

## Chapter 9

# **Evaluation of Corporate Social Responsibility (CSR) and the Market**

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### **Introduction**

The purpose of this paper is to define corporate social responsibility and consider how socially responsible companies come to be evaluated at the market level, in an era that has demanded the sustainable development of socioeconomic systems since 1990.

### **I Definition of CSR**

At first, we will define the concept of CSR (Corporate Social Responsibility). Till now, there have been various discussions on the definition of CSR. The first typical understanding of CSR is that it involves a balance between economic and social aspects. But CSR is a discussion on the process of corporate economic activities per se, not how to balance economic performance and social performance. The second is a typological understanding. Carroll(1981) defines the concept of CSR as a pyramid formed in four-parts; 1<sup>st</sup>-economic responsibility, 2<sup>nd</sup>-legal, 3<sup>rd</sup>-ethical and 4<sup>th</sup>-discretionary responsibility = philanthropy. However, this typological approach cannot analyze the complicated relationship between corporations and society. The third is understanding CSR as a distribution of added value. A theory of CSR accounting shows that added value should be distributed equally not only to stockholders but also to other stakeholders. The essence of CSR discussion is the process of economic activity itself which produces the economic values. Corporations are required to conduct activities in a socially responsible way to

develop a sustainable socioeconomic system.

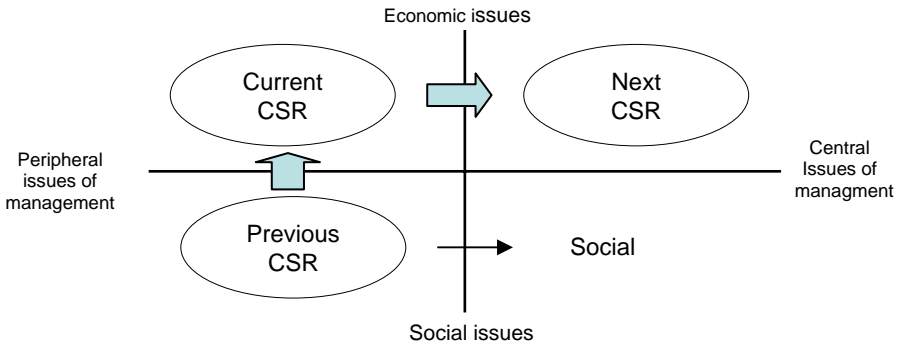
The essential point of CSR is to incorporate social fairness, ethic, environmental and human rights in the management process to make clear their accountabilities to the stakeholders.

What is questioned now is how to manage the issues such as environment, labor and employment, human rights, products, work environment and human rights in developing countries, and the disclosure of information. It's not proper to define that compliance comes first and CSR goes beyond it.

## **II Evaluation of Market Society**

Up to now, CSR has been treated as a periphery of business management, and as a social issue. However, recently it is beginning to be understood as a major part of management, and as an economic issue. It was seen that companies that caused social problems used to be asked their responsibilities, and they came under pressure from social movements outside the marketplace. But since the 1990s, not only boycott activities, but the criterion of CSR has been incorporated into investment, finance, transaction and procurement. Rating and choosing companies in the market by the criteria of CSR is starting to become mainstream. Figure 1 shows the transition of the positioning of CSR in management issues.

Figure 1 Position of CSR



The following are the main five reasons for demanding CSR in the market.

- 1) Purchasing Standards of Consumers (boycott/boycott) : NGOs monitoring the corporate activities and providing information have grown and gained public support.
- 2) Code of Conduct : Standards of corporate activities set by NGOs, international institutions and management organizations. ISO now discusses the setting for a new guidance on the social responsibility of an organization;ISO26000 (<http://www.iso.org/sr>).
- 3) Standards of Investment :The total assets of Socially Responsible Investment (SRI) have grown for the past ten years, and have increased in popularity (SIF2006). A growing number of institutional investors, mainly in pension funds, are beginning to carry out SRI.
- 4) Standards of Finance : Development of environment-CSR conscious financial products. UNEPFI established the Principle of Responsible Investment (PRI) in 2006 (<http://www.unepfi.org>).
- 5) Standards of CSR Procurement : A standard of CSR is incorporating into transaction and procurement conditions. CSR is becoming incorporated also into government procurement.

