



The Business
Case for



Corporate
Responsibility

**The Business Case for
Corporate Responsibility**

Arthur D Little

BUSINESS *in the*

COMMUNITY

Foreward

We live in an increasingly complex and sceptical world. Corporate scandals, stock market downturn, uncertain economy, threat of terrorism – all have diminished trust in the corporate sector and its leaders. Companies have to address this, individually by demonstrating their positive impact on society and collectively by developing comparative meaningful measures by which to report their progress against. Corporate Responsibility is not a fad, but an imperative. Yet even as it becomes more mainstream, stakeholders are becoming more critical, and the standards for meaningful social interaction are rising.

Business in the Community has been in existence for 21 years, but the need for it has never been greater. The need to inspire and engage more companies and the importance of sharing best practice and learning has never been more vital. Therefore, I welcome the opportunity for this joint publication with Arthur D. Little and the simplicity with which it sets out the compelling arguments for companies, large and small, to integrate responsible business practices into the very heart of their operations.

In the coming year Business in the Community will use this document and work more intensely to ensure the accurate reporting of corporate impact on society, without which there cannot be sympathetic consideration of the real challenges and dilemmas companies face.

David Varney

Chairman, Business in the Community and mmO₂

Introduction

Companies that embrace Corporate Responsibility recognise that their social and environmental impacts have to be managed in just the same way as their economic or commercial performance. But getting started, putting Corporate Responsibility principles into practice, can be difficult and many companies struggle to justify the management of social and environmental affairs in terms of tangible business benefit.

Corporate Responsibility should be seen as a journey rather than a destination, and as society's expectations of business continue to get more demanding, the sooner companies start out the better. In recent years much has been written about the subject and the business imperatives¹. There are six commonly recognised benefits that can be gained from an effective business-led approach:

- Reputation management
- Risk management
- Employee satisfaction
- Innovation and learning
- Access to capital
- Financial performance

This paper provides a simple guide to understanding how these benefits can be realised.



Reputation management

Key messages

- 44% of the British public believe it is very important that a company shows a high degree of social responsibility when they buy the company's product.
- 58% of the general public across Europe feel that industry and commerce do not currently pay enough attention to their social and environmental responsibilities².
- Corporate Responsibility offers a means by which companies can manage and influence the attitudes and perceptions of their stakeholders.

The success of every business is dependent upon its relationship with its stakeholders, not least its customers. Enhancing the relationship a company has with its stakeholders increases the potential support that each group has for the company and its strategic objectives (Figure 1). It is through this relationship that a company creates value.

Figure 1: Managing the benefits of corporate reputation



Source: Adapted from Fombrun et al (2000)³

Customers are voting with their wallets when it comes to Corporate Responsibility. In 1998, 28% of the British public believed that when buying a company's product it was very important that the company showed a high degree of social responsibility; by 2002 this had risen to 44%⁴. 86% of consumers have a more positive image of a company that is seen to be doing something to make the world a better place⁵ and a company's responsibilities to society, environmental and labour practices are all seen by the public across 20 countries as more important than its economic contribution⁶.

Unfortunately, distrust among stakeholders, particularly consumers of the adequacy with which companies are addressing their corporate responsibilities is rising. Recent evidence suggests that business leaders are one of the least trusted professional groups to tell the truth. 62% of British adults do not trust business leaders⁷ and 48% of the global public have little or no trust in large companies⁸.

This is alarming since a company's reputation is one of its most valuable assets, topping the intangible asset list of most Chief Executive Offices⁹. For example, it is estimated that 96% of Coca Cola's value comprises intangibles, reputation, knowledge and brand. For Kellogg's this equals 97% and for American Express 84%¹⁰.

BT plc believes that the reputation it has gained as a result of its Corporate Responsibility activities is maintaining and building its market share in a competitive market. It estimates that corporate (social) responsibility accounts for over 25% of image and reputation impact on customer satisfaction¹¹.

