THE IMPACT OF CORPORATE SOCIAL RESPONSIBILITY ON BUSINESS PERFORMANCE – CAN IT BE MEASURED, AND IF SO, HOW?

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Abstract

This paper examines the question of measurability of the impact of Corporate Social Responsibility on Business Performance. It starts with describing newer trends of measuring business performance, showing that one can observe a shift from the classical short-term analysis with particular focus on indicators like shareholder value, revenue and market share toward taking also into account soft indicators, such as employee and customer satisfaction, that contribute to the long-term success of a company. This approach is shown based on the European Foundation of Quality Management (EFQM) criteria. The paper goes on to give an overview of latest trends in the field of Corporate Social Responsibility and then offers a possible way to measure its impact on Business Performance on the basis of the stakeholder concept. It reflects results from ongoing research and was written for presentation at the Berlin International Economics Congress, 2012.

Keywords

Corporate Social Responsibility, Business Performance, European Foundation of Quality Management (EFQM), Stakeholder concept

Introduction

In the refined CSR strategy set forth by the European Commission in 2011 as well as in many past and recent scientific publications, a considerable focus is being set on the benefit of CSR to society as a whole. Consequently, much effort is being made to promote CSR in all member states and companies of all sizes. Furthermore, member states are not only asked to update their individual CSR strategies, but also to prepare for some further regulatory intentions. Some business associations (e.g. the German Chamber of Commerce and Industry) are rather hesitant to accept mandatory CSR requirements promoted by the Commission, although the value and importance of CSR for society is acknowledged. Also, there is more and more awareness that CSR activities are not only merely of charitable nature, but that they also contribute to a positive image of the company, to increased employee and customer satisfaction as well as to other soft factors that need to be taken into account when measuring business success. These developments consequently lead to the question: Is it possible to measure the impact of CSR activities on business performance; and if so, how? This paper is designed to answer this question by first describing what may be understood when using the term business performance (chapter one), then dealing with the latest developments of CSR (chapter two) and finally outlining a possible answer (chapter three) followed by some conclusions and prospects. Relevant literature is mentioned in the reference section at the end of the paper.

I. Business Performance – definition and measurement

a) Background

Business Performance was traditionally a topic that leaders of large companies paid a good deal of attention to, because it gives vital information about the state of the company, its success, development and future outlook. However, even though for large companies it is inevitable to employ Business Performance Measurement Systems, which are usually supported by Information Technology like Data Mining or Data Warehouse, Small and Medium Sized companies traditionally lack well-performed strategies in this area[i]. In addition, little research has been done in the area of Performance Measurement Adaption of SMEs.

All business processes eventually revolve around the target of contributing to the success of the company in one way or another. While the term "success" describes the positive effective overall turnout of a company´s activities, the term Business Performance in itself is a neutral descriptive concept for the effectiveness and the efficiency of the company´s actions in general or of certain parts or processes of the company in particular. Business Performance can be characterized with attributes, for example as "well" or "poor", depending on the expectations of the individual analyzing the data he or she has chosen to examine in order to gain insight into the state the company is in at a given moment. Business Performance is of key interest for the top management of a company. If Business Performance is weak, managers need to intervene in order to return to the path of growth. Especially in a market in which competition is increasing and globalization demands for better competitivity, business leaders need to pay close attention to Business Performance. However, although the necessity to partake in Business Performance analysis and evaluation in order to improve policies and processes in easily understood in theory, putting this concept into practice is not as easy as it may seem. Figure 1 displays the Business Performance of a company in relation to its management, to the business strategy and to the company´s processes: It shows the two-sided approach to Business Performance. On one hand, there is a normative relation on the side of the company management (top-down relation). The leadership´s inherent responsibility is to set out a Business Strategy in which Business Performance is defined: Business Performance must meet or exceed the expectations of the leadership. On the other hand, the bottom-up relation is a descriptive one: Measurement of Business Performance through selected indicators shows the management if expectations are met and gives vital information about necessary adjustments to the business processes that need to be made. The figure shows that both, normative definitions and descriptive measurements of Business Performance must be made. Normative definitions of Business Performance are described within the framework of Business Strategies. They include approaches such as Total Quality Management (TQM) and Management by-strategies. Descriptive approaches to Business Performance often focus on selecting indicators in order to show the status quo of the business processes. However, newer developments in Business Strategies, such as the Baldridge Performance Excellence Program and the EFQM model, include the descriptive components already in its strategy model.

