Corporate Social Responsibility as Risk Management

A Model for Multinationals

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March 2005 | Working Paper No. 10

A Working Paper of the:
Corporate Social Responsibility Initiative

A Cooperative Project among:
The Mossavar-Rahmani Center for Business and Government
The Center for Public Leadership
The Hauser Center for Nonprofit Organizations
The Joan Shorenstein Center on the Press, Politics and Public Policy

Harvard University John F. Kennedy School of Government

Citation

This paper may be cited as: Kytle, Beth and John Gerard Ruggie. 2005. "Corporate Social Responsibility as Risk Management: A Model for Multinationals." Corporate Social Responsibility Initiative Working Paper No. 10. Cambridge, MA: John F. Kennedy School of Government, Harvard University. Comments may be directed to the authors.

Corporate Social Responsibility Initiative

The Corporate Social Responsibility Initiative at the Harvard Kennedy School of Government is a multi-disciplinary and multi-stakeholder program that seeks to study and enhance the public contributions of private enterprise. It explores the intersection of corporate responsibility, corporate governance and strategy, public policy, and the media. It bridges theory and practice, builds leadership skills, and supports constructive dialogue and collaboration among different sectors. It was founded in 2004 with the support of Walter H. Shorenstein, Chevron Corporation, The Coca-Cola Company, and General Motors.

For Further Information

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INTRODUCTION

This paper develops a conceptual framework for companies to manage the emerging social risks they encounter as they go global, and of the contribution of corporate social responsibility (CSR) programs to managing those risks.

Globalization offers many opportunities to companies, but also poses novel sources of uncertainty and risks. Multiple business indicators show that the level of uncertainty for corporate leaders has increased, due in large part to:

- Large extended enterprises made up of independent organizations but with tremendous pressures to grow and perform as a unit;

- Rapid rates of change in technology, connections and information flows as a result of globalization; and

- Problems in managing scale using methods rooted in controlling all decisions across the entire extended enterprise.

The result of the greater interdependencies and hidden vulnerabilities that businesses now face is an increased number of uncertainties in corporate decision-making. Current network-based operating models highlight the growing importance of the extended enterprise by establishing greater connectivity among and between stakeholders across the globe. This connectivity has also created entirely new stakeholders and requires innovative forms of risk management.

These changes in the operating model have led to a significant shift in market power – not just to customers and traditional investors but also, and more importantly, toward stakeholders: communities, employees, regulators, politicians, suppliers, NGOs and even the media. As a result of this shift in market power, "social risk" is a rising area of concern for global corporations.

From a company perspective, social risk, like any other risk, arises when its own behavior or the action of others in its operating environment creates vulnerabilities. In the case of social risk, stakeholders may identify those vulnerabilities and apply pressure on the corporation for behavioral changes. As the ability to listen to corporate stakeholders' perspectives on social issues becomes a competitive necessity, managing social risks will need to become more fully embedded in corporate strategy.

Social risk management strategies can be extremely complex undertakings that must account for and balance numerous conditions, perspectives and variables across the business enterprise. The very nature of social risk places management teams in the challenging position of setting clear direction for a diffused function. For the complex and evolving area of social risk, corporate social responsibility (CSR) programs represent an excellent mechanism for addressing these challenges across the business enterprise.

To appreciate the importance of CSR to social risk management requires understanding three premises. First, CSR is a natural extension of going global analogous to other adjustments of "scaling up" (e.g., forming strategic alliances, finding skilled staff in foreign countries). Second, CSR activities are not discretionary expenditures or the target of cost-cutting activities. Third, CSR must be linked strategically to core business functions to reap the full benefits.

CSR programs are a necessary element of risk management for global companies because they provide the framework and principles for stakeholder engagement, can supply a wealth of intelligence on emerging and current social issues/groups to support the corporate risk agenda, and ultimately serve as a countermeasure for social risk.

THE GLOBAL OPERATING ENVIRONMENT

Globalization can be understood from a number of perspectives. Economists often define it as a march toward a more fully integrated world market.[1] Political scientists conceive of it as a shift away from traditional state sovereignty to a more complex system of 'multi-layered' governance in which non-state actors are increasingly gaining roles in shaping world order.[2] Business schools and companies alike typically think of it in terms of a borderless world for corporate operations.[3] Underlying each of these perspectives is the idea that globalization is being driven by the private and not the public sector, by companies and not by governments, though it is, of course, the actions of governments that have lowered border barriers in the first place.[4]

Globalization has created an operating environment for business leaders that is markedly different from national or local levels, and it is often exceedingly unpredictable. Therefore, business leaders need to understand better the dynamics of the global operating environment in order to manage its related risks effectively. Corporate social responsibility programs can play a central role in this context.

Three aspects of the global operating environment are of particular relevance for understanding the evolving contributions of CSR to corporate risk management, and are elaborated below:

1) Networked operations, value chains and the global economy;
2) Empowerment of global stakeholders; and
3) Dynamic tension between and among stakeholders.

Networked Operations, Value Chains, and the Global Economy

For many companies, going global has meant adopting network-based operating models across different countries, regulatory regimes and cultures. This form of extended enterprises has significantly enhanced the efficiency and effectiveness of companies while improving, and in some cases creating, competitive advantages. However, network-based operating models have also resulted in much more complex relationships, both within corporate domains and between corporations and their external operating environments – indeed, blurring the boundaries demarcating the two.

Networks, by their very nature, involve divesting direct control over significant operations, substituting negotiated relationships for hierarchical structures. Therefore, gone are the days when companies could easily identify the starting and end points of their value chains and hope to manage them as a closed system. A value chain comprises the full range of activities that are required to bring a product or service from its conception to its end use and beyond. Global value chains often stretch across multiple companies, supply chains and wide geographic areas. As the number of such connections grows so, too, do the challenges of relationship management because each component in the value chain brings along with it its own set of local stakeholders. A change in any one stakeholder relationship can ripple throughout the value chain and cause unanticipated consequences for the company.

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1 Deanne Julius, 1997. "Globalization and Stakeholder Conflicts: A Corporate Perspective." *International Affairs,* Vol. 73, No. 3. Globalization and International Relations, p.453.

