

Achieving high performance

CSR at the heart of business

**Stephen Bevan, Nick Isles,
Peter Emery and Tony Hoskins**

THE VIRTUOUS  CIRCLE Ltd

the work foundation

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About the Partners

The Work Foundation

The Work Foundation exists to inspire and deliver improvements to organisational performance through improving the quality of working life. It believes that productive, high performance organisations are those committed to making work more fulfilling, fun, inspirational and effective, and who through engaging their workforce succeed in integrating the many aims crucial to organisational success. Through a unique fusion of research, consultancy and policy influence, The Work Foundation works to develop evidence-based contributions to both policy and practice. As an independent, not-for-profit charity The Work Foundation and its member organisations is leading the public conversation about work in the UK.

The Virtuous Circle

The Virtuous Circle is a specialist corporate social responsibility consultancy working primarily with large national and multinational businesses; but also public and non-profit organisations. Its main aim is to assist its clients to devise CSR strategies that will enhance their brand reputation. The Virtuous Circle sees CSR as an essential prerequisite to improving business or organisational performance based on a firm statement of values, clear objectives and the careful monitoring and measurement of the impact of CSR activities.

Foreword

Corporate social responsibility (CSR) is now firmly entrenched in the business lexicon. For some organisations, activities that they would describe as socially responsible can act as a shield to fend off criticism of their poor business practices and performance. For others, being corporately socially responsible is part of the warp and weft of doing good business. These businesses are already committed to strategies and practices that others will describe as 'CSR' but which they themselves would more accurately call 'high performance'. This report is concerned with the evidence that supports the latter group of business activities.

If one could travel back 400 years to the founding of the first recognisable companies – the Dutch East India Company, for example – one finds that their documents of incorporation are explicit about the wider public benefits that must accrue from their private activities. For the Dutch East India Company this was to regulate the existing trade to maximise returns to the Dutch Republics to fight their enemies and prevent other European nations entering the East India Trade.

The same principle holds for the founding of the great US and British corporations in the 19th and early 20th centuries. For example, through his lifelong involvement with the Temperance Society, John Cadbury believed that in founding his company to provide tea, coffee, cocoa and chocolate as an alternative to alcohol, he was helping poor people alleviate their poverty since alcohol consumption was believed to be a direct cause of poverty and deprivation. At heart, such corporations have always focused on more than simply maximising profits and a return to shareholders. Great companies understand their 'reason to be'.

Clarity of purpose helps drive high performance and only high performance – broadly defined and inclusive of many of the practices we describe as CSR – can deliver great and sustainable businesses with strong reputations. This report provides an invaluable review of the evidence for CSR practice being at the heart of sustainable, high performance, business operations.

The Work Foundation's recent findings from its year-long panel of inquiry into work and enterprise – *The Missing Link: From Productivity to Performance* – identified five strategic business areas which high performance organisations know they must manage equally well.

The Virtuous Circle's *CSR Route Map* reinforces the need for organisations to define better their organisational values and overall purpose. And, as the report

says, the evidence is no longer anecdotal but empirical in supporting the argument for CSR activities becoming an integral part of overall business strategy.

But the evidence quoted extensively in what follows is also clear about the scale of the challenge. Despite some improvements in many macroeconomic indicators – low unemployment, a stable inflation environment, a rule-based fiscal regime, and an upward trend in growth – at a microeconomic level the UK has persistent structural problems. As The Work Foundation's productivity report (see above) highlighted, companies at the top of the performance league were 42% more productive than those at the bottom.

We maintain a veritable army of mediocre, small to medium sized and even larger businesses that simply don't 'get' CSR and don't understand the performance challenge.

If CSR has reached the 'end of the beginning' as a concept, we would argue that it is now time for CSR and high performance to become accepted as being inextricably linked.

Will Hutton

Chief Executive, The Work Foundation

Executive summary

The aims of this report

Despite considerable research conducted over the past five years into the benefits of corporate social responsibility (CSR) – much of it anecdotal and case study based – it remains a fact that many business leaders still only pay lip service to CSR, or are merely reacting to peer pressure by introducing it into their organisations. A smaller number have an inherent sense that it is ‘the right thing to do’ and feel committed to it. Fewer still are convinced about the business benefits and have embedded it throughout their organisations.

This report’s main aim is to summarise the most recent empirical research findings related to CSR and, armed with this information, enable business leaders to move forward firmly committed to the value of CSR in the future development of their businesses.

The report also offers a practical framework for developing CSR in the form of a leadership agenda and the management tools required to put CSR at the heart of business.

The research findings

In assembling this report we have sought studies that seem most useful in marshalling evidence about the effect of CSR on business performance. Many of these studies provide empirical demonstrations of the causal relationships between a broad range of CSR elements, increasing management intelligence and improving decision-making about investing resources in CSR activities. The research is organised into four broad categories:

1. CSR – enhancing the employer ‘brand’
2. Delivering business performance through committed employees
3. CSR and customer preferences
4. CSR and strategic business ‘fit’

The first category shows that employees made a greater contribution towards their organisation if they saw it as being a more responsible employer and this in turn influenced their decision to remain with it. It also highlights the benefit that a business can derive from integrating its CSR activities into its day-to-day operations, making it more likely to be successful for participants, employees, the company and the community.

When we looked at delivering business performance through committed employees, we found strong evidence that businesses that treat their workforce as a cost to be minimised, or as another asset to ‘sweat’ are more likely to be both irresponsible employers and sub-optimal performers. Conversely, a strong correlation existed between the perceived quality of line management, corporate

culture, employee commitment, customer retention and increased sales volume. Progressive HR practices were also a vital key to maintaining the discretionary behaviours that ensure a job is done as well as it can be, designed to motivate able employees to employ such behaviour when the opportunity presented itself.

The third group of studies concentrate on CSR and customer preferences, led by a powerful BT study showing that the highest levels of employee satisfaction relate to the highest levels of customer loyalty and earnings. Ethical criteria are also becoming manifestly more significant in both purchasing and brand loyalty decisions among a growing proportion of consumers in the UK. The message to businesses is clear – ethical practice, CSR performance and the bottom-line are more closely linked than ever.

The final category of research highlights studies that have looked at the way CSR policy and practice form part of the strategic fabric of business strategy. In many ways, for those who argue that CSR can only have enduring and sustainable impact when it becomes part of the business strategy mainstream, the kind of research described here offers the most compelling evidence yet that CSR must be at the heart of business.

The leadership agenda

Although acknowledging the considerable weight of evidence supporting the empirical links between CSR practice and high performance, it is clear that leadership will be the crucial factor in driving a CSR agenda to deliver improved business performance.

A four-pronged leadership agenda has been developed to help business leaders relate to their stakeholders, especially staff:

- 1. Baseline analysis:** know where your organisation stands with its current CSR activities
- 2. Strategic positioning:** decide where, in comparison with the baseline analysis, you want your organisation to be positioned (both with peers and competitors and in regard to CSR indices)
- 3. Engagement:** understand and engage with your stakeholders
- 4. Action:** implement, integrate and evaluate best practice CSR policies and activities in line with business strategy.

The Virtuous Circle has developed a number of specific CSR management tools designed to assist business leaders wishing to put CSR at the heart of their business.

Policy-making and performance

The authors also believe it is imperative for policy-makers to understand the empirical links between CSR and High performance, focusing their attention on the following four areas:

1. Company Law needs reviewing
2. Ensure adequate resourcing for the proposed DTI-funded CSR Academy
3. Examine the system of corporate governance and incentives for investor/company relationships
4. Identify incentives for firms to engage in CSR audits and other CSR activities

Future challenges

The challenge now for the CSR practitioner, policy-maker and board member alike, is to foster the recognition that CSR represents good business practice for every function and should not be confined to programmes conducted by a few departments in isolation from one another.

More research is needed. There are gaps in understanding of the impact of CSR initiatives aimed at environmental improvement and on initiatives with supply chains and among small and medium size businesses (SMEs). Most CSR research to date has been concentrated on larger firms. There is a need for an in-depth independent review of those who have taken CSR to heart to better understand the causality as opposed to correlations. There is also a lack of empirical understanding of the balance between voluntarism and regulation. Finally there is a lack of international comparative data.

Our overall conclusion is that high performance can only be achieved through adopting an integrated approach to CSR embracing the needs of all stakeholders. CSR is no longer merely fashionable but an essential component in delivering improved performance, requiring committed leaders to put it at the heart of business. For all those concerned with making the UK a high performance high productivity economy, CSR offers a route to achieving just that.

