ARE PROFITABILITY AND CORPORATE SOCIAL RESPONSIBILITY COMPATIBLE?

JOSEPH F X ZAHRA*

1. Introduction

Recent months have not been happy ones for the reputation of the corporate sector. The spectacular failures of Enron, Anderson, Tyco and WorldCom has led to a general marking down of shares as investors have wondered how far the rot has penetrated. Clearly, after the failure of Arthur Andersen there is a need to enhance the current corporate governance guidelines. The recent volatility in stock markets have exacerbated the pensions funding problem – a reminder that, whereas many people think of companies as the preserve of bureaucrats and tycoons, the reality is that the major source of investment for most businesses is the pensions savings of millions of ordinary investors. Due to these recent events, there has been a renewed interest in corporate socio-responsibility.

2. The Concept of Corporate Social Responsibility

The concept of Corporate Social Responsibility (CSR) has been developing since the early 1970s. Corporate Social Responsibility encompasses an array of meanings and intended applications that have undergone substantial modifications over time. Thus, there has been no single, commonly accepted definition of Corporate Social Responsibility.

The European Union Green Paper 'Promoting a European Framework for Corporate Social Responsibility' defines CSR as a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.

---

* Chairman, Bank of Valletta plc

In general, it refers to a collection of policies and practices linked to relationships with key stakeholders, value, compliance with legal requirements and respect for people, communities and the environment. It is the commitment of business to contribute to sustainable development to improve quality of life of stakeholders. In this context, an increasing number of organisations have embraced the CSR culture within this scenario. A large consensus on its main features are:

- CSR is behaviour by businesses over and above legal requirements, voluntarily adopted because businesses deem it to be in their long-term interest;
- CSR is intrinsically linked to the concept of sustainable development: businesses need to integrate the economic, social and environmental impact in their operations;
- CSR is not an optional 'add-on' to businesses' core activities – but about the way in which businesses are managed.

3. Corporate Social Responsibility and Business

As companies themselves face the challenges of a changing environment in the context of globalisation, they are increasingly becoming aware that corporate social responsibility is of *direct economic value*. Although the prime responsibility of a company is to generate profits, companies can at the same time contribute to social and environmental objectives through integrating corporate social responsibility as a strategic investment in their core business strategy, their management tools and their operations. Due to the importance and real influence the different stakeholders have on business organisation, management is increasingly considering corporate social responsibility as an investment rather than as a cost: much like quality management.

In Western Europe, Japan and North America, an increasing number of companies are finding that it makes good business sense to fully integrate into corporate strategies, the interest and needs of customers, employees, suppliers, communities and the environment – as well as those of shareholders. Over the long term, this approach can generate more profits and growth.

Sometimes referred to as the *'stakeholder concept'*, this implies that management's task is to seek an optimum balance in responding to the diverse needs of the various interest groups and constituencies affected by its decisions, that is, by those that have a 'stake' in the business. By including societal actors – not just financial interests – the stakeholder model assumes that the enterprise upholds social responsibility.

Corporate Social Responsibility is essentially a concept whereby companies decide voluntarily to contribute to a better society and a clearer environment. There are many factors which are driving corporate social responsibility, including:

- New concerns and expectations from citizens, customers, public authorities and investors in the context of globalisation and large scale industrial change;
- Social criteria are increasingly influencing the investment decisions of individuals and institutions both as consumers and as investors;
- Increased concern about the damage caused by economic activity to the environment;
- Transparency of business activities brought about by the media and modern information and communication technologies.

Being socially responsible means not only fulfilling legal expectations, but also going beyond compliance and *investing 'more' into human capital, the environment and the relations with stakeholders*. The experience and investment in environmentally responsible technology and business practices suggests that going beyond legal compliance can contribute to organisation competitiveness. Going beyond basic legal obligations in the social area, for example: training, working conditions, management-employees relations, can also have a direct impact on productivity. It opens a way of managing change and of reconciling social development with improved competitiveness. I would now like to expand on the relationship of business with the main stakeholders: customers, employees, business partners, the community and investors.

4. Customers

Successful companies build lasting relationships with customers by focusing their whole organisation on understanding what the customers want and on providing them with superior quality, reliability and service. Management guru Tom Peters refers to this as *'having a passion for customers.'* The reason why business is focusing on customers is the increasing evidence that the ethical conduct and environmental and social consciousness of companies make a difference in purchasing decisions. This evidence is supported by research of the Council on Economic Priorities (CEP), a non-profit, USA-based, public service research organisation founded in 1969 to carry out accurate and impartial analysis of the social and environmental records of corporations.

