Values-Based Performance

Seven Strategies for Delivering Profits with Principles

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Corporate Social Responsibility Initiative

The Corporate Social Responsibility Initiative at the Harvard Kennedy School of Government is a multi-disciplinary and multi-stakeholder program that seeks to study and enhance the public contributions of private enterprise. It explores the intersection of corporate responsibility, corporate governance and strategy, public policy, and the media. It bridges theory and practice, builds leadership skills, and supports constructive dialogue and collaboration among different sectors. It was founded in 2004 with the support of Walter H. Shorenstein, Chevron Corporation, The Coca-Cola Company, and General Motors.

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Values-Driven Performance:
Seven business disciplines for delivering profits with principles

Companies today are under intense pressure to rebuild public trust and to be competitive in a global economy. To do this they must act with greater accountability, transparency and integrity, while remaining profitable and innovative. They must engage with activists as well as analysts, cooperate as well as compete, manage social and environmental risks as well as market risks, and leverage their intangible assets as well as their financial and physical assets. We have studied sixty multinational companies that are taking a lead in responding to these challenges. Drawing on their experiences, we present seven business disciplines that move the concept of corporate responsibility beyond the boundaries of compliance, public relations and philanthropy, to become a more integral part of corporate governance, strategy, risk management and reputation. Applied broadly, this values-driven approach offers companies new opportunities for value creation, benefiting not only shareholders, but employees, customers, communities, and society at large.

In June 2003, ten of the world's leading banks joined forces with the International Finance Corporation to adopt the Equator Principles, a set of voluntary guidelines for integrating social and environmental considerations into their project finance operations. A year later their number had grown to almost 30, accounting for some 80% of the world's major project finance deals, and setting a new market standard.

Over a similar period of time, the Extractive Industries Transparency Initiative, an even more ambitious alliance between donor and developing country governments, major energy and mining companies, and non-governmental organizations, has set a new bar for the public disclosure of payments and receipts from natural resource projects.

In North America, a group of institutional investors, accounting for some US$800 billion of funds under management, have established the Investors Network on Climate Change, to encourage investors and companies to manage the risks and opportunities posed by climate change. Less than one year old, the network is engaging with US State Treasurers, public pension fund trustees, corporate board directors, insurance companies, and investment bankers to move the agenda forward.

These are just three examples of an emerging trend. A growing number of business leaders are taking a leadership role, both within their own firms and on a collective basis, to integrate targets for ethical, social and financial performance and accountability into their core business operations and governance structures.

Some critics argue that this is a fad, or a cynical attempt at 'greenwash' and public relations, carried out by large companies that can never have the public interest as a goal. At the opposite end of the spectrum, there are critics who argue that the only social role of business is to meet shareholder interests in a manner that is legally compliant, and that the emergence of a broader definition of corporate social responsibility is neither desirable nor likely to be sustainable. The evidence suggests that something more fundamental is happening; something that has implications for long-term corporate competitiveness and governance.

The crisis of trust, inequality and sustainability

This transformation is in part a response to the unprecedented scrutiny, skepticism and suspicion that has been directed at corporations in recent years. After a decade of triumphant capitalism in the 1990s and infatuation with free markets, liberalization, privatization and buoyant share prices, the bubble burst with a fury. The abuses at Enron, WorldCom, Adelphia, Anderson, ImClone, Global Crossing, Parmalat, Royal Ahold and elsewhere, exposed business to the most serious crisis of public and investor confidence since the Great Depression. The impact of the "morning after" has left many investors and employees not only poorer or without jobs, but also feeling betrayed, cynical, and mistrustful. Poll after poll documents the depth of suspicion and alienation, both in North America and abroad. Business Week/Harris identify a shockingly familiar trend: two-thirds of Americans think that corporations make good products, but only one-third feel that large corporations have ethical business practices.[1]

Figure 1: The crisis of trust, inequality and sustainability

Another factor underpinning mistrust and lack of confidence in our corporations and economic system is the growing public awareness of serious inequalities in the corporate workplace, and at national and global levels. In the United States, the gap between senior executive and average worker compensation grew from 42:1 in 1980 to over 500:1 in 2000, markedly outstripping percentage growth in corporate profits and market performance.

Even during the booming '90s, income inequality rose in America. And while the World Bank estimates that the total number of people living in absolute poverty has declined since the 1980s, the developed world (with 20% of the world's population) enjoys 80% of world income, while 60% of the world's people receive but 6% of world income. The typical European cow lives on subsidies equivalent to $2.50 a day, while over three billion human beings in the world have to get by on $2 or less a day.

