CSR, A risky business -
Risk Management and CSR

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1 Introduction – Creative solutions to the World's problems

Corporate Social Responsibility ("CSR") is about risk management, and risk management is about CSR. If we are able to integrate the discipline of risk management and CSR, the result will be two-fold. CSR will automatically become more embedded into management processes as it will directly feed into strategic decision making at all levels of a business. Secondly, it will encourage investment analysts to recognise and reward CSR.

In this discussion, we investigate the role of CSR and risk management. Responsible companies have long understood their duty of care towards their employees, but more recently, they have accepted that the bounds of their responsibility should be extended to embrace the environment, broader human rights. The failure to do so results in the risk of reputational damage to companies. [1]

In the light of this, socially responsible decision making should take centre stage as part of the company's main strategic business planning exercises. The mutual dependence of corporations and society implies that both business decisions and social policies must follow the principle of "shared value" - this can be achieved by strategic CSR. [2]

The knowledge economy in Europe has expanded, at the expense of the manufacturing sector. As part of Lisbon Strategy, European Union's (EU) has the stated aim to "make Europe, by 2010, the most competitive and the most dynamic knowledge based economy in the world" (EU Lisbon Council, May 2000). The EU defines the knowledge economy by referring to 4 features, which have direct links to CSR:

- the universal use of electronic exchanges of information – Google's business model in China led to their involvement with web censorship, and complicity in human rights infringements
- convergence towards digital technologies
- the exponential growth of the Internet,
- and the opening up of telecommunications markets – Companies such as Nokia have expanded market share by selling to the bottom of the pyramid – for example, based on the author's own experience, many remote parts of, for example, Ghana, have available 2nd generation mobile phone technology.

This discussion will focus on the following questions:

1. How has the knowledge economy influenced and changed the key drivers of CSR?
2. How has the knowledge economy influenced and changed the business case for socially responsible decision making?
3. How can risk reporting metrics be developed to report CSR to markets and other key stakeholders?

2 Changed drivers of CSR

The business case for socially responsible decision making has been described as requiring CSR to be integrated into the business, by analysing the value chain [2], and this requires a clear shift from philanthropy to strategic CSR – from responsive CSR to pro-active CSR.

Company performance should identify, manage and mitigate risks. Companies need to consider the following as part of their strategic business planning: Equitable distribution of benefits; Profit and value; Products production and access (for example in relation to internet gambling).

A model has been proposed to capture the impact of the knowledge economy on shareholder value in respect of CSR. Operating costs are plotted against external costs and an efficient technological frontier is identified. Companies that do not innovate find that a number of drivers including: laws, regulations, NGOs and stakeholders, move the company along the technological frontier to a point where it no longer profitable for the company to carry on business. Companies therefore need to shift the technological frontier through innovations in risk management.

2.1 Bad news travels further and faster - the implications for stakeholders and values and international law

It is arguable that before, a number of recent corporate scandals would have had less effect because of limitations on media before the advent of the knowledge economy. Corporate behaviour has come under the spotlight - this has moved business expectations from 'trust us' to the stakeholders demand for 'prove it', rooted in evidence of (a) Infringements of human rights, (b) Complicity and (c) the business case for reputational management. There are a number of prominent examples: Nokia and Motorola – forced labour; World Com – business ethics; and Nike – Child Labour.

The flow of information has also been beneficial in the development of international law and its enforcement. The increasing power of the media, including the rise of investigative journalism, has meant that unethical management practices have been exposed and reputational capital diminished. For example, the BBC's Panorama covered use of child labour in the M&S Supply chain (15 October, 2000).

2.2 Change in the type of work- Accountability / risk and values

When discussing change, it is worth stepping back and asking the question – what really has changed? It is clear that the knowledge economy has speeded up and increased the volume and speeded up the exchange of information. This has made access to information of all types much more readily available.

Over the period 1993 – 2006 UK's productivity index rose from 82.6 to 105.9 as the volume of work has increased, in part due to the knowledge economy. [3] This change in working patterns has changed the risks faced by today's stakeholders and the accountability measures required to monitor company's performance.

2.3 The need for readily assessable information - Accountability

Business is no longer seen as a neutral participant in the human rights agenda. Instead there exists a potential for business to be considered complicit in human rights and ethics infringements that occur within its sphere of influence. Voluntary initiatives such as the Global Compact (United Nations, 2000a) provide a context for companies to address these issues – thus reducing the risk of alleged complicity in human rights infringements.

