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Theoretical and Practitioner Letters

Defining the socially responsible leader

David A. Waldman [a,*,1], Donald Siegel [b]

[a] School of Global Management and Leadership, Arizona State University, P.O. Box 37100, Phoenix, AZ 85069-7100, USA
[b] University of California, Riverside, CA, USA

Abstract

In recent years, corporate social responsibility (CSR) has received increased attention in both academic and practitioner realms. The authors agree that corporate leaders play a key role in formulating and implementing CSR initiatives, but debate the appropriate drivers of socially responsible decisions and actions undertaken by these leaders. They conclude that an approach which takes into account both instrumental behavior and leader motives or values holds promise in reconciling some of their differences.
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Letter 1

David A. Waldman
School of Global Management and Leadership
Arizona State University
P.O. Box 37100
Phoenix, AZ 85069-7100

Dear David:

Let me begin with some words of praise. I applaud your recent efforts to integrate and synthesize two previously parallel literatures on strategic leadership and corporate social responsibility (CSR). CSR is typically defined as actions on the part of the firm that signal their willingness to advance the goals of identifiable stakeholder groups, such as employees, suppliers, the local community, non-governmental organizations, or broader societal objectives (e.g., enhancing diversity or environmental performance). Furthermore, CSR implies that firms are striving to go beyond compliance, with respect to existing rules and regulations (McWilliams & Siegel, 2001a,b; Waldman, 2007).

It is important to note that most CSR studies, especially those of an empirical nature, have ignored the role of corporate leaders in formulating and implementing CSR initiatives. Top-level managers are obviously in a position

* Corresponding author. Tel.: +1 602 543 6231.
E-mail address: waldman@asu.edu (D.A. Waldman).
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to influence these policies. From my perspective, the lack of attention to the nature of the relationship between CSR and strategic leadership is unfortunate because my research findings strongly suggest that a firm's decision to engage in social responsibility should be viewed as a strategic choice. As an economist, I view that choice as an investment decision, which should be assessed in a rational, calculative fashion. Resources allocated to CSR (e.g., time or financial and human capital) have alternative uses and managers must be mindful of the "returns" to these activities.

More specifically, using a theory of the firm perspective, my co-authors and I have argued that firms engage in profit-maximizing CSR (McWilliams & Siegel, 2000, 2001a,b; McWilliams, Siegel, & Wright, 2006; Siegel & Vitaliano, 2007). Based on this framework, an optimal level of investment in CSR is determined through a standard cost/benefit analysis. That is, companies will (or should be) socially responsible because they anticipate a benefit from these actions, which might include reputation enhancement, the ability to charge a premium price for its output, or the use of CSR to recruit and retain high quality workers (which may increase the quality of output, especially in a service industry). These additional benefits must be balanced against the higher costs associated with CSR, since additional resources must be allocated to allow the firm to achieve CSR status.

The end result is that CSR is likely to be integrated into a firm's differentiation strategies. Indeed, in our own joint research, we have found that the intellectual stimulation component of transformational leadership on the part of CEOs is a strong predictor of the propensity of firms to engage in what we labeled "strategic" CSR. These are defined as dimensions of CSR that are likely to be matrixed into the business and corporate strategies of firms, such as environmental performance (Russo & Fouts, 1997) or product quality-oriented CSR. Therefore, there is probably some common ground between us. We both believe that individual characteristics matter, in the sense that certain leaders are more likely to behave "responsibly" by implementing CSR policies. Thus, studies that ignore the role of leadership in CSR may yield imprecise conclusions regarding the antecedents and consequences of these activities.

In addition, we probably concur that profit maximization is an important goal of strategic leaders, and that the pursuit of CSR should not be at the expense of profits. Finally, we agree that non-financial stakeholders deserve some attention from leaders, although in my view, managers are mainly interested in the instrumental use of such relationships.

In the rest of this letter, I will focus on potential areas of contention with respect to the proper role and nature of responsible leadership. My remarks will have a somewhat normative tone to them, although I believe there is mounting empirical evidence to support most of my assertions. I am a purist when it comes to the fiduciary responsibilities of top-level managers. In my opinion, executive decision-making should be focused exclusively on profit maximization, or more precisely, on shareholder wealth maximization. My interpretation of the results of our joint CSR paper is that the best strategic leaders know how to use CSR instrumentally; that is, for the benefit of shareholders.

I mention this because of the famous adage of the late Milton Friedman, who identified four ways to spend money. First, you can spend your own money on yourself, in which case, the funds are spent quite wisely. Next, you can use your own money to purchase goods or services for others, which is what we do when we give someone a Christmas gift. In this instance, the ability to spend wisely is limited by one's ability to match the preferences of the person receiving the gift. A quick visit to a department store on the day after Christmas illustrates the difficulties of successfully completing that mission. A third method of expenditure occurs when we spend other people's money on ourselves, which occurs when we are on an expense account. In this case, we have little incentive to economize, since others are footing the bill. The final case is when we spend other people's money on other people. According to Friedman, this is exactly what politicians do and thus, he was highly skeptical of the ability of government to spend its funds wisely. Given the separation of ownership and control in large firms (i.e., most top-level managers only have a small percentage of equity ownership of the firm), managers are also spending other people's money and they must be held accountable for their actions. Now, of course, market forces do much to constrain the self-serving behavior of managers.

Recall that CSR involves using the firm's resources to advance societal interests. CEOs of publicly-traded firms could base their CSR choices on their own perceptions of what they think is important or their own moral values. Such actions make me very nervous. Indeed, the late Milton Friedman (1970) expressed the same sentiment and added that the mere existence of CSR was a signal of an agency problem within the firm. As an aside, I do not agree with Professor Friedman on this point. As discussed in McWillliams & Siegel (2001a,b), if there is sufficient "demand" for CSR, it may be profitable for the firm to satisfy this demand. However, it is useful to note that an agency theory perspective (i.e., Wright & Ferris, 1997) implies that CSR is a misuse of corporate resources that would be better spent on valued-

added internal projects or returned to shareholders. It also suggests that CSR is an executive perk, in the sense that managers may use CSR to advance their careers or other personal agendas.