At the same time, the crisis of environmental sustainability is becoming increasingly apparent, with trends in global climate change, water scarcity and declining biodiversity all giving serious cause for concern. Europe and North America, with 15% of the world's population, currently consume more than 50% of the world's of natural resources. China’s explosive growth, combined with continued industrialization and increased consumption in other big emerging markets, will put even greater pressure on the carrying capacity of our natural ecosystem.

In a world where there are an estimated 60,000 multinational companies, many of them with global reach and revenues to match the GDPs of small countries, there are growing expectations that business will be part of the solution to these crises of mistrust, inequality and sustainability.

Growing stakeholder expectations

These trends are creating unprecedented leadership challenges for CEOs, corporate boards, and managers at every level. They include the need to continue delivering short-term financial performance and growth, at the same time as rebuilding trust and credibility, managing new and unfamiliar risks, and responding to growing stakeholder expectations - from more stakeholders in more places, and on more issues than probably ever before in corporate history:

- *Investors* still expect good financial performance, but they are also demanding greater corporate transparency and accountability, and shareholder activism is on the rise.

- *Consumers* are still demanding quality, reliability and good value in the products that they buy, but they also want to know how these products were produced and how workers and the environment are treated along the global supply chain.

- *Employees*, especially recent graduates, still care about decent pay and a good benefits package, but they are also are searching for greater respect, work-life balance, professional growth, and meaning in their work.

- *Governments* are sending a complex mix of regulatory signals and incentives to business. They are increasing regulation and oversight in some areas, with Sarbanes-Oxley being an obvious example, and reversing it in others, turning towards market-based solutions and the private sector to help to solve seemingly intractable public policy problems, from combating HIV/AIDs, to tackling environmental degradation, inner city poverty, low education standards, and homeland security.

- *The media*, after scandals of its own, is shining an increasingly intense spotlight on corporate practices. As a result of unprecedented communications capacity via the Internet and global media, non-governmental organizations, investigative journalists and individual activists, can turn a local problem into a global public relations crisis for a company almost overnight, jeopardizing brand equity and corporate reputation.

- *The general public* seems fed up with what they see as the growing power, influence and abuses of big business and are starting to ask questions such as: What are the values of the corporation? Who is big business accountable to?

Strategies for delivering shareholder and societal value

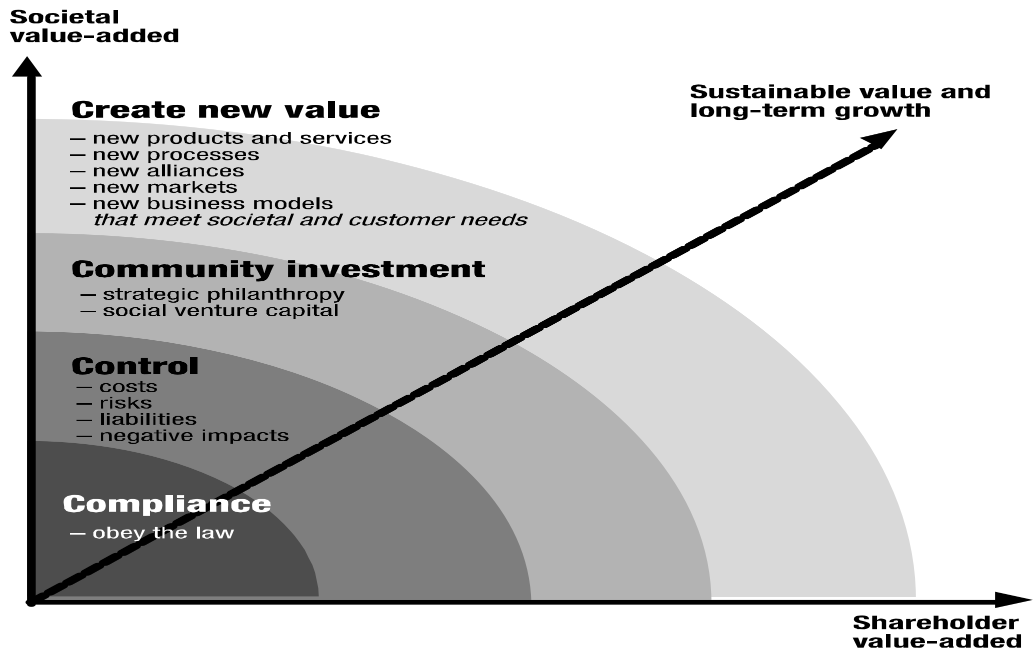
These rising concerns and expectations are creating leadership challenges for companies on a scale and level of complexity that is unprecedented. The central challenge that business leaders face in this demanding environment is how to continue to deliver shareholder value, while also delivering societal value. Doing this requires them to focus on all the normal levers of value creation, such as cost competitiveness, customer focus and Six Sigma, while addressing a new and constantly emerging set of responsibilities and opportunities related to the company’s ethical, social and environmental performance.

