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CORPORATE SOCIAL RESPONSIBILITY AND THE INVESTOR

by
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CORPORATE SOCIAL RESPONSIBILITY AND THE INVESTOR

Edward H. Bowman

MANAGERS' SUMMARY

This paper discusses some of the questions of corporate social responsibility in the context of the interests and role of the investor. About sixty to seventy persons, mostly in corporate organizations, were interviewed in both America and Europe to obtain their ideas, actions and reactions, positions and questions in this area. Literature and theory have been utilized, where helpful, to elaborate certain of the ideas developed here, and is drawn from economics, law, management, finance, and political science.

As is noted in the paper's summary, two myths have been particularly attacked: 1) that corporate social responsibility is dependent upon either and solely the noblesse oblige of the manager or the laws of the government, and 2) that corporate social responsibility is in fundamental conflict with the interests of the investor. A "neo-invisible hand" is present in contemporary western society which confounds and refutes these simple notions.

Introduction

Proxy Contests. The question of Corporate Social Responsibility has interestingly been raised, perhaps most visibly in the last several years, in the context of the investor. It has been the various proxy contests at annual stockholder meetings, starting with "Campaign GM" (General Motors), which have raised for a succession of large and successful American corporations such questions as the composition of the board of directors, corporate by-laws and the legality of pollution, discrimination in employment and promotion for reasons of race, religion or sex, disclosure of information in annual reports, weapons manufacture, business operations in Southern Africa, and environmental damage. Proposals about all of these issues have been brought to the stockholders of a growing list of corporations to be voted on at the annual meeting.

In virtually every case the proposal has been contested by the company with the Securities and Exchange Commission (S.E.C.) as not appropriate for stockholder vote. However, the SEC has approved enough of them for stockholder voting, some in modified form, that many of the issues have been voted upon at the annual meeting. Because proportionately few stockholders attend annual meetings, the votes have largely been by proxy (a signed delegation of the right to vote the shares either in a particular manner, or as the delegate chooses).

While in every case, the majority of shares voted have supported the position taken by the company managements, the advocate groups who have raised the proposals have acknowledged (at least some of them) that their real goal was "awareness" of the issues - by stockholders, the general public, management, and the government. Clearly the campaigns have raised this awareness. Probably the investors who have given most careful consideration to these proxy questions, at least in the sense of organization assignments, study,

discussion, and reports, have been the institutional investors that are charitable corporations, such as foundations and universities. More will be said about these later in this paper.

Sources. Not much research following the canons of social science has been carried out in the areas discussed here. This article draws on the research of a previous study done for MIT (University Investing and Corporate Responsibility) which included: 1) fifty interviews with business executives, institutional investors, advocate groups, and governmental professionals; 2) analyses of these issues and actions taken received from sixty five universities and colleges, and of course; 3) a survey of the literature, including books, journal articles, newspaper clippings, proxy proposals, and company releases. Added to this have been about a dozen interviews in Europe, largely with Belgian executives and institutional investors. What is offered then is essentially a broad, but casual(empiricism.)?

Definitions. Corporate Social Responsibility is of course rather difficult to define briefly. For the moment let it be thought of as including the concern for the impact of all a corporation's activities on the total welfare of society. This paper will draw rather heavily upon the economic concept of externalities to try to shape some of the issues. While most of the costs and benefits of a corporation's activities will be reflected on a corporation's books (costs and revenues, and subsequent profit and loss statements), some effects will not be so reflected and are referred to as externalities. However, it should be made clear initially that while some analysts may define anything that ultimately benefits the corporation as not falling under the definition of "socially responsible behavior," i.e. because it benefits the company, this is considered as too narrow a method of definition here, and misses most of the useful and interesting questions involved. In other words, the concept of externality will be used as a point of departure.

Approach. The question of the relationship between the interests and role of the investor and corporate social responsibility may be addressed in a number of ways. For purposes of analysis, the sequence to be followed here will be an investigation of the potential relations between corporate social responsibility and the welfare and nature of the corporation (presumably of interest to the investor), followed by a discussion of issues more usefully thought about in the context of the stockholder and his portfolio of investments. While not discussing fully the many facets of corporate social responsibility, especially the individual issues of current concern, it will be necessary to introduce some particular ideas in order to throw light on some of the arguments introduced later for the investor. Under "Corporate Social Responsibility" will be discussed profits, externalities, the neo-invisible hand, technostucture, and strategy. Under "Investor" will be discussed perceptions, risk, portfolios, ethics, and information and influence.

Corporate Social Responsibility

Profits. Though outside many persons' view of corporate social responsibility, especially the more active advocate groups, the economic efficiency of a corporation's decisions and activities is considered by many, especially economists (e.g. Professor Milton Friedman), as a major social responsibility of the industrial corporation. The corporation acquires and uses the limited resources of society - labor, materials, equipment, land - and converts them into products and services which society in turn purchases for its own use. With a market system which works reasonably well, the factor markets and product markets and their prices reflect the costs and preferences of society (i.e. all other corporations, governments, and households). According to this view, the corporation which manages this conversion more efficiently than another is serving society better, and hence is performing more responsibly. While market structures and competition, business cycles and the particular industry may influence this measure, profits are an indication and scale of this performance. With room

for some argument, including short run versus long run, return on investment (equity or total) gives a measure of this performance. Clearly this facet of corporate social responsibility can be considered as also of benefit to the corporation and its stockholders.

Externalities. While profits as a reflection of efficiency can be thought of as one major facet of a corporation's responsibilities, certainly one set of concepts which must be introduced to modify this argument is that of economic externalities. Most of the costs of a corporation's activities are reflected in its books of accounts, and most of the benefits and values produced by the corporation are captured in its prices and are therefore also reflected in its books of accounts. However, this is not necessarily true of all its social costs and benefits. Such unreflected costs and benefits are referred to as externalities by economists. Pollution would be a useful current example of such social costs or negative externalities. A factory placing some pollution into a stream, even with the costs it has perhaps already incurred to eliminate some of the pollution, will not normally reflect in its books (and therefore profits and perhaps possible dividends) the pollution which does enter the stream. However, "costs" to society, which will almost always mean other individuals in society, may be incurred as far as downstream water users are concerned. This could include fishermen, householders, industrial water users, municipal water supply systems, swimmers, etc.