*"He that filches from me
my good name ...
makes me poor indeed"*

William Shakespeare



An increasingly common response by companies to the concerns of their stakeholders is to publish their information on their social and environmental performance. 87% of the British public say they would expect to see a copy of any social or partnership report if they were a shareholder, 44% say they would not expect to see one as a customer, but it would improve their perception of the organisation¹².

More than half the top 250 companies now produce reports on environmental, social or ethical performance, demonstrating that non-financial disclosure to external stakeholders has become mainstream¹³.

Corporate Responsibility offers a means by which companies can manage and influence the attitudes and perceptions of their stakeholders, building their trust and enabling the benefits of positive relationships to deliver business advantage.

“Corporate reputations are fragile animals if internal behaviours and values are not explicit, recognised and lived”

John M Sunderland
Chief Executive Officer
Cadbury Schweppes plc

Case study 1: Friends Provident

Friends Provident's Quaker origins have placed ethics at the heart of its business for 170 years and provide the basis for their longstanding commitment to social responsibility. In order to maintain this strong reputation for social responsibility the company has developed a Statement of Business Principles in conjunction with its stakeholders which sets out its core values and responsibilities. To demonstrate that it is fulfilling these commitments Friends Provident is reporting on its social and environmental performance through a dedicated Corporate Social Responsibility Centre¹⁴.

“The public put great emphasis on integrity, so name and reputation are critical to selling business. Therefore Corporate Responsibility, which impacts on name and reputation, is an important differentiator. This is especially true when you are selling long term intangible products such as pensions and life assurance. People cannot ‘test’ or ‘try’ these products, instead they must trust the seller to deliver.”

Ashley Taylor, Manager, Corporate Responsibility and Governance
Friends Provident



Risk management

Key messages

- There is growing pressure for companies to understand and act on a widening range of risks across their business.
- Corporate Responsibility provides a means by which companies better understand and manage risk.
- The effective management of social and environmental risks presents business opportunities.

Corporate Responsibility provides a means by which companies better understand and manage risk. All businesses take risks and make judgements about the level of risk that is appropriate. Many corporations are broadening their definition of risk to encompass wider and longer term risks that incorporate social and environmental issues. In addition, they are engaging with a wider external audience to understand needs and expectations and take action where appropriate.

There is growing pressure for companies to understand and act on a widening range of risks across their business. Over the last few years, there have been a number of guidelines and initiatives to encourage business to manage risks across their business. Examples of these are presented in Table 1 (see below). In particular the Operating and Financial Review (OFR) will have a significant impact in the way companies report on the social and environmental risks to their business.

“By focussing on CSR we can better improve our processes for identifying and managing business risk”

Michael Bailey
Chief Executive Officer
Compass Group plc

Table 1: Examples of guidelines to encourage improved risk management

| Guidance | Year | Sponsor | Detail |
|--|------|----------------------------------|---|
| Operating and Financial Review | 2003 | Department of Trade and Industry | Principles and guidance on how Directors of companies over a certain size should report on issues that are material to shareholder interests, including the company's impact on the environment and wider community. |
| ABI disclosure guidelines on Socially Responsible Investment (SRI) | 2002 | Association of British Insurers | Guidelines on disclosures on environmental, social and ethical matters in company annual reports, including whether or not the company's board has effective systems for managing significant risks. |
| Internal Control: Guidance for Directors on the Combined Code of Corporate Governance (Turnbull) | 2001 | Department of Trade and Industry | Provides guidance on the implementation of the Internal Control Requirements of the Combined Code on Corporate Governance. It requires companies to identify, evaluate and manage their significant risks and to assess the effectiveness of their internal control systems. It includes direct reference to risks related to health and safety, environmental and reputational issues. |

86% of institutional investors across Europe believe that social and environmental risk management will have a significantly positive impact on a company's long term market value¹⁶.

However, a recent survey suggests that, despite many companies understanding the reputational issues associated with sustainability, less than one third of respondents are currently incorporating risks or opportunities associated with sustainability into their internal risk assessment process or business strategies¹⁷.