These emerging responsibilities and opportunities are moving to the mainstream of the business agenda. They are no longer simply about good intentions or the chairman's favorite charitable cause, although strategic philanthropy, employee volunteering, and community investment can all make valuable contributions to society and bottom-line. They go well beyond defense and regulatory compliance, although both the spirit and letter of compliance is the crucial bedrock on which a responsible business is built. For many companies, they are about a more integrated approach to managing risk and reputation. Essentially a focus on control; control of costs, risks and liabilities.

For a small, but growing number of companies, these responsibilities and opportunities are also about corporate strategy and competitive advantage; about creating new value. They are about developing new products, processes, technologies and even transforming business models to serve untapped social and environmental needs or facilitate entry into underserved markets. Developing new markets for carbon emissions trading, creating new environmental, health, and information and communications technologies, and producing more affordable access to essential services such as credit, education, water and energy, especially for the estimated 3 billion people who still live on less than $2 a day, are just a few examples.

In a few cases, business leadership is moving even further. As we illustrated in our three examples at the beginning of this article, some companies are engaging in new alliances that are aiming to fundamentally reshape markets and governance structures, thereby changing the 'rules of the game' for all companies.

Figure 2: Strategies for building shareholder and societal value-added



Source: Adapted from J. Nelson. *The Business of Peace*. International Business Leaders Forum , International Alert and Council On Economic Priorities, 2001.

Mastering the new 'rules of the game'

Mastering these constantly changing expectations and 'rules of the game' requires clear business principles, and new tools and management competencies. The potential benefits of 'getting it right' include better risk management, better relationship management, and better responsiveness in anticipating changing consumer needs. The benefits may also include new market opportunities, better reputation management, better cost management, greater readiness to innovate, improved employee morale, and increased market share and market capitalization.

Failure to adapt to the new rules of the game and to incorporate new tools, can lead to a downward spiral of increased regulatory and compliance costs, litigation and bad publicity, consumer boycotts, lost customer loyalty, high opportunity costs, an inwardlyoriented and risk-averse corporate culture, accelerated depreciation of intangible assets, and, in extreme cases even corporate failure.

It is important to be realistic. ‘Doing the right thing’ does not always pay. There are also risks and costs associated with being first-movers in responding to some of these emerging societal expectations. Developing new products and technologies to serve unmet social or environmental needs, can be as risky as any other innovation, sometimes more so. A company and its leaders can also get exposed by being too far out-in-front of their peers, especially in the short-term. And the bar for what is considered good practice keeps rising, with the leaders in corporate responsibility, rather than the laggards, all too often targeted by activists and the media, in the knowledge that these leaders are more likely to respond.

The new risks and opportunities that companies face are complex and messy – there are no simple solutions or quick fixes. Yet these risks and opportunities cannot be ignored. Denial may work in the short-term, but over time, failure to respond to changing societal expectations is likely to put companies at the risk of increased regulation, public censure, or competitive disadvantage.

Our research and experience leads us to identify seven operating disciplines that values-driven companies are employing to meet and master these new rules of the game.

Discipline #1: Harness Innovation for the Public Good

The ability to turn good ideas into deliverable solutions has never been more important to the success of business and society. Innovation that responds to changing consumer needs and societal expectations is the lifeblood of corporate competitiveness, value creation, and sustainable growth. It is also vital to solving many of the major challenges that our world faces.

Great companies, like Proctor and Gamble, 3M, Toyota and Dupont, understand the immense opportunities and responsibilities of innovation. As a result, they go further than others by integrating ethical, social and environmental considerations into their R&D efforts. They carry out due diligence to minimize negative impacts. They also create new value by developing profitable customer solutions that meet emerging environmental, safety, and social needs, in addition to providing customers with good quality, reliability and value.

