Nature and Structure of Business Shaping Corporate Social Responsibility

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Introduction

Chandler and Hikino (1997) expose that the development of large industrial firms since the 19th century owes both to an increase in the quantity and the mastery of tangible as well as intangible assets. First, the firm increases the quantity of its fixed assets such as plants and machinery, as well as the matching quantity of labour required to operate those fixed assets. The expansion can occur through organic growth or through mergers and acquisitions. This is how firms generate economies of scale. Economies of scope are generated through the process of production optimisation that occurs through the use of higher quality, higher productivity-yield fixed assets, through the hiring or training of more skilled labour, and the improvement of production and management processes in the broadest sense. In particular, Chandler and Hikino (1997, p.34) underline that productivity improvements stem from improvements in "the functional, technical, and managerial capabilities" that "resulted from solving problems related to the following: scaling up the production process; acquiring knowledge of customers' needs and altering products and process to service them; getting to know the sources of supplies and the reliability of suppliers; and becoming knowledgeable in the ways of recruiting, training, and motivating workers and managers".

The success and expansion of large firms owes first to an increase in fixed assets, accompanied and then followed by the development of intangible assets that can take the form of quality improvements embodied in both capital and labour, as well as the firm's *network capital* encompassing relations with customers, employees, suppliers, research institutes, local and national institutions, the media, and NGOs.

This non-exhaustive list constituting the network capital or part of the intangible assets of the firm is very similar to a list of potential stakeholders to the firm that are used in the literature dealing with Corporate Social Responsibility. A stakeholder is "any group or individual who can affect or is affected by the achievement of the organization's objectives" (Freeman, 1984, Jones, 1995, Kreiner & Bhambri, 1988, in Mitchell, Agle, and Wood, 1997, p.17).

For example, Mitchell, Agle, and Wood (1997) synthesize the literature on stakeholder's definition and identification, and propose a methodology to identify and map the stakeholders to the firm using three attributes: power, legitimacy and urgency. The agents that are part of the firm's network mentioned earlier possess clearly at least one of the three attributes.

Lorrain (2005), in a detailed study of Suez Environment (formerly Lyonnaise des Eaux) history from 1980 to 2004, argues that the history and nature of the firm's activities the notion of scale economies does not apply to the water supply sector in France, because the activities are structured around small local exploitation units that are adapted to local needs. These local needs are themselves determined by geography, history and political factors. As a result, firm's competencies are primarily in its relational capital, human capital management, and network management capabilities (pp. 341-342). For Lorrain (2005), the nature of Suez Environment - the public utilities company - lies between the firm and the institution, and as such, is more likely than *firm-only* entities to take early on a large panel of stakeholders into account.

We use the case of Suez Environment to provide an example of why large corporations are more likely to be forerunners in the area of Corporate Social Responsibility, and why large companies have to be leaders in this area in order to survive. This historical case study could help understanding why the future of large corporations lies in the transition from market entities (the firm devoted to the production of goods and services) to institutions (the firm concentrated on its network capital), and how large global corporations can perform their new role in society.

Private company providing a public service: A quasi-institution

Suez Environment is recognized as one of the leaders in the CSR arena[1], and owes probably this performance to the nature and structure of its activities, i.e. to the fact

[1] SUEZ was ranked 5th among the most socially responsible and accountable companies in the world in 2006 (www.suez.com).

that the development of its network capital is central to its success. As industries become mature and global, intangible assets are now also central to industrial Multinational Corporations (MNCs), they are also central to the service industries and the knowledge-based activities. We suggest that betting on the network capital with a focus on CSR matching society's expectation is one of the new challenges for all firms that wish to build and sustain a competitive advantage.

The first change in the environment is the perception and awareness that physical resources become scarcer, and that we need to insure that the needs of future generations will be met. This can be achieved through the minimisation of the use of natural resources, the renewal of such resources, the discovery of alternative resources, and the protection of the planet as a living system.