Even in the absence of CSR, agency problems abound in large, publicly-traded corporations. That is, managers often pursue their own interests at the expense of what is best for the company. Expecting CEOs and other top-level managers to address multiple objectives, and not simply focusing on profit maximization, is simply asking for trouble. Thus, I believe a truly socially responsible leader should only address CSR-related issues when such actions *simultaneously* enhance profitability. I do not wish to imply that managerial "values" are irrelevant or that CEOs should only pursue those values privately. However, I firmly believe that corporate leaders have an obligation to engage in "value-driven," social responsibility (or any other type of social responsibility) only when such actions complement the firm's business and corporate-level strategies.

Managers are not directly accountable to "society," except to the extent that they must obey all the relevant rules and regulations and abide by the law. On the other hand, they are directly accountable to the owners of the firm: the shareholders, who are by far the most important stakeholder of the firm. As far as other stakeholders are concerned, managers should treat such relationships instrumentally, in the sense that they should weigh the costs and benefits of addressing any concerns these constituents may have. Thus, they should continually consider how addressing the concerns of other constituents will (or will not) further the goal of profit maximization.

There may be instances where the interests of shareholders and those of other stakeholder groups do coincide. For example, other things being equal, most consumers prefer a more fuel-efficient vehicle because it reduces the cost of driving and the use of oil. A hybrid version of a Honda Accord generates less pollution than a standard Honda Accord. Thus, it is clear to most consumers that the hybrid car is better than the standard model. Some consumers are willing to pay a price premium for the hybrid car, given that the CSR characteristic of less pollution is an important consideration to them. Therefore, it may be profitable for the firm to produce the hybrid vehicle, while simultaneously satisfying environmental groups and advancing the useful social goal of reducing pollution.

Given the rampant agency problems in large publicly-traded companies, I am quite skeptical about policies that encourage managers to allocate resources to CSR without a clear sense of the return on investment to these activities—as illustrated in the above example. As the late Milton Friedman noted, spending other people's money on other people is often a recipe for profligacy. It makes sense for firms to pursue these policies only when it is in their self-interest to do so.

An excellent recent paper crystallizes this point quite effectively. Husted & de Jesus Salazar (2006) analyze the conditions under which firms can simultaneously maximize profit and enhance social performance. Based on the McWillliams & Siegel (2001a,b) theory of the firm perspective, they conduct a cost/benefit analysis of social responsibility under three scenarios concerning the firm's desire to engage in CSR: altruism, "coerced egoism," and the strategic use of CSR. Altruism describes the case when firms sincerely want to be socially responsible (which corresponds to the case that some people espouse, where top-level managers pursue their moral interests), without regard to how such activities affect the bottom line. Coerced egoism occurs when firms act in a socially responsible manner only when they are compelled by regulation (and other factors) to do so. An example might be when Denny's was instructed by the government to engage in non-discriminatory actions toward employees and customers in the 1990s. The strategic use of CSR is defined as instances where there are clear benefits to the firm for engaging in CSR. The authors demonstrate that *both* society and firms are better off when firms use CSR strategically, than when they are coerced into making such investments or when managers pursue their own moral path.

In sum, I believe that CSR activities should be purely market and profit-driven. Managers have a moral obligation to pursue profit and to engage in social responsibility only when there is a clear return on this investment. The jury is still out on whether CSR-driven strategies can provide a source of sustainable competitive advantage (see Russo & Fouts, 1997; Marcus & Anderson, 2006 for conflicting evidence), but I am confident that there is sufficient demand for companies to successfully pursue CSR-driven business and corporate-level strategies.

I strongly encourage your efforts to explore the role of leadership in CSR strategy formulation and implementation. In your research, you have also shown that the quality of leadership is related to firm performance. I hope that you will agree with me that supposedly "responsible" leadership that encourages the non-instrumental use of CSR can only constitute a waste of corporate resources—and thus, is not really responsible.

Sincerely,
Donald Siegel

Letter 2

Donald Siegel
A. Gary Anderson Graduate School of Management
University of California, Riverside
Department of Management and Marketing
225 Anderson Hall
Riverside, CA 92521

Dear Don,

First, let me say that I am delighted that you agreed to participate in this forum of *The Leadership Quarterly*. For years, I have admired your work and how it bridges the fields of economics and strategic management. I also admire your courage in terms of entering what could be perceived as the "lion's den" with regard to an economics-based view of leadership. However, in reality, I believe that among the readership of this journal, there may be quite a few supporters of the viewpoint that you have put forward about responsible leadership. Moreover, I was working at Binghamton University in the late 1980s and early 1990s when this journal was established. In those early years, it was always the intention of the journal's founder, Bernard Bass, that *The Leadership Quarterly* should have an eclectic bent with ideas and research offered by scholars from a wide range of backgrounds. Indeed, a quick perusal of the journal's mission would suggest that this core purpose remains true today, and hopefully, our discussion will reflect it.

Let me begin my commentary by noting that, as you have suggested, there are some ideas that represent common ground between us. First, we both agree that individual characteristics and behaviors of people in high-level leadership positions do matter in determining the extent to which socially responsible practices of a firm will exist. This may seem somewhat evident to most of the readers of this journal, but as you know, there is very little mention of the role of leaders in the corporate social responsibility (CSR) literature. Second, I agree with your premise that "profit maximization is an important goal of strategic leaders, and that the pursuit of CSR should not be at the expense of profits." Moreover, in principle, there is nothing wrong with strategic thinking surrounding expenditures made for the purpose of social responsibility. Without such thinking, it may be difficult to focus a firm's attention on issues of most importance and for which a firm can offer the most to society (Porter & Kramer, 2006). But with that said, as will become clearer below, there is more than meets the eye when it comes to the pursuit of profit maximization and strategic CSR. Engaging in responsible actions only when the financial gain is clear may not always be the most prudent course of action.

The remainder of this letter will be devoted to describing potential points of contention, as well as how our views might potentially be reconciled. Our differences appear to pertain to three areas: (1) the scope and costs of being responsible as a leader, (2) the moral values of leaders, and (3) the pursuit of profit maximization.