1 CSR – The end of the beginning

1.1 Introduction

“CSR as glorified corporate do-gooding is compromised and flawed. Motives are mixed. Even within the same organisation, for every convincing and substantial project being undertaken, there seems to be another more dubious one going on elsewhere.” *Stefan Stern, The Perils of CSR, RSA Journal, 2004, pp 32-35.*

It seems like we have come to the ‘end of the beginning’ for CSR. At the start of the decade, CSR was often seen as an optional extra by business leaders and as an adjunct of their burgeoning PR functions. With a spate of corporate scandals rocking faith in business ethics, that position appears to have changed for good. But the feeling remains that CSR is too often more a case of ‘business doing good’ rather than ‘doing good business’.

It is clear that we are now witnessing a new developmental phase for CSR. Big corporations, NGOs and governments are taking the complex array of issues that CSR embraces far more seriously than ever before. Perhaps for the first time, mainstream thinking on CSR is beginning to accept that there need be no inherent contradiction between strong business ethics and effective capitalism.

Indeed, as John Kay said: ‘Modern societies did not develop ethical norms which limit and deplore self-regarding materialism out of a perverse desire to restrain entrepreneurial spirits.’¹

Fear of corporate scandal, mere exhortation or a growing legislative ‘rule-book’ seem insufficient for many businesses for which CSR is not even on the radar. Part of the reason for this is that the business gains that can be derived from an active and fulsome approach to CSR have not hitherto been sufficiently obvious or compelling. There are plenty of positive role models and stories, but too little quantitative evidence that CSR activity can deliver tangible business benefits.

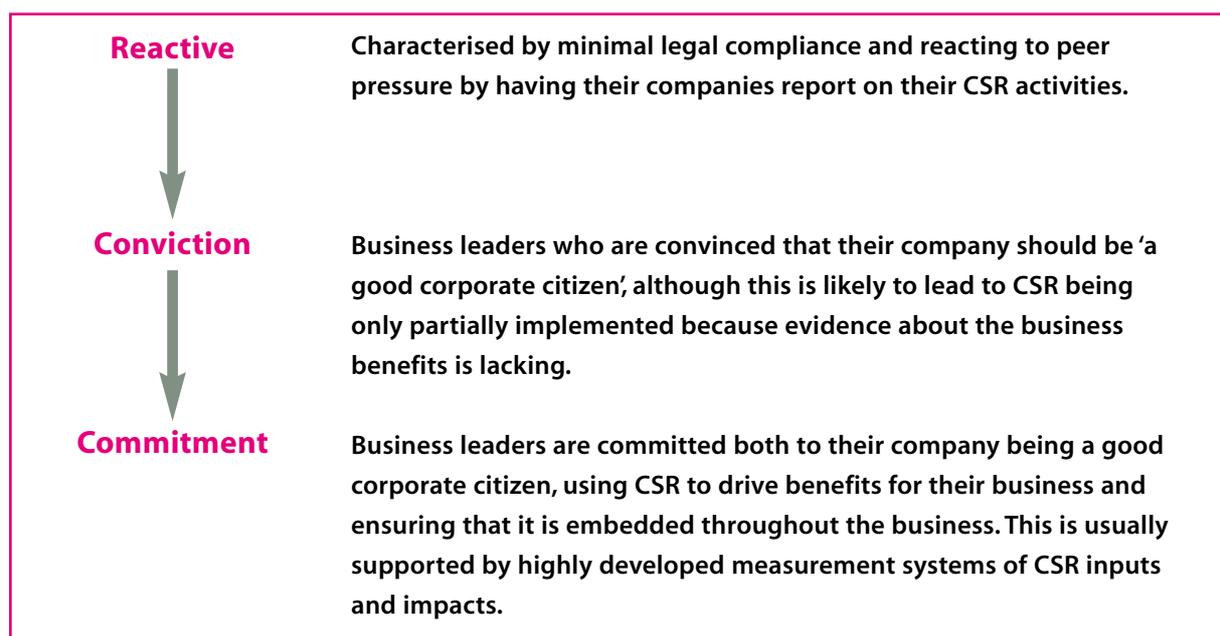
This report is intended to re-focus the debate on the business imperatives that should underpin a truly integrated and coherent approach to CSR in business. We believe that there is now a sufficient body of quantitative and qualitative research evidence to show that CSR, practiced seriously, is good for business. This evidence is aimed at persuading business leaders to move from a position that CSR is intrinsically ‘good’, to being committed about its value for the future development of their businesses. In other words, placing CSR at the heart of those businesses.

1.2 The growth in CSR reporting

One-hundred-and-thirty-two of the leading FTSE 250 companies² reported on their performance in at least one area of CSR in 2002/03 – an increase of more than 26% on the previous year. The question is, is this merely window dressing, or a committed attempt by these organisations to put CSR into the heart of their businesses?

Part of this increase has been due to government legislation, such as the Pension Fund Amendment Act, that has succeeded in raising the profile and importance of socially responsible investment. 86% of institutional investors across Europe now believe social and environmental risk management will have a significant impact on the long-term market value of companies.³ This has also led business leaders to begin to recognise that CSR need not adversely effect their bottom line.

A key factor behind the increasing interest in CSR has been the appearance of public listings such as the *FTSE4Good* and Business in the Community's *Corporate Responsibility Indices*. Business leaders have generally responded to these in one of three ways:



For companies that have gone beyond the reactive stage, the challenge is then to understand how and why CSR delivers business performance benefits in order for them to move through the next stages of conviction and commitment.

2 Delivering business performance through CSR – the research evidence

CSR appears in many guises – corporate social responsibility, sustainability, corporate responsibility, business ethics, corporate citizenship, and the environment and society. Its component parts can also vary, yet at its most basic level we argue that it represents good business practice.

Some of the earlier research into CSR used mainly anecdotal case histories to demonstrate its business benefits. These were often developed by NGOs and other proponents of CSR seeking to give a stronger lead to companies about its benefits, and were usually good quality – both in their methodology and findings. However, they also tended to focus on specific elements rather than encompassing the whole CSR agenda.

In reviewing existing research, we selected studies that:

- Demonstrated strong correlations or causal relationships as a basis for improving management intelligence on the broad range of CSR elements
- Delivered improved decision-making around investment in CSR activities.

The purpose of this section is to highlight some of the research evidence, which begins to build an empirical case that CSR strategy, and practice can make a tangible difference to business reputation and performance. We have been deliberately selective. We have biased our review towards UK examples. We have also given more emphasis to research where a statistical relationship seems to exist between CSR activity and important business outcomes, whether these be financial, customer-focused, employee-driven or more broadly reputation focused.

We have organised the literature into four broad categories:

- CSR – enhancing the employer ‘brand’
- Delivering business performance through committed employees
- CSR and customer preferences
- CSR and strategic business ‘fit’.

3 CSR – enhancing the employer ‘brand’

A positive employer ‘brand’ can be a way of differentiating one organisation from another and creating a strong, distinctive and attractive identity with which current or potential employees can, themselves, identify. For some employees, this identification can be focused on how well an employer is felt to treat and pay its staff. For others, it can be about the need for a deeper congruence between the values of the individual and those projected by the organisation. In the context of understanding the role of business ethics and CSR in forming part of the employer brand, some of the research over the last decade provides insights into the ways that employers and employees are thinking:

- There is evidence that employers are placing more emphasis on their corporate social performance in their recruitment literature to enhance their attractiveness to recruits and those who advise them.⁴ Large businesses such as BP have gone to considerable lengths to reassure potential graduate recruits of their CSR credentials, for example
- There is a growing body of research which shows that employers who are seen as having a positive image in the field of CSR and ethics are seen as being more attractive.⁵

The Work Foundation and the Future Foundation conducted a study to examine the impact of CSR on the employer ‘brand’: *The Ethical Employee*. It was based on 1,050 interviews with economically active adults conducted in 2001. It was aimed at testing whether an organisation’s standing in the field of business ethics and CSR could tangibly affect its reputation as an employer.

Did the employer’s socially responsible approach lead to greater employee commitment, changes in values and attitudes and ultimately to changes in behaviour, as well as making the organisation more attractive to potential employees? In particular, did the findings show that employees made a greater contribution towards their organisation if they saw it as being a more responsible employer and did this influence their decision to remain with that employer?

