The forest and the trees: aligning strategic management with grand social challenges

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Since emerging as a successor to the Millennium Development Goals in 2015, the United Nations' Sustainable Development Goals have set the agenda for grand social challenges (GSCs) around the globe. Significant progress has been made towards some of these goals, for example, reductions in extreme poverty reduction (Goal 1), declines in infant mortality and improvements in health (Goal 3), and access to clean water (Goal 6)[1,2]. Still, achieving the broad set of objectives remains an aspiration.[3] Increasingly, policymakers acknowledge the need for increased private sector engagement on these ambitious targets through a combination of mandatory policies and voluntary actions.

For private enterprises—the primary focus of strategic management scholarship—discussions (and decisions) about how to address GSCs are fraught with difficulty. On the one hand, business leaders recognize the need to create shared value, both to retain their social license to operate among the general public and to forestall potentially onerous government regulations (Porter and Kramer 2011).[4] On the other hand, responses to these calls to redefine the corporate objective function to incorporate social objectives have frequently been both performative (e.g., Sloan 2009, Baker et al. 2022) and limited in their success (Kaplan 2023, Westphal 2023).[5] We argue that these calls have failed to generate the desired impact on GSCs for two reasons.

First, Porter and Kramer (2011)'s view underestimates the challenges of private value capture. While misperceptions of tradeoffs can indeed lead firms to miss opportunities to reduce waste, improve supply chain efficiency, or improve worker health and productivity simultaneously

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[1] SDG Tracker: Measuring progress towards the Sustainable Development Goals - Our World in Data

[2] The Sustainable Development Goals Report 2023 | Department of Economic and Social Affairs (un.org)

[3] In some sense, we expect the difficulty of achieving these objectives to increase over time. As "low-hanging fruit" are picked first, the opportunities that remain tend to be characterized by trade-offs across the goals, such as economic growth (Goal 8) and climate action (Goal 13).

[4] For this article, we define "shared value creation" as the gross benefit that a firm generates with all other participants it interacts with, including externalities. With an appropriate business model, some portion of this value can be captured by the firm as revenues and profits, ideally leading to competitive advantage.

[5] We do not endorse Milton Friedman's (1970) argument that "the social responsibility of business is to increase its profits." At the same time, we note evidence on the performance benefits of CSR is mixed. Margolis, Elfenbein, Walsh (2009) meta-analyze the literature on corporate social responsibility and find more responsible behaviors are positively correlated with financial performance, but the relationship is modest and concentrated in the link between "revealed misdeeds" and lower financial performance.

(a la Porter and van der Linde, 1995), assessing the impact of such efforts on shared value for customers, employees, or policymakers is difficult, uncertain, and often characterized by bias. In surveys, for example, two thirds of respondents typically claim that they will pay more for products that are better for workers or for the planet, yet empirical work shows that only ten to fifteen percent of consumers are willing to pay a significant premium for these products (Devinney, Auger and Eckhardt, 2010).[6] Similar patterns of discrepancies are observed between survey results about graduates' willingness to accept lower pay and their imputed value of corporate ethics or reputation based on their choices (Kuokonnen 2017).[7]

Second is the broad nature of the GSCs themselves. As Jensen (2002: 297) noted, "purposeful behaviour [logically] requires a single-valued objective function." Yet, as is clearly reflected in the 17 UN Sustainable Development Goals, GSCs reflect a broad set of distinct objectives, some of which are in tension with one another. Across organizations, the marginal social benefit to investing in addressing these objectives is likely to be both uncertain and to differ widely, confounding efforts to support decision-making with rigorous analysis. The heterogeneity in values across decision-makers within organizations, reflected, for example, in differing levels of "passion" for addressing environmental degradation vs. human suffering, adds further complexity to these discussions. Absent, then, Jensen's idealized single-valued objective function, private enterprises must make decisions about addressing GSCs against a background of tradeoffs—with private profits, across objectives, and frequently with different stakeholder reactions—that are frequently *ex ante* uncertain.

