

Pathways out of the crisis: CSR as a strategic tool for the future

Anna Peters



Pathways out of the crisis: CSR as a strategic tool for the future

Contact:

Anna Peters
Project manager
Corporate Social Responsibility program
Bertelsmann Stiftung
Telephone +49 (0)5241 81-81401
Fax +49 (0)5241 81-681275
anna.peters@bertelsmann-stiftung.de
www.bertelsmann-stiftung.de/csr
www.csr-weltweit.de

Photograph: Rob Friedmann/iStockphoto

Bertelsmann Stiftung would like to thank Christina Gradl and Claudia Knobloch of Emergia Institut, Berlin, for their input.

Contents

1	Responsibility in the face of crisis – a long-overdue call.....	5
2	Global megatrends - the international crises of tomorrow?.....	6
3	CSR as a response to global challenges.....	8
3.1	CSR outside the market.....	8
3.2	CSR within the market.....	9
3.3	CSR to improve market conditions.....	11
4	Core competence: The ability to work together.....	12

"We have now a mass crash and we have to figure out first how we help those injured by it. Secondly, we have to find out what rules we need for the future in order to avoid this happening again."

Klaus Schwab, founder of the World Economic Forum, Davos, January 2009

"In every crisis, however, there is opportunity. If we have the courage to learn the lessons of the past 18 months and put them into practice beyond the economic sphere, we can put in place new foundations to reshape our world for the better."

Kofi Annan, former Secretary-General of the United Nations, Davos, January 2009

1 Responsibility in the face of crisis – a long-overdue call

Our current financial and economic crisis has fueled a resurgence of interest in an old and familiar concept: responsibility. There are loud calls for responsibility, focusing particularly on companies and their business practices. Now, in the second year after the collapse of Lehman Brothers and the nationalization of Hypo Real Estate, a new commitment to responsibility is being demanded of companies, a commitment that manifests itself in products and services that are transparent and create social value; in foresighted, value-oriented management that recognizes risks and preserves jobs; and in prudent stewardship of the billions being spent on bailouts by taxpayers.

The call for responsible behavior heard in the wake of the crisis is long overdue. Indeed, the current crisis is evidence that existing value systems – above all our financial and economic systems – need to be reexamined. Responsibility means, first and foremost, acting now to meet the challenges of the future. We know that the major crises of the future – a battle over natural resources and a global increase in social inequality – will require nations and private industry to act. Accordingly, it is crucial that we reorganize our economic system in keeping with our ecological and social responsibilities, and this will require rethinking how business, the political sphere and society at large interact with one another.

The debate over corporate social responsibility (CSR) can be helpful in considering these issues. The economic crisis can be an indicator of responsible business activity. It highlights cases in which companies benefit from socially and ecologically responsible management, and others in which social engagement that has no connection to a company's core business tends to fall victim to cost-cutting measures. Two things are very clear: CSR, as a strategic management tool, helps companies prepare for the future and equips them to deal with crisis situations. As a new mechanism for integrating companies more fully into society, CSR provides a way for private industry to join together with policymakers and civil society to work for the common good all over the world. Keeping in mind global megatrends in general and the current international economic crisis in particular, the following pages show how CSR, as a management tool, can be helpful in identifying ways to overcome this crisis and meet the social and ecological challenges of the future.

2 Global megatrends – the international crises of tomorrow?

It is often said that successful companies need an intact society, just as an intact society needs successful companies, and this recognition forms the basis for responsible corporate action. The societal role of a company, or of business in general, is dynamic and changes along with social, technological and ecological developments. As the current economic crisis has shown, society's expectations of companies change as well, along with major political and economic events.

The most important social changes that are taking place today can be divided into four closely related megatrends that have a direct or indirect effect on corporate actions:

- The globalization of value chains (driven by the liberalization of markets and efficient logistics systems)
- An increase in transparency as a result of new communications technologies and global media
- Increasingly scarce natural resources, resulting in environmental damage (climate change, pollution, the loss of natural species)
- Growing social inequality, at both the national and the global level, as a result of disparities in access to the opportunities offered by globalization

From the perspective of private industry, these trends bring with them both economic opportunities and risks. Some of the most important are listed in the table below:

