt this framework to demonize “Corporate America” and link caricatures of greedy businessmen to stir cynicism within the general public. This framework colors and shapes perceptions about the relationship of the corporation to society at both board tables and kitchen tables.

In reality, the interests of society and the business community are not mutually exclusive, but interdependent, and their goals are interlinked. Our society depends on corporations to innovate and invest, thereby improving living standards, creating jobs and wealth, and providing social goods. U.S. corporations are expected to provide a significant portion of the social safety-net (health insurance and retirement income) often provided elsewhere by governments. Corporations also depend on society, and it is in each corporation’s interest to sustain the society in which it operates. An excellent and equitable education system is needed to provide a productive and innovative workforce. Health care that is accessible, affordable, and based on medical best practices is necessary to ensure a healthy society and productive workers. An effective and equitable system of justice keeps all parties productively engaged in the pursuit of the common good. The production of safe, high-quality goods and adherence to labor practices that meet high ethical standards allows corporations to minimize the cost of accidents, attenuate concerns over the threat of litigation, and enhance the value of their brand. In these circumstances, consumers and workers become more attracted to the company and invested in its success. The efficient use of land, water, energy and other resources is needed to both sustain the environment and lower overall costs. But, there are limits to what each individual corporation can afford to do on its own.

The New Corporate Engagement

The social role of business and the question of how businesses can best fulfill that role have been the subject of many books and articles dating back to the inception of capitalism and to the work of its leading proponent, Adam Smith. The Depression of the 1930s broke the implicit social contract that had supported prior business expansion and touched off a fierce public
debate on the role of the corporation and its relationship to society—a debate that culminated in the New Deal. In the last quarter of the twentieth century, “corporate social responsibility” (CSR) became a vogue term, as businesses began to respond to social pressures by initiating CSR programs and appointing CSR officers to demonstrate corporate concern with social causes. Over time, CSR programs have developed from a focus first on philanthropy (what might be called “first-generation” CSR), then on public relations (the “second-generation”), and now increasingly on product development (“third-generation” CSR).

Like many others who recently have examined this topic, we do not favor CSR as a term of art. Some hold the perception, whether fair or not, that CSR activities tend to originate outside the firm and marginalize social concerns, despite the intent to give them greater prominence. Our focus in this statement is different: we are concerned with the interdependence of business and society, and on how corporations should anticipate and incorporate social factors into long-term strategies and objectives. The 2002 report of the Aspen Institute used the term “social impact management” to describe this intersection, and interdependency, of business practice and wider societal concerns. Within such a framework, CSR activities and programs as sometimes narrowly construed may count among the ways corporations react to social demands, but they do not by themselves capture this wider field of interest.

A common critique of mostly first- and second-generation corporate social responsibility programs is that charitable donations and other narrowly focused CSR-related projects serve only as short-term, cosmetic solutions to systemic problems, and as vehicles for public-relations campaigns intended to placate activist NGOs. This view holds that while the rhetoric of CSR appears well-intentioned, many corporations are failing to translate rhetorical commitments to strategic goals and operations. That view does not imply that companies should end CSR activities, nor do we believe that they should. Many CSR programs achieve excellent results both for the corporation and for society. Most companies will want to continue to fund CSR activities and support volunteer programs, but we believe that they also may want to look deeper into their overall interaction with society, as have some firms—under the banner of CSR or otherwise.

Scholars, practitioners, and other analysts have begun to reexamine both why and how businesses engage in the social arena. A 2008 report of the news magazine, The Economist, concluded that the CSR label is unhelpful to understanding the subject because the range of activities coming under its umbrella is vast and third-generation corporate responsibility activities are becoming too important to global companies to categorize them separately from other corporate activities. The conclusion of an influential analysis published in 2006 resonates with our own observations:

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 the 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. (Emphasis added.)

The view that pits society and business at odds with one another is self-defeating. Certainly, there are practical limits to any corporation’s ability to fulfill societal needs—it cannot do everything. And, there will be occasions when conflicts will occur. Nevertheless, the zero-sum view is a losing proposition. Practically applied, it often moves corporations either to fight civil society groups or to try to mollify them with ineffective palliatives. It encourages anti-business groups and opportunist politicians to throw roadblocks in front of nearly every form of business expansion. The 2006 analysis cited above put it in plain terms: “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.”
The Urgency of Action

Our central conclusion is that corporate boards and the leaders they select must integrate relevant societal concerns, such as environmental and human rights considerations, into corporate strategy to strengthen long-term competitiveness and the sustainability of both the corporation and the society in which it exists. A successful framework requires that societal and business leaders view and treat each other as partners, not adversaries. Their actions and public communications should recognize their interdependence and shared goals.

Failure of corporations to shift to an approach—based on substance, not image—that recognizes their interdependence with the societies around them will further erode society’s trust in, and support of, corporations and their leadership, a group that has fallen to an extraordinarily low level of public esteem—71 percent of Americans rate the reputation of corporate America as poor. That result is not in the interests of either business or society. Society overall would be poorer and less able to address its many needs and concerns if business is not engaged in helping to find solutions. Business would also be hobbled, as it risks losing its “license to operate,” imperils its access to needed physical, financial, and human resources, and invites ever greater scrutiny and more stringent regulation.

Although market forces and the power of “enlightened self interest” are pushing many corporations to address these issues, the actions taken thus far are slow, incomplete, and overall inadequate. Certainly, many large, global enterprises have shown that they understand the importance of addressing societal issues because they are confronted by them every day in multiple settings. New evidence of their awareness and of their activities surfaces almost daily, especially with regard to environmental issues such as climate change. The dynamism behind many present day corporate citizenship programs is impressive. But even leading corporations can and should do more, and corporations outside the Fortune 500 need quickly to become more aware of their interactions with society and more active in addressing them.

Failure to address environment, human rights, and other relevant societal concerns puts our prosperity at risk because it lowers our standard of living and the standards of living of future generations. Common problems demand solutions that transcend traditional divides. Business alone cannot solve the world’s problems. Neither can government. Neither can civil society organizations. The responsibility to act falls to all of us.

The purpose of this report is to restore confidence and trust in American corporations and their leaders by encouraging enlightened statesmanship in accounting, corporate governance, other board and management practices, and, as important, the strategic thinking of America’s corporate leaders. This report urges business leaders to consider the critical importance of societal concerns to their companies’ long-term sustainability, and it recommends ways in which corporate directors can take a leadership role better to address these concerns.

Plan of This Study

In the next chapter we examine what shareholders and others say they want from global companies, and we look at how companies have responded. Ample evidence exists that large, global corporations are increasingly attentive to societal issues, especially issues related to the environment. Yet, many have responded to the challenge defensively, which has done little to lessen public distrust.

In Chapter 3 we look at the key leadership role of boards of directors and make recommendations for directors to promote a corporate culture that recognizes societal interdependence and encourages honest reporting and proactive management of societal concerns facing their companies.

Chapter 4 provides some illustrative examples of how these issues have played out in practice. These examples offer no pat answers but illustrate the difficulty of some of the problems faced and the types of solutions that companies have developed.

Chapter 5 examines two difficult issues that fall outside the bounds of any one corporation’s purview. The first is the different regulatory and governance regimes that apply to privately held and publicly held corporations. How do these differences affect responses to societal issues and the competition between these types of companies? The second issue is whether the roles and
responsibilities of government, business, and non-profit entities can be clarified in a way that enhances the individual and mutual objectives of all three groups. Can expectations and perceptions be changed to emphasize positive-sum rather than zero-sum outcomes? What steps can governments take?

Chapter 6 provides a wrap-up of the issues and draws final conclusions.
In the wake of corporate scandal, financial crisis, recession, and increased activism on the part of shareholders, non-governmental organizations, and others, the public is paying increased attention to how businesses operate, what they do, and how they interact with the broader society—their “authenticity,” as one group has termed it. Many of the underlying reasons for such attention are linked broadly to the role of business in society rather than specifically to the corporation as such. But, the larger the business the greater its impact and the more attention paid to it. Most of the largest businesses are public corporations, and these corporations are under the most pressure to contribute actively to the public good. Public corporations have diverse ownership and shares traded in regulated markets. They have unique responsibilities and governance concerns, and operate under specific rules and regulations that set them apart from non-corporate forms of business and from privately held corporations.

Below, we examine some of the pressures on public corporations coming from shareholders and other corporate constituencies. In Chapter 5, we look at how public and private corporations face similar issues yet are treated differently in some respects.

**Long-term Shareholders’ Interests Converge with Societal Interests**

A public corporation has numerous shareholders with varied interests. Though the number one interest of all shareholders is return on investment, specific shareholders, in particular those often described as “activist,” may have additional goals or alternative views on how best to attain that return. Some hope to increase share value by promoting such steps as reducing takeover defenses, raising dividends, or restructuring or selling off corporate units. Others may seek to enhance the corporation’s value by encouraging consideration of how environmental change, human rights issues, or other societal concerns might affect the company’s operations and strategy. Many of these concerns appear in the form of shareholder resolutions.

**The Important Role of Pension Funds and other Institutional Shareholders**

Institutional shareholders—pension, insurance, mutual funds and others—now hold nearly two-thirds of the equity of U.S. corporations. That is a significant change from the 1950s, when they held less than about 10 percent. Defined-benefit pension funds, which most often promote social and governance issues and other concerns that affect long-term value, account for about half of institutional holdings (one-third of total equity).

Defined-benefit pension funds must be long-term investors due to the structure of their liabilities, which demands payments far into the future. That is not to say that pension funds do not pursue short-term gains or trading advantages. In fact, many place a portion of their resources with hedge fund and other managers who trade for short-term profit opportunities. (See box 1, page 14) But at their core, such institutions must pay attention to very long-term financial goals, as the lives of their beneficiaries extend beyond even a 30-year horizon. In addition, pension funds generally are broadly diversified, in many cases indexing their holdings to reflect generally the national and international economies. In economic terms, these funds are so diversified that they internalize externalities—the results of actions by one firm that fall upon others. They gain not when one company outperforms another by shifting costs or profits in a zero-sum fashion, but when companies expand productivity, engage in positive-sum competition, and contribute broadly to the social good.

Some observers also have pointed out that the beneficial owners of pension funds—workers and retirees—have broader interests than just their small financial stake in each of the thousands of companies...
whose shares the pension fund holds. For example, a pension-earning worker would not benefit if the company he works for, and whose shares he holds through his pension fund, pollutes his community lake. At a minimum, such conflicting interests make it difficult for pension fund fiduciaries to represent the full economic interests of their ultimate beneficiaries when focusing exclusively on financial returns. Many pension fiduciaries, therefore, seek to go beyond such a narrow measure of wellbeing.

An additional source of pressure on public corporations comes from foreign shareholders, who play a larger role in corporate finance as U.S. companies are increasingly dependent on foreign capital. Unless current trends are reversed, it seems likely that foreign investors will nudge U.S. corporations to pay greater attention to societal issues.

Capital inflows to the United States amounted to nearly 7 percent of GDP in 2006 and 5.3 percent in 2007. Inflows of foreign capital are forecast to continue at significant levels into the future. A large portion of patient equity capital is supplied by investors in advanced economies of Europe, plus Japan and Australia. Some, too, comes increasingly from sovereign wealth funds in China and the oil-exporting nations of the Middle East. Many pension funds and other institutional investors in the former group of countries, more than the latter, are known to have strong feelings about the social role of corporations in which they invest. The latter group might be presumed not to care as strongly about meeting societal goals, but these funds tend to be relatively passive investors.

Some recent international reports, associated with the United Nations Environmental Program (UNEP) (discussed below), have focused on the fiduciary duty of investment managers to assess how companies handle environmental, social and governance (ESG) issues—a term rapidly replacing ‘CSR’ in discussions of corporate social performance. The UNEP reports conclude that ESG issues can affect corporate (and portfolio) performance, and therefore investors ought to give appropriate weight to them. That conclusion likely will add to shareholder pressure for action and, by some accounts, could create a more explicit duty for corporate boards to review these issues as well.

What do activist funds say they want?

Activist pension funds probably account for no more than 10 percent of total U.S. equity, but they have a substantial effect on the companies they own and on markets generally. Such funds seek to improve the performance of their investments by promoting changes in corporate governance practices and aligning their shareholder votes with their point of view. Their objectives tend to focus on four areas: board independence, minimization of takeover defenses, tying executive compensation to performance while restraining its

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* In part, this increased dependency on foreign capital is driven by a historically low saving rate in the United States matched by extraordinarily high saving in the rest of the world. In part, too, the United States has been and remains an attractive location for investors to place their capital.
growth, and asserting the prerogatives of shareholders, as “owners,” to have a say in the corporation’s affairs.

Such concerns have led many of these funds, their associations (the Council of Institutional Investors and the International Corporate Governance Network), advisors (RiskMetrics’ ISS Governance Services, Glass, Lewis & Co., and Proxy Governance), and others (among them the American Bar Association, Business Roundtable, National Association of Corporate Directors) to develop and publish principles, standards, and other guidelines by which to judge and prod the behavior of public corporations. The law firm Weil, Gotshal & Manges has identified and summarized over 30 distinct governance objectives of some of the major guidelines and codes published by pension funds, business associations, and others.\(^\text{16}\)

Interactions between pension funds and the corporations whose shares they hold can be complicated and testy. The CtW Investment Group (CtW-IG), for example, is a part of the Change to Win (CtW) coalition of unions. Members of CtW affiliates participate in public and Taft-Hartley pension funds claiming about $1.5 trillion in assets. The CtW Investment Group was founded in February 2006. Its self-described mission is to defend the interests of pension funds sponsored by CtW affiliates and other interested groups “by organizing workers’ capital into an effective voice for corporate accountability and retirement security.”\(^\text{17}\) Under this banner, short-term interests can create hostile interactions between the funds and the companies whose shares they hold.

For the 2008 proxy season, for example, the CtW Investment Group strategy was to oppose the re-election of corporate directors who could be connected to the sub-prime mortgage crisis. CtW-IG said it would cast shareholder votes against directors at major U.S. banks who “fail to provide a compelling response” to a request to describe what they did to assess their firm’s mortgage-related risk and management’s efforts to control such exposure.

Short-term considerations aside, the goals of institutional shareholders ought to be consistent with the long-term goals of the corporations in which they invest, and with society overall. A document that closely mirrors CED’s concerns in the current context is “The Hermes Principles,” published by the UK-based Hermes Investment Fund, which invests on behalf of UK pension funds, insurance companies, government entities and financial institutions, as well as charities and endowments.\(^\text{18}\) In its own words, the Hermes Principles attempt to address a simple question: “What should owners expect from UK public companies and what should these companies expect from their owners?”\(^\text{19}\) The answers appear to be as applicable to U.S. companies as to those in the United Kingdom, and Hermes, along with others, has actively sought to hold U.S. companies to the same standard. (See box 2, page 16.)

Other institutional investors hold similar expectations of how corporations should operate. TIAA-CREF, for example, in 2007 published the fifth edition of its “Policy Statement on Corporate Governance,” in which it spelled out its interests as a long-term investor. The following excerpt summarizes, without the detail, much of the contents of the statement:

In keeping with our mission and fiduciary duty, TIAA-CREF continues to establish policies and engage with companies on governance, environmental, social and performance issues. We believe that, consistent with their business judgment, companies and boards should:

(i) pay careful attention to their governance, environmental and social practices; (ii) analyze the strategic impact of these issues on their business; and (iii) fully disclose their policies and decisions to shareholders. We expect boards and managers to engage constructively with us and other shareholders concerned about these issues.

TIAA-CREF recognizes that corporate governance standards must balance two goals — protecting the interests of shareholders while respecting the duty of boards and managers to direct and manage the affairs of the corporation. The corporate governance policies set forth in this Policy Statement seek to ensure board and management accountability, sustain

\(^{16}\) The CtW coalition members are: International Brotherhood of Teamsters (IBT); Laborers’ International Union of North America (LIUNA); Service Employees International Union (SEIU); United Brotherhood of Carpenters and Joiners of America (UBC); United Farm Workers of America (UFW); United Food and Commercial Workers International Union (UFCW); and UNITE HERE.
Box 2. The Hermes Principles

“Hermes’ overriding requirement is that companies be run in the long term interest of shareholders. Companies adhering to this principle will not only benefit their shareholders, but also we would argue, the wider economy in which the company and its shareholders participate. We believe a company run in the long term interest of shareholders will need to manage effectively relationships with its employees, suppliers and customers, to behave ethically and have regard for the environment and society as a whole.

Communication

Principle 1 ‘Companies should seek an honest, open and ongoing dialogue with shareholders. They should clearly communicate the plans they are pursuing and the likely financial and wider consequences of those plans. Ideally goals, plans and progress should be discussed in the annual report and accounts.’

Financial

Principle 2 ‘Companies should have appropriate measures and systems in place to ensure that they know which activities and competencies contribute most to maximising shareholder value.’

Principle 3 ‘Companies should ensure all investment plans have been honestly and critically tested in terms of their ability to deliver long-term shareholder value.’

Principle 4 ‘Companies should allocate capital for investment by seeking fully and creatively to exploit opportunities for growth within their core businesses rather than seeking unrelated diversification. This is particularly true when considering acquisitive growth.’

Principle 5 ‘Companies should have performance evaluation and incentive systems designed cost effectively to incentivise managers to deliver long-term shareholder value.’

Principle 6 ‘Companies should have an efficient capital structure which will minimise the long-term cost of capital.’

Strategic

Principle 7 ‘Companies should have and continue to develop coherent strategies for each business unit. These should ideally be expressed in terms of market prospects and of the competitive advantage the business has in exploiting these prospects. The company should understand the factors which drive market growth, and the particular strengths which underpin its competitive position.’

Principle 8 ‘Companies should be able to explain why they are the “best parent” of the businesses they run. Where they are not best parent they should be developing plans to resolve the issue.’

Social, ethical and environmental

Principle 9 ‘Companies should manage effectively relationships with their employees, suppliers and customers and with others who have a legitimate interest in the company’s activities. Companies should behave ethically and have regard for the environment and society as a whole.’

Principle 10 ‘Companies should support voluntary and statutory measures which minimize the externalization of costs to the detriment of society at large.”

Source: Hermes Investment Fund
a culture of integrity, contribute to the strength and continuity of corporate leadership and promote the long-term growth and profitability of the business enterprise. At the same time, these policies are designed to safeguard our rights as shareholders and provide an active and vigilant line of defense against fraud, breaches of integrity and abuses of authority.20

In summary, shareholders are a diverse group with many individual interests. Institutional shareholders focused on long-term performance are raising important issues about firms’ governance, strategy, and execution. Many of these issues are also being pursued by non-profit, civil-society organizations, frequently called non-governmental organizations (NGOs).

