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The Path to Corporate Responsibility

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Nike's tagline, "Just do it," is an inspirational call to action for the millions who wear the company's athletic gear. But in terms of corporate responsibility, the company hasn't always followed its own advice. In the 1990s, protesters railed against sweatshop conditions at its overseas suppliers and made Nike the global poster child for corporate ethical fecklessness. Nike's every move was scrutinized, and every problem discovered was touted as proof of the organization's irresponsibility and greed. The real story, of course, is not so simple.

Nike's business model—to market high-end consumer products manufactured in cost-efficient supply chains—is no different from that of thousands of other companies. But the intense pressure that activists exerted on the athletic giant forced it to take a long, hard look at corporate responsibility faster than it might have otherwise. Since the 1990s, Nike has traveled a bumpy road on this front, but it has ended up in a much better place for its troubles. And the lessons it has learned will help other companies traverse this same ground.

Over the past decade, I have worked with many global organizations, including Nike, as they grappled with the complex challenges of responsible business practices. This experience has shown me that while every organization learns in unique ways, most pass through five discernable stages in how they handle corporate responsibility. Moreover, just as organizations' views of an issue grow and mature, so does society's. Beyond getting their own houses in order, companies need to stay abreast of the public's evolving ideas about corporate roles and responsibilities. A company's journey through these two dimensions of learning—organizational and societal—invariably leads it to engage in what I call "civil learning." (To map this process for your organization, see the sidebar"The Civil-Learning Tool.")

The Civil-Learning Tool

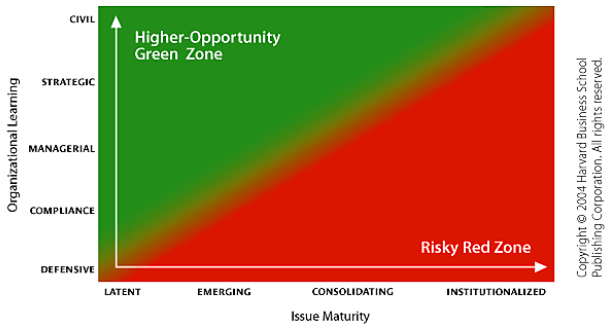
The civil-learning tool is intended to help companies see where they and their competitors fall on a particular societal issue. It can help organizations figure out how to develop and position their future business strategies in ways that society will embrace.

The tool factors in the two different types of learning, organizational and societal. When an issue is just starting to evolve, companies can get away with defensive actions and deflections of responsibility. But the more mature an issue becomes, the further up the learning curve an organization must be to avoid risk and to take advantage of opportunities.

As the tool makes clear, there is a point where the risky red zone turns into the higher-opportunity green zone. The question for most companies is, "Where is that line for my organization?" The answer depends on a host of factors, and a company's actions can actually shift the line in its favor. A company might step way out in front of an immature issue while most of its rivals are still in defensive mode. Cases in point: BP's aggressive stance on publishing the amount of royalties it pays to host governments; Rio Tinto's adoption of a human rights policy when most companies would not go near the idea; and Levi Strauss's groundbreaking "terms of engagement," which set out the company's responsibilities to workers in its global supply chains.

Organizational Learning

Organizations' learning pathways are complex and iterative. Companies can make great strides in one area only to take a few steps backward when a new demand is made of them. Nevertheless, as they move along the learning curve, companies almost invariably go through the following five stages.



Additionally, events in one industry can affect companies in a different industry or organizations in the same industry that are facing different issues. For example, the heated public debate about the pricing of drugs in poorer communities has created a broader debate about the fundamentals of intellectual property rights and the merits of a preventive approach to health at a time when the pharmaceutical industry makes its money from treating illnesses. Similarly, the emergence of obesity as an issue for the food industry has been accelerated by both rising health care costs and the devastating impact of litigation on the tobacco industry.

The Five Stages of Organizational Learning

When it comes to developing a sense of corporate responsibility, organizations typically go through five stages as they move along the learning curve.