Trend	Opportunities	Risks
Globalization of value chains	<ul style="list-style-type: none"> ▪ Cost advantages through global purchasing and production ▪ Access to new raw materials that can lead to product innovations ▪ Development of new markets ▪ Increased efficiency through a focus on core competences 	<ul style="list-style-type: none"> ▪ Dependence on foreign suppliers ▪ Greater difficulty in monitoring standards (quality, environment, social conditions, legal provisions) ▪ Difficulty in recognizing risks and negative effects of transaction chains (competitive disadvantages stemming from the need to comply with national standards, and possibly a "race to the bottom")
Increasing transparency	<ul style="list-style-type: none"> ▪ Efficient internal and external communication ▪ The ability to monitor suppliers and other business partners ▪ Competitive advantages through responsible management (certification and the identification of "black sheep") 	<ul style="list-style-type: none"> ▪ Better monitoring by interest groups (watchdogs) and greater potential for pressure from the media (negative actions can be traced back more quickly to their source) ▪ Competitors can copy products and services more quickly

Increasingly scarce natural resources and climate change	<ul style="list-style-type: none"> ▪ Increasing appeal of resource-saving products and services ▪ Additional sources of income through markets set up to conserve resources, particularly emissions trading ▪ Driver for innovations involving sustainable products 	<ul style="list-style-type: none"> ▪ More expensive raw materials ▪ Greater expense owing to higher fees and investments to prevent environmental damage, so-called “green taxes” ▪ Greater scrutiny by interest groups of corporate behavior that may affect the environment
Growing social inequality	<ul style="list-style-type: none"> ▪ Market opportunities among low-income groups (BOP) ▪ Employees/Trade unions are more willing to cooperate ▪ Greater recognition of good human resources management 	<ul style="list-style-type: none"> ▪ Increased pressure from poor population groups on companies, for example through individual acts of aggression, strikes, demonstrations or political programs ▪ Shortage of well-trained employees ▪ Threat to political/social stability

Weathering a crisis requires strategic management of opportunities and risks. Companies need to recognize relevant trends at an early stage and find ways to respond to them. Ignoring risks in a company’s value chain, or engaging only in passive risk avoidance or risk minimization, is irresponsible as well as bad for business.

The coming shortage of fossil fuels poses a particular danger to automobile manufacturers that have failed to develop alternative drive systems. And the growing low-income population poses a problem for those manufacturers of consumer goods that offer no products to meet the needs of this group. As financial institutions for consumers and bankers develop ever more arcane products, startups like MyC4 are using the Internet to allow small investors to make direct, interest-based investments in small businesses in developing countries.

Successful companies are able to transform social and ecological risks into opportunities, integrating them into their corporate strategies. This allows them to gain a strategic advantage over their competitors, and at the same time they contribute to society and help to avert future crises.

In their efforts to transform social challenges into entrepreneurial opportunities, corporations can learn from social entrepreneurs, who devote themselves to alleviating social ills by developing market-appropriate business models. A pioneer in this area is Nobel Laureate Mohammad Yunus, whose Grameen family of enterprises not only provides loans to the poor, but also offers communication services, energy, educational programs and food.

3 CSR as a response to global challenges

CSR helps to transform social challenges into strategic opportunities. It is a process of experimentation and negotiation in which companies work with their political and societal stakeholders to test innovative solutions and redistribute social responsibilities.

This takes place in three contexts:

- **Outside the market** – philanthropic measures, the involvement of companies as corporate citizens
- **Within the market** – sustainable organization of a company's core business
- **Improving market conditions** – measures aimed at changing overall conditions

In order to respond effectively to complex challenges like climate change and to ensure the sustainability of their businesses, companies need to play a constructive role in all three contexts.

3.1 CSR outside the market

Many companies assume that CSR means engaging in philanthropic activity in their business environments, often motivated by a desire to give something back to society. Social engagement for the benefit of a company's business location or its workforce has a long tradition in Germany. In their foreign locations as well, German companies support projects in such areas as health and education.

However, projects that are limited to sponsorships or donations and have no direct connection to a company's core business have little to do with true CSR, and in a recession they are usually the first activities to fall victim to budget cuts. This type of social engagement is, more than anything else, a cost item whose benefit to the company is difficult, if not impossible, to measure. Its value to society is also limited, since the resources companies have available for philanthropic purposes are not sufficient to achieve a comprehensive solution to social problems.

When companies carry out well considered, strategic activities that are in keeping with their core business rather than simply distributing random donations, this produces far greater benefits for both the company and society at large. This type of engagement promotes sustainable stakeholder management, leads to greater confidence and helps to integrate the company into the surrounding society. As a responsible corporate citizen, a company can test new partnerships, engage in serious dialogue with stakeholders, gain insight into stakeholder interests and acquire new expertise.

German state-owned savings banks [*Sparkassen*] and banking cooperatives [*Raiffeisenbanken*], which have deep roots in their communities, provide an example of how financial institutions can build confidence in the banking sector. Being involved in matters of civic concern is simply part of their approach to doing business. This includes not only donating money to clubs and other organizations, but also civic engagement in the areas of culture, integration and education. Most

important, on-site involvement means that a company's employees contribute their time and expertise at a personal level. The trust that these financial institutions have gained is now paying off: Over the past few months, many customers have deposited their money in Sparkassen banks "for safekeeping." During the turbulent fall of 2008, Hamburg's Sparkassen bank alone recorded new deposits amounting to some €500 million.