Corporate Responsibility offers more effective management of risk, helping companies to reduce avoidable losses, identify new emerging issues and use positions of leadership as a means to gain competitive advantage by influencing new regulation to strengthen competitive advantage¹⁸.



Employee satisfaction

Key messages

- Three in five people want to work for a company whose values are consistent with their own¹⁹.
- There is increasing evidence that the proportion of people wanting to work for a responsible organisation is growing.
- 81% of young people have a strong belief in the power of responsible business practice to improve profitability over time.
- Corporate Responsibility is increasingly the key factor in attracting and retaining a talented and diverse workforce.

"We believe that our employees are one of our strongest assets and by giving them the opportunity to do what they do best everyday our employees feel engaged and fulfilled in their roles. Our vision is to create an environment where great people can do their best work and realise their potential"

Stephen Harvey
Director of People and Culture
Microsoft Ltd.

"A new breed of job seeker is placing ethical issues above financial incentives when considering a job offer. Future job packages need to reflect this new found ethical consciousness among job seekers if companies are to maintain their appeal"

Keith Robinson
Website Director
totaljobs.com

Businesses are run by people for people. As Zadek has commented "they are no more or less than a human intervention for making things out of other things and getting them into use"²⁰. Business is dependent on its employees in its operations, on its relationships with other stakeholders and on the delivery and creation of value. It is not possible to separate employees from a business, they are the business. Understanding and aligning their values with that of the business is critical for business success.

In the UK, the average employee is at work almost two-thirds of all the days in a year. Employment is a significant part of people's lives. Just as people develop and pursue things important to them outside the workplace, they expect to be able to flourish as individuals within the workplace. People want to work for a responsible organisation²². Recent evidence suggests that three in five people want to work for a company whose values are consistent with their own¹⁹ and they will stay with the organisation whilst this consistency remains. The challenge is that companies are not seen to respond to these demands as employees expectation's rise²².

BUPA have reported that engaged, motivated and inspired employees are key to business success. In 1999, they launched "Taking Care of Lives in our Hands" integrating values through the business. This initiative help boost employee satisfaction (up by 20%) and their business turnover (up by 32%)²².

Corporate Responsibility is increasingly the overriding factor in attracting and retaining a talented and diverse workforce.

Case study 2: Centrica

British Gas' National Sales Centre (NSC) is based in Cardiff, South Wales. It employs 2,700 people and is responsible for handling all of the company's domestic gas, electricity and telephone sales enquiries. As Cardiff is a popular location for call centres, employee retention is a real issue. British Gas developed its employee community involvement programme in 2000 as a means of creating a degree of differentiation and improving retention.

After over 1,000 hours of employee time in the community, thorough evaluation was conducted showing:

- Higher Retention rates for individuals who volunteered.
- Improved rating as an "above average" place to work - to 63%.
- Increased job satisfaction levels - to 67%.
- Increased advocacy rates - from 49 to 57% who would speak highly of the company.
- 28% of Action Day participants achieved promotion.
- Increased positive media coverage - 4.3 million media "opportunities to see" generated.
- Absenteeism significantly reduced.
- Improved customer satisfaction ratings: two points above the stretch target²³.



Innovation and learning

Key messages

- Innovation and learning are critical to the long term survival of any business.
- Environmental constraints and societal pressure are narrowing the window of opportunity for business.
- Leaders in Corporate Responsibility are using innovation and learning as a vehicle to turn these constraints into significant business opportunity.

In 1983, a Royal Dutch/Shell survey found that one third of the firms in the Fortune 500 in 1970 had vanished. Shell estimated that the average lifetime of the largest industrial enterprises is less than forty years, roughly half the lifetime of a human being²⁴.