Positive externalities, or social benefits, also exist - to complicate the analysis. Where an employer has a choice between relatively educated and skilled potential employees and disadvantaged, perhaps ghetto employees, and chooses to recruit, hire and train the latter at some added expense, it often has no possibility of capturing these added expenses in the prices it charges for its products. And yet benefits accrue to society because of the choice. The individuals hired and trained as well as their families, their communities and perhaps stores in their communities, government personal income tax collections and perhaps reduced welfare payments, and even subsequent employers may all benefit from this act. (To be more precise, it would

be the marginal positive differences in these benefits over the similar costs associated with the potential employees not hired).

What do these positive and negative externalities mean to the corporation and its stockholders? Perhaps the first answer to this question is that there is the tremendous complication that many corporate activities in the general area of potential externalities - pollution and disadvantaged employee training - may in fact benefit the corporation in many ways and over the longer run. In other words, what is truly an externality, which by definition means not (ever) to be reflected on the company's books, is very often difficult to ascertain.

In evaluating a company's activities related to positive and negative externalities and corporate responsibility, there are at least three facets in an economic consideration of stockholders' interests and future returns to the corporation:

- 1) Which activities?
- 2) How much money is expended?
- 3) What timing?

An attempt is made here to capture some elements of these puzzles graphically.

Which Activities?

Activities which almost surely will economically benefit the corporation.

A

Activities which may or may not directly benefit the corporation.

B

Activities which probably won't directly benefit the corporation.

C

Figure 1

Activities "A" in Figure 1 would include many safety measures within the company's own plants. Employee turnover can be reduced, pay rates for special dangerous jobs can be lower, insurance claims will be fewer, law suits will be less likely. In addition to the

products and services produced by the corporation, which would be the obvious examples of activities of type "A", many related activities could also be so classified. At the other extreme, activities "C" might include gifts to charitable organizations, especially those which are geographically remote from the company's operations.

Activities "B", those of uncertain return, would include many possible corporate responsibility activities (i.e. impacting the total welfare of society), perhaps illustrated by special materials and expenditures for quality control of some packaging materials felt to be related to issues of "consumerism". Though costs would be higher, perhaps sales would be larger, or shipment returns fewer. Some research activities, especially where the results are made publicly available, might be classified here. Activities addressed to customer service, parts, and repairs might be included here. The issue of whether the corporation does or does not benefit from these activities may depend importantly on the company's ability to "internalize" and "institutionalize" these benefits. A public contractual guarantee of service may capture for the corporation the otherwise ad hoc expenses and their benefits, especially for all those customers not needing the repair/replace-ment service and treating the guarantee as value received. Patents may do the same thing for Research and Development benefits, and advertising for product quality. All of these examples of internalizing/institutionalizing what otherwise might be a doubtful activity/benefit will be mentioned again under the "Strategy" section below.

The middle category "B" of questionable returns helps illustrate the second puzzle of how much money is expended. Whether or how much the company benefits economically may depend for many activities on the level of expenditure.

How Much Money is Expended?

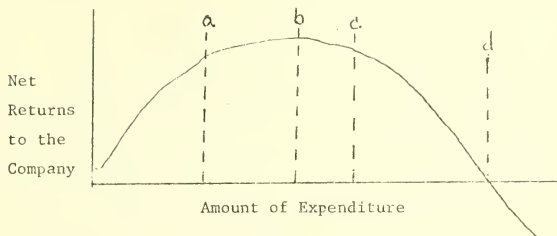


Figure 2

Up to some level of expenditure for many activities, including but not limited to issues of corporate responsibility, the company will receive a net benefit. Maximum benefit in Figure 2 would be at point "b" on the curve. Between points "a" and "c", a fairly wide range of expenditures, the company will receive close to a maximum benefit. Beyond point "c" (or "b") the net benefits fall, and beyond point "d" the "benefit" is negative. Funds spent to recruit, hire, train, place, etc. minority employees could probably be described in their return to the company by such a curve/chart.

The shape of such a curve suggests a number of points for further analysis. 1) Perhaps such a curve may start out as negative and expenditures must approach some kind of critical mass before returns become positive (see "Strategy" below). 2) Economists tend to use the language for a company being beyond point "b" as a company "taxing" itself. The implication is that expenditures made for society's welfare (presumably) and with no economic return to the company is analogous to a tax levied on the company by its own management (and without political legitimacy and sanction). Though the concept may be useful, its place on the curve is extremely ambiguous due to the many kinds of "internalization" possible in our society (see "The Neo-Invisible Hand" below). 3) The shape of the

curve may depend importantly on who "shares" the cost of the activity. With oligopolistic competition and "administered prices", some of the increased cost might be included in the negotiation of prices with customers, including the government. Others who may share these costs with the investor might include both the employees and the tax collector. 4) Some analysts maintain that managements may have typically underestimated the height and length of this net return curve (to "socially responsible" expenditures). Rensis Likert in his various writings (e.g. Human Organization: Its Management and Value), elaborates this idea. He writes in A New Rationale for Corporate Social Policy, "Corporate sensitivity and responsiveness to reactions of its various publics, and to the effect of these reactions on its immediate and long-term profitability and success, depends on accurate information concerning these reactions and their financial consequences. Unfortunately these data do not exist today. Virtually every corporation is handicapped by inadequate and often seriously inaccurate information on these matters." 5) Though an initial view of the curve in Figure 2 may assume that the company (its management) and the investor would wish to choose the point with the highest possible value on the "Net Returns to the Company" scale (what the economist would call a straight and horizontal indifference curve), society might prefer some trade-offs between the scales, i.e. its preferences might be mapped by a curve (indifference or iso-preference) which slopes downwards to the right, i.e. it prefers larger social expenditures and lower company returns. In fact the company management (or the techno-structure described below) might have a preference curve (or utility scale) still different from the investor or from society.

The third puzzle to be graphed deals with the time frame of certain socially related expenditures.

