

First Annual CMA/CAM-I Summit:

The Balanced Scorecard and Corporate Social Responsibility: Aligning Values for Profit (B2)

September 7, 2006

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Agenda

This presentation is based upon a corporate social responsibility competency model:

1. **Awareness** A broad understanding of core CSR characteristics, and
2. **Understanding** A basic knowledge of some of the issues, and how they might affect decision-making.
3. **Application** The ability to supplement this basic knowledge with the competence to apply it to specific activities.
4. **Strategic Alignment** An in-depth understanding of the issues and an expertise in embedding CSR into the business decision-making process with the Balanced Scorecard.

In the Dark: What boards and executives don't know about the health of their businesses –

Deloitte in Cooperation with the Economist Intelligence Unit, October 2004

- *“The results are sobering. While the overwhelming majority of board members and senior executives said they need incisive information on their companies' key non-financial drivers of success, they generally find such data lacking. When non-financial information is available, it is often of mediocre or poor value.”*

In the Dark: Survey highlights

- It is important for boards and executives to track non-financial performance
 - 73% of respondents
- Four factors driving non-financial performance measurement:
 1. Increased global competition
 2. Growing customer influence
 3. Greater awareness of risks to corporate reputation
 4. Accelerating product innovation
- 90% of respondents said critical areas of their businesses cannot be measured in monetary terms
- The ability to track non-financial vital signs is often woeful

In the Dark: Critical Observations

- Two barriers loom large
 1. A lack of tools to evaluate non-financial issues
 2. Scepticism that non-financial performance measures affect the bottom line
- Companies that excel at monitoring financial and non-financial performance
 - Believe that non-financial measures affect profitability
 - Have board members and executives who are knowledgeable about non-financial measures
 - Combine good measures with rewards

1. Awareness

CSR Awareness and Understanding

1. Explain commonly used definitions and terminology
2. Examine the origins of CSR
3. Demonstrate how organizations can strategically manage CSR through economic, environmental and social measurement

What is the definition of Corporate Social Responsibility (CSR)?

- *Why are there different meanings?*
- *A common definition:*
 - *"CSR is about how companies manage the business processes to produce an overall positive impact on society."*

<http://www.mallenbaker.net/csr/CSRfiles/definition.html>

What is the definition of Corporate Social Responsibility?

- *CSR is also described as:*
 - *“..is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments”*

<http://www.sustainability-index.com/>

- *“Achieving commercial success in ways that honour ethical values and respect people, communities, and the natural environment”*

<http://www.bsr.org/BSRResources/IssueBriefsList.cfm>

Origins of the CSR movement

- In theory, CSR is a combination of:
 - Stakeholder theory
 - Corporate accountability
 - Sustainable development
 - Ever changing societal demands
 - Future trends

Origins of the CSR movement

- Major environmental and social calamities attributed to corporations in the 1970s and '80s
 - Poison gas leak that killed thousands at Bhopal, India
 - Crude oil spill in Prince William Sound, Alaska
 - Well-known corporate ethical scandals
- 1992 Earth Summit in Rio de Janeiro
- 2002 UN World Summit on Sustainable Development
- Pressure from special interest and non-governmental organizations

Scope of CSR inside an organization

- Very broad
 - Basic argument is “profit with a conscience”
- Including but not limited to:
 - Governance
 - Environmental sustainability
 - Risk management
 - Workplace issues
 - Cultural norms
 - Local laws and customs
 - Transparency
- Involves every aspect of an organization

5 Business Risks

10 Market Forces		5 Business Risks
5 Mega-Issues	5 Demanding Stakeholders	
Climate Change	Green Consumers	Market Risks Balance Sheet Risks Operating Risks Capital Cost Risks Sustainability Risks + Difficult access to capital
Pollution & Health	Activist Shareholders	
Globalization Backlash	Civil Society / NGOs	
Energy Crunch	Government Regulators	
Erosion of Trust	Financial Sectors	