The underestimation of the challenges associated with capturing value from addressing GSCs, and the complexity and ambiguity that is inherent in predicting the impact of attempts to do so, have important consequences. First, in complex, uncertain settings, it is not uncommon for intelligent, well-intentioned actors to chase fads (Abrahamson 1996; Piazza and Abrahamson 2020) or to engage in herding (Eyster and Rabin 2010, 2014). The short-termism that results from knee-jerk reactions to external pressures, and even to genuinely motivated but poorly formulated efforts to address social challenges by business leaders, often leads to organizational and social waste.[8] Second, it can lead civil society and government leaders to overestimate the degree to which industry will take on calls to address GSCs directly. The need by for-profit enterprises to capture value and support competitive advantages is a fundamental imperative for corporate leaders in competitive markets. Over-estimating the degree to which the corporate sector will address GSCs voluntarily may lead policymakers to undersupply rules, regulations, and incentives necessary to achieve the desired objectives.

[6] For recent work in this area, see McKinsey (2023)'s study: "Do consumers care about sustainability and ESG claims?" https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/consumers-care-about-sustainability-and-back-it-up-with-their-wallets.

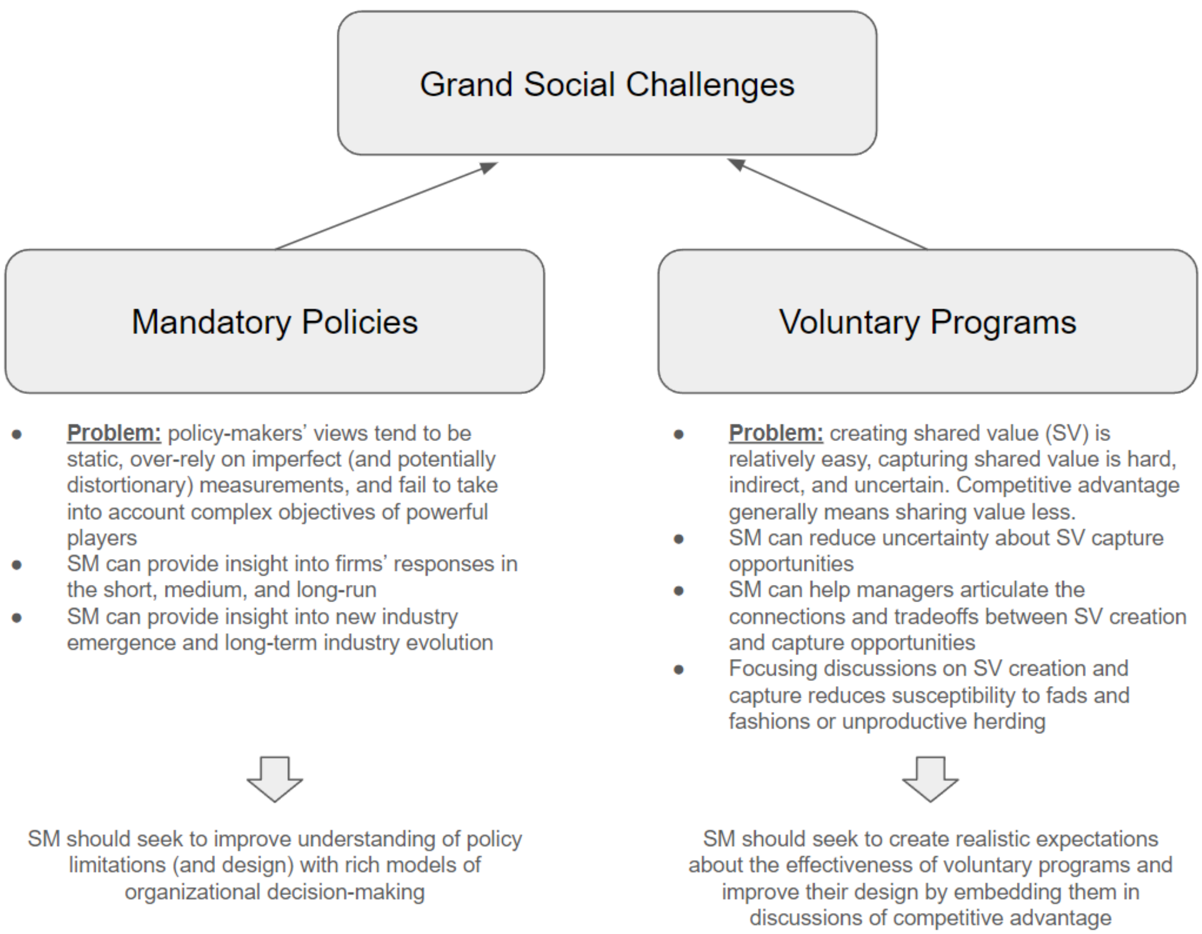
7 We are not arguing that pro-social organizations or pro-social messages in for-profit organizations do not impact workers' willingness-to-accept. Burbano (2016) and other work provides suggests that workers, especially high skill workers, do indeed seek lower pay in some circumstances to work for organizations that are "doing good." Our argument is simply that survey results overstate the degree to which this is the case due to social desirability biases.