2 John Gerard Ruggie, "Reconstituting the Global Public Domain – Issues, Actors, and Practices," *European Journal of International Relations,* 10 (December 2004).

3 See: Kenichi Ohmae, *The Borderless World, rev ed: Power and Strategy in the Interlinked Economy,* 1999. New York: Harper Collins Publishers.

4 Deanne Julius, p.453.

In addition, companies with recognized brands that have networked enterprises extended across the globe inevitably also empower stakeholders in novel ways by providing them the platform to address key social grievances: either because the companies in question violate their own self-professed standards or international community norms in such areas as human rights, labor practices and environmental sustainability; or simply because the companies have the capacity to do something about those issues coupled with the visibility that makes them susceptible to pressure. As a result, senior managers and Boards of such companies inevitably will spend more of their time on issues of external accountability in value chains.

Empowering Global Stakeholders

A corporate stakeholder can be defined as any person, group or organization that can place a claim on a company's attention, resources or output. According to three global business leaders in *Walking the Talk: The Business Case for Sustainable Development,* globalization has expanded the range and reach of corporate stakeholders by "exerting a democratizing and empowering influence worldwide, partly through liberalized telecommunications markets and the advent of the internet."[5] On the global level, such groups form coalitions to challenge government policy as well as corporate behavior. As companies expand their reach in the global economy, they also experience increased exposure to these new (or newly empowered) social actors.

Companies in the United States, Europe and Japan have long practiced local stakeholder engagement. Generally, these efforts are through community relations departments that invest in local charities, practice outreach to community organizations and provide value to the greater population. A global company interacting with global stakeholders faces a far more complex set of operating parameters: more individuals and groups, raising a greater variety of issues, in more diverse settings that are often unfamiliar to senior management. Moreover, many of these challenges can arise in political jurisdictions with weak regulatory frameworks and means of enforcement, higher levels of corruption and inadequate provision of social services.

These contextual conditions, coupled with the myriad cultural issues involved in managing a global enterprise, make it more likely that constituent entities in a company's own value chain will run afoul of corporate policy or international community norms, or that civil society actors will exploit a company's reputation vulnerabilities in the hope of improving those conditions. The more visible the company is, the better the chance of stakeholder advocacy --particularly by civil society organizations, will be in garnering critical media coverage for a particular group's efforts, thereby raising risks for the global companies on the other end.

Global corporations must increasingly accommodate themselves to the fact that outside actors, particularly civil society organizations, for which neither the territorial state nor the profit motive are primary drivers have become an inextricable part of their global operating environment.

Global Stakeholder Dynamics

The concept of civil society includes voluntary and not-for-profit organizations, philanthropic institutions, social and political activist networks, community groups and related organizations.

By way of summarizing the discussion thus far, Figure 1 depicts a stylized model of the dynamic interplay among companies, governments and civil society in the new global economy and the primary roles that these three sectors play. Each sector can pressure the others through various levers of influence that are available to them and can use these levers in response to the activities of the other sectors or

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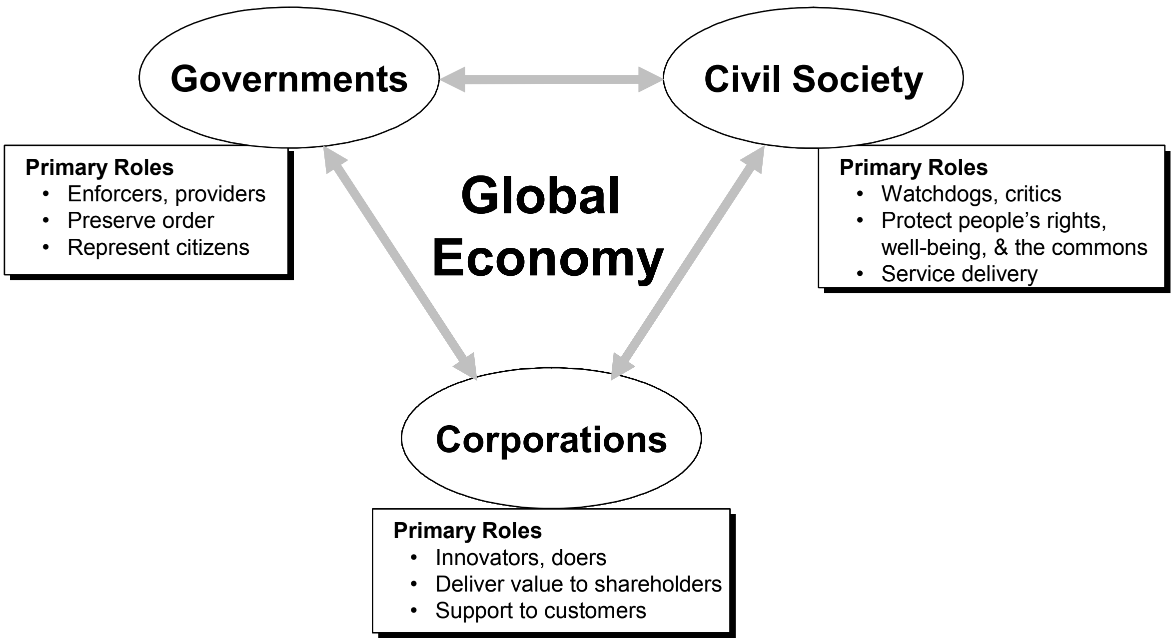
5 Charles O. Holliday, Jr., Stephan Schmidheiny, and Philip Watts. 2002. *Walking the Talk: The Business Case for Sustainable Development,* San Francisco, Greenleaf Publishing p.46.

proactively to trigger desired change in the overall system. Civil society organizations in particular can campaign for changes in corporate behavior through protests, boycotts, trying to change purchasing patterns – or, increasingly, partnering with companies to achieve joint aims. The push and pull of these sectors constitutes a dynamic system within which global companies must now operate, posing both new risks but also opportunities.

Figure 1: The Global Operating Environment



SOCIAL RISK FOR GLOBAL COMPANIES

Companies that operate in the new global environment need to devise systematic means for dealing with the challenges it poses. In this section, we frame one of these challenges as "social risk," and suggest how it relates to overall risk management by companies. In the next section, we argue that corporate social responsibility programs are an effective means to provide strategic intelligence for managing social risks.

