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# business and intervention: let's talk governance

by ali sohail  
for tbi

Philanthropy and directed investments are one form of Corporate Social Responsibility (CSR). However enhancing internal processes (for instance, corporate governance) is another form, which remains largely untapped, especially in Pakistan. This is a startling reality, as evidence from the west increasingly notes the collusion of corporate governance and corporate social responsibility.

It is interesting to note how some firms choose to give a lumpsum amount of money for education, health and other labels (outside their core business) under the pitch of CSR. However they fail to enhance internal processes of their organization which have a subsequent bearing on society, community and their eventual business.

Coach and expert Coro Strandberg has developed a 12 step roadmap to internalize CSR into the governance of an organization. After all, governance is the central most feature of any organization, drawing and directing priorities. The framework is divided into 2 stages. The first stage totaling 6 steps relates to firms beginning to plot a governance framework. The second stage focuses on deepening broad CSR practice. However, before one starts to discuss the framework set out, it is important to understand why internalization of CSR in corporate governance has been undervalued in the past. One of the most prominent reasons is the inability of firms to envision the business case for such initiatives. Instead, it is viewed as a purely social venture.

Kasturi Rangan, a marketing professor at Harvard Business School describes CSR as 'activities undertaken by businesses that enhance their value in the community and society and thus benefit their reputation and brand'. In other words, there are social and private gains to be realized by undertaking CSR endeavours, increasing the scope for profits. In the following, I will review the 12 step framework, drawing connections between theory and practice, and contextualize the discussion to the context of Pakistan, where appropriate.

## Build CSR into Firm's Mission and Values

Coro starts out at the very basic, and hits probably one of the most underutilized yet powerful steps to incorporate and direct change. She notes that CSR should be built into the mission and vision of the organization, keeping in mind stakeholder priorities and international standards, a key requirement to channelize and direct priorities.

Certainly! CSR should be part of the value system of an organization.

However, one wonders why the incorporation of CSR as a 'mission' should be a compulsion across the board, after all,

'mission directs priority'. When small firms start out and struggle to make ends meet, will they, or should they, focus on spending CSR money?

Further, even if one is to endorse the broad view undertaken by Coro, the practical application of such may be weak at times. For instance, some stakeholders may have competing priorities, as benefits of CSR to shareholders may be realized over the long run, with sacrifices and distributed gains in the short run. This may be a tradeoff not acceptable to investors in the short run. Further, Coro herself notes the historical dearth of international standards in the field, but

acknowledges the rising role played by voluntary organizations such as OECD in providing impetus to clear the mist and provide appropriate perspective.

## Communicate Board's Commitment Internally and to Stakeholders

Appropriate communication with a resolute stance is vital to generate confidence, synergy and motivation among stakeholders, when prioritizing and undertaking tasks. However, here-in-lies the contradiction between theory and practice, as commitment is a factor which not only refers to good times, but is probably best tested when the 'going gets tough'!

Many firms in the recent economic crisis have reduced, if not completely erased CSR budgets, a sign demonstrating lack of sincere commitment to the cause. This is extremely unfortunate, as deeper investigation into economic theory suggests reduced opportunity cost of investing in CSR during bad times relative to good. However, under trying times liquidity rather than profitability becomes the core priority of businesses, direction action and response, argues a leading executive. However, most daunting to any organization is the inconsistencies such discrepancy between communication and action may create. Such will not only hamper stakeholder confidence in board decisions and priorities over the short run, but more so, over the long run, with shareholder value becoming the ultimate victim.

#### **Build CSR into Risk Management**

Coro argues the incorporation of social and environment factors in risk and opportunity identification, monitoring and management. If followed by priority, such activities will reap dividends over the long run, especially as initiatives regarding climate change and global warming take impetus in community, government and other social corridors.

Appropriate incorporation of these factors will influence the models used and developed by financial economist to rationalize decision making, as environment and social factors may enhance some, whereas neutralize and negate other opportunities for investment.

However, competing incentives may exist in parts of the developing world especially in countries where markets are immature; firms operate in traditional mindsets; needs are unmet, which may trigger short sighted action to overtake long term environment and social objectives. Moreover,

given the availability of opportunity and scope for attaining quick profits, companies may opt to undertake purely business centered investments.

#### **Integrate CSR into Business Strategy and Provide Oversight**

Business strategy is generally about enhancing the profit line of activity. If CSR contributes to enhancing such, it will instigate the board to incorporate these factors in the overall strategy of business (the business case is developed above). Although recent evidence by Coro based on a study of some Canadian firms concludes that few firms seem to be incorporating CSR in their long term business strategy, signs of positivism do exist. This is especially true for countries such as Pakistan, where religion may have a role in encouraging individuals to undertake such activities.

However, the face of CSR may differ as per environment and business, something Giovanni Arrighi would probably have referred to as the flexibility of capitalism. Some firms may advertise their CSR activities, to directly target clients and enhance their business produce. For example, it may be advertised that Rs. 1 contribution by the public will be met by an additional rupee contribution by the firm for a given public cause. Such activities will enhance public relations of the firm and subsequent brand image. Other firms may focus on tacit provisions, providing unparalleled benefits and company conditions to employees which help retain the best employees, with subsequent dividends to business. For instance, a firm may choose to provide free primary schooling to children of all employees. Lastly, some may undertake CSR through juicing of their 'values' system, which in essence will be part of the tacit rather vocal business strategy.