The second change relates to social issues. The substantial increases in standards of living that people in the North have benefited from since the industrial revolution, the maturation of consumer society shifting from the sole consumption of physical goods to a massive consumption of services and knowledge-based goods have made people who have substantial decision-power more aware of the environmental risks that consumption society entails. Unprecedented globalisation levels and the failure of the South to converge towards Northern income per capita levels, as well as the increasing inequalities in income distribution *within* Northern countries have also had the effect of increasing civil society's awareness of potential social risks within and between nations.

As large companies, and especially MNCs, have larger financial resources and broader reach than States, firms' role in society is slowly but surely moving from the mere provision of goods and services, to institutions with deep roots in and increasing responsibility towards society. Joel Makower & Business for Social Responsibility in Rowe 2005, p.130 states indeed that "four hundreds years earlier, social responsibility shifted from the church to the state, as government replaced religious institutions as society's predominant force. At the dawning of the twenty-first century, business appears the next likely candidate to carry this mantle."

Neoclassical economic theory has long taken government intervention and institutions out of its models, relying on methodological individualism and the mechanisms of supply and demand to explain the working of markets, as if markets could be sustained without the intervention of a *visible hand*.

For Polanyi (2001), totally free markets are impossible because "the three most central commodities to market economies – labor, land, and money – are *fictitious*, they are inventions, they need to be continually made and remade" (Rowe, 2005, p.143). Money is a convention, labour is "another name for human activity which goes with life itself" (Polanyi, 2001, p.), and "land is only another name for nature, what is not produced by humans" (Rowe, 2005, p.143). For Rowe (2005), "not only is state intervention integral to the constitution of markets, but perhaps more importantly for Polanyi, public regulation is necessary to ensure markets do not destroy what makes them possible in the first place: commodified land, labor, and money. There is no logic internal to the market that keeps it from exploiting land and labor in profoundly unsustainable ways" (Rowe, 2005, p.143).

For Polanyi, the commodification of factors of production enables the market, and thus the firm, to exist. Network capital or intangible assets developed by the firm are also important factors of production. Pushing Polanyi's argument further, intangible assets are also a convention that holds value only because it helps increase productivity and profits, under the condition that these intangible assets match society's expectations in terms of social and environmental compliance (through regulation or social norms). Here, the existence of network capital is allowed both by regulation and by social norms, the market requires state regulation to exist, however, as states become weaker, civil society take the lead to enforce social norms and allow network capital to be valuable.

Note that social and environmental compliance is often perceived as a cap to firm's expansion and increase in productivity and profits. However, social and environmental compliance could constitute an incentive for firms to innovate in ways that depart from old patterns of thinking, and therefore trigger expansion and increase in productivity and profits.

On the value of intangible assets as core production factors

Historically, industry has always –to various degrees- taken care of its core factors of production –land and labour - for obvious reasons, i.e. land and labour are scarce resources that need to be protected in order for industry to survive. The service and knowledge-based sectors should in theory care less about mass-labour and land. However, if Lorrain's (2005) argument pertaining that intangibles are key to success is to be true, and if we argue that CSR and stakeholders collaboration constitute a large part of these intangibles that are core production factors for service and knowledge-based industries, then CSR becomes key to success for the industry, service, and knowledge-based sectors.

Marrano, Haskel and Wallis (2007) investigate the role of intangibles in labour and Total Factor Productivity (TFP) growth in the UK using the National Accounts. They find that treating investment in intangibles as investments rather than intermediate consumption lets appear that labour and TFP growth has been accelerating rather than slowing down in the 1990s. In their calculations, intangibles comprise brand equity (advertising and market research), firm specific resources (firm specific human capital and organisational structure), scientific R & D (copyright and licenses costs, new product development costs in the financial industry, new architectural and engineering design and R & D in social science and humanities), and computerised information (software).

Galbreath (2006) studies a sample of Australian firms and finds that management of primary stakeholders – corporate governance and employees relations - can have a positive impact on the bottom line. However, environmental and social responsibility is found to affect firm's performance unfavourably.

We demonstrate that Suez Environment can be qualified as a large private multinational quasi-institution providing a public service, and can be used as an example of what large private multinational companies could achieve by adopting similar strategies in the context of the changing environment. In particular, this case study could help understanding why the future of large corporations lies in the transition from market entities (the firm devoted to the production of goods and services) to institutions (the firm concentrated on its network capital), and how large global corporations can perform their new role in society.