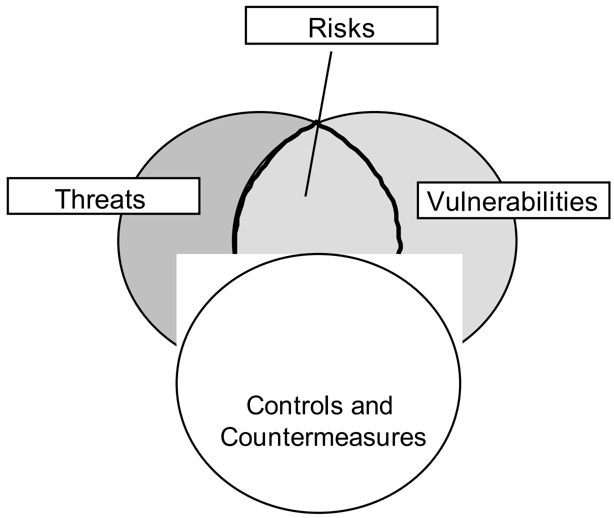
Understanding Risk Management

Risk can be most simply understood in the context of a company's:

- Threats;
- Vulnerabilities;
- Controls and countermeasures.

Figure 2 represents the conjunction of these factors.

Figure 2: Defining Risk



Risk arises when a vulnerability exists within an organization's operating system in the absence of effective controls and countermeasures (i.e., a lack of risk management).

To mitigate risk, companies develop risk management systems. Risk management systems fundamentally aim to address uncertainty in the market place. Their primary goal is to create controls and countermeasures that minimize or eliminate the disruption, loss or damage to business operations, and shorten the recovery time from an unwanted event and, thereby, reducing its impact on the business.

At a very high level of aggregation, the traditional risk management process is conceived as follows:

1. Establish a causal/correlative relationship between the presence of a factor (threat) or group of factors (threats) and a specific undesirable outcome (e.g., internet hacking and compromised network security, unwanted building entry and theft, limited suppliers and interrupted production).

   Threats can be either catastrophic (e.g., natural disaster or critical public infrastructure failures) or slow burn (e.g., climate change, water availability or a competitor's new product or service entering the marketplace).

2. Identify elements of the business or processes that are at risk of experiencing the undesirable outcome. The term 'vulnerability' is often used to describe this state. When a 'threat' meets a potential 'vulnerability,' the business element or process is deemed to be 'at risk'.

3. Take action to eliminate or reduce the identified risk factors, thereby reducing the presence of the associated undesirable outcome: e.g. installing firewalls, limiting access through card readers, or diversifying suppliers, etc.

<u>Understanding Traditional Risks</u>

Companies are very familiar with three broad types of risk – economic, technological and political. These risks are routinely modeled and managed by corporations.

Economic risks, the most familiar of all, primarily involve "the business of being in business." Economic risks concern maintaining profits, sustaining economic growth and protecting investments and shareholder value from market fluctuations – all typically the domain of the CFO.

As recently as the early 1990's, businesses grappled with how to fit technological risks into the strategic decision-making process. Technological risks include managing threats to automated systems, growth in new technology sectors that have radically changed production cycles, or related energy use and costs. The centrality of technological risks has risen as information technology has taken an increased role in driving corporate performance. Technological risk is a growing, integral part of the operating environment and CIO's have become a management mainstay.

Political risks are also a strategic concern for corporations, particularly those operating at the global level. Political risks include managing public perception of corporations internationally (e.g., American companies operating overseas in the midst of an unpopular war), regulatory relationships, shaping the overall legal environment, government relations and geo-politics. Typically, the CEO is responsible for managing political risk.

Some of the emerging risks companies face today show up on their radar screens through well-recognized entry points; the challenge of carbon emissions and climate change is a good example. The number of shareholder resolutions demanding climate change risk management policies from U.S. companies tripled between 2001 and 2002, and climate change-related lawsuits against companies have recently been filed for the first time.[6] Some insurance companies are beginning to demand information from companies for which they provide directors and officers' liability coverage on whether they have a carbon accounting or reporting system in place. Large institutional investors, especially public sector pension funds, are increasingly applying pressure as well. In short, while the particular issue of climate change may pose a new substantive risk for companies, they have institutional means in place for processing it as a combination of "economic" and "political" risks.

The same is not true, however, for emerging risks that are specifically associated with the new operating environment and networked operations of companies, which we call "social risks." They are neither well understood, nor do effective circuits exist within most companies for managing them. Such social risks are particularly pronounced in, but not limited to, the areas of human rights, labor standards and environmental standards and sustainability.

The Rise of Social Risk

Globalization entails a paradox: the more interdependent we become, the more we seem to require order and yet foment change. Interdependence (through complexity) brings greater efficiency and effectiveness – but with it comes greater vulnerability. As described above, corporations operating in the global economy are key players in a dynamic system. The higher the number of interactions, both implicit and explicit, that entities have with one another the more factors are introduced that influence the overall relationship. The dynamic system effectively has more levers and pressure points than existed in the past, many of them critical to smooth operations and playing a role in the optimization of the whole. Those pressure points on business, most notably those pressures by civil society and stakeholders more broadly, constitute *social risk*.

From a company's perspective, social risk occurs when an empowered stakeholder takes up a social issue area and applies pressure on a corporation (exploiting a vulnerability in the earnings drivers – e.g., reputation, corporate image), so that the company will change policies or approaches in the marketplace.