STAGE	WHAT ORGANIZATIONS DO	WHY THEY DO IT
DEFENSIVE	Deny practices, outcomes, or responsibilities	To defend against attacks to their reputation that in the short term could affect sales, recruitment, productivity, and the brand
COMPLIANCE	Adopt a policy-based compliance approach as a cost of doing business	To mitigate the erosion of economic value in the medium term because of ongoing reputation and litigation risks
MANAGERIAL	Embed the societal issue in their core management processes	To mitigate the erosion of economic value in the medium term and to achieve longer-term gains by integrating responsible business practices into their daily operations
STRATEGIC	Integrate the societal issue into their core business strategies	To enhance economic value in the long term and to gain first-mover advantage by aligning strategy and process innovations with the societal issue
CIVIL	Promote broad industry participation in corporate responsibility	To enhance long-term economic value by overcoming any first-mover disadvantages and to realize gains through collective action

The Five Stages of Organizational Learning

"It's not our job to fix that."

In the *defensive* stage, the company is faced with often unexpected criticism, usually from civil activists and the media but sometimes from direct stakeholders such as customers, employees, and investors. The company's responses are designed and implemented by legal and communications teams and tend to involve either outright rejections of allegations ("It didn't happen") or denials of the links between the company's practices and the alleged negative outcomes ("It wasn't our fault"). Think of Royal Dutch/Shell's handling of the controversy around carbon emissions. For years, the company—along with the rest of the energy sector—denied its responsibility for emissions created by the production and distribution of its energy products. Today, Royal Dutch/Shell acknowledges some accountability. But unlike some of its competitors, the company continues to resist environmentalists' demands that it accept responsibility for emissions from its products after they have been sold.

"We'll do just as much as we have to."

At the *compliance* stage, it's clear that a corporate policy must be established and observed, usually in ways that can be made visible to critics ("We ensure that we don't do what we agreed not to do"). Compliance is understood as a cost of doing business; it creates value by protecting the company's reputation and reducing the risk of litigation. Until recently, for example, much of the food industry has understood "health" as the avoidance of legally unacceptable "nonhealth." When Nestlé came under fire for the health dangers of its infant formula—activists claimed that mothers in developing countries would end up mixing the powder with contaminated water, thereby compromising their children's health—its response for many years was to shift its marketing policies to make this hazard clear to new mothers rather than, for example, trying to educate them generally about ways to ensure their babies' overall nutrition. The current public debate on obesity highlights the same dynamics—food companies' instinct is to simply aim for compliance, while the public clearly wants a far greater commitment from them.

"It's the business, stupid."

At the *managerial* stage, the company realizes that it's facing a long-term problem that cannot be swatted away with attempts at compliance or a public relations strategy. The company will have to give managers of the core business responsibility for the problem and its solution. Nike and other leading companies in the apparel and footwear industries increasingly understand that compliance with agreed-upon labor standards in their global supply chains is difficult if not impossible without changes to how they set procurement incentives, forecast sales, and manage inventory.

"It gives us a competitive edge."

A company at the *strategic* stage learns how realigning its strategy to address responsible business practices can give it a leg up on the competition and contribute to the organization's long-term success. Automobile companies know that their future depends on their ability to develop environmentally safer forms of mobility. Food companies are struggling to develop a different consciousness about how their products affect their customers' health. And pharmaceutical companies are exploring how to integrate health maintenance into their business models alongside their traditional focus on treating illnesses.

"We need to make sure everybody does it."

In the final *civil* stage, companies promote collective action to address society's concerns. Sometimes this is linked directly to strategy. For instance, Diageo and other top alcohol companies know that as sure as night follows day, restrictive legislation will come unless they can drive the whole sector toward responsible practices that extend well beyond fair marketing. Among other activities, these companies have been involved in educational initiatives that promote responsible drinking. Likewise, energy companies understand that their industry has to grapple with the sometimes unethical ways in which governments use the windfall royalties they earn from oil and gas extraction. So they are supporting the UK's Extractive Industries

Transparency Initiative, which urges governments to report the aggregate revenues they derive from resource extraction. Some organizations look even further ahead and think about metastrategy: the future role of business in society and the stability and openness of global society itself.

Societal Learning

A generation ago, most people didn't think tobacco was a dangerous health threat. Just a few years ago, obesity was seen as a combination of genetics and unhealthy lifestyle choices—certainly not the responsibility of food companies. Today, ageism is rarely seen as a corporate responsibility issue beyond compliance with the law—but in an era of dramatic demographic shifts, it soon will be.

