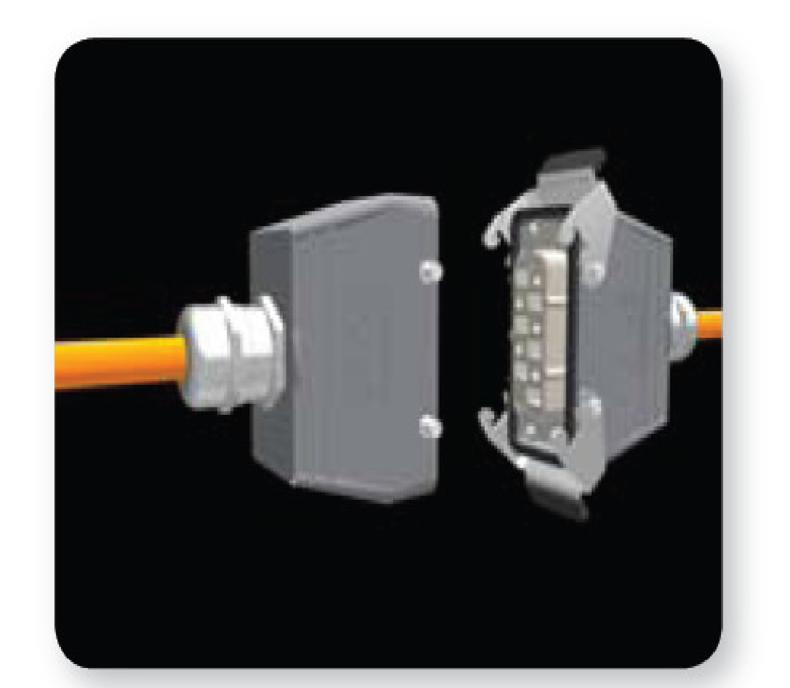
# What is the Relation Between Company Profits, Company Reputations and Corporate Giving?


- Philip Kotler, Ph.D
- Kellogg School of Management
- Northwestern University
- *Maxon Lecture George Washington University School of Business*

# Questions Facing Companies

1. What are the key factors that contribute to a strong corporate reputation?

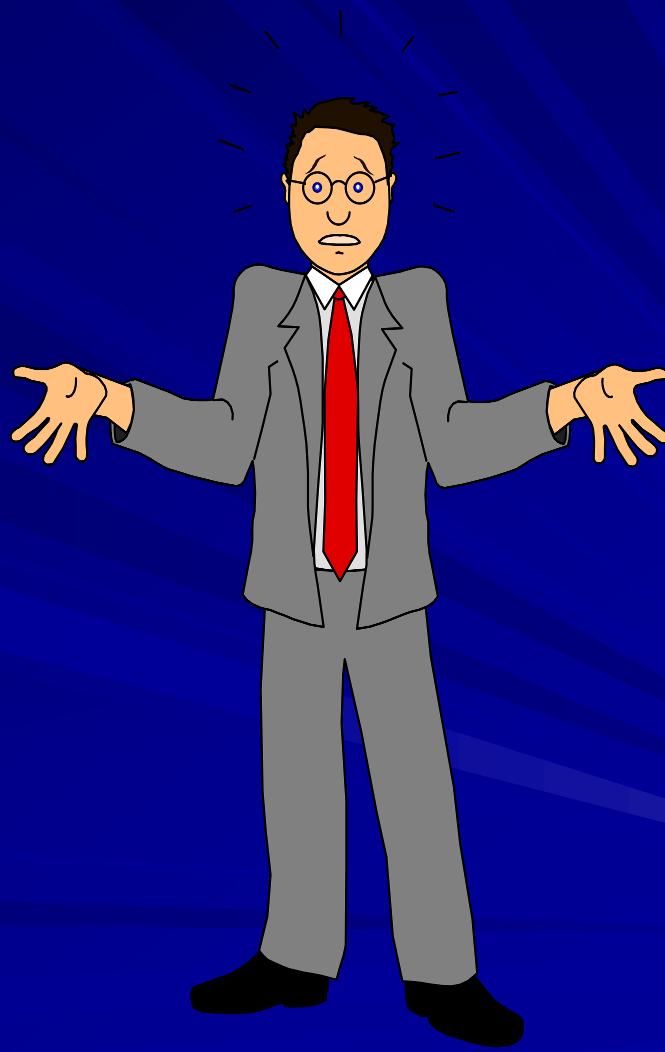
2. Is it right for a company to give away investors money under the idea of corporate social responsibility (CSR)?