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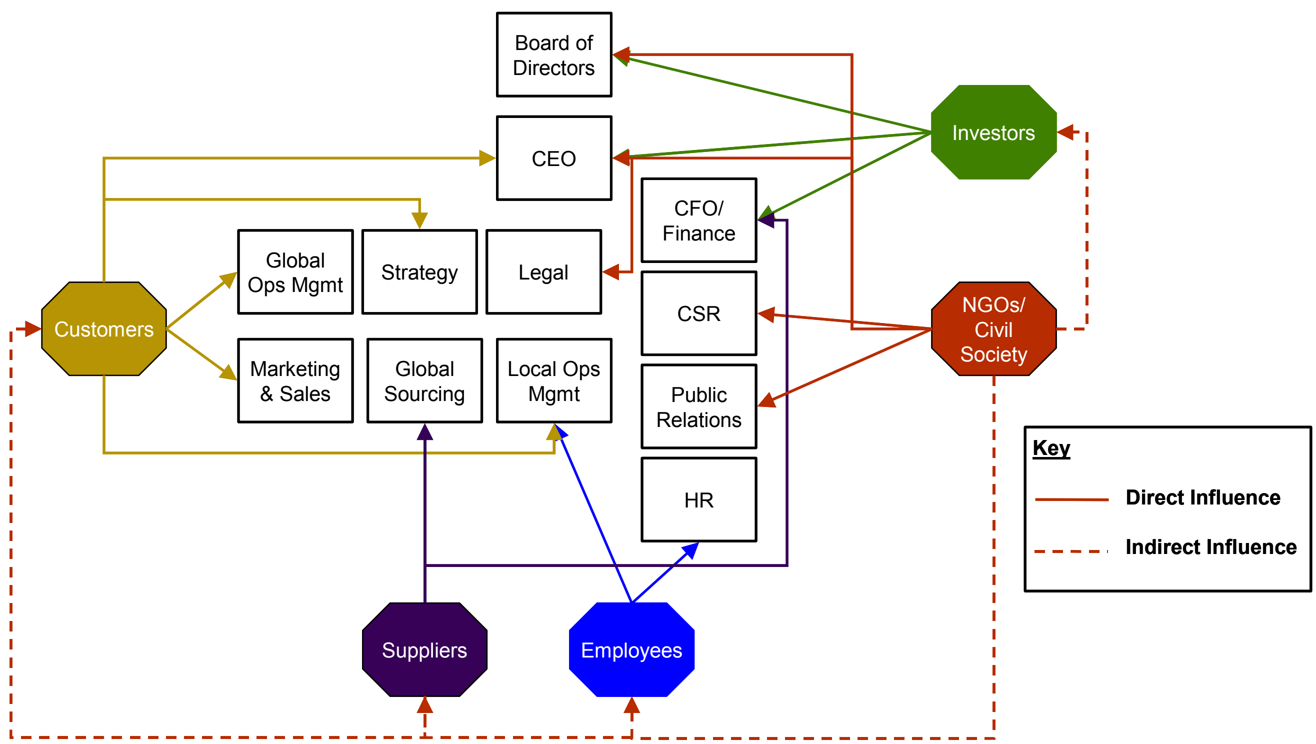
[6] Douglas G. Cogan, "Corporate Governance and Climate Change: Making the Connection," 2003. A CERES Sustainable Governance Project Report, prepared by the Investor Responsibility Research Center, p.11.

The emergence of a social risk can have wide-ranging impacts on various aspects of business (from global operations to sourcing to public relations). As Figure 3 illustrates, any number of stakeholders may transmit a social risk to various divisions in a company. Investors may create shareholder resolutions to change/evolve company policies. Customers may request changes in a company's environmental policies. Employees may raise concerns about outsourcing of jobs overseas. Suppliers may request coverage in a company's healthcare plan. While many of these feedback channels may be familiar to most large public companies, it is emergence of civil society scrutiny, and its resulting social risks, with which many companies are the least familiar and least equipped to manage.

Figure 3: Social Risk Entry Points



From a civil society perspective, a company may well deserve criticism for its social practices. Think of Shell in Nigeria, Nike in Indonesia, oil spills such as the Exxon Valdez, upscale apparel retailers purchasing from sweatshop suppliers, unsustainable forestry practices by the timber industry, or big pharmaceutical companies going into South African courts to keep imported generic AIDS treatment drugs out of that country, suffering one of the world's highest HIV prevalence rates. Even where companies break no local laws, they may stand in violation of their own self-proclaimed standards or be accused of breaching international community norms.

Ironically, a social risk may arise from what appears to be a sound business decision. For example, the quest for cheaper labor to drive down costs appears to make good business sense on the basis of competitive advantage. For many consumer products companies, cheaper labor is necessary for market survival; particularly as large retail giants like Wal-Mart continue to drive down prices and profit margins. However, the decision to employ workers in a developing country without full acknowledgement or adherence to international labor standards could cause a company to run afoul of labor rights watchdogs, resulting in unwanted public criticism of its value chain practices. They are running a risk—specifically a social risk by doing so.

But beyond being seen to be at fault, the global extended enterprise of large multinational corporations can also targeted for the sheer fact that it *does* have global reach and capacity, and that it is capable of making and implementing decisions at a pace that neither governments nor international agencies can match. Other social actors increasingly are looking for ways to leverage this platform in order to build broader social capacity – to help fill governance gaps and compensate for governance failures.[7] For example, AIDS activists picked Coca-Cola for special embarrassment at the 2002 Barcelona AIDS conference not because Coca-Cola has any intrinsic connection to HIV/AIDS, but because it has a prominent global brand and one of the largest distribution networks in Africa. Coca-Cola subsequently agreed to provide treatment not only to its own corporate employees, but also the staff of its independently owned African bottlers.

Hence, the concept of social risk is not necessarily centered on independent normative judgments of corporate right- and wrong-doing. Analytically, social risk is analogous to other risks that companies face, expressing a company's perception of an external factor (e.g., pressure by an NGO for the company's adherence to the Universal Declaration of Human Rights) and an undesirable outcome (e.g., negative impact on company reputation for refusing). In the presence of a social risk, companies have a large degree of discretion to establish appropriate responses based on a company's risk appetite.

The following risk equation summarizes a simplified version of the formulation of social risk, from the vantage point of a company.

Figure 4: Social Risk Equation

$$\textbf{Social Risk} = \left(\begin{array}{c}\textbf{Threat}\\ \text{(Stakeholder + Issue)}\end{array}\right) \times \left(\textbf{Vulnerability}\right)$$

**Note: As expressed previously, "threat" and "vulnerability" are terms of art in risk management lexicon, expressing the view of social risk from a company-centered perspective.*

At the global operating level, social risk transforms what companies had been dealing with through a designated budget line item (for example, community relations) into an area of considerable strategic importance. But insofar as social risk on the global level can affect cost, marketability, public and reputation perceptions, and even operations and supply, it needs to be pulled out of encapsulated corners of the companies and elevated to an area of strategic importance.