P&G, one of America's largest makers of household goods and a pioneer in popularizing the concept of consumer branding and brand marketing, is creating new shareholder and societal value by pursuing what it calls *corporate social opportunity*: the production of new products that improve customers' lives while also making important contributions to environmental quality and social well being. P&G's PuR Water Purifier, for instance, a simple-to-use, low-cost water purifier developed in conjunction with the U.S.-based Centers for Disease Control and the International Council on Nurses, has the potential to save the lives of thousands of children who die each day in developing countries due in large part to lack of clean water. P&G's Safeguard antibacterial soap and its Nutristrar fruit-flavored drink powder, offer other examples of innovative products that solve health dilemmas through more affordable and potentially profitable new products.

Dupont, the oldest industrial company listed on the Fortune 500, is entering its third century committed to an explicit corporate strategy of *sustainable growth*, by which they mean increasing shareholder and societal value while decreasing the company's environmental footprint. Through rigorous metrics, clear targets, due diligence, and a strategy of knowledge intensity, increased productivity and integrated science, Dupont continues to set an impressive pace of innovation. It has turned its legendary commitment to workplace safety into a successful business proposition and started to explore ways to provide affordable consumer products and agricultural services to some of the world's poorest countries and communities. Over the past decade, the company has increased shareholder value by 340% while decreasing its environmental footprint by 60%.

Discipline #2: Put people at the center

The quality of relationships that a company has with its employees and other key stakeholders along its value chain – customers, investors, suppliers, public officials, activists, and host communities – is crucial to its success and its ability to anticipate or respond to changing competitive circumstances and societal expectations. It is the ideas, interests, and energy of people who work in and interact with a business that underpin innovation and drive transformation. Leading companies aim to build relationships that are based on mutual benefit, learning, accountability, transparency and trust.

Every company seems to assert that its employees are its most important asset. Yet, many fail to 'walk the talk'. Great companies have learned that, as Adrian Levy, founder of Canadian firm RLG has observed, "people are not the most important asset of a company – they *are* the company. Everything *else* is an asset."[2]

Consider Alcoa, the world's leading producer of aluminum, operating in a heavy industry and challenging business environment. Having made an extraordinary commitment to make safety the company's number-one priority and performance measure, lost workday injuries have been reduced by 90 percent since 1988, and 75 percent of Alcoa's 487 locations worldwide had zero lost workdays in 2002 – ten times better than the record of its industry peers. Stakeholder engagement at both the corporate and plant level, has been a core element of the company's commitment.

Or take Nike, the innovation-driven, customer-focused corporation with the iconic brand and products at the leading edge of performance and design. Faced with an international outcry concerning exploitative labor practices along its global supply chain back in the late 1990s, Nike embarked upon a transformative journey of organizational learning and change, aimed at improving factory conditions among its own contractors. The company has also joined efforts with other footwear and apparel companies, trade unions, and non-governmental organizations to tackle some of the more systemic challenges associated with global supply chains and international trade; challenges that no one company can solve on its own.

Discipline #3: Spread economic opportunity

Great companies create wealth and increase opportunity. They make systematic efforts to spread economic opportunity as widely as possible, not only to their owners but also in the workplace, along the supply chain, and in local communities. They do so in knowledge that this will help to enhance the prosperity and loyalty of their employees, business partners, and local neighbors, and may also help to build future markets and business relationships for the company. Efforts to spread economic opportunity include making a commitment to employee diversity, investing in local economic development, building business linkages with small and microentreprises, and supporting programs to increase access to information technology, education and training.

Marriott International has been spreading economic opportunity – and gaining loyal employees and competitive advantage – for many years, through its "Pathways to Independence Program", which trains former welfare recipients for entry-level positions.

Daimler-Chrysler is forming innovative supply chain partnerships in countries such as Brazil and South Africa, which aim to be both anti-poverty and pro-environment while developing high quality raw materials for the company's premium cars.

In the U.S., minorities and women represent over 30% of McDonald's company franchisees and some 70% of all applicants in training.

In less than thirty years, Starbucks has created one of the world's most valuable brands out of one its most ubiquitous commodities—coffee. In doing so, it has created impressive value for its owners and employees, including being one of the first companies to offer a stock-option program to part-time employees. At the same time, it is starting to spread economic opportunity, as well as environmental, social and quality standards, by working directly with small-scale coffee producers along its global supply chain.

Bank of America, through its recent acquisition of Fleet Financial, inherits a commercial bank that was among the first to transform its legal compliance obligations into a major and sustainable new business opportunity, by aiming to serve the needs of previously marginalized inner-city neighborhoods. Fleet's Community Bank has grown to 157 inner-city branches, with 1500 employees in five states, leveraging its $5 billion in deposits into a $14.6 billion commitment to mortgage and small-business lending. Fleet, and its predecessor BankBoston, not only achieved corporate hurdle rates of return on its inner-city banking, but helped to enfranchise tens of thousands of new customers and hundreds of new businesses – earning accolades from regulators, easing future acquisitions, and gaining valuable corporate reputation.

