The bottom-line benefits of being a socially responsible corporation

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The case for corporate social responsibility is no longer founded on gut feeling. It's a business imperative.

By Dan Keeler

Photo by Marc Schlossman /Stone

Corporate social responsibility (CSR) has been a buzz phrase for more than a decade now, and recent attention on corporate behavior has put the subject into still sharper focus. Few would dispute that making no effort to be socially responsible can backfire badly. But one question remains, perhaps the most important of all: Does it pay?

Increasingly, companies are including CSR statements in their annual reports. For the ones who approach it as a simple public relations exercise, it is mere window dressing. For others it is part of their commitment to "triple bottom-line" accounting, whereby they report not only their financial results but also their environmental and ethical performance. For many companies, however, CSR represents something they are pretty sure they should be involved in—if only they knew how.

Part of the reason for the diversity of attitudes toward CSR is that there is some confusion over the meaning of the phrase "socially responsible." Some believe it refers simply to corporate giving; others retreat into jargon and suggest companies fulfill their social responsibility by being "good global citizens." Steve Priest, founder of ethics and compliance consulting firm Ethical Leadership Group, believes CSR touches every aspect of a company's business: "A company is socially responsible if it takes seriously its obligations to all of its stakeholders. It's not about whether a company sponsors local events or environmental programs, or has a foundation that gives money to charitable causes. It's about developing a reputation of integrity so there is trust with employees, investors, customers, suppliers, and their communities."

So how do companies develop that reputation? One of the greatest problems facing companies that are interested in being more socially responsible is finding out what it involves. There are plenty of organizations ready to help, but each proposes a slightly different strategy (see box, page 25). Most agree on the key elements, however, and these boil down to simply being aware of your impact on the physical and the human environment.

It's All About the Numbers

Defining corporate social responsibility is one thing. Behaving in a socially responsible way and explaining the benefits to shareholders is another. To make life easier for companies looking to boost their social standing, *Global Finance* has compiled a list of key features of the socially responsible corporation and, perhaps more important, why they make bottom-line sense (see chart below).

Even the most ardent supporters of CSR will admit the financial advantages are hard to quantify, the beneficial results are not necessarily always visible, and they will almost certainly not be felt in the short term.

When asked to explain the hard, bottom-line benefits of CSR, its supporters draw parallels with the development of corporate environmental awareness. A decade ago the green lobby was struggling to prove that behaving responsibly toward the environment made good business sense. The link between a company's environmental awareness and its financial performance is now well established. For example, a study conducted by Washington, DC-based sustainability consultants ICF Kaiser found that companies with strong environmental management practices were rewarded with valuations up to 5% higher than comparable organizations that did not focus on their environmental impact. Acknowledged bottom-line benefits include a reduction of risk and reduced costs from energy use and resource wastage. There is also a public relations advantage that comes from being seen as a caring company, and the perception that the company must be well managed if it is concerned about its environmental impact. Acting in a socially responsible manner is generally acknowledged to produce similar benefits, but quantifying them is more difficult.

Chris Moon, director of corporate ethics consultant at CSR Global, based in the United Kingdom, has no doubts about the business benefits of CSR: "Acting responsibly [regarding social, ethical, and environmental issues] is in the interests of shareholders, enhances company reputation, and is indicative of good management."

For some companies, such as San Francisco-based cloth-

The three key elements of CSR

Responsible companies try to build awareness of their social impact into every level of their operations

Source: ARM

How to do it; why it pays: The *Global Finance* Guide to CSR

The Hard Work

Companies looking to establish a formal CSR policy will need to devise and communicate management's vision of a socially responsible company. Most definitions of CSR focus on three key areas:

Environment

Environmental issues include waste minimization, pollution prevention, and energy and water efficiency.

Workplaces

Maintaining healthy, safe workplaces and ensuring the welfare of employees is one of the most beneficial–and most often neglected–elements of CSR. Managers should concentrate on areas such as training, compensation, working conditions, and the balance between work and family. In hard times, a company's attitudes toward layoffs and downsizing can be important, too.

Community

Often a company's involvement in its community is presented as its commitment to CSR. That's important, but it is only one way of being socially responsible.