What Timing?

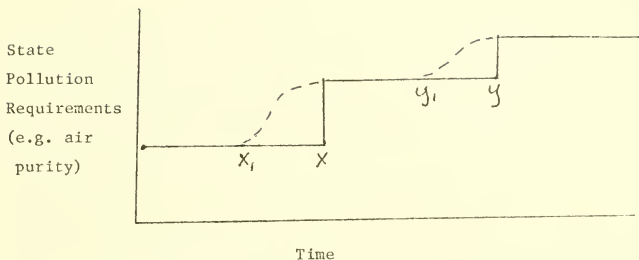


Figure 3

Where a state has announced that air purity pollution requirements will be raised as shown at point "x" in Figure 3, the company may choose to start to make some new expenditures at point "x_i". It may be easier or cheaper not to wait until point "x". Whether such action falls under the label of "corporate social responsibility" is a moot point - the fact is that for the time period from "x_i" to "x", the company's performance is better than that required by state law. If it is now estimated that a new change may be required at point "y" the company might choose to make additional expenditures at point "y_i". In this same regard W. J. Baumol writes in his discussion of special taxes as an efficient way to handle the pollution problem, ("On Taxation and the Control of Externalities"), "If firms are put on notice that the acceptability standards may well be modified in the future this may lead them to construct what George Stigler describes as more flexible plants - plants which are designed to keep down the cost of response to changing standards. Of course, flexibility itself is not costless. However, it may be precisely what is appropriate for a society which is only beginning to learn to grapple with its environmental problems."

At a minimum, the previous discussion has been intended to abolish the myth that there is a simple conflict between corporate social responsibility and either the welfare of the corporation or its stockholders, especially in the case of potential externalities. The only statistical study available on these relations is a paper, "Is Pollution Profitable? The Case of the Pulp and Paper Industry," by Joseph H. Bragdon, Jr. and John A. T. Marlin. Their approach was to take a previous study by the Council on Economic Priorities (C.E.P.), Paper Profits: Pollution in the Pulp and Paper Industry, written by Allan, Kaufman, and Underwood, which ranked over twenty companies in the pulp and paper industry on an index of pollution control (after an intensive investigation of the companies and their various plants). Bragdon and Marlin eliminated a few companies from the first list because of either a) the company's paper operations were only a relatively minor part of total company activities, or b) recent substantial and complicating merger and acquisition activities. The remaining companies were then ranked again for their economic performance, i.e. earnings per share growth and average return on capital. The correspondence between these rankings - pollution control and economic performance - was then statistically tested, and showed a clear, but of course not exact, positive correlation. The authors then go on to discuss what is often a difficult problem in statistical studies - that of cause and effect (see "Investor Perception" below). At a minimum the authors have demonstrated to their satisfaction that corporate social responsibility in this case is not inconsistent with, nor negatively correlated to, profitability and the investor's welfare.

The Neo-invisible Hand. Adam Smith in The Wealth of Nations discussed the affect of the market place as providing the form of provident control necessary to keep the activities of a business, though in self-interest, in the best interests of society. The butcher, the baker, and the candle-stick maker, through their own self-interest, supply

our needs. Because markets are less than perfect, and because of externalities, some analysts feel that the businessman himself must (and does) exercise "self-restraint" in the best interests of society. Other analysts suggest that it is the appropriate role for the government to "internalize" to the business what would otherwise be adverse social externalities. The obvious mechanisms are special laws, taxes, and subsidies. In other words, the economist has traditionally argued for government actions to internalize the externalities, while the "managerialist" has argued for self-restraint and "social-concern" on the part of the businessman.

While partially accepting both of these positions, the argument put forth here is that many sectors of industrial society influence (constrain) the activities of business with a neo-invisible hand, not unlike the markets posited by Adam Smith. Any organization, commercial or otherwise, must maintain a "viable coalition" of all its constituents. The corporation must in some sense be responsible to/for many parties, including its owners, employees, management, customers, communities, government, vendors. Profitability would perhaps be the major responsibility to the corporation's owners. Without sufficient profitability, owners will sell, management will be replaced, or the corporation will even cease to exist. Other, and equivalent, responsibilities to the other parties also exist merely to perpetuate the life of the corporation. While the discussion here focuses on the interests and role of the investor, he must accept this fact of political/social/economic life.

To illustrate that agencies other than the government (as through special taxes) or the manager (as through self-restraint) can internalize to the corporation what otherwise might be considered externalities in conflict with society's welfare, a number of actual examples are drawn from recent European experience, including England, France, Holland, and Belgium. Similar examples could clearly have been supplied from American experience. Who supplies this neo-invisible hand?

1) The Customer - A British company was recently considering and finally did divest itself of a sizeable division. While the division had been losing money and its prospects did not appear bright, the major contra argument to closing or selling it was that the division had long-term service contracts for its equipment all over the world. The parent corporation was concerned that future non-delivery on its service, repair, parts contracts would be substantially damaging to its reputation and for the other parts of its business. The potential externality here would have been the substantial costs to world wide industrial and government customers because of nondelivery of service. The resolution was a careful packaging of sections of the business divested, sale to responsible buyers with protective legal contracts including the delivery of the required service, which in effect cost the selling company something in its sale prices.

Admitting that this example may be considered as rather close to the original market of Adam Smith's invisible hand, it is enough different from the usual product and factor markets to be worth considering. Another possible method that classes of customers may use for internalizing to the company many forms of potential externalities is the boycott. An organized refusal of a sizeable group of customers, and their supporters, to purchase a company's products and services for whatever reason, probably not associated with the product itself, is a further departure from the invisible hand described by Adam Smith. The customer boycott may of course be in collaboration with another one of the agencies described here, such as the community or the union.

2) The Union - A Dutch company planned (and started) to close one of its plants due to unpromising business conditions and prospects. The externalities here would have been the substantial losses of jobs (a form of worker capital) and local community problems (purchasing power, empty houses, lower tax rolls, etc.) Not only did the local union strike the operations of the Dutch Company in Holland, but for the first time in the knowledge of a number of observers, unions in

other European countries (e.g. Germany) struck other plants of the same Dutch Company (it was a multi-national corporation). The company decided not to close the first plant; the unions had internalized the potential external costs.

