The added value of corporate social responsibility

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NIDO brings together companies, public authorities, NGO’s and science in programs aimed at practically-oriented sustainability. This cooperation leads to well-founded solutions and forms a base for further distribution of sustainable development in society.
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Increasing attention for corporate social responsibility (CSR) and shareholder value creation both affect the way in which companies operate. The concept of CSR expects companies to explicitly include the demands and expectations of a wide range of stakeholders in running their business. The increasing focus on value creation on the other hand seems to imply a stronger focus on shareholders. Although CSR and shareholder value creation are not diametrically opposed to each other, it is still rather unclear how the demands and expectations of different stakeholders can be included in business decisions. In this report a general model (Triple Value Assessment™) is described that assists companies in determining the added value of CSR.

Results of applying the model in case studies with five companies in The Netherlands indicate that the model is sufficiently general to address the quite different characteristics of different companies. It meanwhile is flexible enough to zoom in on those specific areas where CSR is most relevant for a specific company.

The model describes three perspectives where CSR exerts influence on company value: economic performance, reputation value and parenting advantage (the horizontal and vertical interlinkages that exist in the company). Regarding economic performance, a linkage is made between value-based management (VBM) and CSR by extending the VBM methodology to the people and planet dimensions. This facilitates Business Units to incorporate CSR in their strategies. CSR can also affect company reputation. Based on the increasingly used Reputation Quotient method, one can qualitatively assess the importance of CSR on company reputation and thereby on company value. The impact of CSR on parenting advantage can arise by leveraging existing CSR-related capabilities throughout the company or by building a "CSR business line". Case studies are provided as examples, except for the reputation perspective. Initial guidelines are given on how the Triple Value Assessment™ can be implemented.

The Triple Value Assessment™ increases the quantitative understanding of the value of existing policies in the area of CSR. By identifying key value levers it also serves as a tool to integrate CSR into business strategy. Based on the pilot studies and literature examples, four CSR archetypes of companies are shown to exist: Core operators have included CSR to their economic benefit and are recognized for their efforts by the stakeholders. Irresponsible participants do not benefit economically from their CSR efforts nor are they recognized for their efforts. Peripheral players are recognized for their CSR efforts, but do not benefit economically from them. Hidden champions, finally, benefit economically from CSR related activities but are not recognized (yet) by the stakeholders.
Over the last decade, two important developments have affected the ways in which companies operate. Companies have found themselves being held responsible by society at large for matters that traditionally belonged to the realm of nation states. Non-economical themes that before could easily be disregarded when making business decisions have now become entangled with the day-to-day running of companies. Meanwhile, the Anglo-Saxon form of shareholder capitalism has become more dominant in other parts of the world. This has pressured managers to run their companies more economically and rationally. The co-existence of these two, apparently conflicting, developments has left companies with the dilemma of how to reconcile or align the two. This alignment is the focus of this report.

1.1 The increasing relevance of corporate social responsibility

Over the last decade explicit attention for the environmental and societal impact of companies has skyrocketed. The United Nations conference in Rio in 1992 has been the starting point for a broad range of initiatives by the international business community in the field of corporate social responsibility (CSR). CSR is driven by two related developments: The increased reliance on market forces in western economies and the increased vulnerability of companies. The stronger dependence on free market mechanisms has led to the perception by many critics that large companies have been engaged in a “silent take over” of the world (Noreena Hertz, 2001). Although this perception is intensively being debated, it has created an environment where more is expected from companies. Apart from the so-called “social dividend” (employment, taxes, contribution to local economic growth etc), companies are increasingly pressured to solve problems that nation states cannot (such as the increased greenhouse effect or systematic violations of human rights). This pressure is exerted through civil organisations like non-governmental organisations (NGOs) that increasingly have a global reach.

1.2 The increasing relevance of shareholder value creation

What are the bounds of the responsibility of companies? This question has been and will be debated for years. By and large two viewpoints exist. The Anglo-Saxon viewpoint is that companies first and foremost responsibility is to generate returns for their owners – shareholders in case of publicly listed companies. In Europe many are of the opinion that a company is responsible to generate returns for all their stakeholders. Opinions differ about what groups are considered to have a legitimate stake in the company, but employees, customers, shareholders, suppliers, local communities and governments are typically included. Although this picture is an oversimplification of reality - many Anglo-Saxon companies for example do acknowledge the prime importance of stakeholders - it serves the purpose of clarity. Because of their focus on shareholders, many Anglo-Saxon companies have implemented value-based management (VBM). Through VBM, companies try to align their internal management system with the external views of shareholders. With the increasing dominance of Anglo-Saxon style capitalism, VBM has washed upon European shores. Shareholder value in Europe, however, is seen as a necessary indicator of the success of a company rather than as the over-riding business objective. Superior shareholder value in this view is the result of successful balancing the different interests
of the various stakeholders. The interests of shareholders and stakeholders are thus seen to be more in line rather than in contradiction. Many studies have confirmed this alignment.

1.3 Report objective: the added value of corporate social responsibility

Although corporate social responsibility and value creation are not diametrically opposed, it is rather unclear how the demands and expectations of different stakeholders can be included in business decisions. For this to be clarified one must have some insight in the economical consequences, or, in terms of value-based management: one needs to obtain insight into the value creating potential of corporate social responsibility.