Discipline #4: Engage in New Alliances

There is a growing need and potential for companies to build cross-boundary alliances, often with non-traditional allies beyond the business sector. Successful companies are creating such alliances for a variety of purposes.

Some companies are collaborating to enhance their core business proposition and performance. Unilever, for example, has embarked on a number of multi-stakeholder alliances over the past decade to support more sustainable fisheries and agricultural practices, and to provide affordable, good quality products to consumers in poor countries and consumers. Atlanta-based carpet manufacturer, Interface, has made customer alliances a central tenet of its efforts to transform its business model into a more sustainable 'closed-loop' service. It is working with customers to deliver high-quality, high-value carpets that use less raw material and energy in their production, and can be returned to the company for recycling, ensuring that they send less discarded materials into landfills and the atmosphere. In essence, customers are getting a full life-cycle service, rather than a one-off product.

Many companies are building new types of partnership to increase the leverage and effectiveness of their philanthropic and community investment efforts. Some of the key trends here are illustrated in Table 1.

TABLE 1: FROM "CHECK BOOK" PHILANTHROPY TO SOCIAL VENTURE PARTNERSHIPS

	OLD PARADIGM GIVING: One-way	**NEW PARADIGM PARTNERSHIPS: Strategic**
PHILOSOPHY	• Discretionary giving • Corporate obligation	• New business discipline • Societal opportunity
METHODS	• Formulaic • Responsive • Conventional • Risk averse • Incremental	• Opportunistic • Anticipatory • 'Out of the box' • Risk-taking • Transformative
DECISION-MAKERS	• CEO and spouses • Board members • Department of good deeds	• Line business managers • Stakeholders • Core strategic competence
PURPOSE	• Conformity • Good will	• Differentiation • Results and reputation
RECIPIENTS	• The 'usual suspects'	• New social entrepreneurs and innovators
REACH	• Local	• Local and global
IMPACT	• Minimal and not measured	• Potentially high, leveraged and measured
EMPLOYEE INVOLVEMENT	• Minimal	• Direct and intense
RELATIONSHIP MANAGEMENT	• One way • Arms-length • Bureaucratic • Paternalistic	• Strategic partnership • Entrepreneurial • Mutual learning
NEXUS WITH CORE COMPETENCIES	• Peripheral	• Linked to core business purpose

Cisco Systems, for example, has been able to expand its Cisco Networking Academies program to over 10,000 academies in all 50 U.S. states and over 150 countries. Working with partners ranging from the United Nations, the United States Agency for International Development and the Peace Corps, to local schools and non-governmental organizations in Africa and elsewhere, the company has been able to support academies in about forty of the world's least developed countries, with a growing percentage of the graduates being women. Also in Africa, ChevronTexaco is working with USAID, UNDP and others to support local economic development programs, and the Coca-Cola system is using its extensive distribution network to work in partnership with the UN and local partners to distribute public health messages and other services aimed at tackling HIV/Aids.

Discipline #5: Be performance-driven in everything

A growing number of the world's most successful companies publicly commit to explicit targets for their ethical, social and environmental performance, in addition to their financial and commercial performance. Their board of directors and senior management team take a lead in identifying key risks and opportunities. They establish management systems, rigorous metrics, incentive structures, training programs and compliance processes to create the performance-driven culture that is necessary to strive towards the achievement of these targets. They report publicly on progress towards their targets, and are committed to continuous learning as a way to drive improvement and to be better prepared to anticipate new risks and to seize new opportunities.

Sustainability reporting, in particular, has become a major trend. Several thousand companies, including many of the world's largest, now report publicly on their social and environmental performance. The multi-stakeholder Global Reporting Initiative, develops and disseminates globally applicable sustainability reporting guidelines, which are used by a growing number of companies and investors around the world. In October 2004, analysts at 17 leading U.S. socially responsible investment firms, representing over $147 billion in assets, recommended that companies start reporting annually on their social and environmental performance, basing their reporting the GRI's Sustainability Reporting Guidelines.