Being responsible can be internally-oriented and cheap

Your conclusion from agency theory that "CSR is a misuse of corporate resources that would be better spent on value-added internal projects …" might suggest that a leader's pursuit of CSR is necessarily both externally-oriented and expensive. I take issue with both of these premises. First, your own definition of CSR includes employees—obviously an important, internally-oriented stakeholder group. As you know, the Kinder, Lydenberg, and Domini (KLD) database provides ratings of CSR for investors who wish to evaluate investment portfolios to exclude companies that violate certain social principles. This database has also been used widely by CSR researchers. For the present discussion, it should be noted that the database includes information regarding employee relations, as well as related issues such as practices pertaining to diversity. Clearly, being a responsible leader may mean paying attention to both internal and external stakeholder groups.

Second, there is no reason to believe that responsible leaders will inherently be raiding the cookie jar to act upon their beliefs. Perhaps it is understandable that your characterization of responsible leadership seems to be exclusively oriented toward identifiable projects and expenditures. Much of the CSR literature deals with firm-level actions, rather than managerial behavior, and the former are typically characterized in terms of projects and expenditures. To be sure, even with regard to employees, it is possible for a firm to make investments in their human resources (e.g., training and development), and research has shown that such a strategic management of human resources can yield positive outcomes (e.g., Youndt, Dean, Snell, & Lepak, 1996).

But on the other hand, when it comes to employees, sometimes responsible leadership practices are largely or even entirely free of monetary costs. For example, firms such as Southwest Airlines, and its Canadian corollary WestJet, are notorious for empowering leadership practices that allow employees a lot of prerogatives in terms of work procedures and decision-making. It is also possible for people in leadership positions to be strong proponents of diversity, thus helping to prevent the type of problems that Denny's ran into that you mentioned in your letter—and doing so free of charge. For example, research has shown that women may have certain behavioral advantages in their leadership role, thus tending to make more effective leaders (Bass & Avolio, 1994; Rosener, 1997). Existing leaders may serve responsibly (and do so free of charge) by allowing the development of women, as well as their promotion into new leadership roles, even when it goes against the norms of an existing organization.

As a final note here, I believe that it is also possible for leaders to act more responsibly *externally* without large expenditures of corporate funds. For example, product and service quality are also aspects of CSR assessed through the KLD ratings. We know through research that total quality management can improve quality without raising costs, and that leadership is a key driver of such management strategies (Powell, 1995; Waldman, 1993). As another example, the simple act of allowing various venues for dialogue with community members, such as town hall forums, can increase communication and cooperation between responsible corporate leaders and the greater community—again, without any significant financial costs. In sum, while I realize that CSR is typically associated with elective expenditures, when we get down to the level of managerial actions, responsible leadership does not have to be expensive.

Are moral values really such a bad thing?

I found it interesting how you seemed to show great trepidation with regard to managers acting upon their moral values, and that "such actions make me very nervous." I suppose that in a general sense, I may get a bit nervous myself if we are talking about, for example, leaders pushing their own religious values. But even in this regard, perhaps an exception is S. Truett Cathy, founder and chairman of Chick-fil-A, who espouses a management philosophy stressing religious, biblical principles. Despite those values, or maybe even because of them, Mr. Cathy appears to be a responsible leader in terms of actions pertaining to employees and customers.

At a broader level, I simply do not agree that actions based on moral values should be worrisome. To help understand my perspective, it is useful to take a closer look at the term responsibility and its meaning. Winter (1991) suggested that individuals with a strong responsibility disposition are able to control their behavior through internal mechanisms. A responsible individual feels an inner obligation to do the right thing. In other words, responsibility is based largely on a moral standard geared toward the concerns of others, and an obligation to act on that standard and to be accountable for the consequences of one's actions. I view the term "others" in a broad manner to include not only shareholders, but others to whom the leader should be accountable, including employees and customers.

I think that your fears regarding the moral leader are misplaced. You suggest that "top-level managers [may] pursue their moral interests, without regard to how such activities affect the bottom line." I suppose that such reckless abandon is always possible, but can you present concrete case examples of leaders who acted upon their own moral interests and wasted inordinate amounts of corporate funds in a manner that negatively affected the bottom line? Perhaps such an example can be found in the Husted & de Jesus Salazar (2006) article to which you refer. They mention the example of how Merck leaders made the decision to donate Mectizan, a drug to combat the so-called river blindness disease, to people in third world countries. Is it possible that Merck was thinking both altruistically and strategically? And how can you really differentiate between these two presumably distinct motives for responsible behavior—which by the way, is an issue that Husted & de Jesus Salazar (2006) themselves acknowledge. In short, I think that you may be presenting a straw man argument in your concerns about seemingly reckless morality.

More importantly, the opposite is more likely to be true in that we should really be worried about people in leadership positions who lack a strong moral compass. Specifically, we have seen examples in recent years of leaders who appeared to lack a responsibility disposition and ended up getting their firms and various stakeholders, including shareholders, in a lot of trouble. Indeed, at firms such as Enron and WorldCom, the amoral/reckless or manipulative pursuit of the bottom line proved disastrous. According to Thomas, Schermerhorn, & Dienhart (2004), leadership integrity is associated with such organizational outcomes as the reduction of business costs. These costs can be in the form of government fines, attorney and audit fees, and investigative costs, and they may be difficult to identify (except in extreme cases, such as Enron) because they are buried within the overall costs of doing business. Moreover, less quantifiable costs could be associated with a lack of leader integrity, such as those due to loss of firm reputation, lower employee morale, and employee turnover or difficulty in recruiting top talent.

Perhaps ironically, the coerced egoism to which you refer is largely a result of leaders not acting in a morally responsible manner, and thus society feels the need to step in with legal or regulatory mandates. In my opinion, the Sarbanes–Oxley Act of Congress represents a clear example. For readers who may not be familiar with this legislation, it is designed to ensure the proper enactment and reporting of financial activities on the part of firms. It requires significant expenditures by firms to ensure compliance, but such expenditures do little to support real productivity or innovation—an inefficiency that an economist such as yourself can surely appreciate. As I recently argued (Waldman, 2007), Sarbanes–Oxley can be viewed as an example of a drain on organizational performance and financial returns that was necessitated by a system in which firms are remiss (or potentially remiss) in policing themselves in terms of social responsibility and ethical behavior. This legislation also represents the type of backlash that can occur when people in executive roles do not practice the responsible leadership philosophy described above. This is not to say that leadership practice can ever fully substitute for legislative initiatives. However, the strength, pervasiveness, and restraints that these initiatives put on productivity and innovativeness can be minimized by greater attention being placed on leader social responsibility—and yes, leader morality. I agree with you that managers are not directly accountable to society. But if more individuals thought of management as a profession with ethical/moral standards, the felt need by society for regulatory intervention aimed at corporate managers might diminish.

