Organized Advocacy and Corporate Social Responsibility

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Abstract

This paper presents a positive theory of how advocates for social programs work with private firms to comply with social mandates for the private provision of public goods. We argue that advocates are organized to provide credible advice for private firms to make cost-effective investment in highly visible social programs. The theory incorporates two explanations to account for advocates’ special role in this process. First, advocates help record and evaluate the firm’s contribution to the public good for interested consumers, employees, and investors to observe; and second, advocates match corporations with high valued-social programs to maximize the returns from the public-private partnership. The theory predicts that firms that delegate social investment to advocates are more likely to invest in numerous social initiatives, including some outside of their core business, and that they will be perceived as better corporate citizens than firms that don’t delegate to advocates.

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1 Introduction

In 2008, FedEx Corp. touted a new milestone for its hybrid-electric fleet of trucks: two million miles in service. Although the press release was not atypical, one aspect stood out. FedEx’s partner in its efforts was the Environmental Defense Fund (EDF), a persistent critic of corporations and their environmental impact. Such "unlikely partnerships," as EDF President Fred Krupp calls them, are increasingly common. For example, EDF works with Starbucks, Citigroup, McDonald’s, and several other large firms. Other activists such as Conservation International and Rainforest Action Network are involved in similar collaborations. In many cases, these partnerships involve the delegation of authority from the corporation to the activist organization in areas related to problem identification and technical assistance.

Why would corporations delegate to activists that often have opposite goals and different incentives? Although this empirical phenomenon is well-documented, we have little theoretical insight into why these relationships develop and persist. To illustrate, consider a large corporation that is exploring an investment initiative designed to mitigate environmental damage. These kinds of investments, as detailed below, are often discussed under the broad umbrella of corporate social responsibility (CSR) (e.g., see Kitzmueller and Shimshack, 2012), and are economically significant, likely in the trillions of dollars (Chatterji et al 2009). Moreover, analysts surmise that nearly every Fortune 500 company now releases an annual social responsibility report to the public detailing these activities.

The precise consequences of the initiative cannot be known with certainty, so the firm seeks guidance from an informed adviser who possesses private, unverifiable information about the impact of the program on important environmental performance measures such as toxic emissions and carbon footprint. If the firm knows the adviser is a passionate advocate committed to promoting a sustainable workplace and environment, it would naturally question her motives. Is the advocate’s advice a true assessment of the merits of the program, or is it simply meant to advance her cause? The clear dilemma the firm faces is that by relying on the advocate’s advice, it becomes vulnerable to manipulation.

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The advocate may exaggerate the benefits of the program to induce the firm to invest more than is justified. Absent the ability to compensate the advocate for the accuracy of her advice, combating this behavior is difficult. On the other hand, the advocate is well informed and her advice on CSR is valuable to the firm. How can she commit to offer credible advice?

This paper develops a formal model to explain these relationships and account for the complex set of actors that underpin CSR efforts, such as social performance measurement agencies and technical consultants. More broadly, we explain the conditions under which corporate delegation to a group of consultants and advocates organized to promote CSR actions can be an optimal choice. Economic analysis of advisory relationships is traditionally divided into two categories: delegation and strategic communication. Under delegation, the decision maker commits herself to a specific action associated with each report to induce the advocate to disclose her true information. By contrast, under strategic communication, the decision maker chooses actions that are sequentially rational given the recommendation he receives. This paper explores a third process that we call organized advocacy. Under organized advocacy, the firm and advocate agree to a chain of command which commits the advocate to make credible recommendations that the firm finds individually rational to follow.

Applying this theory to the CSR context helps explain how the organization of advisory relationships allows advocates to influence firms to implement mutually beneficial actions. Specifically, when firms are weighing various options with regards to social responsibility, the right investment often depends on economic and social conditions that are difficult to predict. Technical staff and environment advocates exist to advise the firm on these choices. Firm staff are fact finders providing verifiable predictions of the right investment. By contrast, the advocate’s advice is free but non-verifiable and it is typically biased toward larger investments than the firm requires. Although tempted by free advice, the firm’s and the advocate’s preferences for investment are misaligned. To rectify this tension, the advocate and the firm organize to determine investment with a three-step process: (i) the advocate observes the optimal intervention and recommends an action, and (ii) the firm implements the recommendation if it appears credible; otherwise, (iii) the consultant reviews it and advises the firm what action to take.

\[^3\text{For a comprehensive overview of these analyses see Gibbons and Roberts (2013).}\]
Despite its simplicity, this process implements the firm’s optimal action. Moreover, this depiction of the advisory process appears to be fairly common in CSR efforts around the world. For instance, as we point out in section 3, many of the CSR initiatives recently adopted by firms have been organized by special interest and government advocacy groups in ways that are similar to the process described above. When viewed through the lens of organization theory, organized advocacy is an efficient way to delegate decisions to better-informed technical advisers and advocates. The firm commits to delegate by reviewing the advocate’s recommendations to ensure they are credible.

An important feature that explains the popularity of organized advocacy is that by collaborating with the advocate, the firm minimizes the cost of implementation. The advocate is a cheap source of accurate but soft information, whereas the firm staff provides expensive but verifiable information. Working together, the advocate and the firm staff complement each other, by increasing the value of each other’s information. In the equilibrium play of organized advocacy, the advocate truthfully discloses the firm’s recommended investment. The advocate is always permitted to implement a low investment recommendation, without costly verification from the firm staff, because truthful disclosure is her dominant strategy in this case. If the advocate recommends high investment, a mandatory review by the staff is implemented to demonstrate her claim can withstand the scrutiny of an independent evaluation.

The foregoing theory provides a compelling reason for firms to rely on information from interested parties and advocates in particular. As Milgrom and Roberts (1986) argue, interested parties tend to be informed precisely because they are interested and are therefore a good source of information for decision makers. However, advocates are distinguished by their willingness to provide free information in exchange for influence. An organized advocate not only influences but compels decision makers to follow her advice by, demonstrating it is credible and by providing this information at least cost.

This finding is interesting for designing social policy in general and CSR in particular. In short, our positive theory of CSR is that these arrangements arise to exploit complementarities in organizational design. In the sections to follow we argue that the demand for intervention the firm receives will determine its CSR activity. The matching of firms to advocates will be positive assortative. Firms with the greatest demand for CSR will gravitate to the stronger, committed advocates who are best organized and can implement
the firm’s desired interventions at least cost. In turn, strong advocates will benefit the most from influencing firms with high demand for CSR. When advocates are committed but do not have significant resources, our theory predicts they will exchange information with firms for a greater commitment to a particular social cause. In these instances, the firm’s distorted social interventions will be viewed as a necessary cost of acting socially responsible.

Finally, in some examples of CSR, rival advocates advise a firm for different causes. Section 4 demonstrates that firms employ rival advocates to cross check each other’s claims to inform the firm’s investment decision. Competing for scarce funds from the firm induces the advocate to verify her own claim and review her rival’s demand at no additional cost to the firm. Therefore, corporations may undertake numerous initiatives spanning a variety of causes and advocates.

**REVIEW OF RELATED WORK**

Our analysis contributes to the large literature on "cheap talk" following Crawford and Sobel’s (1982) analysis of strategic information transmission between a decision maker and an adviser who has unverifiable information. We depart from the Crawford and Sobel framework in that we allow for multiple sources of information, some of them verifiable and others soft, which can either be substitutes or complements for each other. We find the strategic interaction between the information sources leads to better communication and coordination with the decision maker.

Another body of related work are papers by Milgrom and Roberts (1986) and Grossman (1981). These papers model the setting where a single adviser collects and discloses verifiable information as a game of persuasion, showing that an advocate must have hard evidence to be an influential adviser. Che and Kartik (2009) and Van den Steen (2010) extend these analyses to show that an adviser with contradictory views may need to work harder to collect hard evidence to influence the decision maker. As we show below, an advocate with only soft information may be influential as well, if there is another adviser or decision maker with hard evidence to verify her findings. We refer to this corroboration of advice as organized advocacy, where advocates and objective advisers collaborate to inform the decision maker at least cost.

Our model also relates to the literature on the optimal delegation of decisions to advisers and advocates. Holmstrom (1977) is the first to study how the decision maker commits
to act contingent on the adviser’s recommendation. Dessein (2002) and Alonso and Matouschek (2008) characterize the set of decisions that can be delegated and compare it with the set of decisions that can be implemented without delegation. Our analysis identifies conditions on the cost and value of information that ensure a larger set of actions is implemented under delegation than without it.