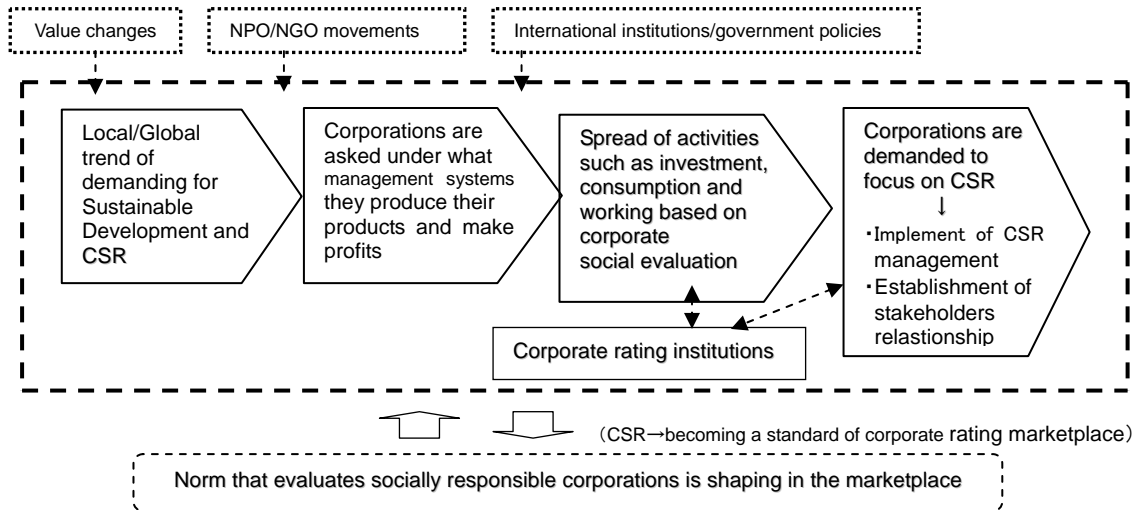
By setting a standard of rating corporations in the market beyond costs and the quality of products and services, CSR is growing in demand, and corporations are asked

whether their production process is proper or not, and whether their management system is accountable or not. CSR elements will get involved with criteria in consumers buying products, investors evaluating corporations to invest, and financial institutions making a loan. Also, CSR is beginning to be included in procurement agreements with suppliers. Environmental and social aspects are joining with subjects such as quality, and cost and delivery date, and CSR procurement is appearing in the market. Through incorporating CSR into the base of economic activities, a new norm is gradually developing in the marketplace, and is leading to the formation of a new standard of corporate evaluation. (see Figure 2 )

With these trends in the marketplace, companies have no choices other than to respond to CSR issues properly whether they can afford to “invest” or not. Of course that does not mean CSR is already incorporated and fixed as a mainstream of the marketplace. But in the past ten years, such movements have gradually spread around the US and EU markets. It can be said that the discussion of CSR is maturing and comes to stay as one of the norms in the market.

Evaluation of Corporate Social Responsibility (CSR) and the Market

Figure2 Evolution of Market Norm



### III The Function of SRI

Next, we will confirm the functions and meanings of SRI and CSR procurement system. Let's focus on the following two styles of SRI. Social Screen : Selection of investment stocks, by rating corporations by both the financial index and the social index and the establishment of SRI mutual funds. Shareholder Activism : Dialogue and engagement with corporate managers taking shareholder resolutions (Tanimoto 2003).

SRI assets in the USA rose more than 3.6 times from \$ 639billion in 1995 to \$ 2.29 trillion in 2005 (SIF2006). This is 9.4% of the \$ 24.4 trillion in total assets under professional management. Nearly one out of every ten dollars is involved in SRI.