While this is a specific company/union interaction, a number of people in Europe maintain that it may well be the unions at a general level, especially at the supra level of EEC, which may have a major impact on corporate social responsibility. The International Herald Tribune on October 6, 1972 carried the lead article, "EEC Weighs 2-Tier Board For Firms" which discussed a proposal that all Common Market countries would adopt the system common in West Germany where employees sit as members of one of the boards. It is not clear of course that this will happen, especially as, "Britain's system of company law is completely different from the one the commission is urging as a uniform basis for all nine members of the expanded EEC." (IHT, October 27, 1972), "There is regret in the EEC headquarters that the issue has side-tracked the principle of having a unified company law ... (NOTE)... The real purpose of achieving a common company statute would be to make mergers within the EEC easier to achieve."

3) The Community- A French company recently built a new plant near a new town and the pollution from the plant was unacceptable to the town. The operation of the plant has been blocked by the community for six months, and it is not clear what will happen or when the plant can begin operating. The community has internalized the pollution (potential) externalities to the company.

A law common to most countries is that a building permit is required from the local community before construction, or even modification, of facilities can start. While such permits have been normally granted with little fanfare, enough cases have recently occurred in both Europe and the United States where major revision in the construction plans, or even outright refusal, has been the outcome to suggest that communities can and will be a major agency to internalize for the corporation potential externalities.

4) The Investor - A Belgian banker has indicated that since the occurrence of the many proxy contests and social problems in

American blue chip companies, his bank for its trust investments has been, "...very hesitant and careful about investing in both these companies and other similiar possible target companies." The externalities cover, of course, a broad spectrum of American problems. The "internalization" of the externalities for the companies is a rather complex function of securities markets, and subsequent cost of capital to the company. (This is further discussed under the "Investor" sections of this paper.)

5) The Employee - A Belgian corporation has recently decided to issue all of its official papers and annual reports in both French (as it had done) and in Flemish (something new). While the cost of this decision may not be substantial, it is an example of a positive externality, the benefits of which will be internalized for the company by its own Flemish employees (and customers and stockholders). The company took this action because it felt that it was an appropriate thing to do "socially" in the touchy area of the two language/culture society of Brussels. The essential point is not whether this was or was not an externality, but that it was a potential (positive) externality the benefits of which will be internalized to the corporation by one of its major constituencies, its employees.

While a number of the examples cited above are far from invisible to either the company or to society, the point made here is that many other potential actions exist for each of the actual ones. The latency of such power and actions is what normally supplies the neo-invisible hand. (If analogies are required for the argument, let them be latent strikes in labor negotiation, and available military force in international negotiation.)

The main argument here centered on the concept of the neo-invisible hand is that it is not solely on the conscience of the manager, nor on the government, that the welfare of society is protected, promoted, or interpreted. The investor must see his interests as a complementary part of the pluralistic institutions of western economic society. His corporation (investments) can operate and survive in no other way than as a negotiated part of this environment.

This point is discussed at a theoretical level by Cyert and March in A Behavioral Theory of the Firm. According to them,

companies seek to avoid uncertainty in order to render the plans and activities which they do undertake, and for which they invest the "stockholder's" money, more certain of outcome. The major way they seek to avoid uncertainty is to have a negotiated environment. An increase in the stability of the coalition of the various constituents reinforces this negotiated environment. While this may seem a cost to some investors, it can be thought of as reducing the risk of their investments, (and as a comfort to the technostructure).

The Technostructure. While there are a number of important elements in the coalition/constituencies influencing the modern corporation, it is perhaps the technostructure which the investor should consider most closely, as it may be least understood relative to his interests and those of society generally. The technostructure in a very fundamental sense sits between corporate social responsibility and the interests of the investor, and coordinates, ameliorates, or arbitrates between them.

We can draw on much recent literature from economists, through political scientists, over to managerialists to explain this phenomenon. Professor John Kenneth Galbraith in The New Industrial State makes the argument that control in the economic, and to some extent political, society has passed through three noticeable stages, always residing in the scarcest resource. First historically comes the landowner. Then with the coming of the industrial revolution and the need for (and returns to) capital, this economic/political control passed to the capitalist. It was during the ascendancy of capitalism that economic science flowered. As Lord John Maynard Keynes has said, men of affairs (and "conventional wisdom," to return to Galbraith), are influenced more than they realize by theories expounded by dead economists, and it is possible that some of the current thinking about corporate social responsibility and the investor must be placed in this category. To return to Galbraith's argument, the economic and political control is now passing or has passed during this part of the twentieth century from the capitalist to the technostructure. Very briefly the technostructure may be defined as the managers,

engineers, economists, lawyers, accountants, personnel specialists, etc. (and their interlocking and interdependent organizational arrangements) who run our medium sized and large corporations, and without which the modern corporation couldn't exist. They are the factor in short supply compared to a rising demand. A half a century ago, Berle and Means in The Modern Corporation and Private Property noted the passing of control of the corporation out of the hands of the "owner" into the hands of the technostructure.

The technostructure has its own needs, values and standards, and being in control, exercises them. It is concerned more with the growth, relative stability, and image of the corporation than "profit maximization", though it may treat "sufficient" profits as a constraint which it must meet. The desire and goals of the technostructure may be quite sensitive to the concept of corporate social responsibility, and many activities of the modern corporation may be an allocation of the "organizational slack", explained in A Behavioral Theory of the Firm by Cyert and March, where a corporation makes expenditures beyond an absolute and "economic" level of necessity. This pool of resources and expenditures can be considered as organizational slack. The power coalition described by Cyert and March may require, as a side-payment, certain "socially responsible" expenditures for support and stable maintenance of the coalition. This is another form of the corporate self-"taxation" described by economists. Economic trauma may of course both evaporate the organizational slack and destroy the coalition, but it is precisely the avoidance of such economic trauma that Galbraith maintains is the function of the government in The New Industrial State at the national or macro-level, and of the technostructure by "uncertainty avoidance" (Cyert and March) at the firm or micro-level.