3. What are the major  ways that a company can manifest social responsibility?

4. How can the company measure the impact of its social giving on the recipients and on itself?

5. How much does corporate social responsibility enhance the corporate reputation?

6. Are socially responsible companies more profitable?



# 1. What are the key factors that contribute to a strong corporate reputation?

# Criteria for Ranking "Most Respected Companies" 2006

1. Quality of products and services
2. Innovativeness
3. Financial soundness
4. Quality of management
5. Social responsibility

# 2. Is it right for a company to give investors money away under the idea of corporate social responsibility (CSR)?

The Hyperion Company, a Business Performance Management software company, offered its employees $5,000 to be used toward the purchase of a hybrid car. They have 2,500 employees.
This can cost the company $12,500,000.

Would you as an investor in this company object?

# Those Opposed to Corporate Giving

- Milton Friedman, Nobel economist, said: “There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game.”

# Those Favoring CSR

- Michael Porter offers four justifications for CSR:
  - Moral obligation,
  - Sustainability,
  - License to operate
  - Company reputation

- Others argue that companies will gain by rewarding all the *stakeholders*.

- CSR will also help offset the public's bad image of many companies.

# Reasons for the Public's Distrust of Business

- Some high profile business scandals in recent years
  - Enron, Tyco, WorldCom

- Some bad decisions
  - Shell Oil sinking of the Brant Spar in the North Sea
  - Pharmaceutical companies resisting lowering prices for African victims of HIV/AIDS
  - Nike's brush with a charge of child labor

- Outlandish payments to corporate leaders
  - A chief executive receives an $82 million pension after his company loses billions in shareholder value.
  - A throng of executives have spent years shifting stock option dates to fatten already-bulging paychecks.

- 84% of Americans agreed that they "would be likely to switch brands to one associated with a good cause, if price and quality were similar."

- The rise of Business Ethics managers within global corporations and citizen "watchnets" and "whistleblowers."

# What Do Most Business Executives Think About CSR?

- Most executives acknowledge the importance of social and environmental responsibility to the bottom line (82%), to their companies' reputations (59%), and to their customers (53%).
- Four out of five executives believe the role of corporations goes beyond simply meeting obligations to shareholders.
- About 10% of company leaders don't practice corporate citizenship saying their only obligation is to make a profit, pay taxes, and provide jobs.
- At the other 10% extreme are companies such as Timberland, Ben & Jerry's, Body Shop, Newman's Own, and Patagonia who believe in social activism.

# Changing the Soul of Capitalism

- R. Edward Freeman in 1984 made a strong case for a stakeholder, not shareholder view of business: “stakeholder relationship management (SRM).”
- “How are we going to make this company an instrument of service to society even as we fulfill our obligation to build shareholder wealth?”
- “This country has been too steeped in materialism and self-centeredness, in having rather than being.”
- Humanistic companies create emotional value, experiential value, and social value, in addition to financial value.
- Humanistic companies focus on five stakeholder groups.
  - SPICE: Society, Partners, Investors, Customers, and Employees.
- These companies contrast to those without a soul: GM, Wal-Mart, etc.

# Winning Through Stakeholder Value Creation - 1

- Jim Collins in *Good to Great* defined "great" companies by identifying the top financial performers and their characteristics.
- Jag Sheth* and his coauthors defined "great" companies by identifying the most humanistic companies.
- They identified the following *Firms of Endearment* :
  - Amazon, Best Buy, BMW, CarMax, Caterpillar, Commerce Bank, Container Store, Costco, eBay, Google, Harley-Davidson, Honda, IDEO, IKEA, JetBlue Johnson & Johnson, Jordan's Furniture, LLBean, New Balance, Patagonia, Progressive Insurance, REI, Southwest, Starbucks, Timberland, Toyota, Trader Joe's, UPS, Wegmans, Whole Foods.
- Sheth was surprised that these companies significantly financially outperformed the outstanding performance of Collins' companies.

