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Think responsibly

In the world of free market, profit-driven capitalism, does it pay to be good? The real question these days, **Charlie Nelson** argues, is can businesses really afford not to embrace corporate social responsibility?

Companies have traditionally made the raw pursuit of profit their overriding focus, but as shareholders have been joined by a multitude of other stakeholders over the past two decades, so the need has arisen for many companies to seriously consider how positively their overall impact on society is perceived in the marketplace. Indeed, business managers have often been advised that making profits already serves the public good, so the very notion of corporate social responsibility (CSR) is ultimately a diversion.

And the case against CSR has some well-known advocates. In 1970, Nobel Prize-winning economics professor Milton Friedman wrote in a *New York Times* magazine article that the only social responsibility of business is to increase its profits – that if a corporation makes a contribution to the community, it prevents the individual stockholder from deciding how to use that money.

But this free market thinking does not allow for the possibility that engagement in CSR could actually increase profits. Nor does it allow for the possibility that a better social outcome could be achieved by leveraging a business

> “This free market thinking does not allow for the possibility that engagement in CSR could actually increase profits.”

competency than could be achieved by shareholders acting individually.

Twenty-five years later and the CSR sceptics were still at it. Friedman's line of thinking was echoed by *The Economist* in January 2005 when its leader article on the subject argued: "Managers, acting in their professional capacity, ought not to concern themselves with the public good: they are not competent to do it, they lack the democratic credentials for it, and their day jobs should leave them no time even to think about it. If they merely concentrate on discharging their responsibility to the owners of their firms, acting ethically as they do so, they will usually serve the public good in any case."

It is not a very imaginative point of view and a modern day Shakespeare may well have retorted "There are more things in heaven and earth, *Economist*, than are dreamed of in your philosophy."

TABLE 1

Statement	% agree strongly	% disagree strongly
Companies should concentrate on making profits and forget about social and environmental issues	5.5	70.9
Companies should not donate to charities	5.8	71.6
Companies should not donate to political parties	55.5	12.4
I take a company's reputation for social responsibility into account when purchasing products	40.6	6.0
I would pay up to five percent more for a product made by a company that did good things for the community, as long as the quality is the same	53.0	4.3
I would pay up to five percent more for a product made by a company that did good things for the environment, as long as the quality is the same	55.6	4.2
I would not invest in a company that damaged the environment	64.6	4.1
Most people would prefer to work for a company that puts a high priority on social and environmental issues	45.5	6.3
Most large companies talk about being socially and environmentally responsible, but don't actually do much about it	51.4	1.8

AN ETHICAL QUANDARY

It doesn't seem to have occurred to *The Economist*, a pro-competition journal, that there is competition to attract customers and to attract the best employees, that some potential customers may prefer to buy from a company that devotes a portion of its earnings to environmental and community causes or that the most skilled potential employees may prefer to work for a company with some kind of a social conscience. These potential customers and employees may even pay higher prices and accept lower salaries respectively as a trade-off for investments in social and environmental capital. Some investors may even prefer to entrust their money to companies that exhibit high levels of social responsibility.

So, is it possible then that CSR engagement can increase company profits? Paul Kerin, a Melbourne Business School professor thinks not. In his Business Review Weekly article of May 2005, he says that despite at least 125 studies since 1971 on the relationship between CSR and financial performance, no clear conclusion has emerged. But what he fails to say is that there is, therefore, also no evidence that CSR engagement is automatically bad for profits, the line taken so forcefully by Friedman and *The Economist*.