10 Market Forces

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5 Mega-Issues	5 Demanding Stakeholders
Climate Change	Green Consumers
Pollution & Health	Activist Shareholders
Globalization Backlash	Civil Society / NGOs
Energy Crunch	Government Regulators
Erosion of Trust	Financial Sectors

**Sea Change
Of
Rising
Expectations**



A Perfect Storm ... of Opportunities

10 Market Forces	
5 Mega-Issues	5 Demanding Stakeholders
Climate Change	Green Consumers
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Innovation
Growth
Productivity
Brand Image **Revenue**
Saving\$
Competitive Advantage



KPMG International Survey of Corporate Responsibility Reporting 2005

- Top 10 drivers of corporate (social) responsibility
 1. Economic considerations
 2. Ethical considerations
 3. Innovation and learning
 4. Employee motivation
 5. Risk management and reduction
 6. Access to capital and increased shareholder value
 7. Reputation or brand
 8. Market position (market share) improvement
 9. Strengthened supplier relationships
 10. Cost savings

http://www.kpmg.com/Rut2000_prod/Documents/9/Survey2005.pdf

Is their proof that CSR is beneficial?

Dow Jones Sustainability Indexes

- *“Launched in 1999, the Dow Jones Sustainability Indexes are the first global indexes tracking the financial performance of the leading sustainability-driven companies worldwide.”*
- *Corporate sustainability leaders achieve long-term shareholder value by gearing their strategies and management to harness the market's potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks.*