Peter Senge, founder of the Centre for Organisational Learning at Massachusetts Institute of Technology's Sloan School of Management asserts that although the death of these firms may be attributed to economic change and redistribution of resources, high corporate mortality is a symptom of deeper problems that afflict all companies that most organisations learn poorly²⁵.

Recent evidence suggests that companies embracing Corporate Responsibility stimulates creativity and learning. 80% of European business leaders believed that responsible business practice allowed companies to invigorate creativity and learn about the marketplace²². Furthermore, over four in five of both employees and CEOs believe responsible organisations are more creative²⁶.

The long term survival of organisations is also dependent upon their ability to understand and act on societal and technological change. Joseph Schumpeter, one of the greatest 20th century economists, coined the term "creative destruction" to describe the dynamic pattern where innovation upstarts unseat established firms²⁷. During periods of dramatic change, incumbent firms²⁷ are unsuccessful in building the capabilities needed to secure a position in the new competitive landscape²⁸.

Hart and Milstein from the University of North Carolina, suggest that dramatic change in the way business operates is inevitable given the significant social and environmental problems facing the planet. They argue that these problems present innovators and entrepreneurs a significant business opportunity²⁸.

The benefits of innovation should not be constrained by the boundaries of the organisation. Many organisations are co-innovating with business partners to identify new approaches that deliver business benefits whilst tackling a social or environmental issue. For example, Nike has programmes in place with six of its material suppliers to collect 100% of their scrap and recycle it into the next round of products, reducing production costs and waste²⁹.

Corporate Responsibility stimulates learning and innovation within organisations helping to identify new market opportunities, establish more efficient business processes and to maintain competitiveness.

Case study 3: The Beacon Press

The Beacon Press' commitment to innovation has made it one of the leading UK printing companies. Their strong commitment to the environment has enabled them to push the boundaries of technology and has demonstrated that new standards of quality can be achieved through environmental best practice. Beacon was one of the first companies to convert to waterless printing having introduced waterless presses when existing machines were due for replacement. The extra capital expenditure incurred to purchase the waterless technology has been offset by reductions in operating costs. Beacon Press' leadership in environmental performance has made them a preferred supplier to other companies waking up to greening their supply chain. Beacon Press now have 1 in 10 of the FTSE350 companies as customers³⁰, they were winners of Business in the Community's Environment Award for Excellence in 2002 and won the Queen's Award for Sustainable Development in 2003.



Access to capital

Key messages

- Corporate Responsibility is a key factor in helping companies access capital.
- 86% of institutional investors across Europe believe that social and environmental risk management will have a significantly positive impact on a company's long-term market value³¹.
- The investment community is increasingly regarding Corporate Responsibility as a proxy of the 'quality of management' of a company.

Corporate Responsibility is a key factor in helping companies access capital:

- Investors are increasingly considering a company's social and environmental performance. Over half of analysts and two thirds of investors now believe a company that emphasises its performance in this area is attractive to investors³².
- Private equity investors are developing tools to identify social and environmental risks in potential investments and are using Corporate Responsibility as a vehicle to leverage finance.
- Banks are developing more effective means to understand social and environmental risks when lending, underwriting or financing projects and implementing social and environmental management systems into decision making particularly to manage their own reputation.
- Public sector lenders are developing increasingly sophisticated measures to reduce risk exposure, particularly in developing countries. Almost all major public sector multilateral financial institutions³³ are implementing environmental criteria in their loans or investment projects in the developing world³⁴.
- General and life insurers are integrating social and environmental factors into their premium calculations.

The message is clear. If you want access to cash, Corporate Responsibility is key.

Traditionally, investors have been portrayed as having little interest in the non-financial aspects of business management. Today, the investment community are more likely to regard Corporate Responsibility as a proxy of the "quality of management" of a company³⁵ and as evidence of the link between good corporate citizenship and good financial performance mounts, few investors can afford to ignore this aspect of business behaviour.

An increasing number of investment funds are now managed according to the principles of SRI, with portfolio managers either screening out businesses that do not meet high environmental or social standards or using their influence to improve the ethical performance of these companies. 33% of institutional investors across Europe claim to offer SRI products, with a further 15% planning to³⁶.

