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Social purpose and value creation

The business returns of social impact

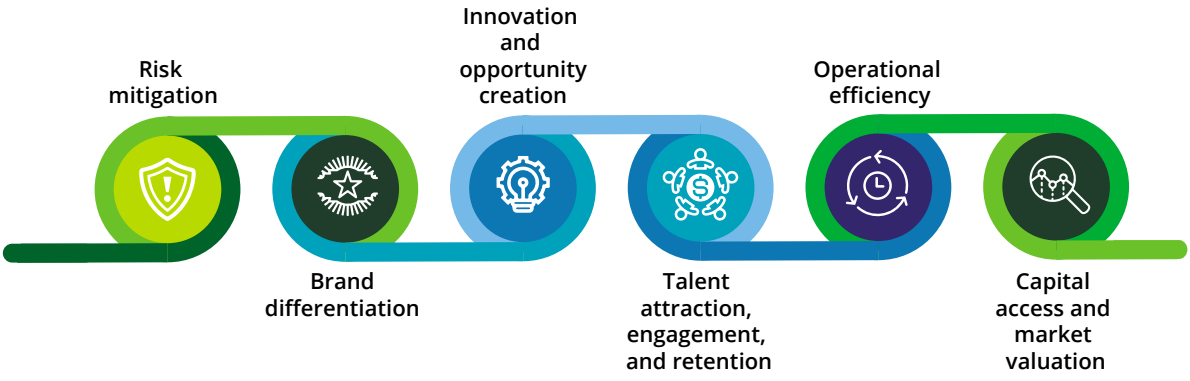
Do socially-beneficial investments—in environmental sustainability, ethical labor practices, empowerment of disadvantaged groups, health and welfare of communities, and the like— actually generate material business returns for companies? Few people would disagree that companies ought to behave in a socially responsible manner. But does it make sense for companies to go beyond the basic motions of being "good corporate citizens" because in the long run, it's just good business?

Companies today face unprecedented scrutiny from consumers, talent, communities, investors, and governments, as expectations rise and information spreads faster and wider than ever. Such pressures have called into question the traditionally narrow and short-term view of maximizing shareholder value. Company leaders increasingly recognize that the shift in stakeholder expectations, from both shareholders and non-shareholders alike, is changing the competitive landscape in significant ways and broadening both the dimensions and time horizon of shareholder value.

However, many leaders still struggle to find the business case for integrating socially and environmentally beneficial practices into core business strategy. **While most view "doing good" as a good thing, the unanswered question for many is: To what extent do these good deeds improve our business and financial performance?** This paper presents evidence, beyond rhetoric and sentiment, to help answer that question. What we found will support existing champions of corporate social strategy and—we hope—will challenge and help persuade skeptics.

In an extensive review of recent and longitudinal data, we found **six key drivers of corporate value creation** when companies integrate social strategy—business model and value chain relative to societal and environmental impact—into core business strategy. From the traditional and defensive to the catalytic and perhaps even counter-intuitive, these drivers are: **risk mitigation**; **brand differentiation**; **innovation and opportunity creation**; **talent attraction**, **engagement, and retention**; **operational efficiency**; and **capital access and market valuation**.

Six key drivers of value creation from corporate social performance



Key findings include:

- Mitigating regulatory risks and securing a social license to operate are long-standing motivators for companies to adopt a social strategy but are increasingly mere table stakes in today's competitive landscape.
- The majority of consumers say they will pay more for products from socially responsible companies—and consumers are increasingly following through on their convictions. Brands with a demonstrated commitment to sustainability are seeing average sales growth outperform brands without demonstrated commitment by fourfold.[1]
- Identifying underserved social and environmental needs are strong drivers of innovation, enabling companies to explore new models and technologies that generate new market opportunities.
- Companies with a strong social strategy tend to see higher employee engagement, and "high engagement" companies have been found to significantly

outperform "low engagement" companies in year-over-year changes in net income and stock earnings per share.[2]