About why is Suez Environment doomed to be "more" responsible than other large companies

Nature of activities

Suez has been formed in 1997 through the merger between Compagnie de SUEZ and Lyonnaise des Eaux, and has both energy and environment activities. We focus on Suez Environment, and more particularly on the water services activity (thereafter Suez Environment). This choice is motivated by the nature of the activity that is intrinsically linked to societal responsibility and sustainable development. The choice also allows to have a long term historical time frame, focusing on Lyonnaise des Eaux until 1997 and and Suez Environment since 1997.

Suez Environment is a public utility company that provides a common good, as well as a service, that has many positive externalities that are not captured by the firm that produces them. For example, the provision of fresh water to homes contributes largely to the improvement and maintain of good health. This is an activity that requires large initial investments, and benefits can only appear in the long-run. Because of the long-term investment with non-appropriable positive externalities, water supply has often been provided by public authorities. This is where the first responsibility of the water supply firm lies, in the provision of a good/service that might bring returns on investment only in the long-run. Maybe more than a responsibility, an engagement in this activity requires a certain frame of mind, combining a long-term vision with the will to provide a quasi-public good.

Another feature of the industry is that water supply is often taken as a classical example of natural monopoly, i.e. an industry where the provision of the good or service by only one firm minimises costs. This argument is questioned and criticised for unjustified protection the industry from competition. Nauges and van den Berg (2007) find that for some countries, the water supply sectors display economies of scale. However, they also find that this depends largely on geographical factors such as total population or population density. The natural monopoly has often been administered by public authorities, as monopolies need close scrutiny in order not to abuse their power. The problem is even more acute for a good that is central to life.

Clark and Mondello (2002, p.72) argue that the case of water supply is a typical case of network industry, "however, this industry has special features because water of good quality is essential for the existence of human life. Matter of ethics and efficiency are therefore inextricably linked together and raise a number of fundamental, ethical, and practical questions for society…water and its quality engage the regulator's liabilities well as that of the monopolist."

Clark and Mondello (2002) also emphasise the fact that water could be classified as a private good because it is divisible and exclusive, however, they argue that "from a purely ethical standpoint, every person does have a right to fresh water access and no consumer may be excluded because of price" (p. 72). For example, one of the United Nations Millenium Development Goals is halving "by 2015, the proportion of people without sustainable access to safe drinking water and basic sanitation" (Millennium Development Goals Report 2005, p. 33).

This suggests that physical and monetary access to, as well as quality of water are recognised globally as a right for every human being. The sector, because of the large sunk investments it requires, often displays large economies of scale, so that water suppliers are natural monopolies. This makes any firm in the sector highly bear important responsibilities in terms of access to, price and quality of water. As a result, the sector stands under acute scrutiny from both government and civil society.

This explains partly why Suez Environment has put so much emphasis on its societal role that is acknowledged through the ranking of the company amongst the most responsible corporations. A second element that is very important to explain this positioning is the structure and strategy that the company has adopted.

Structure and strategy

Suez Environment, and previously Lyonnaise des Eaux, is heavily decentralised for a number of reasons. Historically and geographically in France, Lyonnaise des Eaux has built its water supply network using exploitation units that serve at a maximum an "agglomération", i.e. an extended city. Exploitation units take the form of subsidiary companies, agencies, or partnerships with public or private local actors. Lyonnaise des Eaux has long recognised that quality water services are based on local competencies and partnerships. The international development of Lyonnaise des Eaux in the water services sector has followed the same logic, building on local partnerships. Figures for the end of December 2005 show that Suez Environment (water services) are present in 50 countries (http://www.suez-environnement.com/fr/suez-environnement/qui-sommes-nous/organisation/presence-internationale/presence-internationale/).