The main findings were:

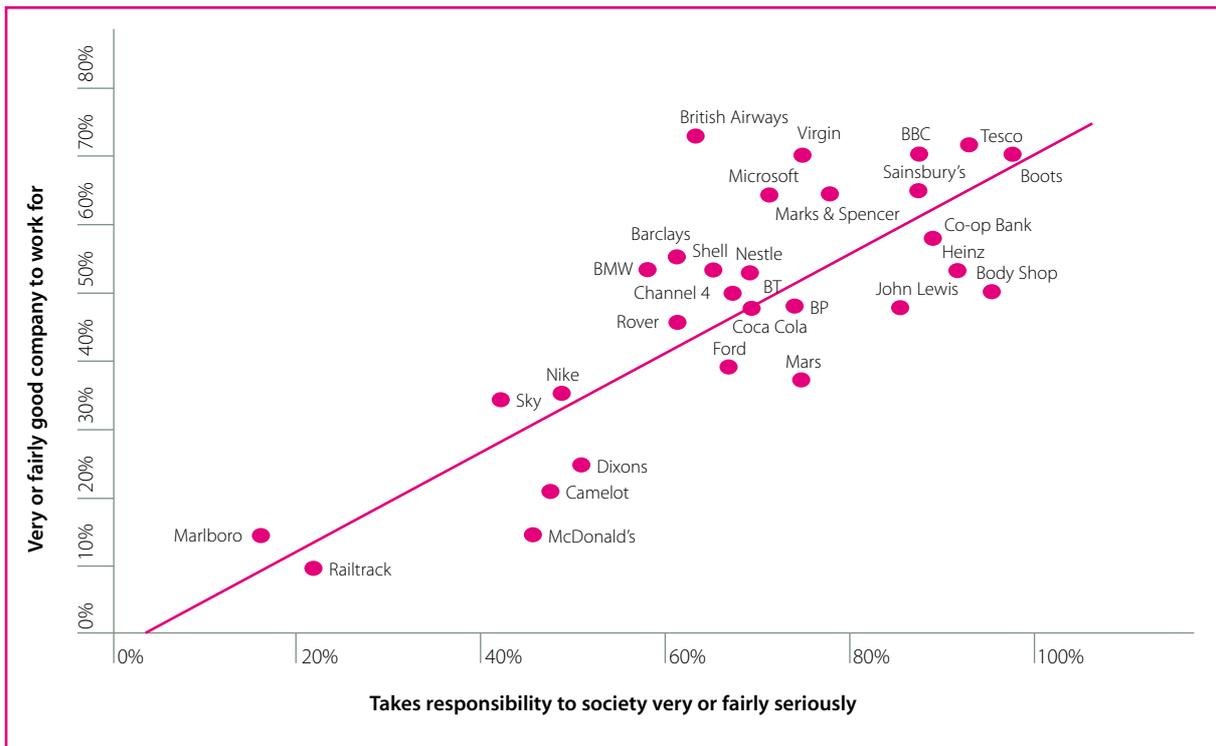
- Approximately 20% of employees found employers with a positive socially responsible image more attractive. Employees in the younger age bracket (18-24) and older employees (45+) were more likely to take into account CSR performance in determining their attitudes towards their current (or prospective) employer. There was a statistically significant relationship between employee loyalty and the organisation’s CSR rating among ethical employees, although the report recognises the importance of remuneration
- Employers that matched the organisation’s values with those of its employees

increased retention. Retention was also affected by the extent to which promises at the point of recruitment were kept.

The study highlights the need for employers to understand better their employees’ attitudes towards their organisation’s socially responsible performance, given:

- Today relatively more affluent employees have the luxury of being concerned about wider issues
- There is a decline in deference towards traditional institutions – and companies in particular
- Globalisation is raising general awareness of living and working conditions everywhere
- News of business and government behaviour is becoming more transparent via new communication technologies
- UK demographic trends will result in 1.3 million fewer young people aged 25-35 and 3 million fewer workers over 35 by 2010.

Employers are going to be increasingly influenced by potential employees’ attitudes to society. This is evident in the graph below showing the attitude of respondents towards 30 leading British companies. There is a strong positive correlation between companies that are seen to take their responsibilities towards society seriously and those seen as a good employer to work for.



A second study, *Marks and Start*⁶, is a recent qualitative analysis of the impact of two Marks & Spencer (M&S) schemes to offer work placements to homeless people. Unemployment, homelessness and social exclusion can seem of marginal interest to employers who are, in general, more pressingly occupied and focused on the needs of making their workplaces productive and making a profit. But some are beginning to recognise that it makes sense for business as well as for society to support more cohesive communities and a more productive, inclusive labour market.

Using a selection of stores across the country, M&S has been offering placements to homeless people that include training and other support. A Work Foundation evaluation study in 2003 found that over 20% of participants ended the scheme with a job either at M&S or with other employers. An important by-product of this initiative was the positive brand benefits that the business is accruing with both existing employees (who are used as ‘buddies’ and mentors) and with customers. As one HR manager said:

“It’s about feeling involved in something that’s really worthwhile, a feeling of satisfaction at being involved in something special. And it really improves staff’s perceptions of Marks & Spencer and the kind of company it is.”

A member of staff acting as a ‘buddy’ to a colleague on a work placement said:

“...coming into work today I knew I did something good.”

While the company did not embark on the programme as a public relations exercise, customer research conducted for M&S found that the active communication of CSR activities is fundamental to brand trust and status and that CSR activities have been shown to influence underlying regard for the company. In total, 9 out of 10 customers recognise the fundamental importance of a commitment to being a leading socially responsible business, 6 out of 10 say it is important to know about these activities.

Whilst the majority felt that they wouldn’t actually change their purchasing behaviour because of a company’s policies 21% state they ‘...have chosen to buy a product or service because of the company’s ethical reputation’ and 18% ‘have boycotted a company’s products on ethical grounds.’

Activities in the community are seen as less important than some other issues of social responsibility (treating staff & suppliers well, having high ethical standards and protecting the environment) but awareness of them significantly

contributes to being viewed favourably and is inexorably bound up with corporate trust. Knowledge of M&S’s involvement in CSR-related schemes such as *Marks and Start* makes 37% of individuals much more positive about the company and 39% a little more positive.

A key generic message from *Marks and Start* is the importance of embedding CSR into day-to-day business. Marks & Spencer are currently integrating their CSR programmes into their HR processes, and the evaluation of the programmes supports this approach. Businesses can benefit from moving away from a ‘bolt-on’ approach to CSR towards a ‘built-in’ approach. Integrating CSR activities into day-to-day operations makes it more likely to be successful for participants, employees, the company and the community.

4 Delivering business performance through committed employees

Considerable attention has been paid, during the last decade or so, to the business case for effective HR strategy and practice. One of the central tenets of human resource management (HRM), for example, is that a highly engaged workforce can contribute significantly to improved business performance. This is especially the case if their role as stakeholders in the business is recognised and actively promoted. Conversely, it is argued, businesses that treat their workforces as a cost to be minimised, or another asset to 'sweat' are more likely to be both irresponsible employers and sub-optimal performers.

4.1 The Sheffield Study⁷

The so-called *Sheffield Study* (1997) was a significant landmark in UK research in this field. Involving a 10-year longitudinal exercise in the manufacturing sector, it set out to answer four key questions:

1. Is there any relationship between employee attitudes (job satisfaction and commitment to their organisation) and the performance of their companies?
2. Can organisational culture predict its subsequent performance?
3. People are a key stakeholder and the HR contribution to the bottom line has been the subject of considerable research. Do human resources management practices make a difference to company performance and, if so, which ones?
4. How do other managerial practices, such as competitive strategies, an emphasis on quality, investment in research and development, and investment in technology, compare with HR practices in terms of their influence upon company performance?

This study showed that 19% of the variability in profitability could be explained by the existence of a reasonably narrow range of HR policies and practices. The study's main recommendations highlighted the difficulties of measuring financial benefit and other potential influences, and as time has passed, the study's recommendations included the introduction of various HR practices that are recognised today as good practice. Nevertheless, there are moves to increase the measurement of HR practices, including the findings of the recent Taskforce on Human Capital Management,⁸ which saw a widespread agreement on the need for better HCM reporting on a formal basis with the relevant metrics in place.