In other words, the technostructure operates as much in an organizational/political/social industrial world as in an economic one, and the modern investor had better realize this fact. Much of what is considered as the best of management practice reinforces this fact. Examples from the literature of this practice include such labels as "Management by Objectives", "The Human Side of Enterprise", "Organization Development", "Human Asset Accounting", "Induce-

ments/Contributions". Though constrained, more or less strongly, by a market economy, management chooses which goals and subgoals it will seek, and the manner in which it will seek them. Social goals are included in the technostructure's portfolio.

Consider some quotes taken from "Public Responsibility in the Private Corporation" by Kenneth Andrews, "Because the executive of today is ordinarily as sensitive as other citizens to the upgrading of our goals as a society, he cannot for long be told that concern for the problems of society, especially those which his company wittingly or unintentionally worsens, are none of his business . . . Corporation executives of the integrity, intelligence, and humanity required to run substantial companies cannot be expected to confine themselves to narrow economic activity and ignore its social consequence . . . As the levels of formal education and professionalization rise, executives will turn to social problems as concerned individuals simply because they want to . . . The problem of bringing together personal and corporate aspirations for a better world are attractive because to men who are intelligent as well as concerned they are intellectually satisfying."

Strategy. It is this management/technostructure which sets the strategy of the modern corporation, not only economic strategy, by also technological, organizational, and social as well. The best modern practice recommended to these managers is that the various facets of their strategy be in fact "all of a piece", i.e. integrated. Only if the strategy is an integrated one, in both its economic components, but in these others as well, will it have a fair chance for survival. To quote Professor Andrews again, "Its social action would include issues most closely related to the economic strategy of the company, to the expansion of its markets, to the health of its immediate environment, and to its industry and internal problems. The extent of involvement relates importantly to the resources available . . . What its competence in such areas (e.g. support of education)

might be is open to question. The question is so serious as to suggest a principle that a company should not venture into good works that are not strategically related to its present and prospective economic functions." To return to our earlier discussion of the neo-invisible hand, the negotiating constituencies of customers, union, communities, governments, investors, and employees will reinforce this strategic relationship. Investors should realize that they are but one of these constituencies, and that it is the technostructure that "facilitates" the negotiations.

To offer some examples of socially related activities, which appear rather close to the strategy of the firm, the following items are chosen from a survey completed by the Senate Commerce Committee (Newsweek, October, 1972):

- Reynolds Metals now pays 10 cents a pound for used aluminum cans or clean household scrap aluminum at 500 collection points throughout the United States. The number of aluminum cans that have been turned in has jumped from 10 million four years ago to 750 million last year.
- Pillsbury is cooperating with the Office of Economic Opportunity to provide protein-rich flour to the poor.
- Lever Brothers has committed 2 cents from each package of ten leading detergent brands sold in Wisconsin to the University of Wisconsin for study of water-pollution abatement.
- Kellogg, Quaker Oats, Del Monte, Libby's, and Campbell Soup are providing crucial ingredient labelling and more nutritional information on their products.

The Investor

Investor Perceptions. Many people interviewed, both institutional investors in Europe and in America, indicate that an appropriate concern for corporate social responsibility on the part of a company is a sign of good management and therefore consistent with and necessary to a good investment. A University Executive Committee policy resolution states (University Investing and Corporate Responsibility), "The Committee deems it prudent to invest only in the securities of corporations in whose management it has confidence as being not only

able and efficient but also responsible to the public interest because these are the corporations that will produce the best long-term results." An American banker stated that, ". . . beyond pure economic issues, any corporation must operate within the social and political structure of the times. As attitudes and problems change, the only way to maximize profits is to be responsive. Those firms that are not responsive will face: 1) large and sudden expenditures for meeting legislative standards, 2) possible economic boycotts, or 3) undercutting of their price/earnings ratio by Wall Street investors who would consider firms with unresponsive managements to be more risky investments."

This view is widely shared and could be explained in a number of ways; a) good investments require good company management, and good management is responsible, worldly and modern, and these traits are evidenced by concern about and involvement in the general social/economic problems of our times; or b) profitable and successful companies have the resources to allocate a portion to social concerns, thus evidencing the power and flexibility of their resources; or c) corporate activities and expenditures for social concern at an adequate level are really in the self-interest of the firm (e.g. permits better employee and management recruiting; solves pollution problems in a manner and at a pace and time advantageous to itself before tightened legal requirements). A somewhat different way to capture these arguments is that the risk associated with a given investment return is lessened with a company's adequate social concern (and risk/return is now the "accepted" way, both scholarly and worldly of viewing investment financial performance).

Where the above belief is widespread, it may well have an effect on the price/earnings ratio that is "assigned" a company. In other words, the market's perception of corporate responsibility may affect the price of the stock, and therefore the investor's return (where both dividends as well as capital gains are considered as included in total return). In addition to this direct effect, the price of the stock will have subsequent effects on the cost of capital to the growing company and ultimately on its earnings. Examples of this effect are

the price/earnings ratio in the issuance of a new equity, perhaps its bond rates -- certainly if the bond is convertible -- and where the corporation is making acquisitions and using its own stock as the purchase price for exchange, a higher P/E will make for a more favorable acquisition. Some attractive acquisitions will be beyond possibility for the low P/E company.

Investor Risk. A different aspect of this argument is an extension of the concept of risk/return. Much research has been carried out recently dealing with the relationship between risk and return. The essence of the findings of this research, performed jointly by brokerage houses, investment management concerns, and university faculties, is that risk and returns are positively (but perhaps imperfectly) correlated. In other words the investor seeking the greater return must accept the larger risk.