Moreover, as discussed earlier, stakeholders are more empowered than ever before on a global level and often unite forces around social issues. There is no global government accountable for the "good of all;" the rules of the game are more amorphous, amplifying the impact of social risk on corporations more used to dealing with set rules of engagement and operation.

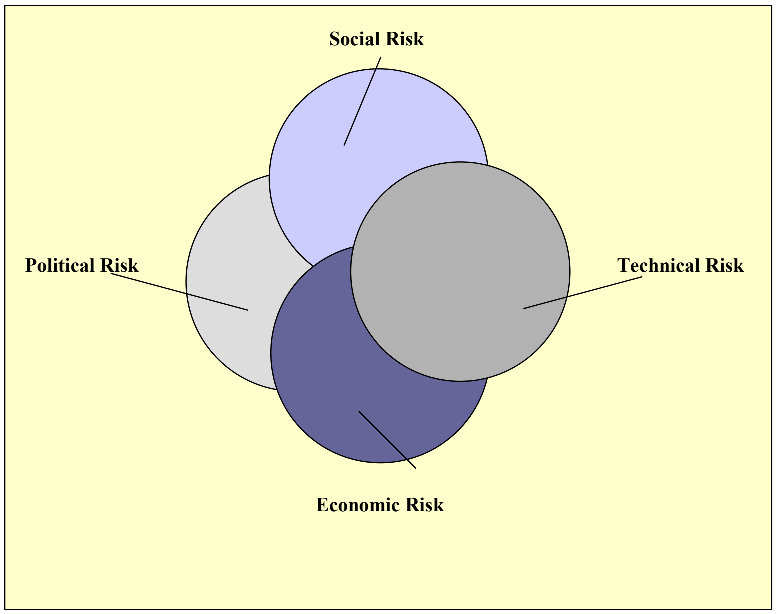
All of these factors suggest that each area of risk management – social, technological, economic and political (STEP) – is becoming of equivalent strategic value for the global extended enterprise and, therefore, must be mainstreamed into the entire organization's value proposition and strategic risk management paradigm. While technological, economic and political risks are mainstays of corporate risk management, social risk must now be treated with equal importance on risk agendas.

7 John Gerard Ruggie, "Taking Embedded Liberalism Global: The Corporate Connection," in David Held and Mathias Koenig-Archibugi, eds., Taming Globalization: Frontiers of Governance (Cambridge, UK: Polity Press, 2003).

Figure 5 summarizes this ‘STEP’ framework.[8]

The increasing complexity of international business also means that risks at the global level are much more likely to crosscut categories (e.g., a social risk may also have political or economic implications), so that they need to be addressed from multiple perspectives simultaneously.

Figure 5: The STEP Perspective on Risk



We now turn to the contribution of corporate social responsibility programs to managing the new risk equation.

CSR AND RISK MANAGEMENT

The Kennedy School of Government’s *CSR Initiative* has defined CSR to “encompass not only what companies do with their profits, but also how they make them. It goes beyond philanthropy and compliance to address the manner in which companies manage their economic, social, and environmental impacts and their stakeholder relationships in all their key spheres of influence: the workplace, the marketplace, the supply chain, the community and the public policy realm.”[9] Given the dynamic interactions of the global economy, adopting a CSR program is natural extension of going global analogous to other adjustments of “scaling up” (e.g., forming strategic alliances, finding skilled staff in foreign countries). CSR, particularly for a global company, is related to corporate risk management through two means: by providing intelligence about what those risks are, and by offering an effective means to respond to them. The key to both, as implied in the above definition, is more effectively “managing stakeholder relationships.”

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[8] STEP is a slight derivation of the commonly used PEST analysis.

[9] See http://www.ksg.harvard.edu/cbg/CSRI/home.htm.

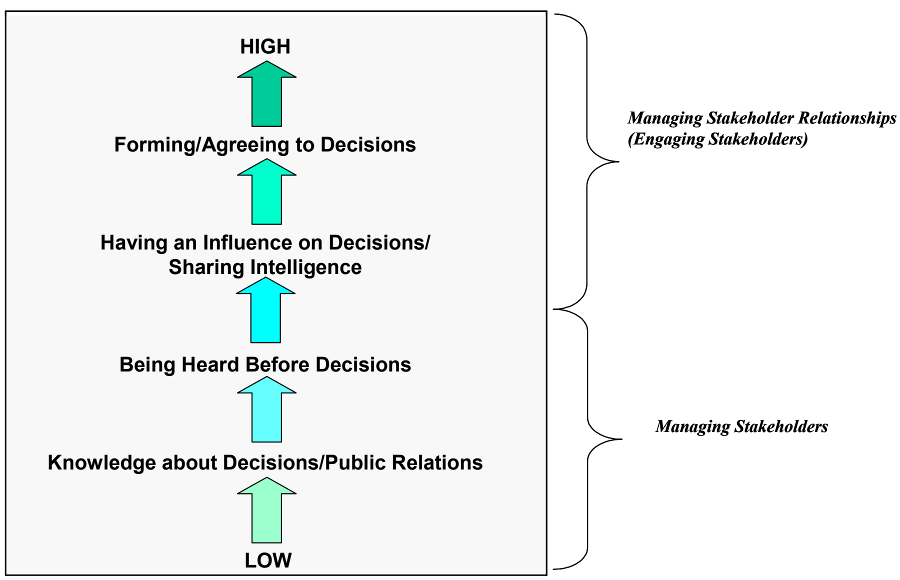
Managing stakeholder relationships is important for global companies because if they do not effectively manage those relationships, stakeholders will likely engage companies in the court of public opinion with little to no say so by companies.