Shareholders and Other Corporate Constituencies May Work Together to Pursue Non-Financial Objectives

The filing of shareholder resolutions for inclusion in companies’ annual proxy statements is but one of many avenues shareholders and others use to exert influence on the corporation. The resolutions have the advantage of being a visible measure of the societal demands on public corporations, although much of the interaction with corporations, even with regard to filed resolutions, takes place behind the scenes. Such resolutions can be filed only by shareholders but many are developed in conjunction with other corporate constituent groups represented by NGOs. Thus, for example, many of the shareholder resolutions filed for the 2008 proxy season that focused on climate change and the disclosure and monitoring of political contributions were promoted by NGOs.

Climate Change Resolutions

Climate change resolutions led among shareholders’ social proposals, with 54 proposals filed during the 2008 proxy season focused on this subject. That doubles the number filed two years earlier and surpasses the previous year’s record high of 43 proposals.21 The proposals generally requested greater disclosure of climate change practices, including information about greenhouse gas reduction targets and renewable energy strategies. Many of the resolutions were proposed by members of the Investor Network on Climate Risk (INCR), an alliance of 60 institutional investors that seeks to promote better understanding of the financial risks and investment opportunities posed by climate change. INCR is coordinated by CERES, a coalition of investors and environmental groups “working with companies and investors to address sustainability challenges such as global climate change.”22

The motivations that underpin the shareholder proposals range from a straightforward concern for the environment to worry that lack of voluntary action will lead to mandated, more-burdensome regulatory measures in the near future. Many investors in the United States look at the European cap-and-trade system for greenhouse gas emissions as a harbinger of future action here. Indeed, groups of states across the country are moving to implement regional cap-and-trade systems in the absence of federal action. In addition, although the United States is not a signatory to the Kyoto Protocol, the possibility of a follow-on agreement with U.S. participation threatens to raise costs for companies with poor environment practices.23 For many shareholders, perhaps the majority of those offering these resolutions, impending regulation in the U.S. market and ongoing regulation abroad constitute a competitive and material risk that corporations ought to address.

For others, the development of new energy-efficient technologies and products provides a commercial opportunity to meet increasingly “green” consumer demand, and should be explored as such. Viewing environmental concerns as an opportunity, many institutional investors want corporations to adapt their day-to-day operations and value-creation strategies to take account of these new challenges and opportunities. For example, three separate 2008 shareholder resolutions requested ExxonMobil to develop specific greenhouse gas reduction goals, put forth and implement a policy for renewable energy research and development, and publish a report on how to lead the development of technologies to achieve a more energy independent United States.24 In another instance, a socially active non-profit, the Nathan Cummings Foundation, submitted a shareholder proposal for Standard Pacific, one of the largest U.S. homebuilders, to adopt specific goals to reduce greenhouse gas emissions in both its operations and its products.*25

* The proposal received 25 percent ‘yes’ votes.
Shareholder resolutions are the most visible and easily measured actions shareholders are taking. But in 2007, a group of institutional investors—mostly public pension funds from such states as California, Florida, Maryland, New York, and New Jersey—led by CERES, petitioned the Securities and Exchange Commission (SEC) to issue interpretative guidance that would force corporations to disclose business risks related to global warming. In essence, the petition seeks to accomplish through SEC action results similar to those sought by the individual resolutions discussed above.

Almost always shareholders act on their own behalf via resolutions or petitions as noted above. More recently, however, New York's attorney general, Andrew M. Cuomo, added the weight of the state to shareholders' concerns about climate change when he subpoenaed several companies seeking to determine if they had properly disclosed risks of building new coal-fired power plants. In August 2008, Xcel Corporation, a leading builder of coal-fired power plants, agreed to disclose to shareholders the material risks, such as future lawsuits or the increased costs of potential regulatory rules that restrict carbon emissions, posed by climate change. Cuomo remarked that the agreement “sets a new industry-wide precedent that will force companies to disclose the true financial risks that climate change poses to their investors. Coal-fired power plants can significantly contribute to global warming, and investors have the right to know all the associated risks.” The agreement, the first of its kind, will likely establish a precedent that corporations face legal recourse if they fail to disclose properly risks related to climate change, and it may provide a template for further such agreements.

Other Social Resolutions

After climate change, the leading category of social issue proposals filed by shareholders in 2007 dealt with political contributions, according to an analysis by the governance rating firm RiskMetrics. Proposals on political contributions usually ask companies to issue semi-annual reports on political contributions and to provide guidelines for making contributions. According to RiskMetrics, the resolutions follow a template developed by the Center for Political Accountability, an NGO that focuses on corporate political spending. As with many such proposals, shareholder proposals related to societal issues often come from activist groups rather than from long-term investors. Nevertheless, boards must give any shareholder proposal due consideration.

Other issues with substantial shareholder/societal support include universal health care, homeland security, employment diversity, human rights, and product safety. These shareholder resolutions typically are a component of a broader campaign to focus public attention. Many of the individual proposals in areas such as health care and human rights in particular are sponsored by unions and religious groups that are simultaneously shareholders (through pension funds) and corporate constituents (in their social functions). Of course, members of these groups are also likely to be consumers, workers, and community neighbors of the companies receiving such proposals.

The effort to promote corporate endorsement of universal, affordable health insurance illustrates many of the complications and challenges facing public corporations. A shareholder proposal asking companies to adopt "principles for comprehensive health care reform," like those devised by the National Institute of Medicine, was submitted to several major U.S. corporations during the 2008 proxy season. The SEC, reversing previous policy allowing exclusion based on infringement of ordinary business operations, allowed the proposals to be included in proxy materials for shareholders' votes. Company responses ranged from acceptance of the principles (GE, Medco Health), opposition to the principles (Boeing, Reynolds American), to engagement and negotiation with shareholders who proposed the principles (Wal-Mart, IBM). Although they arrived at different solutions, each company has had to address such questions as whether it ought to endorse a contentious public policy issue not central to its core competency, how such a policy might impact its own operations and performance, and what the impact of its decision would be on its shareholders, employees, customers, suppliers, and others.

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1 In January 2009, the SEC had not acted on the petition.
2 CED's Vice President and Director of Business and Government Policy, Mike Petro, is a member of the board of the Center for Political Accountability.
3 The proposal received 7.3 percent 'yes' votes from Boeing shareholders. The proposal received 0.8 percent 'yes' votes from Reynolds American shareholders.
Other Demands of Corporate Constituents

Non-shareholders lack a direct voice in corporate matters. As shown above, however, on many issues they have been able to form effective coalitions with shareholders who share their concerns. Such links are not the only means by which corporate constituents can influence business decisions, and, of course, there should be no presumption that such coalitions always operate in the best long-term interests of the corporation. Labor groups, consumer activists, and advocates of other causes have carried out effective campaigns by bringing market pressure or political pressure to bear on corporate targets. Such campaigns are aided by inexpensive and ubiquitous communications technology, notably the Internet. As one analysis put it, “The Internet has already triggered lasting change in the structures of industries and the ways businesses create value. Today, ubiquitous connectivity is creating new relationships among businesses, customers, employees and partners. People now have access to massive amounts of information—and opinions—about products and company practices. This information is available in every part of the globe, every minute of every day.”

The changing landscape for information about business, and its meaning for corporate communications, is well addressed by a report of the Arthur W. Page Society, an association of corporate communications officers and public relations agency CEOs. A particular concern highlighted by their report is the upending of the corporation’s ability to “segment audiences and messages and to manage how it wishes to be perceived.” Today’s corporation is more transparent to all its constituencies and less able to manage public perceptions. In this environment, authenticity—a grounded sense of what defines the company, why it exists, and what it stands for—is the clearest path to building a distinctive brand and achieving long-term success, according to these experts.

As discussed in Chapter 1, a company’s reputation can be one of its most valuable assets. The Edelman Trust Barometer is an annual survey of attitudes towards business and other societal institutions. The 2008 edition of the Barometer showed the most powerful drivers of trust of a business are, in order: the quality of its products or services; customer service; and overall reputation. In this survey, the major drivers of reputation are a company’s social and environmental track record and how it treats its employees. These factors are shown to translate into whether individuals say they will: buy a company’s products or recommend them to others; pay a premium for products or services; choose to invest, speak or write in support of a company’s actions; and support or block its plans to locate in a community.

Wal-Mart Watch is a prime example of a broad constituency-based campaign meant to challenge a company’s reputation and its ability to carry out company plans and policies. Wal-Mart Watch is a project of the Center for Community & Corporate Ethics, whose board includes leaders of the Service Employees International Union (SEIU), the National Partnership for Women & Families, Common Cause, and the Sierra Club. It began in spring 2005 as a nationwide public education campaign to, in its words, “challenge the world’s largest retailer, Wal-Mart, to become a better employer, neighbor, and corporate citizen.” The “success” of the campaign can be seen in Wal-Mart’s battered reputation, coinciding with reduced sales and difficulty in locating new stores. More recently, Wal-Mart has shifted some policies to become a leading retailer of environmental products and a supporter of healthcare reform and other societal initiatives.

Wal-Mart Watch is but one organization focused on one company. The number of NGOs and individuals worldwide engaged in company-or issue-based campaigns is too large to count—or to ignore. Such campaigns can impose real costs on companies. Societal demands are particularly acute in developing countries, many of which hold a more expansive view of both the social role of business and the validity of civil society involvement in business decision making. The business environment in many developing countries challenges global companies in many dimensions. In some countries, the problem is not only that the government or public opinion may demand greater business involvement in society, but also that governments and other social institutions may be unable to supply basic public services such as education and

* CED, Wal-Mart, and SEIU are partners, along with other business, labor and public policy leaders, in the Better Health Care Together coalition, which seeks to reform the U.S. health care system.
health care or to establish and enforce appropriate legal standards. In some locations, particularly in areas where extractive industries have invested heavily in long-term operations and where government authority is weak, the global enterprise may be the dominant social institution. As such, it may be held accountable both for results it cannot control as well as for those it can. In either case, the corporation may be vulnerable to negative publicity and obstruction of its goals unless it is prepared voluntarily to take on societal obligations.

Such challenges are not confined to low-income countries. Weak government authority, or the lack of government provision of services, also encourages within the United States large corporations to provide social services, especially in communities where they have a dominant, long-term presence. In Chapter 5, we take up the question of the division of responsibilities between government and business. But in the present context, we observe that where government leadership is particularly weak, organized civil society groups have ample room to become more active in promoting business solutions to societal problems.

A significant difficulty for businesses, whether in developing countries or in the United States, is to understand both the host of demands on business and its capacity to meet those demands. Some groups admit to seeking a broad “new social contract” between business and society, involving the shifting of some social responsibilities onto business—a goal beyond the means of any one business to satisfy. A company may face so many individual demands that meeting them all would be impossible. Further, it is often the case that different corporate constituents and NGOs have conflicting demands. How does a business decide which ones are legitimate, which ones ought to be addressed, and which ones can be addressed at reasonable cost?

Corporations Have Responded, but Most are Behind the Curve

Businesses differ along many dimensions: size, location, industry, and other characteristics. They also differ on commitment to social engagement, engagement with shareholders or other groups, and recognition of the importance of social factors to their own success. Some corporations (a majority according to one survey) commit to meet specified ethical guidelines. Others set goals to meet environmental and labor standards, plant trees, build homes, construct education centers, encourage employees to volunteer in their local communities, provide free food to low-income countries, or engage in a vast number of other innovative activities. Of course, some do none of these things. Like all business challenges, some corporations are ahead of the curve and others are behind; each corporation will have unique societal issues that may impact its performance. Off-the-shelf solutions are unlikely to work well.

As a general observation, the manner in which corporations engage with society matters to results achieved. Surveys indicate that a majority of companies engage defensively to minimize risk through public relations campaigns (66 percent of those surveyed) or to mollify public concern by making charitable donations (65 percent of those surveyed). Corporate executive officers often employ such tactics despite admitting their ineffectiveness. More successful approaches emanate from a core culture and strategy that guides behavior at all levels of decision making, throughout the value chain, across all areas of operation, at all times. They tend to be proactive, interactive, transparent, and oriented toward integrating societal objectives into long-term business strategy including product development—GE’s Ecomagination initiative is the model.

Most corporate executives, especially those in large, global enterprises, profess a commitment to solving societal problems. They recognize that the value of their company’s brand—its reputation—is based not only on the products and profits they make but also on how they are made and, more broadly, how the company is perceived to interact with society. Seventy-five percent of executives of large firms say that reputation motivates their companies’ efforts to engage in society. Eighty-four percent of CEOs believe corporations must contribute to the broader public good, for example by making philanthropic donations, providing employee benefits, going beyond legal requirements to abate pollution, or meeting ethical standards, according to a McKinsey survey. Surveys also indicate that companies pursue social objectives to retain and recruit employees, and because of the tangible contributions of corporate citizenship activities to the business bottom line.

The aspirations and attitudes of corporate executives, however, do not always translate into equivalent action. A separate McKinsey survey revealed that only half of
In July 2008, the CFA Institute Centre for Financial Market Integrity, a professional association of financial market analysts, published an ESG Manual to help investors and investment professionals better to “identify and properly evaluate the risks and opportunities that ESG issues present.”46 The manual recognizes investors’ increased interest in social factors that increasingly are affecting the valuation of corporate shares. It provides a primer on the vocabulary of ESG analysis and a road map to help investors and analysts find applicable information in company reports.

In 2007, Goldman Sachs launched its “GS Sustain” focus list, which analyzes companies on the basis of “sustainability of corporate performance.”47 While the GS Sustain analysis claims no hard evidence that investing on the basis of environmental and social criteria adds value on its own, it does suggest that firms that integrate and publish economic, social, and environmental criteria with financial analysis have outperformed the market by 25 percent.48 Other investment groups, such as Citigroup, JP Morgan, and West LB, also have initiated dedicated ESG units.49

The GS Sustain analysis grows out of an invitation from a group of investors that formed the Asset Management Working Group of the United Nations Environment Program Finance Initiative (UNEP-FI). The UNEP-FI, launched in 2003, has been actively examining “the materiality of environmental and social criteria as they relate to the portfolio management of mutual funds, pension funds and other institutional funds.”45 In 2007, it issued findings based on reports provided by ten sell-side brokerages

Financial Analysts and Investors Use Social Information to Evaluate Company Performance

A frequently cited reason why corporations do not pay more attention to societal issues is that they do not see such concerns to be relevant to the bottom line or of material interest to investors, aside from the few socially responsible investment (SRI) funds that are managed specifically with regard to such concerns. If investors and investment valuation models do not confirm the worth of social engagement, the incentive to undertake such activities will be low. Recent research, however, indicates that social engagement is a significant factor in valuing a company’s performance, and stock analysts have begun to pay attention.45

Numerous factors constrain corporate behavior and make it difficult to engage in societal concerns. Corporate executives, particularly those in smaller firms, typically cite “not enough money,” “not enough time,” and “not enough people” as the three principal factors limiting corporate engagement.44 Costs limit even the most productive activities of a corporation, and differences in costs between a company and its competitors can be a decisive factor. Unless a company’s competitors bear similar costs, the individual firm may conclude that it will be penalized if it diverts resources from immediately productive activities to pursue objectives that are longer term or appear ancillary to the company’s mission. Surveys suggest that CEOs of large and small corporations alike seem to prefer structural-type governance reforms—instilling ethical guidelines and practices—over more substantive, and potentially costly, reforms.

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The GS Sustain analysis starts from the premise that “Globalization and a changed political landscape are combined with significant changes in populations, urbanization, resource utilization, climatic patterns, and employee and consumer attitudes. The evolution of communications networks means that there is greater connectivity than ever before and, in conjunction with the rise of the NGO, companies operate in a more transparent environment than previously.”50 Its model evaluates how companies interact with four key factors: the economy in general, their industry, society, and the environment. It specifically incorporates the principles of the UN Global Compact and holds that “leadership on these issues is crucial.”51 (See box 3 on the UN Global Compact, page 22.)

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Box 3. The Ten Principles of the UN Global Compact

The UN Global Compact has rapidly become the standard for companies and others seeking a forum for issues involving business/society interdependence. Launched in July 2000, the Compact had over 4000 business participants in April 2008. The Compact does not police or enforce adherence to these principles, although it has delisted companies that failed to report or demonstrate participation. It relies on voluntary compliance and the power of public information and non-business activism to encourage participants to follow through on their commitments.

The Global Compact’s ten principles in the areas of human rights, labor, the environment and anti-corruption enjoy universal consensus and are derived from:

- The Universal Declaration of Human Rights
- The International Labor Organization’s Declaration on Fundamental Principles and Rights at Work
- The Rio Declaration on Environment and Development
- The United Nations Convention Against Corruption

The Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labor standards, the environment, and anti-corruption:

Human Rights
- Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
- Principle 2: make sure that they are not complicit in human rights abuses.

Labor Standards
- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labor;
- Principle 5: the effective abolition of child labor; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment
- Principle 7: Businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption
- Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

Source: UN Global Compact
on the importance of ESG issues to financial evaluations. The three key findings of the UNEP-FI report are:

- ESG issues are material – there is robust evidence that ESG issues affect shareholder value in both the short and long term.
- The impact of ESG issues on share price can be valued and quantified.
- Key material ESG issues are becoming apparent, and their importance can vary between sectors.

Other analysts and investors buttress these findings. SRI funds were estimated to hold $2.7 trillion in assets under management in 2007. Some financial analysts are incorporating quantitative and qualitative ESG factors into their asset valuation models, and commercial services are offering other forms of data and analysis of ESG issues. Analysts may use some unusual indicators in their evaluations. One expert found that firms listed on Fortune magazine’s list of the “100 Best Companies to Work for in America” enjoyed double the market return from 1998 to 2005, illustrating a positive relationship between job satisfaction and equity pricing. Another trio of authors used specific screening criteria related to social performance and social interests to identify 30 so-called “firms of endearment” – defined as firms that strive to bring the interests of their primary constituents into strategic alignment. These firms are calculated to have significantly out-performed the S&P 500 index over a ten-year period.

Some, though not enough, institutional investors have pointed to the need for more information on what they term “extra-financial” information. Extra-financial information is generally qualitative, related to long-term risks such as global warming, other environmental concerns, and the potential for public concern leading to new regulation. Such information is described as:

Fundamentals that have the potential to impact companies’ financial performance or reputation in a material way, yet are generally not part of traditional fundamental analysis. For example, future political or regulatory risks, the alignment of management and board with long-term company value, the quality of human resources management, risks associated with governance structure, the environment, branding, corporate ethics and stakeholder relations.