In England, total assets by social screen stood at £ 224.5billion in 2001, 12.7% of the market (Sparkes 2002) . It grew about 10 times comparing to £ 22.7billion in 1997. One of the reasons of this growth, especially with the revision of Pension Act in 2000 as a turning point, is that pension funds incorporated SRI into their performance.

In Japan, the size of SRI is still very small, it is composed of only SRI mutual funds and just a few corporate pension funds. As of the end of March 2006, there were 24 SRI funds, their total assets ¥258.5 billion(<http://www.morningstar.co.jp>). The total net assets of all the mutual funds in Japan at that time is ¥58.479trillion<sup>1</sup>, so the percentage of SRI assets is only about 0.4%. This means SRI mutual funding is not enough strong to influence on the market.

SRI has not yet become a mainstream of the market even in the US, nor in England, having the largest SRI market. The current small size of the market does not allow companies which are selected in the SRI index and mutual funds to have the advantage of others in fund raising. However, corporations chosen from the broad rating standards such as social, environmental and economic aspects, receive good reputations in the market society. It might take a little more time until earning a high reputation in the SRI rating comes to be understood as a common criterion in the general finance market. To have the market mature to evaluate CSR, establishing the laws and systems expanding SRI and

helping individual/institutional investors to grow are also required.

With the trend of SRI becoming a mainstream as indicated above, the mainstreams in finance have tended to include SRI in their financial scheme recent years. In financial institutions, a trend of incorporating Environment (E)、Society (S) and Governance (G) into investment standards is beginning to spread. The rating of corporations is based on financial data in the mainstream, but in the mid-and long- term, environmental risks and an inadequate governance system influence the financial performance. There is such a movement to try to take on these material elements into corporate evaluation. It is said that this style involves only socially critical risk factors and differs from the basic SRI style that covers all of the social and environmental issues. However, as the market matures, mainstreams in finance face to meet these needs responsively. It is said that the rating systems for corporations have been gradually changing.

Asset Management Working Group of UNEP FI issued a report “Materiality Report” on June 2004.<sup>2</sup> Materiality is a term that means having an important impact on corporate management and evaluation. UNEPFI is considering an investment principle for institutional investors that points out that those factors such as Environment, Society and Governance have a great impact on the investment portfolio of institutional investors. The United Nations secretary general Kofi Annan launched “The Principle of Responsible Investment” in April 2006(<http://www.unpri.org>). This is a guideline of how to consider E, S and G when financial institutions make investment decisions and involve themselves in the stock market. The importance of a rating style called “Materiality Evaluation” is starting to be realized now.

#### **IV The Function of CSR Procurement**

Next, we will look at how CSR procurement works. If CSR comes to be incorporated as a part of procurement standards, corporations will get influenced directly by its movement. Along with a spread of production network, not only for parents companies but

subsidiaries, supply chains and subcontractors both at home and abroad, their business process and CSR systems are beginning to be questioned. Quality, cost and delivery dates are indispensable for purchase agreements. In addition, “environmental procurement” which outlines standards for the environment has been incorporated into purchasing criteria and has spread and stabilized over the last ten years. Along with the globalization of production activities, strict environmental standards are required also in local production factories. In addition, compliance followed by labor and human rights issues is to be included in the criteria.

As a negative part of globalization, the “sweatshop” problem, forced labor under poor working conditions, has been revealed in the developing countries. NGOs criticizing and monitoring labor, human rights and environmental issues in factories in developing countries are growing. Should the boycott movements become spread in the market, corporate reputations would get severely damaged. In this situation, companies including suppliers and their partners abroad are beginning to engage in making procurement standards on labor, human rights and environmental issues. IT companies in the US and Europe establish a unified platform of CSR procurement.