[8] One prominent example of a poorly formulated effort in education (Goal 4) is the One Laptop for Child project: https://www.theverge.com/2018/4/16/17233946/olpcs-100-laptop-education-where-is-it-now

At the same time, over-regulation and, more importantly, poorly designed regulation stifles progress and can generate significant waste, which may, in turn, lead to backlash and policy reversal. Effective policy making, then, requires *both the ability to anticipate correctly what the corporate sector will do voluntarily and the ability to predict the reactions of firms to mandatory rules and regulations*, both in the short- and long-term.

This is potentially good news for strategic management, which has the tools to help organizational leaders and policymakers resist fads and focus on consistent, adaptive progress toward long-term goals. Our goal in this short article is to identify some of the existing insights from strategic management that can help with this effort and to highlight future directions that strategic management might take to further improve its ability to help business leaders and policy makers address GSCs. Our reasoning is very much in line with Mahoney, McGahan, and Pitelis (2009), who call for a greater recognition of the tight interdependence between public and private sectors. The right mix of mandatory policies and voluntary programs can only be identified and implemented by recognizing this interdependence, which strategic management is uniquely positioned to do. Figure 1 highlights our intended contribution.

Figure 1. How can strategic management contribute to grand social challenges?



Note: SM refers to "the field of Strategic Management" in the figure above.

Mandatory Policies and Grand Social Challenges

By definition, shared value includes a multiplicity of stakeholders and externalities. It recognizes that the impacts of firms' decisions extend beyond immediate market participants and are not fully captured by traditional financial metrics. With GSCs, the divergence between private value and shared value often motivates policymakers' use of incentives and regulation to "nudge" for-profit firms in the right direction. But the effectiveness of public policies depends on the extent to which policymakers understand the strategic and dynamic nature of business decisions in the private sectors. We highlight three common pitfalls.

First, policymakers' views of firms are typically too static. Policies are often based on the current business landscape and available technologies, but firm strategies are dynamic, and the industries they comprise are characterized by ongoing entry and exit (Schumpeter 1942, Hayek 1948). The strategic decisions made by firms—heterogeneous in their goals and capabilities—in response to the policies often lead to an equilibrium totally unexpected when the initial policies are made. For example, subsidies for electrical vehicle (EV) batteries incentivize companies to mine for lithium and cobalt in otherwise unfavorable locations. As metal prices collapse with oversupply, or when new battery technologies emerge, such investments become wasteful both economically and environmentally. Since firms with different capabilities or investment horizons are going to respond differently to policies, the market clearing price will be hard, if not impossible, to predict (Mankiw and Whinston 1986, Bresnahan and Reiss 1991).