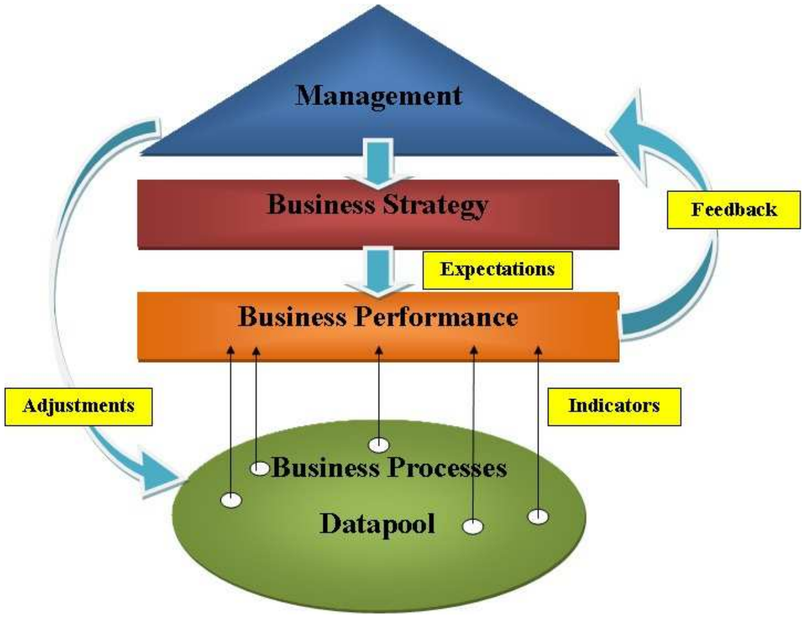

Figure 1: Business Performance in the Business architecture (own illustration)

Once indicators are selected, the peculiarities of the different indicators must be identified and a predefined weighing executed in order to measure the current performance of the company. Usually this is not only done once, but in a frequency that allows the administration to evaluate possible improvements or deteriorations and to act upon them in time. The auditing process can be done either internally or externally. Performance Measurement Systems were described in 1995 as "the set of metrics used to quantify both the efficiency and effectiveness of actions"[ii]. The measurement process can be done in an automated way using information technology. Often large companies have the financial ability and adequate human resources to purchase and to implement necessary IT equipment, such as software programs like SAS or ORACLE. But SMEs frequently lack these possibilities even though they would like to implement some kind of performance management. For this reason it is inevitable to equip SMEs with easily-understandable systems that contain indicators that are not too difficult to measure.

b) The EFQM model as a reference system

EFQM is an abbreviation of the non-profit organization "European Foundation for Quality Management" and was founded in 1988 by the presidents of the 14 founding members, among them BOSCH, OLIVETTI, VOLKSWAGEN, FIAT and ELECTROLUX[iii]. The foundation is based in Brussels, Belgium and has now more than 500 member organizations in more than 55 countries and 50 industries.[iv]

The intent of establishing this foundation was to provide for a European version of an excellent quality award based on the philosophy of Total Quality Management. The most popular quality award at the time was the American Malcolm Baldridge National Quality Award. Less known in western countries but popular in Asia was the Japanese Deming Prize. The initial EFQM model relied to a large decree on the criteria and weighing of the Malcom Baldridge Award. Significant new developments were the inclusion of a broader stakeholder approach and the equal weighing of enablers and results. In the economic and scientific communities of the European Union, the EFQM model soon achieved high recognition and many non-profit organizations became members.

In May 2009 – and thus in the middle of the financial and economic crisis- the Board of Governors of the EFQM Foundation formally requested an update of its Business Excellence model. The EFQM Foundation states that its request for the update was influenced by a variety of stakeholders such as members, assessors, partners, trainers, learning networks and even EU representatives[v]. Therefore, the revised model contains up-to-date key drivers of Business Excellence. The changes also reflect the increasing awareness for the need of sustainable economic and social performance.[vi]

Figure 2 shows the newest version of the model. In order to measure and compare business performance, 8 criteria have been set up by the EFQM and grouped into two main categories: Enablers and Results. Enablers represent factors that help companies achieve their desired results. Excellent businesses have a leadership that supports sustainable development, sets up a consistent strategy, works effectively together with partners, makes use of resources in an optimal way and focuses on people. Next to these factors, the processes, products and services are evaluated. On the results side, not only classical key results like market share and growth, turnover and profit are evaluated, but also soft factors like the impact of the business processes on its own people, on the customers, and on society. Long-term-focused activities like corporate social responsibility are to be considered as important as shareholder value and other rather short-term-focused factors. According to Serban and Ghenta[vii], the EFQM-model is used as a diagnostic model and serves as a basis for an expansion that includes aspects of social and environmental responsibility. Using this model, the companies learn to evaluate themselves and to measure their own progress for continual further development. This is difficult to do in prosperous times. It is more difficult to maintain this commitment in a time of rapid technological innovation cycles; rising international competition; fundamentally changing processes; frequent changes in the economic, social, and customer environment; and, last but not least, in a time of financial or economic crisis.