Lorrain (2005) relates the history of Lyonnaise des Eaux internationalisation and emphasizes the fact that foreign markets were first explored by a handful of collaborators and that the human aspect of partnership building had been at the core. Lorrain (2005, p. 342) states that the competencies of the firm lie in its relational capital, in human resources management, in its capacity to organise the network. The structure of the company itself emphases the centrality of the relationships with different stakeholders: the company is built upon these relationships, and relationships as intangible assets have long been recognised as central assets.

The second important aspect in the structure is that every partnership or local operation is specific so as to preserve local business and social communities as well as the exploitation of the environment. While the classical approach of the multinational company would be replicating a uniform model worldwide taking little local content into account, Suez Environment's strategy is underpinned by its extreme adaptation to the local environment.

Suez Environment has fully integrated the notion of "public service" and exports the concept abroad via its implantation. While adapting locally via partnerships taking into account the specificities of the environment, the company promotes this notion of public service via a global management of the technical systems and incomplete contracts (Lorrain, 2005, p. 345). Instead of entering the market with the latest technology and capital in order to gain new markets, the company focuses on the provision of a quality service in the long term, and is involved in a long term partnership with local actors. Local actors are understood as local business partners, state representatives, customers and local communities. Relationships appear bilateral in both the discourse and the practice, as Suez Environment has set up several initiatives in order to have a constructive dialogue with stakeholders.

Besides, Suez Environment is also active in developing activities and initiatives that are connected but peripheral to its core business. This strengthens the "local rootedness" (Suez corporate term) of the company while enlarging its perimeter of responsibility:

"SUEZ also contributes to regional and territorial programs of sustainable development by participating in numerous civic actions. In France, for example, Lyonnaise des Eaux and SITA joined Sustainable Development Week to sensitize local populations to the conservation of the environment; in the USA, United Water contributes to the integration of minorities by redistributing important government contracts in smaller projects that are within reach of smaller suppliers or contractors.

Finally, all over the world, Group employees volunteer to assist social support actions in the face of emergencies, and are involved in longer term projects to encourage the economic and social development of the most disadvantaged populations." (http://www.suez.com/en/developpement-durable/major-challenge/local-rootedness/a-civic-and-supportive-business/a-civic-and-supportive-business/).

What lessons for other large companies?

In this paper we propose that Suez Environment can be analysed as a large private multinational quasi-institution that procures a public service. Its exemplarity can be used for what other large private multinational companies could achieve by adopting similar strategies in the context of the changing environment. In particular, this case study sheds some light on why the future of large corporations lies in the transition from market entities (the firm devoted to the production of goods and services) to institutions (the firm concentrated on its network capital), and how large global corporations can perform their new role in society.

The first argument about the nature of activities at Suez Environment could make the case exceptional and with no relevance to other domains of activity. One way to look at it is to consider each product or service as something that could contribute greatly to the well-being of living creatures, while having close to zero negative effects on nature. While it is easy to imagine the link between the procurement of quality water to human beings, it might be more difficult to imagine the final impact of a video game or a bolt on a truck on the wellbeing of people. What businesses need to concentrate on is the *ultimate* impact their products have on human beings, so as to be able to – from a strategic point of view - imagine under what scrutiny –society advancing - they will be tomorrow. From an ethical point of view, companies need to realise this ultimate impact so as to make adequate decisions, and in doubt, adopt the principle of precaution.

The second lesson is that the concept of thinking and acting local-global (Suez as a multinational company emphasising greatly its "local rootedness"), rather than choosing between the classical top down approach that receives increasing criticism and the yet-unmanaged approach of the think local act global, is a new strategy to explore for multinational companies. It has the advantage of opening new markets, not only interesting host governments, but also interesting closely local communities. Another advantage is the set up of long-term and stable relationships that can foster the implementation and development of sustainable business practices that are only profitable on the long term.

Of course, Suez Environment also receives critics, especially regarding their disengagement in water services in some developing countries. The pull out is generally explained by the inability to raise the price of water and the consecutive handover of water services operations to local state agencies. This underlines clearly that there will for long be a limitation to what for profit companies can achieve in terms of societal responsibility, the first reason being that their budget constraint is far tighter than the one of States, the second reason being that this budget constraint conditions their survival.

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