In sum, I concur with Ghoshal (2005, p. 76) who lamented in his description of the typical training of future business leaders as "propagating ideologically inspired amoral theories [that free] students from any sense of moral responsibility." Perhaps the first step in changing the landscape of such training grounds is to embrace leader morality, rather than fearing or eschewing it.

Profit maximization: more than meets the eye

I have saved the crux of your arguments for last. Throughout your commentary, you stress the importance of the exclusive pursuit of profit maximization on the part of managers, and to do otherwise, would suggest that they are being sidetracked by selfish pursuits. In a sense, how could anyone who strongly believes in a capitalistic system disagree with what you are suggesting? Moreover, your ideas follow closely from agency theory which would suggest that steps need to be taken to ensure that the interests of managers and owners are aligned (Jensen & Meckling, 1976). Presumably, without a close and verifiable correspondence between leader actions oriented toward social responsibility on the one hand, and profit maximization on the other, those interests will not be aligned.

At the outset, I want to make clear that I strongly agree with your underlying notion of the value of a free-market, capitalistic system. As should also be apparent from my above comments, I further agree that such systems should be as free as possible from regulatory constraint. However, at the same time, I understand the reason for regulatory constraint when there is a strong potential for a failure of responsible leadership at the corporate level, as I have outlined it here. With all of that said, I take issue with the way that you have articulated responsible leadership in relation to profit maximization.

There are a number of problems as I see it. First, you seem to equate profit maximization with shareholder needs and interests. As such, you are representing a traditional model that is still largely accurate in modern times—but not totally, as I think you know. Shareholders of many firms are increasingly demanding that their firms to "do well by doing good," to quote the theme of the 2007 Academy of Management conference. Indeed, the basic purpose of the KLD database is to provide potential investors with information regarding the social performance of firms. I only raise this issue for the purpose of clarification. I suppose that it is possible to reconcile your viewpoint with creative attempts to align social responsibility with profit maximization, as suggested in your Honda Accord example.

Second, your proposition that high-level managers should not address multiple objectives follows closely from the work of Jensen (2001, pp. 298 and 300) who suggested that managerial "efforts should be guided by the sole purpose of increasing shareholder value … as a precursor to purposeful or rational behaviour." Accordingly, your rationale would suggest that managers should only pursue CSR initiatives when they can be closely linked in a cause/effect function to profitability. But how definitive must this link be, and when can a manager fall back on logic and/or intuition? Even Husted & de Jesus Salazar (2006, p. 87) acknowledged that firms may pursue the type of strategic CSR that you suggest "even though they may be uncertain about their ability to extract all the benefits provided by such investments."

My real fear is that your insistence on such rigid instrumentality would preclude managers from taking initiatives, challenging the status quo, and working toward the new visions that, ironically, might help profit maximization in the long term. Furthermore, the new visions that are most likely to inspire followers are those that include values relevant to the needs of a multitude of stakeholders, as described in more detail below. It is interesting to note that an emphasis on the "instrumental use of … relationships" that you espouse coincides with transactional leadership, which also

emphasizes exchange relationships and a more restricted application of values on the part of people in leadership positions. In contrast, transformational leadership is oriented toward a sense of purpose that takes into account interests and values more broadly defined, as well as new and exciting visions. As compared to transactional forms of leadership, transformational leadership has been more consistently associated with performance at the individual, group, and organizational levels (Judge & Piccolo, 2004; Lowe, Kroeck, & Sivasubramaniam, 1996).

In short, my fear is that the type of responsible leadership that you are suggesting will stifle transformational leadership and, ironically, the profit maximization that you stress so emphatically. A recent study conducted by my colleagues and me might help to clarify my concerns (see Sully de Luque, Washburn, & Waldman, 2006). The study involved approximately 500 CEOs and their organizations spread across 17 countries on 5 continents. The CEOs were asked about the factors or values that they considered to be of most importance in their decision-making. One set of factors was labeled *economics* values, which included giving priority to profits, cost control, and maintaining market share in one's decision-making. A second set of factors was labeled *stakeholder* values, which included giving deference to employee relations and development, customers, environmental concerns, and the welfare of the greater community. Confirmatory factor analyses showed that these two sets of factors were indeed distinct. Two subgroups of direct reports (i.e., top management team members) of the CEOs were also involved in the study. The first group evaluated the extent to which their respective CEO led in an authoritarian manner by dominating decision-making processes, acting in a highly directive or commanding manner, and so forth. They also evaluated whether the CEO led in a visionary manner by attempting to anticipate future events, communicating in an optimistic way about the future, and so forth. The second group evaluated the current financial performance of the firm in relation to competitors, as well as the extent to which they put in extra effort and make personal sacrifices for the organization.

Analyses of the data revealed some fascinating findings. First, CEOs with strong *economics* values tended to be viewed by followers as highly authoritarian, while not being viewed as visionary. Second, and conversely, CEOs with strong *stakeholder* values tended to be viewed by followers as highly visionary, while not being viewed as authoritarian. Third, CEOs with strong stakeholder values and who were viewed as visionary are in firms that are simultaneously better performers—in terms of both current financial results, as well as the extent to which followers show extra effort and make sacrifices.

So what exactly do these findings suggest? The most important implication is that top-level executives who place too much emphasis on rational, quantifiable profit maximization may find that their values or desires go unrequited. In other words, even though they pursue such an emphasis with profits squarely in mind, those profits may not be realized. Moreover, in the process, they will be viewed by followers as authoritarian, rather than visionary. In contrast, executives who give deference to multiple stakeholder groups in their decision-making, not just shareholders and their financial interests, may actually end up yielding better results for their firms. As such, and perhaps somewhat paradoxically, by not yielding to the type of calculative, profit maximization strategies that you espouse, executives may be able to better benefit the needs of all stakeholders—including the shareholders or owners of the firm.