Aghion and Tirole (1997) consider the optimal allocation of decision rights within an organization, revealing a trade-off between incentives for information acquisition and control. Similar to our analysis, they find delegating control of decisions induces the advocate to gather more information. In related analysis, Dewatripont and Tirole (1999) show that competition between advocates (motivated by financial or career concerns) can lead to more informed decisions in administrative proceedings. By contrast we find that advocates working with firm staff lead to better decisions at lower cost.

Our work also pertains to the literature on CSR and its link to competitive advantage. The once lively debate whether public goods should be provided by private corporations (initiated by Friedman 1970 and continued by Porter and Kramer 2002) has shifted to a discussion of how corporations can best perform their social activities to reap private benefits. For instance, Besley and Ghatak (2007) and Kotchen (2006) explore the efficiencies associated with combining public services with privately provided goods. Brekke and Nyborg (2008) and de Bettignies and Robinson (2013) illustrate the advantage socially responsible corporations have in recruiting highly trained and dedicated employees, and Heal (2005) argues that CSR firms enjoy better access to capital markets. Our positive model builds on this literature to explain the private benefits corporations realize in making social investments. In related work, Baron (2001) and Maxwell, Lyon, and Hackett (2000) suggest political expediency and avoiding regulation are motives for CSR. Our theory further suggests that political activists promote social investment by helping corporations select and implement these initiatives rather than threatening them if they do not.

The rest of the paper proceeds as follows. Section 2 presents our model and illustrates how organized advocacy is designed to function. Sections 3 and 4 characterize the potential for organized advocates to influence corporate social policy. Section 5 concludes with a summary and topics for further research.
2 Model

This section presents a simple model of corporate decision making with public and private stakeholders and multiple advisers. Although general enough to capture various institutional settings, the model is intended to provide a positive theory of organization design for promoting CSR.

2.1 What is corporate social responsibility?

A firm (F) seeks to act socially responsibly. F may act for reasons of political and economic expediency to avoid government intervention, consumer boycotts, the risk of litigation, or regulatory oversight. Alternatively, F may be altruistic, wishing to contribute to the public good or to reduce social and economic inequities. Whatever F's motives, we require a workable definition of social responsibility and good corporate citizenship. Here, we follow Heal (2005) in envisioning that CSR is implemented by Coasian bargaining, where social costs are externalized and corporations bargain with society about who will ultimately bear these costs. In this section and the next, we construct a positive model of how this Coasian Bargain may be implemented in practice.

2.2 Evaluation of CSR performance

Non-governmental organizations (NGOs), private and public stakeholders, and social performance rating agencies represent the interests of society. These parties monitor and evaluate the firm's social performance. Although, high-profile firms are naturally heavily scrutinized, most large firms in developed countries voluntarily provide data on social investments to rating agencies. These raters act as intermediaries between corporations and the public interest to construct performance indices to evaluate and rank CSR (e.g., Chatterji et al. 2009). Some prior work has found that firms respond to these ratings and pay attention to their scores (Chatterji and Toffel, 2010). As Heal (2009) argues, a positive rating may improve staff morale, enhance brand equity, reduce the firm’s cost of capital, and forestall regulatory intervention.

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4See Baron (2001), Lyon and Maxwell (2003), and Heal (2005).
By necessity, CSR performance is measured ex-post, because it is an assessment of what cost was avoided by the corporation’s intervention, or what benefits were produced because it was proactive. Activists, agencies and social opinion typically perform the measurement. This evaluation becomes the standard, the accounting, or as some say, the "Hall of Shame or Fame" by which the corporation is publicly judged.\textsuperscript{7} Although the measurement of CSR is imperfect and subject to measurement error and misinterpretation, it is thought "to be necessary" to influence and publicize good corporate behavior.\textsuperscript{8}

An ideal process for evaluating CSR behavior is to measure and reward the corporation for the social surplus it provides. Suppose the firm is expected to provide one public good or service that reduces social conflict. (The analysis is extended to multiple public goods below.) For concreteness, the good is environmental restoration, which is measured as \( e \in \mathbb{R}_+ \) dollars invested to meet demand for environment quality indexed by state of demand, \( x^e \in \mathbb{R}_+ \).\textsuperscript{9} The firm invests \( e \geq 0 \) at cost \( \gamma e \) and incurs quadratic costs for unmitigated damages of \( p(x^e - e)^2 \), where \( 2px^e > \gamma \) to avoid uninteresting cases.\textsuperscript{10} The firm’s ex-post performance given state \( x^e \) and action \( e \) is

\[
P(x^e, e) = -p(x^e - e)^2 - \gamma e,
\]

For convenience, we can rewrite this expression in terms of a quadratic loss function,

\[
P(e^*, e) = \bar{R} - p(e^* - e)^2,
\]

where \( e^* \equiv x^e - \frac{\gamma}{2p} \) is the optimal intervention as a function of the state \( x^e \) (corrected for cost), and the social loss from depleting the environment is minimized when \( e = e^* \) and \( \bar{R} \equiv R(e^*) = \bar{k} - \gamma e^* \) is a constant independent of \( e \), which represents the maximum evaluation possible.\textsuperscript{11}

Consistent with efficient Coasian Bargaining, \( P(e^*, e) \) rewards the firm for cost-effective

\textsuperscript{7}The Hall of Shame refers to the Charity Rating Guide and Watchdog Report performed by the The American Institute of Philanthropy (AIP) as to which charities are most deserving of donor support.

\textsuperscript{8}Porter and Kramer (2006)

\textsuperscript{9}This expenditure provides for reductions in emissions, energy conservation, waste-site cleanup, and remediation of local eco-systems.

\textsuperscript{10}To ensure the firm intervenes at a strictly positive level, we assume that the opportunity cost of investing \( \gamma \) is less than the benefit of investing \( 2px^e \).

\textsuperscript{11}The assumption of quadratic preferences allows for a straightforward solution to the delegation problem we will address below. Moreover, the quadratic loss function is the work horse for most analyses of delegation and therefore allows us to compare our findings with those in the literature.
remediation that takes into account the firm’s opportunity cost \( \gamma \) for providing public goods. At the same time, the firm is penalized for insufficient action or for excess care, sometimes referred to as "greenwashing" in the literature.\(^{12}\) According to Heal (2005), "It is not enough to have your plan (referring to the corporation) for reducing conflicts with groups in society, this plan has to be acceptable to them too– it takes two to avoid a conflict!". If the firm operated under complete information, it would select \( e = e^* \) to minimize its loss. Without complete information, \( F \) chooses an action that differs from the optimal intervention by the amount \((e^* - e)^2\), which is penalized at rate \( p > 0 \), reflecting the marginal cost of choosing the non-optimal mitigation. In practice the penalty \( p \) could be determined by "yard stick" competition (e.g., Schleifer, 1985), where the performance of numerous firms operating under similar conditions is compared. Alternatively, the penalty might be determined by public opinion, or chosen as a policy instrument to motivate the firm to match the required demand for intervention.

### 2.3 Information

Prior to evaluation the preferences of the evaluators as a function of \( e \) and \( e^* \) are known, as is the firm’s ability to act to reduce social conflict and cost. However, the demand for the intervention is uncertain, although it is known two optimal intervention states \( e_h^* \) (\( h \) for high) and \( e_l^* \) (\( l \) for low) exist, where \( e_h^* > e_l^* > 0 \) and each intervention will be drawn with probability one-half. Presumably the size of the optimal intervention \( e^* \), which is determined by the state \( x \) and opportunity cost \( \gamma \), varies by the company. A petroleum corporation like \( BP \) would be expected to weigh in primarily on environmental restoration, whereas an apparel company like \( Nike \) might not be expected to contribute as much to environmental restoration. Although the assumption two (or a finite number of) optimal interventions are possible might be unrealistic, it does provide us with a sufficiently rich setting to study delegation of decision-making authority.\(^{13}\)

After the state is observed and the firm has acted, the public and corporate sector share a common knowledge as to what type of corporate social investment would have been most beneficial to prevent an environmental disaster. However, it is unlikely that social interveners could or should prescribe actions for the firm to take ex ante to reduce


\(^{13}\)The assumption that the number of equally likely realizations of \( x \) is finite is only a simplifying assumption, as a model with a continuous distribution of realizations would confirm.
potential environmental conflicts. As Benabou and Tirole (2010), Heal (2005), and others argue, firms are better informed than the public about intervening most effectively, so that CSR should be delegated to the firms.

### 2.4 Implementing CSR

Governments, activists and the media are increasingly holding firms responsible for the social consequences of their activities (Porter and Kramer, 2006). As a result, firms must decide how to address the CSR demands they are expected to fulfill. To be a successful corporate citizen requires the firm to undertake a cost-effective search for the most valuable and timely interventions to reduce their social liability. Firms may choose among the following options to determine their CSR agenda.