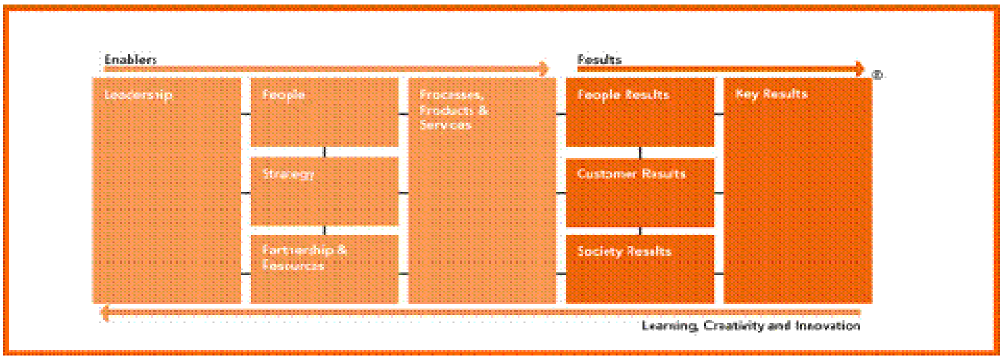

Figure 2: The EFQM 2010 model. Source: Gemoets (2009)

Next to a simplification of terms, the weight given to each criteria was changed while still carefully maintaining the equal value between the capacity of an organization, displayed

Figure 3: New weighing of criteria. Source: Gemoets (2009)

by the five “enablers criteria”, and the performance it delivers for its stakeholders measured by the four “results criteria”. Capacity and performance each account for 50% of the total.

Figure 3 shows the new weighting percentages. While the criteria themselves have not changed significantly, there have been some shifts in the underlying fundamental concepts. In an analysis of the revised concepts, one can see that the content has been changed to promote a more balanced and sustainable view of business culture and processes.[viii]

While some criteria and weighing of criteria was changed, the underlying structure of the model was not altered. Based upon the well known Plan-Do-Check-Act-cycle, the system was named RADAR, an acronym for “Results, Approach, Deployment, Assessment and Refinement. The RADAR system is a framework surrounding the actual EFQM criteria and the evaluation process. Similar to the radar system in airplanes or water vessels its function is the surveillance of a changing environment, with the aim of displaying possible negative impacts and therefore prompting adjustments and changes of the system. Its components constitute fundamental core principles that build the basis for all business processes, such as achieving balanced results, adding value for customers and taking responsibility for a sustainable future. All processes must contribute to the goals formulated in the fundamental principles, and the RADAR system ensures that no detachment takes place. Figure 4 shows the RADAR system graphically.

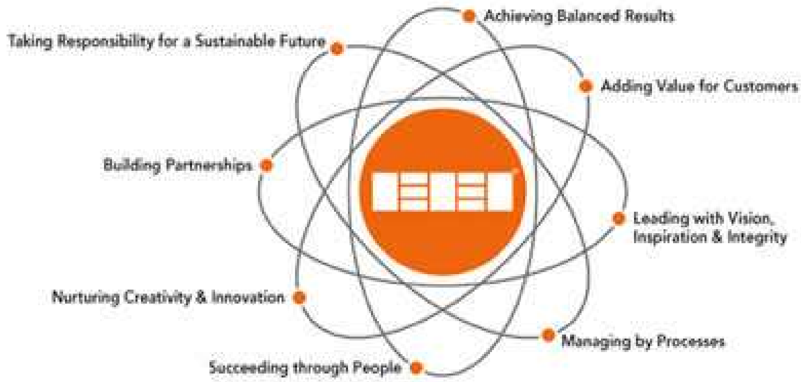

Figure 4: RADAR system surrounding the EFQM criteria, taken from the EFQM website [www.efqm.org, Feb. 28th, 2012]

The EFQM model is becoming more and more popular, not only to evaluate and manage quality, but also for other management aspects. It has gained international recognition with a rising number of companies and institutions joining from non EU-countries, such as countries of the Persian Gulf-region.