The trick, then, is for companies to be able to predict and credibly respond to society's changing awareness of particular issues. The task is daunting, given the complexity of the issues as well as stakeholders' volatile and sometimes underinformed expectations about business' capacities and responsibilities to address societal problems. Many civil advocates, for instance, believe pharmaceutical companies should sell lifesaving drugs to the poor at reduced prices; after all, the drug companies can afford it more than the patients can. The pharmaceutical industry has claimed over the years that such price limits would choke off its research and development efforts. But today, drug companies are exploring how to sustain R&D while pursuing price reductions in developing countries and how to integrate the prevention of illness into their business models.

Danish pharmaceutical company Novo Nordisk has created a practical tool to track societal learning on some of its core business issues—animal testing, genetically modified organisms, and access to drugs. The drugmaker's approach can be adapted and used by any company facing any number of issues. (See the exhibit "The Four Stages of Issue Maturity.") In the early stages, issues tend to be vague and their potential significance well below conventional thresholds used by the financial community to determine materiality. These issues are often first identified through a company's interactions with nontraditional sources of knowledge, such as social activists. As one senior business manager explains, when he deals with nongovernmental organizations, "I see the future of our markets, our products, and this business."

The Four Stages of Issue Maturity

Pharmaceutical company Novo Nordisk created a scale to measure the maturity of societal issues and the public's expectations around the issues. An adaptation of the scale appears below and can be used by any company facing any number of societal issues.

STAGE	CHARACTERISTICS
LATENT	• Activist communities and NGOs are aware of the societal issue. • There is weak scientific or other hard evidence. • The issue is largely ignored or dismissed by the business community.
EMERGING	• There is political and media awareness of the societal issue. • There is an emerging body of research, but data are still weak. • Leading businesses experiment with approaches to dealing with the issue.
CONSOLIDATING	• There is an emerging body of business practices around the societal issue. • Sectorwide and issue-based voluntary initiatives are established. • There is litigation and an increasing view of the need for legislation. • Voluntary standards are developed, and collective action occurs.
INSTITUTIONALIZED	• Legislation or business norms are established. • The embedded practices become a normal part of a business-excellence model.

The Four Stages of Issue Maturity

As issues mature, they become absorbed into mainstream professional debate and eventually into practice. Once leading companies adopt unconventional commitments and practices around certain societal issues, laggards must either follow suit or risk the consequences. In 1991, when Levi Strauss publicly launched its "terms of engagement"—which defined the labor standards for Levi's business partners and was one of the world's first corporate-conduct policies—every other company in its industry looked the other way, arguing that labor standards in other people's factories weren't their responsibility. When the Body Shop adopted human rights policies in the mid-1990s, most mainstream companies deemed its practices unfeasible. And when BP CEO Sir John Browne acknowledged in his infamous Stanford Business School speech that BP had a co-responsibility to address the challenges associated with global warming, he was taking a leadership role and betting that others would have to follow—as indeed they did. Each of these actions played a big part in dragging the rest of the players in the industry toward common approaches to responsible business practices.

How Nike Just Did It

Nike's story illuminates better than most the tensions inherent in managing corporate performance and societal expectations. In the 1990s, the company was blindsided when activists launched an all-out campaign against it because of worker conditions in its supply chain. There's no doubt that Nike managed to make some extraordinary errors. But it also learned some important lessons. Today, the company is participating in, facilitating, convening, and financing initiatives to improve worker conditions in global supply chains and promote corporate responsibility more generally.

From Denial to Compliance.

Nike's business model is based exclusively on global outsourcing. Simply put, the company has rarely produced a shoe or a T-shirt outside of its design studio. By the time the company was singled out in a 1992 *Harper's Magazine* article for the appalling working conditions in some of its suppliers' factories, almost all of its competitors were using a similar sourcing model. Labor activists in the early 1990s were exerting enormous pressure on premium-brand companies to adopt codes of conduct in their global supply chains. These groups targeted Nike because of its high-profile brand, not because its business practices were any worse than its competitors'.

The company's first reaction was defensive. "We said, 'Wait a minute; we've got the best corporate values in the world, so why aren't you yelling at the other folks?'" one of Nike's senior managers recalls. "That was a stupid thing to do. It didn't get us anywhere. If anything, it raised the volume higher." The company realized it couldn't just shut out the noise. It eventually responded to activists' demands for labor codes and, after further pressure, agreed to external audits to verify whether these codes were being enforced.