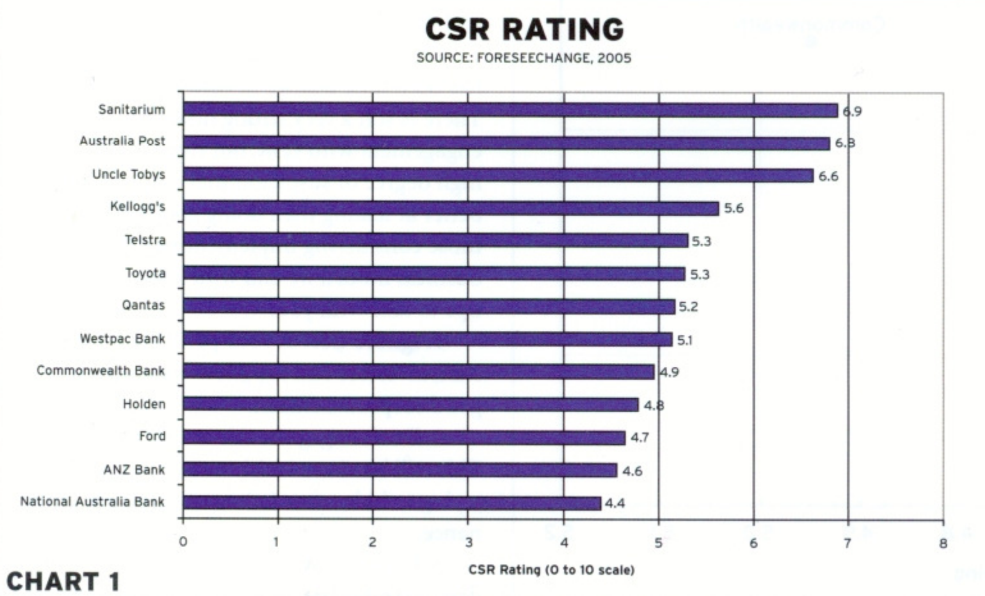

CHART 1

Could it be that being good isn't all that bad? Corporations in Australia and around the world would seem to think so. They have largely rejected the advice of Friedman and *The Economist* and have embraced CSR. Many, including at least two of Australia's big four banks, are openly advertising their CSR achievements and awards.

SIZING UP CSR

The reason why was perhaps best summarised by Shell's submission to a parliamentary inquiry investigating how to encourage CSR. Arguing against regulation, Shell's submission said those companies with a good approach "will be ultimately rewarded for doing so, while those that don't will suffer the reputational and, ultimately, business costs for not doing so" (*Australian Financial Review*, 10 October 2005).

Shell believes that apart from areas such as environmental and occupational health and safety, where a level of regulation is required, the "court of public opinion" is the most effective mechanism ensuring companies meet society's expectations. Businesses are on trial and, though the jury's still out on whether CSR can fatten up the bottom line, there is emerging data to suggest that public opinion holds CSR practices in high regard.

A 2005 survey by Foreseechange set out to benchmark opinions via a nationally representative telephone survey of 500 adults. In reviewing the results of this survey, it is important to note that all respondents are consumers of goods and services, the vast majority make purchasing decisions and vote in elections, most are in the workforce (over 60 percent of adults), and most are shareholders (44 percent directly and 55 percent directly or indirectly according to ASX surveys).

The first part of the survey asked respondents to indicate their degree of agreement with nine statements (five point scale: agree strongly, agree a little, neither agree nor disagree, disagree a little, disagree a lot). The proportion with strong agreement or strong disagreement is set out in Table 1 on page 51.

These opinions strongly support both the altruistic and enlightened self-interest cases for CSR participation. They suggest the potential for businesses to gain market share and increase margin and to attract staff and investors. The data also shows, however, that there is a high degree of scepticism among the public as to the real motivations of CSR practitioners. It will be important for participants to ensure that CSR activities are substantial rather than window dressing.

The second part of the survey asked respondents to evaluate 13 corporations on the basis of whether they did good things for the community and whether they were good or bad for the environment. These two measures have been combined into a CSR index which ranges from zero to 10. A value of less than five indicates more bad ratings than good ratings, a value of greater than five means that there are more good ratings than bad ratings, and hence a value of five indicates a balance between good and bad ratings. The average ratings are shown in Chart 1 on page 51.