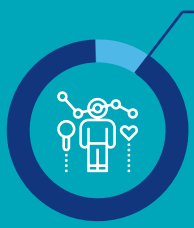
- Operational efficiencies from more sustainable practices can save companies up to 45 percent in costs, with an ever-growing list of major companies seeing annual savings in the hundreds of millions.[3]
- Capital markets tend to reward socially active firms, with companies added to the Domini 400 Social Index realizing a 2 percent gain in share price on average, while those removed from the list saw a 3 percent loss.[4]

While each value driver may vary in its level of relevance and significance for specific companies, depending on industry and market ecosystem, they collectively demonstrate the increasing importance of social impact when it comes to today's operating environment, particularly with consumers, talent, and investors.

Risk mitigation

Historically, corporate efforts around social responsibility and stakeholder engagement often arose to mitigate regulatory and social risks. This value remains and is perhaps more important now than ever, as increasing public demands can translate into higher levels of regulation, and greater availability of information often leads to magnified repercussions from noncompliance.

Risk mitigation serves primarily to protect corporate value and the license to operate. Recent research suggests that 30 percent of the value in any company is at risk from consumer backlash or regulatory pushback.[5] When Nike came under fire for overseas labor practices in the late 1990s, the company's turnaround effort to regain its brand standing took years and came at significant cost.[6] A similar incident today would likely translate into even greater value loss, as regulators and a growing number of third-party agencies set increasingly stringent social standards and consumers have ever more access to reporting. Global studies show that 81 percent of consumers now seek reviews or ratings prior to making a purchase, and 90 percent of consumers will switch brands to support a good cause and boycott a brand due to irresponsible business practices.[7,8]



90% of consumers will switch brands to support a good cause and boycott a brand due to irresponsible business practices.[7,8]

Effectively mitigating risks through a social strategy requires each company to diagnosis and understand its unique set of stakeholders and the demands in each of the markets it operates in or aspires to enter. As Indra Nooyi, Chairman and CEO of PepsiCo, notes, "Being a CEO is no longer [just] dealing with your employees, your customers, suppliers, your investors. It is dealing with governments, NGOs, with any interested party who decides to challenge your company.[9]

Brand differentiation

Beyond the identified value of mitigating risks, a strong social strategy can also enable companies to gain significant market advantage. The consumer landscape is undergoing dramatic shifts in purchasing preference, in the United States and abroad. Increasingly, consumers are putting their purchasing power behind their social values. A 2015 Nielsen survey found that 66 percent of consumers globally are willing to pay more for products and services that come from companies committed to positive social and environmental impact, up from 55 percent in 2014 and 50 percent in 2013.[10] While Nielsen found a gap between consumers' strong stated preferences and actual purchasing behavior, post-sales analysis of more than 1,300 brands confirmed that brands with a demonstrated commitment to sustainability saw average sales growth outperform that of brands without demonstrated commitment by fourfold, at 4 percent and 1 percent growth respectively.[11]

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The consumers who care most about social and environmental performance are also some of the most influential "taste makers." In a 2015 large-scale, US consumer survey, Deloitte found that although the number of consumers who included social impact attributes as a key decision driver in a recent purchase may still be the minority, these consumers are more likely to be Millennials, parents, or from high-income brackets—demographics representing significant purchasing power and that have disproportionate influence on overall consumer trends and preferences.[12]

Innovation and opportunity creation

Attention to social and environmental needs also enables companies to uncover or access new market opportunities. In an assessment of companies ranked by major business publications as sustainability leaders (using a broad definition of "sustainability," inclusive of social and environmental considerations) and those ranked as innovation leaders, Deloitte found a powerful causal relationship: Companies that are sustainability leaders are more than four times more likely to be recognized as innovation leaders in separate, independent rankings.[13] Various market examples also exist of how greater sustainability conscientiousness can lead to greater market innovations and competitiveness. One of the clearest examples is the rise of organic food. Whole Foods—from its origins as a natural food store to becoming the first national retailer certified organic by the USDA and remaining the largest organic and natural food retailer in the world—in large part both catalyzed and capitalized on the market opportunity for natural and organic foods.[14]