Nike hired high-profile firms or individuals to conduct the audits, which were initially one-off events. But these companies and individuals had little actual auditing experience or credibility in labor circles, and the approach backfired. Statements such as former UN Ambassador Andrew Young's casual conclusions that all was well in Nike's supply chains were publicly challenged and subsequently proved to be flawed or overly simplistic. Consequently, many labor activists believed Nike's early, failed attempts at building credibility were proof of insincerity.

Companies frequently resist accepting new responsibilities because they see how risk-taking organizations are criticized for their efforts to do just that. But the pressure on Nike was so intense that it couldn't afford to wait until the whole sector advanced. Labor activists' demands for action were cascading into Nike's core and highly profitable youth markets in North America and Europe. So in 1996, Nike "went professional" in creating its first department specifically responsible for managing its supply chain partners' compliance with labor standards. And in 1998, Nike established a Corporate Responsibility department, acknowledging that acting responsibly was far more than just reaching compliance; it was an aspect of the business that had to be managed like any other.

Managing Responsibility.

By the turn of the millennium, Nike's labor-compliance team was more than 80 strong. The company had also hired costly external professionals to audit its roughly 900 suppliers. Even so, new revelations about Nike's failure to adhere to its own labor codes constantly came to light. Many outsiders took this as proof that the company still lacked any real commitment to address labor standards. Those inside Nike's walls were incredibly frustrated by their failure to move past this ongoing crisis. After a particularly painful documentary on Nike aired in the United Kingdom, the CEO assembled a team of senior managers and outsiders led by Nike's vice president for corporate responsibility, Maria Eitel. The team was instructed to leave no stone unturned in figuring out how to get beyond the company's continued failure to effectively comply with its own labor codes.

The team's review didn't focus on the behaviors of factory managers and workers, as many previous studies did; the group considered issues at the factory level symptoms of a larger systemic problem. Instead of looking down the supply chain, the team studied the upstream drivers. After six months, it concluded that the root of the problem was not so much the quality of the company's programs to improve worker conditions as Nike's (and the industry's) approach to doing business.

Like its competitors, Nike offered performance incentives to its procurement teams based on price, quality, and delivery times. This standard industry practice undermined Nike's many positive efforts to comply with its own codes of conduct; it had the unintended effect of actively encouraging its buyers to circumvent code compliance to hit targets and secure bonuses. And there were other tensions between Nike's short-term financial goals and its longer-term strategic need to protect the brand. For instance, the company's tight inventory management often led to shortages when forecasting errors were made. That created urgent short-term needs for more goods to satisfy market demand, which drove procurement teams to take what they could get. Often, this would force suppliers to cut corners to push the envelope on delivery times, which would drive up overtime in the factories—exactly what Nike's labor code was trying to prevent. To cap it all, when something went wrong and Nike's reputation took a hit, the procurement, marketing, and inventory management teams weren't the ones that suffered financially. The brand shouldered the burden, and the legal and other costs were charged to the corporate center, not to those whose behavior had caused the problem in the first place.

Nike realized that it had to manage corporate responsibility as a core part of the business. Technically, it was relatively easy to reengineer procurement incentives. The review team proposed that Nike grade all factories according to their labor conditions and then tax or reward procurement teams based on the grade of the supplier they used. But commercially and culturally, it wasn't so simple. Nike's entrepreneurial culture extended from brand management to procurement. Any challenge to that spirit was considered by many as an affront to a business model that had delivered almost continual financial success for three decades.

Nike's resistance to shifting its procurement methods cannot be dismissed as some irrational distaste for change. It knew that constraining its procurement teams would involve real costs and commercial risks. And the hard reality was that Nike's efforts to secure adequate worker conditions delivered little to the financial bottom line in the short term—which was the sole focus for the bulk of the company's mainstream investors. (For more on the business implications of doing good, see the sidebar "Being Good Doesn't Always Pay.") Nike's challenge was to adjust its business model to embrace responsible practices—effectively building tomorrow's business success without compromising today's bottom line. And to do this, it had to offset any first-mover disadvantage by getting both its competitors and suppliers involved.

Being Good Doesn't Always Pay

There is no universal business case for being good, despite what we might wish. Civil regulation, attacks by NGOs to damage corporate reputations, and the like rarely cause measurable, long-term damage to a fundamentally strong business. In the short term, which is what most investors focus on, variations in financial performance are usually attributable to business fundamentals such as design, cost of sales, and market forecasting.