The Council on Economic Priorities offers information on over 700 companies and its availability empowers consumers, investors, and activists to cast their economic vote with knowledge of corporations' performance on such factors as environment, community outreach, quality of life in the workplace, information disclosure, and the advancement of women and minorities. The reputation of companies in these and other areas does influence consumers' choice of brands and producers and often leads to switching brands even if there is a price differential. Basically, it encompasses the task of considering the consumer as a citizen.

5. Employees

Certainly, employees are the most important asset businesses have, since human capital is the most important determining factor in an organisation's competitive edge. The quality of life in the workplace and on the job, affects our whole life as well as that of our families. Socially responsible businesses are doing more to provide work which is meaningful and which helps employees develop and realize their potential. They are seeking to provide fair wages, a healthy and safe work environment, and a climate of respect.

Management practices and human resource policies often include empowerment of middle management and employees; better information sharing and communication throughout the company; better balance between work, family, and leisure; greater work force diversity; continual education and training; and concern for employability as well as job security.

Companies are also finding that profit sharing and share ownership can enhance motivation and productivity and decrease employee turnover, such as the Bank of Valletta employee foundation whereby employees are given share units, which can be converted into cash on retirement.

6. Business partner

Suppliers in some areas of the world violate fundamental human rights in such areas as child labor and working conditions. With increasing pressure from consumer groups, some companies are acting to insist upon respect for human rights on the part of their suppliers and are taking action to monitor performance in this area.

7. Communities

Nowadays, companies can make important contributions to these communities, and especially to local communities, through providing meaningful jobs, fair wages and benefits, and tax revenues. The success of business is linked to the health, stability, and prosperity of the society and of the communities in which it operates. If education is neglected, or not relevant to the needs of business, as is too often the case, companies cannot have a competitive work force. Community-focused businesses like banks, retailers, and newspapers cannot prosper in declining localities.

So the problems of education, health, crime, unemployment, and drugs dramatically affect business. While business has traditionally considered these to be the exclusive domain of government, today more and more business leaders are accepting part of the responsibility to improve the communities in which they do business. We, at Bank of Valletta, take this to heart and have included it within our mission statement which states ' We are committed to enhance the prosperity of the communities in which we operate with absolute integrity and to support further the development of the Maltese economy'.

8. Socially Responsible Investment

Many economists, business leaders and investors say that the purpose of business is to maximise shareholder wealth. Truly world class companies are generally able to show well above average returns and be environmentally and socially responsible. Furthermore, they are more conscious of the need to invest for future growth and profits and for the sustainability of their enterprises. They are also aware that satisfying the other stakeholders can be a source of competitive advantage. This brings us to an emerging group of shareholders referred to as ethical investors, or as socially and environmentally conscious investors, whose factor ethical and moral considerations are reflected in their investment making process. Modern ethical investing began in the United States in 1969, centring at that time around issues like the war in Vietnam and Ralph Nader's attacks on poor safety of automobiles. Today, one of the questions frequently raised about activities and strategies in social responsibility is whether they detract from a company's financial performance.

There is increasing evidence, though perhaps not conclusive for sceptics, that social responsibility correlates positively with financial performance. One encouraging bit of evidence for this proposition is the performance of the shares of companies, which have passed social and environmental screens. The 'Domini 400 Social Index' is an index of the share prices of 400 common stocks of American companies, which were chosen based on their performance on environmental and social performance screens. Socially and environmentally responsible policies provide investors with a good indication of sound internal and external management. They contribute to minimise risks by helping to anticipate or even prevent crises that can affect the reputation of the organisation and cause a dramatic drop in the share price.

Following my discussion on the relationship of corporate social responsibility with the main stakeholders, I would like to further develop my argument on what makes a good corporate citizen and what are the determining factors in Corporate Social Responsibility and human rights.

9. What makes a good corporate citizen?

In responding to the increased globalisation of the world economy, companies have recognised that they need to be globally competitive in order to survive. Good managerial practice and appropriate strategies to establish sustainable business over the long term have become essential tools for effective competition. At the same time, pressure on companies from investors, governments, local community groups and campaigning NGOs to monitor, manage and report on their impact on social, health and environmental issues is increasing. From a company viewpoint, the development and protection of reputation and the recognition and management of risk are key issues.

Companies are therefore increasingly looking at their business strategies in terms of the values which underpin them, their relationships with a broad range of stakeholders, and the impact of business on the local communities and environments in which they operate. Such 'good corporate citizenship' can be seen as a natural progression of good managerial practice, but experience has shown that in order for it to be successful, it must be an integral part of business strategy and core business practices.