The Pay-Off

- Improved access to capital, particularly from socially conscious investors
- Reduced operational risk, which can also lead to lower bank loan rates
- Reduced insurance premiums
- Reduced overhead through becoming more eco-efficient
- Enhanced brand image and reputation
- Increased sales and customer loyalty
- Increased ability to attract and retain employees
- Better employee relations
- Increased productivity and quality
- Improved health and safety of employees
- Reduced regulatory oversight
- Due diligence requirements may be reduced as a result of better corporate governance
- Divestitures may be eased due to reduced perceived risk and improved governance
- Approval from media or activist groups

Sources: Canadian Conference Board; GoodCorporation; Business for Social Responsibility

Talking about a revolution: Many executives say they want to help, far fewer actually do anything

ing manufacturer Levi Strauss, this conviction is enough. "The benefit we get from being socially responsible is that people truly love the product, and they trust the company they buy it from," says Bill Chaisson, the company's CFO. Ethical Leadership Group's Priest concurs: "Loyal customers lead to better profits and, therefore, higher stock prices. Being socially responsible is one way of building loyalty."

Cambridge, England-based microprocessor designer ARM is also committed to being a socially responsible organization and is not overly concerned about quantifying the benefits. John Herring, ARM's CSR coordinator, admits, "In some respects being a socially responsible company is an act of faith."

Other companies, however, need more than pure faith to prompt a move toward being more actively socially responsible. It is this that is driving the search for proof that being socially responsible is indeed financially beneficial.

Hewson Baltzell, CEO of Innovest, New York-based firm that helps companies assess their eco-efficiency, is working to define measurable benefits from CSR. "We're trying to find the social issues that are business drivers," he says. "We believe that qualitatively you can show how issues like child labor will impact on, say, brand and image. Quantifying it is trickier."

Nick Wright, London-based head of corporate responsibility at investment bank UBS Warburg, believes the search is beginning to pay off, though: "Evidence does seem to be accumulating that there is a correlation between socially responsible companies and a good bottom-line performance. Whether there is a causal relationship is not yet clear," he says.

More Than Just a Financial Pay-Off

The continuing dearth of clear quantifiable evidence that social responsibility pays off in direct financial terms is frustrating for proponents of CSR. There are, however, plenty of other less tangible but still significant benefits. UBS Warburg's Wright believes the most significant relates to one of many businesses' most important resources: people. "People increasingly prefer to work for or do business with what is deemed to be a socially responsible company," he says.

Increasingly, companies are recognizing that their reputation plays a crucial role in attracting and retaining the right people. As Chaisson at Levi Strauss points out, "The fact that we have these responsible actions does attract employees."

Philipp Kauffmann, a partner at the Center for Innovative Leadership, based in Amsterdam, claims companies that do not act in a socially responsible way are finding they are unable to attract or to keep "high potential" individuals. The cost to the company, while hard to quantify, can be high. "If they lose individuals because of this, it is a tangible loss to the company," he says. According to Tom Manning, principal at Boston-based business performance consultants Pulse International, companies with a high service element to their business may find this has a direct and painful impact on the financial bottom line. "There is a strong cause and effect to very good employee retention and good customer satisfaction that emanates from a well-satisfied workforce," he says.

> **"Loyal customers lead to better profits and, therefore, higher stock prices. Being socially responsible is one way of building loyalty."**
>
> **STEVE PRIEST, ETHICAL LEADERSHIP GROUP**

According to Kauffmann, the flip side of the staff retention and motivation coin is productivity. "If people work in an environment that is aligned with their personal values, they will be more productive," he explains.

While that increased productivity feeds through directly to the financial bottom line, it can also affect investors' sentiment about the company. And that sentiment has a direct

Photo by John Riley/AP Photos


Companies that treat workers with respect are finding they gain more than just a clear conscience

impact on another factor that is crucial to the financial health of a corporation: access to capital.

Any companies that still consider social responsibility to be more a public relations issue than a core business issue need only look at the growth in socially responsible investing (SRI). As far back as 1999 SRI accounted for 13%, or $2.2 trillion, in assets under professional management in the United States. In North America as a whole, growth in SRI assets under management is 40% per year. Growth of all funds under professional management is just 15%.

In Europe, particularly in the United Kingdom, funds that focus on social responsibility are also growing rapidly (see chart, page 25). In an August 2001 analysis of the SRI market, UBS Warburg concluded that growth in ethical funds would "accelerate across Europe as financial services providers rush to capitalize on the latent demand."

With a large and growing pool of potential investment focused on socially responsible companies, it is hardly surprising that businesses are beginning to take notice, says Bill Russell, president of New York-based Ecos Technologies, which builds environmental management systems. "Almost every company I talk to makes a link between their efforts regarding CSR and the social investor communities," he comments. "Trying to attract the capital from those pools of money seems to be a real interest of all the companies now."

Investors in ethical funds are not motivated solely by a

♥ Can't justify an investment in CSR? Just imagine the cost of getting it wrong

In the mid-1990s, global sportswear manufacturer Nike was riding high. Its distinctive "Swoosh" logo was one of the world's most powerful and recognizable brands, and its marketing skills were considered second to none. Nike was the epitome of the modern business, universally recognized and widely respected.