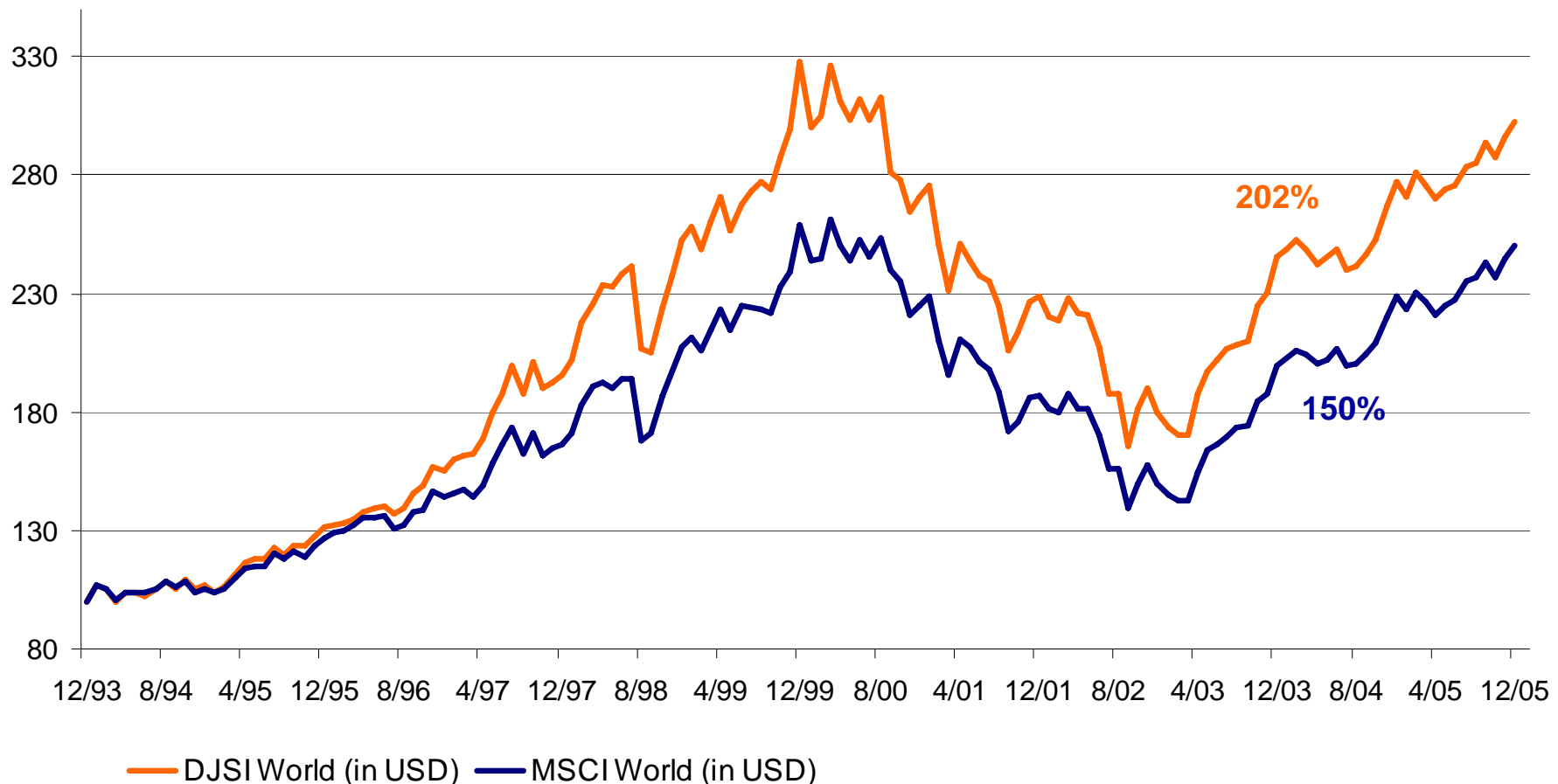
<http://www.sustainability-index.com/>

- Focus on long-term profitability
- Improved governance and risk management

The Proof

■ DJSI World – USD Performance and Risk (I)

December 1993 - December 2005, USD, Total Return Index



KPMG International Survey of Corporate Responsibility Reporting 2005

■ Executive Summary:

- Purely environmental reporting prior to 1999
- Two countries lead CSR reporting
 - Japan 80%
 - UK 71%
 - Highest increases in Italy, Spain, Canada and France
- Almost 2/3 of CSR reports include a section on governance and risk management
- Stakeholder dialogue mentioned in 40% of reports
- Social topics are discussed by almost 2/3 of reports
- Reporting on supply chains is now common
- Climate change was discussed in 85% of reports
- A general focus on long-term sustainability

Criticisms of CSR

- Must become institutionalized or it is simply a marketing or public relations exercise
- Poor performance combined with slick marketing is just that:
 - Ecotistical claims or those that are *“characteristic of those having inflated the truthfulness about their own environmental accomplishments”*

Criticisms of CSR

- Economic analysis?
 - Micro: Yes it is profitable
 - Macro: Unknown at this time
- Viewed as a non-tariff trade barriers in developing countries
- Can add unnecessary costs to businesses
- Benefits are seen as consequences of competitiveness, not the drivers

2. Understanding

What is Triple Bottom Line (TBL) reporting?

- *Triple = Economic + Social + Environmental*
- *“At its narrowest TBL reporting is a framework for measuring and reporting corporate (organizational) performance against economic, social and environmental parameters”*
www.sustainability.com
- *A move from one dimensional economic reporting to three dimensional economic, social and environmental reporting*

TBL Reporting

- Through the application of what is called the *Global Reporting Initiative 2002* or GRI and is defined as “*a common framework for sustainability reporting*”
<http://www.globalreporting.org/about/brief.asp>
- Started in 1997 by the Coalition for Environmentally Responsible Economies and the United Nations
- GRI became independent in 2002, and is an official collaborating centre of the United Nations Environment Programme (UNEP) and works in cooperation with UN Secretary-General Kofi Annan’s Global Compact.

Overview of TBL Reporting

Economic

- Generally Accepted Accounting Principles
- Customers
- Suppliers
- Employees

Social

- Bribery and corruption
- Political contributions
- Child labour
- Security practices
- Indigenous rights
- Training and diversity

Environmental

- Energy
- Water
- Biodiversity
- Emissions, effluents, and waste

**Traditional
Financial
Reporting**



**TBL
Adds**



How organizations strategically manage CSR through triple bottom line reporting

- TBL reporting enables organizations to:
 - Measure and manage their financial and non-financial performance and impacts, or lack thereof
 - Have their performance and impacts verified independently (audited)
 - Communicate effectively with stakeholders:
 - Consumers, governments, investors, employees, other stakeholders and 'watchdog' groups