CSR as Strategic Intelligence

The first step in any form of risk assessment is collecting adequate information about its substance and intensity. Stakeholder engagement through CSR programs provides an invaluable source of information about social risks. Managing stakeholder *relationships* differs from simply managing *stakeholders*. A stakeholder management mindset embodies a "mechanistic paradigm where the organization perceives itself as a closed system capable of autonomous action independent of the external context."[10] Its focus is the dissemination of information *to* stakeholders, through public relations or community relations, on decisions already made without completing the feedback loop. This way of managing stakeholders is ineffective in global operating environments given networked value chains and the empowerment of global stakeholders. Managing stakeholder relationships requires closing the loop; it means truly *engaging* stakeholders.

Figure 6 illustrates a sliding scale of managing stakeholders/relationships, as developed by the World Bank.[11] Managing stakeholders, represented by information dissemination to groups, is at the bottom of the scale; managing stakeholder relationships, represented by engagement strategies, is at the top.

Figure 6: Stakeholder Engagement Model



The term "engagement" captures the various mechanisms that have been used by organizations to listen to, and account for, the views of stakeholders, as well as involving them in the provision of solutions. One step above the dissemination of information to stakeholders, a company may begin to engage them before a decision has been made through (for example, joint workshops or task forces.) At the next level, stakeholders gain some influence on decision makers in addressing a particular social issue. At the highest

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10 Ann Svendsen and Myriam Laberge. "Co-Creative Power: Engaging Stakeholder Networks for Learning and Innovation," www.collectivewisdominitiative.org.

11 Based on RC Calow, BL Morris and AR Lawrence. 1999. *Stakeholder Analysis and Consultation*. The World Bank Group.

level, stakeholders are viewed as co-decision makers in forming an approach or solution. These strategies are examples of completing the feedback loop—both informing stakeholders and having them inform a company around a particular social issue.

For any one company, only few stakeholders may warrant reaching the highest levels of engagement, but managing stakeholder relationships is a key dimension of effective CSR programs for all global companies. Effectively managing stakeholder relationships focuses on issues, problems and opportunities that go far beyond one organization and involve the whole global system or network. Learning, sensing, and innovation are the hallmarks of such an approach. By integrating the business sensing, learning, and innovations gained from CSR programs, companies can better manage their risks and subsequently their economic, social and environmental impacts, in a manner that is roughly analogous to what they learn from their customers, a more well established form of business intelligence gathering.

For a global company, stakeholder groups can provide strategic intelligence regarding the company's risk environment around particular economic, social, political or environmental issues. Stakeholder engagement strategies essentially provide antennae through which to pick up signals of impending challenges and also possible responses. Over time, integrated information flows between stakeholders and companies can form the base of knowledge about social issues and the systemic nature of those problems. Among the key questions that can be answered by engaging with stakeholders on a particular social issue are these:

- What is the issue or problem?
- How complex is it?
- What is its scope?
- Who else has an interest in the problem?
- What is working and not working in the current approach?
- What would be accomplished by engaging others in the dialogue?

Many global companies have found that multi-stakeholder initiatives are a particularly cost-effective tool for generating strategic intelligence of this sort. Some are organized within individual sectors – be it forestry, apparel, or the chemical industry. Others are organized around such social issue areas as human rights. Even more comprehensive, the United Nations Global Compact, which has become by far the world's largest corporate citizenship initiative with more than 1,800 participating companies, involves companies, labor and civil society organizations in promoting ten UN principles in the areas of human rights, labor standards and environmental sustainability.[12]

But the information picked up by these antennae has to be fully internalized by companies. If it is merely encapsulated in a CSR program its impact will be limited; if it is linked to the organization's strategic risk management paradigm, then it can be of considerable help.

The assessment and management of social risks needs to be fully aligned with other, more familiar forms of risk management, as reflected in Figure 7. Primarily, elevating social risk to a level of equal strategic importance as technical, economic and political risk requires developing an analogous system for managing it or integrating it into the existing system. In order to integrate social risk management with other forms of strategic risk management, a comparable process for internal and external risk sensing, reporting and monitoring should be employed. Figure 7 conceptually illustrates how information generated by a CSR program can form a key aspect of the knowledge base for creating an effective countermeasure to social risk.

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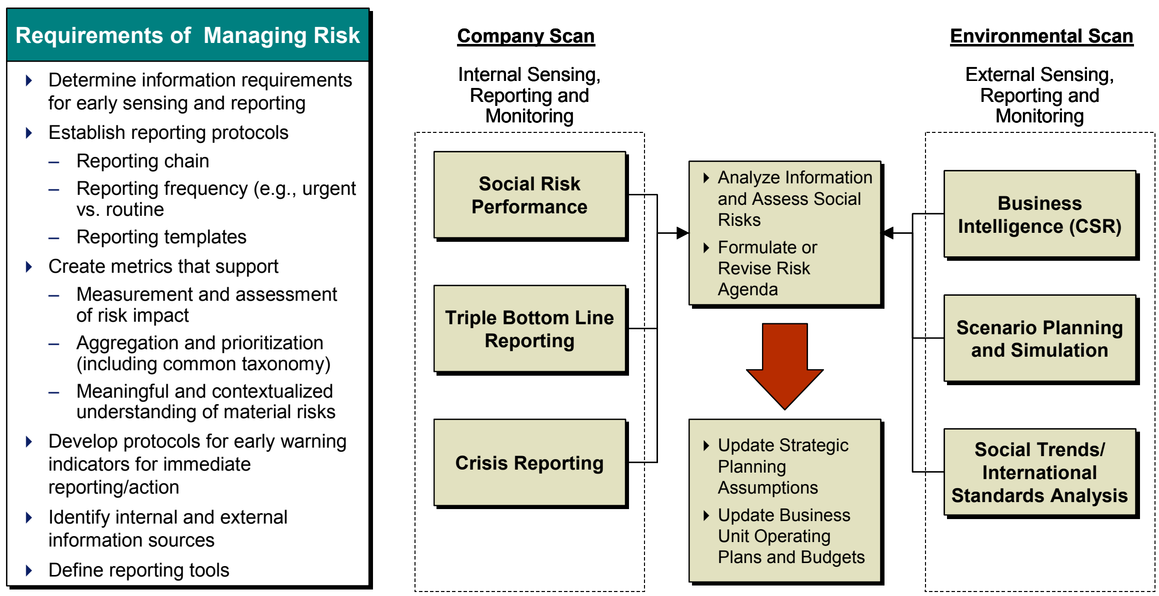
[12] See http://www.unglobalcompact.org

Figure 7: Social Risk Managed as Strategic Risk (Conceptual Picture)



A company's vulnerability and threat for any type of risk can be reduced through better internal and external sensing, reporting and monitoring. Gaining knowledge of social expectations from better connections with stakeholder groups, increased understanding of international standards/norms by which a company should abide, and smarter allocation of resources are all enabled through linking a CSR program to a risk management program. When these various dimensions are combined, social risks can be better managed.