4.2 From People to Profits

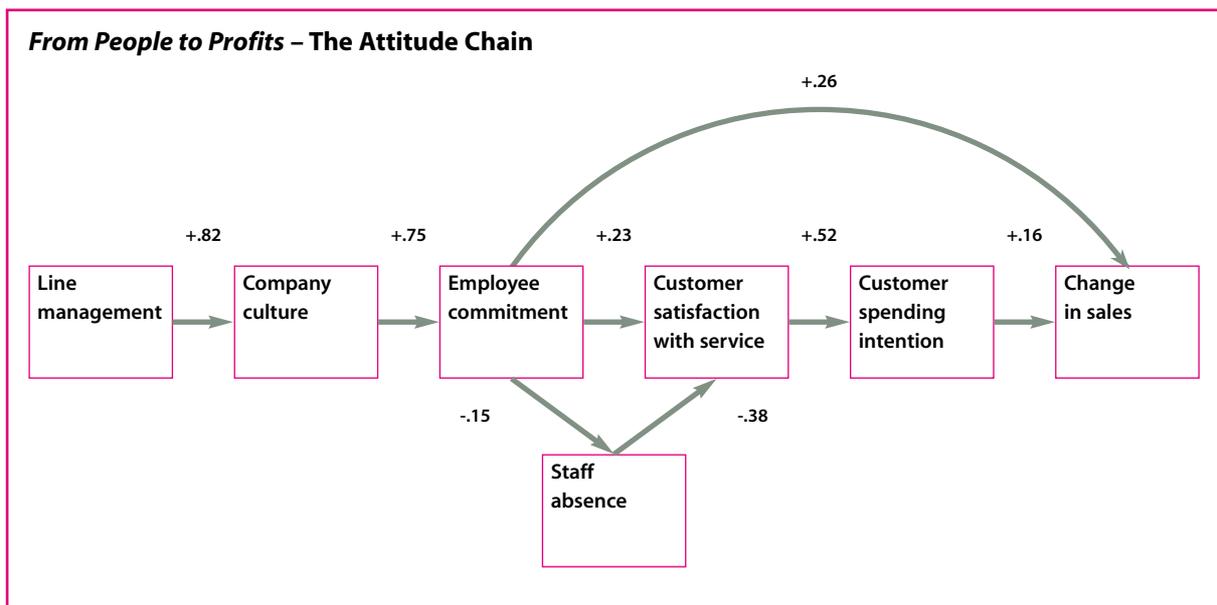
*From People to Profits*⁹ a study conducted by the Institute for Employment Studies in 1999 demonstrated a positive correlation between employee satisfaction, customer satisfaction and revenue. Its approach was based on a study conducted in the USA at Sears¹⁰ which showed that retaining existing customers was much more cost-effective than acquiring new ones, and that the service climate created by committed employees was a central driver of success.

This was a research study focusing on one of the UK's largest retail companies, based on a selection of almost 100 its stores. It used a database collected over two years containing the attitudes of over 65,000 employees and 25,000 customers, whose opinions were surveyed regularly. Using structural equation modelling techniques, which allow the relationship between a complex set of variables to be mapped, the researchers were able to establish a strong correlation between the perceived quality of line management, corporate culture, employee commitment, customer retention and sales volume.

Their attitudes were correlated against a wide range of business performance measures:

- Cash sales
- Absence
- Staff turnover
- Customer complaints (service related)
- Regional location
- Working patterns
- Staff demographics

The model below illustrates the strength and direction of the relationships found by the study.



This study demonstrates the effect of percentage changes at each part of the chain. It also showed:

- The importance of measuring commitment, rather than satisfaction. Previous studies showed that between 60-80% of customers who had defected to competitors claimed to be 'satisfied' or 'very satisfied' in surveys taken prior to their decision to move
- The main conclusion was that employee commitment impacts directly on sales through higher customer service satisfaction and led to a reduction in employee absenteeism
- Positive employee commitment, including pride in the company and identifying with its values, is an important factor in delivering high-value customer relationships.

Many UK businesses have now accepted the validity of this research and have built their own models, and now routinely collect data on employee commitment rather than employee satisfaction alone.

5 CSR and customer preferences

5.1 Enlightened Values¹¹

British Telecom (BT) conducted a study to understand the relationship between the main variables that drive customer satisfaction. The study was based on 3,000 regular face-to-face interviews with customers conducted over 80 months.

BT's study incorporated a variety of variables that might have an impact on customer satisfaction, and isolated the variables with most impact. The BT study showed the key factors resulting in percentage changes in customer satisfaction were:

- Products and experience -0.31
- Contact and experience (largely based on customers' experience of events) -0.46
- Price and value -0.06
- Image and reputation (largely based on image) -0.42

BT's analysis of its image components showed that specific CSR activities represented more than 25% of the image and reputation component. The analysis showed that, were BT to lose its positive reputation for its CSR activities, its customer satisfaction levels would drop by up to 10%.

However, the key issue for BT was the extent to which it could relate customer satisfaction (and hence CSR) to the bottom line. This was identified through two additional studies:

- First, the highest levels of satisfaction related to the highest levels of customer loyalty. BT believes this is related to their eight million most valuable customers who each delivered £70 annually in earnings before interest and taxes (EBIT), totalling some £560 million
- Second, the survey results demonstrated that dissatisfaction with customer service hits profits. A study comparing advisers in a call centre indicated that a single adviser with poor people handling skills could reduce profits by up to £300,000 through a drop in custom.

Lastly, based on its MORI findings (1,100 UK adults annual CSR study), BT also demonstrated that 70% of the proponents of CSR were ABC1s – the higher spenders on telecommunication services. BT's conclusion was that CSR increases customer satisfaction and has a positive impact on both revenues and profitability.

5.2 Ethical Purchasing Index 2002¹²

In a review of the UK ethical purchasing picture, the Co-operative Bank and the New Economics Foundation found that consumer perceptions of ethical business practices and ethical products and services had a significant impact on spending and customer loyalty. It found that:

- Ethical business activity contributes £13.9 billion to the UK economy

- Sales in the so-called 'ethical marketplace' rose by 19% in the two years to 2001
- The cost of consumers switching brands for ethical reasons was £2.6 billion
- That 52% of consumers have boycotted a product or service for ethical reasons, and two-thirds report that they never return to the product once it has been associated with unethical practice.

These data demonstrate that a growing proportion of consumers in the UK are recognising that their spending power can make a difference to the commercial success of businesses. As ethical criteria become more significant in both purchasing and brand loyalty decisions, and as the economic strength of ethically aware consumers increases, the message to businesses is clear – ethical practice, CSR performance and the bottom line are all more closely linked than ever.

6 CSR and strategic business 'fit'

The final category of research examines studies that have looked at the way CSR policy and practice form part of the strategic fabric of business strategy. In many ways, for those who argue that CSR can only have enduring and sustainable impact when it becomes part of the business strategy mainstream, the kind of research described here can represent the most direct evidence that CSR must be at the heart of business.

6.1 *Does Business Ethics Pay?*¹³

Having a code of ethics is seen as being a fundamental part of a CSR programme. The study *Does Business Ethics Pay?*¹³ in 2003 compared 50 companies from the FTSE 250 that had a code of ethics with a further 50 that did not. One of the critical factors for choosing such companies was continuity of financial information over the four years covered by the study. Those with a code of ethics outperformed those without such a code on three out of four measures of corporate value. The three measures that showed such a relationship were economic value-added, market value-added and stability in P/E ratio. However, there was no discernible difference in the fourth measure, return on capital employed between those with such a code and those without a code.

This result failed to take into account the many other factors that could have improved corporate values, resulting in a demonstration of a correlation, rather than determining causality.

Unfortunately, the stock market's appreciation of socially responsible investment (which would include the extent to which a code of ethics is present) remains sceptical – fund managers are not universally positive about the relative balance between risk and return on socially responsible investments and retain a degree of scepticism about their long-term performance.¹⁴

Business leaders that used these and other similar research studies as the basis for developing their CSR programmes were working on the basis of conviction, rather than commitment. They needed to move towards a more rigorous method of evaluating the business case for CSR, and lacked a fuller understanding of the potential benefits of placing CSR programmes at the heart of their business processes.

6.2 *The Workplace Trends Survey 2004*

This survey, to be published in full later in 2004, is conducted annually for corporate partners of The Work Foundation and examines a range of practices among UK workplaces. The most recent survey asked additional questions about the extent to which CSR and external stakeholders are being placed at the core of business strategy and practice.

The results of the 2004 survey show that high performing organisations tend to be those that have indeed put CSR at the heart of the business and from the initial analysis of findings there does seem to be a strong correlation between CSR activity and higher performance. In particular:

- Firms in the manufacturing, business services and services sectors that report that CSR is a primary or strong business focus are almost twice as likely to have experienced profit growth in the last three years as those who report that it is a minor or negligible focus
- Firms in the business services and services sectors that report that CSR is a primary or strong business focus are almost twice as likely to have experienced an increase in market share in the last three years as those who report that it is a minor or negligible focus.

The survey indicates that business strategy and practice that is informed by CSR principles and a stakeholder focus is associated with stronger business performance.

**6.3 The Missing Link:
From Productivity to
Performance¹⁵**

The Work Foundation's most recent published study, initiated as a result of promptings from the DTI, attempted to identify the root causes of productivity differences between the UK and its key competitors. *The Missing Link: From Productivity to Performance* resulted in the development of a high performance index (HPI) based on interviews with over 1,000 UK CEOs. It showed conclusively that the UK's productivity is lower than many of its main trading partners. A wide range of performance issues affects this, many CSR-related.