#### 2.4.1 No search

One strategy is no search \((N)\), whereby the firm selects an action based on its initial expectations as to the intervention(s) that are most likely to materialize. Knowing there are two equally likely optimal interventions, \(e_h^*\) and \(e_l^*\), that may arise, the firm selects a single action \(e\) to maximize its expected performance,

\[
F^N = \max_e \left[ \frac{P(e_h^*, e) + P(e_l^*, e)}{2} \right],
\]

The \(N\) strategy is least costly but it yields poor a expected CSR evaluation.

#### 2.4.2 Search

An alternative strategy is for \(F\) to search in-house \((S)\), for the optimal intervention. At a cost of \(C_v\), the firm’s staff or an outside expert can provide verifiable evidence as to which optimal intervention, \(e_h^*\) or \(e_l^*\), the firm should select. It is important that the firm staff or outside expert be objective and unbiased, because the firm wishes to acquire accurate information about the optimal intervention. The firm’s expected surplus under option \(S\) is

\[
F^S = \frac{P(e_h^*, e_h^*) + P(e_l^*, e_l^*)}{2} - C_v.
\]

In-house search yields the best CSR results, but it is very costly to implement.
2.4.3 Delegate to an advocate

An alternative to searching in-house is for $F$ to delegate the firm’s CSR action to one of two types of environmental advocates denoted by $E_m$. The advocate is very knowledgeable about environmental affairs and conservation, but she is known to be a biased supporter of environmental intervention, no matter what the state of world happens to be. Advocate $E_s$ is a self advocate who derives utility (net of influence costs, $C^S$),

$$E_s(e^*, e) = \lambda^S e_s - C^S,$$

from the interventions $e_s$ that she personally recommends the firm implement.\footnote{The subscript "s" attached to the action variable $e$ denotes that advocate $E_s$ receives credit for recommending the firm to implement $e_s$.} $E_s$ represents the environmental advocates who derive financial rewards or reputation benefits for being known as the advocate who influenced the firm to adopt intervention $e_s$. The strength of $E_s'$s preference for recognition is reflected by $\lambda^S > 0$, the marginal utility received for each unit of $e_s$ the advocate influences the firm to implement.

Advocate $E_I$, the ideological advocate, has utility (net of influence costs, $C^I$),

$$E_I(e^*, e) = \lambda^I e - C^I,$$

which reflects the intrinsic marginal utility $\lambda^I > 0$, she derives from the firm’s environmental intervention, independent of who influences the firm to act. The ideological advocate represents the special interests that are driven by their support of the environmental cause. She only cares to maximize the environmental intervention the firm adopts.

The advocates are willing to search for free and to make recommendations for action $r(e^*) \in \{e_h, e_I\}$ based on their observation of the state. However, because the advocates are biased supporters of the environment, the information they observe on the optimal intervention, although accurate, is soft and can only be verified by the firm’s staff at a cost of $C_v$. Moreover, the advocate is not allowed to receive positive transfers based on the accuracy of her recommendation, but is permitted to compensate the firm’s staff for verifying her recommendation. Hence, the advocate’s credibility as an objective adviser limits her ability to influence $F$ to adopt a particular action. However, the firm can cross check the advocate’s recommendations $r \in \{e_h, e_I\}$ at a cost $I^{ma}(e_h, e_I)$ (to be determined). Hence the firm maximizes its expected surplus under the delegation strategy by choosing
actions \{e_h, e_l\} in order to solve,
\[
F^{E_m} = \max_{\{e_h, e_l\}} \left[ \frac{P(e_h^*, e_h) + P(e_l^*, e_l) - \bar{I}^m(e_h, e_l)}{2} \right] \text{ for } m = S, I
\]
The delegation strategy is likely to be less costly than in house search, but implementing the desired optimal interventions may not be possible, due to the bias of the advocates.

Given the foregoing options, the firm’s optimal CSR strategy as determined by
\[
F^* = \max_{T \in \{N, S, E_s, E_l\}} F^T,
\]
is the strategy that allows the firm to minimize the social and private costs of CSR interventions.

3 To Search or Not to Search

As a benchmark consider CSR performance when \(F\) searches in-house and when it doesn’t search. Because \(F\) has diffuse priors that \(e_h^*\) and \(e_l^*\) are equally likely to occur, he is concerned about matching his action to the optimal intervention. He would like more information before acting, but search for the optimal intervention is costly. Comparing \(F^S\) with \(F^N\), we have:

**PROPOSITION 1:** (Search Vs. No Search) \(F\) prefers to searching over not searching whenever the value of information exceeds the cost of information,
\[
\frac{p(e_h^* - e_l^*)^2}{2} \geq C_v
\]

By searching, \(F\) perfectly matches his action with the optimal intervention. Otherwise, \(F\) selects the expected intervention that is less effective. The value of information \(\frac{p(e_h^* - e_l^*)^2}{2}\), is the loss avoided by acting optimally. However, the increased accuracy comes at cost \(C_v\). \(F\) thus prefers to search when the value of information exceeds the cost.\(^{15}\)

\(^{15}\)This result generalizes to the case in which the in-house search is partially (not completely) informative about the optimal intervention. Assume the firm can only confirm the realization of \(e^*\) with probability \(\alpha \leq 1\) at a cost of \(C_v\). Then the value of information becomes \(\frac{\alpha p(e_h^* - e_l^*)^2}{2}\) and \(F\) prefers to search provided
\[
\frac{\alpha p(e_h^* - e_l^*)^2}{2} \geq C_v.
\]
The firm’s no-search performance is an instructive baseline to compare with command and control regulation. With no search, it is as if \( F \) is regulated to provide the ex-ante efficient command and control mitigation, \( \hat{c}^* = \frac{c_1 + c_2}{2} \). By this benchmark, delegating the social investment to \( F \) provides no advantage assuming the regulator represents the public interest and has jurisdiction and resources to monitor the firm.

### 3.1 Implications for CSR

Our model has at least three important implications so far.

1. **Well intended but misguided social investment will often occur:** The firm may wish to engage in CSR in a particular domain for example, water quality, but it may not know where to perform the project and which groups are most affected by the problem. A thorough project search can provide this information.

2. **CSR is likely to occur in response to high demand and local needs:** High demand interventions such as cleanup of a local toxic waste site, are typically signalled by a large penalty \( p \) for failing to respond. Information is more valuable in identifying high-demand interventions, suggesting these interventions are good CSR projects for the firm. The firm is likely to prefer local over regional interventions to the extent that information about local interventions is better and the benefits of participating as well as the cost of not intervening are more visible for local projects.\(^\text{17}\)

3. **CSR is likely to occur in response to low-probability, catastrophic events:** Low-probability, catastrophic events such as an oil spill, an explosion at a chemical manufacturing plant, or a credit card breach, are certain to be CSR projects for which the firm will be held responsible. The firm will be the party that can avoid these accidents at least cost, and will be held liable by social opinion as well as the law. As an example, after a recent breach of customer credit card information, Target offered its customers free credit reporting.\(^\text{18}\)

\(^{16}\)Command and control is direct regulation of an economic and social activity, in contrast to incentive regulation which relies on rewards and punishments to induce desired behavior.

\(^{17}\)Most firms will have a section of their CSR materials dedicated to the local "community." An example can be found here: http://corporate.ford.com/our-company/community.

Most of the rating agencies assess the firm’s impact on the local community as well. See Chatterji et al. (2009).

\(^{18}\)Tsukayama, Hayley, "Target says customers signing up for free credit monitoring after data," The Washington Post (http://www.washingtonpost.com/business/technology/target-says-
4 Organized Advocates

Delegating decisions to an advocate requires the most intricate organization design of the three processes we analyze. Three independent agents—the rater, the firm and the advocate—collaborate to support the firm’s CSR program. Upstream of this process, the rater evaluates and certifies the firm’s performance for public consumption, in effect providing derived preferences for the firm to maximize CSR performance. The firm staff is essential to checking which type of investment would be socially responsible. However, their advice is a cost the firm would like to avoid. The advocate is most valuable here at the information-gathering stage. The advocate is an interested party wishing to influence the firm to adopt the highest and most ambitious intervention, whether it is needed or not. Fueled by career concerns in the case of the self-advocates or by their concern for protecting the environment in the case of the ideological advocate, these advocates are willing to advise the firm in the hope of influencing it to adopt their preferred social intervention. Although the advocate is well informed about the most effective social interventions, the firm staff must cross check her recommendation for certain types of actions to ensure it is credible. All of the aforementioned interactions between the parties are integrated and organized by design to promote CSR behavior.