Efforts to promote such analysis and to incorporate it into securities research have come mostly from European pension funds and asset managers, who in 2004 founded the Enhanced Analytics Initiative (EAI). EAI members have agreed to allocate a minimum of five percent of their broker commissions to brokers whose securities research integrates analysis of extra-financial issues. They have also set aside some resources to evaluate whether broker research conforms to EAI interests. The expectation is that as EAI membership grows and as members increasingly allocate brokerage funds for enhanced, long-term research, sell-side securities analysts will respond by increasing the supply, and the quality, of such research.

As of January 2008, US-based members of EAI were the Calvert Fund, a large mutual fund emphasizing socially responsible investing, and two large public pension funds, CalSTRS and NYCERS. In our view, more U.S. defined-benefit pension plans should show an interest in such research and valuation methods. Doing so would have a powerful impact on corporate conduct.

Other collective and individual efforts are starting to take root. In April 2008, for example, the CalPERS Board signaled its view of the importance of environmental disclosure by expanding its corporate governance guidelines to encourage companies to disclose and act on climate risks. The guidelines reference the 14-point “Corporate Governance Checklist” developed by CERES. CalPERS also announced it would work with the INCR to survey investment managers regarding their ability to evaluate climate risks and opportunities of the companies in which they invest.

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1. Members listed at launch of EAI were: AGF Asset Management (France), NP Paribas Asset Management (FR), MISTRA (Swedish Foundation), PGGM (NL), RCM (UK), Deutscher Investment Trust (dir) and dresdnerbank investment management (dbi) (Germany), Universities Superannuation Scheme (USS) (UK).

2. At the same time, the Board also adopted new corporate board diversity guidelines to encourage the inclusion of diversity as a factor to assess corporate board nominees.
The weight of evidence cited above is that business leaders cannot avoid confronting the intersection between societal and business concerns. But they also need to pay close attention to traditional financial criteria, the bottom line. The Goldman Sachs analysis put it this way: “Our conclusion is that companies need to manage all inputs to their business in order to enjoy sustained competitive advantage and a valuation premium versus their peers. What is more profound, perhaps, is that investors cannot rely on ESG factors alone but need to integrate them into an industrial framework and valuation methodology to pick stocks.” In the next chapter we look at how corporate boards can provide the right leadership to help their companies manage their interactions with society and build long-term shareholder value.
In this chapter we explore what boards can do to help their companies to integrate societal concerns into strategic plans, improve the execution of those plans, improve reporting and communication about their efforts, and ultimately improve the long-term performance of the corporation. Data on board involvement with such issues are incomplete, although research indicates that high-performing companies generally put greater emphasis on board consideration of social and environmental concerns, while poorly performing companies were more likely to have no one in charge of such issues.\(^6\) One source reports that over the last five years the number of Fortune 500 companies with a board committee overseeing the environment jumped from 10 percent to 25 percent.\(^6\) According to a survey conducted by The Economist Intelligence Unit (EIU) of The Economist magazine, globally 26 percent of companies place responsibility for “sustainability performance” with the board.\(^6\) Respondents also reported that boards spent an average of 20 percent of their time on social and environmental performance. A different survey, conducted by the Boston College Center for Corporate Citizenship, indicated that only 12 percent of U.S. or Canada-based companies have a stand-alone CSR department that reports only to executive management or the board of directors.\(^6\)

However accurate the data, boards could spend more productive time considering the long-term sustainability of the corporation, which means finding practical ways — through production, research and development, investment, marketing, communications, human resource development, and other processes — of carrying out a strategy that includes the interaction between the corporation and society. **Sustainability, in this context, means the ability of the corporation to operate, add value, and endure because it demonstrates a compelling understanding of its financial, environmental, and social performance, and an actionable strategy for enhancing long-term shareholder value based on that understanding.**

We recognize that boards may find it exceedingly difficult to set aside time during regular board meetings to discuss long-term sustainability issues, although optimally such issues would be integrated with other specific concerns. Nonetheless, specific time for discussion of such issues might be allocated, for example, during a board’s annual retreat.

### Meeting Shareholder and Public Goals

For many directors, uncertainty about the validity of societal concerns and about how these factors interact with corporate performance stand in the way of the board’s taking a greater role in examining such issues. Yet, changes in practice brought about since 2002 by law, regulation, and market pressure have empowered boards to shoulder more responsibility for the corporation’s long-term strategic direction. Societal issues seem likely to play an ever larger role in determining a corporation’s long-term performance, thus demanding more board attention.

Boards are uniquely positioned to make sure that the long-term interests of the corporation are not lost or sacrificed to the pressures of daily business activity.

Successful boards will help the CEO to balance short-term and long-term goals. Boards can serve as a buffer between the CEO and market forces that make unhealthy short-term practices difficult to resist. They should support – and protect – CEOs and other senior managers who take the long-term view.

A review of literature and our own experiences lead us to conclude that as a practical matter, directors must be loyal to the long-term interests of the corporation, and by doing so, help their companies achieve long-term sustainability.

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\(^7\) The EIU study defines sustainability to mean “policies and processes which enhance the financial, environmental, societal, human, and other resources on which the company involved depends for its long-term health.” It is unclear, however, what definition respondents used when answering survey questions about sustainability.
those interests are best served when directors incorporate social considerations into their deliberations. That does not mean that other corporate constituents any more than shareholders should determine company policies, that social considerations should trump hard-headed business analysis, or that the corporation should be viewed as an arm of government or an instrument of social policy. It does, however, mean that directors have an obligation to act as stewards of the corporation’s long-term economic health. They should widen the purview of their deliberations to give weight to societal issues that impact the firm’s longer-term performance.

As one expert put it, directors “are fiduciaries who are, by law, charged to manage or provide for the management of the business and affairs of the corporation. That role is the core concept of the modern business corporation and is central to effective corporate governance and should not be diminished or neglected.”

Directors have the ultimate power to define the long-term interests of the corporation, and because each corporation has a stake in the health and welfare of the society in which it operates, its directors cannot afford to ignore that social environment.

Shareholder-Value Maximization

The question of the relationship of the corporation to associated non-shareholder groups and to society in general is virtually as old as the limited-liability corporation itself. The traditional, dominant view is the “shareholder primacy” model. In principle, maximizing shareholder value, in the narrow sense of seeking the greatest economic profit, maximizes the value of the corporation and, hence, its value to society. As the argument goes, all claimants benefit as the corporation innovates and grows to satisfy shareholders’ economic demands.

Only shareholders, theorists posit, have the incentive to maximize the total value of the corporation. In principle, shareholders claim the residual of the firm’s net income after paying suppliers, employees, management, bondholders, and others with committed claims. They thereby enjoy most marginal benefits and incur most marginal costs resulting from positive or negative firm performance. As the principal owners and suppliers of capital, shareholders have both the right and incentive to sell underperforming shares. In the extreme, shareholders can supplant underperforming management by replacing the board either through direct election of new directors or by transferring share ownership to an alternative entity. This “market for corporate control” provides ample incentive for the board and management to maximize the net total value of the corporation, and hence shareholder value.

By contrast, claimants to fixed cash flows, such as employees, suppliers, and debtholders, have incentives to maximize their share of the total but not necessarily to enhance overall firm value. At least in the short term, whether a firm performs well or extraordinarily well matters very little to those with fixed, inframarginal claims (payments not dependent on additional sales or revenues).

Thus, shareholders have been granted primacy of place in the U.S. system of corporate governance. Maximization of shareholder value drives managers to implement output-maximizing strategies mindful of relative costs and benefits. As the company grows, employees benefit from increased wages, communities benefit from a larger tax base, and suppliers gain more business.

The Mediating Board

As best practices and regulatory imperatives have empowered boards to take a more central role in the governance of U.S. corporations, scholars too have re-examined the role of the board and found it to be more central than the standard shareholder-maximization model implies, with implications for societal concerns.

One well-developed theory posits a model of governance that views directors as “mediating hierarchs.” In this view, boards are responsible not only for leading the corporation to maximize long-term profits but also for mediating the competing needs and interests of shareholders, customers, suppliers, employees and other groups. Stated briefly, “the appropriate normative goal for a board of directors is to build and protect wealth-creating potential of the entire corporate
The theory fits nicely with the reality of corporate law, which does not require directors to follow slavishly the demands of shareholders—as diverse as those demands are likely to be. Directors must give due consideration to their decisions and not line their own pockets, otherwise they may direct the company’s resources as they see fit. The well-established “business-judgment rule,” by which courts will not review the actions of a board unless improper conduct is alleged, protects directors from second guessing and legal liability in the event that decisions do not lead to anticipated benefits.

In the end, of course, boards and managements are motivated not by theory but because they face certain realities in the market place. Those realities include the need to satisfy diverse constituencies with diverse objectives, even among shareholders. Speculative traders who hold shares briefly want one thing, while long-term investors may want another. Passive investors want steady long-term returns, while active investors may want higher rewards commensurate with greater risk taking. In the wake of the recent financial crisis, preservation of capital may be a key objective for many. They must also aim to satisfy those market participants who are not yet shareholders but could become ones if convinced of the soundness and profitability of the corporation and its ability to return a reliable stream of income over the long term.

Employees and other constituents also must be satisfied. Like shareholders, employees who hold the specific human capital of the firm also have residual interest in the corporation and cannot be treated only as short-term costs. Nor can suppliers or local community groups be held out of the equation without damaging the long-term interests of the company. As is often the case, as a corporation grows it develops a stronger web of interests vital to the corporation’s long-term performance and sustainability (as a going concern), and thus a wider network of interests that must be satisfied. The development of corporate culture and broader social/public goals, as described above, is a natural, market-based response to these growing interests.

Directors, who have the sole authority to determine how economic surpluses will be used—for example, between dividends for shareholders or retained earnings for future investment—are in this model empowered to ensure that each constituency is appropriately satisfied and motivated to enhance the long-term value of the corporation—and to help define the values of the corporation. These mediating hierarchs have a goal to “balance the competing needs and demands of shareholders, creditors, customers, suppliers, executives, rank-and-file [workers], and even the local community, in a fashion that protects specific investments in the corporation and keeps the corporation alive, healthy, and growing.” In this context, good governance has the qualitative characteristic and goal of ensuring the corporation’s long-term success.

A Practical Path to a Longer-Term and Broader View of Shareholder Value

The eminent scholar and former Dean of Harvard Law School Robert C. Clark holds that a well-articulated and qualified view of the shareholder primacy model—appropriately understood to allow directors discretion to satisfy the needs of non-shareholder corporate constituents as well as the shareholders themselves—may produce the same practical results as the mediating hierarchs model. Because the latter model is unfamiliar to many and may be viewed as lying outside the mainstream legal view of the board, which continues to emphasize directors’ fiduciary obligations to shareholders, Clark suggests a variant of the traditional model that we find appealing.

Clark accepts the mainstream view that directors have a fiduciary duty to maximize shareholder value, subject to three important “constraints”: 1) directors should cause their corporation to obey the law; 2) directors should cause the corporation to meet all of its legal obligations to non-shareholder constituencies; and 3) directors should cause their corporation to respond to market, social, and normative forces to keep constituents optimally involved in the corporation’s business. He terms two additional caveats the “matters of conscience exceptions:” directors may cause their corporations to engage in charitable giving; and directors may cause their corporations to “cease participating in” unethical practices (such as genocide and apartheid), even when those actions are profit maximizing and not illegal under applicable law.

Clark argues, and we agree, that an expanded shareholder-primacy model, which incorporates non-shareholder interests, may be superior for two
reasons. First, by creating a single goal of maximizing shareholder value (even with due consideration for non-shareholders), the shareholder primacy standard makes it easier to judge the actions of directors in contrast to a standard that encompasses multiple and hard-to-compare interests. Second, a board focus on shareholder value makes it clear that social goals belong primarily in the political arena, which is designed to make and execute public policy for the whole of society. As discussed above, corporations may achieve social objectives in various ways, but making it an explicit goal of the corporation would at once create competing standards for evaluating business judgments and competing venues for the pursuit of social goals.

Leadership from the Board

Directors have a legal obligation and duty to address the long-term performance of the corporation. Directors’ fiduciary duties include broader societal concerns that affirmatively affect the corporation’s performance and long-term sustainability. To meet that duty, directors must consider the concerns of all—not just current shareholders, managers, or other powerful constituents—who are in a position to affect a company’s long-term performance. In today’s environment, boards must know that they are empowered to reject actions that produce only short-term financial results at the expense of the long-term interests of the corporation. Compensation policies, for example, should not be designed to promote purely short-term share price enhancement.

The CEO is mainly responsible for carrying out the board’s directions. Boards should tie a portion of CEO and senior management’s performance compensation to metrics based on the corporation’s performance on such concerns. That would provide direct incentive for top management to pay attention to those issues. It also would require the corporation to disclose the link between performance pay and the chosen benchmarks. The challenge of motivating managers, especially at mid levels, to pursue policies established at the top of the company is as common as it is difficult. Mid-level managers, some steps removed from policy formulation, may have competing objectives and feel a lack of urgency about pursuing corporate goals, especially when those goals may not readily appear to contribute to quarterly (or monthly) profits. Therefore, pay incentives at top levels and down the line are important for achieving results.

The board’s involvement would be assured due to its role, primarily through the compensation committee, in setting compensation criteria and in disclosure of them. Indeed, the board would have to consider the types of information it would need to evaluate the CEO’s performance, and it would have to start tracking such information. The former general counsel of GE, in a recent book, offered several examples of such information, including: special reports from functional experts within the corporation responsible for such key issues as the environment, health and safety, labor and employment; review of concerns going through the corporation’s internal monitoring or “complaint” system, such as GE’s ombudsman system; an assessment of trends in formal government proceedings lodged against the company; and an assessment of whether early warning systems were able to anticipate problems or controversies faced by the company. (See box 4 on page 29 for examples of corporations that tie incentive pay to societal concerns.)

More generally, directors regularly should consider how the company plans, manages, and communicates its interaction with society. The board should insist that management report regularly to it and to the public on non-financial performance, including social performance.* To institutionalize the process, the board may want to establish a special committee or empower its governance committee to take responsibility for oversight. That committee should report to the full board and appear regularly on its agenda.

CED, in previous policy statements, has discussed the critical role of the board of directors in the current era. Our focus in those reports started with the board itself—assembling the right talent for board positions and maintaining board independence. Once in place, we recommended that boards should be engaged in the development of managerial talent through succession planning and support and oversight of the corporation’s strategic plan. Those two elements—choosing the right leadership and having the right plan—are critically important in the current context as well. In addition, directors have an important role in

* Of course, these need not be the same reports, but public reporting must be truthful and easily understood.
promoting honesty in reporting and improving communications with shareholders and the general public.

**Choosing the Right Leadership**

There is probably no more important responsibility of a corporate board than to choose the right individual to lead the company as its chief executive officer. The CEO will choose the team that will run the corporation, make the key decisions that determine the corporation's performance, and set the corporation's culture, which will affect thousands of decisions made by individual employees on a daily basis—decisions that will not often rise to the board's attention but will have a substantial affect on the company's performance. 

When choosing a CEO, the board's selection committee should be mindful of the role that person will play in setting the tone and direction of the company with regard to ethics, integrity, and engagement with shareholders and other interested parties.

Those who study corporate performance, management, and governance credit the intangible asset of corporate culture as being among the strongest competitive factors driving sustained long-term superior performance. As the former general counsel of GE put it, “Ultimately, it is a company’s culture that sustains high performance with high integrity.” That culture comes from the company’s leadership and the “tone” it sets at the top of the company. “Tone,” of course, must be backed by action. Leaders have to be able to both communicate forcefully the company’s guiding principles and demonstrate that behavior with respect to those principles will have real (positive and negative) consequences. Executives and managers must know and understand that they have a formal responsibility for such key societal issues as environmental, health, and safety concerns.

Changes in the business environment, as described above, have changed the responsibilities of the CEO of

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**Box 4. Examples of Corporate Reporting on Compensation Tied to Societal Concerns**

Our recommendation to tie a portion of executive performance pay to metrics based on societal concerns is beginning to become practice in some leading corporations. Two examples of such practice follow. The disclosures made by these two companies are clearly a step in the right direction, yet short of ideal. They provide information about the existence of performance incentives linked to broader societal concerns, but they do not reveal much supporting detail.

The Dupont Company reported in its 2008 proxy statement that 20 percent of executive short-term incentive pay would be based on “individual performance.” As stated in the proxy, individual performance is “based on the employee’s performance versus personal, predetermined critical operating tasks or objectives (e.g., attainment of specific sales goals, achievement of fixed cost reduction targets, successful introduction of a new product). In addition to the employee’s contribution to the Company results, a factor in determining individual performance is a qualitative assessment of performance on the Company’s core values: safety and health; environmental stewardship; highest ethical behavior; and respect for people.”

The American Electric Power Co. (AEP) proxy statement reported the following: “In establishing performance objectives, the HR Committee considers the interests of other major AEP stakeholders, such as its employees and customers, in addition to those of its shareholders. For example, the HR Committee tied 2007 annual incentive compensation for all executive officers and other key employees to employee safety, environmental stewardship, customer reliability and diverse candidate hiring goals while also tying funding for annual incentive compensation to AEP’s earnings per share. For 2008 the HR Committee again established four categories of goals for AEP’s annual incentive compensation plan: Safety, Operations, Regulatory and Strategic Initiatives. The environmental stewardship and customer reliability goals are included in the Operations category, while the diverse candidate hiring goal is included in the Strategic Initiatives category.”

*Source: 2008 proxy statements.*
major, global corporations. Some observers have noted that as societal demands on business have increased, political skills have become a more valuable asset for corporate leaders.78 Thus, boards should consider a candidate’s ability to operate effectively in different environments and to communicate effectively to different constituencies alongside other standard business skills.

As we said in an earlier publication, the board’s role does not end with choosing the CEO.79 The board must remain engaged in succession planning. Such involvement is especially important with regard to maintaining a corporation’s culture and vision of its relationship with society. Although hiring from outside is always an option, it is important to grow talent internally. Among the benefits is that internal talent is steeped in the corporation’s traditions and culture and will adhere to its foundational principles.

Having the Right Plan: Company Codes, Value Statements, and Strategic Plans

In many corporations, tone and a culture of engagement start with a vision statement that establishes what the company stands for—what its value proposition is. Such a statement helps guide decision making and minimize risk by establishing a standard that goes beyond minimums established by local jurisdictions, which can vary considerably from place to place. In the best cases, such a statement underpins decision making and action. In the worst cases, it is forgotten immediately after being written and posted. Boards can play a role by helping to ensure that the corporation has a strong vision statement that is used to guide decision making.