Second, measurement matters, and incentives can have perverse effects. Policies direct resources to observable and quantifiable metrics, and firms shift resources, often in inefficient ways, just to "check the box" (Goodhart 1975, Holmstrom and Milgrom 1991). Studies have identified so-called threshold effects, i.e., firms tweaking technical labels or financial categories to fit in the exact criteria set by the government. Volkwagen's Dieselgate scandal is an extreme example, but it is no secret in the industry that some products are designed to game EPA emission requirements, at least in the short run. For example, a crossover-utility functions as a passenger car but qualify as trucks, subject to a more lenient emission standard. While gas efficiency is improving across all categories, the US automakers are shifting more production to heavy trucks and SUVs, negating the gains from efficiency improvement. Carbon emissions credits trading is another example in which firms may seek compliance by using models and metrics that are not always transparent to the public.

Third, firms' motives are complex and shifting, making it difficult to identify and address opportunistic behavior. Just as firms constantly face tradeoffs, policies almost always have conflicting goals, which leaves room for cherry-picking and competing interpretations, especially when it is a market with a small number of players. For example, the $740 billion Inflation

Reduction Act (IRA) in 2022 includes a series of measures for the local production of EVs. On the one hand, the clean vehicle tax credits seek to promote EV consumption for the purpose of reducing emission and improving the environment. On the other hand, the strict mineral and battery local content requirements for tax credit eligibility means higher overall prices and slower transition to EVs. Since only a handful of EVs on the market can meet the requirements for full credit, the balance between the two conflicting policy goals can be influenced by the agenda of individual companies. Geopolitical tensions further complicate the picture, where policies for greater social goods intersect with the interests of national champions facing global competition.

Industrial policy, then, has a long history of unintended consequences that arise from policy-makers' superficial understanding of firm behavior. For example, the voluntary export restraint imposed by the U.S. on Japan in 1981 was meant to alleviate competition from Japanese carmakers and give some breathing room for Detroit to develop more fuel-efficient cars. But enjoying the higher profit brought by trade protection, Detroit did not sense any pressure to change. Meanwhile, Japanese carmakers responded to the restraint by setting up manufacturing facilities outside of Japan and by innovating into higher value-added cars, leaving a market vacuum in the low-end market to new entrants from Korea. Five years into the implementation of the policy, Detroit was facing more foreign competition than before. Strategy scholars have a front-row seat on how firms make decisions in response to policies – and in response to their competitors' strategic moves – and so can inform the development of more forward-looking policies. GSC policies should be informed by rich behavioral models, grounded in empirical studies of organizations, that strategic management scholars have developed over the years.

Voluntary Programs and Grand Social Challenges

While we draw inspiration from Kramer and Porter's (2011) work on creating shared value—highlighting opportunities for firms to contribute to both societal and economic progress—such win-win opportunities may be limited in practice and the trade-offs between public and private interests remain a central concern for business leaders. Here we emphasize three observations on how to better conceptualize these critical tensions in future strategy scholarship and practice.

First, stakeholder expectations about environmental and social sustainability are dynamic too. Just as policymakers need to appreciate the dynamic firm responses to changes in the institutional environment, business leaders must reflect on the nature of competitive advantage amidst rapidly evolving stakeholder expectations around environmental and social sustainability. As Larry Fink's recent retreat from the 'ESG' terminology demonstrates, such expectations have followed a non-linear path in recent years and increasingly diverge across stakeholder groups. Consequently, voluntary business commitments that made sense under one expectation for future policy—for example, rapid progress toward decarbonization under net-zero pledges—can backslide whenever policy ambitions waver and economic trade-offs facing firms become more salient. To manage the challenges posed by an increasingly volatile set of external pressures, business leaders need to rigorously connect commitments on GSCs back to the firm's strategy and profit motive. Such a connection provides a "north star" to guide consistent investment in the GSC domains that are aligned with stakeholders' objectives.

