



Chazen International Study Tour Report

Corporate Social Responsibility: An Emerging Form of Risk Management in Europe

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A Note from the Authors

The authors are MBA and International Affairs students at Columbia Business School and Columbia School of International and Public Affairs. From March 5 to 12, 2005, they participated in a study tour to France and Belgium that was organized in concert with the Business School's Jerome A. Chazen Institute of International Business. The information about the organizations discussed in this paper is primarily drawn from the authors' interactions during this trip with the following representatives:

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Jean-Nicolas Caprasse, Managing Partner, Deminor Rating SA

Matt Christensen, Executive Director, Eurosif—The European Social Investment Forum

Dieter Frisch, Founder, Transparency International

Bernard Giraud, CSR Director, Groupe Danone, and Executive Director, CSR Europe

Sylvain Guyoton, Head of SRI Research Operations, Vigeo

Peter Lacy, Executive Director, European Academy of Business in Society

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Chazen International Study Tours

Designed to enhance the classroom curriculum, Chazen International Study Tours offer students and their faculty adviser an intense, firsthand experience of the business culture of their chosen country or region. Study tours are initiated by students and organized with the help of the Jerome A. Chazen Institute of International Business. During study tours students meet with leading executives and government officials while visiting businesses, factories and cultural sites. Recent destinations include China, France, India, Japan, Russia and Scandinavia.

In today's complex global environment, sophisticated money managers continuously seek new ways to beat the market and distinguish themselves from their competitors. On a recent study trip to France and Belgium, the authors encountered innovative approaches to risk management in the form of corporate social responsibility (CSR). During a series of meetings, we discovered the ways in which CSR is being used in daily business practices, ratings agencies, governmental initiatives and strategic NGO collaboration. Amid this multipronged approach, we identified a common theme, namely, the idea of controlling for downside risk by exploiting additional information on firms' CSR activities. Included activities were how firms set up and monitored their governance structure, what social and human rights policies were implemented and how firms controlled their environmental footprint. This paper further explores this trend from the various stakeholders' standpoints, examines the impact and highlights some of the barriers to increased adoption of CSR by investors and company management. Our discussions with European business and political professionals suggest that this use of extrafinancial information is not a momentary fad but rather a lasting structural change in the way investments are made in the European securities markets. However, given the long-term horizon of CSR strategies, concrete and consistent results are yet to be determined.

CSR Risk Management in Practice

Eric Borremans, a 1992 graduate of Columbia Business School, believes his job at BNP Paribas will soon be obsolete, and he is extremely delighted about it. Yes, you read that right. As head of sustainability research, he works closely with equity and credit analysts on European large caps to examine extrafinancial indicators on a broad range of areas, including environmental impact, human rights policies, labor practices, corporate governance and transparency. Unlike most asset managers, Borremans and his team go beyond the basic financials to examine how these additional indicators may negatively affect a company's stock price. Borremans believes that the long-term positive financial returns of going beyond basic financials will cross over to BNP's conventional asset management group, thus making his team and position unnecessary.

"Three or four years down the road," he says, "the frontier between socially responsible investment and the mainstream will fade away," driven by market competition and three other forces. The first force is pressure from pension funds to use sophisticated extrafinancial data to protect assets from losses. The second is the rise of CSR ratings agencies, including Deminor and Vigeo, which catalogue and rate many of these indicators and are currently partnering with BNP.¹ The third is the wave of legislation in Europe mandating that companies begin to measure and disclose social and environmental risks.

¹ BNP Paribas, "BNP Paribas Asset Management Strengthens Its Socially Responsible Investment Process and Teams Up with the Rating Agencies Deminor and Innovest," press release, January 22, 2003.

For example, the European Union (EU) recently issued a directive on emissions trading, establishing absolute limits and a cap and trade system to decrease industry carbon dioxide emissions. Furthermore, a recently enacted EU action plan on corporate governance aims to establish consistent corporate governance standards across organizations, with the overriding goals of increasing shareholder rights and enhancing the competitiveness of European business.² Given these trends, Borremans believes that all asset managers will start incorporating this type of extrafinancial data into their overall analysis.