One of the icons of corporate responsibility statements is a one-page “credo” of the Johnson & Johnson Company, written over 60 years ago, which puts in plain language how the company sees its responsibilities. The company takes great pride not only in the written words of the Credo but in its use as a guide to business strategy and action. It is credited as playing an important role in motivating the company’s highly regarded response to a crisis in 1982 and 1986 related to its Tylenol product, a small quantity of which was adulterated with cyanide and used as a murder weapon.80 Many commentators have pointed out that in this statement shareholders are mentioned last. (See box 5, page 31.) Other similar, though often longer, statements help many companies establish their identities, anchor expectations, and aid decision making.

In addition to individual corporate mission and value statements, such as Johnson & Johnson’s, many leading companies have signed onto global, regional, or industry-specific statements. Such statements, like the United Nations Global Compact (highlighted in Chapter 2), the Caux Roundtable Principles for Business, and others, provide a way for companies to demonstrate their commitment to well-established social principles and standards, which provide accepted benchmarks for performance. (Appendix 1 provides a select list of such principles and the organizations that support them.)

The question of how to address societal issues and where to locate responsibility for such issues is complicated. Identical solutions will not fit all corporations. Some corporations will find it useful to have a board committee with responsibility for environmental and other societal issues and so-called sustainability reporting. Some boards already have acted on environmental issues. Several companies have created new environmental committees; others use existing committees, such as the governance committee, to oversee environmental issues.81

The number of shareholder proposals focused on environmental issues nearly doubled from 2004 to 2008, and increasingly shareholders are asking for environmental oversight committees. A 2008 shareholder proposal, for example, asked three companies—Apple, Intel, and Kimberly-Clark—for the amendment of bylaws to establish a board-level committee on sustainability.82 As envisioned by its sponsor, such a committee would “be authorized to initiate, review, and make policy recommendations regarding the company’s preparation to adapt to changes in marketplace and

* Though the UN Global Compact and Caux Roundtable both offer companies a way to commit to social issues, tangible differences exist. For example, the Caux Roundtable encourages companies to follow a broad set of principles while the UN Global Compact attempts to verify compliance and remove companies from its rolls when they fail to meet obligations.
† The proposal received 7.2 percent ‘yes’ votes from Apple shareholders, 4.5 percent ‘yes’ votes from Intel shareholders, and 4.6 percent ‘yes’ votes from Kimberly-Clark shareholders.
‡ The SEC allowed a fourth proposal to Sunoco to be omitted from the proxy on the grounds that it constituted “ordinary business.”
Box 5. The Johnson & Johnson Credo

We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products and services. In meeting their needs everything we do must be of high quality.

We must constantly strive to reduce our costs in order to maintain reasonable prices.

Customers’ orders must be serviced promptly and accurately.

Our suppliers and distributors must have an opportunity to make a fair profit.

We are responsible to our employees, the men and women who work with us throughout the world. Everyone must be considered as an individual. We must respect their dignity and recognize their merit. They must have a sense of security in their jobs. Compensation must be fair and adequate, and working conditions clean, orderly and safe.

We must be mindful of ways to help our employees fulfill their family responsibilities. Employees must feel free to make suggestions and complaints. There must be equal opportunity for employment, development and advancement for those qualified. We must provide competent management, and their actions must be just and ethical.

We are responsible to the communities in which we live and work and to the world community as well. We must be good citizens – support good works and charities and bear our fair share of taxes. We must encourage civic improvements and better health and education. We must maintain in good order the property we are privileged to use, protecting the environment and natural resources.

Our final responsibility is to our stockholders. Business must make a sound profit. We must experiment with new ideas. Research must be carried on, innovative programs developed and mistakes paid for. New equipment must be purchased, new facilities provided and new products launched. Reserves must be created to provide for adverse times. When we operate according to these principles, the stockholders should realize a fair return.

Source: Johnson & Johnson
environmental conditions” that might affect the sustainability of the business.83

The response of the board of American Electric Power (AEP) to a shareholder proposal (ultimately withdrawn) is instructive. The AEP board undertook a study detailing how AEP might prepare for future regulations regarding the reduction of carbon dioxide and other emissions. The study, conducted through a committee process, recommended some scaling back of plans to invest in clean-coal technology due to concerns about future regulation. In addition, the board now ties some executive bonuses to environmental-performance targets. (See box 4, page 31.)

Our basic recommendation with regard to societal issues is not a “one-size-fits-all” solution. As each corporation is unique, each will have unique societal issues that may impact its performance. These should be the board’s concern. Our recommendation is simply that boards should play an active role in encouraging company management to evaluate the various options available and to decide explicitly what it ought to do, based on sound business grounds that incorporate a longer-term view. In some cases, it may decide to do nothing. In some cases, it may decide to set up a special committee, as many of the Fortune 500 have for environmental issues. Our view is that in most cases, especially for large global enterprises, the decision likely will be at least to adopt a value statement or modify an existing one, join one or more of the international standards (such as the Global Compact), or do both.

Once a decision has been made and justified, the board should monitor implementation and continue to evaluate the company’s strategy on the basis of long-term costs and long-term benefits. The integration of social considerations into strategy changes the company’s stance from reactive to proactive and interactive. It enables managers to think of social impacts not only as risk-management issues, but also as business opportunities (for example, GE’s Ecomagination initiative).

**Honesty in Reporting and Enhanced Communication**

Transparency—honest reporting—consistently ranks at or near the top of the list of what society cares most about.84 Based on survey responses, stakeholders appear to seek authentic interaction with corporations. Open and honest communication with shareholders and stakeholders can relieve some of the distrust shown by surveys. In the best case, it can build support and loyalty to a company’s mission, converting skeptics to engaged partners. In today’s world of open communications, all types of information about the corporation, much of it inaccurate, is available to anyone willing to search for it. In such an environment it behooves the corporation to make accurate, honest, and insightful public disclosures of its activities and its motivations—in a word, to be transparent.

Modern corporate boards are much more engaged in dialogue with shareholders than boards of the past, and much has been written about board-to-shareholder communications.85 The best advice recognizes that “shareholders have legitimate interests in information about corporate policies and practices with respect to social and environmental issues such as climate change, sustainability, labor relations and political contributions.”86 Dialogue with shareholders, of course, does not mean that directors must agree to everything shareholders want. In the first instance, the prevalence of competing and often conflicting demands makes it impossible to please everyone. Ultimately, directors must use their judgment about the course of action that is in the best long-term interest of the corporation.

*Directors should recognize the value of corporate communication with shareholders and the public on issues that bear on the company’s reputation and brand value, even when such communication may not be required by regulation or fit neatly into financial disclosure formats. Boards that have a non-executive chair or lead director may want to consider a communications role for that person on such issues and topics.* Many corporations are today reporting on so-called “triple-bottom line” results, also called “sustainability reporting,” which expands traditional financial reporting to include environmental and social performance. Such reporting serves several purposes. It opens or enhances communication with the general public, effectively demonstrating an outward commitment to transparency and the improvement of environmental and societal conditions and other related concerns. At the same time, it helps inform decision makers about social impacts, shapes deliberations
about corporate strategy, and helps to attract employees and customers.

To many corporate directors, however, “sustainability” reporting has become synonymous with an “environmental and social” report. To conflate these concepts pushes sustainability issues to the margins of most corporate discussions and decision making. To be most relevant, sustainability must be about the ability of the corporation to operate and add value over the long term because it can demonstrate a compelling understanding of, and strategy for, its financial, environmental, and social performance.

Although not officially sanctioned, many global corporations are using standard formats developed by the Global Reporting Initiative (GRI), which was initiated in 1997 by the non-profit group CERES and later joined by the United Nations Environmental Program (UNEP). At present, over 1,500 companies, including many of the world’s leading brands, have adopted its guidelines, according to GRI. Although GRI has become the most used standard, other options for triple-bottom-line reporting include the Enhanced Business Reporting (EBR) framework, which CED highlighted in previous reports with regard to disclosure of non-financial indicators of long-term value.

The global trend toward the adoption of sustainability reporting creates a de facto standard of reporting. Sixty-eight percent of the top 250 global companies listed on the Fortune 500 embrace sustainability reporting. A recent study issued by the Corporate Register shows that over the last ten years, corporate sustainability reports jumped from 462 to 2,450 worldwide. Such reporting, however, is significantly more prevalent among European firms than their U.S. counterparts. Of the six hundred new GRI reports issued by companies over the last two years, only forty-seven were submitted by U.S. firms.

As much as we consider environmental sustainability reporting to have important benefits, we are cognizant that such reporting has costs. Even simple monitoring and data gathering are not free activities. The costs of data analysis and actions taken based on such analyses must also be included. Third-party verification of claims in sustainability reports and common standards of reporting would make such reports more valuable, but at a cost. We also recognize that the costs of such reporting are likely to be a proportionately greater burden on small companies than on large ones. Thus, aside from mandated environmental and labor reporting to government regulatory agencies, corporate “sustainability” reporting should remain within the purview and at the discretion of individual companies (as they exercise their responsibility for honest and full communications with shareholders). Directors should use their authority to help their companies find a firm-specific way to communicate effectively with shareholders and the public—through the regular annual report to shareholders, a separate public report, or in some other way.

Our expectation is that many more companies than are now reporting will find it supportive of their long-term self interests to engage in such reports. And, many may find that the cost of not verifying claims and of not employing common standards may be greater than supposed, as unverified claims and non-standard reporting lack a degree of standing, are treated skeptically, and are more susceptible to challenge by NGOs, the media, and others. Of course, when corporate boards include environmental or labor criteria as a factor in senior management’s performance bonuses, as recommended above, reporting would be mandatory.

Some European countries are starting to mandate some environmental and labor reports. In 2006, the U.K. parliament passed the Companies Act, which requires an annual business report to include information on the environment, employees, and social issues. Denmark and the Netherlands also instituted mandatory environmental reporting, and France now requires all companies on the “premier march” of the Paris stock exchange to report on a series of social and environmental issues. The 2005 EU Accounts Modernization

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7 In October 2006, GRI published the most recent version of its reporting framework, G3, which details 49 core indicators, 30 additional items and their related protocols. Signatories to GRI are divided into categories for beginning (C), intermediate (B), and advanced (A) reporting. The lowest level, C, requires the firm’s most senior-level decision maker to articulate its approach to sustainability, describe the parameters of the report, identify the GRI indicators used, explain its governance structure and list stakeholders and how the firm engaged them to produce the report. ‘C’ level reports must also include at least 10 performance indicators with a minimum of one from each of the three categories (e.g. social, economic and environmental). Additional information can be found at www.globalreporting.org.
Directive compels medium and large companies to provide an annual report that includes financial and non-financial performance indicators, including environmental and employee issues.\(^9\)

U.S. firms by comparison lag in the adoption of “sustainability” reports.  A 2007 Grant Thornton survey found that only 29 percent of U.S. companies produce sustainability reports, either internally or externally.\(^9\) Fifty-five percent of executives say their companies have no plans to publish such reports in the future.\(^9\) There are some notable exceptions.  A recent (2008) report by Hewlett-Packard, for example, broke new ground by including a list of its largest suppliers as part of its annual “Global Citizenship Report.”\(^9\) Many NGOs have emphasized the importance of supply-chain issues, and in releasing its list, H-P said it hoped to increase suppliers’ accountability and that its increased transparency would lead to improved industry standards.

As discussed in Chapter 2, institutional investors, many of them based in Europe, are increasingly pressuring companies to publish sustainability reports, and the INCR has filed a formal petition with the SEC to require all public companies to disclose information on climate risk in mandatory filings.

Among the difficulties encountered in implementing sustainability reporting are the lack of standardized metrics that would allow comparison of performance across industries and companies. Some firms, according to RiskMetrics, report only “lagging” indicators of what has already happened instead of “leading” indicators that may help predict what will happen.\(^9\) Many firms report solely on environmental performance indicators, while others may include human rights and other concerns. Unlike financial audits, few companies enlist independent consultants or third-party organizations to evaluate and verify the legitimacy of their reports.

In March 2008, the International Corporate Governance Network (ICGN) issued a consultative document on non-financial business reporting that emphasized from the institutional investors’ perspective the desire for better reporting on ESG and other non-financial issues.\(^9\) ICGN wants to see ESG reporting integrated with consideration of other financial and non-financial factors that may affect the company’s ability to achieve strategic objectives. It notes that while separate “sustainability” reports can serve a wide audience, investors are interested in issues that have a material affect on corporate performance. Moreover, they point out that such material issues should be included in a company’s annual report, which is addressed to shareholders and approved by the board, thus demonstrating that directors have taken them into account.

To anyone looking at trends in corporate reporting, it is clear that the public, shareholders, and governments are demanding more, better, and more honest disclosures on nearly all aspects of a corporation’s performance. It is also important for business leaders to understand that in today’s global communications environment information is everywhere and accessible to everyone, meaning that even if they want to, companies cannot hide their interactions with society. Whether it is environmental, human rights, labor, or other societal issues, businesses—especially large global corporations—should expect their activities to be made public. In such an environment, proactive, transparent reporting, especially if externally and independently verified, puts the company ahead of the curve and gives it an opportunity to get its story across and take appropriate actions before others misuse the information.

Directors should promote honesty in reporting not only on financial results and other non-financial aspects of their company’s operations, but also on the risks, opportunities and results of its social interactions. Such reporting should show how the company evaluates the long-term impact of potential costs and benefits.
This chapter illustrates how some corporations have treated contentious societal issues. In the best circumstances they understand how their business interacts with society and apply that understanding to achieve strategic long-term goals. Like most business decisions, judgments have to be made under conditions of great uncertainty, and current policies and practices are chosen after some missteps along an irregular path.

The examples below concern the environment and climate change and human rights. They offer no simple solutions but rather illustrate the difficult problems companies face and the responses they develop. In these cases, corporate leaders have made considered judgments based on the facts, circumstances and trends. In several of these cases, companies have taken unpopular decisions. In all cases, it is too soon to render final judgments. While we do not second guess their decisions, their efforts raise important questions.

**Corporations and the Environment: Many Businesses are Trying to Incorporate Climate Change into Corporate Strategy**

Environmental concerns have slowly evolved from a fringe interest to a core concern of society. For many businesses, environmental issues have reached a tipping point, transforming them from a costly, adversarial problem to a net income generating solution. The adoption of environmental best practices can directly reduce costs, and eco-friendly technologies provide new profit opportunities. Consumers have shown a willingness to buy products from firms that minimize environmental degradation, take seriously the challenges of climate change, and employ environmental best practices. Companies that can help consumers to lower their own energy and environmental costs have a competitive edge in today’s market. The prospect of legislation to regulate or tax carbon emissions to address global warming will benefit companies that have begun to reduce carbon emission, and penalize those that have not.

In this setting, most corporate leaders acknowledge the problem of climate change. Sixty percent of global executives, according to a McKinsey survey, see climate change as a critical component to long-term strategy. Seventy percent of corporate executives recognize a causal link between climate-change best practices and corporate reputation and brand value.

Although most corporate leaders aspire to be part of the solution, few meet public or even personal expectations. Eight out of ten executives believe corporations should help ensure a clean and safe environment, though only half of all executives claim to meet that goal. Forty percent of global executives “seldom or never” account for climate change in product development, investment plans, regulatory strategy, or purchasing.

Corporate leaders, worldwide, increasingly consider climate change and other environmental trends an opportunity to enhance firm value, though U.S. companies are still more likely to see risks rather than opportunities. Four out of ten corporate executives consider the risks of climate change equal to the opportunities. Almost as many, thirty-seven percent, see climate change as mostly an opportunity with limited risks, up from 25 percent last year. Sixty-one percent of executives think that the effects of climate change, if managed well, will produce profits. An August 2008 survey conducted by the Deloitte LLP’s U.S. Center for Corporate Governance and Corporate Board Member magazine found that one half of respondents say climate change and business sustainability is integrated into their business strategy and risk management. The survey of more than 200 directors of large American public companies also found that the more committed a company is to addressing climate change, the more likely it is to include this commitment in its strategy.
and risk management practices. A McKinsey study found that companies that instituted climate-change risk-management policies out performed companies within the same sector but without equivalent poli-
cies.¹⁰¹

Many corporate executives say they expect (even want) government regulation, though many are ill-prepared for regulatory change. For example, 80 percent of corporate executives around the world expect the implementation of domestic climate change regulation within five years.¹⁰² And over 70 percent of corporate executives say they want government regulation, although they pointedly don’t want the government to become “controlling, restrictive or stifling.”¹⁰³

The imposition of regulation would challenge companies on many levels. Not surprisingly, most corpora-
tions do not have emission targets for greenhouse gases.¹⁰⁴

Seventy percent of corporate executives are not accountable, via performance review, for achieving climate-change targets.¹⁰⁵ A recent study found that 40 percent of all U.S. companies that operate within the EU have not started to prepare for the new European REACH environmental regulations, which will mandate manufacturers to report and cease from using chemicals harmful to human health and the environ-
ment.¹⁰⁶

Consumers say they are more likely to buy products from firms that act to abate climate change and envi-
ronmental degradation, but they admittedly need help telling the difference among companies with regard to climate change records. Half of consumers reportedly are more likely to purchase products from petroleum companies that invest in alternative energies. But, over 60 percent of consumers could not name companies friendly to the environment.¹⁰⁷ The same study found that people are more likely to buy from companies that produce environmentally friendly goods or respect the environment.*

The following case study on the oil industry aptly illustrates some of the contentious issues and com-
mercial challenges facing a key industry associated with environmental issues.

**BP and ExxonMobil**

Oil and natural gas company products account for almost 60 percent of U.S. carbon dioxide emissions. The oil companies have been challenged to recognize both their contributions to environmental impacts like global warming and the effects that climate change (and the efforts to address them) will likely have on their business models.¹⁰⁸ This section illustrates the different ways in which industry leaders BP and ExxonMobil have responded to these challenges.

**BP identified environmental trends, evaluated public opinion, spotted an opportunity, and took a calculated risk**

BP, formerly known as British Petroleum, is the world’s third largest integrated oil company. In 1997, Sir John Browne, BP’s chief executive at the time, argued in a widely distributed speech that BP could not afford to ignore a developing scientific consensus that linked human activities, via carbon dioxide emissions, to increased global temperatures and climate change. The speech marked a clear course change for BP, which previously opposed government action on climate change. Shortly thereafter, BP partnered with the Environmental Defense Fund, a member-based envi-
ronmental action group, to develop and implement an internal system for trading greenhouse gas emissions; sought consultation from socially responsible invest-
ment (SRI) funds and NGOs on sustainability report-
ing; and pledged to reduce emissions by 10 percent from 1990 levels by the year 2010.¹⁰⁹

Despite media praise across the country, the decision was risky, and appeared to make little strategic sense in the short run. Because BP’s portfolio of physical assets had a high ratio of oil to less-carbon-intensive natural gas, BP would need to make substantial investments to meet emission targets.