4.1 Self-advocacy

We first investigate the delegation of decision making to a self advocate. \( F \) chooses a self advocate \( E_s \) to advise him.\(^\text{19}\) The advocate is a known supporter of environmental intervention who derives surplus (net of influence cost \( C^S \)),

\[
E_s = \lambda^S e_s - C^S.
\]

Influence costs \( C^S \) consist of the advocate’s private cost \( c_s \geq 0 \) of observing the optimal intervention, as well as \( C^S_v \in [0, C_v) \), the cost \( E_s \) incurs in assisting the firm staff to verify

\(^{19}\)If multiple advocates exist, the firm selects the strongest of the advocates to advise him. Delegating to multiple self-advocates for the same cause offers no advantage, because only one will receive credit for advising the firm. \( F \) selects the advocate who is the strongest supporter, assuming he knows the relative strength of the different advocates. If the advocates’ strengths are unknown, the firm could hold an auction to determine which advocate offers the most favorable advising terms, an option, however, that we don’t consider in this paper.
her observations are authentic. We assume $F$ wishes to delegate the choice of action to $E_s$ who is asked to select an action $e_h$ or $e_l$ that best matches the optimal intervention. To implement the desired actions, the advocate and the firm play a delegation game governed by this agreement.

### 4.1.1 Delegation agreement

**Stage 1:** $E_s$ privately observes the optimal intervention $e^*$ at cost $c_s \geq 0$. $E_s$ recommends action $r(e^*) \in \{e_h, e_l\}$, where $e_h$ and $e_l$ are the actions $F$ intends to use when the optimal intervention is $e^*_h$ or $e^*_l$, respectively.

**Stage 2:** If $E_s$ recommends $e_l$ it is approved by $F$ without review. If $E_s$ recommends $e_h$ she transfers $C^S_v \in [0, C_v)$ to $F$ to verify the recommendation. $F$ implements the recommendation if it is verified, otherwise $F$ selects action $e^*_l$, and $E_s$ is not credited for her recommendation.

Before analyzing this game, note three provisions of the agreement. First, requiring $E_s$ to certify her report when she recommends the high action alleviates the "cheap talk" problem. Second, the delegation may, but need not, contain actions $(e^*_h, e^*_l)$ that are sequentially rational for $F$ to implement. Although these actions would be the most desirable for $E_s$ to implement, implementing sub-optimal actions instead would be more cost effective. Third, to prevent improper influence payments between the parties, the advocate may only pay the firm staff to verify her recommendation.

### 4.1.2 Implementation

Implementing the desired actions at least cost requires that the following incentive compatibility conditions and obedience constraint are satisfied:

\[
C_v^S \leq \lambda^S(e_h - e_l) \quad \text{(ICh)}
\]

\[
\lambda^S e_l \geq -C_v^S \quad \text{(ICl)}
\]

\[
-c_s + \frac{1}{2} \lambda^S e_l + \frac{1}{2} (\lambda^S e_h - C_v^S) \geq \max \left[ \lambda^S e_l, \frac{\lambda^S e_h}{2} - C_v^S \right] . \quad \text{(O)}
\]

Constraint (ICh) requires that when $E_s$ observes $e^*_h$, the payment $C_v^S$ to verify her recommendation is less than the additional surplus from truthful reporting.\(^{20}\) Constraint (ICl)

\(^{20}\)Recall $E_s$ receives $\lambda^S e_l$ whenever she recommends $e_l$, and she receives $\lambda^S e_h - C_v^S$ whenever she recommends $e_h$ and her recommendation is confirmed.
is satisfied when \( e_l \) is observed because \( E_s \) prefers \( \lambda^S e_l \) over paying \( C_v^S \) to have her recommendation \( e_h \) rejected. The obedience constraint \((O)\) requires that spending \( c_s \) to observe \( e^* \), recommending the optimal action and paying for verification (when necessary), exceeds the maximum of [recommending \( e_l \) or \( e_h \), without observing the optimal intervention].\(^{21}\)

The constraints \((IC_{Ch})\), \((IC_l)\), and \((O)\) define the set of actions \( \{e_h, e_l\} \) that may be implemented. The cost to \( F \) of implementing the actions is \( \bar{I}^S (e_h, e_l) = \frac{C_v - C_v^S}{2} \), because only the recommendation of action \( e_h \) is reviewed at net cost to \( F \) of \( C_v - C_v^S \) and this cost is incurred one-half of the time. Hence the optimal delegation of action to \( E_s \) may be written as the solution to

\[
F^{E_s} = \max_{\{e_h, e_l, C_v^S\}} \left[ \frac{P(e_h^*, e_l) + P(e_l^*, e_l)}{2} - \frac{C_v - C_v^S}{2} \right] \quad (F^{E_s})
\]

s.t. \((IC_{Ch}), (IC_l)\) and \((O)\).

One question of interest is whether \( F \) is able to implement her sequentially rational or ex-post efficient actions, \( \{e_h^*, e_l^*\} \). To do so, the firm induces \( E_s \) to obediently observe and recommend the optimal action for each state. The cost to \( E_s \) of being obedient \( c_s \), is the cost of observing the state, whereas the benefit of being obedient \( \lambda^S (e_h^* - e_l^*) / 2 \), is the additional surplus from correctly recommending \( e_h^* \) rather than \( e_l^* \) after observing state \( e_h^* \). For a sufficiently strong advocate, the benefit from being obedient exceeds the cost, \( \lambda^S (e_h^* - e_l^*) / 2 \geq c_s \). This explanation leads to our first result on self advocacy,

**PROPOSITION 2:** (Self-advocacy): A set of strong advocates exists with marginal utility, \( \lambda^S \geq 2c_s / (e_h^* - e_l^*) \), that are delegated the selection of the firm’s optimal action \( e \in (e_h^*, e_l^*) \). The firm receives expected surplus,\(^{22}\)

\[
F^{E_s} = \left[ \bar{R} - \frac{C_v - C_v^S}{2} \right].
\]

**Proof** See Appendix

In outsourcing CSR to independent agents, the firm designs a process for information acquisition, communication, and decision making. The firm staff’s ability to communicate hard information about the firm’s prospects is necessary and sufficient to implement the optimal actions. Nonetheless, the firm prefers to be advised by an advocate. When

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\(^{21}\)Constraint \((O)\) also requires it to be individually rational for \( E_s \) to participate, which is ensured because \( E_s \) may at least recommend \( e_l \) and receive strictly positive surplus.

\(^{22}\)Note \( \bar{R} = (R(e_h^*) + R(e_l^*)) / 2 \).
the advocate is sufficiently strong, the firm can rely on her to direct its CSR program with minimal oversight. Although these results are consistent with Aghion and Tirole (1997) and Dessein (2002), who find that delegating decisions to agents with moderately misaligned preferences from the decision maker may be beneficial, we find conditions when delegation may be preferred even when preferences are completely misaligned.

Our model is not the first analysis to demonstrate the organization advantage of contingent delegation of decisions to interested parties in matters of public and corporate policy. For instance, Mookherjee and Png (1989) demonstrate the advantage for revenue-collection agencies of delegating the reporting of income to tax-payers. Although tax-payers can misreport their earnings, the agency may conduct a costly audit of the report. By committing to audit based on the income reported, the agency delegates the audit decision to the tax-payer, who employs his private information about income to avoid costly audits and penalties. In a similar vein, the organized advocate is delegated the choice of whether her recommendation is to be "rubber stamped" or reviewed by the firm staff.

However, unlike the tax-payer who is forced to participate in the revenue-collection process, the advocate in our model must be induced to acquire costly information in order to make decisions on behalf of the firm. To induce information-collection requires the firm to cede control of some decisions to the advocate. As we demonstrate, it is only possible to induce advocates with a sufficiently strong interest in the firm’s decision to participate. This finding provides a rationale for why decision makers may only "rely on the information of a sufficiently interested party" when acquiring costly information. But as Milgrom and Roberts (1986) and Aghion and Tirole (1997) observe, interested parties must also be able to communicate verifiable information to influence the decision maker. Because the strong advocate is known to be biased, her source of hard evidence must be trustworthy, objective, and disinterested in the firm’s action. Our theory of organized advocacy provides for an objective and disinterested firm staff to verify the advocate’s recommendation. The staff aligns the advocate’s and firm’s preferences for truthful recommendation by forcing the advocate to recommend the appropriate action corresponding to each state. The staff is essential for the advocate to make credible recommendations, and without the staff’s certification, the advocate would be unable to influence the firm and would therefore not be incentivized to acquire information.