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Analysts point to Whole Foods substantially influencing other major food retailers' offerings in response to shifting consumer preferences.[15] The simultaneous growth in the demand and supply of organic products, both spurred on by Whole Foods, has helped US organic food sales triple over the past decade, increasing 11 percent in 2014 alone to become a $35.9 billion market.[16]

Similar patterns are appearing in other industries as well. In the auto industry, sales of electric vehicles, from both industry disruptors like Tesla and forward-looking titans like Nissan, grew 60 percent worldwide in 2015, compared to global sales growth of less than 3 percent for the industry as a whole during the same period.[17,18,19] Analysts forecast that, given the concurrent shifts in technology and consumer preferences, electric vehicles could grow from less than 1 percent of new car sales today to account for up to 35 percent of all new car sales globally by 2040.[20] Similarly in the energy sector, renewable energy is expected to see the largest growth in the sector over the next five years, reaching over 26 percent share of global power generation by 2020.[21] This growth is driven by consumer demand and government policy, as well as more cost-effective technologies, as exemplified by the 50 percent growth in global sales of solar panels in recent years.[22]

The value of brand differentiation and market access through a business strategy tied to social impact is most substantial for consumer-facing companies. Effectively translating social strategy and offerings into competitive advantage requires these companies to have a deep understanding of their key customer segments and to be highly attuned to these customers' respective brand biases and demand preferences. Companies should identify which issues have greatest salience for their customers as well as when to lead and when to follow on issues to effectively prioritize company initiatives and resources across the diverse elements of social impact. While this is no simple feat, a 2008 survey of 250 business leaders worldwide found that more than half of those with corporate social responsibility programs reported believing that such activities are giving them an advantage over their top competitors, and 68 percent have begun focusing on using social impact activities as a growth platform.[23] Today's market and consumer trends suggest that those 2008 figures would have only continued rising in the years since.

Talent attraction, engagement, and retention

Companies across the board can benefit from the value of a social strategy when it comes to talent. Substantial research shows that corporate social performance can have a significant impact on companies' ability to attract, engage, and retain talent.[24] In a survey of nearly 2,000 students and college-degreed workers across three generations, 45 percent of respondents said they would take a 15 percent pay cut for a job that makes a social or environmental impact and 51 percent said that a sense of social purpose is "essential" or "very important" for their ideal job.[25] Similarly, brand value research conducted with 17,000 individuals across 15 countries found an organization's level of environmental responsibility to be a powerful recruitment tool, with 80 percent of respondents preferring to work for a company that "has a good reputation for environmental responsibility."[26] Furthermore, the study found that employees were even more concerned about working for an environmentally responsible firm than purchasing goods or services from one.[27] As Vivienne Cox, former CEO of BP Alternative Energy noted, "The first reward [of sustainability] is the ability to attract the very best people. Until recently, many good graduates would not consider a career in the oil industry; now they will consider a career in an alternative energy business, even if it is inside an oil company."[28]

"High engagement" companies had higher 12-month change in net income (14 percent vs. -4 percent) and higher 12-month growth in earnings per share of company stock (28 percent vs. -11 percent) than "low-engagement" companies.[32]

In addition to talent attraction, a company's social programs can enhance employee retention and engagement. A number of studies have found that social and environmental impact programs contribute to companies experiencing better employee morale, engagement, and loyalty, helping reduce turnover by up to 50 percent and increasing overall productivity by up to 13 percent.[29,30] Such impact on employees can have dramatic implications for company financials, with the average real cost of losing an employee ranging from tens of thousands of dollars to one-and-a-half to two times the employee's annual salary.[31] Furthermore, research comparing companies with the highest and lowest employee engagement found "high engagement" companies had higher 12-month change in net income (14 percent vs. -4 percent) and higher 12-month growth in earnings per share of company stock (28 percent vs. -11 percent) than "low-engagement" companies, underscoring the impact of employee engagement on company performance.[32]