For instance, Hewlett-Packard has been active in CSR procurement since 2003. The following companies have joined HP: Del, IBM, Cisco Systems, Microsoft and Intel and so on. They collaborated to establish a uniform standard of CSR procurement “Electronics Industry Code of Conduct” (EICC) in the fall of 2004 (<http://eicc.info>). EICC have been outlining standards to promote industry criteria for socially responsible business across the globe since 2005. The Code is made up of five sections. That is, 1)Labor, 2)Health and Safety, 3)Environmental, 4)Management System, 5)Ethics, (Version 2.0 October 2005) . The companies work collaboratively with suppliers to develop harmonized approaches for the monitoring, reporting, and auditing of the social and environmental issues and programs to enhance supplier capabilities.

In Europe, Global e-Sustainability Initiative (GeSI) is developing a supplier standard based on CSR in the information and community industry (<http://www.gesi.org>) . The core



members of the working group, CSR on supply chains, are BT, ERICSSON, Vodafone, Motorola, Deutsche telecom and Panasonic mobile. EICC and GeSI established a partnership in the fall of 2005. HP and Cisco system are the same members of this group. They are expected to establish a unified method of monitoring suppliers and of risk assessment.

Some Japanese companies are also making efforts to set CSR procurement standards. Sony participated in EICC in 2005. NEC have incorporated CSR into fundamental policies of their procurement standards since 2005, and they are demanding their suppliers to consider CSR. The following six points are indicated as major issues especially from the point of risk management: 1)Quality and safety risk of products, 2)Environmental risk, 3)Information security risk, 4)Risk of fair-trade, 5)Occupational safety and health risk, 6)Human rights risk. According to NEC's CSR section, they have already dealt with 1) ~ 4), but haven't started to commit 5) and 6) in the developing countries<sup>3</sup>. A lack of understanding CSR in the developing countries can be seen among most of the Japanese companies.

In implementing CSR procurement, it's important to make collaborative efforts with group companies and suppliers without a one-sided rule for subcontractors, the same way as environmental procurement is conducted. For example, the CSR manager of Mitsubishi Plastics, Inc. says that they are aiming for sustainable development with their partners as following the standard, not focusing on selecting their business partners<sup>4</sup>. In contrast, Wal-Mart in China takes a strong position to have no commitment or to even cancel their contracts with companies without a certain achievement of CSR.

As the network of CSR procurement spreads in the market society, its influence becomes much stronger. NEC is included as one of the top 40 suppliers of HP from the beginning when it started in 2003, and NEC were also demanded CSR procurement from Vodafone in England. But they could not manage issues such as improving working conditions and human rights in developing countries although they were preparing for their CSR management system. They had to grasp the situations of suppliers and take a serious

approach to CSR consistently on a global scale. With their group companies, they reviewed their code of conduct, and have started to develop a new approach to those issues since April 2004<sup>5</sup>.

There is global pressure on many Japanese companies concerning CSR procurement because they have not properly managed their local subsidiaries' and suppliers' activities in developing countries. Domestic suppliers and small and medium-sized companies are finding themselves in a situation where they can't say they have enough resources to carry on CSR any more. The requirements of CSR procurement will spread more in the near future.

When implementing CSR procurement, we face financial burdens. It costs a lot for manufacturers to develop their own standards of behavior in order to operate and improve systems that supervise, manage and monitor their suppliers. To reduce such costs and prevent the companies which are already committed from being disadvantaged, it is a good idea to construct common platforms. For the suppliers, it's tough work to meet the demands of compliance with each standard from different manufacturers. If a unified standard comes to be specified by industry, that would lead to cost saving.

## Notes

<sup>1</sup> The Investment Trusts Association, Japan, <http://www.toushin.or.jp/result/getuji/g5.pdf>

<sup>2</sup> [http://www.unepfi.org/work\\_programme/investment/materiality](http://www.unepfi.org/work_programme/investment/materiality)

<sup>3</sup> From the interview with Mr. Hitoshi Suzuki, Manager of CSR Promotion Unit and Social Contributions Office, NEC, Jan. 28, 2005

<sup>4</sup> Nihon Keizai Shinbun, Dec. 26, 2005

<sup>5</sup> The same as note No.3.

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