According to those involved, BP’s shift was a strategic and proactive attempt to carve out competitive advan-

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*According to the McKinsey report, “55 percent of the respondents say they have already refused to buy the products of a food and beverage company because they had heard it was acting against the best interest of society. Just as many say they have bought the products of a food and beverage company because they had heard it did something to benefit society. The average for all sectors surveyed was 49 percent for both buying and refusing to buy products.”
tage, gain market share, engage and enlist other constituent groups, and avoid becoming what one manager termed a “dying, Victorian smokestack industry.” Another recalled that “this was a business decision, a cold, hard way of getting competitive advantage by taking a distinctive position.” A third manager added that, “The question is whether we want to have a growth future or a shrinking future. These decisions are strategic. We believe that we, the oil companies, are loathed by the world’s publics. We have to rebuild trust.”

BP has, by-and-large, met its rhetorical aspirations with action. It received the top score of one-hundred global companies for climate change strategies. It cut greenhouse gas emissions by 10 percent below 1990 levels; partnered with Chevron to found the Carbon Mitigation Initiative at Princeton University to carry out research on carbon capture and storage, installed 4,100MW of cogeneration capacity; and in 2004 started a $350 million energy efficiency program. In 2005, BP announced plans to invest $8 billion in solar, wind, hydrogen and combined-cycle power technologies over the next ten years.

BP ties bonuses for executives to meeting environmental performance goals, mandates public disclosure of all climate change projects, and requires an independent audit review of various reports and emission totals. It instituted the position of Chief Environmental Officer, created an executive committee on the environment, and has been active in the development of industry protocols and guidelines for reporting greenhouse gas emissions.

Nevertheless, BP has had its share of negative publicity since committing to move ‘beyond petroleum.’ An explosion and fire at its Texas City oil refinery, due to failure to implement and enforce basic safety measures, led to the death of 15 oil workers and injury to 170 others. Excessive corrosion of a major pipeline caused a production shutdown at Prudhoe Bay. Though BP’s reputation for environmental stewardship cushioned the reaction of SRI and NGO communities, BP continues to bear criticism for both events, and these communities continue to monitor BP’s activities. Recently, a coalition of SRI firms condemned BP for contracting to extract oil from tar sands, which produces three times the greenhouse gas emissions of ordinary oil and uses large quantities of fresh water. One member of the coalition explained, “We do not wish to see the benefits of BP’s leadership as a renewable energy innovator to be offset by the harsh environmental impacts unleashed by tar sands development.”

In summary, BP refashioned its approach to climate change issues. It identified environmental trends, plumbed public opinion, weighed potential risks and opportunities, and moved proactively to incorporate climate change issues into its operations. It reached out to the general public and shareholders. BP improved its reputation and created comparative advantage where none existed prior, though, from time to time, it struggles to balance its commitment to the environment with short-term market needs.

ExxonMobil has mostly defended its position as the largest non-government, global oil and gas company.

ExxonMobil is the world’s largest integrated oil company. ExxonMobil CEO Rex Tillerson has frequently pointed out that over the next 25 to 30 years, the world is likely to require substantial fossil fuels to meet energy needs, and two-thirds will come from oil and natural gas. Thus, ExxonMobil has approached climate change mostly by continuing to supply the world with fossil fuels. Implicitly, if not explicitly, its business judgment has placed a premium on future oil and gas production and related services.

At the same time, ExxonMobil has quietly increased the energy efficiency of its refineries and chemical plants. Since 1973, ExxonMobil achieved a 35 percent reduction in energy and carbon dioxide intensity rates of production. ExxonMobil has interests in 100 cogeneration facilities in more than 30 locations worldwide. It has invested more than $1 billion in such facilities since 2004 and has an interest in power generation, with a capacity of more than 4.5 gigawatts. New facilities under construction around the world are expected to increase this capacity to more than 5 gigawatts in the next three years. ExxonMobil has pledged to invest $100 million over the next ten years to the Global Climate and Energy Project at Stanford.

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* See ExxonMobil’s comment, page 55.
University, chartered to develop new technologies to lower greenhouse gas emissions. It has also been active in the development of industry protocols and guidelines for reporting greenhouse gas emissions.

ExxonMobil’s considerable achievements in reducing emissions have been overshadowed by media reports on the company’s efforts to turn back various shareholder resolutions asking for action on environmental issues, and by its long-standing though diminished support for research and public advocacy denying the role of carbon emissions on global warming. (See ExxonMobil’s comment below.)†

Based on their evaluations of ExxonMobil’s business and communications strategies, both Goldman Sachs and CERES have ranked ExxonMobil last among major oil companies on their respective environmental indices. ExxonMobil discloses greenhouse gas emissions in their Annual Corporate Citizenship Report and in reports to the Carbon Disclosure Project. However, it does not set carbon emission reduction targets and does not quantify the potential impact of climate change on shareholder value or how possible climate change regulatory measures might affect the company’s competitive position. ExxonMobil has a Public Issues Committee that reviews the corporation’s policies related to safety, health and the environment, but does not have an executive or executive committee expressly focused on the issue of climate change. According to the company, climate change issues and policies have been reviewed annually by the full ExxonMobil Board of Directors. In addition, the CEO and other members of the Management Committee have discussed issues relating to greenhouse gas emissions and climate change.

ExxonMobil’s perceived actions or lack of actions have prompted a plethora of shareholder resolutions. In 2003, shareholders proposed a resolution for increased disclosure of the risks of climate change. In 2005, a similar proposal called for disclosure of the financial impacts of climate change. In 2007, shareholders also proposed a number of resolutions that asked ExxonMobil to develop specific greenhouse gas reduction goals, invest in renewable energy research and development, and publish a report on how to lead the development of technologies to achieve a more energy-independent United States. In 2008, 66 members of the Rockefeller family, long-term shareholders in the company, filed multiple shareholder resolutions that would require ExxonMobil to reduce greenhouse gas emissions, develop a renewable energy policy, and convene a task force to study how climate change impacts developing economies.

Change appears to be taking place. ExxonMobil has in some respects shifted its public stance. It stopped funding scientists whose work aimed to discredit the science of global warming. It also met with other large corporations and environmental groups to discuss steps to achieve cost-effective carbon-emission regulation. Philip Sharp, president of Resources for the Future and a meeting participant, noted that, “They (ExxonMobil) are taking this debate very seriously. My personal opinion of them has changed by watching them operate.” More recently, Kenneth Cohen, ExxonMobil’s vice president of public affairs, made a

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† ExxonMobil comments as follows: ExxonMobil’s response to shareholder proposals indicates that the company has already undertaken many of the proposed actions, and already published information asked for in new reports. ExxonMobil does not support research aimed at denying the role of greenhouse gases in global warming. It contributes to and supports a variety of research across the range of issues involved in climate change: a deeply complex subject. Ongoing research will be essential to advise policy responses in the future by providing improved understanding of the risks and opportunities to mitigate and adapt to them. ExxonMobil’s views on certain policy issues that must be considered in formulating a response to the risks of climate change should not be confused with denial of the underlying science or risks.

† ExxonMobil comments as follows: The company argues that estimating such financial impacts would be completely speculative at this time, since near and long-term policy decisions by key nations, including China and the USA, have yet to be taken. In ExxonMobil’s view, it is impossible today to assess potential implications for shareholder value from regulatory approaches to address rising greenhouse gas concentrations. The company believes that investments are long-lived and their commercial viability will depend on a combination of market and technological change as well as on policy and regulatory developments. In particular, this includes the different responses of competitors to the array of challenges, and in this sector, the response of oil producing nations and OPEC.

‡ The proposal received 22.2 percent ‘yes’ votes.

§ The proposal received 28.4 percent ‘yes’ votes.

** The proposal concerning greenhouse gas emissions goals received 31.1 percent ‘yes’ votes, while the proposal concerning renewable energy investment levels garnered 7.3 percent ‘yes’ votes.

†† The proposal concerning greenhouse gas emissions received 30.9 percent ‘yes’ votes, while the proposal concerning a renewable energy policy garnered 27.5 percent ‘yes’ votes.
remark that paralleled Browne’s speech twelve years earlier: “The risks to society and ecosystems could prove to be significant, so despite the areas of uncertainty that do exist, it is prudent to develop and implement strategies that address the risks.”

Despite these recent changes, much of the public, the scientific community, and the public policy community continue to view ExxonMobil as resisting change. With time, perhaps those views may change to align better with ExxonMobil’s current policy positions, assuming they hold steady. Yet, even its current policies garner controversy. ExxonMobil reportedly may continue to fund some organizations that deny the science of climate change, although as indicated above the company refutes such reports. The company has not signed the U.S. Climate Action Partnership, a leading alliance of over thirty corporations and environmental groups calling for implementation of a cap-and-trade mechanism to reduce greenhouse gas emissions. But the company indicates that it supports other policy approaches, including a more effective tax-based approach to controlling greenhouse gas emissions. (See ExxonMobil’s comment below.)

Investors appear split. On one hand, early in 2008, the company earned record profits and its shares soared. On the other, analysts place it far behind other oil companies in adapting to likely future conditions. As the company reported a drop in 2008 oil production of nearly 8 percent and an increase in costs of searching for new reserves, analysts questioned ExxonMobil’s strategy. If its judgments about climate change prove correct, ExxonMobil will likely continue to thrive well into the future. But if it has chosen the wrong strategic path, it is likely to suffer both directly because of opportunities missed, and indirectly because of the enmity and distrust it garnered by ignoring those calling for it to take a different course. (See ExxonMobil’s comment below.)

Corporations and Human Rights

Like the United States Bill of Rights, the Universal Declaration of Human Rights (UDHR) recognizes basic rights and freedoms of individuals. But where the Bill of Rights is enforceable in the United States, the UDHR is an aspirational statement subject to the laws and cultures of individual nations. The protection and promotion of human rights, therefore, often depends on the actions of other sectors of society, including business.

In market-based capitalism, as now nearly universally practiced, the business case for human rights is self-evident. Corporations depend on a socio-political environment that values and enforces individual rights. A lack of secure individual rights threatens the physical security of employees and physical resources, creates political instability, and adds risk to business planning and decision making. The absence of the rule of law or a well-functioning judiciary, associated with the absence of rights, makes for a mercurial and risky investment climate. Governments that refuse to respect human rights tend to act antagonistically toward entrepreneurs, property rights, and the free flow of ideas that underpin robust corporate performance.

The general case for business to promote respect for human rights is not necessarily the same as an individual company’s incentive to adhere to global standards of human rights. If it were, child and slave

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1 ExxonMobil comments as follows: ExxonMobil is an active member of numerous trade and business associations with public positions on climate policy that are responsive to the policy debate. ExxonMobil is active in numerous processes of policy dialogue including with Resources for the Future, the Brookings Institution and the US Center for Clean Air Policy. That the company has not joined one particular group—USCAP, which supports a cap and trade approach to greenhouse gas controls — is hardly a material comment. In fact, the company believes that the pros and cons of a variety of policy approaches should be considered. Indeed, the efficiency, transparency and predictability of a market-based approach using greenhouse gas taxes would appear to offer many advantages over cap and trade programs. This approach is supported by many leading economists, and was noted in a recent U.S. Congressional Budget Office report to be a far more efficient and transparent policy approach than a cap and trade approach.

† Although ExxonMobil’s share price fell significantly toward the end of 2008, its decline was about half that of the S&P 500 average and significantly less than its major competitors.

1 ExxonMobil comments as follows: As stated previously, the business viability of ExxonMobil will depend on how it manages a variety of strategic risks: commercial, technical, political and regulatory. To date, results have shown that ExxonMobil is an industry leader in this regard. Furthermore, ExxonMobil’s policy is to comply with all laws and regulations applicable to its business. As various jurisdictions adopt measures to address greenhouse gas emissions, ExxonMobil will apply its considerable technical and analytical resources to achieve compliance in a cost effective manner that preserves business value. Past performance in addressing the range of business challenges that confront the industry suggests that ExxonMobil will be at least as effective as its competitors in this process.
labor and other reported labor abuses would not occur. The record on human rights of large global corporations with name recognition and broad media coverage can be a significant factor for the value of their brands. Allegations of human rights abuses carry high costs of litigation, strained societal relations, loss of consumer trust, and often a presumption of guilt even if the allegations prove false.

Unlike environmental practices, human rights behavior cannot generate a revenue stream, although they can help avoid revenue losses that occur when a company is accused of human rights violations. Six percent of executives think human rights will influence shareholder value either positively or negatively.* Forty percent of executives, up from 34 percent last year, consider human rights standards mostly an opportunity with limited risks. 128 At best, corporations committed to human rights and a healthy and secure work environment can add to their bottom line through greater employee loyalty, easier recruiting, higher productivity, and the avoidance of negative publicity.

Survey data indicate that large U.S.-based corporations have an incentive to uphold high standards of human rights practice, and at least nine out of 10 corporations say they maintain a human rights policy or adhere to explicit human rights principles. 129 One study found that 62 percent of the public expects corporations to abate human rights abuse around the globe. 130 Another found that 71 percent of the public expects mutual fund companies to account for human rights abuses when investing abroad. 131

The lack of uniform terminology and reporting make it difficult to determine what practices and policies are actually in place. Many corporations confuse human rights with worker rights. Less than one-quarter of surveyed corporations recognize human rights that are not labor related, although those are most of the UDHR-guaranteed rights. Furthermore, the level of commitment is unclear. Although nine of ten corporations say they have a human rights policy, only half as many corporate executives as public respondents agree that corporations should actively try to abate human rights abuses globally. Half of all corporations say their supply-chain-management policies address human rights by either requiring or only encouraging suppliers to meet a standard. Three-fourths of all corporations commit to a safe work environment, although only 60 percent forbid forced or child labor.

The issues of human rights take many forms. Most people think of human rights and business in terms of supply-chain management, because news coverage has focused on that area. Revelations of abuses in the manufacture of apparel and other consumer products have threatened brands like The Gap and Nike, and have prompted them to take more control over their suppliers’ practices. Human rights issues have also had an impact on information and communications technology firms. The following case study focuses on non-labor issues that have arisen with regard to technology companies’ operations in China.

Information and Communications Technology Firms Struggle to Protect Human Rights in China

Information and communications technology (ICT) firms such as Yahoo, Microsoft, Google, and Cisco are in the business of facilitating and enhancing the flow of information. They face pressure from shareholders, customers, and others to promote transparency, human rights and other democratic ideals (including users’ rights of free expression and privacy), to support their companies’ reputations and thereby strengthen the value of their brands.

The Chinese market for ICT services is growing rapidly and presents companies with strong profit opportunities. Of course, any company must observe legal rules in countries where it does business. However, the conditions imposed by the Chinese government make it difficult if not impossible for ICT firms to meet harmoniously all of the expectations described above.

The Chinese government deploys a minimum of twelve agencies and tens of thousands of public and private

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* Some shareholders disagree. Investors Against Genocide, for example, initiated a campaign to target mutual funds invested in PetroChina, Sinopec, ONGC, and Petronas—all accused of indirectly funding genocide in Darfur.

† Conspicuous items include information on the Falun Gong spiritual movement, Tibetan independence, the Dalai Lama, Tiananmen Square, and web-sites Radio Free Asia, the BBC’s Chinese language service, and Wikipedia. Results of Internet searches of these words are displayed but links are inoperative.
personnel to monitor online behavior and enforce myriad Internet regulations. It polices cyber cafes, shuts down websites at will, provides a platform for citizens to report information harmful to national interests, and explicitly bans five-hundred keywords from public search. Internet service providers must obtain a license from the Ministry of Information Industry, maintain a comprehensive record of customer use for sixty days, and provide user information upon government request. To complicate matters, the U.S. government forbids U.S. companies from selling “crime control and detection” equipment to China (though experts debate whether U.S. law covers the sale of filters or other repressive information technologies).

What follows provides a sketch of recent actions of ICT firms operating in China, highlights the reaction of shareholders and other constituents, and suggests a potential pathway ICT companies might pursue going forward.

U.S.-based ICT Firms in China

Controversies that have sparked public reaction in the United States include the following:

- Shi Tao, a Chinese journalist, sent an email (from his Yahoo account) to an American pro-democracy organization explaining that a communist party official warned him of the risks to covering the 15th anniversary of pro-democracy demonstrations in Tiananmen Square. When asked by the Chinese government to turn over Tao’s user information, Yahoo complied. Tao was sentenced to ten years in prison.

- In a separate case, China’s Public Security Bureau arrested Wang Xiaoning, an advocate and writer, for “incitement to subvert state power.” Yahoo supplied evidence showing that Wang founded electronic journals Democratic Reform Free Forum and Current Political Commentary through Yahoo! Groups.134

- Google and Microsoft prohibit the search of words such as “human rights,” “freedom,” and “democracy.” The governments of China, Turkey, Syria, Pakistan, Thailand, and Myanmar at one point or another, all blocked Google’s YouTube for showing politically sensitive video footage. China, for example, banned the web site after video surfaced of Chinese soldiers beating Tibetan monks and dragging them through the streets.135

- Microsoft extirpated the blog of Anti (Zhao Jing), a research assistant for the Beijing Bureau of The New York Times. The termination followed a post that supported journalists at Beijing News who protested the dismissal of its editor-in-chief.136

- Cisco Systems sells China tens of thousands of routers programmed to monitor Internet usage, highlight for the secret police any ‘subversive’ sentiments, and prevent Internet users in China from accessing banned websites. Cisco also invented Policenet, which affords officials of the Public Security Bureau access to electronic records of all Chinese citizens.137

Shareholders and other corporate constituents reacted

The actions of Yahoo, Google, Microsoft, and Cisco described above spurred lawsuits, shareholder proposals, and condemnation by Congress. Journalists and editorial boards across the country repudiated the notion that obeying national laws and policies excused the companies’ actions.139

Guo Quan, a former professor at Nanjing University, announced plans to pursue legal recourse against Google and Yahoo for excising his name from search results.140 Shareholders issued proposals that called on Google to refuse “proactive censorship,” to employ all legal means to resist demands for censorship, and to stop storing information that could be used to identify users in countries that restrict Internet access.141 Harrington Investments proposed a resolution to have Google create a human rights committee.142

In 2006, Boston Common Asset Management (BCAM) put forth a shareholder proposal that would have required Cisco to adopt a human rights policy and issue a report that explains how the Chinese use its products.4 Subsequently, BCAM and the NGO Reporters Without Borders formed a coalition with 35
investor institutions that support "shareholder resolutions that we believe are favorable to freedom of expression." In congressional testimony, BCAM remarked that "engaging in short sighted business operations that undermine widely accepted human freedoms is simply not a sustainable practice." What can companies do?