In sum, as I have suggested, there may be more than meets the eye when it comes to profit maximization. Do the findings mentioned above suggest that executives should not be concerned with such things as profit and cost control? Of course not. However, there may instances that, in order to act responsibly as a leader and to be effective, managers will have to balance the concerns of multiple stakeholder groups. They may even perceive a need to act without a clear understanding of return on investment.

Can these differences be reconciled?

So there you have it. It should be obvious that although we agree on a number of underlying issues or values, we also clearly differ in our approaches to responsible leadership. But in the remainder of our discussion, I would like to challenge the both of us to find ways to reconcile these differences. For example, perhaps a model could be derived whereby instrumental thinking and leader morality coincide, rather than coming into conflict. Such a model would be in line with earlier thinking in the leadership literature that transactional and transformational leadership can be complementary, rather than mutually exclusive (cf., Lowe et al., 1996). However, I would caution that the espousing of moral values in an instrumental or calculative manner could lead to the leader being viewed in an inauthentic manner, thus resulting in deleterious outcomes (Avolio, Gardner, Walumbwa, Luthans, & May, 2004). In any event, I will be interested in seeing how our discussion progresses.

Sincerely,
David

Letter 3

David A. Waldman
School of Global Management and Leadership
Arizona State University
P.O. Box 37100
Phoenix, AZ 85069-7100

Dear David:

Thanks for your kind words. Given your stature in the field and my status as an interloper from economics (entering the "lions den," as you so aptly put it), I appreciate your positive reaction to some of my views on this topic. We have now established that there is some common ground in our consideration of leadership and corporate social responsibility. Therefore, I will focus most of the remainder of my comments on our differences. Most of these differences relate to our divergent notions of what constitutes "responsible" leadership. I would also like to clear up some confusion you appear to have regarding my views on CSR, vis-à-vis agency theory. The concluding section will take up your challenge to reconcile some of these differences.

Agency theory and CSR

Let me begin with the misinterpretation regarding agency theory, since it affords me the opportunity to more emphatically state my position on responsible leadership and CSR. In your letter, you appear to suggest that I have concluded that CSR is a misuse of corporate resources, which would be better spent on other projects. I never reached such a conclusion, which would indeed follow from a strict agency theory perspective on CSR (as you correctly point out). The notion that firms should never be "socially responsible" was the view espoused by the late, great Milton Friedman in his famous New York Times op-ed article in 1970 (Friedman, 1970), who famously asserted that the mere existence of CSR was an indication of an agency problem, and therefore an abominable practice.

In my previous letter, I pointed out that I emphatically *disagreed* with Professor Friedman on this point. More specifically, I believe that managers *should* engage in CSR, and indeed, have an *obligation* to engage in CSR, when it is beneficial to the firm. This applies to both "external" and "internal" CSR and CSR "projects" that are expensive. I am indifferent as to whether the CSR is internal or external and inexpensive or expensive, as long as the *benefits* from this activity exceed its costs. I agree with your assertion that employee empowerment (which some regard as a "socially responsible" managerial practice) need not be expensive and indeed, may ultimately reduce costs.

Calculating the costs and benefits of CSR

I also wish to elaborate on the notion of "cost." While it is conceivable that a "responsible leadership practice" may be free, in terms of *monetary* costs, it is important to take account of what economists refer to as the *opportunity* cost, when considering various strategic options. This concept is what Professor Friedman was alluding to in his other famous aphorism regarding the non-existence of a "free" lunch. The opportunity or economic cost is the cost of something in terms of an opportunity forgone (plus the foregone benefits that could have been realized from pursuing that course of action). Thus, to convince me of the desirability of a responsible leadership practice, you would have to take account of all relevant costs. More on that topic later.

I may be responsible for some of this confusion because most of the examples I provided concerned the external use of CSR. Thus, to summarize, managers should be socially responsible, both internally and externally, even when it is expensive to do, as long as this activity generates a sufficiently high return to offset the additional costs (both the actual and opportunity costs). Others have referred to this as the instrumental use of CSR, which I strongly support since it can be beneficial to the firm. I only object to CSR when it is not used instrumentally or when the "return on investment" in CSR is insufficient.

Managerial motives for CSR

Next, I would like to address the subject of moral values and CSR. You ask for an example of a leader who pursued his moral interests at the expense of shareholders. Let me provide one: William Clay Ford, Jr. (Bill Ford) of Ford Motor Company, who mapped out a "hydrogen strategy" for his company, which was designed to make Ford the environmental leader in the industry (Muller & Fahey, 2004). Ford said the following regarding his pursuit of environmental social responsibility: "That's something I believe very strongly in, not just because I believe it's the right thing to do—but because I also believe that society is moving that way and moving that way rapidly, and we want to be

seen as leading that" (Muller & Fahey, 2004, p. 46). The pursuit of this policy, which clearly stemmed from Bill Ford's "moral compass" (your term), had disastrous results for the firm.

As Abby McWilliams and I have pointed out (McWilliams & Siegel, 2001a), there is a key distinction between economic and management perspectives on CSR. In modeling human behavior, economists assume *homo economus*—the notion that man is a perfectly rational economic agent who always chooses the "best" option when purchasing goods or services (as a consumer) or making a managerial decision. Such an individual is, by definition, cold and calculating, yet by no means amoral. This key assumption enables us to provide authoritative advice regarding public policy and managerial decision-making, so we are quite reluctant to abandon it. Saint Thomas Aquinas' famous saying—"*hominem unius libri timeo*" ("I fear the man of a single book") might apply to my brethren in the economics profession.

Not surprisingly, academics in the field of management, and especially those who study leadership, are more interested than economists in studying managers as individuals. Management scholars also tend to focus on the moral choices that managers face when encountering CSR, while economists devote most of their attention to the outcomes of CSR, rather than the motives for engaging in this activity. To paraphrase the late Richard Nixon, we believe in "watching what people do, not what they say." I would apply the same logic to leadership ("moral" or otherwise).