It has turned out to be a long and rocky path for Nike and other companies working to get the labor piece right. Several multistakeholder initiatives were launched that focused on the development of credible and technically robust approaches to compliance. Most well-known in the United States are the Fair Labor Association (FLA), which was initially established with support from the Clinton administration as the Apparel Industry Partnership, and the SA8000 standard, which evolved with help from parties outside the United States. The multistakeholder Ethical Trading Initiative (ETI) emerged from the United Kingdom. Each initiative has distinct

Nike has been highly profitable the past three decades—a period in which it was also subjected to continuous and vociferous opposition to its business practices. Consider the global media coverage of the company's alleged malpractices and the widespread anti-Nike protests at North American universities (a core market segment for Nike). Yet institutional investors have shown a startling disinterest in Nike's handling of its labor standards.

The high-profile, two-year case of activist Marc Kasky versus Nike brought the company before the California and federal supreme courts for allegedly misrepresenting the state of labor standards in its supplier factories. Even now, after an out-of-court settlement, the case raises the specter of further legal action against Nike and others based on similar claims of commercial misstatements. Yet the case has barely raised an eyebrow from the mainstream investment community. Coping with such challenges, it seems, is simply an acceptable overhead cost of doing business.

That's not to say, however, that responsible business practices cannot pay. As with any business opportunity, the chances to make money by being good must be created, not found. Reinventing one's business isn't easy. And doing so in socially responsible ways involves a major shift in managerial mind-set—from a risk-based, reputational view of corporate

characteristics, involves diverse companies, and associates with different NGOs, labor organizations, and public bodies. But all have broadly responded to the same need to develop, monitor, and comply with now commonly accepted labor standards underpinned by UN conventions.

Responsible Business Strategies.

Nike's underlying business strategy wasn't static as it moved up the corporate responsibility learning curve. The prevailing trade agreement in the apparel industry, the Multifiber Arrangement (MFA), was nearing its end. The MFA had established country-based garment import quotas to the all-important U.S. market. The growth of Nike's apparel supply chains during the 1990s was partly driven by cost grazing–the ongoing search for lower prices. But the MFA had reinforced that need to graze because companies had to search the world for spare quota. The MFA also inhibited businesses like Nike from making longer-term procurement commitments to their suppliers and thwarted the stable conditions needed to advance opportunities for brands to invest in technological and managerial progress.

The MFA's expiration on January 1, 2005, will accelerate the consolidation of supply chains. With disperse supplier relationships and no quotas to destabilize, experts argue, the scene is set for changes in the apparel industry that will be as significant as the advent of globalized supply chains themselves, which was a major factor in Nike's original success.

It’s not just that there will be fewer and larger suppliers. Intensified competition is pushing apparel makers to shorten the time between design and market even as they continue to cut costs. The industry will probably move to some form of lean manufacturing—shifting away from traditional top-down managerial styles toward greater worker self-management that delivers more flexibility and productivity. Some estimates suggest possible manufacturer cost savings of up to 25%.

In terms of worker conditions, the move toward lean manufacturing could reduce the total number of people employed, especially if fewer, more stable supply chains lead to advanced production technologies. But the shift could also improve conditions for the remaining workers over time. Because lean manufacturing requires employees to learn new skills, it would put upward pressure on wages and improve management’s behavior toward workers. Clearly, Nike and its competitors will soon have new opportunities to create value and new ways to align those opportunities with responsible business practices. The challenge is to manage the transition to a post-MFA world in a responsible fashion.

Nike’s 2004 acquisition of the athletic apparel and footwear brand Starter also affects Nike’s strategy in terms of corporate responsibility. Starter is sold at large retailers such as Wal-Mart, Kmart, and Target, and the acquisition is a key element of Nike’s growth strategy as the company reaches the limits of organic growth in some of its core markets. Now that it has entered the world of value-channel economics, Nike must concern itself with high product volumes and low margins while also maintaining its commitment to its labor codes.

Although it is a king-size operator in the market for premium goods, Nike has far less leverage in the market for value items, in which it must deal with retailers like notorious cost-squeezer Wal-Mart. Furthermore, value customers focus on price and are generally less responsive to ethical propositions—particularly those involving faraway problems like worker conditions in Asia or Latin America. Nike’s public position on these issues is clear: It is committed to maintaining its labor compliance standards in all product lines and in all supply chains. But the business model underlying value-channel economics requires that Nike find new ways to keep its social commitments. Part of Nike’s response to this challenge has been to argue for regulated international labor standards, which would offset any possible competitive disadvantage that Nike would incur if it had to go it alone.