A recent definition for corporate citizenship that came out of the World Business Council on Sustainable Development is that:

> *'Corporate citizenship is the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve the quality of life of all their stakeholders.'*

10. The relationship between CSR and human rights

Corporate social responsibility has a strong human rights dimension, particularly in relation to international operations and global supply chains. This is recognised in international organisations, such as the International Labour Organisation's Tripartite Declaration of Principles concerning multinational enterprises and social policy. Human rights are a very complex issue presenting political, legal and moral dilemmas. Companies face challenging questions, including how to identify where their areas of responsibility lie as distinct from those of governments, how to monitor whether their business partners are complying with core values, and how to approach and operate in countries where human rights violations are widespread.

Under increasing pressure from NGOs and consumer groups, companies and sectors are increasingly adopting codes of conduct covering working conditions, human rights and environmental aspects, in particular those of their subcontractors and suppliers. They do so for various reasons, notably to improve their corporate image and reduce the risk of negative consumer reaction. It is increasingly recognised that the impact of a company's activities on the human rights of its workers and local communities extends beyond issues of labour rights.

With respect to human rights, there is a need for ongoing verification where the implementation and compliance with codes is concerned. The verification should be developed and performed following carefully defined standards and rules that should apply to organisations and individuals undertaking the so-called 'social-auditing'. Monitoring, which should involve stakeholders such as public authorities, trade unions and NGOs, is important to secure the credibility of codes of conduct. A balance between internal and external verification schemes could improve their cost-effectiveness. As a result, there is a need to ensure greater transparency and improved reporting mechanisms in codes of conducts.

11. Corporate Socially Responsible: What approach?

A socially responsible approach to business cannot be enforced on an organisation's operations: it needs to be built into the culture of the organisation. The recent European Union Green Paper on Corporate Social Responsibility is a step in the right direction but should not be the means to an end by imposing a tight framework with which all organisations would need to comply.

Development of a CSR policy is a dynamic process, influenced by market conditions, the local setting, national frameworks, cultural and historical aspects, and so on. Each company must therefore be able to choose and define its own approach to corporate responsibility. This having been said, it needs to be noted, of course, that common principles for responsible business conduct have been established at international level, within the framework of OECD, ILO and the UN.

These initiatives are widely recognised in the business community and often considered a source of inspiration when companies draw up their own approaches. It should be recalled that CSR refers to responsible business practices and goes beyond compliance with legislation in force in the countries of operation. CSR policies are being increasingly developed as an element of competitiveness. The diversity of approaches and instruments is an expression of the innovative and dynamic character of companies' CSR initiatives and a reflection of the multiple different contexts in which companies operate. Taking this into account, the diversity of CSR practices and instruments cannot be regarded as a potential source for market distortion.

I therefore recommend that the following Union of Industrial and Employers' Confederations of Europe recommendation be taken into consideration:

- *CSR is voluntary and business-driven.* Companies perform their social function first and foremost through the creation of wealth and employment; they do this within the existing legal framework. In parallel to its statutory obligations, each company can develop other social or environmental activities to the service of society. However, this additional effort must remain voluntary.
- *There is no 'one-size-fits-all' approach to CSR.* In order to be successful, CSR policies must be developed from within the organisation and be adapted to its specific characteristics and circumstances. Moreover, these policies will not be static, but develop and be refined on a continuous basis, as new situations and challenges arise.
- *CSR is inextricably linked to the three pillars of sustainability relating to economic, social and environmental considerations.* The multi-disciplinary character of responsible business conduct and its potential for improving companies' total performance makes CSR an important issue.
- *CSR is not about shifting public responsibilities on to private companies.* A debate on CSR has to respect the distribution of roles between governments and companies: it should not overlook the responsibilities of governments and multilateral organisations *themselves* when it comes to the promotion of democracy and human rights, and the creation of a climate conducive to social and economic progress.

These points add up to a strong case for mutual self-interest between stakeholders in the exercise of corporate social responsibility.

References

European Commission Green Paper: *Promoting a European Framework for Corporate Social Responsibility*, July 2001, COM (2001) 366 final

Business in Society: *Good Corporate Citizenship in the Commonwealth, Commonwealth Business Council*, London: Commonwealth Secretariat, 2002

Communication from the Commission concerning Corporate Social Responsibility: *A Business contribution to Sustainable Development*, Brussels 2nd July 2002, COM (2202) 347 final.

UNICE Comments to Communication from the Commission concerning Corporate Social Responsibility: *A Business Contribution to Sustainable Development*, 28 November 2002, 2002/109.07/UNICEcomments_finalen.