For example, high performance – as defined by companies – includes factors such as:

- Shareholder value
- Product service diversity
- Collecting market intelligence
- Prioritising customer needs
- Product service quality
- Stakeholder focus
- Performance at innovation/technological frontiers
- Innovation
- Highly skilled workforce
- Attracting good quality employees
- Investing in workforce training
- Recognising unions
- Performance related pay

The study also linked this to Total Factor Productivity (TFP) – the UK performance measure preferred by many economists. The study showed that five overlapping areas determine high performance:

- Customers and markets
- Shareholders and governance
- Stakeholders
- HR practices
- Creativity and innovation

No one area alone can influence performance, as they all are interdependent. Comparing these five areas against our broader definition of CSR – employees, community, marketplace (customers and suppliers) and environment – it is clear that there is significant overlap.

The study also showed companies at the top end of the HPI, based on 1,000 companies, are 42% more productive than those at the bottom of the survey. Even more importantly, it demonstrated positive links with the bottom-line – those companies at the top end of the HPI were more likely to be risk takers, have higher aspirations and more growth based strategies, to be more likely to innovate and network, and more likely to access skilled employees and retain them.

A 1% increase in a company's rating on the HPI leads to:

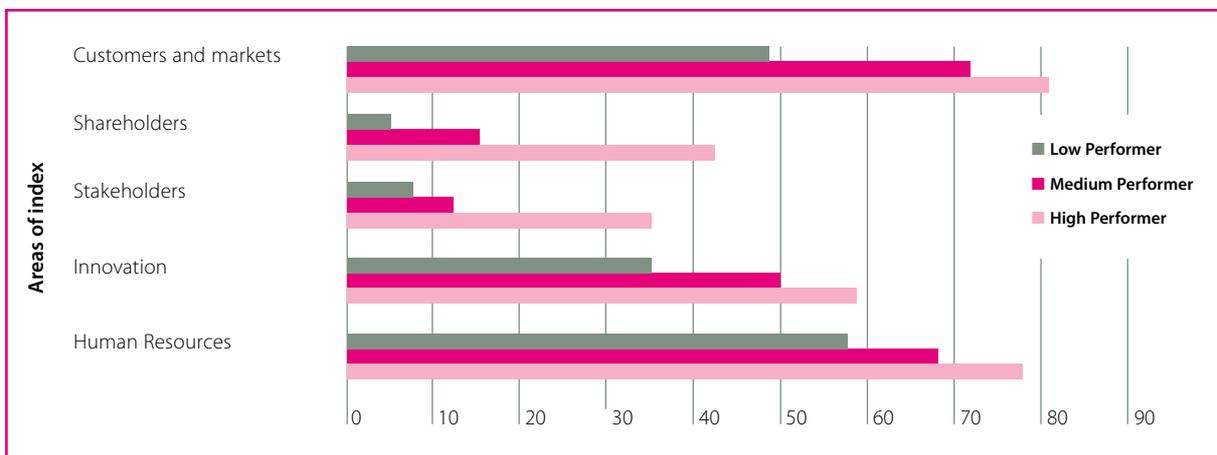
- 0.7% increase in productivity (TFP)
- 6.0% increase in performing at technological frontier
- 0.3% rise in ability to recruit and retain a highly skilled workforce
- 0.3% increase in attracting highly skilled workers within the industry
- 0.9% increase in performing against the industry benchmark
- 2.5% rise in overall sales per employee
- 2.5% increase in growth
- 1.0% rise in profitability

These results show that there are productivity benefits to be gained by those businesses striving to reach the technology frontier by investing in the technology and by building up a high quality workforce; as well as those that invest in information about the consumer and market, offer an enhanced range of products/services and are associated with innovation.

In line with a volume of previous empirical work, The Work Foundation found that 'bundles' of strategies do have an identifiable effect on productivity and that pursuing individual strategies in isolation does not.

However, the study showed no apparent differences between sectors and performance in the HPI. It seems a reasonable extrapolation, therefore, that the benefits from developing a CSR agenda are not sector related either.

This study is one of the first to link the wider range of CSR activities to the bottom line, showing clear correlations between the five areas of the HPI and business performance as demonstrated in this graph:



The study's most important message is one of interdependence and demonstrates to business leaders that CSR needs to be embedded across all business functions. Adopting a 'tick box' mentality towards it will seldom achieve any lasting business benefits.

Hence, a **commitment** towards CSR will deliver higher organisational performance benefits because CSR addresses the needs of all stakeholders.

The Missing Link study shows that CSR activities are already embedded in the business operations of the most productive and profitable businesses. It clearly shows that to achieve high performance ie. above-average productivity and profitability, a company has to embrace the key elements of the CSR agenda as part of a balanced approach to management.

The Missing Link study highlights strongly the relative importance of labour in determining productivity, rather than capital. In short, people matter and how they are managed and interact in the workplace is crucial to the productivity of any business.

These results imply that firms focusing on creating shareholder value whilst also taking into account the needs of other stakeholders and employees, will achieve higher productivity. Aligning the objectives of employees, shareholders and external stakeholders is beneficial to business and people and managing their competing needs is integral to being a socially responsible organisation as the matrix below demonstrates.

The correlation matrix of strategic objectives

	Customers and markets	Shareholders	Stakeholders	Human Resources	Innovation
Customers and markets					
Shareholders	Positive – not significant				
Stakeholders	++	++			
Human Resources	+++	++	Positive – not significant		
Innovation	++	++	++	++	

++ indicates statistically significant at 5% level

+++ indicates statistically significant at 1% level

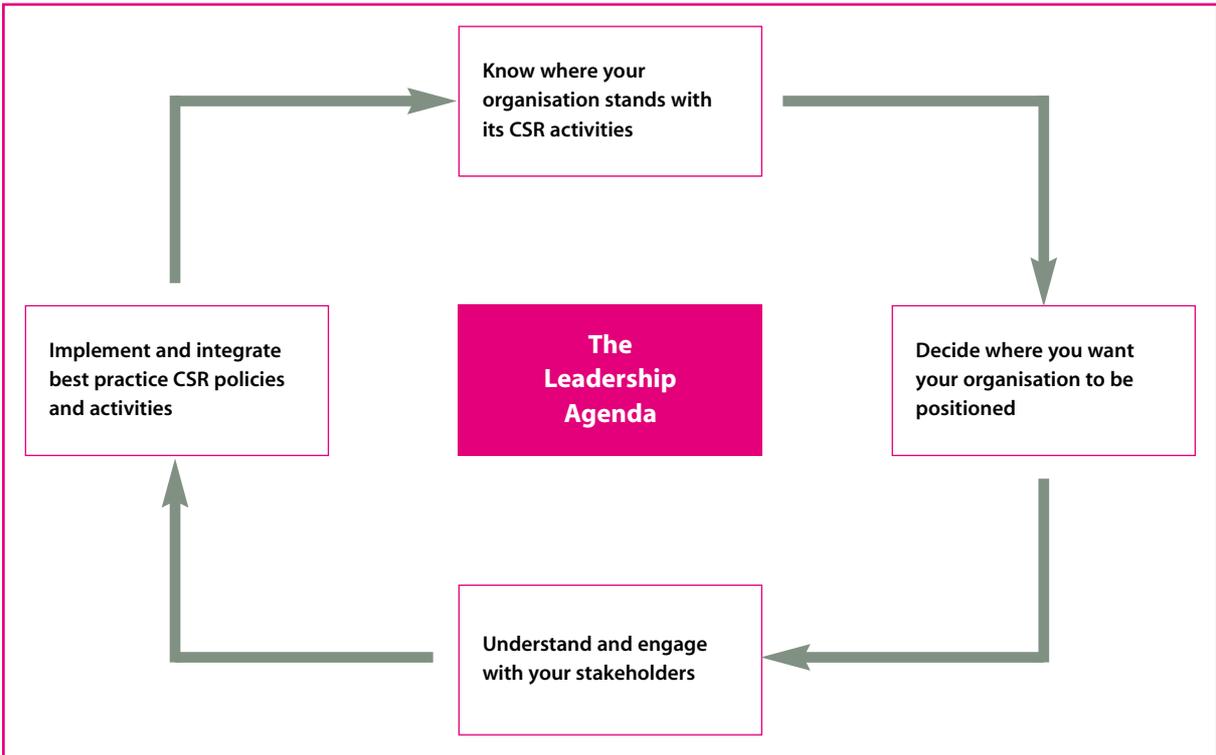
What this table shows is that there are strong associations between stakeholder value, customer and market priorities, innovation and shareholder value. What appears clear is that CSR in its broadest sense does not inhibit company performance – rather, as part of a comprehensive strategy it is likely to lead to performance and productivity gains, resulting in a stronger investment proposition to shareholders.