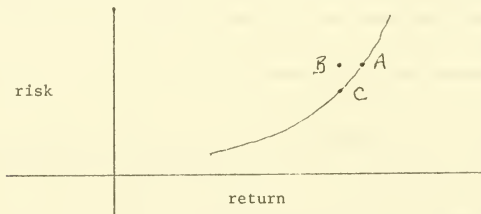


Figure 4

The curved line in Figure 4 represents the available return to the efficient portfolio willing to take a specific risk. Both points "A" and "C" are on the efficient surface, with "A" having the higher return but also a higher risk. Some organizations or investors might choose portfolio "C" because their needs are more risk-averse. However, as can be seen, portfolio "B" does not fall along the efficient surface. It would be possible, or would have been possible, to accept the same risk and have returns as high as "A", or to have accepted the same returns and have risks as low as "C".

To complete this risk/return argument, many institutional investors now argue that the corporation which is not responsive to corporate social responsibility will be a more risky investment. While it is true perhaps that the research mentioned does not focus on this kind of risk, as it deals with statistical risk rather than latent risk (or "systematic risk" rather than "residual risk"), and though it is probably overly simple to summarize this argument so briefly, this is equivalent to stating that the corporation not socially responsible may be a security investment for its stockholder in the class of portfolios suggested by point "B" on the chart. In other words, the investor could have obtained a lower risk (in the sense used here) with the same return, or if he had chosen, a higher return with the same risk.

Investor Portfolios. An interesting argument has been made for the economic interest of the stockholder in the corporation's expenditures for socially beneficial activities or externalities. It is best made in the words of the original authors, Henry C. Wallich and John J. McGowan, ("Stockholder Interest and the Corporation's Role in Social Policy" contained in A New Rationale for Corporate Social Policy):

"In this paper, we attempt to show how diversification of ownership radically alters the 'interest of the stockholder'. Corporate activities become worthwhile to the diversified stockholder that would not be so to the stockholder in a single firm It is possible to identify three possible investment bases that a corporation might adopt. The narrowest base would take account only of returns directly appropriable by the corporation - the conventional approach to the evaluation of returns. An intermediate policy would include returns appropriable through the market system by the corporate sector as a whole. Finally, a wide-based approach to evaluation of returns would include not only market-appropriable returns but also returns accruing to the community (including corporations and stockholders) not appropriable through the market by the corporate sector In the extreme case envisaged here, every investor who chose to hold any of his wealth in equities would hold shares in every corporation . . . (under certain rather restrictive assumptions, there exists a unique, optimal equity portfolio for risk-averse investors that includes all equities) (or such a mutual fund). . . .

. . . It is immediately clear that under such conditions it would be contrary to the stockholders' interest for individual corporations to adopt the narrow-based approach - that which instructs each corporation to look only at returns appropriate by it and which is the keystone of arguments advocating a minor role in social policy for corporations. If there are investment opportunities which would lead to improved environmental conditions, a better labor force, or whatever, and the returns appropriate by the corporate sector as a whole exceed costs, then they should be seized. Not to seize them deprives investors of returns they might otherwise enjoy . . . therefore, stockholders should desire that all corporations go at least as far as adoption of the intermediate-based approach. The conclusion of this analysis is that the proposition that corporation involvement in social policy is contrary to stockholders' interest is both misleading and irrelevant. . . . once it is recognized that corporations are not usually owned by a group of investors who own shares in only one corporation, but by individuals who as a group typically own shares in a very large number of corporations. . . ."

In the case of the Swedish economic recovery from the recession of the late 1960's, it is maintained by a number of analysts that the recession was shallower and the recovery quicker because of the impact of pollution control capital investments made at that point. For those governmental economists looking for counter-cyclical investments (forced or subsidized by the government), such expenditures may be more socially useful than building pyramids. This involvement is not contra to the Wallich-McGowan argument for "voluntary" expenditures for externalities as being in the interest of the diversified investor. It is also in the spirit of Galbraith's new industrial state, where the government side of the partnership assumes the responsibility for stable national growth (an obligation not always satisfactorily performed).

Investor Ethics. While allowing for the argument that some word other than "ethics" should be used in this section, it is clear that many investors have some concern for the activities of the companies in which they are invested. The stockholder is an owner of the corporation, benefits from the corporation's activities, has invested in the corporation for them, and may feel, at least in part, responsible

for them. This is an observed fact, though not necessarily a universal one. Universities and foundations, as institutional investors, are perhaps obvious examples of investors who have taken this position. A University committee has stated (University Investing and Corporate Responsibility), "There has emerged almost a moral imperative to take seriously our responsibilities and to express these concerns in appropriate ways. As stockholders, we agree that the university must assume some accountability for the activities of the corporations whose ownership we share." A large pension fund manager has stated, ". . . even though you are the trustees of other people's money, you still ought to step up to bat on these non-economic issues. With size comes responsibility, and you cannot escape it because on issues like this not taking a stand is effective action."

Banks and insurance companies, both in America and in Europe, seem more commonly to consider the moral and economic issues as so closely interrelated (for the reasons of the viable coalition of constituencies as previously discussed) that they consider the separate question of morality as highly hypothetical.

A number of surveys have recently been taken by commercial profitmaking investment managers of their shareowners or trust beneficiaries. Dreyfus Fund, Wellington Fund, and The First National City Bank are some of these recent surveyors. While the questions asked have differed somewhat, the responses have been fairly consistent -- shareholders and trust beneficiaries believe that investments should be made including as part of the analysis what is here called corporate social responsibility. While an overwhelming majority of the 28% responding shareholders of the Wellington Fund 6,500 shareholders surveyed perceived a close correspondence between economic performance and corporate social responsibility, probably the more interesting question and response was the following: "Even if other companies offer better investment prospects, a mutual fund should invest only in socially responsible companies . . . i. e. those that avoid pollution with their manufacturing plants; those concerned with product safety; those that do not discriminate in their hiring practices:"

	<u>Total %</u>
Strongly agree - - -	27.3
Generally agree - - -	28.8
Not sure - - - - -	11.1
Generally disagree -	19.9
Strongly disagree - -	12.9

An interesting comparative comment is that a Belgian banker, who feels he would know of such a survey in Europe, does not believe any such survey has been conducted. In this same regard he acknowledges that the concern with the many corporate social responsibility issues currently so visible in the United States today is less in Europe, and certainly so in connection with the investor. He feels however, that Europe will pass through somewhat the same stages as America, in perhaps five years.