The Global Reporting Initiative

- The GRI has evolved into the globally recognized methodology for generating corporate social responsibility reports
- It is a voluntary set of TBL guidelines
 - For now
 - New reporting changes in some countries now include mandatory elements of the GRI

The GRI Principles

1. *Transparency*
 2. *Inclusiveness*
 3. *Auditability*
 4. *Completeness*
 5. *Relevance*
 6. *Sustainability Context*
 7. *Accuracy*
 8. *Neutrality*
 9. *Comparability*
 10. *Clarity*
 11. *Timeliness*
- Report Framework**
- What to Report**
- Quality and Reliability**
- Access to the Report**

GRI Indicators

- Purpose of a GRI indicator is to communicate information
 - Direct and indirect impacts
 - Core and additional indicators

GRI Indicators

- Indicators are both qualitative and quantitative
 - Professional judgement and common sense should be used
 - 1. Report absolute figures
 - Scope and scale of impact
 - Enables calculation of contribution to a larger impacts
 - 2. Report ratios
 - Demonstrate relationship between several factors
 - Productivity/efficiency
 - Intensity
 - 3. Percentages

<http://www.globalreporting.org/guidelines/2002/dannex5.asp>

GRI Economic Performance Indicators

- Customers
 - Net sales
- Suppliers
 - Cost of goods sold
- Employees
 - Total payroll and benefits
- Providers of capital
 - Increase/decrease in retained earnings
- Public sector
 - Subsidies received broken down by country or region

GRI Environmental Performance Indicators

- Materials
 - Total material use other than water
- Energy
 - Direct energy use by primary source
- Water
 - Total use
- Biodiversity
 - Description of major impacts on biodiversity
- Emissions, effluents, and waste
 - Greenhouse gas emissions

GRI Environmental Performance Indicators

- Suppliers
Performance of suppliers
- Products and services
Significant environmental impacts of principal products and services
- Compliance
Incidents and fines for non-compliance
- Transport
Environmental impacts of transportation used for logistical purposes
- Overall
Total environmental expenditures by type

GRI Social Performance Indicators

Society

- Community
Description of policies to manage impacts on communities
- Bribery and corruption
Description of policies, procedures and management systems
- Political contributions
Description of policies, procedures and management systems
- Competition and pricing
Describe any court decisions pertaining to anti-trust and monopoly regulations

GRI Social Performance Indicators

Product Responsibility

- Customer health and safety
Number of complaints upheld by health and safety regulators
- Products and services
Number of complaints upheld by product information and labelling regulators
- Advertising
Number and types of breaches of advertising and marketing regulations
- Respect for privacy
Number of substantiated complaints

GRI Social Performance Indicators

Human Rights

Description of policies, guidelines, corporate structure and procedures to deal with:

- Strategy and management
- Non-discrimination
- Freedom of association and collective bargaining
- Child labour
- Forced and compulsory labour
- Disciplinary practices
- Security practices
- Indigenous rights

GRI Social Performance Indicators

- Employment
 - Net employment created and average turnover segmented by region or county
- Labor/management relations
 - Provision for formal worker representation in decision-making
- Health and safety
 - Standard injury, lost days, and absentee rates
- Training and education
 - Average hours of training per year per employee
- Diversity and opportunity
 - Description of equal opportunity policies or programs

Is the GRI a panacea?

- No
 - The GRI is not a
 - Management system
 - Code of conduct
 - Performance standards system
 - The GRI does not provide:
 - Direction on how to design internal data management and/or reporting systems
 - Methodologies for preparing, monitoring or verifying CSR or TBL reports
 - More on this topic later in this presentation
- <http://www.globalreporting.org/guidelines/2002/a08.asp>

GRI Cons

- Report costs

- \$200,000 to \$750,000 US to develop and produce a GRI compliant "CSR" report
- Including staff time and production costs

http://www.bc.edu/centers/ccc/Pages/resources/kn_resart_gri.html

- Challenges to connect the GRI process to existing management systems and operating procedures
- Attractive only to those companies already committed to social and environmental issues
- Some organizations collect GRI related data, but do not share it for competitive reasons

GRI Pros

- Allows for “benchmarkability”
 - Intra and inter-industry comparisons
- Sector specific supplements have been created
 1. Automotive
 2. Financial Services
 3. Mining and metals
 4. Public agency
 5. Tour operators
 6. Telecommunications

In development

- Apparel and footwear
- Logistics and transportation

<http://www.globalreporting.org/guidelines/sectors.asp>

3. Application

Who consumes TBL information?