II. Corporate Social Responsibility – historical and current developments

The European Commission defined CSR in 2006 as "*A concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis".*[ix] The individual actions of companies undertaking CSR measures are voluntary and are until now not standardized. Currently, there are voices demanding for legislation on the EU level that aim at raising CSR activities onto a mandatory component of business activities. Proponents of this requirement argue that companies play a vital role in society and therefore should contribute to growth in social issues. Opponents to these demands hold that privately run companies should not be held responsible for activities that should primarily be the domain of public agencies and private initiatives.

However, awareness of Corporate Social Responsibility is not a new development. Concern for society and environment can be traced back to the beginning of time. According to one of the oldest known written documents, the account of Genesis by the biblical writer Moses, man was instructed by his Creator to "fill the earth and govern it" (Genesis 1, 28), and is later challenged: "The LORD God took the man and put him in the

Garden of Eden to work it *and take care of it*" (Genesis 2, 15), thus implying a balanced approach to using natural resources and exercising responsibility.

During the course of history awareness of social and environmental responsibility developed from individual social and environmental concerns and led to the perception that also collectives, such as profit-oriented businesses, need to partake in responsible activities that do not necessary produce profits visible in the short run. In the ancient Codex Hammurabi, excavated in Susa in 1902 and displayed today in the Louvre, Paris, a number of laws address the responsibility businesses carry for the effects of their products and processes on customers and citizens: For example, if a property developer would build a house that collapses later because of faulty statics and thereby causes the death of occupants, severe punishment would be due. Hammurabi's crowning took place around 1800 B.C., and similar laws were set up already about 300 years earlier by the Sumerian king Ur-Nammu.

Looking back to the immediate present, between 2006 and 2011 the European Commission worked on refining the definition of CSR as well as its strategy in respect to understanding and practically implying CSR in companies within EU member states. One of the questions addressed was the possible shift from voluntary actions to a mandatory requirement for enterprises to implement a CSR strategy. Business associations by and large have criticized this prospect, largely due to an increased load of reporting duties that would exceed the capacities especially of SMEs. For instance, the Association of German Chambers of Industry and Commerce stated repeatedly that, particularly in SMEs, CSR is a widely spread concern on the management level and that the voluntary approach would lead to best results. Key drivers for change should therefore not be requirements formulated by political institutions, but rather pressure built up by society and different stakeholders, such as customers. Business Associations like the German Chamber of Industry and Commerce took various actions in an effort to publically display the already existing CSR activities, e.g. by conducting round tables and instigating contests in which commendable CSR activities were rewarded.

However, the European Commission altered its 2006 definition of CSR in October 2011 adding that

"CSR should have in place a process to integrate social, environmental, ethical and human rights concerns into their business operations and core strategy in close collaboration with their stakeholders".

This wording replaces the original solely voluntary approach with a weak requirement, depicted in the word "should". Concerning SMEs, the commission states that "for most small and medium-sized enterprises, especially micro-enterprises, the CSR process is likely to remain informal and intuitive". The Commission sets out an action plan for the period between 2011 and 2014 with eight focus areas[x]:

1. CSR and good practices should become more visible. In order to achieve this vision, a new European award is to be established and stakeholders should meet in a more formal way to set common goals and monitor progress in the CSR strategy of the affected companies.
2. Levels of trust should be tracked and improved by the European Commission by launching a public debate on the role and potential of enterprises and by organizing a survey on citizen trust in businesses.
3. Self- and corregulation initiatives are to be guided and improved by the Commission.
4. EU policies in the field of consumption, investment and public procurement are to be aimed at enhancing market rewards for responsible business conduct.
5. The Commission intends to develop a legislative proposal for company disclosure of their environmental and social performance.
6. CSR should be integrated in education, training and research with potential funding possibilities.
7. EU member states should present and update their national CSR strategies and
8. CSR should be aligned and embedded in other international programs, including the OECD Guidelines for Multinational Enterprises, the 10 principles of the UN Global Compact, the UN Guiding principles on Business and Human Rights, ILO and ISO 26000 standards.

Considering the definition and strategy lined out by the Commission, it becomes evident that CSR will be a focal issue in succeeding years and that all effort is taken to make CSR more verifiable, better known and more widespread.