3.2 CSR within the market

Responsible corporate management occurs mainly in the context of a company's core business, and this is where the company's influence on society, for good or ill, is most evident. It is here, therefore, that opportunities are greatest to create sustainable value and make a lasting contribution to society.

Sustainable innovations in products, processes and management systems allow companies to meet the challenges of the future. The most important tools are outlined below.

The term **product innovations** refers to the creation of new kinds of products as well as to opening up new customer groups by offering products and business models tailored to their needs.

- **Resource-saving products:** New products that are more environmentally friendly than traditional models (e.g. Toyota's hybrid car), that are made of raw materials that are less damaging to the environment (e.g. Apple's MacBook, which contains no arsenic or mercury), or that can be completely recycled, present valuable business opportunities. In banking, socially responsible investing (SRI) is becoming more and more important. Such investment funds help to finance socially and ecologically responsible companies, reduce their risks and provide financial incentives for development. In the past five years alone, the volume of ecologically responsible and sustainable funds in Germany has grown by a factor of eight, to a level of more than €25 billion. While the economic situation of the last few months has been difficult, an increased awareness of environmental issues and higher prices for fossil fuels have benefited this sector and will contribute to continued positive business development.
- **Opening up underserved markets:** Companies can win customers among groups with a low level of market participation (the "base of the pyramid") by offering products tailored to their needs (e.g. smaller packaging units) or through unusual business models (e.g. shared use of durable goods such as telephones). Certain banks and insurance companies have begun to attract low-income customers in developing countries by offering them microloans and micro-insurance policies. While still small, this sector represents a promising market for the future, particularly when market saturation or competitive pressures lead to the loss of existing business areas.

Process innovations enhance operational performance, leading to a more efficient use of resources, greater stability and legitimacy, and lower costs and liability risks.

- **Sustainable supply chain management:** It is important not only to make sure that suppliers deliver on time and provide high-quality products, but also to monitor their production and transport conditions. Are suppliers adhering to the ILO labor standards and complying with

environmental protection regulations? Is it possible to reduce transport-related CO₂ emissions – for example by changing from road- to rail-based shipping? If the entire supply chain reflects concern for social and ecological issues, this enhances the company's reputation both internally (among its employees) and externally (in society at large), as well as promoting risk management.

- **Cleaner production:** By identifying and implementing organizational and technological improvements in the production process, companies can optimize their use of raw materials and energy and minimize liquid, solid and gas waste products.

Management innovations are new ways of promoting responsible corporate management at all levels of the organization. This includes planning, implementation and evaluation using appropriate management systems.

- **Issue management:** When a company takes a foresighted approach to economic, social and environmental risks, it has a strategic advantage over its competitors. This means having a 360-degree system in place to identify opportunities and risks that arise as society changes. Organizational structures also need to be flexible to allow for a rapid response to such opportunities and risks, thereby minimizing damage to the company's reputation. CSR is, therefore, an inter-departmental function; rather than being limited to "CSR managers" and communications departments, it is an organizational principle that underlies corporate management as a whole.
- **Holistic leadership training:** Sustainable management requires executives who think in terms of sustainability, a perspective that should begin with university economics departments. In the corporate setting, staff development should focus on helping corporate executives to develop this skill by, for example, taking on assignments in developing countries or working on cooperative projects with partners in civil society (corporate volunteering). Moreover, a truly integrated concept of CSR can only prevail if executives live in accordance with their companies' stated values. Such corporate executives as Jeffrey Immelt of General Electric and his Ecoimagination program demonstrate how visionary leadership can provide even traditional companies with a sustainable orientation. Making sustainability an important consideration for human resources management substantially enhances a company's reputation among its employees and attracts talented job candidates.
- **Sustainability-based incentives:** Sustainability training will not bear fruit if incentives are offered only for maximizing short-term profits. Analyses have shown that a system which focused on rewarding executives for increasing quarterly profits was instrumental in leading to the financial crisis. In order to reward sustainable management, bonuses should be linked to long-term performance figures that reflect success in such areas as reducing greenhouse gases, increasing employee satisfaction and investing in new business areas like renewable sources of energy.
- **Triple bottom line evaluation:** Sustainable management requires monitoring a company's performance not only in economic, but also in ecological and social terms. Triple bottom line evaluation is essential for setting goals that go beyond business results and then monitoring the degree to which these goals are achieved. Furthermore, non-financial corporate performance figures facilitate access to credit transactions.