- Lifestyles of Health and Sustainability (LOHAS) describes a \$226.8 billion U.S. marketplace for goods and services focused on health, the environment, social justice, personal development and sustainable living.
- The consumers attracted to this market have been collectively referred to as *Cultural Creatives* and represent a sizable group in the USA.
- Approximately 30 percent of the adults in the U.S., or 63 million people, are currently considered LOHAS consumers.

<http://www.lohas.com/page/home.html>

LOHAS consumer market segments and size

MARKET SEGMENT MARKET SIZE

Sustainable Economy \$76.5 Billion

Healthy Lifestyles \$27.5 Billion

Alternative Healthcare \$30.7 Billion

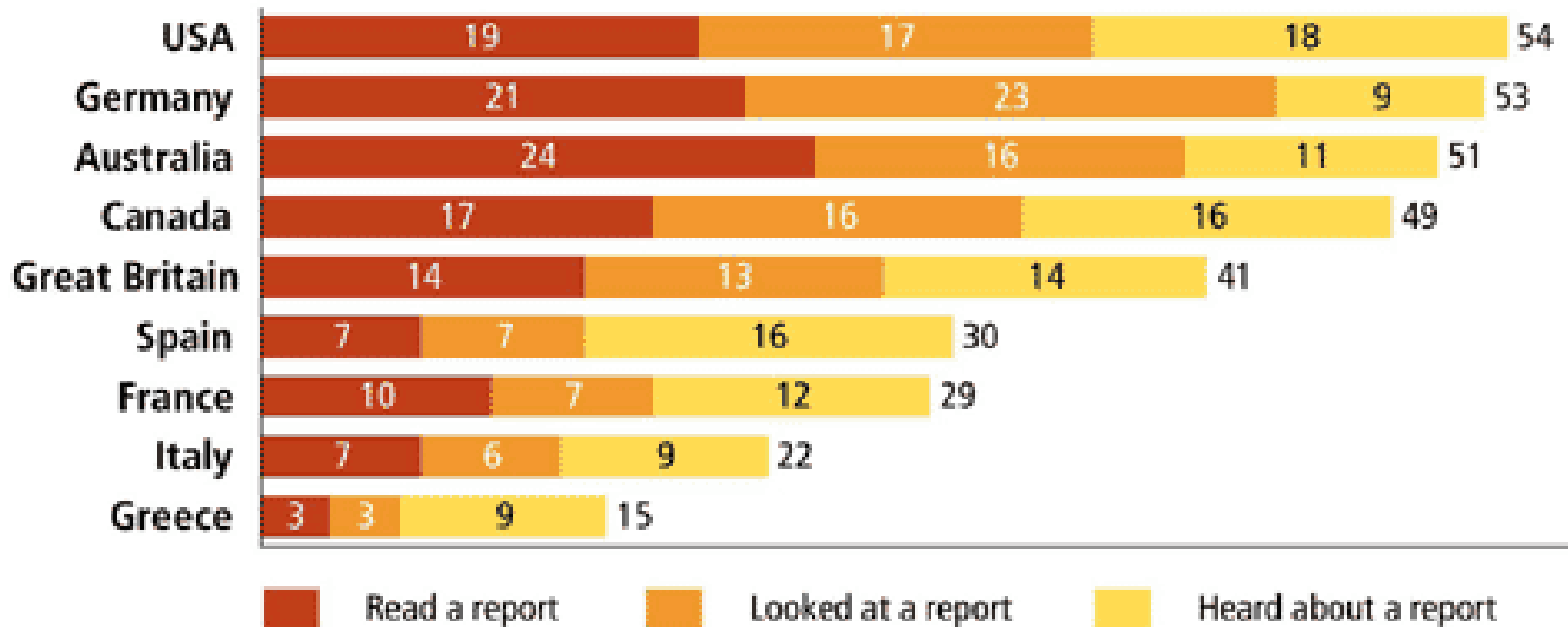
Personal Development \$10.6 Billion

Ecological Lifestyles \$81.2 Billion

**TOTAL U.S. LOHAS
MARKET \$226.8 BILLION**

Are consumers aware of CSR reports?

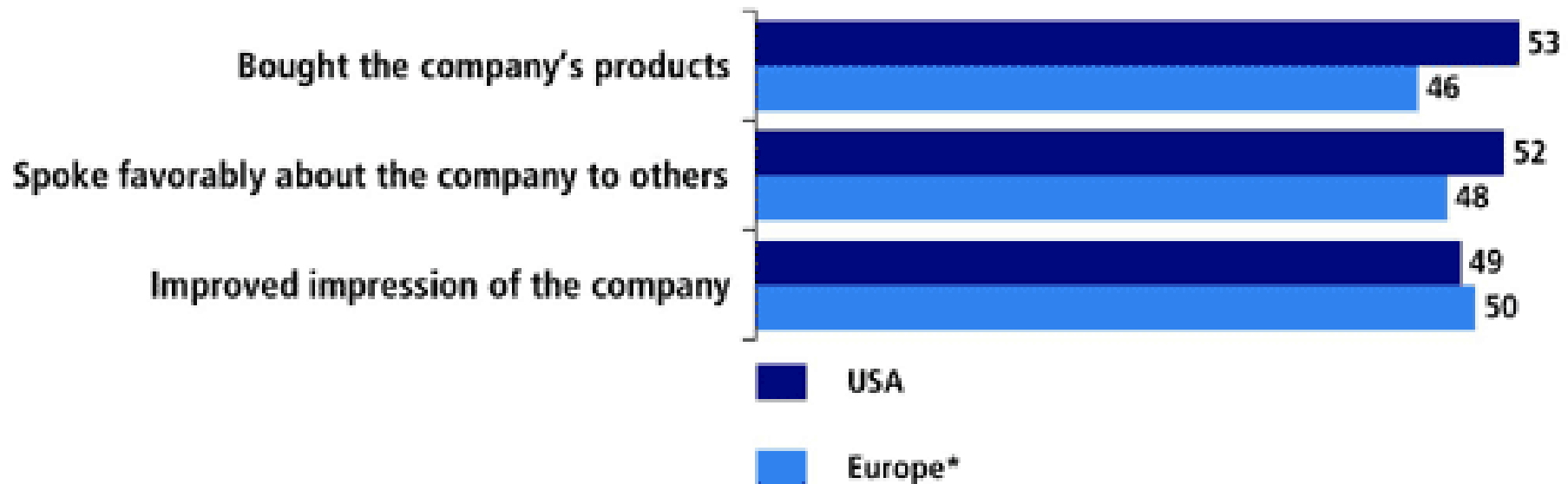
Have Read or Heard of a Corporate Social or Environmental Report
Selected Countries, 2004



Do consumers care about CSR reports?

Impacts of Reading a Corporate Social Report

USA versus Europe, 2004



* Europe includes France, Germany, Great Britain, Greece, Italy, and Spain

Subsample: Respondents who have read or heard about a corporate social or environmental report

LOHAS: Another Example

- GlobeScan survey, April, 2005, Canadian consumer survey about CSR over the last year
 1. 40% of the respondents reported punishing a company by either:
 - Not purchasing their products
 - Speaking about them critically
 2. Canadians have high expectations of companies, especially in the fields of:
 - Environmental protection
 - Product health and safety
 - Fair treatment of employees

5 Sustainability Stages

5. Purpose / Passion

4. Integrated Strategy

3. Beyond Compliance

2. Compliance

1. Pre-Compliance

- Organizations can generate a competitive advantage by:
 - Turning or adapting one or more of CSR elements into a core competency, which is very difficult for their competitors to both replicate and compete against
 - Consciously and sincerely managing elements of corporate social responsibility

4. Strategic Alignment

Why the Balanced Scorecard?