China's continued economic expansion will be built, at least in part, on a thriving information and communications technology sector. The complicated decisions companies like Yahoo, Google, Microsoft and Cisco face will not abate anytime soon.

Going forward, the tradeoffs for these companies involve difficult calculations about the relative benefits and costs of actions in both home and host countries. The profit opportunities for leading ICT companies in China are substantial, yet bad publicity and negative reaction in the United States can hurt their reputations and share values.

One prominent solution proposed to guide company behavior in this sector is "for the industry as a whole to develop clear protocols for how to interact with governments when faced with these sensitive issues, whether in China, Europe, the United States or elsewhere." The Berkman Center for Internet & Society at Harvard Law School has partnered with the Center for Democracy and Technology and Business for Social Responsibility, leading human rights groups, academic institutions, and technology firms to develop a set of "Principles on Free Expression and Privacy." The initiative, agreed to in Fall 2008, outlines a set of principles for businesses to follow "when they encounter laws and practices that may contravene international human rights standards or are at odds with law or culture in their home jurisdiction."

The Principles on Free Expression and Privacy initiative might constitute a way forward for ICT companies. The initiative should encourage companies to shift their strategies from reactive to proactive. Yahoo, Google, and Microsoft, in an effort to determine what laws, social norms, or principles should bind their behavior abroad, actively participated in this and other initiatives. Though the initiative applies especially to the information and communications technology industry, a similar approach could be instituted across other sectors that face similar constraints and pressures.

A Role for Directors in Considering Corporate Strategy and Societal Concerns

Business decision makers operating in globalized markets may need little reminding of how complicated such markets are and how strategically important societal issues have become. Whether decisions are made after considerable deliberation or in the heat of a moment when there is little time to do other than react, business decisions that intersect with societal interests can reverberate in unexpected ways.

Directors can play a key role in helping a company to get ahead of the curve, to step outside of day-to-day pressures, and to think strategically about the long-term interests of the corporation. As discussed in Chapter 3, directors are uniquely placed to ask tough questions about how a corporation's strategy interacts with societal concerns that form the landscape in which the business operates and to develop appropriate incentives for company executives to deal constructively in that landscape.

As the studies above illustrate, there is not one answer that fits every circumstance. But a number of existing internationally accepted initiatives, such as the UN Global Compact, the guide published by the Business Leaders Initiative on Human Rights, or the recent report issued by UN Representative John Ruggie, might serve as guideposts for forward-thinking directors who want to incorporate human rights best practices into daily operations. Directors should determine what initiatives, or perhaps what principles within various initiatives, best fit their firms' specific goals regarding human rights, and then ask management to put forward plans to implement such policies.

Companies simply cannot avoid confronting the hard questions posed by environmental, human rights, and other societal concerns. In the next chapter we examine the role government can play to help companies better address these concerns.

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* Google's share price, for example, dropped considerably the day of the Congressional hearing.
† Additionally, Yahoo launched a Business & Human Rights Program, started a fund to "provide support to other political dissidents and their families," and began lobbying the United States government for the release of the journalists.
Throughout the preceding chapters we have drawn distinctions between businesses in general and publicly held corporations in particular. Our primary interest is in public corporations, which generally are larger than privately held corporations, partnerships, and other forms of business organization. Public companies are more highly regulated with particular regard to disclosures and requirements for reporting to shareholders. But, as noted throughout, in large measure the kinds of societal pressures faced by public corporations are common to all businesses.

Two persistent issues that filtered through our discussion are the topics of this chapter:

First, is the competitive field balanced between public and private forms of business? In particular, do private-equity-owned corporations face the same societal pressures and obligations as their publicly held counterparts?

Second, what is the proper division of labor between business and government? Shouldn’t governments take primary responsibility for addressing societal concerns?

**Issue 1: Corporations Owned by Private Equity Companies Face Many Similar Market Pressures but Different Corporate Governance Requirements**

The actions of private firms are subject to the same market forces and the same societal pressures as large, public corporations. Of course, private-equity-owned firms differ from public corporations on a number of accounts: disclosures; access to funding; executive compensation; shareholder/ownership rights; and investors’ liquidity to name a few. But these differences neither protect private firms from market competition nor free them from exposure to societal concerns (including government regulation). In fact, market forces, pressure from non-governmental organizations, and enlightened self interest continue to nudge these private firms toward a more operational and sustained integration of social issues with company strategy. Others, of course, remain resistant to change or fly under the radar of social monitors.

This section chronicles two short examples, focused on private-equity firms, to illustrate how some such firms have interacted with contentious societal issues. As in the previous chapter, we neither offer pat answers nor render final judgments. Instead, the examples aim to highlight recent developments and evince the complications that private-equity firms face and how they have responded. The first example focuses on the acquisition of TXU Energy by Kohlberg Kravis Roberts & Co (KKR) and Texas Pacific Group (TPG); the second examines the Carlyle Group’s acquisition of the nursing-home chain Manor Care.

**KKR and TPG partnered with the Environmental Defense Fund to integrate environmental concerns into corporate strategy**

In February 2007, KKR and TPG bought TXU for $69.25 a share, a 20 percent premium, and assumed nearly $13 billion in debt. The deal was valued at $45 billion. On the surface, the deal, excluding perhaps its exceptional size, seemed similar to the 160 other transactions conducted by KKR over the last 30 years. But KKR, for the first time, enlisted the advice of the Environmental Defense Fund (EDF), an environment-focused nonprofit organization. EDF acted as a consultant and eventually endorsed the sale of TXU to the private-equity firms. The partnership, itself unusual, received wide media coverage. When EDF endorsed the acquisition, praise proliferated across environmental web sites and prominent news media. The *International Herald Tribune* characterized the deal as an ‘environmental watershed.’ CNN averred that “Private equity goes green.”

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* As this report was being written, KKR was in the process of becoming a publicly traded corporation. It remains privately held as we publish. When it acquired TXU it was privately held.
The deal garnered attention for a number of reasons, among them the initiative shown by KKR and TPG’s approach to EDF. For almost one year prior to the deal, EDF had led an aggressive media campaign to educate Texans about the threats posed by TXU’s proposed plants, rallied political support and threatened legal action. TXU responded in kind. The back and forth devolved into a virtual shouting match with neither organization appearing to listen to the other. Though it might appear to some that KKR partnered with EDF to mollify and effectively quiet EDF and other environmental activists, and that EDF agreed to the partnership to serve private rather than public interests, the facts point to a different conclusion.

Most important, the KKR-EDF partnership did not end after the acquisition of TXU, and was not limited to that one acquisition. KKR, showcasing an interest in environmental issues over the long run, asked EDF to serve as an adviser on energy consumption, waste output and carbon emissions for KKR’s entire U.S. portfolio, in what it termed its “green portfolio project.” EDF agreed to serve in an unpaid capacity to maintain its independence and to be able to continue to push aggressively for various environmental reforms. In addition, EDF won a number of concessions in the TXU acquisition. On the front end of the negotiations, the investors committed to scale back the planned building of coal plants, from eleven to three. KKR and TPG also agreed to reduce TXU’s carbon emissions to 1990 levels by 2020; endorse the platform of the U.S. Climate Action Partnership; tie executive compensation at TXU to climate stewardship; double investments in clean, renewable energy; and establish a Sustainable Energy Advisory Committee to help the company adopt a more green business model.150

The partnership, put plainly, proved much more than an attempt by a private company to “buy off” activist concerns; nor was it a “sell-out” by an NGO. Instead, the partnership was an earnest effort by both parties to get ahead of an ever-evolving market. According to the co-director of KKR’s energy practice, KKR wanted to partner with EDF to “get ahead of an issue, and potentially set an example in terms of how best to manage, monitor, and improve environmental footprints across the portfolio.”151 One expert, commenting on the KKR-EDF partnership, makes the broader point that “some of the largest corporations whose very business model depends on environmental damage are moving away from their core business practices to emphasize sustainability and resource protections.”152 Put slightly differently, investors that once eagerly funded power plants without regard for environmental externalities are showing a more long-term concern that relies on a business model incorporating environmental outcomes and concerns about sustainability.

The partnership also speaks to the universal nature of societal concerns and the value of a proactive corporate strategy. The fight over TXU’s environmental effects had nothing to do with its status as a public or private corporation. Likewise, KKR’s embrace of environmental concerns was indistinguishable from what a forward-looking public corporation might have done. The case is distinctive because corporations generally have not actively sought cooperative ventures with NGOs; only recently have they started to seek out such strategic partnerships. KKR and many of the public corporations we have examined are leveraging such partnerships to get ahead of a changing market, with the expectation that, over the long run, they will be able to realize tangible gains. The same logic applies to the interests of NGOs like EDF, which recognize that they need the scale and influence that reside in the private sector. As we note below, from the corporate perspective the primary differences between public and private endeavors of this type is the nature of public disclosure.

The Carlyle Group and the SEIU engaged in an acrimonious dispute over the purchase of Manor Care

The Carlyle Group, with the purchase of Manor Care, owns 37,000 beds that span 30 states and 552 different facilities. On the surface, the Carlyle Group’s acquisition of Manor Care nursing homes shares many similarities with the acquisition of TXU by KKR and TPG. Carlyle bought Manor Care for $67 per share, a 20 percent premium over Manor Care’s stock price; assumed $5.5 billion in debt; and paid Manor Care executives over $250 million. But the execution of the deal differed drastically from the aforementioned case. KKR and TPG were able to develop a strategic partnership with EDF, TXU’s principle critic, to integrate environmental concerns into corporate decisions. The Carlyle Group, in contrast, became embroiled in a caustic fight with the SEIU, which represented Manor Care workers and presented itself as concerned primarily with the quality of patient care rather than the employment and working conditions of its membership.
The Carlyle Group’s attempt to purchase Manor Care drew the interest of the SEIU for a number of reasons. First, Carlyle’s purchase efforts began shortly after one expert published a report finding that nursing homes purchased by large investment firms scored worse than national rates on 12 of 14 indicators that regulators use as a means to measure the care provided for long-term residents. The report spurred ranking members of the Senate Finance Committee to send letters to a number of investment firms, including Carlyle, regarding the role of private equity firms in the nursing home industry. In a press release, Max Baucus, Senator from Montana, pointed out, “Nursing homes aren’t just investment vehicles. They’re homes for some of America’s most vulnerable citizens.” Many of the investors, by contrast, argued against the validity of the findings. Most contended that the buyouts actually turned around nursing homes approaching bankruptcy. In short, Carlyle’s attempt to buy Manor Care took place as controversy erupted over private-equity acquisitions of nursing homes in general.

Adding to the tension, Manor Care itself had a history of falling short on a number of standards of care and compliance before the acquisition. Between 2004 and 2007, Manor Care was found to have 23 percent more violations of standards of care than in the previous three years. Eight out of 10 Manor Care facilities reported nursing staff levels below government recommendations. In Pennsylvania, 30 Manor Care homes were cited for failing to provide the care and services deemed necessary to maintain the highest quality of life. Ten were cited for failing to prevent the spread of infections. Eight were cited for failing to store, cook, and provide food in a safe way. Across the country, only 4 percent of Manor Care nursing homes were in compliance with federal care standards.

Manor Care’s poor performance along with skepticism surrounding the deal set the stage for the SEIU campaign. From when Manor Care shareholders approved the buyout until the deal closed, SEIU led a campaign to commit the Carlyle Group to improve patient care and provide quality health care for patients and employees. A significant concern for SEIU was that the debt assumed by Carlyle would necessitate cost-cutting measures including layoffs of union members.

Carlyle attempted to ease public and union concerns by issuing a ‘patients first’ pledge. The pledge, which promised high-quality care, education and training for staffers and state-of-the-art facilities, constituted a rare step for a private equity firm. A Carlyle spokesperson stated, “It would not be in our interest in any way to have patient care suffer. It is fundamental to our investment thesis that we continue to improve and enhance patient care because that will attract even more patients and make this a better investment. This is logical and simple. If we didn’t provide good care, we wouldn’t have good patients.” Nevertheless, SEIU and some health care experts dismissed the pledge, however earnest. The math, most alleged, did not add up. They asked, “How could a private equity firm at once assume billions of dollars of debt, improve the quality of patient care, which would require additional short-term costs, and pass profits along to shareholders?”

Carlyle’s failure to provide specifics to back up its “patients-first” pledge, and the SEIU’s predictable opposition to the pledge, provided the impetus for an increasingly bitter dispute. David Rubenstein, co-founder and Managing Director of the Carlyle Group, remarked, “The SEIU is not happy that 60,000 workers at the company aren’t unionized...It’s really an effort to increase unionization, and not so much to worry about patients’ health care.” Andrew McDonald, a spokesperson for SEIU, retorted that “Long before Carlyle chose to target nursing homes as their latest cash cow, SEIU has been fighting to improve care in nursing homes...SEIU has fought for and won hundreds of millions of dollars in funding to improve care over last decade.”

The Carlyle Group completed its takeover of Manor Care at the end of 2007, and acrimony between Carlyle/Manor Care and SEIU continues. The SEIU still stages protests, and now runs a website, “Carlyle Fix Manor Care Now,” which aims to hold Carlyle accountable for its promises. Similar to “Wal-Mart Watch,” the website highlights news stories that allege poor standards of care, less-than-state-of-the-art facilities, perceived abuse of workers rights and inadequate staffing levels. For its part, Carlyle and Manor Care have been relatively quiet, appearing to adopt an ignore-it-and-it-will-go-away strategy. An Internet and news media search revealed only one relevant press release from Manor Care announcing the formation of an independent advisory committee on quality of care.
Contrasts between public and private-equity-owned firms

The public does not discriminate between public and private corporations. Nor, at this scale, do non-governmental organizations or society at large. Private firms, as illustrated by the above examples, face strong pressure to serve public as well as private interests. Neither public nor private companies need adopt universal, once-size-fits-all solutions. Partnering with non-governmental organizations, for example, might make sense in some cases but not in others. Conflict and confrontation are sometimes unavoidable. The more important point is that both publicly held and private-equity-owned businesses must become more adept at incorporating societal concerns into strategic frameworks and business plans.

Were the Carlyle group a public corporation, one also might expect to see the SEIU pursue its concerns about patient quality and workplace standards through shareholder resolutions, which have become a principal means for union pension funds to express their membership’s concerns. In addition, one might expect more public reporting by the company about its efforts in these areas, in contrast to its virtual silence on these topics currently. Paradoxically, the SEIU pension fund, like other union and public pension funds, is a major investor in the Carlyle Group and stands to benefit financially from Carlyle’s investments. But, investor rights in private equity funds are more circumscribed than in public corporations.

For private firms, voluntary disclosure might serve as a starting point. Private firms are not compelled to disclose as much information as public firms. Information disclosed voluntarily via press releases, as demonstrated by Carlyle’s patient pledge, often faces intense scrutiny and skepticism from non-governmental groups and society more broadly. As pointed out in earlier chapters, the internet and communications revolutions have given anyone with Internet access the power to develop and disseminate information in ways that conflict with a business’s own attempt to craft a message or image about itself. Many businesses will find that honesty and fair dealing are the only safe harbors.

Nonetheless, private-equity-owned corporations will have some competitive advantages over public corporations solely because they retain more discretion and more choice than public corporations with respect to disclosures. Public opinion is strong but not always strong enough to compel such private firms to act as if they were public ones. How great an advantage a private firm might have in this dimension is unclear, and a case can be made that in the current era of openness the insularity of private firms may in fact be a disadvantage.

A similar judgment might be reached with regard to shareholder resolutions. Private-equity-owned firms do not have to deal with such resolutions, which are viewed by many corporate executives and directors as an annoyance. But shareholder resolutions can in the long run make public corporations stronger, not weaker, as they force corporate boards to confront issues they might otherwise have ignored. Either way, private equity firms are, like public corporations, dependent on capital markets. Because the sources of capital are essentially the same in all markets, the lack of certain formal shareholder rights in private equity investments does not mean that providers of capital—notably public and union pension funds—will be less assertive in private markets than they are in public ones.

Issue 2: What Are The Proper Roles and Responsibilities of Government, Business, and Non-Profits with Regard to Societal Concerns?

Government plays many economic roles in market capitalist systems. Among governmental objectives are: macroeconomic growth and stability; social equity in the distribution of income and taxation; and regulation of market competition. Most important to the issues addressed in this report, government is generally expected to provide public goods and compel private entities to account for the costs (externalities) they impose on society—the two primary concerns that corporations are increasingly called upon to address.

Providing Public Goods

Public goods come in many forms. In economic terms, public goods are characterized by non-rival consumption and non-excludability—that is, one person’s consumption does not reduce the good’s availability to others, and producers cannot block its use by any particular individual. Government provision of national
security and infrastructure are the most frequently cited examples.

A clean environment and a culture of respect for human rights also can be considered as public goods because they can be enjoyed by all. (As discussed below, these “goods” also can be analyzed as externalities.) Clearly, government has the primary role in establishing and enforcing social policies in these areas, and that is what governments around the world have done. Normally, the business role is to obey local laws and regulations. But laws and regulations typically set minimums. Many businesses, especially global corporations, often exceed these minimum standards. In developing countries, global corporations often raise local standards by importing environmental and labor practices they employ in higher-income countries. For example, tight labor markets for skilled workers, despite an excess supply of unskilled labor, often cause global corporations to provide higher compensation either in the form of higher wages or improved fringe benefits.

In advanced economies, like the United States, the pressure to exceed regulatory minimums is strongest when it appears that government policies lag behind societal attitudes. For example, most observers consider that U.S. environmental policy has not caught up with societal concerns about the risks of climate change. That has two important effects. First, it creates a demand for businesses to accept voluntarily some of the costs of complying with higher standards. Second, it creates a mix of risks and opportunities for businesses based on their evaluation of changes in policies that might occur when the political system eventually acts to satisfy societal opinion. Throughout this report we have discussed these two effects and the need for corporate leaders to address them in cost-benefit terms.

In the U.S. context, a lack of trust in political institutions undermines social progress and shifts public demands from political leaders to business leaders. Some businesses have calculated that the benefits of leadership in areas of societal concern outweigh the short-term costs. For others the costs are just too great, especially when competitors may not follow suit and markets will not reward their leadership. As noted in Chapter 4, business leaders increasingly urge regulation to create more certainty in the marketplace and to level the competitive environment.