Therefore a study regarding the added value of corporate social responsibility has been conducted by Triple Value Strategy Consulting. This study has been carried out within the context of the Netherlands Initiative for Sustainable Development (NIDO) programme ‘From financial to sustainable profit’. NIDO was established in 1999 and is funded by the Dutch government. The purpose of the foundation is to give sustainable development a structural anchor in society. The NIDO programme ‘From financial to sustainable profit’ aims to initiate and support change processes among companies that wish to create a link between their financial performance and their record in ecological and social matters (Cramer, 2001).

1.4 Research methodology: pilot studies with five companies

In order to determine the added value of CSR a general model (the Triple Value Assessment™) has been developed that has been subsequently tested in five pilot studies with companies that participated in the above-mentioned NIDO programme (see the Appendix for a description of the companies). The model distinguishes three pathways through which corporate social responsibility can add value for a company: Enhancing the economic performance, increasing the reputation value and contributing to the parenting advantage (the horizontal and vertical interlinkages that exist in the company).

Based on the preferences of the five participating companies, pilot projects have been executed to test the applicability and relevance of the general model. Model development and the subsequent pilot studies were carried out in 2002.

1.5 Structure of this report

In Chapter 2, the general outline of the model is presented and the three perspectives of the model - the contribution of corporate social responsibility to economic value, reputation value and parenting advantage are introduced. These three perspectives are each discussed in more detail in the following three chapters. The results of some of the pilot studies are presented here as well. Chapter 6 contains initial guidelines on how to implement the model. The main conclusions and a generalization of the results are discussed in Chapter 7.

4 For a good example we refer to The virtuous cycle of shareholder value creation (Bughin and Copeland, 1997).

5 Triple Value Strategy Consulting advises companies how to take sustainable development to the core of their business. For more information: www.triple-value.com.
Research on the added value of corporate social responsibility is still in its infancy. A few studies have elucidated the generic merits of corporate social responsibility for business. For instance, WWF-UK in cooperation with Cable & Wireless has provided an overview of these benefits and summarises a number of management concepts that are useful in developing the business case (Kemp, 2001). The UK consultancy SustainAbility has collected an impressive amount of case evidence (Van Heel et al., 2001). This case evidence is categorised according to ten measures of business success (ranging from shareholder value and operational efficiency to reputation) and ten measures of sustainable development performance (such as ethics and values, commitment to environmental and social measures and engaging stakeholders). Based on the resulting hundred boxes, it is judged that corporate social responsibility has a positive impact on business performance. However, the verdict is rather complex to digest since many of the measures overlap. Furthermore, this approach analyses some aspects of business cases of many different companies but it does not dig down into the business case for any specific company. In a World Resource Institute report Donald Reed describes a range of existing techniques to determine the financial value of corporate social responsibility (Reed, 2001). On the basis of this overview he concludes that none of them is satisfactory. They are of great use to quantify tangible assets but of little use for intangible assets. Reed argues that tangible and intangible matters must be addressed quite differently.

The study carried out in the context of the NIDO programme set out to bridge this gap in knowledge. The purpose was to explore how a single overall model could be developed to assess the financial benefits of corporate social responsibility for an individual company. Such a model can help companies to identify more easily their own set of values, and thereby also facilitates the process of implementing corporate social responsibility. Any model to determine the added value of corporate social responsibility must therefore be sufficiently general to allow widely different companies to apply it. At the same time the model must be specific enough to allow each company to accept the results. Either one of these requirements can only be fully met at the expense of the other. As a result the model constitutes a compromise: it will be shown to be applicable for a wide range of companies and be flexible enough so that companies can tailor it to their specific situation.

In developing the model the financial system currently used by each specific company was taken as a starting point. Moreover, the analysis focused on those aspects that were the most relevant for the company concerned in the context of corporate social responsibility. Roughly speaking, three aspects can be of importance for companies:

- Increasing economic efficiency through environmental and/or social innovations
- Protecting and enhancing the company’s reputation vis-à-vis the market and society at large
- Profiting from the parenting advantage - the benefit of belonging to a larger entity (the parent company)

Therefore the backbone of the model developed here comprises the following three perspectives: Economic performance (relatively tangible), Reputation value (intangible) and Parenting advantage (a mix of tangibles and intangibles). Figure 1 shows schematically the total value of a company as the sum of these three perspectives. Corporate social responsibility can have an impact on all three.
The Market Value Added reflects what is usually called the financial fundamentals that reflect the measurable economic performance. Technically, it is the discounted value of the stream of Economic Value Added (EVA) in future years. EVA is a quantity often used in value-based management (see below). Reputation Value typically reflects intangibles such as company reputation, trust in management, corporate governance, transparency etc. Investors price these intangibles, although it is less than clear how this works. Parenting Advantage (or structure) reflects the value put on the entire business portfolio by investors. The premiums represented by reputation and parenting advantage together make up the expectation premium of a company: the difference between the total (or market) value and the fundamental value. This difference is the quantification of investor confidence. The calculation of the fundamental value of a company can
never be exact. The expectation premium that is calculated as the difference between market and fundamental value is therefore not exact either. Despite this imprecision, the disaggregation of total company value in the three components is useful since corporate social responsibility can have very distinct impacts on each of them. Figure 2 shows a diagram that summarises the impact that corporate social responsibility has on a company's total value. Some of the relevant value drivers are also indicated.

The small triangles or pyramids in Figures 1 and 2 indicate the relationship of the three perspectives with the organisation structure. Business units - the lower half of the pyramid - are primarily concerned with economic performance. At the top of the pyramid, at the corporate level the relation with stakeholders is actively managed (e.g. public affairs, corporate communication, investor relation etc), although corporate reputation is obviously a reflection of the behaviour of the entire company. The parenting advantage of the company depends on the company's structure, as indicated by the corresponding pyramid. It must be kept in mind, however, that the three perspectives in Figure 2 are not independent. Important linkages and reinforcements do exist. These three perspectives each contribute to the total value of a company.