- **Transparent communication:** Transparency in both internal and external communications is important for the success of strategic CSR. Proactive, honest communication with a company's stakeholders, including a discussion of corporate values, activities, successes and challenges, is the foundation for building trust. Within the organization, values and goals must be not only communicated, but also demonstrated. Employees need opportunities to discuss their understanding of corporate goals and their reservations, as well as their ideas for how best to achieve those goals. And the time is long past when glossy brochures on sustainability were enough for communicating with external stakeholders. Companies are expected to provide readily understandable reports based on measurable performance figures that have been reviewed by outside experts. An ongoing dialogue with external stakeholders, including critics, is an important source of information for issue management.

When CSR thereby becomes part of a company's "DNA," the company gains social relevance and acceptance, along with greater stability and efficiency – in short, it becomes more competitive. A. T. Kearney's study of "Green Winners," published in February 2009, shows that during the current crisis, the value of the 99 largest companies listed in the Dow Jones Sustainability Index and the GS Sustain Focus List has experienced a smaller decline than that of other companies in their respective industries. In the period from May to November 2008, these companies' stock market losses, in 16 of 18 industries, were smaller than those of their competitors by an average of 15 percent.

3.3 CSR to improve market conditions

The crisis has made one thing unmistakably clear: The market cannot function without the help of government. It has also shown that when companies act in a way that destroys public trust in their contribution to society, they lose their legitimacy – their "license to operate" – along with the confidence of investors and consumers. To be sure, government has intervened in the economy to an unprecedented degree over the past months, rescuing banks and automobile manufacturers with the help of state funds; but the limits of government intervention are evident. Even in 2009, with multiple elections being held in Germany, it is impossible for politicians and policymakers alone to solve all of the problems facing society. Instead, it is essential to take a decentralized approach, with the participation of private industry, in order to develop rules and regulations aimed at getting the crisis-ridden markets back on track and finding solutions to such global challenges as climate change.

Companies can be involved in this effort in two ways:

- **Soft law:** Many companies have joined together to form initiatives or quasi-governmental self-regulatory arrangements, under the auspices of industry or trade associations, to set standards, for example regarding working conditions. These initiatives either voluntarily expand on existing law or remedy gaps in existing legislation. Examples include the banking sector's Equator Principles, which address the responsible financing of loan transactions; the AVE Sector Model for Social Responsibility, which contains rules on procurement in foreign trade; and the Extractive Industries Transparency Initiative (EITI), under which companies agree to disclose their payments to governments.

- **Responsible lobbying:** Companies not only implement voluntary standards and rules governing their actions; they also work to pass laws intended to reconcile the ecological, economic and social objectives associated with their core business. For example, they seek to eliminate subsidies for agricultural exports, dismantle barriers that deny developing countries access to markets, and pass stricter laws on climate protection. They are also active in issues that affect their target groups, as in the efforts of the cosmetics company Mary Kay to combat violence against women.

There are many factors that affect corporate engagement aimed at improving market conditions, and such engagement can only succeed if other sectors in society exert pressure or become involved. One wonders whether the current crisis might have been prevented if the financial sector had agreed on voluntary risk-assessment measures for financial instruments. It remains to be seen whether pressure from civil society and the political realm will convince the banks to put such measures in place. We need both a strong government and a strong civil society, forces that are capable of criticizing the undesirable effects of entrepreneurial action and pushing for changes in corporate behavior.

4 Core competence: The ability to work together

The financial and economic crisis has made two things very clear: First, given the coming political, social and economic upheaval in connection with resource distribution, poverty and justice, a call for responsibility is long overdue. Responsibility begins with an awareness of risks and a willingness to start now to address those risks. Second, all involved – whether the business community, policymakers or civil society – need to accept their responsibility. Global developments are so complex that all three sectors must work together if they are to build sustainable structures to meet the needs of the future.

Corporate social responsibility is a good way of making companies part of this tri-sector partnership. CSR allows companies to join with governments and civil society in a process of negotiation aimed at solving society's problems, with all involved offering the benefit of their core expertise.

The ability of all three sectors to work together is the key to solving the complex problems we face. The ability to cooperate is a core competence if companies are not only to survive the crisis, but to emerge from it with renewed strength. Together with their partners, they can shape a sustainable future for themselves and society. The ability to work together means more than polite interaction. Exchanging views and networking are a constructive part of the management process – which is no longer characterized by steep hierarchies and longstanding prejudices, but by equal participation. This also means the freedom and the ability to consider unconventional solutions, an openness to new insights, transparency, an ability to assess the feasibility of new ideas and the courage to think ahead to the future. By choosing this path, companies will become trailblazers in the effort to achieve a sustainable society.