A Definition of Corporate Social Responsibility

Definitions of CSR vary, but generally it is defined as business practices that consider an array of economic, social and environmental impacts beyond those that are purely financial. Organizations practice CSR when they carry out reforms to simultaneously maximize social and economic benefits and to minimize the negative impacts of business decisions, ultimately contributing to longer-run sustainability. Firms investing in such things as fossil fuel substitutes, waste reduction, labor relations and local communities should ultimately be uniquely positioned to outperform their competitors as competition heightens.³ The spectrum for CSR measurement is quite broad and can encompass such criteria as intellectual property, human resources management, socioeconomic impacts in developing countries, corporate governance, environmental and social impacts of products and management, workers rights, political involvement, community involvement and social-ethical or moral issues.⁴

In Europe, CSR is defined as only those business activities that achieve social and environmental outcomes over and above what is required by law. In other words, once a business activity becomes part of compliance to legal regulation, it is no longer considered CSR. While there are short-run costs associated with implementing CSR reforms, our conversations with European business and political leaders highlighted their beliefs that in the long run the benefits to the firm and to society as a whole outweigh these costs.

The European Commission (EC), the executive body of European Union, has become a proponent of CSR and has identified the movement as a key strategy for becoming the world's "most competitive and dynamic knowledge-based economy capable of sustainable economic growth with more and better jobs and greater social cohesion."⁵ For example, CSR initiatives that improve employment practices can strengthen the commitment of employees, correspondingly increasing productivity and innovation. Similarly, consumer

² David McCairney, "A Budding Mainstream Identity," *Funds Europe*, no. 14 (Dec. 2003/Jan. 2004): 38–41.

³ United Kingdom, Department of Trade and Industry, *Corporate Social Responsibility: A Government update*, May 2004, http://www.societyandbusiness.gov.uk/pdf/dti_csr_final.pdf, 10–21.

⁴ Eurosif, *Socially Responsible Investment among European Institutional Investors*, report, 2003, 6.

⁵ European Commission, Directorate-General for Employment and Social Affairs, *Promoting a European framework for corporate social responsibility*, green paper, 2001, 4.

confidence may rise when a company is socially and environmentally responsible, and this shift contributes to further growth. Therefore, the quality and quantity of jobs would also expand. Recognizing the potential benefits of CSR as keys to the region's competitive growth in the global economy, the EC has taken a major step forward with the launch of a debate on the best strategies for increasing enterprises' social contributions in its green paper *Promoting a European framework for corporate social responsibility*.

Increasing Demand for CSR Information

Demands for more transparent business practices as well as rising concerns about the impact of business on society have led to the creation of a number of tools to measure and report on CSR performance.⁶ Of new and particular interest is that the European investment community has begun to embrace and support a growing business sector of specialized CSR ratings indices and firms. In particular, the FTSE4 Good World Index, the Domini 400 Social Index, the Dow Jones Sustainability Index and more than 35 specialist research organizations have all launched within the past two decades.⁷ Today specialized research houses provide the second-largest share of research requested by the socially responsible investment (SRI) industry, and 76 percent of fund managers and analysts interviewed by CSR Europe see a clear link between nonfinancial risks and shareholder value. As a result, they systematically take into account such issues as the ability to innovate (65 percent), corporate governance and risk management (54 percent) and management of customer relations (49 percent).⁸ Asset managers and investors seem to be increasingly willing to pay for information on CSR performance, with the belief that it will improve risk analysis and, ultimately, investment decisions.

To examine this trend in more detail, we engaged in discussion with executives at two ratings agencies, Vigeo and Deminor, to understand their business models and to hear their projections for the future of the industry. The agencies differ in areas of focus: Vigeo rates CSR performance broadly, and Deminor focuses on corporate governance indicators. But they share the common aim of meeting investor needs by collecting and analyzing information on extrafinancial indicators and offering standardized measurements for understanding companies' CSR performance vis-à-vis their competitors.

To analyze CSR practices, Vigeo takes into account 38 specific criteria, grouped under the domains of human rights, clients and suppliers, community, environment, corporate governance and human resources. Included in its satisfied client list are Allianz Global

⁶ European Commission, Directorate-General for Employment and Social Affairs, *ABC of the Main Instruments of Corporate Social Responsibility*, report, 2004, 5.

⁷ European Commission, Directorate-General for Employment and Social Affairs, *ABC of the Main Instruments of Corporate Social Responsibility*, report, 2004, 49, 56.