The value arguments for corporate social responsibility differ from company to company. As stated before, the model constitutes a compromise: it should be applicable for a wide range of companies and yet be flexible enough for companies to tailor it to their specific situation. To assess the validity of this compromise, the model described above has been tested in pilot studies with five companies. For reasons of confidentiality only aggregated results from these studies will be reported below.
3.1 Value-based Management

Historically, profit has been the key indicator of a company’s economic performance. Companies generate profit in very different ways, however. The need to judge economic performance better led to the development of numerous return measures. The two best-known examples are Return on Equity and Return on Investment. These measures provide a fairer way to compare companies than mere profit. Nevertheless, they do not give a clear indication of whether a company actually creates value.

The essence of value-based management is to invoke the perspective of shareholders in the way a company measures its performance. A shareholder expects a certain return on his investment and when a company does not meet his expectations the shareholder is likely to sell his stake. Put another way, shareholders’ equity has an explicit cost attached to it that must be paid. In value-based management this is accounted for by subtracting the cost of capital from the financial return of a company. The best-known method is the Economic Value Added (EVA™), developed by consultancy Stern Stewart in the seventies (see Tully, 1993). The definition of EVA is:

\[
EVA = (\text{ROCE} - \text{CoC}) \times \text{CE}
\]

(After tax) Cost of Capital Employed

The attractiveness of value-based management lies in the integration of a number of management tasks: allocation of capital, investment decisions, performance measurement and incentive compensation. Through consistent use of value-based management, conflicting targets are avoided. These advantages are obviously not limited to publicly listed companies.

Value is being created or destroyed when EVA increases or decreases. Value creation is more about changes in EVA than about the actual numbers. Value can be created in three ways: increasing the Return on Capital Employed, decreasing the Cost of Capital or adding to the amount of Capital Employed (provided returns are higher than the Cost of Capital and do not decrease through growth). Value destruction occurs when the returns decrease or - less frequently - when growth is achieved while returns are below the Cost of Capital. There are numerous examples of growing companies reporting increasing profits while actually destroying value.

As is indicated in Figure 1, one has to translate the stream of all future EVAs into Market Value Added. If EVA grows at a constant rate, the calculation of Market Value Added is as follows:

\[
\text{MVA} = \frac{EVA}{\text{CoC} - \text{Growth rate}}
\]

Market Value Added is an indicator of how a shareholder would value all future EVAs. A simple example illustrates the use of the equation. Suppose that a company reduces its energy use by 100. Assuming this saving recurs each year and assuming a cost of capital of 10%, this results in a Market Value Added of €1000. The Market Value Added will amount to €2000 when each energy saving increases by 5% per year.

3.2 Linking corporate social responsibility to value-based Management

By linking corporate social responsibility to value-based management a more consistent framework arises: People-Planet-Capital. These are the three resources which every
company uses. The better the resources are used, the higher the value a company creates. From this conclusion it is only a small step to see other ways in which we can apply EVA. In the above formula we looked at Return on Capital Employed and the cost of that capital. By the same token we can look at Value Added per employee and the cost per employee or the Value Added per ton raw material use and the cost of raw materials etc. The overview in Figure 3 shows the similarity of these formulae.

Through this extension of the argument we have generalised the value-based management methodology to the people and planet dimensions. Of course, the people dimension comprises much more than employees and planet means many more things than just raw material use. But this methodology puts the people and planet dimensions on the management radar screen. The similarity of the formulae allows for a uniform interpretation. The quantities indicated by Return on Capital Employed, Value Added per employee and Value Added per ton raw material indicate the efficiency of resource use. Together with the other two terms – the cost of a resource and the amount used - a company’s performance can be analysed. The attractiveness of the formulae lies in the fact that one views the same objective (value creation) from three different angles. The pitfall of ending up with many conflicting conclusions (or worse, targets) is thus avoided. The case study of DSM Coating Resins illustrates this methodology, although it must be stated explicitly that DSM uses a different form of value-based management, not based on EVA. The Dumeco case study in Paragraph 4 emphasises the raw materials viewpoint in greater detail. Many other aspects can (and often should) be included and the methodology does provide a clear way of doing so. It can be universally applied, but the outcomes are always company-specific.

7 The ROCE equivalent used by DSM is Cash Flow Return on Investment (CFROI) and the equivalent of EVA used by DSM is Cash Value Added. It is beyond the scope of this study to address the differences.
DSM Coating Resins - Resource efficiency in three dimensions

DSM is a worldwide player in life science products, performance materials and industrial chemicals. DSM Coating Resins (DCR) is part of the Performance Materials cluster of DSM group. DCR is the world market leader in powder coating resins and ranks among the European leaders in wet coating systems.

The economic performance of the company has been analysed from three perspectives: Capital, People (employees, measured in Full Time Equivalents or FTEs) and Planet (measured by tons of raw materials). The results are shown in Figure 4. From 1996 through 2000, DCR has improved the efficiency of resource use in all three dimensions. The large increase of value added (VA) per FTE is partly countered by higher cost per FTE. The main drivers of the 33% increase in economic value added are the higher Value Added per employee, the increased capital efficiency (higher VA / €) and a higher production volume, as reflected by the increase in the use of raw materials. These drivers are not independent of each other, but they do provide different perspectives on performance.