Unless you can convince me that leadership (and CSR for that matter) and managerial motives affect performance, it all sounds like a bunch of hot air. I know that you have an excellent *Academy of Management Journal* article (Waldman, Ramirez, House, & Puranam, 2001) on this topic, which was one of the first empirical studies to demonstrate that certain aspects of leadership have a positive influence on performance. However, a recent paper by Agle, Nagarajan, Sonnenfeld, & Srinivasan (2006) appears to refute your findings, so I think it is fair to say that the jury is still out on this issue. Until there is a larger body of empirical evidence in support your assertion that "moral" leadership matters, I would be careful not to make bold predictions about the impacts of moral leadership on performance.

Regulation and CSR

I agree with some of the arguments you advance regarding Sarbanes–Oxley, although I would frame the relationship between social responsibility and regulation somewhat differently. I share your antipathy toward this poorly-designed legislation, which was enacted based on an overreaction to an artificial, media-induced ethical "crisis." Unfortunately, such twisted journalism does have a direct impact on public policy and the media's bias against business is unlikely to change in the near future.

Thus, it is important for managers to be mindful of public perceptions regarding ethics and social responsibility, since they can shape the legislative landscape. In this regard, management scholars have recently devoted considerable attention to examining efforts undertaken by firms to engage in self-regulation (e.g., Christmann & Taylor, 2001, 2002; Delmas & Terlaak, 2001; King, Lenox, & Terlaak, 2005), especially along the environmental dimension.

In my view, such initiatives are undertaken for strategic reasons, not because managers wish to behave in a morally responsible manner. That is, managers engage in these activities not just because they hope to forestall additional regulation, but also to raise entry barriers (to keep potential competitors out of the market) and to appeal to consumers and suppliers who wish to see the firm achieve higher levels of environmental performance (beyond that which is required by law).

Although we agree on the need to forestall regulation, I fail to see how Ghoshal's (2005) slapdash, pollyanaish essay on the evils of agency theory, transactions cost economics, the five forces model, game theory, and the principle of shareholder wealth maximization will help us prevent further Enrons. In fact, his argument seems logically inconsistent, in the sense that one of his primary criticisms of applying economic logic to managerial decision-making (which underlie all the aforementioned tools and theories) is that a concept such as agency theory teaches us that we should not trust managers under certain conditions. That seems to be a key lesson from Enron. Therefore, perhaps we need *more* economics (which presents a "dismal" view of man) in MBA programs, not *less* economics, as Ghoshal advocates. I fail to see how a focus on "positive" outcomes or processes, as opposed to the "negative" view of economics, will result in better outcomes. Maybe this connection is obvious to you and readers of this journal, but I fail to see it.

Managers should have a realistic view of the business world and such economic theories are useful for helping corporate executives formulate strategic decisions on the basis of realistic assumptions (e.g., rivals wish to capture market share from their competitors, managers might pursue their own interests at the expense of the organization's best interests, and incentives affect the behavior of workers and managers). Focusing exclusively on positive outcomes, processes, and attributes, and thus, avoiding the "dismal science," might make sense as a human resource management strategy. However, it is a recipe for disaster for strategic decision-making and ultimately, the long-run profitability of the firm.

I have no problem with your suggestion to address leader morality and also agree with your conjecture that CSR can be a profit maximizing strategy (my term). Indeed, I have written extensively on this topic and shown that for many firms, this is a viable option (depending on the "demand" for CSR and cost of satisfying that demand). Your assertion that my framework implies that managers should only pursue CSR initiatives when they can be directly linked to a return on such actions (higher profitability) is also correct.

Based on your excellent rejoinder to this point, I will amend that to allow for the possibility that it is sometimes difficult to establish this link beforehand. Therefore, there may be instances where leaders can take the initiative to undertake such investments, even when the payoffs accrue to the firm in the long term. Similar arguments regarding "managerial myopia" have been made about R&D projects and your point is well taken. Perhaps a visionary leader can overcome this myopia.

Reconciling differences

As you point out, we agree on many aspects of CSR and leadership. My approach to responsible leadership stresses the obligation managers have to deploy the resources as effectively as possible, based on instrumental thinking, in order to maximize the wealth of the firm. I actually consider that a moral obligation, but apparently others (including you) seem to have a broader notion of morality. Still, we both agree that there is some overlap between instrumental behavior and leader morality.

My recent research (McWilliams & Siegel, 2000, 2001a; Siegel & Vitaliano, 2007) clearly demonstrates that firms engage in "strategic" social responsibility. That is, they matrix CSR into their business and corporate-level strategies. We have also found in our joint research (Waldman, Siegel, & Javidan, 2006), based on linking data from psychometric studies of CEOs with information on the social performance of companies, that the "intellectual stimulation" dimension of transformation leadership is strongly positively correlated with the propensity of firms to engage in strategic CSR. Something is clearly going on at both the micro and macro levels. Even I am now convinced that managerial motives may be important.

However, I remain convinced that it is *not* morality or ethics that drives managerial decision-making with respect to social responsibility. Although I rarely make normative statements, I will make an exception in this case: I think it is wrong for managers to devote time and effort to morality and ethics until we have additional theoretical and empirical evidence on the connection between motives, ethics, morality, and outcomes at the individual (i.e., employee, manager) and firm levels.

Sincerely,
Don

Letter 4

Donald Siegel
A. Gary Anderson Graduate School of Management
University of California, Riverside
Department of Management and Marketing
225 Anderson Hall
Riverside, CA 92521

Dear Don:

I want to compliment you on representing your perspective quite adeptly. You have done a great job of presenting an economic/instrumental viewpoint of what socially responsible leadership is all about. To that end, I am sure that some of the readers of our exchange will find it quite amazing how two people can take a term like socially responsible leadership and come up with such disparate interpretations. Indeed, although there is some overlap between us (as you point out), there are still some very large differences. My hope is that in the years that follow, theory and research will continue to develop in an effort to more clearly understand this very important concept.

For this final letter, I want to address our most serious points of contention. Some of these areas of disagreement are simply a continuation or clarification of points made in my previous letter, while others will represent some new

thinking. I will end this letter with another, broad-brush attempt at reconciliation of our views—or at least a strategy for how such a meeting of the minds might eventually evolve.

Ghoshal: Pollyanna or Prophet?