Source: Raj Sisodia, David B. Wolfe, and Jag Sheth, *Firms of Endearment: How World-Class Companies Profit from Passion and Purpose* (Wharton School Publishing, 2007)

# Winning Through Stakeholder Value Creation - 2

- These Firms of Endearment shared the following characteristics:
  - They align the interests of all stakeholder groups
  - Their executive salaries are relatively modest
  - They operate an open door policy to reach top management
  - Their employee compensation and benefits are high for the category; their employee training is longer; and their employee turnover is lower
  - They hire people who are passionate about customers
  - They view suppliers as true partners who collaborate in improving productivity and quality and lowering costs
  - They believe that their corporate culture is their greatest asset and primary source of competitive advantage.
  - Their marketing costs are much lower than their peers while customer satisfaction and retention is much higher.
- Their marketing is about:
  - Triggering great word of mouth rather than heavy brand advertising (Google and Starbucks did no advertising)
  - They do not rely on frequent sales or heavy promotion

# 3. What are the major ways that a company can manifest social responsibility?

| | |
|---|---|
| Avon | *Breast cancer* |
| General Mills | *Better nutrition* |
| General Motors | *Traffic safety* |
| Home Depot | *Habatat for Humanity* |
| Kraft | *Reducing obesity* |
| Levi Strauss | *Preventing AIDS* |
| Motorola | *Reducing solid waste* |
| Pepsi Cola | *Staying active* |
| Shell | *Coastal cleanup* |
| Petsmart | *Animal adoption* |
| Aleve | *Arthritis* |
| British Airways | *Children in need* |
| Starbucks | *Protecting tropical rainforests* |
| Best Buy | *Recycle used electronics* |

# Some Observations

- Most companies will do some good, for some cause, at least some of the time.
- Companies need guidance in choosing social responsibility initiatives because they are besieged on a daily basis by:
  - Nonprofit organizations, special interest groups, politicians, even colleagues, board members and stockholders.
- There are “best practices” for choosing among social issues.

# Company Support of Causes

- The most-often supported causes are four:
  - community health
  - safety
  - education
  - the environment

- Company support may include:
  - cash contributions
  - In-kind services
  - sponsorships
  - employee volunteers
  - access to company facilities and distribution channels
  - matched giving schemes
  - event support and sponsorship
  - cause-related marketing

# Six Corporate Social Initiatives

- Cause promotions
- Cause-related marketing
- Corporate social marketing
- Corporate philanthropy
- Community volunteering
- Social responsible business practices

Source: Philip Kotler and Nancy Lee, *Corporate Social Responsibility: Doing the Most Good for Your Company and Your Cause*, Wiley 2005.

# Two Types of CSR

- Responsive CSR
  - Good citizenship (GE supporting schools near GE plant)
  - Mitigate harm from value chain activities (DuPont)

- Strategic CSR
  - Transform value-chain activities to benefit society while reinforcing strategy (GE using windmills)
  - Strategic philanthropy that leverages capabilities to improve salient areas of competitive context (Toyota’s Prius)

Source: Michael E. Porter and Mark R. Kramer, “Strategy & Society,” *Harvard Business Review*, December 2006.

# Criteria for Selecting a Good Cause

- Consistent with the product line and company reputation.
- Helps recruit the kinds of employees company needs.
- Makes a significant impact on the target market.
- Likely to generate strong word-of-mouth.
- Can draw attention as a good deed.

# Best Practices

- Choose only a few social issues to support that are a concern to communities where you do business and align with company's mission and values and which support business goals and inspire employees and customers and can be supported for a long time.
- Select multiple initiatives for a single cause rather than several causes
- Establish clear and measurable objectives for the client and the company.
- Measure and report outcomes for the company and cause.

# But There Are Risks and Costs of Being a Good Corporate Citizen

- The company will be deluged with funding solicitations.
- Stockholders may sue.
- Difficult to terminate CSR sponsorships.
- Risk of seeming hypocritical (McDonalds).
- Risk of a scandal that makes a lie of the company's claim to social responsibility.
- Visibility for corporate efforts may be lost.
- Coordinating with cause partners can be time consuming.
- Staff time and involvement can be significant.
- Efforts may require external expertise.
- Promotional expenses can be significant.
- Consumers may be skeptical of corporate motivations and commitment.
- Tracking resource expenditures and value can be difficult and expensive.

## 4. How can the company measure the impact of its social giving on the recipients and on itself?

About 20% of companies now report their CSR activities in their annual report.

Try to judge these social investments in the way that you would judge your commercial investments.

## 5. How much does corporate social responsibility enhance the corporate reputation?

# Companies Are Increasingly Being Rated on Social Responsibility

- The Council on Economic Priorities evaluates company performance on a range of social dimensions and publishes *Shopping for a Better World* to influence consumers' purchasing decisions.

- *Fortune* magazine annually rates "Most Admired Companies" where social responsibility is included as a factor."

- *Fortune* magazine annually rates "Best Companies to Work For."