**Implications for CSR**

4. **The best adviser is a strong organized advocate:** The misalignment in preference for intervention between the firm and the strong advocate makes advocacy a superior

---

23 See also the related papers by Reinganum and Wilde (1985) and Malumad and Mookherjee (1989).
organizational design for many settings we have identified. The explanation is that the strong advocate has sufficient incentive to inform the firm about its optimal intervention when she receives the credit in return. We believe this explains the rise of "unlikely partnerships" between groups like EDF, Conservation International, the Rainforest Action Network, and large corporations.

By contrast, a weak advocate, one with a smaller utility $\lambda^S$ for its cause, requires additional inducements to advise the firm, that increases the firm’s cost of implementation and reduces the value of information.

**PROPOSITION 3 (Weak Self-advocacy)** A $\Delta \in (0, 2c_s / (e^*_h - e^*_l))$ exists such that weak self-advocates with marginal utility $\lambda^S \in (\Delta, 2c_s / (e^*_h - e^*_l))$ may be delegated selection of the firm’s action $e \in \{e^*_h, e^*_l - \Delta\}$, where $\Delta > 0$. The firm receives expected surplus,

$$F^{E_s} = \left[ \bar{R} - p (\Delta)^2 - \frac{C_v}{2} \right]$$

**Proof:** See the appendix.

Ironically, the less-biased self-advocates don’t perform as well as the biased ones. The firm’s cost of implementing a given set of actions is higher and the implemented actions are distorted from the optimal interventions, when relying on the weaker advocate. The rationale for this result is that inducing a weak advocate to collect the information required to advise the firm is more difficult. The firm must induce the advocate to acquire information by increasing the variance in actions that are implemented to increase the value of information for the advocate. Now if the weaker advocate always recommends the low action, without observing the state, she suffers an expected loss of surplus equal to $\lambda^S (e^*_h - e^*_l + 2\Delta) / 2$, that must be greater than the cost $c_s$ to observe the optimal intervention and avoid the loss.\(^{24}\)

Distorting the actions implemented in each state is necessary for information collection, but it comes at a cost of reducing the firm’s CSR performance. Now the firm undersupplies action in the low state and oversupplies action in the high state.

**Implications for CSR:**

5. **Weak advocates are less effective advisers:** As a consequence, firms will seek out the most biased and staunch supporters of their cause.

6. **Firm’s advised by weak advocates will spend more and be perceived as**

\(^{24}\)Lewis and Sappington (1997) and Szalay (2005) similarly observe the necessity of distorting the delegation set of alternatives, to induce agents to become informed about the best actions to implement.
less socially responsible: Firms that are advised by known strong advocates will be viewed as better corporate citizens, because their performance will be better on average.

4.2 Ideological advocacy

$F$ chooses an ideological advocate $E_I$ to advise him. The advocate is a known supporter of environmental intervention who derives surplus

$$E_I(e^*, e) = \lambda^I e - C^I,$$

equal to her utility $\lambda^I e$ from prescribing the action $e$ the firm adopts, minus $C^I$ the cost she expends to advise the firm. Importantly, $E_I$'s utility depends only on the level of action $e$ the firm implements, in contrast to the self-advocate $E_S$, who only derives utility from interventions she personally induces the firm to adopt. $E_I$'s preference is driven by her belief that corporate provision of environmental restoration is insufficient. As Heal (2005) and Conroy (2005) explain, ideological advocates tend to lobby for sustainable supply chains dedicated to reducing poverty and assisting impoverished suppliers of agricultural commodities and natural resource products.

We assume $F$ wishes to implement a different action for each state, $r(e^*) \in \{e_h, e_l\}$. $E_I$ is willing to provide recommendations for actions, provided she can increase the expected action the firm would adopt without her advice. In the absence of $E_I$, assume $F$ would search in-house and receive expected surplus equal to $F^S = R - C_v$. Taking $F^S$ as the firm's default option, $E_I$ proposes a delegation agreement to $F$ with the following provisions:

4.2.1 The Delegation agreement

**Stage 1:** $E_I$ privately observes the state $e^*$ at cost $c_s$. $E_I$ recommends action $r(e^*) \in \{e_h, e_l\}$.

**Stage 2:** If $E_I$ recommends $e_l$, it is approved without review. If $E_I$ recommends $e_h$, $F$ implements it, provided it is verified by his staff; otherwise, $F$ implements $e^*_I$ (the individually rational action given state $e^*_I$).\(^{26}\)

This agreement is similar to the agreement between $E_s$ and $F$ with a few exceptions. First, $F$ only agrees to this delegation if the expected surplus from delegating to $E_I$ exceeds

\(^{25}\)Because of the scarcity of ideological advocates, we're assuming $E_I$ has all of the bargaining power to propose a take-or-leave-it offer to the firm.

\(^{26}\)Recall, a recommendation is proven to be incorrect if $F$ provides evidence that the state differs from the advocate’s report. Hence if $E_I$ recommends $e_h$ and her recommendation is found to be incorrect, the firm selects the sequentially rational action $e^*_I$ corresponding to the optimal intervention.
the default option surplus, such that $F^{E_I} \geq F^S$. Second, no monetary transfer occurs from $E_I$ to $F$ because $E_I$ extracts all of the surplus from advising $F$.

### 4.2.2 Implementation

Implementing the desired actions at least cost requires the following incentive compatibility, obedience, and participation constraints are satisfied:

\begin{align*}
\lambda^I e_h &\geq \lambda^I e_l, \\
\lambda^I e_l &\geq \lambda^I e^*_l, \\
-c_s + \frac{\lambda^I (e_h + e_l)}{2} &\geq \max \left[ \lambda^I e_l, \frac{\lambda^I (e_h + e^*_l)}{2} \right], \\
\left[ \frac{P(e^*_h, e_h) + P(e^*_l, e_l)}{2} - I^I(e_h, e_l), \right] &\geq R - C_v.
\end{align*}

Regarding $(ICh)$, if $E_I^I$ observes $e^*_h$ and recommends $e_h$, she receives $\lambda^I e_h$ which should be greater than the utility $\lambda^I e_l$ she receives if she reports $e_l$.\footnote{Recall, if $E_I$ erroneously recommends $e_h$, she is awarded $e^*_l$ instead.} Regarding $(ICl)$, if $E_I^I$ observes $e^*_l$ and recommends $e_h$, her recommendation is rejected by $F$, leaving her with $\lambda^I e^*_l$, which should be less than $\lambda^I e_l$, the surplus she receives for truthfully recommending $e_l$. In addition, an obedience constraint exists for $E_I$ to satisfy, indicating $E_I^I$'s expected surplus generated from investing $c_s$ and recommending the appropriate action (the LHS of $(O)$) exceeds the expected surplus of recommending $e_l$ or $e_h$ without being informed (the RHS of $(O)$). The final constraint $(DO)$ requires that the firm weakly prefers to delegate to $E_I$ rather than search.

The constraints above determine the actions $\{e_h, e_l\}$ the advocate can implement. The advocate’s goal then is to

\[
\max_{\{e_h, e_l\}} \left\{ \lambda^I (e_h + e_l) - c_s \right\}
\]

s.t. $(ICh), (ICl), (O), \text{ and } (DO)$.

In what follows, we assume $E_I$ is strong in that her utility for the intervention $\lambda^I$ is sufficiently large. In that case, only the default option constraint $(DO)$ is binding in the problem above. Summarizing our arguments to this point, we have the following proposition that is proved in the appendix.

In what follows, we assume $E_I$ is strong in that her utility for the intervention $\lambda^I$ is sufficiently large. In that case, only the default option constraint $(DO)$ is binding in the problem above. Summarizing our arguments to this point, we have the following proposition that is proved in the appendix.
**PROPOSITION 4:** (Ideological Advocacy) Assume $E_I$ is strong so that $\lambda^I$ is sufficiently large. Then a delegation Agreement exists that implements uniformly higher-than-efficient actions

\[ e_h = e_h^* + \Delta, \quad e_I = e_I^* + \Delta. \]

The Agreement provides $F$ expected surplus

\[ F^{E_I} = \frac{P(e_h^*, e_h) + (Pe_h^*, e_h)}{2} - \frac{C_v}{2} = F^S, \]

that $F$ weakly prefers to searching.

**Proof:** See the appendix.

The intuition for this finding is that exchanging higher action for more information provides mutual gains when starting at the optimal intervention $e^*$. The firm is indifferent to increasing action whereas $E_I$ strictly prefers a higher action. This exchange is mutually beneficial; the firm avoids some costs of verification when $E_I$ observes $e_I^*$, whereas $E_I$ induces the firm to adopt higher actions in all states of the world.

**Implications for CSR:**

7. **Ideological advocates exert real influence over the firm by stipulating the set of actions it may implement:** Furthermore, $E_I$ prefers these actions because they are higher than the actions the firm would normally implement. Many corporations have adopted liberal allowances and compensation of upstream suppliers to satisfy best-practice sustainability standards because of this mutually beneficial exchange.