And then? Well, then it turned out that some of its products were produced in sweatshops by workers who were paid a pittance and, sometimes, treated abysmally. Its hyper-recognizable brand suddenly began to get some very unwelcome attention.

Nike has been struggling ever since to recover. The company acknowledges the problems it has had and has made a determined effort to present itself as being caring and socially responsible. At a recent conference in New York, Maria Eitel, Nike's vice-president for corporate responsibility, asserted that corporate responsibility was woven into the fabric of the company. "Corporate responsibility ... is absolutely integral to who we are," she said.

Many people seem not to have noticed. The word "Nike" became synonymous with exploitation of workers in developing countries and is still often used as shorthand for the perceived ills of globalization. A simple search of recently published media articles mentioning "Nike" and "sweatshop" in the same breath turned up plenty of results. One writer in the sports pages of the United Kingdom's *Independent* newspaper pined for the days when soccer players "earned less than a seamstress in a Nike sweatshop."

Despite the assurances from its top brass that corporate responsibility is deeply ingrained in the company's collective consciousness, Nike still finds itself the focus of allegations that it is responsible for or associated with the maltreatment of workers in developing nations. A March 2002 report by the charity Oxfam, for example, claims Nike is still buying goods from factories that are effectively sweatshops. The report makes similar allegations against rival sportswear company Adidas, but it is Nike that suffered most attention as a result.

Regardless of the veracity of the allegations, Nike's experience shows that getting it wrong can be a very expensive mistake. It can take much longer to win back respect than to build it in the first place. And losing it takes but a moment.

Photo top: Jaime Puebla/AP Photos; bottom: Tina Fineberg/AP Photos

Risky business: Poor environmental management creates more than just a health hazard

Photo by Lenny Ignelzi/AP Photos

desire to do the right thing; they are betting that socially responsible funds will outperform their less discerning rivals. While long-term performance figures are hard to come by—the field is too new—recent reports suggest the investors may be right.

In its March 2002 report on sustainable development (SD) and socially responsible investing, the Conference Board of Canada (CBC) said there is "compelling recent evidence indicating that investment portfolios composed of companies committed to SD have, on the whole, generally matched or outperformed their benchmarks." Aggregating the conclusions of 18 separate reports on socially responsible investments, the CBC added, "SD practices have a positive impact on overall shareholder value and/or share price performance."

Such is the strength of the social investing market that even companies such as Phillip Morris are beginning to take notice. "We're conscious of the proliferation of social investing," says Tara Carraro, manager of corporate communications at Phillip Morris Management. While the company is well aware it would be unlikely to find itself in the portfolio of any existing socially responsible investment fund, it is looking at how it can improve its social credentials. "We are trying to listen and learn from other companies and from … those generally interested in CSR. For us, corporate social responsibility is important because it's about the public's expectations. It's also about good management of risks and opportunities, and assuring growth and building shareholder value in the long run."

> **"The whole question of sustainability is going to be the largest motor for innovation in the coming years."**
>
> **PHILIPP KAUFFMANN, CENTER FOR INNOVATIVE LEADERSHIP**

The nature of many of its products means Phillip Morris would fail most tests for ethical investment. But its interest in CSR reflects a growing tendency for investors to treat a company's attitude toward social responsibility as a yardstick for the quality of its management. Vicky Pryce, chairman of London-based GoodCorporation, which is creating a "kitemark" system for socially responsible companies, says: "Managing your business in a way that looks after your stakeholders means you have better management, greater transparency, and you are likely to survive longer. If you associate corporate social responsibility with running a sustainable business, then it makes sense to behave that way."

This link has not gone unnoticed by the investment banks, either. UBS Warburg's Wright describes his bank's interest in its clients' social behavior as a risk management tool: "Because people have found this correlation between companies that have a CSR program and their performance … it's an indicator of good management. It tells you that management is keeping an eye on things out there."

UBS Warburg is certainly not alone in this approach. Financial institutions themselves are under pressure to show they are looking at social factors when they select their investments. And they are recognizing the role they can play in promoting socially responsible behavior. Many observers believe the institutions could prove to be the crucial lever that shifts corporate social responsibility into the mainstream. As institutions buy into companies because they are corporately responsible, it induces companies to behave in that way because otherwise their shares will be out of favor with institutions and, ultimately, the market.