A better outcome would be one where political institutions could be relied upon to address intelligently public concerns and close the gap between social expectations and government policies. The recent example of the government’s response to the financial crisis of late 2008 makes such outcomes seem illusory. After the President and Treasury Secretary proposed a broad and unrestricted grant of authority to spend $700 billion to shore up the failing financial system, Congress seemed set to pass a revised bill that, however imperfect, seemed able to go a long way to stabilize the financial markets, at least in the short term. But partisanship, doctrinaire views, internecine squabbling, lack of confidence in the executive branch, or some combination of these factors scuttled an initial agreement among political leaders of both parties. Although a rescue bill finally was approved, the high-stakes drama, played out before an anxious nation, revealed how badly fractured the institutions of national governance are.

Elsewhere, CED has addressed the problem of Washington’s broken policy process. The situation we describe here is but one manifestation of the cost of that problem. It is, to say the least, an unusual situation when business leaders are virtually asking for regulation. Our conclusion and recommendation is that political leaders should understand the costs they impose on business and society at large if they do not take action to improve political governance and policy making. They need seriously to address reforms in ethics, lobbying, redistricting, earmarks, and other legislative procedures and executive practices to break the logjam holding back policy reforms in substantive areas such as global climate change.

Another type of public good is the ability of governments to facilitate collective action, that is, to prompt (without the force of regulation) individuals or businesses to act in their collective interests when the incentives for each potential actor are either not strong enough to induce action or, in fact, push in the opposite direction. The incentive for free riding, for example, can inhibit individuals and businesses from taking costly action when they might benefit from the action of others while themselves doing nothing. The government’s involvement in the promotion of codes of conduct and other “voluntary” industry programs is an example of such “collective action” and the use of the government’s power of persuasion. Many of
these industry codes, such as the apparel agreement, extractive industry agreement, and others, have come into existence with at least some governmental encouragement. The Extractive Industries Transparency Initiative (EITI) provides a good example of how government can use its good offices to bring interested parties together to establish a voluntary agreement to benefit all.

The objective of the EITI is to achieve “greater transparency in payments and contributions made by companies and revenues received by governments for natural resource extraction.” It evolved out of a number of prior initiatives, starting with a 1999 report of the NGO Global Witness, *Crude Awakening*, which focused attention on corruption of government and military leaders in Angola, oil companies that lacked transparency and accountability, and lending practices of the international financial institutions. The report triggered a coalition of Global Witness, Transparency International-UK, the Publish What You Pay campaign, and ultimately the UK’s Foreign & Commonwealth Office, which spearheaded the EITI initiative.

The litany of problems faced by companies in extractive industries and local economies with high-value natural resource endowments is well stated in the following passage:

> The squandering of public revenue skews patterns of investment and further enriches elites; it corrupts governance and erodes the rule of law; it exacerbates regional conflicts and threatens national unity; it deprives local communities of their right to development and condemns them to poverty. Companies’ bottom lines may not be affected in any one year, but the cumulative squandering of revenues takes its toll: it challenges their social license to operate; endangers their local operations; and threatens their global reputations. It does so by stoking tensions between oil-producing communities and the companies operating amidst or in close proximity to them. It puts companies in the unwanted position of acting as de facto surrogate governments, due both to the default of the real government authorities and to the sometimes violent demands of the local communities. And it can make the companies appear complicit in human rights abuses committed by security forces called in to quell local unrest and disruption of oil operations.164

As destructive as these results are, little incentive exists for any individual company to break from existing practices. BP tried unsuccessfully in 2001, when it announced (separately from the Publish What You Pay initiative) that it would disclose all contract payments made to Angola. But the Angolan government pushed back and BP dropped the initiative.

BP’s action, however, served as a tonic to the group of non-governmental organizations. It also made clear that any initiative would have to include both oil companies and governments of oil-rich nations. In 2002, George Soros provided the necessary financial support to the now umbrella “Publish What You Pay” campaign. And at Soros’ urging Tony Blair, at the 2002 Johannesburg Sustainable Development Summit, announced plans for the EITI. Shortly after Blair’s announcement, the UK government convened a conference composed of 140 delegates representing seventy governments, companies, industry groups, international organizations, investors and non-governmental organizations.

Under public pressure from this collective group, and the use of what is sometimes called “soft” government power, companies and governments were able to agree to the EITI principles, which oblige companies to publish what they pay for extractive mineral rights and governments to publish what they receive.

Since the conference, the EITI has enjoyed some initial successes, although more difficult stages of implementation lie ahead. Nearly 40 of the world’s largest oil, gas and mining companies endorsed the EITI, and the vast majority has completed the ‘International-level Company Self-Assessment Form.’ The EITI also garnered the endorsement of the G8, G20, African Union, European Union, and over 70 global investment institutions that together manage $14 trillion in assets. Twenty-three countries have reached ‘EITI Candidate’ status, meaning that the country met the sign-up indicators. Another ten countries already published audited EITI reports. Many more are at present working toward the above goals.
Another example from an extractive industry, diamond mining, illustrates both the role that governments can play and the potential benefits of a corporation’s social strategy. Since 2003, diamond production has operated under the rules of the Kimberley Process Certification Scheme (KPCS), which certifies shipments of rough diamonds as coming from areas that are “conflict-free.” The initiative started when Southern African diamond-producing states met in May 2000 to discuss ways to stop the trade in ‘conflict diamonds’ and ensure that diamond purchases were not funding violence. It has grown to incorporate 48 members, including the United States and the European Community. Member companies account for approximately 99.8 percent of the global production of rough diamonds.

The activities of the De Beers company, the leading global producer of rough diamonds, are particularly relevant to both the role of government action and the broader theme of the interaction between corporate strategy and societal concerns. Before taking a strategic turn toward a society-based strategy, De Beers had a reputation as a profit-maximizing (near) monopolist, largely unconcerned with its impact on the African societies in which it operates. By the late 1990s, De Beers’ strategy was yielding fewer benefits for the company, and the proliferation of so-called ‘blood diamonds,’ linked to rebel groups that forced workers to mine for diamonds to secure financing for arms purchases, was damaging the reputation of the diamond industry and hence De Beers’ profits.

In response to social and market pressures, De Beers repositioned its strategy to work with governments, local communities, and non-governmental organizations. De Beers worked with NGOs on the blood diamonds issues and was instrumental in the creation of the World Diamond Council to represent the international diamond industry in the Kimberley Process. Although De Beers’ market share dropped from a high of 80 percent to 40 percent, its profits have increased under the current regime, which reassured consumers and reinvigorated the diamond market.

De Beers’ strategy has not been confined to engagement in the Kimberly Process. Its leadership in Botswana, in particular, has helped both the company and the country to thrive. De Beers’ specific operations in Botswana are built around a 50-50 partnership with the government (aside from the government’s overall stake in the De Beers company). In addition, De Beers has built roads, hospitals, and schools, instituted HIV/AIDS treatment and awareness programs, and hired over 600 locals to work at a new diamond sorting plant moved recently from London to Gaborone, Botswana.

De Beers’ transformation benefited from strong leadership, local knowledge, and, at least with regards to Botswana, an eager and engaged democratic government. Gareth Penny, chief executive of De Beers, recognized the interdependence of business and society, remarking that “we think our approach is a competitive advantage...the country can now attract banks and service industries—and avoid the natural resource curse....We are part of the solution.” Another key part of the solution has been the active support and participation of the government of Botswana, which has been democratic, intelligent, and relatively free from corruption, according to Transparency International.

Regulating Externalities

An externality is the effect of an economic decision by one party on others whose interests were not taken into account. Such effects may be positive or negative, although governments are most frequently called upon to limit the effects of negative externalities, typically through taxes or regulation that compel firms to recognize or “internalize” the costs of externalities imposed on others.

Government regulation of externalities and business strategy intersect in several ways. Most obviously, businesses must implement programs to comply with government mandates in areas such as environmental protection, labor rights, bribery, money laundering, and other concerns. Businesses have adopted programs either in anticipation of regulation or to show that less onerous voluntary efforts could accomplish goals similar to those of proposed regulatory mandates. Regulatory programs have spurred many businesses to offer new products and services to fulfill the needs of

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1De Beers Investments is a privately held, ownership company registered in Luxembourg. It has three shareholders: Anglo American plc, a publicly trade corporation, holds 45 percent of shares; the Oppenheimer family’s Central Holdings holds 40 percent of shares; and the Government of the Republic of Botswana owns 15 percent.
new markets created by regulations. U.S companies, for example, have been among the leaders in development, production, and sales of emission control devices such as scrubbers, catalytic converters, and other products developed in response to clean air standards.

Over a decade ago, CED published a policy statement, Modernizing Government Regulation: The Need for Action, which contained recommendations for improving government regulation to account for social concerns. (The “findings” of that report are contained in box 6, at right.) CED articulated four overarching principles that continue to serve as a guidepost for sound regulatory policy:

- Regulation is warranted only when markets do not work as well as regulation to protect citizens and consumers.
- Regulatory authority should not be exercised capriciously, and the delegation of such authority by Congress to regulatory bodies should be limited to ensure this.
- Congress and the regulatory agencies should publicly and objectively evaluate in some form the expected benefits and costs of proposed major regulatory efforts, using disinterested, professional, scientific advice. Such evaluations should also be applied periodically to major existing regulations.
- Where feasible and effective, regulations should be applied with a “soft touch” that allows flexibility of response, including the use of market incentives, in lieu of command-and-control directives.

These principles and findings pointed to what some now term “smart regulation.” Smart regulation draws from an array of ideas linked to performance-based and principles-based regulation. It rejects one-size-fits-all models and the extremes of rules that are either too loose or too rigid. It seeks to strike an appropriate balance between flexibility and efficiency.

An overly rigid regulatory regime with strict enforcement provides dependability and predictability. Corporations will, not surprisingly, comply with regulatory rules, often staying within their strict confines while testing boundaries. But a rules-based regulatory model that directs all corporations to adhere to identical requirements does not always make political or practical sense. Overly burdensome regulations are costly and hamper economic growth. Historical circumstances account for much of the United States’ regulatory regime being rules-based, but it is doubtful that newly imposed regulations would follow this path. Most analysts view rules-based regulation as focused too narrowly on the targeted outcome while neglecting

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**Box 6. Findings of Modernizing Government Regulation**

The American people overwhelmingly—and correctly—believe that government regulation is needed to achieve many important economic and social goals. Regulations spring directly from the desire for clean air, drinkable water, safe workplaces, reliable financial markets, improved medicines, and competitive industries. Government regulation is therefore a large and necessary presence in the American economy.

Nevertheless, the current regulatory system produces too few benefits at excessive cost. This is not well understood by the public, since the main costs of regulation are hidden from public view. Those costs show up only indirectly in the form of higher prices, diminished product variety, lower rates of innovation and productivity growth, and reduced job opportunities. A more efficient regulatory system would be both more effective and less costly.

Current efforts to effect meaningful regulatory reform are severely hampered by distrust on both sides of the regulatory debate. Individuals committed to the resolution of health, safety, and environmental problems are suspicious of any effort that is seen as possibly obstructing or delaying their objectives. Individuals committed to the reduction of “big government” decry those who would proceed rapidly to address such problems with costly or ill-designed remedies. To reconcile these two polar extremes, or at least to narrow the gap between them, CED believes that better information, based on sound science and analysis, is needed in the regulatory process.

*Source: Modernizing Government Regulation: The Need for Action*
that the choice of process might achieve the same outcomes at lower costs (that is, with greater efficiency).

Excessively loose regulatory regimes have some benefits, but lack teeth. Loose regulation—self regulation, voluntary codes of conduct, and the like—involves less cost, allows ample flexibility in meeting goals, and engenders less business opposition. But absent penalties or any measure of accountability, the benefit of free riding always provides a strong incentive not to cooperate. Many corporations simply will not self-regulate or follow industry guidelines. Although we have demonstrated throughout this report that self regulation and voluntary codes can help businesses to address societal concerns, they cannot always substitute for sound regulation that establishes fair competitive rules and achieves well-articulated societal goals. Furthermore, though public scrutiny and market incentives can be powerful forces exposing and checking bad behavior and violations of self-regulatory principles, they are no substitute for enforcement by government monitors. Also, a lack of effective disclosure requirements can make it difficult for interested parties to hold public and, especially, private corporations to account.

Smart regulation presents a nuanced, middle-of-the-road strategy that fits neatly between the extremes. Smart regulation resembles performance-based regulation, which requires corporations to achieve an outcome but allows them to determine how that objective is to be met. It relies more on markets than on commands. Society benefits as corporations achieve societal goals, such as, emitting less carbon dioxide, protecting the rights of workers, or providing more access to more information. Corporations benefit by having the ability to meet social expectations without sacrificing competitive advantage or being forced to incur excessive costs.

Performance-based regulation, though a better balance of flexibility and efficiency than the policies mentioned above, still suffers from some drawbacks. For example, the greater the number of compliance strategies employed by corporations, the more difficult verification becomes. One solution is to mandate greater transparency and disclosure to provide government monitors, shareholders, and other corporate constituents the information necessary to evaluate performance. Government regulators might consider a “comply or explain” requirement such as that initiated in corporate governance codes in Britain and now used elsewhere in the European Community. The ‘comply or explain’ approach calls for companies to disclose how they have complied with corporate governance codes or explain why they have not. In essence, government sets goals, and corporations must disclose their performance relative to those goals; markets provide the discipline.

In sum, government has the primary role in establishing benchmarks for the achievement of societal goals through regulation. But regulation need not be heavy handed; it can apply a ‘soft touch’. Smart regulation attempts to strike an appropriate balance between predictability and efficiency by allowing businesses greater flexibility in how they meet objectives. This approach puts greater reliance on market forces and disclosure to achieve desired results. The goal, as one commentator put it, is to “strike the right balance” and “create a framework which allows entrepreneurs to flourish, but which also engenders trust in investors and consumers.”

Democracy, Political Institutions, and Business

In 2007, the book, Supercapitalism, by former Secretary of Labor Robert Reich, explored many of the themes we have examined in this report and specifically in this chapter. Reich concludes that efforts to encourage corporate businesses voluntarily to address societal concerns misdirect social energy that ought to be aimed at persuading government to meet its responsibility to provide solutions to societal problems. In Reich’s analysis, the last several decades have seen a shift of power away from individuals in their roles of citizens and towards their roles of consumers and investors. That shift has made it easier for social activists to affect corporate behavior than government policies. In a sense, increased competition in the economic sphere has made businesses more responsive to consumers and investors, while ‘oligopolistic’ conditions in the political sphere have resulted in political stagnation and a lack of responsiveness to societal concerns.

Although we do not agree with all of Reich’s analysis or conclusions, there is a great deal of truth in the finding that many businesses appear at present to be more responsive to many of society’s concerns than are governments, and that many anti-business social campaigns divert attention from government’s responsibility to address social problems. We agree, for example, that
government must step up to its responsibilities and that “business statesmen” in the United States can play an important role by speaking out for government solutions to pressing policy concerns, such as unsustainable cost increases in federal entitlement programs, the lack of universal health care, environmental damage from climate change, and the threat to human rights in many developing countries—issues that businesses are being pressured to address piecemeal.

But better government responsiveness to societal concerns does not mean that business should reverse course and stop addressing such concerns also. As we have said throughout this report: Corporations must integrate relevant societal concerns into corporate strategy to strengthen long-term competitiveness and the sustainability of both the corporation and the society in which it exists. A healthier political system would make that task easier, but it would not eliminate the need for businesses also to act.
Chapter 6
Conclusion

Like the economist in the joke who sees something working in practice and asks whether it can work in theory, skeptics question whether corporations can sustain societal-based strategies, and cynics wonder whether corporations should. But global corporations, by paying greater attention to their interaction, or interdependence, with society, are redefining the balance between commercial concerns and societal concerns, such as preservation of the environment and human rights. These firms continue to prove both skeptics and cynics wrong, and they lead the way by showcasing the new competitive strategies of the 21st century.

The existence of the myriad and varied approaches by corporations to societal concerns demonstrates that “the market has spoken.” Such practice is not only possible but necessary to secure those corporations’ long-term interests. It improves the societies in which they operate (draw resources from and sell to) and therefore also improves the long-term sustainability of the businesses themselves.

Our experience and the research conducted for this report inform an urgent call for those directors of public corporations who have yet to address the new realities of global competitive markets to exercise appropriate stewardship. They must lead an evaluation of the long-term sustainability of their business strategies in light of changes in societal attitudes. Such an evaluation is even more important in light of the financial crisis of 2008, which in part grew out of short-sightedness toward risk and public responsibilities.

Our recommendations to all directors emphasize the need for independent judgment and fidelity to the long-term interest of the corporation. They are not “one-size-fits-all” solutions. Each corporation will have unique solutions that fit its need. In summary, we recommend:

- The board of directors has ultimate responsibility for the performance of the corporation. This responsibility is well served when directors, acting as stewards of the corporation’s long-term interest, give weight to societal issues that impact the firm’s longer-term performance.

- Boards should encourage company management to evaluate societal concerns, examine the various strategic responses, and decide on sound business grounds what management ought to do.

- When choosing a CEO, the board’s selection committee should be mindful of the role that person will play in setting the tone and direction of the company with regard to ethics, honest reporting, and engagement with shareholders and other interested parties. Boards should tie a portion of CEO and senior management’s performance compensation to metrics based on the corporation’s performance on such concerns.

- Directors regularly should consider how the company plans, manages, and communicates about the company’s interaction with society. The board should insist that management report regularly to it and to the public on non-financial performance, including social performance. To institutionalize the process, the board may want to establish a special committee or empower its governance committee to take responsibility for oversight and reporting. That committee should report to the full board and appear on its agenda on a regular basis.

- Directors should recognize the value of communicating to shareholders and the public on issues that bear on the company’s reputation and brand value, even when such communication may not be required by regulation or fit neatly into financial disclosure formats. Boards that have a

* Of course, these need not be the same reports, but public reporting must be truthful and easily understood.
non-executive chair or lead director may want to consider a communications role for that person on such issues and topics.

As we complete work on this project, an intriguing debate is taking place among academics and practitioners about “creative capitalism,” a term coined by Microsoft chair Bill Gates to denote the use of market forces for reducing global poverty and inequality. Although the term lacks clear definition, the debate about it has touched on many of the themes analyzed here. Of most relevance is the virtual consensus that capitalism is inherently creative; it creates jobs, income, wealth, and an ever expanding variety of new and better goods and services that improve people’s well being. At the same time, the debate has revealed how easily well-informed observers can fall into the Friedmanian trap of placing the pursuit of profit in opposition to the corporation’s pursuit of societal goals. As we have demonstrated, and as many of the participants in the creative-capitalism debate relate, the two goals can go hand in hand. Certainly, clashes between private profit and societal goals frequently occur, but in the long run these pursuits should not be viewed as a zero-sum conflict. The interests of society and the business community are not mutually exclusive, but interdependent, and their goals are interlinked. The important point is that all businesses must consider how social concerns interact with strategic frameworks and business plans.