Despite the somewhat higher efficiency, the larger use of raw materials points to an increase of the environmental footprint. However, use is also made of renewable resources (egg resins based on plant oils). This effect may be incorporated in the methodology by replacing the quantity ‘tons of raw materials’ by ‘tons of non-renewable resources’. An increase in value added per ton of raw material can then also be achieved by increasing the amount of renewable resources.
3.3 Relevance of corporate social responsibility

With the (partial) linkage of the people and planet dimensions to value based management we can start investigating how corporate social responsibility can play a role in improving economic performance.

Figure 5 summarises some strategies and methods, categorised along the people, planet and capital dimensions and the three terms of the EVA formula, as discussed above.

The main purpose of this overview is to illustrate that one cannot limit oneself to simply quantifying the people, planet and capital dimensions; there is also a need to bring in improvements. Let us give some examples. Along the Capital dimension, new production techniques can reduce the amount of capital that needs to be employed. Green production routes are becoming increasingly important in the chemistry industry for example (Bachman et al, 2000). This has the potential to save substantially on investments in large-scale plants. It is now well accepted that inclusion in sustainable investment portfolios will decrease the cost of capital, especially when this market keeps growing. The American chemical company Dupont claims that corporate social responsibility has reduced its correlation with the overall stock market. This reduced volatility is being rewarded by investors and thus is a source of value creation. Along the People dimension, the examples given to increase the efficiency of resource use (value added per FTE) do not need to be elaborated here. Over the last year or so, a new strategic direction for companies is being developed. These ‘bottom of the pyramid’ strategies are based on the premise that low-income markets present a potent opportunity for the world’s wealthiest and largest companies (Prahalad and Hammond, 2002). They can pursue profitable growth by bringing prosperity to the world’s poor. The business models needed for this are quite different from existing ones. Typically, they are capital-extensive and people-intensive. Along the Planet dimension, numerous concepts and tools can be employed to increase the efficiency of resource use. Even conventional business magazines have started to recognise the potential of these (Amoto, 2000). Less obvious is the fact that corporate social responsibility can reduce the cost of resources. Despite great reductions in cost, renewable resources are generally still more expensive than non-renewable alternatives. However, renewable resources typically show much less price volatility.
Volatility can dramatically increase costs. Dupont in part contributes the above-mentioned reduction of stock market volatility to this effect. The next paragraph will describe in more detail how these concepts can be coupled to Economic Value Added.

3.4 Building the value tree for corporate social responsibility

For a company or business unit, the concept of EVA can be rather abstract. Managers recognise the goal of creating Economic Value Added, but need to establish a link with their daily activities. We therefore have to disaggregate the EVA formulation into a tree where managers and employees at different levels recognise the individual branches. From the pilot studies it has become very clear that such a disaggregation will prove useful only when it bears a close resemblance to the "mental model" that managers have of their business. This can be assured by involving people from Accounting & Control in the process. They tend to have a broad overview of all parts of the organisation and the linkages that exist between them. Moreover, they can indicate beforehand whether the value-tree can be (partly) quantified. This quantification is very necessary. Without quantification people are easily tempted to dismiss the relevance of corporate social responsibility since "they live in a world where numbers count". Although such quantification is nearly always incomplete, it is of great help in getting a feel for the degree of relevance and it helps focus discussions on concrete things. The case study of KLM Cargo is an example of this disaggregation.
KLM – Building the value tree

KLM, Royal Dutch Airlines, is the world's oldest airline still operating under its original name. The company transports passengers (64% of revenue) and cargo (15%) across its worldwide network. In addition, KLM maintains aircraft for third parties (15% of revenues). For KLM we have developed a value tree, in which the company’s ROCE indicator is disaggregated into a number of value levers, as shown in Figure 6. ROCE has been taken here rather than EVA since the various business units use it for monitoring performance.

Changes in EVA and MVA is straightforward (as discussed in paragraph 3.1).

For the KLM Cargo division we have determined the changes of ROCE related to changes in absenteeism and energy use. The corresponding change in EVA amounted to € 80,000. Based on KLM’s cost of capital of 9%, the corresponding Market Value Added (the value that shareholders would attach to the improvements) is almost € 900,000. Using EVA rather than indicators such as payback period enables a more consistent evaluation of CSR related investments.

The ROCE indicator can be influenced by each of the value levers, the grey "buttons" in the diagram. By linking sustainability indicators to the value levers one obtains an initial qualitative view of how corporate social responsibility may have an impact on economic performance. The relations that are thought to be the most significant can subsequently be detailed and quantified.

Although many manufacturing companies try to work with companies that are part of the production chain, transport is often not considered yet. It can be expected that this will change in the future. Henceforth it can be expected that the "buttons" revenue / ton kilometer and load factor become more dependent on the sustainability performance of the transport company.
Creating reputation value through corporate social responsibility

4.1 The Value of Reputation

Compared to economic performance, (corporate) reputation is a rather intangible quantity. An exact and generally agreed-upon definition is not available - nor is it needed here. The following statement suffices: "Reputation is the net result of the interaction of all experiences, impressions, beliefs, feelings and knowledge that stakeholders have about the performance of a company". Reputation is based on the past but it reflects stakeholders' expectations about the future quality and performance of a company. In this sense reputation ensures continued and successful access to the markets (whether for customers, employees or capital) in which a company is active.

Today's reputation thus influences tomorrow's performance. It is not surprising, therefore, that several studies have shown that corporate reputation translates into financial value. It has been shown statistically that a 60% increase in reputation correlates with a 7% increase in market value. (Srivastava et al, 1997). Although the exact value of reputation cannot be determined, it is generally accepted that a good reputation serves as an insurance that assures access to the important markets in which a company operates (notably customers, employees and shareholders).