When asked about The World Council of Churches decision (International Herald Tribune, August 23, 1972, "Church Council to Sell Off Stocks as Anti-Racism Step"). . . to set an example to its more than 250 Protestant and Eastern Orthodox member churches in the fight against racism by liquidating its financial stake in all corporations doing business with white-ruled African countries," several European institutional investors responded that it made sense for a church.

For those individual investors who prefer the mutual fund type of investments, and who are also concerned with the possible ethical questions of a corporation's activities, a new class of mutual fund has sprung up. These "clean funds," of which there are now half a dozen, will have as part of their prospectus and charter the investment in social benefactors, measured in some way by the fund's own procedures and organizations, and the fund shareholders will expect this aspect of performance. While the total investments of these institutions may as yet not be large in relation to the total market, over a period of time they may grow and their investment behavior could influence the price and as previously argued the earnings of a corporation, and of course therefore the return to the stockholder.

The Dreyfus Third Century Fund is an example of such a "clean fund" recently established. Its May 7, 1971 Prospectus indicates it is,

"seeking capital growth through investment in companies, which . . . not only meet traditional investment standards, but which also in their corporate activities show leadership in, or have demonstrated their concern for, improving the quality of life in America. . .

Activities by portfolio companies in the areas of the protection and improvement of the environment and the proper use of our natural resources, consumer and occupational safety, product purity and its effect on the environment, equal employment opportunity, and the health, education and housing demands of America, will be considered by the Fund in its investment selections.

It is also the intention of the Management of the Fund to eliminate from its portfolio the securities of companies that . . . cease to meet these criteria for the Fund's selections. It must be recognized, however, that there are few accepted standards in this area of the Fund's objectives, and the development of suitable standards will be largely within the discretion and judgment of the Management of the Fund. . . .

The Fund does not intend to invest in or hold securities of companies merely because those companies have demonstrated corporate responsibility; securities must also be deemed suitable for long-range capital appreciation. . . . A principal purpose of the Fund is to provide a professionally managed investment medium for those individuals and institutions who desire to channel their investments into companies which have demonstrated a social consciousness. . . the Fund may forego or dispose of investments in securities of companies which on traditional investment considerations alone might appear to offer opportunity for capital growth.

The introduction of the additional criteria discussed above as an element of portfolio selection and evaluation may encourage companies to take action which will make their securities eligible for purchase by the Fund. Other investors may be encouraged to use similar portfolio management techniques, and the Fund would hope that its policies will have a positive effect in influencing corporate action."

Both the International Herald Tribune (August 10, 1972) and Newsweek (September 18, 1972) have included articles that mention that the new clean funds in their early existence have not performed as well

as the market place (Dow Jones Industrial Average) or their competitors (all mutual funds). Many reasons are cited for this by various people, but it is clearly a bit early to make a judgement on their prospects. Perhaps, however, one way to highlight the problems of such funds is to compare their approach to that of many universities, who are also institutional investors with a concern for corporate social responsibility (and externalities).

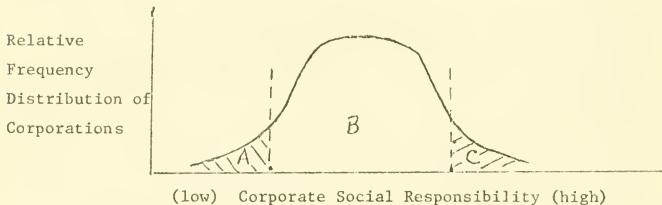


Figure 5

The graph in Figure 5, though overly simplistic, helps focus on two essentially different approaches an investor may take to the issues of corporate social responsibility, if he wishes to consider them at all. On the scale of corporate social responsibility, however constructed and measured, the large majority by far of corporations can be considered in middle ground - note that no marker of a generally acceptable level or even the zero separation between positive and negative have been placed on the chart; it is not important to the argument here. From the large survey conducted for the report, University Investing and Corporate Responsibility, a fair conclusion can be drawn that the universities, by and large, concern themselves as investors with the small minority of corporations which they might individually place in category "A" - the "flagrant cases". These can be safely excluded from a portfolio, given the large number of alternative investments currently available, with no discernible affect on either the return or the risk of their portfolios (using the currently acceptable definition by financial economists for these terms). An investor, who to the contrary, focuses on the small minority of corporations at the other extreme, category "C", by any scheme defined, the "outstanding social benefactor cases", faces

a substantially different problem than that described as the typical university's approach. For many investors, a concern with category "A" rather than category "C" may be more sensible.

Some individual investors interviewed have expressed the feeling that they do not wish to buy shares in mutual funds any longer because they "want to know and control what companies their money is invested in." The reasons given are essentially what is here described as a university orientation, i.e. exclusion of category "A". As mentioned later in the section entitled "Investor Information and Influence", one person's reasons for placing a firm in such a category may be quite different than another person's. While the mutual fund management community appears to be rather skeptical of the "clean funds", which essentially focus on category "C", (in the conceptual framework described here), they should perhaps re-examine their own reasons given for why many recent months have shown net redemptions for their own funds. As has been quite evident in the financial press, mutual funds have been generally losing their business - more shares are being turned back in for redemption than are being newly purchased. One possible explanation (among the many that are given) is that though the typical private investor may not wish to purchase shares in "clean funds", he also may not wish to keep his shares in the regular funds, which purportedly make no ethical distinction per se in their investments.

Investor Information and Influence. Following the moral/ethical interest of the stockholder, the information, influence, and power of the investor should be explored. Currently some of the most visible issues under the rubric of corporate social responsibility are more "political" than economic. They deal with the rights of the stockholder to know and to nominate. Where advocate groups have been unable to require by proxy votes corporations to leave South Africa, they have now turned to the somewhat less ambitious and at the same time more saleable idea of disclosure proxy contests. These currently

deal with white, colored, and black job distribution and pay scales in South African operations. Several companies (including IBM) have agreed to supply these statistics without a proxy vote - others have refused and a proxy fight will ensue. The estimate made here is that more stockholders will vote for their "right to know" than they have for the more substantive choices. Harvard University and M.I.T. have recently voted their proxies for such proposals.