Collective responsibility simply makes sense. After the acquisition of Starter, Nike sent out letters to stakeholders explaining its approach: "Whatever the channel where Nike products are sold, we have a growing conviction that it is essential to work with others to move toward the adoption of a common approach to labor compliance codes, monitoring, and reporting to help ensure broader accountability across the whole industry. This will take time, but through these efforts and with the active participation of all the major players, we believe we can further contribute to the evolution of supply chain practices, including in the value channel." Nike recognized that its long-term success required it to expand its focus from its own practices to those of the entire sector.

Toward Civil Action.

Nike has been involved in various initiatives designed to bridge corporate responsibility and public policy, starting with the FLA in 1998. In July 2000, CEO Phil Knight attended the launch of the Global Compact, UN Secretary-General Kofi Annan's multistakeholder initiative designed to encourage responsible business practices. Knight was one of the 50 or so chief executives of companies, NGOs, and labor organizations from around the world who were at the event. He was the only CEO of a U.S. company in attendance; since then, many more U.S. organizations have associated themselves with the initiative. At the launch, Knight announced Nike's "support of mandatory global standards for social auditing," asserting that "every company should have to report on their performance" against these standards. His proposal meant that Nike's suppliers and competitors would have to share the financial burden of securing a regulated level of worker conditions in global supply chains. When the social performance records of all the companies were made public, Knight believed, Nike would be revealed as a leader, which would help protect the brand.

In early 2004, Nike convened high-profile players from the international labor, development, human rights, and environmental movements at its Beaverton, Oregon, headquarters. Their willingness to attend was itself a testament to how far Nike had progressed—from a target of attack to a convener of erstwhile critics. Even more notable was the fact that the topics discussed weren't specific to Nike's operations. The conversations focused on the potential negative fallout from the MFA's demise.

The end of the agreement raises the challenge of how to assist countries with garment industries that may be suddenly rendered far less competitive in international markets. For example, a significant portion of the export-oriented garment industry in Bangladesh is at risk. Today, that sector employs upward of two million people and accounts for 75% of the country's foreignexchange earnings. Similar data for countries in Latin America, Africa, and Asia highlight the potentially disastrous social and economic fallout if the transition to a post-MFA world is botched.

The MFA is ending partly because of the lobbying by NGOs and governments of key exporting countries; they argued that the agreement was a barrier to trade for developing countries. Even though companies will be downsizing, relocating, and consolidating in response to the MFA's demise, the business community was not a significant player in this trade change and, in fairness, cannot be held responsible. However, the public is already focusing on which companies are laying off workers and with what effects. Nike is one of a few companies that believe, regardless of how this situation arose, they must be part of the solution if they don't want to be seen as part of the problem.

So Nike has joined a group of organizations—including companies such as U.S. retailer the Gap and UK retailer Asda; NGOs such as Oxfam International and AccountAbility; labor organizations such as the International Textile, Garment, and Leather Workers Federation; and multistakeholder initiatives such as the ETI, the FLA, and the Global Compact—to explore how such an alliance could help to address the challenges of a post-MFA world. This alliance might be well placed to advise governments and agencies like the World Bank on ways to develop public programs to assist workers in the transition; establish a framework to guide companies in their realignment of their supply chains; or lobby for changes to trade policies that would confer benefits to factories and countries that took labor issues into greater account.

Nike is, of course, a business, and as such is accountable to its shareholders. But the company has taken significant steps in evolving a strategy and practice that shifts it from being an object of civil activism to a key participant in civil society initiatives and processes.• • •

In dealing with the challenges of corporate responsibility, Nike has come to view the issue as integral to the realities of globalization—and a major source of learning, relevant to its core business strategy and practices. That learning prompted the company to adopt codes of labor conduct, forge alliances with labor and civil society organizations, develop nonfinancial metrics for compliance that are linked to the company's management and its broader governance, and engage in the international debate about the role of business in society and in public policy.

As Nike's experience shows, the often talked-up business benefits of corporate responsibility are, at best, hard-won and frequently, in the short term, ephemeral or nonexistent. When accusations arise, it's easy for companies to focus on the low-hanging fruit—employee morale, for instance, or the immediate need to defend the brand. But making business logic out of a deeper sense of corporate responsibility requires courageous leadership—in particular, civil leadership—insightful learning, and a grounded process for organizational innovation.

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