Many also fall into the trap of a shareholder-primacy view, arguing that corporate directors cannot pursue any objective other than maximizing returns to shareholders. Throughout this report, we have made a case and demonstrated through examples that directors are not mere robotic agents of shareholders’ short-term interests. They must exercise independent judgment to focus on the long-term interests of the corporation, not the narrow interests of some, often short-term, shareholders.

One provocative comment as the ‘creative capitalism’ debate wound down intersects with CED’s long-standing interest in public policy and the role of the business community in helping to advance our society as a whole. The author of that comment posited that the business community’s greatest contribution to overcoming societal problems may lie not in corporate policies but in business statesmanship—the willingness of business leaders to speak out on public policies that affect the national good. That is a theme on which CED was founded, and which it continues to advocate today. But it is not an either-or choice. U.S. business leaders should consider both how their business strategies interact with societal issues and how they personally can make a difference by supporting sound public policies that address society’s key concerns.

Finally, our focus has been primarily on the private sector, specifically publicly traded corporations. Other private-sector businesses and, most important, public-sector institutions also have key roles to play. The public sector in particular must bear primary responsibility for addressing societal concerns and for providing a favorable environment for business decision making. A significant step in that direction would be for political leaders to understand that they are imposing unacceptable costs on business and society by their failure to reform political governance and policy making. The political system must begin to address seriously America’s long-term social and economic problems. A healthier political system would make businesses’ tasks easier, but it would not eliminate the need for businesses also to act. Our societal problems, both nationally and globally, are complex, numerous, and sizeable. Solving these problems will require contributions from all sectors of society.

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1 The debate was held on the website http://creativecapitalism.typepad.com/creative_capitalism. A collection of the essays, blogs, and notes on the website was published in book form, December 2008.
We appreciate the opportunity to respond to CED’s report, Rebuilding Corporate Leadership: How Directors Can Link Long-Term Performance with Public Goals, specifically to statements pertaining to ExxonMobil in the section on climate change and corporate strategy.

Our general comments related to the points made in the draft are as follows:

As we have stated publicly numerous times, rising greenhouse-gas emissions pose significant risks to society and ecosystems. These risks warrant action by individuals, companies and governments. Since most of these emissions are energy-related, any integrated approach to meeting the world’s growing energy needs over the coming decades must incorporate strategies to address the risk of climate change. We have the same concerns as people everywhere – and that is how to provide the world with the energy it needs while reducing greenhouse gas emissions.

ExxonMobil has a long record of taking actions to reduce greenhouse gas emissions in our operations, of helping consumers reduce their emissions, and supporting research into advanced technology with the potential to make a significant reduction in future global emissions. We are also an active and constructive participant in dialogue on policy options with NGOs, industry and policy makers around the world. ExxonMobil also played a leadership role in developing internationally endorsed methods and protocols to measure and report greenhouse gas emissions from oil and gas operations. Since 2004, we have invested more than $1.5 billion in activities that reduce greenhouse gas emissions and improve energy efficiency. In addition, we are spending $4 billion in gas utilization and commercialization projects to reduce natural gas flaring. Our actions are delivering results. Through efficiency actions taken in 2006 and 2007, we reduced our greenhouse gas emissions by about 5 million metric tons in 2007. This is equivalent to removing about one million cars from the roads in the U.S.

ExxonMobil’s support for thoughtful research and analysis on climate issues is long-standing. This includes support for fundamental science at The Lamont Doherty Earth Observatory of Columbia University, The Hadley Centre for Climate Prediction, MIT, Princeton and Yale; for economics at ABARE, Charles River Associates, MIT, and Stanford; and for technology at the IEA GHG R&D Programme, Georgia Tech, MIT, University of Texas, and Stanford. Our initiative led to the creation of the Global Climate and Energy Project at Stanford, with $225M support for a decade long effort to develop the fundamental science for a portfolio of advanced technologies. GCEP has over 40 programs at 20 institutions around the globe involving over 300 graduate and post-doctoral students. Our own research includes public and proprietary efforts on advanced fuels and engines, fuel cells powered by onboard reformers to make hydrogen from liquid fuels, advanced battery technologies for hybrid vehicles, and multiple efforts to lower the cost and improve the performance of carbon capture and storage. Our scientists have published over forty papers on climate science and technology in the peer-reviewed literature and participate directly as lead authors in the Intergovernmental Panel on Climate Change and as experts in numerous national and international expert panels.

Over many decades, ExxonMobil’s performance for its shareholders has benefited from a studied approach to managing risks in all phases of our business. This includes disciplined analysis in the selection of long-term investment opportunities, care in the execution of project development and management, and efficient operation of existing facilities and businesses. In meeting the growing energy needs of society and doing so with respect for the environment our approach considers and manages the full range of risks, including commercial, technological, political and regulatory risks.

Risks include understanding and responding to climate change through research, analysis, participation in the policy debate, a strong focus on systems for compliance with emerging regulations, and the ability to achieve competitive advantage through development and use of advanced technology.
Self-descriptions of select initiatives, guidelines and compacts focused on environmental, social, and governance issues*

AccountAbility: “AccountAbility advises and mentors a growing number of businesses, nonprofits and governments in the development of their approach to accountability, learning and performance. Enabling better dialogue, information exchange and the creation of shared value will remain our focus as we continue to develop the AA1000 Series and the related suite of tools that put accountability into practice in individual businesses and organizations. In the past five years we have also focused on the incentives and policies that influence individual organizations and on the emerging role of new partnerships with integrated private gain and public purpose and which are increasingly at the heart of rule making and enforcement.” http://www.accountability21.net/

Amnesty International: “Amnesty International aims to highlight human rights abuses in which companies are implicated and how governments fail to prevent these abuses or hold companies to account when they occur.”

“The organization is campaigning for global standards on business and human rights and stronger legal frameworks at both national and international level to hold companies to account for their human rights impact.”

“Amnesty International also calls on companies to make respect for human rights an integral component of their business operations, including through their dealings with other companies, partners, associates, subsidiaries, suppliers and government officials.” http://www.amnesty.org/en/business-and-human-rights

Aspen Institute Business and Society Program: “The Business and Society program (BSP) is dedicated to developing leaders for a sustainable global society. Through dialogues and path-breaking research, we create opportunities for executives and educators to explore new pathways to sustainability and values-based leadership.” http://www.aspeninstitute.org/

Boston College Center for Corporate Citizenship: “For more than 20 years The Center for Corporate Citizenship has provided research, executive education and convenings on corporate citizenship topics. Because of our affiliation with Boston College’s Carroll School of Management, we function as an educational institution, a think tank and an information resource — all in one place. And all focused on fundamentally and measurably improving your company’s ability to build and leverage its citizenship efforts for the benefit of society.” http://www.bccc.net/

Business for Social Responsibility: “Business for Social Responsibility (BSR) provides socially responsible business solutions to many of the world’s leading corporations. Headquartered in San Francisco and with offices in Europe and China, BSR is a nonprofit business association that serves its 250 member companies and other Global 1000 enterprises. Through advisory services, convenings and research, BSR works with corporations and concerned stakeholders of all types to create a more just and sustainable global economy.” http://www.bsr.org/

Business Leaders Initiative on Human Rights: “The Business Leaders Initiative on Human Rights (BLIHR) is a programme to help lead and develop the corporate response to human rights. It is a business-led programme with 13 corporate members.”

“Our principal purpose is to find “practical ways of applying the aspirations of the Universal Declaration of Human Rights within a business context and to inspire other businesses to do likewise”. In our second three-
year period until 2009 we are committed to sharing our tools and experiences not only within the group but with all interested companies.” http://www.blihr.org/

**Carbon Disclosure Project:** “The Carbon Disclosure Project (CDP) is an independent not-for-profit organization aiming to create a lasting relationship between shareholders and corporations regarding the implications for shareholder value and commercial operations presented by climate change.” http://www.cdproject.net/index.asp

**Caux Round Table:** “The Caux Round Table (CRT) is an international network of principled business leaders working to promote a moral capitalism. The CRT advocates implementation of the CRT Principles for Business through which principled capitalism can flourish and sustainable and socially responsible prosperity can become the foundation for a fair, free and transparent global society.” http://www.caux-roundtable.org/

**Ceres:** “Ceres companies come in a range of sizes - multinationals to small operations - and a range of sectors from financial services to manufacturers, to electric power to retailers and technology companies. Ceres companies are able to achieve competitive advantages by integrating environmental and social performance into their business strategies. They understand that environmental and social issues pose potential risks for their businesses and are committed to addressing them. Ceres companies are committed to enhancing value through: In-depth engagement with stakeholders and shareholders, disclosure of environmental and social commitments and results, and continuous performance improvement.” http://www.ceres.org/

**Electronic Industry Code of Conduct:** “The Electronic Industry Code of Conduct (EICC) is a code of best practices adopted and implemented by some of the world’s major electronics brands and their suppliers. The goal is to improve conditions in the electronics supply chain. Development of the Code was a multi-stakeholder effort, influenced by internationally-recognized standards.” http://www.eicc.info/

**Equator Principles:** “Project financing, a method of funding in which the lender looks primarily to the revenues generated by a single project both as the source of repayment and as security for the exposure, plays an important role in financing development throughout the world. Project financiers may encounter social and environmental issues that are both complex and challenging, particularly with respect to projects in the emerging markets.

The Equator Principles Financial Institutions (EPFIs) have consequently adopted these Principles in order to ensure that the projects we finance are developed in a manner that is socially responsible and reflect sound environmental management practices. By doing so, negative impacts on project-affected ecosystems and communities should be avoided where possible, and if these impacts are unavoidable, they should be reduced, mitigated and/or compensated for appropriately.

We believe that adoption of and adherence to these Principles offers significant benefits to ourselves, our borrowers and local stakeholders through our borrowers’ engagement with locally affected communities. We therefore recognise that our role as financiers affords us opportunities to promote responsible environmental stewardship and socially responsible development. As such, EPFIs will consider reviewing these Principles from time-to-time based on implementation experience, and in order to reflect ongoing learning and emerging good practice.

These Principles are intended to serve as a common baseline and framework for the implementation by each EPFI of its own internal social and environmental policies, procedures and standards related to its project financing activities. We will not provide loans to projects where the borrower will not or is unable to comply with our respective social and environmental policies and procedures that implement the Equator Principles.” http://www.equator-principles.com/

**Extractive Industries Transparency Initiative:** “The EITI is a coalition of governments, companies, civil society groups, investors and international organizations. It supports improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil, gas and mining.” http://eitransparency.org/
Fair Labor Association: “The mission of the Fair Labor Association (FLA) is to combine the efforts of industry, civil society organizations, and colleges and universities to protect workers’ rights and improve working conditions worldwide by promoting adherence to international labor standards. The FLA conducts independent monitoring and verification to ensure that the FLA’s Workplace Standards are upheld where FLA company products are produced. Through public reporting, the FLA provides consumers and shareholders with credible information to make responsible buying decisions.” http://www.fairlabor.org/

Global Business Coalition on HIV/AIDS, Tuberculosis and Malaria: “GBC is a Coalition of more than 220 companies united to keep the fight against HIV/AIDS, tuberculosis, and malaria a global priority. The Coalition’s members share learnings from the front lines of the fight, and GBC provides tailored support so that companies can take an active role in defeating the pandemics. GBC also organizes collective actions among companies, and links the public and private sectors in ways that pool talents and resources.”

“GBC will establish clear, actionable principles and standards for baseline corporate engagement on AIDS, TB and malaria. As a first step, we will convene a cross-sector working group to produce such a framework. There is increasing clarity about what the private sector can and should do to maximize overall impact on these diseases. By defining a common agenda for business globally, and providing guidance and support wherever possible for its implementation, we will reinforce all programs — local, national, and international; government, NGO, and private sector. These principles and standards will also provide a starting point for higher-level individual and collective action.”

Global Reporting Initiative: “A multi-stakeholder governed institution collaborating to provide the global standards in sustainability reporting.” It provides guidelines for organizations to use as the basis for disclosure about their sustainability performance, and also provides stakeholders a universally-applicable, comparable framework in which to understand disclosed information. http://www.globalreporting.org/Home

Human Rights Watch Business and Society: “Human Rights Watch is dedicated to protecting the human rights of people around the world. We stand with victims and activists to prevent discrimination, to uphold political freedom, to protect people from inhumane conduct in wartime, and to bring offenders to justice. We investigate and expose human rights violations and hold abusers accountable. We challenge governments and those who hold power to end abusive practices and respect international human rights law. We enlist the public and the international community to support the cause of human rights for all.” http://www.hrw.org/doc/?t=corporations

International Labour Organization: “The International Labour Organization (ILO) is devoted to advancing opportunities for women and men to obtain decent and productive work in conditions of freedom, equity, security and human dignity. Its main aims are to promote rights at work, encourage decent employment opportunities, enhance social protection and strengthen dialogue in handling work-related issues.”

“The ILO is the global body responsible for drawing up and overseeing international labour standards. Working with its Member States, the ILO seeks to ensure that labour standards are respected in practice as well as principle.” http://www.ilo.org

Kimberley Process: The Kimberley Process is a joint governments, industry, and civil society initiative to stem the flow of conflict diamonds—rough diamonds used by rebel movements to finance wars against legitimate governments. The trade in these illicit stones has fuelled decades of devastating conflicts in countries such as Angola, Cote d’Ivoire, the Democratic Republic of the Congo and Sierra Leone. The Kimberley Process Certification Scheme imposes extensive requirements on its members to enable them to certify shipments of rough diamonds as ‘conflict-free.’ http://www.kimberleyprocess.com/

OECD Guidelines for Multinational Enterprises: “The guidelines (www.oecd.org/daf/investment/guidelines) are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. They provide voluntary principles and standards for responsible business conduct in a variety of areas including employment and industrial
relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation.”

http://www.oecd.org/

**OECD International Trade and Core Labour Standards:** “What are the major developments with respect to trade and labour standards since the OECD’s 1996 study on Trade, Employment and Labour Standards? What is being done to promote these standards? What evidence is there of progress? What are the possible links between core labour standards, trade, foreign direct investment, economic development and employment? International Trade and Core Labour Standards addresses these and related questions. It also provides a current overview of key issues with respect to core labour standards and their relation to trade and employment, aiming to provide a common basis for constructive policy dialogue among the concerned parties in the future.”  http://www.oecd.org/

**Petroleum Industry Guidelines for Reporting:** “The International Petroleum Industry Environmental Conservation Association (IPIECA), American Petroleum Institute (API), and International Association of Oil and Gas Producers (OGP) jointly initiated the development of these Guidelines to promote credible, consistent, and reliable GHG accounting and reporting practices from oil and gas operations.”  http://www.ipieca.org/activities/climate_change/downloads/publications/ghg_guidelines.pdf

**RugMark Foundation:** RugMark is the international nonprofit organization that “recruits carpet producers and importers to make and sell carpets that are made without illegal child labor. By agreeing to adhere to strict no-child-labor guidelines and by permitting random inspections of their carpet looms, manufacturers earn the right to place the certified and individually numbered RugMark label on their carpets. If inspectors find children working on looms, they are offered the opportunity to go to school instead, and producers and importers lose the privilege to use the RugMark label.”  http://www.rugmark.org/home.php

**SustainAbility:** “SustainAbility advises clients on the risks and opportunities associated with corporate responsibility and sustainable development. Working at the interface between market forces and societal expectations, we seek solutions to social and environmental challenges that deliver long term value. We understand business and what society expects of it.”  http://www.sustainability.com/

**The Greenhouse Gas Protocol Initiative:** “The Greenhouse Gas Protocol (GHG Protocol) is the most widely used international accounting tool for government and business leaders to understand, quantify, and manage greenhouse gas emissions. The GHG Protocol, a decade-long partnership between the World Resources Institute and the World Business Council for Sustainable Development, is working with businesses, governments, and environmental groups around the world to build a new generation of credible and effective programs for tackling climate change.”  http://www.ghgprotocol.org/

**The United States Climate Action Partnership:** “USCAP is an expanding alliance of major businesses and leading climate and environmental groups that have come together to call on the federal government to enact legislation requiring significant reductions of greenhouse gas emissions.”  http://www.us-cap.org/index.asp

**Transparency International:** Transparency International is a global network including more than 90 locally established national chapters and chapters-in-formation. These bodies fight corruption in the national arena in a number of ways. They bring together relevant players from government, civil society, business and the media to promote transparency in elections, in public administration, in procurement and in business. TI’s global network of chapters and contacts also use advocacy campaigns to lobby governments to implement anti-corruption reforms.”  http://www.transparency.org/

**United Nations Global Compact:** “The Global Compact is a framework for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, the environment, and anti-corruption. As the world’s largest, global corporate citizenship initiative, the Global Compact is first and foremost concerned with exhibiting and building the social legitimacy of business and markets.”  http://www.unglobalcompact.org/
Voluntary Principles on Security and Human Rights: The Voluntary Principles on Security and Human Rights are intended to "to guide companies in balancing the needs for safety while respecting human rights and fundamental freedoms." http://www.voluntaryprinciples.org/


The Council provides a platform for companies to explore sustainable development, share knowledge, experiences and best practices, and to advocate business positions on these issues in a variety of forums, working with governments, non-governmental and intergovernmental organizations.” http://www.wbcsd.org/
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<tr>
<th>Organization</th>
<th>Name</th>
<th>City, Country</th>
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<tbody>
<tr>
<td>CE</td>
<td>Circulo de Empresarios</td>
<td>Madrid, Spain</td>
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<tr>
<td>CEAL</td>
<td>Consejo Empresario de America Latina</td>
<td>Buenos Aires, Argentina</td>
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<tr>
<td>CEDA</td>
<td>Committee for Economic Development of Australia</td>
<td>Sydney, Australia</td>
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<tr>
<td>CIRD</td>
<td>China Institute for Reform and Development</td>
<td>Hainan, People’s Republic of China</td>
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<tr>
<td>EVA</td>
<td>Centre for Finnish Business and Policy Studies</td>
<td>Helsinki, Finland</td>
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<tr>
<td>FAE</td>
<td>Forum de Administradores de Empresas</td>
<td>Lisbon, Portugal</td>
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<td>IDEP</td>
<td>Institut de l’Entreprise</td>
<td>Paris, France</td>
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<td>IW</td>
<td>Institut der deutschen Wirtschaft Koeln</td>
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<td>北京经济学会</td>
<td>Keizai Doyukai</td>
<td>Tokyo, Japan</td>
</tr>
<tr>
<td>SMO</td>
<td>Stichting Maatschappij en Onderneming</td>
<td>The Netherlands</td>
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