At the same time, by partnering with other social actors, including civil society organizations, as many companies now do, companies can also work to improve the contextual conditions that pose emerging risks for them in the first place. Thus, a growing number of global and national companies now collaborate to build greater social capacity to respond to the HIV/AIDS crisis in heavily impacted countries.[13]

Issue Evolution

There is a real danger for companies in *not* partnering with social actors: simply because a social risk may initially be "picked up" by the CSR antennae, there is no guarantee that is where it will remain. A host of "social risks" have begun as issues that were primarily understood and addressed by CSR departments. However, as those social risks continued to gain attention with civil society, public policy and media outlets over time, senior managers were also forced to pay attention, as core business operation became impacted. Figure 8 outlines a sample evolution of a social risk from a primarily "CSR issue" to a material risk. The rise of obesity as a social risk in the U.S. and Europe is one case in point for this progression; the challenges faced by Nike as a result of conditions in its global supply chain is another example.

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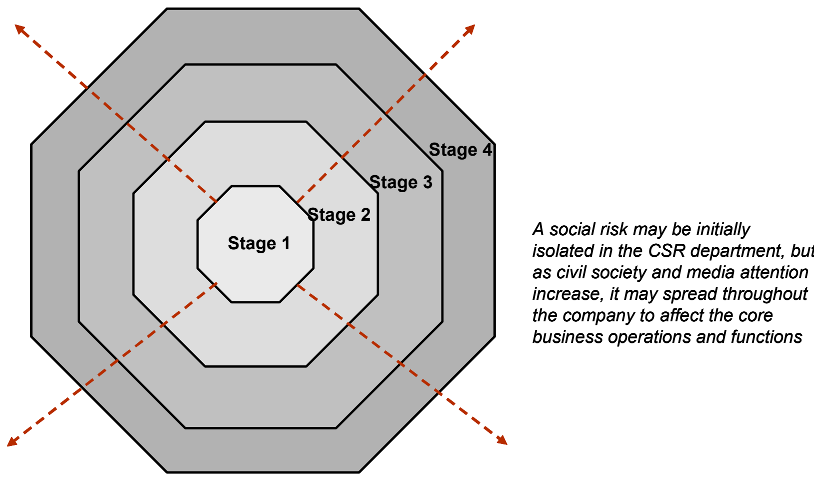
[13] For illustrative cases, consult the Global Business Coalition on HIV/AIDS at http://www.gbcaids.com, and the World Economic Forum's Global Health Initiative at www.weforum.org/site/homepublic.nsf/Content/Global+Health+Initiative.

Figure 8: Evolution of Social Risks



	Stage 1	Stage 2	Stage 3	Stage 4
Social Issue	‣ Social issue begins to gain attention with civil society (e.g., NGO or advocacy group picks up the issue) ‣ Media attention light	‣ Public policy community picks up issue and begins to publicize the issue/ effects ‣ Civil Society efforts increase ‣ Media attention medium to high	‣ Increase in public awareness of the issue ‣ Civil society pushes for changes ‣ Lawsuits may be filed ‣ Media attention high	‣ Public awareness high ‣ Civil society engaged ‣ Legal cases in progress ‣ Media attention high
Company Reactions	**CSR Department Responsible for social risk**	**Legal Department investigates; lobbying arm addresses issue; PR statements released**	**Risk managers evaluate issue; changes in business model explored (risk management); C-suite consulted**	**CEO decides if a risk is "material," changes in business operating policies occur (risk management)**

Obesity. Stakeholders (health and consumer advocates) have long targeted US and European food industries to be held accountable for playing a role in the expanding girth of citizens. Until recently, the issues related to obesity and the nutritional content of, in particular, processed foods were addressed primarily by CSR departments or savvy PR wings (Stage 1). PR departments spent much time diverting attention from any blame that could be laid at the door of the junk food manufacturers and fast food chains to the issues of personal responsibility and exercise.

However, as the issue has grown in magnitude (Stage 2) public policy experts, including the National Institute of Health in the U.S., have begun to discuss and publicize information on the significant health and mortality effects of the obesity epidemic. Even popular culture in the U.S. has picked up the issue, creating popular movies about the effects of eating fast food for one month. Food companies finally have had to respond (Stage 3).

Now, advocates in the U.S. are pushing for a "fat tax" for certain foods, seeking ways to restrict what foods are available to children in schools, and suing fast food companies for responsibility in the onset of some diseases. Businesses have now begun to investigate ways to improve their food products and offer healthier choices on their menus. In addition, other industries have begun to take interest in the obesity issue. According to the Washington Business Group on Health, companies lose $12 billion per year due to higher use of health care to treat obesity-related diseases, lower productivity and absenteeism.

In the summer of 2004, a slew of U.S. corporations (Ford Motor, General Mills and IBM included) formed the Institute on the Costs and Health Effects of Obesity to address the growing epidemic of obesity. The Institute plans a U.S.-wide weight-awareness campaign and a summit to share ideas to combat fat. Meanwhile companies have been exploring ways to improve the nutritional content of foods, and one of the largest food manufacturers in the U.S., Kraft, has agreed to slowly phase out the advertisement of junk food to children.

Laws in the UK are currently being developed that require companies to report these social issues (and any other environmental, corporate governance, ethical and/or reputation issues) as “materials risks” that could affect their financial performance in the future. Companies have effectively reached Stage 4 with the obesity social risk, and are now being having to make costly changes to their business models and products.