Second, shared value creation does not guarantee private value capture; sustainable impact requires sustainable profits. We teach MBA students to differentiate between value creation (increasing willingness to pay for outputs or lowering opportunity costs for inputs) and value capture (raising prices to customers or lowering prices from suppliers). Implicitly, creating shared value—i.e. improving the social and economic outcomes of the firm and society—leaves open the questions of how that new value will be captured and by whom (including stakeholders beside customers and suppliers). While it is neither necessary nor desirable for firms to seek to capture all the shared value that they create addressing GSCs, it is also perilous to capture too little shared value.[9] Business leaders cannot focus only on sustainable social impact and ignore sustainable profits. For example, fair trade practices in coffee farming can lead to higher willingness to pay among consumers of premium products, but demand for lower-priced ethical products is more elastic. While companies like TOMS have succeeded by selling to the ~10% of consumers who care deeply about ethical business practices, most firms face a less socially-motivated demand curve. They thus must develop alternative strategies to capture shared value, including improving their ability to recruit, retain and motivate employees, reducing their cost of capital, or increasing their access to public resources.

Third, the tension between shared value creation and private value capture varies by ownership structure or business leaders' approach to philanthropy. Rarely, companies may prioritize shared value creation and forgo capture; one oft-cited example is Patagonia's disclosure of technological innovations such as organic cotton in the effort to spur broader industry adoption that could reduce environmental harm. While some might argue such decisions indirectly contribute to willingness to pay by boosting Patagonia's role as an industry leader, the additive impact beyond higher-profile corporate philanthropy and activism is unclear, especially relative to opportunity costs from forgoing technological differentiation. It is difficult to imagine such an approach from a publicly traded corporation, demonstrating the importance of aligning shared value strategies with the values and incentives embodied within ownership structures. It is also true that private value capture can contribute indirectly to shared value creation. Consider, for instance, Warren Buffett's high-profile decision to contribute his personal wealth to philanthropic causes while vocally eschewing corporate social responsibility in his investments. While such generosity builds on a laudable American tradition of private philanthropy, it forgoes the opportunity to engage business

[9] Capturing shared value should not be construed as only the bottom line. Rather, we support the expansive view espoused by Klein et. al (2013) of those who have some residual claim over the surplus co-created by the activities and nexus of contracts associated with the firm.

as an essential driver of any response to GSCs. Thus, while private philanthropy can contribute to progress on GSCs, it is unlikely to be sufficient on its own to provide the scale and impact required for systemic changes. At the same time, leaving GSCs unaddressed increasingly poses systemic risks to society and the business environment, underlining a need to engage the private sector directly in shared value creation and capture.

From Shared Value to Shared Understanding

Although we contend that strategic management scholars have vital perspectives that can inform decisions about when to use mandatory policies to address GSCs and how to design these policies, effective engagement with these questions may benefit from richer models of policymaker and firm decision-making in the context of GSCs. Specifically, we need greater understanding of beliefs and values vary across both public sector and private sector leaders both to predict behavior and to facilitate conversations between them. Moreover, when key stakeholders—particularly policymakers, but also civil society and even management scholars—have had unrealistic expectations of what firms will do voluntarily, this may reflect a tendency to assume that standout exemplars of shared value creation are representative of most firms, when they are clearly not. Likewise, CEOs should neither assume that policymakers are far-sighted and sophisticated in their grasp of organizational behavior, nor that policymakers are myopic and naïve in their assumptions on how firms will respond to mandatory policies. In practice, decision makers in all sectors are drawn from a distribution of objective functions and time horizons. Recognizing this explicitly has the potential to reduce misunderstandings and the errors that result from them. Building on rich literatures in behavioral economics, organizational behavior, and political science, strategic management scholars are well-positioned to address this heterogeneity and to connect the public and private sectors to create more successful collaborations—both voluntary and mandatory—to better address GSCs.

Conclusion

A combination of mandatory policies and voluntary actions will be required to address grand social challenges. The ability of strategic management to integrate insights about individual behavior in organizational contexts operating in competitive environments provides added value for policymakers, who need a dynamic perspective on the impact of mandatory policies. Meanwhile, the focus of strategic management linking value creation and value capture by specific stakeholder groups generates a useful framework for managers, who must understand the short- and long-term tradeoffs associated with voluntary programs. Scholars in strategic management should lean into these conversations to help policymakers and managers alike resist fads and increase the effectiveness of public and private efforts to address grand social challenges.

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