- *The Balanced Scorecard is designed to use leading, lagging, qualitative and quantitative indicators, just like TBL reporting is used to measure the success of corporate social responsibility efforts*
- *Choosing the CSR indicators that correctly match a corporation's strategy is the both and art and a science*
- Strategy is both deliberate and emergent

Why is the Balanced Scorecard an excellent CSR management tool?

- Well known and established
- The 4 perspectives are easily adaptable to the CSR opportunities and challenges
- One does not need to “reinvent the wheel”
- Can be used to craft and implement strategy

Purpose of the Balanced Scorecard

- Kaplan and Norton state that the Balanced Scorecard can be used to:
 - Clarify and update strategy
 - Communicate strategy throughout the company
 - Align unit and individual goals with strategy
 - Link strategic objectives to long term targets and annual budgets
 - Identify and align strategic initiatives
 - Conduct periodic performance reviews to learn about and improve strategy

Overview of the Balanced Scorecard

1. **Financial perspective** - this will be familiar to most people, such as financial ratios, liquidity or cash flow measurements.
2. **Customer perspective** - seeks to measure aspects directly impact on customers, such as customer surveys, complaints or competitive rankings.
3. **Internal business perspective** - looks at the impact of internal processes on the business, such as how many warranty claims are made or how successful are we in generating new business.
4. **Innovation and learning perspective** – measures how well an organization uses knowledge, such as how much revenue comes from new ideas or how many employee suggestions are implemented.

http://www.bostoncoop.net/~tpvov/wiki/index.php?title=Balanced_scorecard

Objectives, measures, targets and initiatives

- Each of the 4 perspectives are supported by:
 1. Objectives: Major objectives to be achieved
 2. Measures: Observations that used to measure progress towards reaching the objective
 3. Targets: Specific target values for the measures
 4. Initiatives: Specific action programs initiated to meet targets, measures and ultimately objectives

Strategic Alignment

- *The Balanced Scorecard and Corporate Social Responsibility: Aligning values for profit*
- CMA Management Magazine
 - October 2005 Issue

A Perfect Storm ... of Opportunities

10 Market Forces	
5 Mega-Issues	5 Demanding Stakeholders
Climate Change	Green Consumers
Pollution & Health	Activist Shareholders
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Innovation
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Productivity
Brand Image **Revenue**
Saving\$
Competitive Advantage



Figure 3: Examples of how to integrate CSR into the Balanced Scorecard's four perspectives

Balanced Scorecard Perspective	10 Market Forces (Objective)	GRI Measure: How success or failure is measured using the triple bottom line (A common framework for sustainability reporting)	Target: The level of performance or rate of improvement required
Financial	"Green" consumers	Energy consumption footprint (annualised lifetime energy requirements) of major products	Annual reduction in energy footprint for new products
Financial	Energy crunch	Direct energy use segmented by source	100% renewable energy
Financial	Financial	Increase/decrease in retained earnings at end of period	Percentage
Internal	Pollution and health	Standard injury, lost day and absentee rates and number of work-related fatalities (included subcontractors)	0 lost-time injuries & fatalities, or long-term illnesses
Internal	Climate change	Total greenhouse gas emissions	Annualised reduction
Internal	Governments and regulators	Incidents and fines for non-compliance with all laws and regulations	0 incidents or fines
People and Knowledge	Civil society/NGOs	Policies, guidelines and procedures to address needs of Indigenous people	Number of Indigenous employees
People and Knowledge	Activist shareholders	Business units currently operating or planning operations in or around protected or sensitive areas	Number of employees trained in environmental management practices
Customer	Erosion of trust/transparency	Policy to exclude all child labour	No child labour
Customer	Globalization backlash	Supplier performance related to environmental commitments	Use of 100% organic cotton or coffee

Strategic Alignment

- *The Value of Values: How to recruit and retain the best talent with strategic values-based management*
- CMA Management Magazine
 - September 2006 Issue

Important Workplace Values

- In 2003, the MK Level Playing Field Institute in collaboration with the Centre for Survey Research at the University of Connecticut surveyed U.S. employees and employers about their most important workplace values.