Even though CSR is not a completely new topic, an increased public awareness regarding social responsibility of companies started to develop during the late 50's and early 60's of the 20^{th} century. This led to new literature about Corporate Social Responsibility (CSR) as well as to models for corporate conduct. During this era, managers started to ask themselves what was expected of them by society and what their responsibilities ought to be. However, many believed that business and ethics are two contradictory terms and that they are therefore difficult to combine. M. Friedman (1970) for instance argued that CSR served solely the personal benefit of company managers in raising their reputation in society, thus leading to higher personal wages, while shareholders would experience loss because companies were not profiting from CSR activities as these activities would incur only expenses. He argued that businesses should focus only on increasing their profits and not on adding value to society in general. This reasoning was in line with the market driven approach coined by Adam Smith: The invisible hand of free markets would produce best results if all agents would strive to maximize their profits.[xi]

In this context, one issue that has frequently been addressed is the question, for what and to whom companies actually are responsible when pursuing business. A radically different view have those who argue that a company is responsible for all of its stakeholders and should take greater responsibility for society at large and should seek to solve social and environmental problems in its markets[xii]. In other words, this view has expanded the definition of 'stakeholders', beyond merely the investors and shareholders, to include all of society. The stakeholder concept was described in a detailed way by E. Freeman (1984). Freeman argued that managers should tailor their policies to satisfy the needs of all the stakeholders, not just those of the shareholders. In this approach, CSR became a strategic mandate for business leaders and thus a favorable task also for the top management level.[xiii]

Ever since, the stakeholder concept has been fine-tuned, and more and more systematic research has been done on the different constituents that should be taken into consideration. According to Carroll and Buchholtz (2003), the stakeholders can be subcategorized into primary stakeholders, consisting of shareholders (owners), employees, customers, business partners, communities, future generations and the natural environment; and secondary stakeholders, made up of the local, state and federal government, regulatory bodies, civic institutions and groups, special interest groups, trade and industry groups, media and competitors.[xiv] However, the categorization is rather arbitrary and, for the sake of SMEs, the stakeholder concept should be adapted to the individual circumstances of the company. Since budgets, personnel, and available time for strategic evaluation are usually limited, SMEs should identify key stakeholders and should cater their CSR approaches to an easily comprehensible scope of stakeholders.

Donaldson (1990) went a step further: According to him, managers were not only to engage in CSR activities because of strategic reasoning, but rather because of the existence of a "moral mandate" for them to act responsibly, without regard to the effects on the company. However, he also stated that there is a "Business Case" for CSR.[xv] Jones (1995) describes the mutual benefit of CSR activities for businesses and their stakeholders, in particular for the stakeholders: Since firms display responsibility by their CSR involvement, they are perceived as trustworthy and thus as safe market transaction partners.[xvi] One can take this approach a step further and can conclude that companies not involved in CSR will not be attractive to customers, employees, suppliers and other stakeholders, because there is a lack of trust: the company is seen as a profit-maximizing organization with little or no regard to the needs of its business partners or customers and hence unattractive to do business with.

Nowadays, however, researchers and authors agree that the address of ethics is crucial to the enhancement of long-term corporate success. Therefore, business ethics has received enormous attention, and numerous books have been written about this subject during the last twenty years. Especially in large companies and due to globalization, there is increased pressure on companies and managers to act ethically and socially responsible. Through the internet, television and press, most customers are aware of issues such as child labor, exploitation of workers, destruction of the environment, etc. As a result, pressure from different stakeholders along with massive media coverage has forced many companies to take action in order to protect their public reputation.

Currently, corporate responsibility is the second most important factor in a company's reputation next to the quality of products. According to some scientific research, customers do not evaluate companies based only on the features of their products and services, but also on what business practices they are engaged in, how their products are produced, and what effect on society the company has[xvii]. Consequently, issues such as animal testing, environmental damage, irresponsible marketing, violation of land rights, trade union relations, fair wages and working conditions have become highly important for companies to consider since corporate actions now play a central role in customer decision-making. Moreover, managers have realized the enormous costs that public scandals generate such as disruptions, expensive legal entanglements, lower employee morale, difficulties in recruiting, internal fraud and loss of public confidence.[xviii]

Even though there have been a number of scientific articles about the different aspects of CSR – theoretical and empirical approaches – the research is still at an early stage. In one article, the state of knowledge in this field is even described as "embryonic".[xix] However, scientific examination has already taken place and should be considered.