8. **Ideological advocacy is a pragmatic behavior for the policy advocate who is driven to support what she believes to be a worthwhile cause:** Cause-driven activists are becoming an increasingly important network to reward environmental responsibility and poverty reduction in developing countries. In practice, the $E_I$ combines performance evaluation and advice into one service by requiring the firm to adopt a higher (than satisficing) response based on the firm’s expected required intervention. The standards are set by a certification system that holds the firm to performance standards that are deemed appropriate by global certification agencies. These agencies, which include the Forest Stewardship Council and the Fair Trade certified system, evaluate and certify the performance of transnational corporations in the fields of natural resource commodities, who would otherwise escape recognition or scrutiny for their CSR performance.
4.3 Two-sided advocacy

Corporations frequently undertake several public-good investments. The typical Fortune 500 company will list CSR efforts across many different areas, acting as a steward for critical resources such as water and energy as well as an activist for distributive justice and the fair distribution of corporate surplus among its customers, employees, and investors. Some rationales for this behavior are that it enables the corporation to expand its CSR visibility, to diversify its social investment portfolio, and perhaps not as obvious, to reach out to different social cause advocates and stakeholders for advice and guidance.

To investigate the rationale for multi-sided advocacy, consider the firm that in addition to environmental restoration, decides to supply \( d \in \mathbb{R}_+ \) units of distributive justice. \( d \) provides for the redistribution of income between workers, suppliers, and consumers and a more equitable division of corporate surplus among social and corporate stakeholders. With two public goods, the CSR evaluation for reducing corporate societal conflicts now becomes a two-variable quadratic loss function of the form,

\[
P(d^*, e^*, d, e) = \bar{R}(d^*, e^*) - p[(d^* - d)^2 + (e^* - e)^2].
\]

Now advocates \( D_m, E_m \) exist for each intervention \( d \) and \( e \) and mode \( m = S \) (self), \( I \) (ideological) with identical preferences for their preferred intervention,

\[
D_m = \lambda d - C, \quad E_m = \lambda e - C, \quad \text{for } m = S, I
\]

The advocates are assumed to be strong, meaning their preference for intervening \( \lambda \) is sufficiently large that each is willing to advise the firm as the lone advocate under the agreements presented above in sections 4.1.2 and 4.2.2.

Initially, it is common knowledge that there are two optimal interventions for each cause, \( d^* \in \{d^*_h, d^*_l\} \) and \( e^* \in \{e^*_h, e^*_l\} \), that the high and low interventions for each cause are equal, \( (d^*_h = e^*_h, d^*_l = e^*_l) \), and that the joint distribution of optimal interventions is negatively correlated such that \( pr(d^*_h, e^*_l) = pr(d^*_l, e^*_h) = 1/2 \). Hence the sum of optimal interventions for each realization of states is a fixed amount to be divided between competing causes. We have constructed this special case to investigate whether employing rival advocates to advise the firm is effective.

\[28\] We are considering the interaction between rival advocates of the same mode \( m = S \) or \( I \) only. A possibly interesting extension, that we haven’t analyzed, is for advocates of different causes and different modes to advise the firm.
4.3.1 Information sharing between rival advocates

The interaction between opposing advocates is modeled as a two-stage process.

**Stage 1:** The firm stipulates four mechanisms in which each advocate may choose to participate

\[ M^{O_m}, M^{D_m}, M^{E_m}, M^{D_m,E_m}. \]

In mechanism, \( M^{0_m} \), neither advocate participates so that \( F \) searches in-house for the optimal interventions. For mechanism \( M^{D_m} \) and \( M^{E_m} \), the firm \( F \) is advised by one advocate \( D_m \) or \( E_m \), and the final mechanism \( M^{D_m,E_m} \) has both advocates advising the firm simultaneously. The expected surpluses of the advocates participating in the different mechanism are reported as their payoffs in a simultaneous-move participation game in Normal form below in Tables 1 and 2, respectively.

For instance, Table 1 depicts the participation game between ideological advocates \( D_I \) and \( E_I \). The advocates simultaneously decide whether to participate, \( P \), or not participate \( N \). If neither or both ideological advocates participate, they each receive the same payoff listed in the upper diagonal quadrant or lower diagonal quadrant, respectively. The off-diagonal quadrant lists the payoffs to both advocates when only one participates. In previous analyses leading up to this point, we have analyzed and computed the payoffs for all but the last mechanism, \( M^{D_m,E_m} \). The payoffs for that case suggest a mechanism \( M^{D_m,E_m} \) that implements the optimal interventions at minimal cost to the firm.

<table>
<thead>
<tr>
<th>( D_I/E_I )</th>
<th>( N )</th>
<th>( P )</th>
</tr>
</thead>
<tbody>
<tr>
<td>( N )</td>
<td>( \left[ \frac{\lambda(d_h^<em>+d_l^</em>)}{2} \right] ), ( \left[ \frac{\lambda(e_h^<em>+e_l^</em>)}{2} \right] )</td>
<td>( \frac{\lambda(d_h^<em>+d_l^</em>-2\Delta)}{2} ), ( \left[ \frac{\lambda(e_h^<em>+e_l^</em>+2\Delta)}{2} \right] )</td>
</tr>
<tr>
<td>( P )</td>
<td>( \left[ \frac{(\lambda(d_h^<em>+d_l^</em>+2\Delta)-2c_S)}{2} \right] ), ( \left[ \frac{\lambda(e_h^<em>+e_l^</em>+2\Delta)}{2} \right] )</td>
<td>( \frac{\lambda(d_h^<em>+d_l^</em>-c_S)}{2} ), ( \left[ \frac{\lambda(e_h^<em>+e_l^</em>)}{2} \right] )</td>
</tr>
</tbody>
</table>

**Table 1:** Participation of Ideological Advocates
Before proceeding to Stage 2 of the agreement, let us prove such a mechanism does exist. Consider the following mechanism $M^{D_m,E_m}$ intended to implement the optimal intervention at least cost to the firm:

<table>
<thead>
<tr>
<th>$D_S/E_S$</th>
<th>$N$</th>
<th>$P$</th>
</tr>
</thead>
<tbody>
<tr>
<td>$N$</td>
<td>[0], [0]</td>
<td>$[0], \left[ \frac{\lambda(e_h^<em>+e_l^</em>-2c_s-C^S)}{2} \right]$</td>
</tr>
<tr>
<td>$P$</td>
<td>$\left[ \frac{\lambda(d_h^<em>+d_l^</em>)-2c_s-C^S}{2} \right], [0]$</td>
<td>$\left[ \frac{\lambda(d_h^<em>+d_l^</em>)-c_s}{2} \right], \left[ \frac{\lambda(e_h^<em>+e_l^</em>)-c_s}{2} \right]$</td>
</tr>
</tbody>
</table>

**Table 2: Participation of Self-advocates**

Step 1: A random advocate, in this case $E_m$, is chosen to go first. $E_m$ observes $(d^*, e^*)$ at cost $c_s$ and recommends $r^E(\cdot, \cdot) \in \{(d_t^*, e_h^*), (d_h^*, e_l^*)\}$:

- if $r^E = (d_h^*, e_l^*)$, $F$ implements it and the delegation ends, and both advocates receive credit for their desired intervention.
- if $r^E = (d_t^*, e_h^*)$, $E_m$ shares her observation with $D_m$.  

Step 2: $D_m$ reviews $E_m$'s observation and decides to observe $(d^*, e^*)$ at cost $c_s$ or not, and then recommends $r^D(\cdot, \cdot) \in \{(d_t^*, e_h^*), (d_h^*, e_l^*)\}$:

- if $r^D = r^E$, $F$ implements it and both advocates receive credit.
- if $r^D \neq r^E$, $F$ observes $(d^*, e^*)$ and charges $2c_s + c_\varepsilon$, (where $c_\varepsilon > 0$) to the advocate who makes the wrong recommendation when $m = I$. Only the advocate with the correct recommendation receives credit for its intervention, when $m = S$.

In the appendix, we prove this mechanism implements the optimal interventions at no cost to the firm. Sketching the proof here to understand the advantage of relying on rival advocates for advice is instructive.

**Proof (sketch):** The mechanism $M^{D_m,E_m}$ provides for a sequential signaling game between advocates $E_m$ and $D_m$ and the firm $F$. In Step 1, $E_m$ decides whether to be informed or uninformed about the optimal intervention. $E_m$ prefers to be uninformed to avoid the cost of observation, but only if she can conceal her ignorance of the optimal

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Evidence consists of data and predictions that are sufficient for an advocate to establish the firm’s optimal intervention.