The most prominent effort to measure corporate reputation is the "Reputation Quotient", developed by the Reputation Institute. The Reputation Quotient of large companies is now routinely measured in several countries. In the Netherlands, the results of the last study appeared in October 2002. Contrary to many brand/reputation measurement systems, the methodology of the Reputation Quotient is non-proprietary which implies in theory that it can be used freely. In practice this does not happen since measurements typically involve thousands of people who complete questionnaires.

The Reputation Quotient is the cumulative outcome of people's answers on twenty questions in six categories, shown in Figure 7. As a first indication (USA, 1999) of the statistically determined strengths of the different reputation drivers have been indicated. As will be discussed shortly, these strengths can differ considerably from country to country.

The heading Emotional Appeal can be seen as integrating the other five topics.
Ultimately, it is Emotional Appeal (does one like, trust and respect an organisation?) that has been shown to influence reputation the most. The topics Social (and environmental) Responsibility and Workplace Environment have a strong association with corporate social responsibility and are shown to have a strong impact on a company’s reputation. Within these topics, the items 'treats people well' and 'good place to work' have been statistically shown to have the largest impact on reputation.

Corporate social responsibility also plays a role in other topics, albeit in a more indirect way. An example of this is the topic Products & Services, where the item "stands behind product" is the main determinant. Health and safety risks of a product and how the company handles them are part of this.

As stated before, the strengths of the various reputation drivers depend on cultural differences and have been shown to change considerably from year to year. The most striking difference in the results of the 2002 RQ study in the Netherlands for Figure 7 is that Vision & Leadership turned out to be the most crucial factor for reputation. Nevertheless, the fact that the highest Reputation Quotient in the United States for three years in a row was achieved by Johnson & Johnson, the company that also scored highest on the topics Products & Services and Social Responsibility and second highest on Workplace environment, underlines the importance of these topics as reputation drivers.

Measurements of the Reputation Quotient are too infrequent and too much oriented towards well-known organisations to provide a generic tool for reputation management within companies. But the completed measurement projects have provided useful information about what drives reputation.

General observations from the various studies would include the following:

• A company’s Reputation Quotient is higher when it operates close to the end customer;
• Single-brand companies tend to have higher Reputation Quotients;
• Although the Reputation Quotients of individual companies can fluctuate significantly from year to year, the overall picture remains fairly constant. This is illustrated by the fact that the RQ scores as measured in the Netherlands in 2002 can be for 90% deduced from the scores in 2001. In fact, the probability of a company experiencing an increase or decrease of more than two positions is only 40%.

Blauw Research has performed measurements for five of the nineteen companies participating in the NIDO programme “From financial to sustainable return” (KLM, DSM, Coca Cola, Rabobank Group and Nuon). The results are not publicly available.

From the ten companies with the highest RQ scores in the 2002 study in the Netherlands, seven are single-brand companies.

Linear regression of the RQ rankings in 2001 and 2002 in the Netherlands yields r² = 0.90 (n=22, 8 companies were not present in both years).

Based on the frequency distribution of position changes of all 22 companies that appeared in both years.
As with economic performance, where the change in Economic Value Added, rather than the absolute value, is an indication of value creation, so it can be argued that a change in the Reputation Quotient is what really counts. This creates a level playing field, since all companies can improve their reputation regardless of the fact that only a few of them will ever reach the top position. Analysis has revealed five reputation drivers (Fombrun, 2000). Generally, a company’s reputation is enhanced when it:

1. Occupies a distinctive position in the minds of the key stakeholders
2. Focuses clearly on a core theme in its communications (e.g. Johnson & Johnson focuses on trustworthiness in all of its communication)
3. Is consistent in its communication with all stakeholders (notably employees, customers and shareholders)
4. Communicates in a way that is authentic and relates to the company identity
5. Is transparent about its affairs

4.3 Coupling the impact of CSR and Reputation Quotient and company value

Unfortunately, in none of the five pilot studies did the analysis focus specifically on assessing the CSR related added value of reputation. The companies involved preferred to focus on the previously mentioned value-based management methodology. Nevertheless, some guiding principles for such an assessment are provided here.

For companies of which the RQ scores are known, these scores are the obvious starting point. Except for the most visible companies, these scores are normally not known unfortunately. This, however, does not make the RQ methodology useless since in most companies there is quite some cumulative - albeit diffuse - knowledge about the key-stakeholders and their expectations. Using the RQ items, it is henceforth possible to undertake a self-evaluation provided that this diffuse knowledge can be effectively mobilised. In such a self-evaluation one can score the company relative to its main competitors. This self evaluation can be verified based on interviews with some external stakeholders. Based on the existing research on the strength of the various RQ drivers (as indicated in Figure 7) one can assess how an improvement of the CSR related drivers could improve the overall RQ score. As stated before, the strength of the various drivers (among which the CSR related drivers) varies in time and differs from country to country. This of course must be accounted for when assessing the impact of CSR on reputation. Using the results of the RQ studies that are now conducted annually in many countries one can stay informed about the changes in relevance of the various RQ drivers.

Although it is generally accepted that a good company reputation translates into a higher financial value, the academic studies differ widely about the size of this effect. The previously mentioned result of Srivastava et al (1997) seems to be on the lower side of the range of estimations. Extrapolating their result that a 60% change in reputation translates into a 7% change in market value, one could use as a rule of thumb that a 10% change in RQ translates into a 1% change in market value15. Together with the reputation self-assessment one can thus very roughly estimate the financial benefits of improving a company’s reputation.