7 CSR at the heart of business

7.1 Establishing a leadership agenda

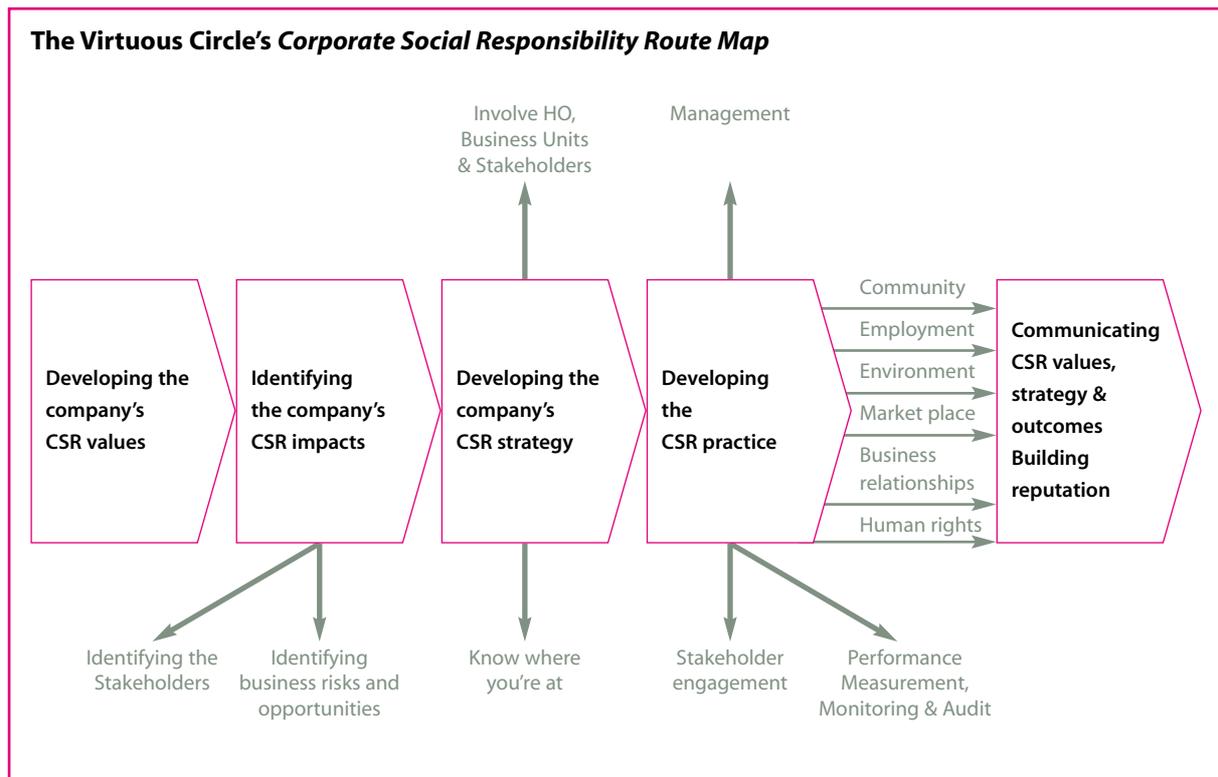
What is clear from the various studies discussed in this report is that establishing CSR at the heart of business – thereby achieving higher business performance – does not require new management techniques but rather, new management perspectives.

For this purpose, the critical factor is leadership practices. For business leaders wanting to move from conviction to a commitment to CSR in their organisations, there is a need for a leadership agenda that can help them in communicating with their stakeholders, especially staff. This leadership agenda is based on the findings of the extensive empirical studies reviewed earlier. It outlines the business benefits attainable from CSR and, as a result, will improve an organisation’s ranking in indices like the HPI. The leadership agenda has four key elements:



7.2 Baseline Analysis: know where your organisation stands

Much of the work undertaken with TVC’s clients over the past two years starts at this juncture. The experience gained suggests that many large companies do not know the full range of CSR activities being undertaken locally. For this reason, TVC has developed its CSR Route map:



The CSR Route Map is designed to provide a working framework for senior managers seeking a pathway towards CSR. Three key issues usually predominate:

- The absence of a vision or values on which to base CSR
- Knowing where the company is at in CSR
- How should it communicate its CSR activities?

Not knowing where you're at in CSR is usually bound up with the following:

- CSR often involves the measurement of new activities
- When CSR activities are not new they have often not been reported upon and hence not measured
- CSR activities may not be brought to the attention of senior management for a variety of reasons, including not meeting corporate rules or guidelines or using the appropriate budget codes for such activities – often linked with community actions.

Hence, local managers may be concerned that reporting (or even advertising) what they are doing may result in corporate support being withheld from them in the future.

For the business leader, understanding where the organisation is at normally requires engaging in the following three activities:

1. Undertaking a review of the internal activities of the organisation.

This can be far more of a challenge than expected because one has to adopt an external view and challenge accepted practice. Too often a company can overlook its existing CSR activities; activities that seen from the outside would be regarded as very high quality. TVC calls it 'looking for the Golden Nuggets' – ie. activities that are not regarded as exceptional because they are not regarded as the exception.

2. Identifying the sources of information. In TVC's experience the information needed for CSR is often unreported or unidentified. A lateral view is required both to identify the information route and its source. In a recent instance a department was unable to provide any quantitative information to enable improvement measures to be established. Instead, TVC had to track back to core data held within the procurement function to establish new performance indicators which surprised many in the organisation who had not regarded such a department as being a source for this type of information.

3. Setting up the measurement routines. The burden of internal organisational reporting is already extensive, so providing new information is often seen at best as onerous and at worst, lacking value. To gain an insight into the extent of CSR activities, some measurement is necessary. To avoid creating frustration within the ranks of middle and junior management, care must be taken to minimise the number of performance indicators measured and to ensure those reporting on them fully understand their value and where they fit in the organisation's range of business drivers.

**7.3 Strategic positioning:
decide where you
want your organisation
to be positioned**

7.3.1 Comparison with peers and competitors

Business leaders need to decide at the outset where they want to position their organisation in CSR. To do this requires an external reality check since, no matter how good an organisation is internally in terms of its CSR activities, if it does not communicate them to key stakeholders, it will continue to be regarded as performing poorly in this area.

Every aspect of the organisation's proposed CSR positioning should be looked at in terms of the cost and benefits. To achieve the *right* balance also requires some understanding of the business benefits from achieving a higher performance rating on the HPI, as well as an understanding of the costs of improving CSR activities vis-à-vis competitors. One way of identifying which

actions are required to develop an organisation's preferred stance on CSR is by using TVC's 'Reputation Radar' modelling technique.

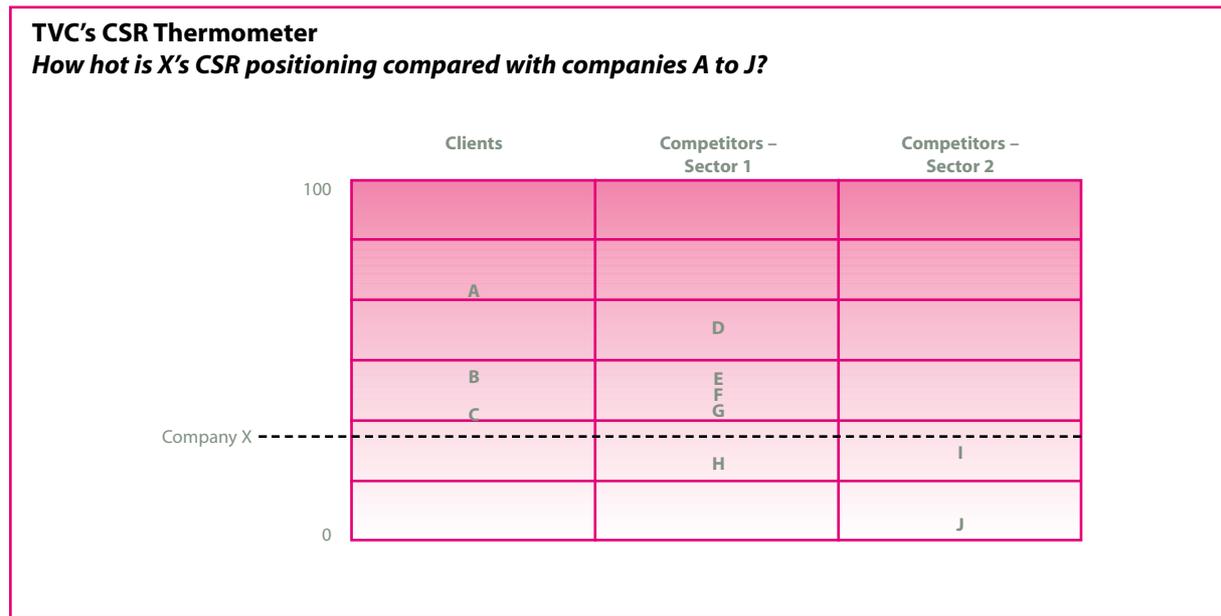
In the following example, TVC was asked by a major consumer services organisation – 'Company X' – to compare its CSR performance with 22 other companies covering the different business sectors in which it operated.