Nike. The case of Nike illustrates more specific dangers of not linking CSR and stakeholder intelligence to core business processes, but also how one company fixed this disconnect to create a win-win outcome.[14]

Nike is an example of one of the pioneer companies that initially struggled in linking a comprehensive CSR program (stakeholder engagement) with core business processes (risk management) as part of its overall approach to business performance. As Nike’s experience shows, not linking CSR and related stakeholder intelligence to core business processes can leave a company vulnerable, with no appropriate controls or countermeasures.

Nike’s business model is based on global outsourcing. In 1996, Nike found itself at the center of a fury after a New York Times column accused the company of profiting from “sweatshops” of “wretched origin” to create its athletic apparel. Soon Nike was at the center of an international controversy. International labor groups united and over 40 demonstrations occurred at Niketowns and universities across the United States. Nike reported that it was proactively addressing the issue of labor practices by seeking to make good working conditions a reality in its Asian factories. All contractors were required to sign a Memorandum of Understanding that, in general, committed them to comply with local laws regarding minimum wage, overtime, child labor, holidays and vacations, insurance benefits, and working conditions, and to maintain records documenting their compliance. To assure compliance, the company contracted accounting companies to conduct spot audits of labor and environmental conditions.

Despite their attempts to address these labor issues through contracting, “one-off” spot checks failed to build credibility with labor activists. As the protests continued, Nike realized that managing the labor issue minus strong stakeholder involvement would be insufficient. It not only needed better information on its actual labor practices, but it needed to consider the opinion of stakeholders on its practices, as well as ways to internalize the information collected. It needed better social risk management.

In 1996, Nike developed its first department for managing its supply chain partner’s compliance with labor standards. In 1998, Nike developed a CSR program *linked with its core business functions and planning* to address the labor issue and the associated stakeholders head on. This department became managed as any other aspect of the business and the data collected from it became operationalized so Nike could increase its overall business performance. In 1999-2000, under President and Chief Operating Officer, Tom Clarke's, leadership, CSR was integrated it into one of five its business performance objectives for the corporation.

As Nike made an explicit commitment to CSR, its approach to labor issues also changed. Through the Global Alliance for Workers and Communities, Nike interviewed some 9,000 young workers in their Indonesian suppliers about their needs. Nike’s CSR program also supported the launch of multilateral initiatives that focused on the development of compliance in labor standards (e.g., Fair Labor Association, Apparel Industry Partnership, SA 8000 Standards). In 2004, Nike convened international labor, development, human rights and environmental groups at its corporate headquarters.

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[14] Simon Zadek. “The Path to Corporate Responsibility” *Harvard Business Review,* Dec 1, 2004.

Nike's experience demonstrates the challenges of operating in a complex global environment and the ability of social risk to appear forcefully and gain great momentum quickly through large networks. It demonstrates the danger of addressing a social issue through isolated means (e.g., spot audits) and ignoring the larger context of stakeholder activism and the benefits of shared information. Further, Nike illustrates that CSR activities are not discretionary expenditures. CSR must be linked strategically to core business functions to reap the full benefits.

Nike's VP of Corporate Social Responsibility at the time has since acknowledged the strides in the company's risk management as a result of its labor crisis.[15] Nike's CSR approach is now organically linked with its corporate strategy and risk management, addressing both the core global issues and accounting for empowered stakeholders. Through fostering multilateral forums, Nike has also developed means to effectively engage stakeholders to share information, thereby learning and innovating in its labor practices. CSR is now fundamentally important to the viability of Nike, as seen in its explicit link to its business performance goals. Nike recognizes that is can only become a more profitable and sustainable company if it is corporately responsible.

CONCLUSION

Global companies face a new reality that has changed the nature of risk and risk management: networked operations and global value chains, empowered stakeholders, and the dynamic tension among sectors. The emergence of the new forms of social risk cannot be mitigated through traditional means. The new environment requires innovation by companies in both sensing and understanding these risks, and in adapting risk management systems to include new tools and network-based models of information sharing.

Risk management by global companies should be adapted to include corporate social responsibility programs. CSR provides the framework and principles for stakeholder engagement, supplies a wealth of intelligence on emerging and current social issues/groups to support the corporate risk agenda, and ultimately serves as a countermeasure for social risk. Granted, effectively integrating CSR into core business functions can be difficult, as the experience of Nike illustrates

Companies with global operations can only address social risks by balancing those risks against business decisions and determining the quality of engagement with stakeholders and their associated issues. Companies should begin the process by 1) identifying the empowered stakeholders and their key issues and 2) determining the highest level of engagement and information sharing necessary to address their concerns and reap the mutual benefits from improved accountability and better relations with stakeholders.

But understanding a stakeholder issue isn't the solution to anything in and of itself. It is a competitive necessity also to utilize the knowledge embedded in global networks. The linkage of CSR to core business processes can improve a company's overall approach to risk management by improving strategic intelligence and knowledge of social issues/groups. This allows a company to not only design better risk management for current issues but also help anticipate those coming down the pike.

[15] Email interview with Maria Eitel, President Nike Foundation (former VP of Corporate Responsibility). 1/11/2005.

Kennedy School of Government, Corporate Social Responsibility Initiative
The CSR Initiative at the Kennedy School of Government is a multi-disciplinary program that undertakes research, education and outreach activities, to study and enhance the public role of private enterprise and develop the next generation of leaders. It focuses on exploring the intersection between corporate responsibility, corporate governance and strategy, public policy, and the media. The CSR Initiative is a cooperative effort between the Kennedy School's Center for Business and Government, Center for Public Leadership, Hauser Center for Non-Profit Organizations, and Joan Shorenstein Center on the Press, Politics and Public Policy.

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Acknowledgements

Key contributors to this paper from Booz Allen include Chris Kelly, Mike Delurey and Joe Babiec and from the Kennedy School include Jane Nelson, Michael MacIntyre and Tamara Bekefi. This paper was made possible with support from the founding sponsors of the CSR Initiative, The Coca-Cola Company, ChevronTexaco, General Motors, and Walter H. Shorenstein, and Booz Allen's Community Relations Department.

Beth Kytle and John G. Ruggie, *Corporate Social Responsibility as Risk Management: A Model for Multinationals*, Corporate Social Responsibility Initiative, Kennedy School of Government, Working Paper # 4 – March 2005.

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