#### **Develop a CSR Focused Committee or Embed a Mandate in a Pre-existing Committee**

Coro provides scope for various methodologies for incorporating CSR into the governance framework. Before one can comment on the choice of committee, one needs to ask, whose money is it anyway!

The answer is simple: it belongs to the shareholders (the owners of the company), who have subsequent representation on the board. Therefore, the mandate in essence will have to come from the owners (after all, the money belongs to them), but the execution can be channelized through the creation of a new subcommittee, under the jurisdiction of the former. This is probably what Coro refers to as a focused approach. The ideal manner of execution (embedded or focused) will depend upon the context of application, referring to the location, industry, knowledge, mindset and cultural setting of the environment concerned.

#### **Report to Stakeholders on CSR Committee**

Third party reviews and audits of CSR with a focus on distributing and sharing of information with key stakeholders (including shareholders) is a step advanced by Coro to enhance accountability, purpose and progress of the firm on the issue. However, evidence to support the application of the proposition, remains weak at best. Although considered crucial by many CSR experts including Dr. Rangan, as such can help firms identify shortcomings, enhance and at times transform business practices, there are also various political economy factors which will deter firms from undertaking such audits. For instance, firms may not want external parties to view and disseminate the internal workings of the organization. Secondly, political influence, lip service and strategic choices may deter firms

from providing an open book review, especially in a competitive business environment (among other factors).

### Reward Executives for CSR Performance

The incentive structure is a key driver for human activity across the board, whether it is activities relevant to CSR or any other. Rewards do not necessarily have to be financial, but in fact the incorporation of nonfinancial gains is crucial, as argued by Coro.

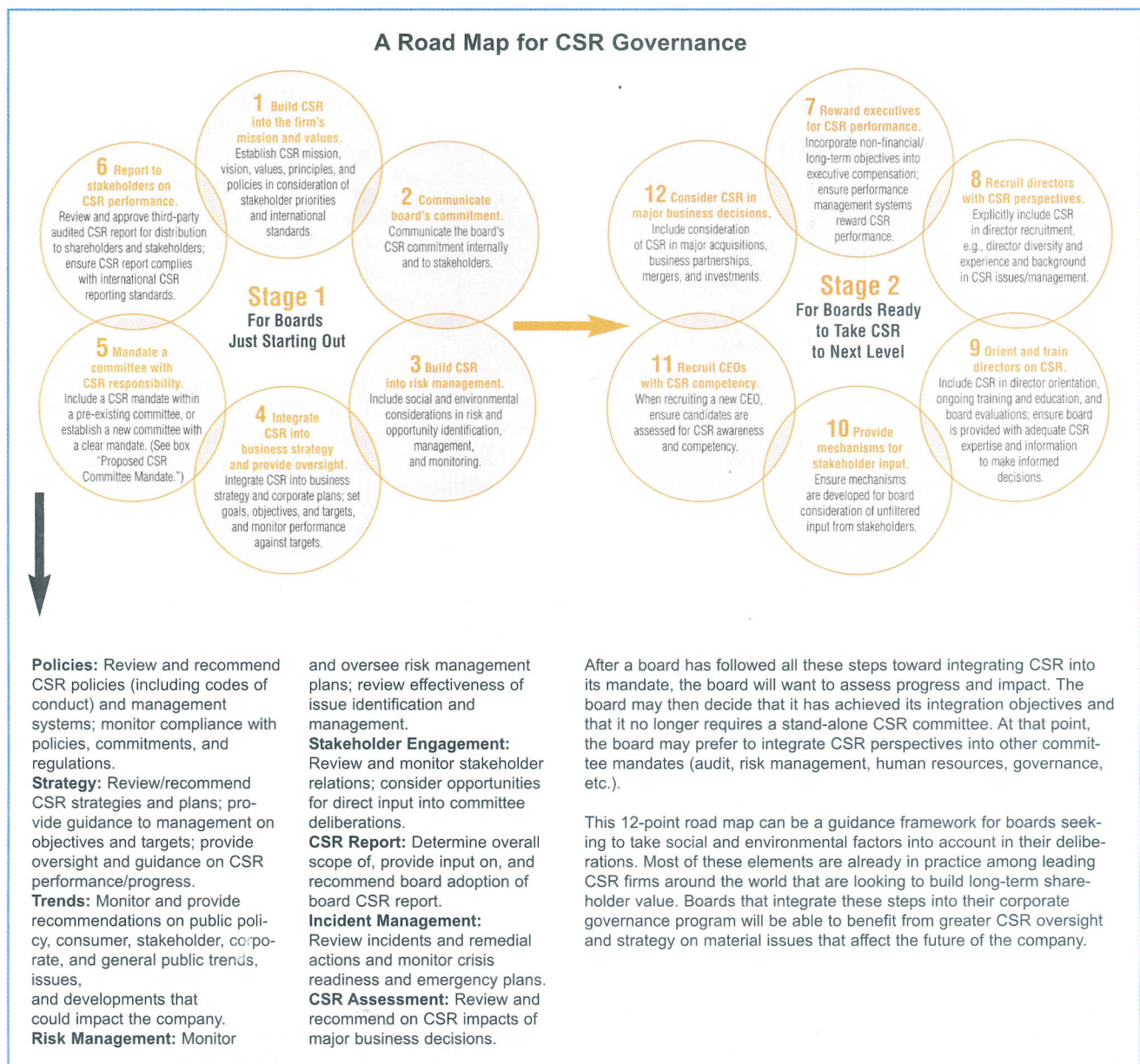
If one argues that CSR enhances the shareholder value of the firm, a recent study denotes that increases in shareholder compen-