⁸ SustainAbility, *Values for Money: Reviewing the Quality of SRI Research*, Report, 2004, 4.

Investors, BNP Paribas and Lazard Frères, all three of which have a financial stake in Vigeo.

In rating corporate governance standards, Deminor scrutinizes criteria within four main rating areas: procedures around shareholder rights, transparency of board operations, strength of board structure and the range and strength of a company's takeover defenses. Its clients are mostly asset managers but also include corporations, such as Telecom Italia and Ford Motor Belgium, that are interested in better understanding and improving their performance in the field of CSR.

Borremans knows what he is talking about when he says major investors believe extrafinancial information can limit downside risk. He is part of two large-scale pan-European projects in which investors have channeled resources toward CSR-related risk management. One is the multinational Enhanced Analytics Initiative led by six pension funds. This group, with combined assets of €330 billion (\$429 billion), agreed to allocate 5 percent of their commissions to those securities brokers that were best at integrating nonfinancial issues into their research. Brokers including Deutsche Bank, Goldman Sachs, HSBC, UBS and WestLB were praised by the members of the Enhanced Analytics Initiative for the way such issues as corporate reputation, human capital and environmental risk management were factored into research notes.⁹ Pensioners, for obvious reasons, are more concerned with the long-term performance of companies, and thus CSR—or the lack thereof—is being used as a tool for discovering hidden risks down the road.

The second program Borremans is involved in is the Carbon Disclosure Project. A team representing 143 of Europe's leading institutional investors wrote to the world's largest 500 companies seeking information on their greenhouse gas emissions. The numerous indications of accelerating human-induced climate change made it clear to the institutional investors that there are business risks and opportunities that have implications for the value of investments in corporations worldwide. Examples of issues looked at include changes in weather patterns; political and regulatory momentum moving against significant carbon emitters; the development of emissions-sensitive technologies, products and services superseding those existing today; and shifts in consumer sentiment due to a corporation's stance on climate change. Thus, these investors felt it necessary to improve their understanding of climate-change risks and opportunities.¹⁰ The list of the supporting investors reads like a who's who of the global pension fund and fund management industries, and together they have assets of €15.4 trillion (\$19.8 trillion). What seems to be

⁹ Kit Bingham, "Appetite grows for information on non-financial performance," *Financial News*, February 6, 2005.

¹⁰ Carbon Disclosure Project, "\$10 Trillion Investor Initiative Rates 500 Largest Global Companies' Action on Climate Change; Verdict: Improving but Could Do Better," press release, May 19, 2004, http://www.cdproject.net/press_release.asp.

emerging is that investors have learned that a collective approach to gathering information on risk factors is more effective than acting individually.¹¹

In reaction to the growing sector of CSR ratings agencies, business leaders are putting some internal structures in place to measure and report CSR matters. Organizations are recognizing the importance of CSR ratings to investors, as well as the financial benefits and competitive advantage that may result from proactively incorporating corporate-governance, environmental and social factors into long-term business strategies. Additionally, businesses are recognizing the benefits of partnering with reputable NGOs to meet certain environmental and human rights benchmarks that help them in the public affairs arena and also with consumers. The confluence of these events has generated interest in CSR among mainstream European business leaders and investors.¹²

Strategically Anticipating Legislation

The effect of legislation on risk management and investment decisions revolves around anticipating and preparing for rules and regulations coming down the pipeline. The business practices that governments legislate often involve social and environmental externalities related to CSR, so companies that incorporate risk management variables into project finance and investment decisions can strategically plan in the areas likely to become subject to regulation. Businesses do this by engaging with NGOs and lobbyists to make sure that they have inside information about pending legislation. Although it is difficult to predict the timing of legislation, forward-looking companies can incorporate potential changes early in their analysis versus developing strategies in reaction to changes in the legislation. Since companies in Europe voluntarily enact CSR practices and not all choose to do so, the adoption of CSR schemes becomes a potential competitive advantage. Even though CSR by definition is outside the realm of regulation in Europe, business leaders and other related organizations are responding to the European Union's proactive position on promoting CSR as part of a broader global economic strategy.

European CSR Networks and Stakeholder Engagement

The advent of CSR networks, as well as other initiatives being formed by business leaders to facilitate information flow among stakeholders (ranging from investors to academic institutions), indicates a growing interest in CSR.