Important Workplace Values

Workplace values	Employer belief	Employee perception	Gap
Highest quality product or service	81%	50%	31%
Ethics and honesty	75%	51%	24%
Discrimination free workplace	79%	55%	24%
Long-term organizational survival	73%	50%	23%
Fairness	65%	38%	23%
Good public image	65%	53%	12%
Rewarding a job well done	52%	31%	21%
Diversity	42%	30%	12%

Table 4 - Sample values-focused scorecard

Balanced Scorecard Perspective	Objective (important workplace values identified by the MK Level Playing Field Institute)	Measures (GRI Indicators)	Potential Targets
Financial	Long-term Organizational Survival	Outlook on the organization's main challenges and targets for the next year and goals for the coming 3-5 years	Cash flow, ROI target or sales revenue per employee
Customer	Good Public Image	Procedures related to customer satisfaction, including results of surveys measuring customer satisfaction	Increase in customer satisfaction (survey)
	Highest Quality Product or Service	Procedures for improving health and safety across the life cycle of products and services	Number of health and safety improvements
	Fairness	Procedures for complaints and grievances filed by customers, employees, and communities concerning human rights	No violations of human rights
Internal Processes	Discrimination-Free Workplace	Incidents of discrimination	No incidents of discrimination
	Diversity	Disclosure and results of diversity and equal opportunity policies	Percentage increase in minority employees
Learning and Growth	Ethics and Honesty	Extent of training and risk analysis to prevent corruption	No charges or convictions for corruption, mandatory employee training
	Rewarding a Job Well Done	Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings	Percentage of employees accessing performance and career development review

Summary

- *Key non-financial drivers*
 - *Corporate social responsibility*
 - *Workplace values*
- *When non-financial information is available, it is often of mediocre or poor value.*
 - *Identify your stakeholders*
 - *Ask them what they do and do not value*
 - *Use a combination of leading and lagging indicators*

Summary

- In the Dark: Survey highlights
 - It is important for boards and executives to track non-financial performance
 - 90% of respondents said critical areas of their businesses cannot be measured in monetary terms
 - The ability to track non-financial vital signs is often woeful

Summary

- Two barriers loom large
 1. A lack of tools to evaluate non-financial issues
 2. Scepticism that non-financial performance measures affect the bottom line
- Companies that excel at monitoring financial and non-financial performance
 - Believe that non-financial measures affect profitability
 - Have board members and executives who are knowledgeable about non-financial measures
 - Combine good measures with rewards

Summary

- Two barriers loom large
 1. A lack of tools to evaluate non-financial issues
 - *International TBL reporting standard: Global Reporting Initiative Guidelines*
 - *Common sense*
 2. Scepticism that non-financial performance measures affect the bottom line
 - KPMG's survey: Top 10 drivers of corporate social responsibility

Summary

- Companies that excel ...
 - Believe that non-financial measures affect profitability
 - ❖ 10 Market Forces: 5 Mega-Issues + 5 Demanding Stakeholders
 - Have board members and executives who are knowledgeable about non-financial measures
 - ❖ 90% of respondents said critical areas of their businesses cannot be measured in monetary terms
 - Combine good measures with rewards
 - ❖ Compensation systems can be directly tied to CSR or values-focused Balanced Scorecards

Conclusion

1. **Awareness** A broad understanding of the core CSR characteristics
2. **Understanding** A basic knowledge of some of the issues, and how they might affect decision-making.
3. **Application** The ability to supplement this basic knowledge with the competence to apply it to specific activities.
4. **Strategic Alignment** An in-depth understanding of the issues and an expertise in embedding CSR into the business decision-making process with the Balanced Scorecard.