In my previous letter, I briefly provided a quote from the work of the late Sumantra Ghoshal (2005). In that piece, as well as other work (e.g., Ghoshal, Bartlett, & Moran, 1999; Ghoshal & Moran, 1996), Ghoshal has questioned the fundamental, economics-based thinking that has lent itself to so many of the prescriptions that management educators have tried to impart to practitioners. Judging from your response, my mentioning of Ghoshal obviously struck a nerve. Given your economics background, I am not surprised by your spirited response and characterizations of his work. To be sure, that work goes to the heart of our differences regarding socially responsible leadership in that it emphasizes the importance of such things as the balancing of multiple stakeholder needs and perspectives, as well as the interplay between morality and management.

But is Ghoshal really “Pollyannaish,” as you put it? The dictionary defines a Pollyanna as a person characterized by irrepressible optimism and a tendency to find good in everything. I'm not so sure that this description really defines Ghoshal's work. Obviously, he does not find good in much prior management theory, and his optimism for the future of organizations and their management is at best tempered. Perhaps you are referring to Ghoshal's basic views of managers and employees. To a degree, I would agree that Ghoshal's writing coincides with the notion that under the right circumstances (e.g., proper selection, training, and acculturation), a somewhat positive psychological viewpoint is warranted (cf., Luthans, 2002a,b; Snyder & Lopez, 2001). However, I think that it is hyperbole to suggest that Ghoshal's optimism was irrepressible, and that he found good in everything—in other words, as described further below, he was not a Pollyanna.

To the contrary, I believe Ghoshal to be more in line with what I would term management “prophet,” similar to others who have gone before him, such as Chester Barnard, Abraham Maslow, Doug McGregor, and Peter Drucker. Why would I suggest such a thing? Again, I refer to how the dictionary defines prophet. Specifically, it characterizes such an individual as a leading spokesperson for a cause, doctrine, or group. Perhaps you might concede that whether or not you agree with Ghoshal, he certainly does strongly represent a certain viewpoint. The dictionary would also suggest that a prophet is gifted with more than ordinary insight and has the ability to foretell future events. We probably part company here, but I strongly believe that Ghoshal's work does provide extraordinary insight and that future scholars will build from it. If the award-winning, Ghoshal (2005) piece is any indication, his work is at the very least highly cited.

As an example, let's consider your insistence on a strictly instrumental basis for leaders engaging in socially responsible actions. Your rationale appears to be analogous to an agency theory perspective which would suggest the need for formal mechanisms to control individuals so that their opportunistic, self-interests will not end up hurting the organization. This “dismal” view of people, as both you and Ghoshal (2005) put it, actually has some basis in psychological principles pertaining to the use of rewards and punishments for controlling behavior. But human behavior is much more complex, especially in dynamic organizational settings.

Ghoshal & Moran (1996) describe how the assumption of opportunism and the mechanisms to deal with it, such as those prescribed by agency theory, can become self-fulfilling and damaging to the organization. Let's take the now famous case of Enron as an example. Agency theory would suggest that managerial rewards should be tied closely to firm outcomes, such as stock price. Executives at Enron engaged in a variety of actions, many of which were illegal, to thus make sure that stock price would be inflated, albeit artificially. Perhaps the solution according to agency theory might be more elaborate sanctions, incentives, and guidelines to ensure that the interests of executives will be aligned with those of the firm. But the question needs to be asked regarding how much of the Enron misbehavior was due to inherent self-interest or opportunism and how much of it was caused by the very system put into place to prevent such misbehavior (and is the solution simply a more elaborate control system).

Ghoshal & Moran (1996) viewed increasingly elaborate control mechanisms as a vicious cycle for two key reasons: (1) the resentment among managers and employees that elaborate control systems cause, and (2) the game-playing in which people will engage in order to beat the system to which they have been conditioned. Although Ghoshal was not a psychologist or organizational behaviorist, he demonstrates much insight in line with positive psychology. Specifically, he stresses employee/managerial development (rather than a mere reliance on control mechanisms), management's role of establishing a sense of purpose (rather than simply being designers of strategy), and inspiring collective action (rather than stressing the actions of opportunistic individuals transacting in the market).

To summarize, contrary to your claim, there is nothing in my reading of Ghoshal's work that would negate “the principle of shareholder wealth maximization.” Moreover, there is nothing in his work to suggest that control

mechanisms and instrumental actions on the part of leaders (e.g., instrumental CSR behavior) should be altogether discouraged. However, he does demonstrate a realization of the limits of such approaches, and how organizations may "fail when they are unable to create the social context necessary to build the trust and commitment that are needed for maintaining cooperation" (Ghoshal & Moran, 1996, p. 42). In other words, control mechanisms and associated reliance on instrumental behavior need to be balanced with a broader perspective that includes (rather than precludes) managerial values and morality. I will return to these points below as I address the need to broaden an instrumental perspective in the pursuit of socially responsible leadership.

Leadership, morality, and performance

I want to address statements that you made regarding leadership and leader morality on the one hand, and firm performance on the other. To be sure, it is difficult to make the connection between these phenomena. Leadership and leader values are individual-level constructs, while firm performance is obviously at a higher level of analysis and is the result of a myriad of factors depending on the context. Be that as it may, there are some points that you make to which I would like to add some clarification.

For example, you cast some doubt on whether leadership as a general concept matters as a predictor of firm performance. You mention some of my prior work (e.g., Waldman, Javidan, & Varella, 2004; Waldman et al., 2001) which has focused on what Brown & Trevino (2006) would refer to as socialized charismatic leadership. Although not dealing with morality or integrity directly, such leadership is generally concerned with the development of shared vision and sense of purpose, rather than the personalized self-interests or vision of the leader. In general, our research would suggest that such forms of leadership are indeed predictive financial measures of organizational performance, especially under conditions of perceived uncertainty. I realize that Agle et al. (2006) report findings in line with the notion that socialized charismatic leadership is simply an attributional perception resulting from prior firm performance. However, as I intend to report in subsequent research, their work is consumed with a number of conceptual, methodological, and analytic problems. In any event, while overall I agree with you that "the jury is still out on this issue," I would bet that future research will bear out a predictive (rather than attributional) relationship between socialized charismatic leadership and firm performance, or at least mediators of that relationship.