It goes without saying that any conclusion arrived at using the above guidelines - be it the impact of CSR on RQ score or the impact of RQ score changes on company valuation - must be interpreted with care. Rather than providing definite answers the guidelines help to structure (CSR) reputation assessments and to provide a very rough estimation of the financial impact.
6.1 Parenting Advantage
The last of the three perspectives of how corporate social responsibility can enhance the value of a company is in the area known as corporate strategy. Many different concepts of corporate strategy exist. The concept of Parenting Advantage contains most of the aspects that are thought to be relevant for corporate strategy. Loosely defined, parenting advantage deals with the fact that a company should not just be a good parent, but the best possible parent for each particular business (Goold, Campbell and Alexander, 1994). Four sources of parenting advantage can be distinguished:

- **Stand-alone influence**: each subsidiary is viewed as a separate profit centre. These businesses are controlled and monitored using basic performance targets. Value is created by strategic decisions such as the appointment of managers and approving major capital expenditures;
- **Linkage influence**: value is created by improved co-operation and synergy benefits;
- **Central functions and services**: corporate value is created through the provision of administrative and managerial services to the businesses;
- **Corporate development**: value creation is built up through portfolio management.

Figure 9 illustrates a number of drivers of Parenting Advantage. It is not enough when a company creates advantages along the lines of one or more of the examples in Figure 9. True parenting advantage is only achieved when more advantages are present for the individual businesses than any other company could provide. Although in practice this is hard to judge, one must always be ready to admit that a particular business may be better off under different ownership.

6.2 Linking corporate social responsibility to Parenting Advantage
Corporate social responsibility can create parenting advantage in two ways. Firstly, it may have an impact on some of the drivers
in Figure 9. Many examples can be given here. One example is improved access to capital markets through a company’s inclusion in sustainable investment portfolios or funds, leading to lower capital costs compared to if the parent did not own the business unit.

The German chemical concern BASF, for example, has a company-wide Competence Centre on eco-efficiency, which lowers the cost for individual businesses to achieve competitive advantages by increasing the eco-efficiency of their products. Dupont, the American chemical company, applies a sustainability co-efficient when making portfolio investment / divestiture decisions. Yet another example could be the increasing need for formal reporting on corporate social responsibility. Such an effort might be considerably cheaper when a business unit belongs to a parent that can provide this service.

The second way in which corporate social responsibility may help create parenting advantage is through incorporating in the portfolio a business model that is entirely based on corporate social responsibility. This could potentially activate all of the drivers of parenting advantage mentioned in Figure 9. The Anglo-Dutch company Unilever for instance has transferred a successful detergent for poor people from the Indian market to Brazil. The case study of Dumeco is another case in point (see Figures 10 and 11).

© A well-known sustainable investing index is the Dow Jones Sustainable Group Index.
Dumeco is one of the largest meat companies in Europe. The company is active in almost all parts of the value chain: from breeding through to the production of consumer-ready fresh meat products. Through the acquisition of a majority share in De Groene Weg (The Green Road) in 2001, Dumeco became active in the market for organic meat. The value chain of organic meat differs significantly from the conventional meat chain since no fertilisers and pesticides are used, the animal feed is free of hormones, and there is much greater attention for animal welfare. De Groene Weg can therefore be seen as the socially responsible entrepreneur within Dumeco.

The added value of corporate social responsibility for Dumeco has been analysed from two perspectives: economic performance and parenting advantage. The main conclusions are presented in Figure 10: the business model of the Groene Weg does not improve the economic performance of Dumeco but it does create parenting advantage. These two aspects will be discussed below.

**Economic performance**

The economic performance of De Groene Weg is not as good as the economic performance of the site located in the village Best (Best Location hereafter), which applies the more conventional business model. The main reason for this is the lack of economies of scale within De Groene Weg. Although the profit margin per kilogram of meat is higher in the Groene Weg business model, this advantage is more than cancelled out by the much lower capital efficiency, i.e. fewer kilograms of meat are produced per Euro of capital employed. This is shown in Figure 11. (The numbers in the graph have been modified for reasons of confidentiality.)
Figure 11 is a contour graph of Return on Capital Employed (ROCE). The different zones in the graph each represent an interval of ROCE. ROCE is the product of the values on both axes and therefore increases from left to right and from top to bottom, i.e. higher EBIT (Earnings before Interest and Taxes) per kg and higher kg per Euro Capital Employed respectively. De Groene Weg has a higher profit margin (EBIT per kg) than the Best location. However, the much lower capital efficiency (fewer kgs per Euro Capital Employed) cause the ROCE to be significantly lower.

**Parenting advantage**

De Groene Weg does create considerable parenting advantage for the Dumeco group. Dumeco can be considered as being very close to the ideal parent for De Groene Weg. Parenting advantage is created using each of the four drivers mentioned in Figure 11. Because of the access to cheaper finance for De Groene Weg within the Dumeco group and the restructuring opportunities for Dumeco, Stand-alone influence parenting advantage is created. Linkage influence consists of the market synergies that arise within the entire group because of a better use of the existing market access infrastructure and the wider product range (e.g. the retailer Albert Heijn buys both conventional and organic meat). Both value chains possess knowledge that can be valuable for the other. Through transfer of this knowledge, De Groene Weg can achieve more efficient production and the other Dumeco companies may benefit from the knowledge about sustainable meat production to reduce risks in their own value chains. This creates parenting advantage through the Central functions.