The European Social Investment Forum (Eurosif) is a "pan-European stakeholder network whose mission is to encourage and develop sustainable and responsible investment and better corporate governance."¹³ As a mover in the public discourse on CSR,

¹¹ Kit Bingham, "Appetite grows for information on non-financial performance," *Financial News*, February 6 2005.

¹² For further information on this growing investor trend, see "Who Cares Wins: Connecting Financial Markets to a Changing World," June 2004, www.gsb.columbia.edu/socialenterprise/news/finmkt0407.html.

¹³ Eurosif, "Eurosif and Socially Responsible Investment," <http://www.eurosif.org/pub2/1about/index.shtml>.

Eurosif acts as a clearinghouse of information on CSR impact, NGO lobbying, existing ratings and multilateral government efforts on behalf of investors, fund managers and companies.

Another network, the European Academy of Business in Society (EABIS), founded in 2002, is a partnership between leading businesses and the academic community. This organization's mission is to equip current and future business leaders with the mindset and capacity to put business in society at the heart of the way companies are run by integrating the changing role of business in society into the mainstream of business research, education and training.¹⁴ EABIS defines new approaches to conceptualizing CSR as well as shapes the way current and future executives strategize.

Direct relationships between companies and NGO stakeholder groups are also developing in Europe. NGOs lobby for legislation and regulation to ensure standards for socially and environmentally responsible—and thus sustainable—corporate behavior. Business leaders have begun to partner with them to formulate strategic risk management plans and forward-looking investment decisions. The business-NGO relationship can be mutually enforcing, with corporations benefiting from a stamp of approval and NGOs gaining influence over business practices.

The World Wildlife Fund (WWF) is one such NGO that has a mission to “stop the degradation of the planet's natural environment and to build a future in which humans live in harmony with nature.”¹⁵ With a thumb on the pulse of upcoming legislation, WWF assists companies in anticipating change and formulating their long-term strategies. Through its Climate Savers program, WWF partners with businesses to arrive at “new and additional reductions in carbon dioxide emissions.”¹⁶ So far, multinational companies like Johnson & Johnson, IBM, Nike, Polaroid, Collins Pine and Lafarge have joined the Climate Savers program.¹⁷ In broader terms of risk management, this approach can pay off for a wide range of companies over time as they incorporate the legislative influences early on rather than suddenly shifting business course to accommodate new regulations.

Costs and Benefits of CSR to Companies: A Look at Groupe Danone

Headquartered in France, Groupe Danone is a world leader in the food industry, with 2004 net sales of €13.7 billion (\$17.6 billion). Its major products are fresh dairy, biscuits and bottled water and include such brands as Dannon and Stonyfield Farm, LU cookies and Evian.

¹⁴ EABIS, “About EABIS,” <http://www.eabis.org/about/default.aspx>.

¹⁵ WWF, “WWF—who we are and how we came about,” http://www.panda.org/about_wwf/who_we_are/index.cfm.

¹⁶ WWF, “Climate Savers Q&A,” http://www.panda.org/about_wwf/what_we_do/climate_change/our_solutions/business_industry/climate_savers/q_a/index.cfm.

¹⁷ WWF, “Climate Savers—Business Partners,” http://www.panda.org/about_wwf/what_we_do/climate_change/our_solutions/business_industry/climate_savers/index.cfm.

Our meeting with Bernard Giraud, director of sustainable development and social responsibility at Groupe Danone, highlighted recent measures that this organization has put in place to position itself ahead of the curve by pursuing a joint commitment to business success and social responsibility. More specifically, in order to integrate social responsibility across all its divisions and into day-to-day business operations, in 2001 Groupe Danone launched Danone Way, a comprehensive assessment program that measures performance on more than 100 CSR practices. As an example, Danone Way defines 20 guidelines relating to transparency, including “compliance with guidelines for conflicts of interest, verification of financial and distribution channels, and breakdown of powers/responsibilities.”¹⁸ The program also places a strong emphasis on risk prevention with the implementation of Vestalis, a tool that helps identify risks and adopt action plans at the business-unit level. Another key area is environmental management, which considers the ability of business units to limit hazards at industrial facilities and reduce energy consumption.¹⁹