A further change may be an easier mechanism for individual groups of stockholders to nominate director candidates. It is probable that the S.E.C. will permit this modification in standard industrial practice. An additional issue for the S.E.C., which is the major governmental agency concerned with corporate information disclosure, is the possible or probable expenditures that a corporation will have to make for environmental protection or pollution control. Here, for perhaps the first time, the S.E.C. has taken the position that such probable problems and expenditures must now be included in corporation prospectuses, the legal and public instrument associated with the public acquisition of new capital. When and as other issues of social concern can be demonstrated to have substantial financial impact on the corporation, a reasonable forecast might be that the S.E.C. will also require their public disclosure.

A further kind of information disclosure, for the investor and for others, now being discussed is the so-called "Social Audit." Several groups, including some businessmen, now advocate and/or consider that business should have a rather objective study done periodically of the corporation and its activities with the results of the study made public. Of course there would be numerous questions to be resolved in such a study - such as who should do it, how it should be done, on what aspects of the firm, etc. The term social audit obviously draws on the legitimacy of the financial audit performed by certified public accountants. One firm, Abt Associates, has already included a social audit in its 1971 Annual Report. While not fully comparable, R. G. Barry Corporation has included a Human Resource Accounting in its annual reports for several years. At least some firms in the last several years have been performing, or having

performed, what may be called social audits for internal consumption. Professors R. A. Bauer and Dan H. Fenn, Jr. of Harvard University have recently completed a book sponsored by the Russeil Sage Foundation, the draft of which was entitled The Corporate Social Audit. While the book deals with many issues, one of the recommendations seems to be that corporations either may or should consider an internal type of social audit before launching into the more difficult, for many reasons, publically published social audit.

When and if social audits, or their kin, become more available, they will supply additional information to the investor for his use in making decisions about buying or selling securities, and/or the question of how or whether to vote his shares for the various proxy proposals at annual meeting time.

One paradoxical comparison between America and Europe in the area of investor information and influence is that in Europe the information is generally less and the influence is certainly more by the institutional investor. The annual and other reports of the typical European corporation contain less information than those of the typical American corporation. However, the type of institutional investor in Europe known as the holding company exercises much more influence and control over their holdings than is the case in America. The point could be argued that the holding company is an unusual type of institutional investor. While this point might be granted, the case is that it is quite common, one might almost say dominant, on the continent. They have all the information they seek (beyond public reports) to exercise what influence they choose.

The American institutional investor, on the contrary, neither concentrates its investments for control purposes - as a matter of law, nor historically has been much concerned with influencing the American corporation. The well known "Wall Street Rule" is that if you don't like something (management, policies, record, prospects, problems, etc.) then sell the stock. The multiple volume Institutional Investor Study: Report of the Securities and Exchange Commission notes that, "Publically held corporations in the United States have

evolved into highly centralized power structures in which the beneficial owners - the shareholders - have relatively little effective control or influence . . . corporate managers tend to become self perpetuating; its ultimate responsibility is to the market place which objectively evaluates corporate performance . . . institutional investment has created the most formidable potential counter-force to corporate managerial hegemony; institutions may have the economic power to control or influence corporate affairs...(however) ... table (-) shows that relatively few (institutional investors)(34 out of 215) participated in general corporate matters . . . Even fewer institutions (10) reported that their efforts had some impact."

The impact that the stockholder might or should have is of course a puzzling question. Different shareholders, especially in the domain of social questions, may have decidedly different priorities and choices. One answer to this is to allow the market place to sort it out. Another which is currently in progress at an East Coast corporation is the design of a lengthy questionnaire for stockholder response dealing with issues of corporate social responsibility. Perhaps a number of companies are considering this approach. As mentioned earlier, a number of commercial institutional investors have already used it. It will be interesting to see how the technostructures chose to sort out this facet of their constituency negotiations.

The "rules" of this negotiation process, which are in part supplied by government laws, are different from one country to another and also change within one country as both the culture and the law changes. The government, in other words, is often a third party in the negotiations between the company (its technostructure) and another agent such as the stockholder. It was only in 1953 in the United States that corporations were legally recognized as having the right to make charitable contributions (with "stockholder money"). Professor Philip Blumberg in "Corporate Responsibility and the Social Crises" points out, ". . . in 1953 the Supreme Court of New Jersey, in A. P. Smith v. Barlow, discarded single-minded reliance on the so-called benefit test and upheld a \$1500 corporate donation to Princeton

University, relying at least in part on business's social responsibility to higher education . . . subsequent judicial decisions involving charitable contributions have uniformly held in favor of the corporation power to act . . ." He goes on to make the further interesting argument that, ". . . in light of current political realities, it is difficult to imagine the Internal Revenue Service challenging the deductibility, as ordinary and necessary business expenses, of corporate social expenditures. Therefore tax policy concerning the deductibility of corporate social expenditures may ultimately come also to control the question of validity under corporate law." Law, especially corporate law, is often essentially a process of negotiation, sometimes solely with the government and sometimes also with another agent such as the stockholder.

Conclusions

While many individual ideas are explored in this paper, two myths are particularly attacked: 1) that corporate social responsibility is dependent upon either and solely the noblesse oblige of the manager or the laws of the government, and 2) that corporate social responsibility is in fundamental conflict with the interests of the investor. These may be straw men, but they are seen often enough, either implicitly or explicitly, to warrant attack.

Corporate social responsibility, which can be thought of as the concern for the impact of all a corporation's activities on the total welfare of society, is constrained, elaborated, interpreted, and negotiated by many agents in modern western society. The investor is one, but only one, of these agents, and the technostucture, also one of the agents, essentially conducts the negotiations.

Corporate social responsibility, as an integral element in the corporation's strategy, is seen by enough investors as an important factor in a corporation's success, chance for survival, or latent risk, and in fact is such a factor, along with the health of the corporate sector generally, that the two elements of corporate social

responsibility and the investor's interest must be seen as closely and positively related. Which end of the spectrum of corporate social responsibility, i.e. high or low, the investor wishes to concern himself or herself with may be an important choice.

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