More relevant to our current discussion, you attempt to connect leader morality or values to firm performance, and you suggest that there is either a negative relationship or no relationship at all. The evidence that you present for a negative relationship is a brief anecdote pertaining to Bill Ford, current CEO of the Ford Motor Company. To be fair, I asked you to provide such an example in my last letter. But as I have already noted, connecting leadership to firm performance is a difficult task that is made even more tenuous when a particular action or even a set of strategic decisions on the part of a CEO of a large firm is suggested to be the cause of that firm's performance, or in this case, "disastrous results" as you put it.

I looked at the Muller & Fahey (2004) article in *Forbes*, from where you took this anecdote, and I have a few observations. First, the authors do little in the article to try to connect the Ford Motor Company's recent financial problems to the actions of Bill Ford with regard to his pursuit of environmental social responsibility. Instead, they attribute such performance largely to historically-based, fixed costs in plants and labor—problems with which I believe Bill Ford has been attempting to deal since becoming CEO in 2001. Second, much of the article seems to be suggesting that rather than the cavalier pursuit of personal "moral interests at the expense of shareholders," Bill Ford's actions actually appear to be more in line with the type of instrumentally-based social responsibility that you are recommending. In other words, Muller & Fahey (2004) are suggesting that Bill Ford's pursuit of hydrogen-powered piston vehicles has more to do with ultimate competitive advantage for his company, and less to do with his own personal values. In reality, it's probably a little bit of both, which may be the real lesson to be learned from this case example. Specifically, human motivation and behavior are inherently complex, and as illustrated in this case, may represent a combination of moral values and instrumental thinking on the part of people in leadership positions. I will return to this point below as I once again attempt to reconcile our differences. For now, suffice it to say that Ford's choice to develop an environmentally-friendly car may yet prove to be a wise choice financially. But when does the investment in CSR need to show its financial value, and why should such long-term thinking not be guided to some degree by managerial values?

I am sure that we could go around and around all day regarding our differing interpretations of particular leaders, their motives or values, and effects on their firms' performance. And I wholeheartedly agree with you that, despite the conceptual and empirical problems, we need more cross-levels research to better understand the connection between leader values and morality on the one hand, and firm-level outcomes on the other. But with that said, I will remind you of evidence presented in my previous letter. Specifically, Thomas et al. (2004) provide evidence that leadership

integrity is associated with such financial organizational outcomes as the reduction of business costs. Furthermore, the Sully de Luque et al. (2006) findings would suggest that managers who place an emphasis on balancing multiple stakeholder needs in their decision-making, as opposed to placing more emphasis on the rational pursuit of profits and cost control, may paradoxically end up with more favorable outcomes for themselves and their firms. Specifically, these managers will tend to be viewed as more inspirational or visionary, as opposed to autocratic, and their firms will have a higher likelihood of actually achieving favorable financial outcomes. In short, evidence is beginning to emerge regarding the favorability of leader values stressing integrity and the concern for multiple stakeholder groups, although I will cede to you that much more work needs to be done.

Toward reconciliation: broadening the instrumentality perspective

We both agree that firm performance should not be sacrificed for the sake of socially responsible leadership, and I have no problem with conscious efforts to have these two phenomena align whenever possible. With that said, the strong stance that you take regarding instrumentally-responsible leadership goes too far in my opinion. I wish to make two key points regarding an instrumental approach to socially responsible leadership that need to be considered in an attempt to broaden this perspective that you have so adamantly presented.

First, you make both descriptive and normative statements regarding "strategic" or "instrumental" social responsibility. Is there really that much definitive evidence regarding why leaders engage in socially responsible actions or behaviors, and does that evidence really point so much toward instrumentality? Yes, people in leadership positions or decision-making roles are rational and calculative, but they are also intuitive at times, and that intuition can be beneficial. Yes, these people (as well as lower-level employees who must implement CSR initiatives) can be opportunistic, especially in certain organizational culture contexts. But they can also be seeking a sense of purpose, meaning, and identity in relation to the organizations of which they are a part. My point is that motivation, behavior, and relationships in organizations and networks are complex and cannot always be reduced to simple one-on-one, opportunistic exchanges.

As an example, a "strategic" CSR decision might be made at the upper echelons of a firm that it should show more concern for customers and their needs (and invest resources to that end, such as enhanced employee training) because a rational analysis would suggest that such actions will end up yielding a strategic advantage for the firm. Further, in line with an agency theory perspective, rewards and punishments of managers and employees will be geared toward the pursuit of customer satisfaction. What such a strategy does not take into account is that although it is seemingly rational, people may not fully implement it because of a lack of commitment or collective cooperation to satisfy customers. Lower-level managers and employees may be quick to see that their higher-level leaders are not really genuine or authentic in their concern for customers, and thus, may not be inspired to fully perform. Further, as already noted, they may simply find ways to "game" the system to make it appear that customers are being served better. In short, what I am suggesting is that at least to some degree, we should balance instrumentality with an allowance for leaders to be intuitive and work from their own values and morality in pursuing socially responsible endeavors. You might view my argument as simply a different twist on instrumentality since firm performance is still a key outcome. But the main difference is that the broadened perspective that I am suggesting here does not rely on only calculative, rational logic; nor does it define socially responsible leadership solely in terms of achieving firm performance. Rather, such performance is only one of many important outcomes for a responsible leader.

A second issue pertains to the practicality of a strict, instrumental approach. The type of rational, calculative behavior that is implied by an instrumental approach to social responsibility is best applied to the really broad initiatives or strategic decisions that leaders might make. With that said, I applaud you for acknowledging that even under such circumstances it may be difficult to apply a strict instrumental approach since the payoffs may not be clearly calculable. Moreover, as I pointed out in my prior letter, socially responsible leader behavior need not be limited to large initiatives or decisions, and can pertain to the day-to-day actions and decisions of leaders. Over 30 years ago, Mintzberg (1973) talked about the frenetic nature of management and how people in leadership positions are oftentimes forced to make decisions on the fly without a lot of information or data. Accordingly, if a strict, instrumental approach were always taken, socially responsible leadership might rarely be shown. Managers should not be precluded from resorting to intuition and values. Instead, I see a need for theory that will help guide managers in their balancing of instrumentality with intuition and values in the pursuit of socially responsible leadership practices.

Sincerely,
David

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