

# How to improve corporate social and environmental responsibility

June 28 2019, by Holly Ober

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Social and environmental responsibility in globalized supply chains are hard to police. That task often falls to nongovernmental organizations, or NGOs, that publicize abuses and call out irresponsible corporations and industries.

According to new research led by the University of California, Riverside NGOs are more likely to sway companies into ethical behavior with carefully targeted reports that take into consideration a range of factors affecting the companies and industries. The report also finds that too much pressure can actually backfire.

The study suggests that in some circumstances, vertical integration, where companies own and control all steps of the production process, can be both economically feasible and promote responsible sourcing throughout an industry.

"Vertical integration costs firms a lot of money. It's not easy and not everyone can do it," said [Adem Orsdemir](#), an assistant professor of operations and [supply chain](#) management at UC Riverside and first author of the study. "But if you can do it, it's best."

Manufactured goods usually require raw materials or components produced in countries far away from where they are assembled or marketed. Although many countries have laws to protect workers and the natural environment, enforcement is often lax or nonexistent. Thus, industry relies on independent audits to inspect and verify that their

suppliers comply with laws.

Certification by independent auditors can't always be trusted. The auditing organizations can also be inefficient or corrupt, and their inspectors are often thwarted or fooled by unscrupulous producers. This leaves to NGOs the heavy responsibility of monitoring supply chains and holding corporations accountable.

Orsdemir wants to help NGOs direct their limited resources. Intrigued by the example of Taylor Guitars, he examined several scenarios in which exposure by NGOs could influence corporate behavior.

Taylor Guitars, a high-end El Cajon-based guitar manufacturer, learned there was no way to ensure that ebony—black wood from an endangered species of tree—was produced sustainably. So the company bought an ebony sawmill in Cameroon, where ebony can be legally harvested. This move to vertical integration allowed Taylor to oversee and control every step of the production process, from harvesting the ebony to building the guitars.

Taylor doubled the company's wages, instituted and enforced strict labor and [environmental policies](#), and invested in social welfare programs in ebony-producing communities.

Because companies that import illegal ebony face hefty fines by the U.S. Fish and Wildlife Service as well as potential consumer backlash, other musical instrument manufacturers started buying ebony from Taylor Guitars. This practice is known as horizontal sourcing.

Orsdemir wondered under what conditions it would be economically feasible for companies to vertically integrate instead of maintaining an unethical or unsustainable status quo. He mathematically modeled two competing firms selling in the same market under pressures that included

the risk of being exposed for failed corporate social and environmental responsibility, or CSER, and the effects such exposure could have on consumer demand for their products.

He found that in industries where horizontal sourcing is unlikely, firms keep the status quo under low CSER violation exposure risk and vertically integrate under moderate violation exposure risk. Surprisingly, they may maintain the status quo under high violation exposure risk, even when it has a strong negative effect on the overall consumer demand for the industry.

"Essentially, what happens is, even if the firm vertically integrates to become responsible, there is a high chance that its competitor would get caught in a violation, impacting the whole industry demand negatively and making responsibility efforts of the firm futile. So, it prefers to stay as it has always been," Orsdemir said.

Where horizontal sourcing is possible, a firm vertically integrates under moderate-to-high CSER violation exposure risk. However, the firm may not share responsible supply through horizontal sourcing if most of its competitor's customers start buying from them instead. If negative attention on the competitor's violations spurs customers to start buying only from the responsible company, it has no incentive to share its responsible supplies with competitors. The responsible firm benefits but industry-wide responsibility doesn't necessarily improve.

The results mean that firms should be conscious about external pressures and the possibility of horizontal sourcing in the industry when considering vertical integration for CSER.

The results also provide guidance for NGOs' violation scrutiny and reporting policies for firms that could adopt vertical integration and horizontal sourcing.

"NGOs can blame companies or industries," Orsdemir said.

Where horizontal sourcing is unlikely, NGOs should specify both violating and nonviolating firms specifically in their reports, rather than call out an entire industry. Good firms will benefit when they are named.

"If horizontal sourcing is not possible too much pressure may backfire and discourage firms from vertical integration," Orsdemir said. "On the other hand, trying to create positive [consumer demand](#) for responsible firms is always good."

When horizontal sourcing is possible, NGOs should allocate more resources to scrutinizing firms' CSER violations and should create industry-wide violation reports. But the researchers say NGOs should avoid naming specific firms, which may discourage the sharing of responsibly sourced supply by driving customers to only the responsible firms. This could help improve responsibility within the [industry](#) as a whole.

The paper, "Ensuring Corporate Social and Environmental Responsibility Through Vertical Integration and Horizontal Sourcing," is published in *Manufacturing & Service Operations Management* and is part of a special issue on value chain innovations in developing economies.

**More information:** Adem Orsdemir et al, Ensuring Corporate Social and Environmental Responsibility Through Vertical Integration and Horizontal Sourcing, *Manufacturing & Service Operations Management* (2019). [DOI: 10.1287/msom.2018.0744](https://doi.org/10.1287/msom.2018.0744)

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