The Virtuous Circle's Reputation Radar – All companies' comparison



It compared performance based on a ten point scoring system – using data sources available in the public domain for each company, such as websites and published reports – on the basis that 'perception is reality'. The Reputation Radar chart shows how company X performed against each competitor across the 10 indicators.

Such results can also be presented visually on a centigrade 'thermometer' scale as shown below. This enabled company X's board to have a very meaningful discussion about where they wanted to be positioned, and how far they wanted their CSR programme to develop company X's future reputation.



The value of this in-depth comparison is well illustrated by the subsequent comment of company X's HR Director who felt strongly that his department was performing far better than the 'Reputation Radar' showed. The CSR Director responded by saying that unless he was told about the achievements of the HR department he could not communicate them to the stakeholders!

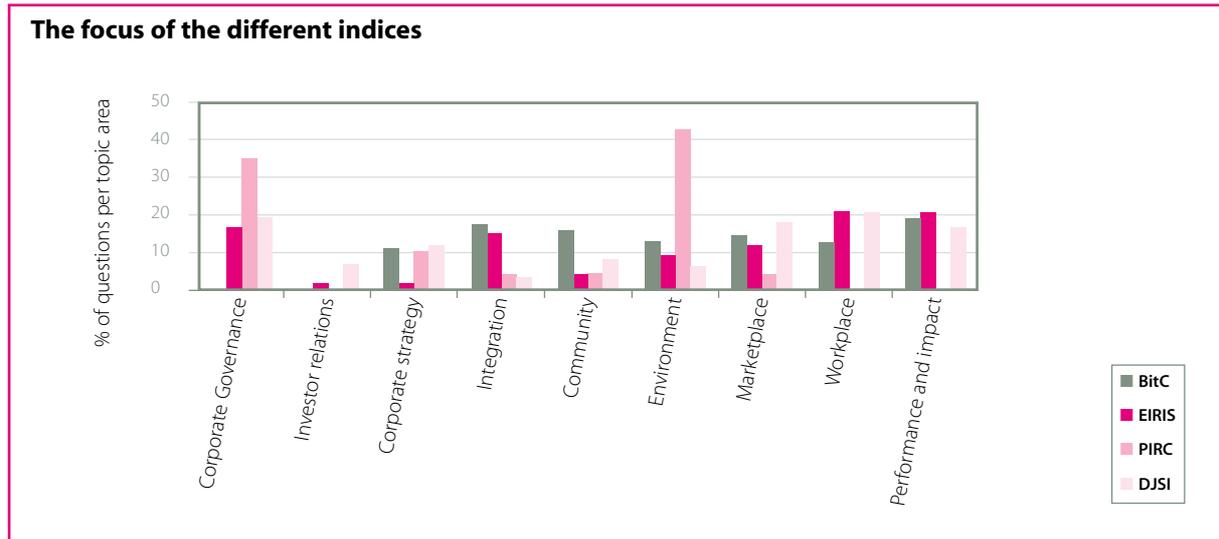
7.3.2 Responding to the indices

CSR indices abound, sometimes engendering concern amongst board directors, particularly if a low score has been awarded that is potentially damaging to the reputation of the company.

Despite this, we found that few comparisons are made between the various indices or their constituent parts. To answer this on behalf of one of its clients, TVC compared four questionnaires the company had responded to in the previous year and the following table shows how their focus differs. The inescapable fact is that indices are not all the same.

Not only did the balance vary between each questionnaire, so did the numbers of questions asked – the longest asking nearly two and a half times more than the shortest. In addition, some asked sector specific questions and others not.

What was also apparent is that these questionnaires are not static – were the same exercise undertaken today there is no doubt that many of the factors referred to would have changed.



It would be wrong to single out any of the questionnaires now in circulation – the four referred to in the chart represent only a handful of the total. Indeed, they have been very successful in helping companies to appreciate that operating in a responsible manner is a matter of concern to many outside the company.

However companies, and board members in particular, often respond to these indices without asking how the questions were constructed and, as a result, what the outcomes really mean. Business leaders need to decide which indices are right for their business and focus attention on providing the relevant information to the questions they pose.

This is not to say that they should not get too concerned about the other results, but rather that they should use their chosen index as a benchmark by which they can measure their internal progress. This enables a company to focus on using one index as a benchmark to measure its progress towards the CSR goals it has set for the business, rather than worrying overmuch about the results from the others. Most importantly it should be remembered that being active in CSR is not about ticking boxes.

7.4 Engagement: understanding and engaging with your stakeholders

TVC's experience shows that companies are often poor at understanding and communicating with their stakeholders, especially external ones.

In this arena CSR has three main forms – compliance, risk and reputation management. The focus to date has been mainly on the first two forms. There now needs more focus on the latter as part of a structured programme of stakeholder dialogue.

One of the biggest challenges is an apparent lack of rigour in stakeholder profiling, marketing and communications. In this instance, we are using the term 'marketing' to define understanding audiences and the most effective manner of communicating with them.

The first step is to identify those stakeholders with whom there should be a more extensive dialogue, including organisations as distinct from individuals. A leading multi-national client of TVC's seeking to engage with Non Governmental Organisations (NGOs) had to answer a series of questions – should we have a dialogue with NGOs and, if so, which ones? Lastly, what should be the nature of the dialogue?

One of the biggest challenges for business leaders is how to take an objective external perspective. Sometimes it can be achieved just through dialogue. In other instances it needs a more extensive canvassing of views and attitudes.

TVC's CSR Brand Quality Survey is designed to understand stakeholders' attitudes towards:

- The organisation and its business sector
- The value of CSR in its sector
- Its standing in CSR terms vis-à-vis its competitors
- The level of understanding of current CSR practices by the organisation in question (including how stakeholders responded to CSR communication messages)
- The 'wish list' of CSR activities that would be most favourably received.

In a recent survey for a major UK transport business, the Brand Quality Survey showed a significant disparity between the value the board placed on its community activities and the value some external stakeholders placed on those same community activities.

As importantly, recent research amongst web users by TVC demonstrates the importance of more targeted use of web communications to stakeholders. Current perception of CSR web communications suggest companies have treated their websites as a receptacle for information putting in almost everything bar the kitchen sink, and that reporting is included for reporting's sake. The stakeholders we interviewed described a sense of frustration at being unable to access the information they felt was important to them. What was clear from our research was that these stakeholders used the website more than the companies had anticipated – and in different ways to those expected.

Equally, from a reputation perspective, there is a risk that the website will convey an image of the business that is different to the one that may be deduced if the stakeholder is in face-to-face contact with the business. This dichotomy of personality is likely to do the business harm in the long run, and there is great value in understanding how your stakeholders perceive you – and contrast that to what may be the business's current perception.

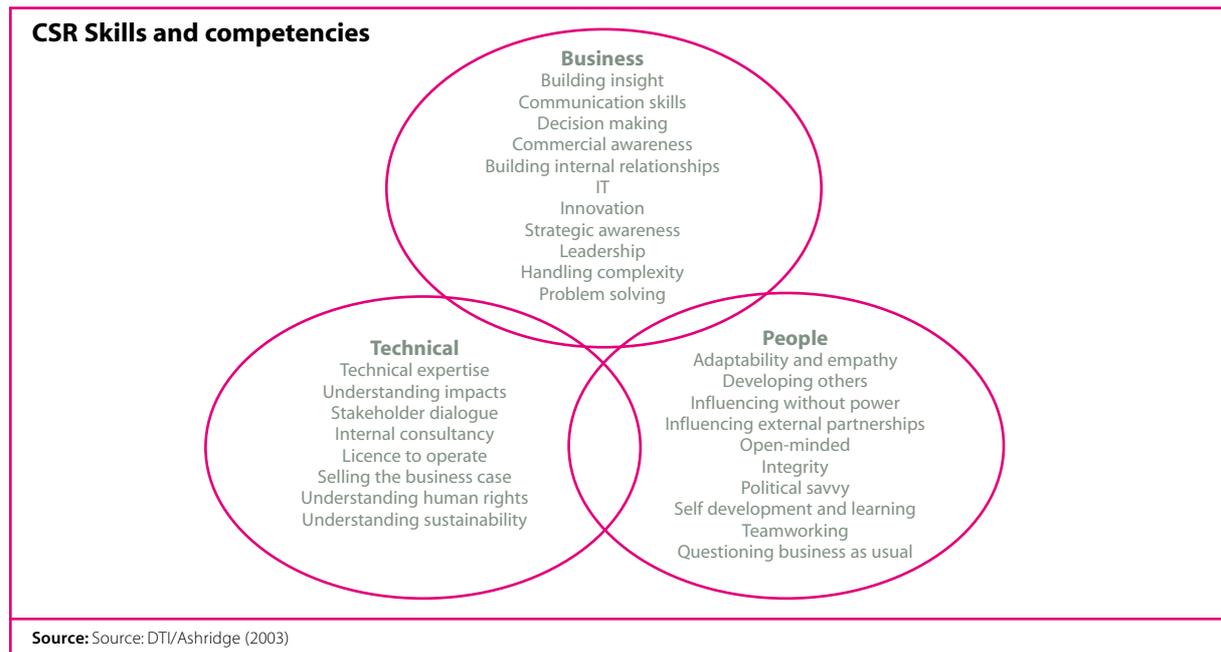
7.5 Action: implement and integrate best practice CSR activities and policies

This is often a very challenging task for the CSR champion in a business. How many departmental heads will accept that they may not be operating to best practice levels? Indeed, they may have good reasons why such levels are not being attained, or even aspired to.