In the United Kingdom this process has been boosted by recent legislation. While they are under no obligation to direct their investments to socially responsible companies, UK pension fund managers have to state whether they considered environmental, ethical, and social issues when making their investment decisions. At the very least, the legislation has brought the issue of social investing to the attention of investors and institutions alike.

Some believe it has been highly effective. Herring at ARM says his company's initial focus on CSR as an issue was triggered by messages from shareholders prompted by their need to assess their own investments."The change in [pensions fund] legislation raised the debate," he says.

Capitalism Redefined

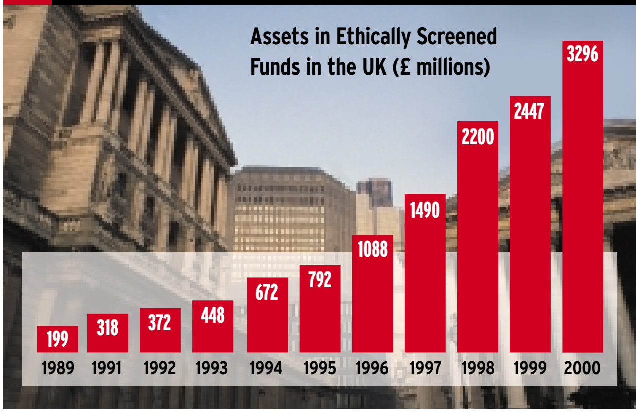
In Europe legislative and regulatory pressure is stronger than in the United States. But, says Priest at Ethical Leadership Group, companies in the States have plenty of incentive to look into their own social behavior."Europe is far ahead in terms of institutionalizing corporate responsibility legislatively. In the United States, however, there will be a lot of attempts to address corporate governance in a much narrower sense. Competitive pressure will drive it."

His belief is backed up by consultant PricewaterhouseCoopers' most recent annual Global CEO Survey, which interviewed chief executives from Europe, Asia, and the Americas. More than two-thirds of the 1,161 respondents said corporate social responsibility was vital to the profitability of any company. Revealing a stark disparity between words and action, though, only 24% of the CEOs currently report publicly on their corporate social responsibility issues.

Part of the problem harks back to the confusion over what is genuinely socially responsible corporate behavior. As Priest notes:"Almost every CEO I talk to will say they are socially responsible. But most of them would not want to get up at a shareholders' meeting and make that a central part of their presentation, because they have some discomfort that it can be proven."

With countless consultants and pressure groups working to prove the link between CSR and corporate financial health, though, those CEOs may well be able to be more outspoken about their commitments. John Ganzi, executive director at the Finance Institute for Global

A force to be reckoned with



Source: EIRIS

Sustainability, is convinced the answer is near."Eventually someone is going to come up with metrics and variables that can be quantified. Then we'll be able to assess what makes bottom-line sense and what doesn't," he asserts.

As with so many developments in business, waiting on the sidelines for the parameters to become clearer may no longer be an option. According to Kauffmann at the Center for Innovative Leadership, CSR will redefine the prevailing business model:"The whole question of sustainability, both social and environmental, is going to be the largest motor for innovation in the coming years. It is about taking capitalism seriously by valuing the capital that is fundamental to productivity—natural and human resources."

Ultimately, though, it may be competitive pressure that drives the growth of socially responsible capitalism. It will be less a question of what companies will gain by being responsible but what they will lose if they are not. ■

Dan Keeler is managing editor of *Global Finance.*
Email: *dkeeler@gfmag.com*

Making sense of CSR: Where to find help

Even finding agreement on what is acceptable social behavior can be difficult. A prime example of the sort of moral dilemma faced by companies attempting to adopt CSR is the issue of child labor. Innovest's Baltzell spells out the ethical conundrum: "Is it bad to have children making your products, but not bad to have children not going to school and not working so they have no money anyway?" Baltzell believes the visibility of such issues will lead to a consensus developing. "Increasingly, companies are saying, 'We don't want to use slave labor, so if we are going to have people in emerging markets producing our products, we want to be doing it in a way that pays a fair wage.'"

Confusion over the nature of social responsibility may be the prime reason for companies holding off declaring their intention to adopt CSR. Fortunately, there are a number of organizations committed to promoting CSR. Companies looking to become more responsible, or to publicize the fact that they are already, will find a wealth of resources available to help. A few of them are listed here.

Organizations That Can Help

GoodCorporation
■ www.goodcorporation.com

The Institute of Business Ethics
■ www.ibe.org.uk

Finance Institute for Global Sustainability
■ www.figsnet.org

Global Reporting Initiative
■ www.globalreporting.org

Business for Social Responsibility
■ www.bsr.org

Conference Board of Canada
■ www.conferenceboard.ca

Photo by Andrew Ward