Despite Groupe Danone’s size, Danone Way has been able to promote accountability and the best practices of individual subsidiaries throughout the entire organization. Subsidiaries rank CSR performance on a set of clearly defined criteria that identify strengths and weaknesses so that action plans can be developed with the overriding goal of increasing corporate responsibility toward employees, customers, suppliers, local communities and shareholders.²⁰

Groupe Danone also highlighted some of the costs associated with implementing measurement programs and CSR reforms. In the case of Danone Way, defining and assessing best practices requires broad staff participation and substantial time costs. Additional costs are incurred in translating measurement results into action plans to improve CSR performance in areas of weakness. For example, Groupe Danone aims to increase environmental responsibility by reducing the water and energy consumed in production and the materials used in product packaging. These measures involve substantial up-front investment in R&D, which could include working on the eco-design of packaging and plants, and investment in upgrading production facilities.

However, preliminary results indicate the substantial cost savings from lower water and energy consumption and material use may offset initial investments in research and technology. For example, when Group Danone established an environmental management system in 1999, energy consumption and water consumption each decreased by about 30 percent.²¹ Additional benefits stem from the positive perceptions of Groupe Danone as

¹⁸ Groupe Danone, *Danone 2002 Social and Environmental Responsibility Report*, 8.

¹⁹ Groupe Danone, *Danone 2003 Social and Environmental Responsibility Report*, 14.

²⁰ Groupe Danone, <http://www.danone.com/>.

²¹ Groupe Danone, *Danone 2002 Social and Environmental Responsibility Report*, 51.

an environmentally conscious company and from rising sustainability in the communities where Groupe Danone operates.

A look at Groupe Danone's stock price over time indicates that substantial CSR investments have not negatively impacted the company's bottom line vis-à-vis the S&P. The organization first started rolling out Danone Way four years ago, and its stock price has increased 50 percent since January 1, 2001 (see appendix), in contrast to the S&P, which has declined 10 percent.

While the evidence is inconclusive, academic research also indicates that corporate social responsibility has a positive impact on financial performance. A recent study entitled "Corporate Social and Financial Performance: A Meta-Analysis"²² carried out an extensive analysis of research on the link between corporate social responsibility and stock market performance. Lead author Professor Marc Orlitzky of the Australian Graduate School of Management (AGSM), along with Professors Frank Schmidt and Sara Rynes of the University of Iowa, analyzed 52 studies published between 1972 and 1997, utilizing a statistically rigorous "study of studies" technique. While correlation does not equate to causation, their results imply a positive correlation between corporate social responsibility and company financial performance across industries. The paper was the recipient of the annual Moskowitz Prize (named after CSR research pioneer Milton Moskowitz), which honors outstanding research in the field of socially responsible investing (SRI).²³

The Future of CSR

In Europe there is a convergence of pressures on firms to align their corporate decision making into what can be called a sustainable approach to business. Not the least of these pressures are coming from asset managers like Borremans at BNP Paribas, who discriminates based on best in class because he is finding evidence that indicates that companies performing well on CSR measures are less likely to experience costly environmental cleanups, corruption and labor disputes. The growing number of ratings agencies is also a mounting force in that they are establishing the structures to measure and report CSR. At the same time, the European Commission is advocating CSR practices to increase the competitive advantage of European businesses. Lastly, NGOs are lobbying for legislation to enforce compliance with social and environmental standards.

Organizations must be willing to take risks in order to successfully implement CSR reforms and can often incur short-term costs and a corresponding hit to quarterly earnings. Yet, evidence points to longer-run financial benefits stemming from improved efficiency

²² *Organization Studies* 24, no. 3 (2003): 403–11.

²³ William Baue, "Moskowitz Prize Study Removes Doubt Over Link Between Strong Corporate Social and Financial Performance," SocialFunds.com, October 26, 2004, <http://www.socialfunds.com/news/print.cgi?sfArticleId=1555>.

and sustainability. Groupe Danone encountered challenges rolling out Danone Way, which required a substantial investment of employee energy and time to implement throughout its global network of subsidiaries. But the payoffs are already becoming clear, with increasing efficiency, a rising stock price and positive brand recognition as a socially and environmentally sound organization. Other organizations are starting to respond to the confluence of pressures, and many in Europe are of the mindset that CSR-based competitive advantages are there for the taking. Based on our conversations with representatives from the European Commission, ratings agencies, NGOs and investors, we also believe the future economy will be built on them.

Appendix