If we take these consumer perceptions for the big four banks and correlate them with financial and market performance measures, we can see that a pattern begins to emerge. The correlation with the earnings per share growth of the big four banks is statistically significant (Chart 2 on page 52). Though we can't claim that better CSR perceptions cause better earnings per share growth (there could be factors causing both, such as better management), this is at the very least more evidence that CSR engagement does not automatically hurt the bottom line as assumed by Friedman and his ilk.

Another conclusion here is the important role of consumer perceptions and how CSR efforts are communicated to those consumers. When RepuTex rated the banks in 2004, it rated the National as second to Westpac, with ANZ third and Commonwealth fourth. Thus, there is no correlation between the RepuTex ratings and earnings per share growth. Hence, communications are a very important component of a successful CSR strategy. But the communications need to be very cost-effective, otherwise the corporation could be perceived to be spending money on advertising that could have been used to do more good works.

We can also chart the relationship between the CSR ratings and market share changes. In the new vehicle market, the highest rated CSR index company gained share after the ratings were measured and the lowest rated CSR index company lost share (Chart 3 on page 53). The same trends were also visible in the breakfast cereals market. Once again we cannot claim causality, as other factors – such as new products, pricing and other marketing activities – would be expected to be influential too.

That said though, this empirical study has found evidence that consumer perceptions of good CSR are associated with positive market and financial outcomes.

The study was updated in 2007 and there has been little change in consumer opinion. There is still a very strong desire for corporate engagement with CSR, but there is also still a high degree of suspicion that corporations are better at talking than doing good works. For those considering implementing CSR into their business model, we end with a few important tips to take with you:

1. Ignore CSR at your peril. Your customers, staff, investors and suppliers want you to be a good corporate citizen.

2. Don't engage in token CSR activities. This will be viewed with suspicion that you are trying to hide some failing of corporate governance.

3. Ensure that your CSR program results in demonstrable benefits for the community.

> "Business managers have often been advised that making profits already serves the public good, so the very notion of corporate social responsibility is ultimately a diversion."