In order to measure development, indices other than productivity are required. The human development index (HDI) no longer focuses on purely economic issues; and the FTSE4good index has been developed. These measures help to improve transparency of CSR issues. Companies need to be able to predict and credibly respond to society's changing awareness of particular issues. [4]

Therefore, the change in the speed of work and has created a need for more readily digestible information formats. Most traditional company level CSR reporting has taken the form of lengthy reports. The award winning De Beers 2005/06 CSR report, 'Living up to diamonds', adopts a structured format with analysis presented under headings such as Economic, Ethics, Employees, Communities and Environment. [5]

The share price of De Beers did not respond to the release of the De Beers 2005/06 CSR report. There is a perception that mainstream investors do not reward CSR. To a large extent CSR considerations are not top of the agenda of mainstream investors. It is important to find ways of articulating CSR work to investors and shareholders in a format that they will be able to readily use in valuation work.

2.4 Are we sure that the market doesn't value CSR? Do markets value risk? (risk and opportunity)

The knowledge economy has the effect of increasing the volume of information available to investors and equity analysts. It has commonly thought that equity markets doesn't value CSR, but that markets do penalise companies when something goes wrong, as a result of having poor CSR policies.

However, we should instead ask ourselves the following question. Do markets value risk? In Financial theory, the capital asset pricing model (CAPM) is commonly used, this model presumes that all investors can hold a diverse portfolio of investments through owning stocks and bonds. When considering the risk of a particular investment, the critical issue is how the addition of that investment will impact the risk of the entire portfolio. Risk is central to the value placed on investments. [6]

A consequence of the knowledge economy has been to make risk management information more readily available to investors – for example Prudential Plc's Economic Capital Analyst presentation, which includes a treatment of operational risk.[7] In certain sectors, for example, insurance and banking such risk management reporting information is common place. This format of information should be extended to CSR reporting.

3 Changed business case for socially responsible decision making

The knowledge economy has changed the business case for socially responsible decision making by moving the argument from being about public relations and compliance towards one of doing ‘positive good’.

It can be argued that this shift would not have occurred without the knowledge economy bringing information into the hands of stakeholders. Case studies prove that the best examples of corporate CSR have been birthed through the fires of crisis. Many companies have been forced through crisis to change by adopting the following new approaches: partnership, rights and responsibilities, social reporting, indicators and performance indicators, reconsider financial drivers, strategic business planning and development rights.

The UK Insurance Industry has taken note of this trend. In a recent report, the Association of British Insurers (the ABI) stated that, “On the whole, mainstream equity analysts have shown relatively little interest in corporate responsibility. They have tended to regard the issues as having little relevance to earnings forecasts and shareholder value – in the timescale which mainly concerns them …. This situation has changed, slowly, since the mid- 1990s when corporate responsibility began to grow. One in three sell-side analysts now say they believe social and environmental issues are important in evaluating companies. Some firms have taken specific steps. For example, UBS has contracted the CR specialist firm Innovest to train staff on environmental issues. HSBC and Dresdner Kleinwort Wasserstein have employed specialist staff to stimulate awareness and understanding of corporate responsibility among their equity specialists and clients. And in some sectors which will be significantly affected by current developments, analysts have begun to take social and environmental issues into account in their analysis, e.g. utilities, where several analysts 28 have published reports on the impacts of climate change and the European Union’s emissions trading scheme.” [8]

4 Risk reporting metrics for CSR

Having addressed the impact of the knowledge economy on the business case for CSR and socially responsible decision making, in this discussion, we are going to focus on how can we give companies the framework / tools to clearly articulate the business case for their company in a way that is meaningful for investors.

CSR practictioners should adopt the techniques used by risk managers.   They need to take a step by step approach to analysing the problems faced by companies, in order to demonstrate the value to business of CSR.

A top down approach to developing CSR risk management frameworks has been used. Under this model international laws, the international declaration of human rights, national laws and regulation are used a driver for risk management, as companies need to comply with these laws. A bottom up approach is proposed where the starting point for the analysis is the engagement of stakeholders.

In this discussion, we propose an alternative bottom up approach under which risks are analysed in order to develop adverse scenarios which are faced by companies. The process follows step by step process for analysing the risk facing companies in order to develop CSR policies. The analysis should not just be focused on the company's risks, but should also cover the risks to the society

The EU's Basel II framework introduced a standard industry approach for operational risk in financial services companies - this framework can be extended to cover CSR. Companies face three key challenges: risk management, risk measurement and embedding risk management in their businesses. Techniques of bottom up stress and scenario testing are used throughout the World in Financial Services. For example, the Bank of Japan (BoJ) regularly carries out analysis to assess its exposure to the following risks, Earthquake; Fraud; Lawsuit; Contract checks; System problem; Business continuity plans and Labour-related problems. At BoJ the Risk Analysis Department already carry out CSR by a different name. [9]

The bottom up framework as applied in the financial services industry is outlined below, this model is applied to the De Beers Case study in Appendix 1.