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29Evidence consists of data and predictions that are sufficient for an advocate to establish the firm’s optimal intervention.
intervention from $F$ and $D_m$. The mechanism forces $E_m$ to make the first recommendation, which induces her to observe the state to avoid a costly error. For instance, if $E_m$ recommends $(d_h^*, e_h^*)$ without observing the true state $(d_h^*, e_h^*)$, the game ends and $E_I$ ends up with $\lambda e_h^*$, her second-best outcome with probably one-half without knowing whether she could have attained a higher payoff of $\lambda e_h^*$. If $E_m$ recommends $(d_h^*, e_h^*)$ instead, she is expected to reveal her evidence to $D_m$ for a cross check. However, $E_m$ has no evidence to reveal. It’s easy to show that $D_m$ correctly infers that only an uninformed type would not submit evidence, implying that $E_m$’s recommendation can not be trusted. Consequently, $D_m$ observes the optimal intervention to cross check $E_m$’s recommendation and subsequently invalidates $E_m$’s report with probability one-half,\footnote{A uninformed recommendation will be incorrect 50% of the time.} which costs $2c_s + c_e$ for $E_I$ to validate and causes $E_s$ to lose credit for implementing $e_i^*$.\footnote{Recall a self advocate is not credited for advising the firm if her recommendation is invalidated by the firm.} As a result, $E_m$ chooses to be informed initially, where her best continuation play is to truthfully recommend the optimal intervention and to share her information with $D_m$; when required. In turn, $D_m$’s best Step 2 response is to confirm $E_m$’s recommendation when asked. These two strategies constitute the unique best-response equilibrium, thus proving that the mechanism implements the desired agreement at no cost to the firm.

**LEMMA 1:** The mechanism $M_{D_m,E_m}$ implements the optimal interventions at no cost to the firm.

We now proceed to Stage 2 to complete our argument.

**Stage 2:** The advocates simultaneously decide whether they wish to advise the firm or not under the conditions of the mechanisms $\{M_{O,m}, M_{D,m}, M_{E,m}, M_{D,m,E_m}\}$. The participation process is, as previously indicated, modeled as a simultaneous move game in Normal form, with the payoffs for each advocate mode, $I$ and $S$, appearing in Tables 1 and 2 respectively.

It is apparent that the unique equilibrium is $(P, P)$, both advocates participate, whenever $m = I$ or $S$. The ideological advocates game portrayed in Table 1, is a prisoner’s dilemma; both advocates prefer the no-participation outcome $(N, N)$, but participating is a preferred strategy for each advocate independent of the other’s strategy. As a result the advocates end up with their least preferred payoffs, as rivals for the firm’s attention. Similarly for the self-advocates case, participation is a dominate strategy, however, this leads the advocates to their jointly preferred outcome, $(P, P)$. Each advocate prefers the other advocate to participate in order to share the costs of observation.

**PROPOSITION 5:** (Two-Sided Advocacy) Suppose $D_m$ and $E_m$ are strong. Then
the two-step mechanism implements the efficient actions at least cost and provides the expected surpluses,

\[
D_m\left(M^{D_m,E_m}\right) = \frac{\lambda(d^*_h + d^*_l) - c_s}{2}
\]

\[
E_m\left(M^{D_m,E_m}\right) = \frac{\lambda(e^*_h + e^*_l) - c_s}{2}
\]

\[
F\left(M^{D_m,E_m}\right) = \bar{R}(d^*, e^*)
\]

**Implications for CSR:**

9. **Two sided advocacy offers two advantages to the firm implementing CSR:**

First, rival advocates can share the cost of gathering information when at least some correlation is present in the optimal interventions. (Although we’ve analyzed the negative correlation case, the same conclusion applies when positive correlation occurs.) Second, the rival advocates cross check each’s recommendations in order to protect their own interests. The threat that the firm will investigate different recommendations will dissuade either advocate from making false or uninformed recommendations. These advantages of employing multi-sided advocates might explain why several corporations, such as Goldman Sachs, state they work with numerous non-profit and academic partners across several issue domains.\(^{32}\)

## 5 Conclusion

We have sought to explain the CSR movement from the perspective of organization economics theory. Our theory posits that CSR requires collaboration and organized effort from various stakeholders affected by the operations of the company. Rating agencies play an important role in evaluating the outcome of CSR and disseminating the results to interested parties. The key challenge firms face concerns which CSR projects to select to maximize their ratings. Advocates, although biased, possess valuable information about projects. However, firms cannot trust that the advocates will provide accurate information, given their biases. To remedy this tension, the firm acquires costly expertise to provide an accurate assessment of projects. The process of organized advocacy then allows activists to suggest projects and the firm to verify them when necessary.

Our theory further predicts that which CSR activities can be implemented depends on the motives of the advocate and whether advocacy is one or two-sided. We further predict that the strongest advocates, those with the neccessary resources and preferences to search effectively, will be most influential on firm CSR. Those firms with the greatest

\(^{32}\)http://www.goldmansachs.com/citizenship/corporate-engagement/
demand for CSR and the required resources to evaluate advocate selections will partner with the strongest advocates.

Our theory provides a framework for understanding the emergence of CSR and the myriad of actors associated with these activities. It also explains why firms engage in CSR projects and what their goals are, an important issue in reconciling economic theory with this growing phenomenon. Nonetheless, our model of CSR is special in a number of regards. For instance, we restrict attention to instances in which the firm can instantly discriminate between reliable and unreliable recommendations. In many applications, however, firms lack expertise and gradually learn through trial and error. Recent work by Boleslavsky and Lewis (2013) may provide some insights into how firms delegate greater responsibility to advocates who show the precision of their predictions over time.

6 Appendix

6.1 Proof of Propositions 2 and 3

The solution to the firm’s optimal delegation problem,

\[ F^E_s = \max_{\{e_h, e_l, C_S \in [0, C_v]\}} \left[ \frac{P(e^*_h, e_h) + P(e^*_l, e_l)}{2} - \frac{C_v - C^S_v}{2} \right] \]  \hspace{1cm} (F^E_s)

s.t. \((ICh), (ICl)\) and \((O)\)

is most easily solved by finding the solution to the relaxed problem where only the obedience constraint is binding. In this case \((F^E_s)\) is transformed into finding the solution to

\[ L = \max_{\{e_h, e_l, C_S\}} \left[ \frac{P(e^*_h, e_h) + P(e^*_l, e_l)}{2} - \frac{C_v - C^S_v}{2} \right] + \mu_0 \left( -c_s + \frac{1}{2} \lambda^S(e_h - e_l) \right), \]  \hspace{1cm} (A1)

where we assume, for convenience, the binding obedience constraint is

\[-c_s + \frac{1}{2} \lambda^S(e_h - e_l) \geq 0 \]  \hspace{1cm} (O')

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A sufficient condition for \((O')\) to be the binding constraint is that \(e_h^*\) is not too large relative to \(e_l^*\). The first order conditions for the solution to \((A1)\) are,

\[
L_{e_h} = p(e_h^* - e_h) + \frac{\mu_0\lambda^S}{2} = 0 \quad \text{(A2a)} \\
L_{e_l} = p(e_l^* - e_l) - \frac{\mu_0\lambda^S}{2} = 0 \quad \text{(A2b)} \\
\mu_0 \geq 0, -c_s + \frac{1}{2}\left(\lambda^S(e_h - e_l)\right) \geq 0 \quad \text{(A2c)} \\
\mu_0 \left(-c_s + \frac{1}{2}\left(\lambda^S(e_h - e_l)\right)\right) = 0. \quad \text{(A2d)}
\]

Suppose \(\lambda^S \geq \frac{2c_s}{e_h^* - e_l^*}\). Then it’s easy to verify that \(\{e_h = e_h^*, e_l = e_l^*, C_v^S \in [0, C_V]\}\) solves \((A2a) - (A2d)\). Suppose \(\lambda^S < \frac{2c_s}{e_h^* - e_l^*}\) then it’s easy to verify there is a \(\Delta \in (0, e_l]\) such that \(\{e_h = e_h^* + \Delta, e_l = e_l^* - \Delta, C_v^S = 0\}\) is the solution to \((A2a) - (A2d)\) provided \(\lambda^S\) is sufficiently large such \(\lambda^S \in \left(\frac{\Delta}{e_h^* - e_l^*}\right)\). This confirms the results reported in Propositions 2 and 3.