CORPORATE SOCIAL RESPONSIBILTY RATING AND EARNINGS PER SHARE GROWTH

SOURCE: FORESEECHANGE AND ANNUAL REPORTS

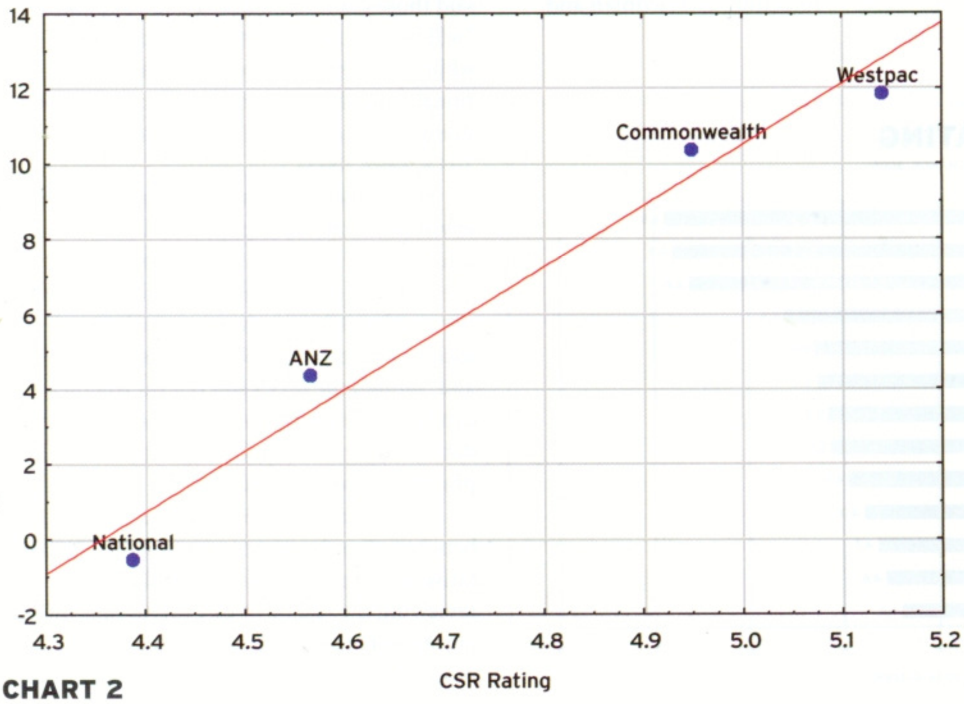

CHART 2

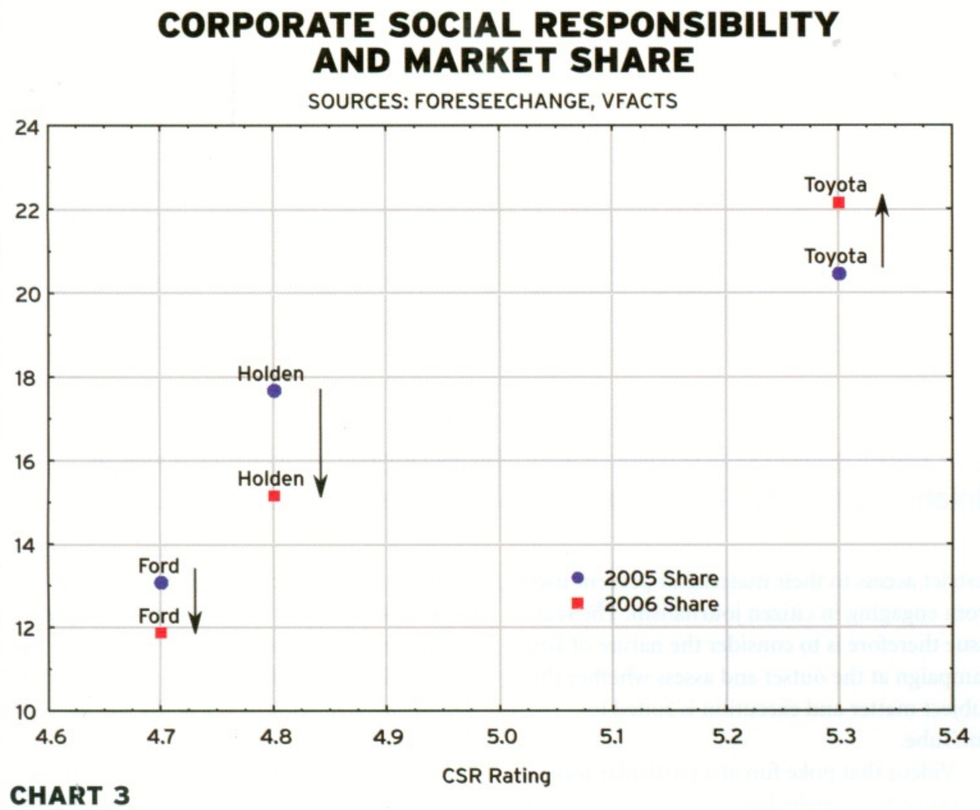

CHART 3

4. Curry favour with politicians via your CSR program rather than via donations to political parties.

5. Communicate the community benefits of your CSR program in a cost-effective way. Spending a lot of money advertising your achievements will be seen as spending money that could be used for even more good works. Make good use of your website, packs and physical locations.

6. View CSR as a component of corporate strategy. Porter and Kramer ('Strategy and Society' in *Harvard Business Review*, December 2006) identify reactive and strategic CSR:

- corporate citizenship initiatives (reactive)
- mitigating harm arising from a firm's value chain activities (reactive), and
- doing things differently from competitors in a way that provides a social or environmental benefit while lowering costs or better serving a particular set of customer needs (strategic) (Toyota's development of the Prius is a good example of this strategic CSR).

Ultimately, the evidence is beginning to suggest that CSR continues to play an important role in consumer buying decisions, and as such is not to be dismissed lightly. **M**