A common assumption is that Millennials make up the primary—or perhaps only—group to heavily consider a company's social impact when assessing their career choices and experience. The data, however, suggests otherwise. Studies have found that workers across generations prefer working for socially and environmentally responsible companies.[33,34] For example, the Center for Talent Innovation Research found that, for Gen X, 91 percent of women and 76 percent of men feel it is important to contribute to their community or the wider world through work. These figures are echoed in the 90 percent of Baby Boomer women and 79 percent of Baby Boomer men who reported the same.[35]

With social issues garnering ever greater attention at the local, national, and global levels, it is perhaps unsurprising that they also influence how people chose where to work and their motivation at work. As such, an integrated business strategy and social vision can help provide employees across generations with a greater sense of purpose at work, which then readily translates into better business performance through increased talent attraction, engagement, and retention.

Operational efficiency

Attention to social impact does more than help mitigate risk, strengthen brand positioning, open new market opportunities, and secure talent. It can also translate into more efficient and cost-effective operations. Supply chain initiatives aimed towards sustainability and ethical practices have been found to help boost productivity, decrease materials usage, and subsequently result in significant cost savings.[36,37] While the general sentiment is often that more sustainable practices come with a hefty price tag and operational burdens, a growing number of companies have the experience—and see the numbers—that more sustainable operations can in fact lead to meaningful efficiency gains and cost savings. In short, being cost conscious and environmentally friendly can be complementary rather than conflicting aims.

A multi-year study involving nearly 1,000 companies found that companies that encouraged their suppliers to reduce resource use saw up to a 45 percent reduction in operating costs.[36] A large-scale survey focused on the suppliers themselves found that suppliers across industries each saved on average $1.3 million per year when taking initiatives to reduce emissions and resource consumption, with cost savings increasing each successive year. Many case examples help illuminate the findings cited above. One is that of PepsiCo's sustainability programs, which produced more than $375 million in cost savings in the first four years of launch from improvements such as reductions in water consumption and waste generation.[38] Such savings subsequently helped the company achieve double-digit growth in operating profits over the same period.[39] Efforts to enhance the environmental impact of operations can also lead to other positive business outcomes beyond savings. Coca-Cola's introduction of PlantBottle technology, a fully recyclable plastic bottle made partially from plants, primarily aimed to achieve cost improvements and reduce long-term dependency on fossil fuels. However, this effort also served Coca-Cola by providing a strong marketing platform for Coca-Cola, attracting support from environmental organizations, and opening new business opportunities in licensing the technology.[40]

Capital access and market valuation

Despite the value drivers discussed above, many company leaders harbor uncertainty around how investors and financial markets will react to companies with a clear commitment to social impact. A common fear is that, in spite of the identified ethical value and benefits to society, the adoption of a social strategy gives companies reputational capital at best, but are ultimately rejected by investors and punished by financial markets. The data proves otherwise.

Companies with a strong social strategy are in fact seeing increased access to financing. While the budding field of impact investing initially focused on smaller companies and start-ups, even well-established companies are now targeted—or rejected—by the growing $1 trillion socially-responsible investing industry.[41] The cohort of socially responsible investors has itself grown to include institutional investors such as pension funds and endowments, as well as traditional funds such as JP Morgan Chase and Kohlberg Kravis Roberts (KKR).[42,43] KKR, with more than $98 billion in assets under management, has explicitly made environmental, social, and governance (ESG) considerations significant criteria in its investment decisions, with programs in place to partner with its portfolio companies to strengthen their ESG strategy.[44] KKR reasons that, "Companies that carefully manage environmental, social, and governance risks and opportunities today should be better situated in the future as diminishing resources, changing consumer demands, and increased regulation are expected to pose greater challenges and opportunities."[45] Thus, KKR calls its investments in socially responsible companies simply "smart business."[46]