In the US, there were \$2.34 trillion of SRI funds under management in 2001³⁷, approximately one of every eight dollars under professional investment. In Europe, £12.2 billion has been invested in the SRI retail market and £336 billion in the SRI institutional market³⁸.

These issues are not limited to the SRI community, 33% of mainstream analysts say environmental factors are important in their evaluation of companies, compared to only 20% in 1994. The figures for social issues have increased by an even wider margin, from 12% to 34%³⁹.

Although the original driver for SRI may have been individual investors voicing concern over where their money was being invested, there is evidence that investing in companies who are managing their corporate responsibilities offers better long term returns. A recent review of the Dow Jones Sustainability Indexes (DJSI)⁴⁰ suggests that between 2002 and 2003, the DJSI outperformed the mainstream market. During this period, the DJSI World (in USD) increased by 23.1% while the Dow Jones World Index (in USD) went up by 22.7% and the MSCI⁴¹ World (in USD) rose by 21.2%⁴².

Corporate Responsibility facilitates access to capital. Companies seeking finance for new ventures or to attract the investment should see Corporate Responsibility as an opportunity to widen their access to capital.

"SRI has increased by over 1000 per cent in the last four years"

Mark Makepeace
Chief Executive
FTSE Group



Financial performance

Key messages

- Corporate Responsibility builds competitiveness and is vital to profitability.
- Over half of Chief Executives across Europe (and 4 in 5 in the UK) argue that the business benefits of Corporate Responsibility are not exaggerated, and 92% accept it is their responsibility to drive this through the business⁴³.
- Having a core purpose beyond making money can help to achieve long term financial performance.
- Corporate Responsibility offers direct improvements to the bottom line.

In *Built to Last*, Collins and Porras compared 18 companies that had been operating successfully for at least 50 years with 18 of their direct peers, all of which had been well-known and relatively successful at certain points in their history. Collins and Porras found that a key characteristic in distinguishing the so-called “visionary” companies from their peers was having a core purpose beyond making money. Being clear about this purpose helped “visionary” companies achieve far greater long term financial performance than their peers. One dollar invested in 1926 in a fund comprised of “visionary” companies would have grown to \$6,356 by 1990, compared to \$955 for a dollar invested in the comparison group⁴⁴.

Recent research supports Collins and Porras’ findings. The Institute of Business Ethics published a study of FTSE 250 companies showing that those with an ethical code in place for over five years outperformed the average on economic and market value-added⁴⁵. For 79% of fund managers and analysts surveyed in 2003, the management of social and environmental risks has a positive impact on a company’s market value in the long term⁴⁶.

78% of senior business leaders across Europe believe that only by fully integrating responsible business practice will companies be more competitive⁴⁷ and nearly 70% of CEOs say that Corporate Responsibility is “vital” to profitability. Even in the current economic climate, it will remain a high priority for 60 percent of CEOs globally⁴⁸.

Corporate Responsibility can also lead to direct improvements on the bottom line. Anticipating and lobbying impending legislation can reduce future costs of compliance, understanding how your company uses materials, manages energy and waste can reduce operational costs and integrating environmental specifications into new assets can reduce lifecycle costs and improve efficiency.

Corporate Responsibility opens opportunities to reduce present and future costs to the business and it serves to improve competitiveness, market positioning and profitability.

Case study 4: Novo Nordisk Eco-efficiency in design and construction

In the pharmaceutical industry time-to-market is a critical factor. As a result, Novo Nordisk needed to develop a fast track approach to design and construction of production facilities. This involved the use of pre-assembled modules that are not necessarily the most resource-efficient. A new procedure was introduced in 2002 to ensure environmentally sound project design in construction, extension and conversion of production plants. The procedure was tested on a new plant in Denmark resulting in energy and water-saving measures in the design of up to 45%. The extra cost was less than 1% of the total investment with a payback of just over a year. The programme reduced operating costs by \$1million, making it an attractive return on investment⁴⁹.