- 84% of Americans in 2002 said that they "would be likely to switch brands to one associated with a good cause, if price and quality were similar."

# America's 100 Best Corporate Citizens

- Each year *Business Ethics* publishes the 100 best American companies out of 1,000 that are evaluated.
- They evaluate the degree to which the companies serve seven stakeholder groups: shareholders, community, minorities and women, employees, environment, non-U.S. stakeholders, and customers.
- Information is gathered on lawsuits, regulatory problems, pollution emissions, charitable contributions, staff diversity counts, union relations, employee benefits, awards, etc.  Companies are removed from the list if there are significant scandals or improprieties.
- Source: *Business Ethics*, Spring 2003, p. 6.  The research is done by Kinder, Lydenberg, Domini (KLD), an independent rating service.

# 20 Best Corporate Citizens (2003)

1. General Mills
2. Cummins Engine
3. Intel
4. Procter & Gamble
5. IBM
6. Hewlett-Packard
7. Avon Products
8. Green Mountain Coffee
9. John Nuveen
10. St. Paul
11. AT&T
12. Fannie Mae
13. Bank of America
14. Motorola
15. Herman Miller
16. Expedia
17. Autodesk
18. Cisco Systems
19. Wild Oats Markets
20. Deluxe

Source: Ibid., *Business Ethics*, Spring 2003

# Why Reputations Matter

- Customers
  - Reputation affects purchase decisions
- Employees
  - Reputation affects decisions to engage, commit, and stay
- Investors
  - Reputation affects investment decisions
- The media
  - Reputation affects coverage
- Financial analysts
  - Reputation affects ratings

Source: Ibid., *Fame & Fortune*

# Rationale for Companies Investing in Social Initiatives

- Companies need to differentiate themselves.  Companies with civic virtue will be preferred.
- Companies need a decision framework for facing daily requests for sponsorships, improved health coverage, injury prevention, environmental protection and community contributions.
- Corporate heads and boards need to understand the social pressures and opportunities facing their companies.
- Companies need to build a bank of public goodwill to offset potential criticisms.
- Employees, investors, and partners will be more motivated and loyal.

# Does Corporate Giving Enhance the Company's Reputation?

- What is the effect of the Bill and Melinda Gates Foundation that is spending billions to fight malaria, TB, and AIDS on Microsoft's reputation?
- What is the effect on Warren Buffett's businesses as a result of his gift of $31 billion to the Bill and Melinda Gates Foundation?
- What is the effect of Sir Richard Branson's $3 billion commitment for alternative fuel research on Virgin businesses?
- Gates, Buffett, Virgin and Google may well be changing the rules of corporate philanthropy, with the perceived sizes of their commitments

# 6. Are Socially Responsible Companies More Profitable?

# **Relationship between CSR and Profitability is Tenuous**

- Some companies that are indifferent to social responsibility make a lot of money (and many don't).
- Some companies that are highly ethical don't make a lot of money (and many do).
- Companies that perform well in *economics* and in *ethics* are likely to outperform others.

# Research Findings

- The correlations between financial performance (FP) and social performance (SP) is sometimes positive, sometimes negative, and sometimes neutral, depending on the study.
- Even when FP and SP are positively related, which causes which?
- Most probable finding is that high FP firms invest slack resources in SP and then discover the SP leads to better FP, in a virtuous circle.
- Companies may use Pascal's Wager to justify social responsibility investments.

Source: Sandra A Waddock and Samuel B. Graves, "The Corporate Social Performance-Financial Performance Link," *Strategic Management Journal*, vol. 18:4, pp. 303-319, (1997).

# Under What Conditions Will Corporate Social Responsibility Lead to Higher Profits?

- When a higher proportion of the target market or public in that country cares about company social responsibility.
- When the company is significantly more socially responsible than its competitors.
- When the company's competitors have been tainted with scandals.
- When the company's products, services and value delivered are superior to its competitors.

# Recommendations

- A company should determine its civic positioning as well as its market positioning.
- Simply giving money to philanthropy doesn't mean you have core values, a core purpose and core goals.
- Social responsibility can be carried out for selfish reasons as well as selfless reasons. It guarantees the continuation of a healthy society and economy.
- A company that adopts stakeholder theory will have to change its culture, structures and systems.
- A company should consider setting up two groups:
  - A CSR group (external and civic)
  - An ethics group (individual employee issues)
- A company should encourage its investors to take a longer view of company goals and strategies.
- A company should include in its annual report its performance on its social initiatives.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