### 6.2 Proof of Proposition 4

The solution to the advocate’s problem, assuming only the default option constraint is binding, can be written as

\[
L = \max_{\{e_h, e_l\}} \left[\frac{\lambda^I}{2} (e_h + e_l) - c_s\right] + \beta \left[\tilde{R} - \frac{p(e_h^* - e_h)^2}{2} + \frac{p(e_l^* - e_l)^2}{2} + \frac{C_v}{2} - [\tilde{R} - C_v]\right], \quad \text{(A3)}
\]

\(^{33}\)A sufficient condition for the obedience constraint to bind at \(-c_s + \frac{\lambda^I(e_h - e_l)}{2} = 0\) is that \(e_h^* \leq 2e_l^*\).
where \( \beta \geq 0 \) is the Lagrange multiplier attached to the \((DO)\) constraint in the text. The first order conditions for the solution to \((A3)\) are

\[
L_{e_h} = \frac{\lambda_I}{2} + \beta \left[ p(e_h^* - e_h) \right] = 0 \quad \text{(A3a)}
\]

\[
L_{e_l} = \frac{\lambda_I}{2} + \beta \left[ p(e_l^* - e_l) \right] = 0 \quad \text{(A3b)}
\]

\[
\beta \left[ \bar{R} - \frac{p(e_h^* - e_h)^2}{2} + \frac{p(e_l^* - e_l)^2}{2} + \frac{C_v}{2} - \frac{R - C_v}{2} \right] = 0 \quad \text{(A3c)}
\]

\[
\beta \geq 0, \left[ \bar{R} - \frac{p(e_h^* - e_h)^2}{2} + \frac{p(e_l^* - e_l)^2}{2} + \frac{C_v}{2} - \frac{R - C_v}{2} \right] \geq 0 \quad \text{(A3d)}
\]

It is easy to verify that there exists a \( \Delta = \left( \frac{C_v}{2p} \right)^5 \) such that \( \{e_h = e_h^* + \Delta, e_l = e_l^* + \Delta\} \) is the solution to \((A3a) - (A3d)\), thus confirming Proposition 4.

6.3 Proof of Lemma 1

For the mechanism \( M^{D_m,E_m} \) to implement the optimal interventions, it must be incentive compatible for the advocates to observe the optimal interventions and to make truthful recommendations. Working backwards from Step 2 of the mechanism, we require the following constraints to be satisfied:

(i) If \( E_m \) recommends \((d_l^*, e_h^*)\) and \( D_m \) observes \((d_l^*, e_h^*)\), \( D_m \) prefers verifying over contesting the recommendation because,

\[
\lambda d_l^* > \lambda d_l^* - (2c_a + c_e) \quad \text{for } m = I \quad \text{(ICh)}
\]

\[
\lambda d_l^* > 0 \quad \text{for } m = S.
\]

(ii) If \( E_m \) recommends \((d_l^*, e_h^*)\) and \( D_m \) observes \((d_h^*, e_l^*)\), \( D_m \) prefers contesting over verifying the recommendation, because

\[
\lambda d_h^* \geq \lambda d_l^* \quad \text{for } m = S, I \quad \text{(ICl)}
\]

(iii) If \( E_m \) recommends \((d_l^*, e_h^*)\) and \( D_m \) observes no evidence, we assume (and verify below) \( D_m \) infers \( E_m \) did not observe \((d^*, e^*)\). Hence, \( D^m \) infers that \( d = d_l^* \) and \( d = d_h^* \) with probability 1/2.
$D_m$ chooses between three options: (1) recommend $(d_h^*, e_1^*)$; (2) recommend $(d_l^*, e_h^*)$ or (3) observe $(d^*, e^*)$ at cost $c_s$ and recommend $r (d^*, e^*) \in \{(d_l^*, e_h^*), (d_h^*, e_l^*)\}$. The expected payoffs for $S$ and $I$ are respectively,

$$\text{max} \begin{bmatrix}
\frac{\lambda (d_h^*)}{2} \\
\text{Op(1): } r=(d_h^*, e_1^*) \\
\frac{\lambda d_l^*}{2} \\
\text{Op(2): } r=(d_l^*, e_h^*) \\
-c_s + \frac{\lambda (d_h^* + d_l^*)}{2} \\
\text{Op(3): Obedience}
\end{bmatrix}, \quad \text{max} \begin{bmatrix}
\frac{\lambda (d_h^*) - (2c_s + c_\varepsilon)}{2} \\
\text{Op(1): } r=(d_h^*, e_1^*) \\
\frac{\lambda d_l^*}{2} \\
\text{Op(2): } r=(d_l^*, e_h^*) \\
-c_s + \frac{\lambda (d_h^* + d_l^*)}{2} \\
\text{Op(3): Obedience}
\end{bmatrix}$$

It is easy to verify Option 3 (obedience) is the best option if $D_m$ is strong such that,

$$\lambda \geq \frac{2c_s}{(d_h^* - d_l^*)}$$

because, the expected surplus from the obedience option is greater than the expected surplus from options (1) and (2) for both advocate types,

$$-c_s + \frac{\lambda (d_h^* + d_l^*)}{2} \geq \text{max} \begin{bmatrix}
\frac{\lambda (d_h^*)}{2} \\
\text{Op(1): } r=(d_h^*, e_1^*) \\
\frac{\lambda (d_h^*) - (2c_s + c_\varepsilon)}{2} \\
\text{Op(1): } r=(d_h^*, e_1^*) \\
\frac{\lambda d_l^*}{2} \\
\text{Op(2): } r=(d_l^*, e_h^*) \\
\lambda d_l^* \\
\text{Op(2): } r=(d_l^*, e_h^*)
\end{bmatrix} \quad (O_D)$$

Summarizing, $D_m$’s surplus-maximizing strategy is to verify recommendations she observes and to investigate recommendations that she doesn’t observe.

Moving backwards to Step 1 assume $E_m$ expends $c_s$ to observe $(d^*, e^*)$.
(iv) If $E_m$ observes $(d^*_t, e^*_h)$, her best play is to recommend $(d^*_t, e^*_h)$ and share her evidence with $D_m$. $D_m$ will confirm the recommendation and $E_m$ will receive her maximum surplus of $\lambda e^*_h$.

(v) If $E_m$ observes $(d^*_t, e^*_h)$ her best play is to recommend $(d^*_t, e^*_h)$ and receive surplus $\lambda e^*_h$. Otherwise, if $E_m$ recommends $(d^*_t, e^*_h)$ and (i) she provides evidence of her observation to $D_m$ her recommendation will be denied, or (ii) she doesn’t provide evidence, $D_m$ will investigate her recommendation to show it should be denied.

Summarizing, whenever $E_m$ observes $(d^*, e^*)$, her best play is to recommend the optimal intervention and to provide evidence to $D_m$, if necessary. If $E_m$ recommends $(d^*_t, e^*_h)$ and doesn’t provide evidence, $D_m$ rationally infers $E_m$ has not observed $(d^*, e^*)$ and that $E_m$’s recommendation is uninformative. This validates our assumption above, that $D_m$ rationally infers that $E_m$ has not observed $(d^*, e^*)$ whenever $E_m$ does not present evidence.

(vi) If $E_m$ is obedient and expends $c_s$ to observe $(d^*, e^*)$, her expected surplus is given below by the lhs of $(OE_I)$ and $(OE_S)$ respectively for $m = I, S$. If $E_m$ does not observe $(d^*, e^*)$ her expected surplus is given by the rhs of $(OE_I)$ and $(OE_S)$ respectively for $m = I, S$.

\[-c_s + \frac{\lambda (e^*_h + e^*_l)}{2} \geq \max \left[ \lambda e^*_l, \frac{\lambda (e^*_h + e^*_l) - (2c_s + c_e)}{2} \right] \text{ for } m = I \quad (OE_I)\]

\[-c_s + \frac{\lambda (e^*_h + e^*_l)}{2} \geq \max \left[ \lambda e^*_l, \frac{\lambda e^*_h}{2} \right] \text{ for } m = S \quad (OE_S)\]

Mimicking the analysis behind $(OD)$, it is easy to verify that the obedience constraints $(OE_I)$ and $(OE_S)$ are satisfied if $E_m$ is strong such that

\[\lambda \geq \frac{2c_s}{e^*_h - e^*_l}\]

Summarizing, we find the unique equilibrium to the two-sided advocate game is for both advocates to act obediently. The mechanism $M^{D_m,E_m}$ implements the optimal interventions at no cost to the firm and it provides expected surpluses of

\[D_m(M^{D_m,E_m}) = \frac{\lambda(d^*_l + d^*_t) - c_s}{2}\]

\[E_m(M^{D_m,E_m}) = \frac{\lambda(e^*_h + e^*_l) - c_s}{2}\]

\[F(M^{D_m,E_m}) = \tilde{R}(d^*, e^*)\].
7 References

References


