Insights into Corporate Social Responsibility measurement

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Abstract

This article is aimed at identifying and measuring impacts of CSR at the company level, both in financial and non-financial performance. CSR contribution to firm performance has been widely discussed in the management literature in the last decades. However, efforts in building a straight link between CSR and financial performance at the macro level have led to no single answer, given the complex nature of CSR outcomes. Our contribution builds on existing literature in CSR strategy and CSR measurement and develops a model for assessing CSR financial and non-financial outcomes from a company-specific perspective. We also argue that measuring CSR outcomes can lead to further integration of non-financial issues in management systems and better inform strategic decision-making processes. Finally, a case example illustrates the proposed model.

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1 Introduction

In the last ten years, Corporate Social Responsibility (CSR) has become a mainstream topic in both management literature and practice (De Bakker et al., 2005, Margolis and Walsh, 2003). Nowadays, almost every large company currently discloses information concerning its environmental and social performance, in addition to its financial results. Even when the degrees of maturity of CSR policies are very different among countries, sectors and companies (Zadek, 2004) the integration of CSR into the firm’s strategy has been undertaken by a large number of them. This move seems to respond to a growing complexity of the context in which companies operate, where social and environmental concerns fostered by stakeholders and the society at large have become critical strategic issues in many cases. This is what a survey carried by IBM among over 1000 top managers indicates (IBM, 2010). Thus, the greater complexity of the context is also leading to an increasing need of specific techniques and mindsets (Swanson et al., 2007) that can help to understand how non-financial value is created and how to integrate its several dimensions into strategic decisions.

This societal interest on non-financial performance has led to the emergence of a wide array of non-financial reporting standards and compliance codes (e.g. GRI, SA8000). In addition, there is also a trend to non-financial accountability requirements from specific stakeholders, such as capital markets (e.g. Dow Jones Sustainability Index, FTSE4GOOD) or the public sector, as it can be seen in the recent communication of the European Commission on CSR (European Commission, 2011).

However, the future of non-financial reporting seems unclear, since the costs associated with this wider accountability of companies remain to be calculated and the benefits will depend on the extent that accountability practices are integrated into the firm’s strategy (International Integrated Reporting Committee, 2011).

Thus, the aim of our article is to develop a measurement model of financial and non-financial impacts of CSR. This approach should provide a better understanding of how value is created through CSR policies and how non-financial outcomes could better inform strategic decision making.

The remainder of this article is organized as follows. First, we review CSR literature related to CSR strategy and its contribution to firm performance and sustainability. Second, we explicitly review company-level approximations to CSR outcomes measurement and we develop our model. Third, we illustrate the implications of our approach with a case example at Red Eléctrica de España (REE), where it has been implemented. Finally, we outline our conclusions and suggest future research areas.
2 Literature Review

The interactions between business and society have drawn a lot of research within the academic community since more than fifty years (Bowen, 1953). Boulding’s (1956) view of organizations as open systems can be considered the first attempt to stress the relevance for an organization of the various stakeholders that constitute its environment. This vision was also central in Thomson’s Organization Theory (1967), which introduced the idea of protecting business core functions from unpredictable impacts of the broader context.

Since then, Corporate Social Responsibility (CSR) -and other related concepts like Corporate Social Performance (CSP) and Corporate Citizenship– have been developed and conceptualized by influent scholars like Carroll (1979) and Wartick and Cochran (1985), though there is still no single definition today.

2.1 The “Business Case” for CSR

Added to these general conceptualizations, the “business case” of CSR has generated a lot of research since the 1970s. On the one hand, empirical studies have tried to assess whether CSR contributes to the Financial Performance (FP) of the firm, by statistically exploring the causal link between CSR and FP. On the other hand, theoretically grounded studies have aimed to explain this value creation by means of different theories of the firm.

2.1.1 Quantitative Studies

Within the first group, scholars have used different quantitative aggregates to measure FP and CSR. For example, Orlitzky (2003) categorized FP measurement proxies into: market measures (e.g. share value, Tobin’s q), accounting measures (e.g. ROI, total profits) and perception measures. At the same time, he broke CSR measures down into company self-report information, reputational measures, 3rd party assessments (rating agencies) and perception measures (e.g. stakeholders’ view of the firm).

Despite the number of studies devoted to this question, differences in measuring both CSR and FP have led to no single answer to the relationship between them, while it is true that a vast majority of this research has shown a positive correlation (Margolis et al., 2007).

This purely quantitative approach has been criticized by its weak results. Thus, some influent scholars have underlined the need for a theoretical focus that could shed more light into the nature of this relationship by exploring the various mediating mechanisms that allow for it (Wood, 2010).
2.1.2 Theoretical Studies

Theoretically grounded research on the instrumental view of CSR assumes that CSR value creation is ultimately connected to the broader context in which the firm operates and thus, addressing stakeholders’ concerns can bring bigger and more sustained financial returns to the company. In this sense, CSR is seen as being part of the firm strategy, and its design and deployment should contribute to the attainment of strategic goals set (Burke and Logdson, 1996).

This link to corporate strategy has been explored by different theories of the firm, including Stakeholder Management Theory (Freeman, 1984) and the Resource Based View (RBV) of the firm (Wernerfelt, 1984). Stakeholder Management Theory focuses on value creation as a consequence of meeting the societal (external) demands on the firm. The RBV of the firm states that the possession of rare, valuable, inimitable and not easily substitutable resources (Barney, 1991) determines the ability to the firm to outperform others. The natural RBV (Hart, 1995) extended the later by connecting social and environmental challenges to companies’ resources, showing that CSR policies can contribute effectively to the firm’s competitive advantage.