Discipline #6: Practice superior governance

The governance agenda for business is being fundamentally reshaped. The emerging agenda calls for more rigorous approaches to corporate governance. But more than this is now required. Superior governance is also about a company's overall legitimacy and wider acceptance by stakeholders, including but not only shareholders. It is about increased transparency, accountability, integrity and independent overview of all key areas of corporate performance – ethical, social and environmental, as well as financial – what is increasingly termed as sustainability governance. It is also about tackling bribery and corruption, and ensuring more transparent interaction between business and government everywhere that companies operate –what we have termed public governance.

A growing number of companies are establishing dedicated board committees focused on addressing corporate responsibility or public issues. A 2001 study by the Conference Board concluded that 15% of U.S companies surveyed had such committees, compared to fewer than 10% in 1980. Early results of research that we are undertaking on the U.S. Fortune 200 companies at the Kennedy School of Government, points to this figure having grown to almost 30%. These board committees are called a variety of names and have wide-ranging responsibilities, but most are chaired by independent directors and cover the ethical, social, environmental and public policy issues of greatest relevance to the company and its industry sector. Notable examples of board leadership in this area include: DuPont, General Motors, McDonalds, Nike, Rio Tinto, BP, Ford Motor Company, GlaxoSmithKline, the Coca-Cola Company, and SABMiller.

Discipline #7: Pursue purpose beyond profit

Sustained, long-term business leadership is built upon clarity of purpose, principles and values. Each company has a core purpose to provide goods or services that meet customer needs or aspirations and yield a profit. In great companies, however, this purpose extends beyond short-term profit and the creation of shareholder value. It often encompasses a longer-term vision to make a contribution to improve peoples' lives and be a force for progress in the world.

Together with its principles and values, purpose is what a great company stands for and would stand by, even if adhering to them results in a competitive disadvantage, missed opportunity or increased costs. Purpose, principles and values are the bedrock of excellence. The manner in which they are articulated and implemented plays a key role in determining a company's strategic direction, its corporate culture and the policies and incentive systems by which it operates and impacts the world.

As Jeff Immelt, Chairman and CEO of General Electric, commented in a November 2004 interview with FORTUNE magazine, "The reason people come to work for GE is that they want to be about something that is bigger than themselves. People want to work hard, they want to get promoted, they want stock options. But they also want to work for a company that makes a difference, a company that's doing great things in the world."[3]

This sentiment is shared by John Browne, Group Chief Executive of BP. Over the past fifteen years, Browne has built one of the world's most innovative, competitive and profitable energy companies, while also being out-in-front of many of his peers, in publicly addressing and starting to tackle some of the world's most intractable challenges, such as global climate change and the costs of corruption in developing countries. He has argued, "No enterprise, no institution, perhaps no individual can really succeed without a sense of purpose – a purpose which explains and guides every step. Our purpose, our fundamental objective is to be one of the world's great companies. That means delivering results and doing our business exceptionally well day by day. But it also means aligning our activity with the world's needs, leading change and being a force for progress in everything we do."[4]

The potential of delivering profits with principles

The seven business disciplines call for investment and conviction. There are no simple solutions when it comes to delivering profits with principles in today's complex world. Goalposts keep moving. Boundaries keep changing. Competition keeps increasing. Expectations of shareholders, customers, employees, communities, regulators and other stakeholders keep rising. As daunting as the challenges are, it is riskier to do nothing. The long-term self-interests of corporations and the public interest are inextricably interwoven. Successful and sustainable companies need the existence of prosperous and just societies.

Business cannot, and should not, be expected to address or resolve all the world's economic or social ills. Companies cannot solve international terrorism, poverty and other global dilemmas. Yet there is no more powerful and promising engine for increasing prosperity and opportunity than the market system operating within effectively-regulated and broadly accepted governance frameworks and spearheaded by principled companies and business leaders.

Working in partnership with governments and civic organizations, companies have the resources, technology, creativity, ingenuity, networks and problem-solving skills to produce products and services that can improve the quality of people's lives, while decreasing the impact on the environment. Companies operating with principles can regain the sense of energy, innovation, optimism and dynamism that characterized the 1990's, without the greed, hubris and arrogance that precipitated their demise. They can harness the enormous potential of private enterprise to make the world a better place, while remaining profitable and competitive. This, we believe, should be the fundamental purpose of a good business.

Footnotes:

1 Business Week, June 24, 2002, pp 39.

2 Speech by Adrian Levy, founder and former chairman RLG International, March 2001.

3 Gunther, Marc. Money and Morals at GE. FORTUNE magazine, November 15, 2004.

4 John Browne, Group Chief Executive, BP. Statement in BP in China: Partnership for Progress, September 2000.

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