The final source of parenting advantage comes from corporate development. The two value chains have very different risk profiles. In Figure 11 one can readily observe that a slight decrease of earnings per kilogram (e.g. through lower prices) leads to drastically lower ROCE values for the Best location. De Groene Weg is much less sensitive to this effect and therefore acts a "natural hedge". Also, the higher added value model of De Groene Weg (because of the higher earnings per kilogram) may provide better opportunities for future growth.
Implementing the method

As stated before, the Triple Value Assessment™ needs to be tailored to the specific circumstances of companies using it. The three perspectives - economic performance, reputation value and parenting advantage - are of different importance for different companies. Here we will provide some guidelines for implementing the methodology.

Applying the method involves four steps, as is illustrated in Figure 12.

The person responsible for CSR in a company, who ideally reports to the CEO, first of all needs to determine which CSR perspective is of most relevance. This will be discussed shortly. Depending on the chosen perspective a team needs to be composed. Figure 12 provides some guidance on which functions should be included, based on the experience gained in the case studies. Of course, other functions may be valuable but the functions mentioned here are indispensable. Although the analyses can differ substantially for different companies, the most typical ones are mentioned here. The reader is referred to the previous chapters for additional detail. Finally, the aim of a project to determine the added value of CSR is to arrive at conclusions on how the contribution of CSR to the market value of a company can be increased. Therefore improvements need to be identified and implemented, targets must be set and the management support must be acquired (e.g. through a board presentation).

As is clear from Figure 12, the choice of the perspective from which the added value of corporate social responsibility determines the next three steps. More than one perspective will likely be important for a typical company, but it is recommended that one starts with a focused effort using only one of the suggested perspectives. Figure 13 provides a flow chart to help companies decide which perspective to consider. Based on four questions one can determine which perspective is the most relevant to consider (next).
Figure 13 Flow chart to determine perspective for assessing added value of CSR

1. Tangible competitive advantage: Yes/No
   - Yes: Insight into value creation
     - Yes: CSR leveraged in company
       - Yes: External recognition for CSR efforts
         - Yes: Reputation assessment
       - No: Parenting Advantage assessment
     - No: Economic Performance assessment
   - No: Reputation assessment

2. Insight into value creation: Yes/No
   - Yes: CSR leveraged in company
     - Yes: External recognition for CSR efforts
       - Yes: Reputation assessment
     - No: Parenting Advantage assessment
   - No: Economic Performance assessment
The Triple Value Assessment™ presented above enables companies to build the Value Case for corporate social responsibility by:
- Increasing the quantitative understanding of the economic value of existing policies in the area of corporate social responsibility;
- Extending the method of value-based management from the Capital perspective to the People and Planet perspectives
- Identifying key value levers based on which corporate social responsibility can be integrated into business strategy

The model enables (senior) management to establish a focus when working out the company's overall strategy in relation to corporate social responsibility, by distinguishing economic performance, reputation value and parenting advantage.

Companies are different and so are the ways through which they integrate corporate social responsibility into their business. By assessing the impact of corporate social responsibility on the (tangible) economic performance and (intangible) reputation value and parenting advantage, four archetypal companies can be defined (see Figure 14).

The obvious sweet spot in this diagram is when corporate social responsibility contributes to economic performance and has a large impact on company reputation and parenting advantage. Companies or business units in this region have taken corporate social responsibility to the core of their business. These 'Core Operators' can

![Figure 14: Four Entrepreneurial Archetypes with respect to Corporate Social Responsibility](image)

Harvest the fruits and stay alert

High Impact of corporate social responsibility on reputation premium and/or parenting advantage

Peripheral Player

Core Operator

Irresponsible Participant

Hidden Champion

Change the corporate social responsibility agenda

Exploit your capabilities internally and externally

Economic performance

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The obvious sweet spot in this diagram is when corporate social responsibility contributes to economic performance and has a large impact on company reputation and parenting advantage. Companies or business units in this region have taken corporate social responsibility to the core of their business. These 'Core Operators' can
typically have a strong vision about the relevance of corporate social responsibility but they have forgotten about the economic performance. They need to focus more on the financial side of things or they risk increasing skepticism, inside and outside the company: As Kaiser Wilhelm II famously said "Morality is all very well but what about the dividends?". Lastly, "Hidden Champions" are rewarded economically for their corporate social responsibility but their results go largely unnoticed. Leverage of their capabilities - inside and outside the company - may improve the situation.

Among the five pilot studies carried out in the context of the NIDO programme we have encountered both Peripheral Players and Hidden Champions. A real Core Operator has not been identified, nor did we encounter an Irresponsible Participant. However, these companies do exist. A good example of a Core Operator is the Anglo-Dutch food giant Unilever, which has taken sustainable development to the heart of its business. It adds to the economic performance and the company is widely recognised as a leader\(^{18}\). Probably the best-known example of an Irresponsible Participant is Monsanto. Motivated by sustainable development, the company launched seven sustainability teams\(^{19}\). An interview with CEO Shapiro regarding the relevance of sustainable development for Monsanto appeared in the Harvard Business Review. However, the genetically modified food crops, which were developed to fight global hunger, did not make any money at all: markets in many parts of the world refused the products. Moreover, many pictured the company as the enemy of people and planet\(^{20}\). Since then, the company has sacked its CEO. It has publicly stated that the company will take a deliberately different path from the past.