3. CSR Measurement Model

CSR literature offers a wide range of examples of the contribution of CSR to company value drivers, such as growth opportunities (Kurucz, 2008), consumer trust (Pivato et al 2008) or employee attractiveness (Greening and Turban, 2000) (See Wood (2010) for a comprehensive review). At the same time, the nature of CSR business outcomes has been conceptualized in different ways (Knox and Maklan, 2004; Kurucz, 2008), most of them underlining its financial and non-financial aspects.

From a company-level, there are some empirical attempts to evaluate outcomes of isolated CSR Projects (Weber, 2008; Salazar et al., 2011). However, we argue that an integrated financial and non-financial approach to CSR impacts is missing, as well as their link to strategic management and external reporting.

Our model (see Figure 1) considers three CSR layers within an organization: the CSR operational layer, where resources are effectively allocated to CSR projects (thus generating direct costs and revenues), the CSR strategic management level, where the full range of CSR outcomes, both financial and non-financial, must be measured and integrated into further decision-making, and the CSR reporting layer, where the information generated is also communicated to stakeholders and society.
3.1 Financial Outcomes of CSR

The most direct impact of CSR projects is the cost of resources associated (e.g., investments in the community, employee benefits). Nevertheless, some CSR projects can also raise direct revenues for the company (e.g., energy savings). If data are available, then the most common way to evaluate the attractiveness of an investment opportunity is the Net Present Value (NPV) method (Weber, 2008), which we adopt at this point. Given that NPV has some limitations regarding the uncertainty of CSR-driven revenues, some alternative methods, like real options theory (Husted, 2007), would also have to be considered.

3.2 Non-Financial Outcomes of CSR

Non-financial outcomes of CSR constitute the broader range of impacts that CSR has within an organization, motivated both internally (e.g., employee commitment) and externally (e.g., corporate reputation). Some authors stress the role of CSR in enhancing firm intangible resources, such as innovation, human capital, reputation and culture (Surroca et al., 2010). Other approaches also include transforming non-financial impacts into monetary terms (Figge and Hahn, 2011).

From a company-specific approach, the identification of relevant non-financial outcomes requires to gain deep knowledge about the company and its specific context, as well as a close interaction between researchers and the company staff. For this reason, action research methodology (Coughlan et al., 2002) was chosen in our case example. Once company-specific non-financial outcomes of CSR are identified, quantitative indicators must also be given to allow for measurement. According to existing literature examples (Carlucci, 2010; Hubbard, 2009), Key Performance Indicators (KPI) are selected, following Carlucci (2010) criteria: relevance, reliability, comparability and consistency.
Once KPI data are available, their integration into strategic management can be accomplished by means of several techniques and tools. Among them, the adaptation of Kaplan and Norton’s Balanced Scorecard (1992) to sustainability and CSR issues (Bieker, 2003; Schaltegger et al., 2010) and the system dynamics perspective to identify the impacts associated with CSR policies (Santos et al., 2002, Parisi and Hockerts, 2008) are specially well suited for the integration of KPIs.

4 Case Example: Red Eléctrica de España

Red Eléctrica de España (REE) is the transport and system operator of the Spanish electric network. It mission is to provide high voltage electric power transmission from generation plants to distribution substations and to operate the national electric system. The company, of over 1700 employees and annual net sales (2010) of 1400 Mo. €, shows a strong commitment to the grid integration of renewable energies (about 25% of total in Spain).

REE’s CSR practices have been widely acknowledged by both Spanish and international organisms. In 2011, REE has received the European Foundation for Quality Management (EFQM) Prize “Taking responsibility for a sustainable future”, and its Sustainability Report has been recognized as the best one among the biggest 35 Spanish companies (IBEX-35).

4.1 Methodology

The objective of the case example was to test our CSR measurement approach and evaluate CSR contribution to both financial and non-financial performance of REE. Initial data sources included semi-structured interviews with department managers, as well as public documents (website releases and Sustainability Reports). Action research methodology (Coughlan et al., 2002) was chosen in order to help the company to identify CSR impacts and implement the model.

4.2 CSR Outcomes

The first step of the case study was aimed at estimating the costs and revenues associated to existing REE’s CSR projects. Costs identified included CSR Department operating costs, but also CSR projects across the whole company (e.g., CSR certification for suppliers, energy efficiency audits) as well as the labor costs associated. Direct revenues from CSR projects were also calculated.
Second, interviews with managers were conducted and CSR impacts on the organization were identified. These impacts were then assigned quantitative KPIs. At this step, an effort was explicitly made to consider indicators that already existed, so that the costs associated with measurement were kept as low as possible.

Measurement of both financial and non-financial CSR outcomes provided a comprehensive snapshot of CSR global performance, as well as a more accurate knowledge of the processes driving this value creation through the organization.

5 Conclusions

In this article we have proposed a measurement model for CSR impacts at the company-level. By reviewing the existing literature we showed that an integrated approach for assessing both financial and non-financial outcomes of CSR was missing. Our model considers three CSR layers within the organization: the CSR project layer, the CSR strategic management layer and the CSR reporting layer, and illustrates the relationship between CSR measurement and decision making.

An exploratory case study was conducted, which highlighted the usefulness of a company-level approach to fully understand CSR outcomes. However, its application to further examples in different business settings would certainly provide enriching insights and would help to refine and validate the approach.

Finally, given the complex nature of CSR outcomes, some interesting future developments could include the study of specific tools and techniques that are able to integrate them into strategic decision-making. The adaptation of the Balanced Scorecard, as well as other techniques from the system dynamics field, like causal and cognitive mapping, are thought to be promising research avenues.

6 References