Companies added to the Domini 400 Social Index saw a 2 percent gain in share price on average; those removed averaged a 3 percent loss. [48,49]

Not only are many companies with strong social strategies gaining preferential access to capital, they are also rewarded by the public markets. Empirical evidence show that publicly listed companies with corporate social responsibility programs see a boost in stock market value.[47] In a study of market reactions to companies' entry into and exit from the Domini 400 Social Index, companies added saw a 2 percent gain in share price on average, while companies removed saw a 3 percent loss.[48,49] Being added to the Dow Jones Sustainability Index likewise provides a lasting positive boost of around 4 percent in share value.[50] More broadly, a meta-analysis of 167 studies assessing the relationship between "Corporate Social Performance" and "Corporate Financial Performance" over a 35-year span showed a positive relationship between corporate social performance and corporate financial performance.[51]

Companies that engage in socially responsible practices also tend to experience less market volatility, perhaps due to the greater likelihood of loyal customers, engaged talent, and more cost-effective and resilient operations. A study of the share prices of more than 3,000 companies between 2004 and 2010 found that companies with corporate social responsibility programs had a 4 percent lower market beta (risk volatility).[52] Thus, companies that integrate social impact into their strategy and operations typically seeing greater access to capital, more favorable public market response, and decreased market volatility.

Conclusion

Companies today are subject to stakeholder expectations as never before. Governments view companies with both hope and wariness. Consumers demand social responsibility and transparency. Employees seek purpose and impact through work. Investors weigh social impact in tandem with financial performance. As stakeholders become ever more sophisticated in assessing corporate social performance and as information reaches near ubiquity, companies can no longer get away with a glossy annual corporate social responsibility report or a one-off day of service led by a small, siloed team.

As such, companies face the critical need—and have the immense opportunity—to compete in the marketplace with a business strategy that includes a coherent social strategy. Many company leaders have likely sensed this but have been stalled by uncertainties of the actual business implications of adopting an integrated social strategy. As discussed above, however, extensive research—global, large-scale, longitudinal, and cross-industry—substantiates the "sense" that doing good is also good for the business. Companies are now winning and losing in no small part based on their social strategy, with significant value to be gained across many dimensions. In highlighting key findings from years of global research, Nielsen notes that "social responsibility is a critical part of proactive reputation management. And companies with strong reputations outperform others when it comes to attracting top talent, investors, community partners, and most of all consumers."[53]

Though often cited as the leading critic of corporate social responsibility, Milton Friedman would perhaps agree that in the world today, a company's focus on shareholder value and profitability would be incomplete without social and environmental considerations. Profitability, competitiveness, and long-term business sustainability are now increasingly tied to—and even dependent upon—a company's ability to set and succeed against their corporate social strategy.

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Authors

Kurt Dassel
Managing Director
Deloitte Consulting LLP
kdassel@deloitte.com

Kurt is a is a Managing Director at Monitor Deloitte, a unit of Deloitte Consulting, where he specializes in economic development, competitiveness, and inclusive business with a primary focus on emerging market economies. Kurt has led development projects in numerous regions across Africa, the Middle East, and Asia, as well as in North America. These efforts have focused on economic development strategy, improving livelihoods, starting-up and upgrading development institutions, attracting private sector investment, fostering greater innovation, and aligning the implementation efforts of government, business, and NGOs. Many of the projects have focused on specific industries and sectors including agriculture, metals and mining, tourism, transportation and distribution, textiles, information technology, and biopharmaceuticals.

Xi Wang
Manager
Deloitte Consulting LLP
Xiwang5@deloitte.com

Xi is a Manager at Monitor Deloitte, a unit of Deloitte Consulting, where she focuses on growth and innovation strategy for companies and international organizations, market and economic development, and cross-sector partnerships. She has both advised and worked in-house with multinational corporations, governments, NGOs, and early stage start-ups. In addition to her corporate and public sector work in the US, Xi has lived and worked in countries across Africa, Asia, Europe, Latin America, and the Middle East.

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