The pilot studies show that corporate social responsibility can lead to added value. Which value is created depends on the company and the sector to which it belongs. By attuning the Triple Value Assessment\(^{\text{TM}}\) to the company-specific value creation process, the costs and benefits of corporate social responsibility can be mapped out systematically. The company representatives involved in the process generally became enthusiastic as a result of looking at their business from the new viewpoint of corporate social responsibility. As one of them stated: "The concept of corporate social responsibility has inspired me to reconsider my business model\(^{21}\). Involving Accounting & Finance functions in the process turns out to be crucial. It ensures that the Triple Value Assessment\(^{\text{TM}}\) remains close to the "mental model" that managers have of their business and that the financial data needed are supplied. Based on positive feedback from the managers involved it can be expected that they will continue to use the Triple Value Assessment\(^{\text{TM}}\) to integrate corporate social responsibility into their core business. This model offers promising perspectives to link the People and Planet performance of a company with its financial value. The most important next step is the application of the methodology to more companies.
A matter of choice - The future of the company, The Economist, December 19, 2001, p. 74-76

Amoto, I. Green Chemistry Proves It Pays - Companies find new ways to show that preventing pollution makes more sense than cleaning up afterward, Fortune, July 24, 2000, p.270U.


Tully, S, "The real key to creating value", Fortune, 20 September, 1993, 38-44.

Appendix - Profile of the companies in the pilot studies

**DSM**
*Company profile*: DSM is active world-wide in life science products, high-grade materials and industrial chemicals. It concentrates on taking up leading positions in activities with high added value. DSM divides its business groups into three strategic clusters:
- Life Science Products (especially for use in pharmaceutical and food industry)
- Performance Materials (high grade plastics for the global market)
- Industrial Chemicals (DSM Fibre Intermediates, DSM Melamine, DSM Agro and also (until 1st January 2002) DSM Petrochemicals).

*Economic position*: DSM’s annual turnover is almost EUR 6 billion. DSM’s strategy is to increase this annual turnover to a level of about EUR 10 billion in 2005, partly by its own growth, partly by acquisitions.

*Number of personnel*: DSM has 20,000 employees, employed in over 200 branches spread all over the world.

**Dumeco B.V.**
*Company profile*: Dumeco B.V. is a European food concern specialising in meat. Dumeco’s policy is to produce fresh meat products using an ‘integrated quality chain strategy’. This concept is founded on two basic ideas:
1. Chain management
2. Integrated quality management
The strategy is focused on the production of an increasing range of “added value” products.

*Economic position*: Turnover in 2001 was EUR 2.3 billion, an increase of almost 40% when compared with the year 2000 (EUR 1.6 billion). Dumeco managed to obtain a considerable increase in profits (EUR 6.8 million, against EUR 0.4 million in 2000). This increase is mainly the result of more effective cost management as well as the advantages gained from synergy following the integration of several large acquisitions. At the same time Dumeco suffered greatly as a result of foot and mouth disease as well as a fire at its biggest production centre in Boxtel.

*Number of personnel*: At the end of 2001, the total number of staff in the Netherlands was about 5,000.

**Koninklijke Luchtvaart Maatschappij NV (KLM)**
*Company profile*: KLM Royal Dutch Airlines is the oldest scheduled airline in the world and ranks seventh among the more than 260 international airlines in terms of international revenue ton-kilometers flown. Its home base is Amsterdam’s Schiphol Airport, one of the most modern airports in the world. KLM is at the centre of the KLM group, which also includes KLM Cityhopper, Transavia Airlines and Buzz.

Within its formal alliance with Northwest Airlines, and co-operating closely with European and inter-continental network- and route partners, KLM and its partner airlines operate a route network connecting more than 360 cities in 78 countries. In the financial year 2001/2002 KLM carried 15.5 million passengers and 490,000 tons of cargo and mail.

*Economic position*: The financial 2001/2002 turnover was EUR 6,532 million, which is a decrease of 6% compared to the previous year. This resulted in an operating loss of EUR 94 million.

*Number of personnel*: On 31 March 2002, 30,381 people worked for KLM, of whom 26,728 were within the Netherlands and 3,653 in other countries.

**Perfetti Van Melle**
*Company profile*: Perfetti Van Melle is a global confectionery company that manufactures and distributes sugar confectionery and chewing gum products. It has a global span, being active in the Asian Pacific area,
Europe, the Middle East, Africa and the Americas. Its corporate headquarters are in Lainate (Italy) and Breda (the Netherlands). Besides being responsible for the production of four of its brands, Perfetti Van Melle Benelux B.V. is responsible for sales activities in Northern and Western Europe for Mentos®, Frisk®, Meller®, Fruittella®, Klene® and Wybert®. Perfetti Van Melle Benelux B.V. has production factories in Breda and Weert.

**Economic position:** Today, Perfetti Van Melle is the world’s sixth, and Europe’s second largest confectionery Group, marketing strong international brands like Mentos, Frisk, Fruittella, Klene, Brooklyn, Alpenliebe and Golia.

**Number of personnel:** Perfetti Van Melle employs over 9,000 people, all over the world.

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**Uniqema Nederland B.V.**

**Company profile:** Uniqema Nederland B.V. was founded in 1858 as a candle factory and has developed independently until 1960 and thereafter as a division of Unilever. Since 1997 it has been a division of the ICI Group. The head office of this group is located in Gouda, where the biggest company, Uniqema, is also based. Uniqema is an oil and chemical company, which means that it processes vegetable and animal oil and fat into semi-finished products, which are used in a wide variety of industries and markets.

**Economic position:** Total production adds up to about 170,000 tons, with sales of about EUR 200 million. More than 90% of these sales are for the export market, with about 40% of those exports going outside Europe.

**Number of personnel:** The Gouda site employs about 550 people, of whom about 370 are employed by Uniqema.