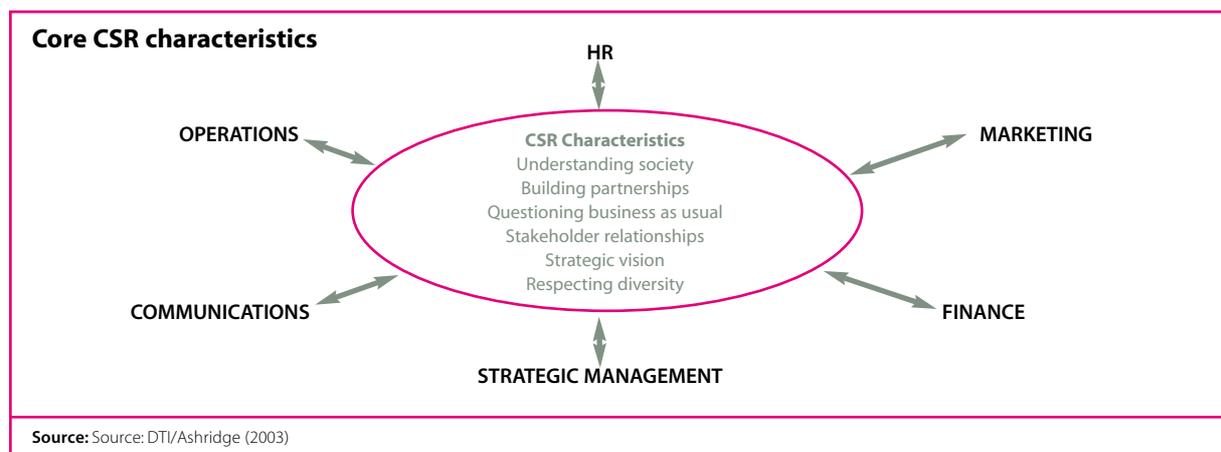
In our experience, the best approach is often to use the internal functions both to set the levels of best practice in terms of CSR appropriate to its business sector and to review the extent to which they are attained within the business. For one client, TVC adapted its Reputation Radar technique to enable multinational comparisons of their CSR practices within the various business functions. The difficulty of undertaking such a review expands logarithmically the more locations and countries a company operates in. At the conclusion of this review, the question needs to be raised as to why the organisation is not performing at best practice levels, and whether there is business benefit from doing so?

The studies emphasise the importance of adopting a pan-disciplinary approach. Yet few companies have yet to manage their CSR activities on this basis. A silo mentality still prevails, with few departments exchanging business performance issues in order to develop a pan-disciplinary stakeholder solution.

A recent report sponsored by DTI and the Corporate Responsibility Group underlines the importance of taking a pan-disciplinary approach.¹⁶ Here are two charts taken from the report. The first establishes the skills and competencies required to manage CSR within an organisation. It is worth reflecting how few of managers probably possess the range of skills and competencies identified in the chart below.



This chart identifies the nature of the integration between corporate functions:



Whilst there needs to be leadership to ensure that CSR is placed at the heart of business, the outputs from the individual functions need to be co-ordinated and integrated to ensure that high performance can be achieved – CSR (and the reputation an organisation derives from it) is only as strong as its weakest link.

The findings of their report led the DTI to announce a programme to establish a CSR Academy that encourages and develops the CSR Director to take responsibility for integrating and co-ordinating all CSR activities. We acknowledge the importance of the *Changing Manager Mindsets* study in identifying the importance of providing suitable training and development programmes to ensure that the necessary skills are available within an organisation.

8 The public policy fit

Though the thrust of this report has been primarily aimed at business leaders and decision makers, public policy makers have a clear responsibility to understand the empirical links between CSR and high performance and then take appropriate action. Indeed the European Multi Stakeholder Forum on CSR is due to report later in 2004 and the conclusions from that body may well trigger further legislation or best practice guidance for UK firms to take note of.

Much of the Information and Consultation Directive in its implemented form will look very CSR in appearance. It will fundamentally challenge the way that employees as stakeholders are involved in business decision-making. It will make the employee voice both more prominent and more difficult to ignore.

Public policy in this field must steer a delicate course. In particular, the balance between legislation and incentives, or sticks and carrots, needs careful consideration. On the whole, while legislation should create a stable floor for best practice to flourish it must not stray into areas where prescription becomes a stumbling block or leads to evasion, thus failing to provide the stimulus to better practice that was the original intent. Thus, the public policy focus should be concentrated in the following areas:

- Company Law needs revisiting. The minimal reporting prescriptions on CSR activities contained in the soon to become operational Operating and Financial Review should be strengthened
- The DTI's CSR Academy is to be welcomed, and we would urge that the Government allows sufficient resources to ensure its success, and that it works closely with other departments to join-up ongoing work in CSR-related areas, such as deprived communities
- The government needs to re-examine the system of corporate governance and incentives for investor/company relationships that will help prevent shareholder value maximisation from becoming the overriding strategic goal to the exclusion of other elements that contribute to high performance
- Recently, the Myners Report on pension fund governance and the Higgs Report on the role of non-executive directors offered important ideas for reform. It is clear, however, that the various initiatives and ideas need to be brought together in a more generalised effort to assist collaboration and constructive interaction between shareholders and managements
- HM Treasury during the course of this year should look at what fiscal incentives might be available to encourage companies to invest in CSR audits and to encourage further investment in 'green' technologies and community engagement where appropriate.

We are not arguing for greater regulation in the field of CSR. In practice, the growing body of case law, together with regulatory changes already in the pipeline, are likely to shape the context within which organisations operate during the next few years. However, we believe that those firms whose CSR ambitions are limited to minimal compliance with regulatory requirements are missing a fundamental point – that most of their stakeholders are now seeing genuine CSR as a pre-requisite not just of ethical practice but of sustainable business performance. The doctrine of ‘doing no harm’ is no longer enough.

9 Conclusions

Though this paper has presented a considerable weight of evidence to support the empirical links between CSR practice and high performance more evidence is urgently needed. Our knowledge of the relative importance between the different CSR variables in terms of economic impact needs to improve. There is also an urgent need to build up panel study data over time to measure changes in performance as organisations implement further CSR reform.

In addition there are gaps in understanding of the impact of CSR initiatives aimed at environmental improvement and on initiatives with supply chains and among small and medium size businesses (SMEs). Most CSR research to date has been concentrated on larger firms. There is a need for an in-depth independent review of those who have taken CSR to heart to better understand the causality as opposed to correlations. There is also a lack of empirical understanding of the balance between voluntarism and regulation, and whether (and how) they lead to different outcomes.

Finally there is a lack of international comparative data. The Work Foundation intends to launch a further tranche of research into high performance and CSR constituents shortly, which will provide more insights into some of these areas.

However we do believe that the findings of the research studies included in this report offer conclusive evidence that CSR needs to be placed at the heart of any business in order for it to deliver higher and sustained improvements in performance. In other words, the debate about CSR has moved from the anecdotal to the empirical.

The challenge now, for CSR practitioner and board member alike, is to foster the recognition that CSR represents good business practice for every function and should not be confined to programmes conducted by a few departments in isolation from one another. Equally for policy makers such an empirically based understanding would help current conversations that largely occur without any recourse to research evidence of the kind presented in this report.

The overall conclusion is that high performance can only be achieved through adopting an integrated approach to CSR, embracing the needs of all stakeholders. CSR is no longer merely fashionable but an essential component in delivering improved performance, requiring committed leaders to put it at the heart of business. For all those concerned with making the UK a high performance high productivity economy, CSR offers a route to achieving just that.

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