sation have little to do with shareholder value. Subhabrata Banerjee documents a negative relationship between both, in his recent book 'Corporate Social Responsibility: The good, the bad, and the ugly'. He notes that CEO's of top 10 US companies which performed badly in 2003 noted through their stock value, attained pay increases in terms of salaries, bonuses and other benefits. Similarly, he documents another study drawing a connection between CEO pay raises and employees lay off. The recent recession documents a similar path, where bonuses were given to executives employed in (some) firms which were earlier bailed out by government (tax payer) money.

Therefore, even if the CSR reward structure were to exist (which should), the questions remains will it be able to compete with the existing incentive structure.

### Recruit Directors with CSR Perspective

Directors should have a diverse portfolio and be conscious of the society at large. In other words, be aware of the impact their business will have on the broader community. When recruiting directors, it is vital to identify individuals from a varied background, in order to enhance (optimize) the value of each board member. This is important as such will enable the presence of different perspectives on one



table, which is crucial for informed decision-making. If all directors view the world from one lens, the quality of discussion and output will be low.

It is important to develop a board encompassing individuals with competing perspectives (CSR inclusive), as this would enrich the quality of decisions taken by the board.

### **Orient and Train Directors on CSR**

To appropriately target and attain CSR objectives, on-going training is one part of the spectrum. Moreover, CSR relative awareness needs to come from mainstream academia, where current and future directors, managers and financial guru's need to be trained and education (starting at an early age) in the field. A focus on the business advantage of undertaking CSR as a serious mandate needs to be developed.

Trainings are a continuous process and should not be restricted to directors in specific, as it is floor workers and managers which materialize the actual change. However, frequent change in management and turnover in working staff may discourage firms from investing in such workshops, leading to reduced member commitment and low CSR relative results. It is important to note that continuous training, evaluation and a knowledge driven analysis will have a cost attached to it, which will deter organizations from undertaking such activities, especially small firms with limited capacity.

### **Provide Mechanisms for Shareholder Input**

Coro recommends a mechanism which provides scope for unfiltered input from shareholders to the executives of the firm, in other words, honest, frequent and open communication between the two parties. Such would probably be an ideal scenario in any case, regardless of the nature and focus

on the company. However, the existence of such a mechanism, will not necessarily lead to the incorporation of CSR factors in the business mandate. This stems from the argument made earlier, as not all investors are seeking long term gains, as many are interested in short term returns, hence competing incentives may exist.

Further, in countries such as Pakistan, where the political and social climate is continuously changing, the definition of the long run may be 3 to 4 years in most cases. Therefore, if CSR relative investments do not produce appropriate dividends (within the time frame), even institutional investors (long run focused) will be deterred to vote for such initiatives, as it will not enhance their wealth to the desired level. In other words, the opportunity cost for such activities will be high.

### **Recruit CEO's with CSR Competency**

Here we need to define the scope of the word 'competency'.

A chief executive officer does not necessarily have to be a CSR specialist, even if such is the core business of the firm. The CEO is the operational chief of a firm, in other words the chief manager, not necessarily a specialist in product development or service. However, yes, an overall understanding as noted above is important, which probably not only refers to the CEO, but also to other members of the team. After all, diversity and the ability to relate to the broader society is a human quality we should all seek to develop. Moreover, it is important to remember that the CEO is not the owner of the company. He is elected by the board (owners) to run the company, and manage their money (not his own) in the best of their interest.

### **Consider CSR in Major Business Decisions**

Once again, 'consideration' is a

vague term. If one is to accept CSR in the scope of climate concern, is it fair to say companies willing to invest and expand in alternative energy, are CSR friendly? Not necessarily. The firms investing in alternate energy may be interested in the sector to attain the profit potential it has to offer over the long run, not necessarily the CSR scope it will attain. Therefore, the era of rising awareness and growing consumer choices, may bring business and CSR closer to one another.

Should CSR be the driving force behind every major business decision? Not necessarily!

It is important to remember, that if businesses were not making money, they would not exist, and the scope for CSR would automatically diminish. Therefore, the sustainability of business is as important to undertaking CSR activities, as CSR is to the ultimate sustainability of business. ■

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#### **Note**

The Roadmap for CSR Governance was published in 2008 and has been reviewed in **tbl** with permission from Coro Strandberg.

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#### **About the Writer**

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