Conclusion

Companies that embrace Corporate Responsibility can open doors on new markets, new opportunities and new relationships, set the scene for long term profitability and increase the competitiveness of the communities in which they operate. Conversely, companies that fail to manage their responsibilities to society as a whole risk losing their so-called Licence to Operate – the unwritten authority to do business that is granted by a company's stakeholders at large.

Stakeholder views, and their expectations of corporate behaviour, are shaped by what they see happening in the world around them. And with today's communication networks, the world extends from the local neighbourhood to the planet as a whole.

Examples of global challenges

Our society is facing a unique set of global challenges. For example:

- 78% of the world's population remain poor⁵⁰ and many are unable to meet their most basic needs.
- 28% of the world's children under five years old are still severely or moderately undernourished⁵¹.
- Air pollution is estimated to cause five per cent of the world's deaths each year⁵².
- The 1990s were the warmest decade and 1998 the warmest year on record.
- The second hottest year on record after 1998, was 2002.
- In the 1990's approximately 2% of the world's forests were lost⁵³.
- It is estimated that about 10% of all known plant species are under threat of extinction as a result of our activities⁵³.

The role of business in providing the wherewithal to tackle these global challenges was highlighted by Kofi Annan at the World Summit on Sustainable Development in Johannesburg in September 2002. He told the business community directly that they have the finance, the resources and the technology to bring about the changes that are needed to address the world's major social and environmental problems. The rationale for Kofi Annan's statement is very clear. Business is the primary source of investment in productive capacity and main employer in most societies.

But, Corporate Responsibility is not restricted to big business. Companies of all sizes can benefit, as responsible suppliers to corporate customers, by reducing risks, in attracting and retaining talented staff, through the exploitation of new markets for responsible products and services, in meeting responsibility criteria set by lenders and last but not least by reducing operating cost.

Many companies are already leading the way, driven by their belief that Corporate Responsibility is essential to their business. Although visionary leadership and the values of individuals in many companies are proving instrumental in bringing about greater responsible business practice⁵⁴, the business case for this action is compelling.



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www.weforum.org/corporatecitizenship

About Arthur D. Little

Arthur D. Little is a global management, technology and environmental consulting group serving major public and private sector clients. We are one of the world's premier consulting firms, with more than 1,000 staff members based in around 40 offices around the world.

In the UK we employ some 100 consulting staff in our offices in London and Cambridge. We provide a full range of management consulting services to the UK market and overseas through our global Practices. At our Cambridge base we can provide some 50 environmental, safety and risk specialists. With a track record of over 30 years, we work with companies and governments to help them deal with the most difficult environmental, social and safety risk problems, and in so doing move further along the path to sustainable development. We help companies manage their environmental, health, and safety risks effectively to maintain their licence to operate and meet the needs of their business in a sustainable and responsible manner. Our staff are specialists in applying technical expertise and industry knowledge with a broad business perspective.

About Business in the Community

Business in the Community is a unique movement in the UK of over 700 member companies, with a further 1600 participating in our programmes and campaigns. We operate through a network of 88 local business-led partnerships, as well as working with 45 global partners.

Our purpose is to inspire, challenge, engage and support business in continually improving its positive impact on society.

Members of Business in the Community commit to action and to the continual improvement of their company's impact on society.

Our members commit to:

Integrate, manage and measure responsible business practice throughout their business
Impact through collaborative action to tackle disadvantage
Inspire, innovate and lead by sharing learning and experience

Business in the Community works globally through its partnership with the International Business Leaders Forum. We work across the European Union as a partner of CSR Europe and as the co-ordinator of the Cecile Network.

Together our member companies employ over 15.7 million people in over 200 countries worldwide. In the UK our members employ over 1 in 5 of the private sector workforce.

For information on Business in the Community visit www.bitc.org.uk