III. The indirect approach to measure the impact of CSR on Business Performance

As outlined in the first chapter, the EFQM model provides a modern and intuitive approach to integrate CSR activities into the observation of Business Performance and the measurement of Business success on a sustainable foundation. Some companies have already implemented new CSR strategies linked with EFQM evaluation. For example, in 2011, the operator of the Ferenc Liszt airport in Budapest announced that, together with business partners, it had developed and deployed a CSR strategy based on the EFQM model. The name given to this undertaking was "Committed to CSR excellence", thus combining the ideas of quality with its aim for excellence and CSR. According to the company, the aim was not only to implement a fitting strategy for the airport industry (the stated goal was to develop three successful CSR activities within one year), but also to be an example to other Hungarian companies, thus leading by example.[xx]

Furthermore, the EFQM model provides an ideal framework for the measurement of CSR activities and their influence on Business Performance, in the sense that the model provides guidelines regarding how much weight should be given to different "enablers" and "results" criteria within the overall performance measurement.

But how can the CSR component in the evaluation of Business Performance be isolated? First, one needs to identify the contribution of CSR to each examined criteria. Second, since the affected criteria are closely linked to known stakeholders, relevant data of these stakeholders must be collected. An effective method of obtaining data on the basis of the stakeholder concept is the collection of data by means of interviewing different groups, for example in the form of a questionnaire. The satisfaction levels of different stakeholder groups in this concept are the dependant variables, whereas the cumulated CSR activities resemble the independent variable in this simple regression analysis with only one regressor (the CSR activities). In the data collecting process of the *dependent variable*, the stakeholder satisfaction level, it will be important to eliminate other factors that contribute to the satisfaction level of the examined groups. These factors are e.g. wage, gratification programs, retirement programs, carrier opportunities, an ergonometric workplace and many more. For this reason, the questionnaires must be clearly focused on the effect of only the CSR activities on stakeholder satisfaction. In the case of an employee questionnaire, this can be achieved by formulating questions such as:

- *"Are you aware of the fact that your company has participated in program x?"*
- *"Do you approve of the company´s involvement in program x?"*
- *"Does the involvement of the company make you think better of the company?"*
- *"Do you think your company should do more such activities? In which areas?"*

However, although these questions will already generate some useful information as far as the acceptance and also effects of CSR activities are concerned, they do not automatically offer useful data for an econometric analysis. For this means, another necessary step must be taken: The collected data must be transferred onto a cardinal scale. For this reason, a model must be developed which accounts for all relevant aspects of the effects of CSR activities on the satisfaction level of a number of different stakeholders and, in a further step, on the satisfaction level of all stakeholders. This will be done by first determining satisfaction levels for various stakeholders and then computing a weighed averaged of all satisfaction values in order to obtain a single value which will be used to perform econometric tests:

$$\mathrm{SSL}_{tot} = \sum_{n=1}^{x} \left(\frac{1}{\mathrm{n}}\right) \mathrm{SSL}_n$$

In this calculation SSL_{tot} resembles the total satisfaction level and SSL_n the satisfaction level of a certain number of stakeholder groups.

On the side of the *independent variable*, the CSR activities, a similar process must be developed. The activities of the company must be transferred into and displayed on a cardinal scale. But how should one measure CSR activities of various companies with differing sizes and, furthermore, how can CSR activities and the impact on stakeholder satisfaction levels be compared? Since companies vary in size and business branch, an optimal solution would be to measure CRS as a budget share of all business expenses per a selected observation period (CSRE). A plausible econometric model equation therefore would be:

$$SSL_{tot} = \alpha + \beta CSRE\ (i) + \varepsilon(i)$$

In this equation the parameter α describes the value for the intercept parameter, β the influence of CSR expenditures on SSL_{tot} and ε depicts an error term. The explanatory parameter β shows the influence of a 1% increase of CSR expenditure on the explained variable, SSL_{tot}. This procedure provides essential information for managers and business owners when CSR budgets are determined. The concept is rather straight-forward and easy to handle once relevant stakeholders are determined and a conclusive concept measuring satisfaction levels is established.

Conclusion and prospects

Can the impact of CSR on Business Performance be measured? Yes, it can. However, an indirect approach must be chosen. Although it is virtually impossible to subtract out the influence of CSR on Business Performance directly, it is possible to determine the influence of CSR on different stakeholders of the company by using a new approach: It is necessary to measure changes in stakeholder satisfaction levels due to investments in Corporate Social Responsibility. In a further step, a company must then determine how much it should value a rise in SSL_{tot}. The EFQM system provides a useful model to establish the value of corresponding soft factors for long term business success. Further study could focus on the determination of an optimal CSR budget which would provide companies with useful information in their struggle to integrate CSR into their overall business strategies.

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