Risk identification	**Develop plausible adverse scenarios for each material risk and consider**	**Develop key risk indicators (KRIs), key control indicators (KCI) and key performance indicators (KPIs) for companies to report risk management performance.**
Identify risks which the company is exposed to. Risk management information is often readily available in the form of risk registers, regular Management Information ("MI") reports and governance related documentation. Immaterial risk should been screened out. The risks should be reviewed to see if any significant risks have been excluded. Map risks identified to external benchmarks and other risk classifications. Companies need to demonstrate awareness of key industry risks, and how much (reputational) capital can be saved. Companies need to have robust identification and completeness review procedures, and these need to be documented.	Severity of scenarios considered. It is important to ensure that the scenarios considered are sufficiently adverse as to require the development of risk mitigation strategies. Granularity of scenarios: It is important to demonstrate that a robust bottom up approach has been used. Companies need to document detailed working to support their choice of operational risk scenarios. Risk mitigation: Develop mitigation strategies for each scenario or identify how much capital company needs to hold against each scenario. Consider diversification effects – i.e. company gets a benefit from the fact that all the adverse scenarios are not expected to occur at the same time.	This could include developing risk reporting "dashboards" and reporting tools to graphically present risk management information. Regular reporting format need to developed. These should be brief presentations targeted at investors and equity analysts summarising: Key risks Key adverse scenarios Key mitigation strategies KRIs, KCIs and KPIs What has changed: Progress in risk management since the last report

5 Conclusions

In this discussion, a bottom up risk analysis approach has been outlined which can be used to link CSR to broader risk management. The bottom up approach can be used to propose KRIs and KCIs for monitoring and reporting risk management. These could be used to develop risk reporting 'dashboards' which could be used by equity analysts and other stakeholders.

Good high quality KRI and KCI information could be used as the basis for the development of CSR information could give the market positive signals regarding a company's risk management. This information if regular and digestible, then over a period of time, markets could give a positive value to CSR.

In the knowledge economy, the business case for CSR can be found in risk management. However, 49% of top European business managers believe that the purpose of CSR initiatives is mainly about image. [10] Clearly work is needed to win hearts and minds of senior management. The use of existing business risk management frameworks can help provide a clear way to embed CSR in the management of business, shareholder value and communication with key stakeholders.

6 References

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10. European Business Monitor Survey (2007), UPS, Briefing March 2007.

Appendix 1

Background: dealing with Aids in Botswana [7]

Risk identification[A]	**Materiality screening**	**Scenario development**	**Mitigation strategies**
• Data security • Carbon footprint • Child labour • Forced labour • Working hours • Health and safety • Freedom of association and collective bargaining • Discrimination • Discipline • Remuneration • Human rights • Environment • Ethics / anti-corruption • Economics	Exclude the following as not issues in this specific case: Child labour Data security Discrimination Discipline Working hours Human rights	• Health and safety – risk of workforce contracting HIV /AIDS, with consequent productivity issues • Environment – failure of water management policy • Carbon footprint – product air freighted – climate change levies • Child labour / Forced labour - bad publicity and infringement of national/international laws • Freedom of association and collective bargaining – bad publicity • Remuneration – underpaid workers – bad publicity, bad staff retention, poor productivity • Economic – need to support economies of diamond mining countries where De Beers active	• Health and safety: Provide the following to work force, families and communities: o HIV treatment o Health education o Healthcare o Introduce target of zero fatalities • Child Labour/ Forced Labour: o Monitor mining operations to ensure / control no forced labour or child labour. Document efforts. • Remuneration: o Increase base pay – minimum wage o Flexible working o Other benefits – e.g. education / health care o Can lead to positive publicity • Water management strategy – during droughts – emergency relief programs; donation to Government funds for drought relief. Look at alternative water sources. Use water consumption targets. • Ethics / anti-corruption – All diamond ‘sightholders’ required to subscribe to best practice Principles. • Economics: Make sure that local taxes are paid. Support local entrepreneurs. build infrastructure, supporting local suppliers – e.g. of ferrosilicon.

(A) Generic risk identification indicators should be used for each industry