CSR in Turbulent Times

Turbulent Times: CSR Now needed more than ever before
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I feel they've taken leave of their senses and I hope that in Europe we will not see politicians and parliamentarians replicating the sort of irresponsibility and political partisanship that we have seen in Washington. The American banking system is going to have to reinvent itself... It's going to be consolidated, it's going to operate in a different way, it's going to have to operate with more responsibility, less risk. [Peter Mandelson, EU Trade Commissioner]

Introduction

Turbulent times: financial storms in the US and UK will have implications for all of us. Main Street and Wall Street cannot be separated. If the captains of those financial companies, now in crisis or bankrupted, had acted more responsibly with a proper Corporate Social Responsibility strategy then their vessels would not have sunk nor would they be on the brink of foundering. Responsible business will be the new mantra. Indeed, we go further, and suggest that the demise of investment banks in their present form would be the best news possible for CSR!

What went wrong?

Lehman Brothers stated in its 2007 letter to its shareholders *[1]* that *'Strong corporate citizenship is a key element of our culture. We actively leverage our intellectual capital, network of global relationships, and financial strength to help address today's critical social issues.'* Regarding sustainability they stated *[2]* '*As a global corporate citizen, **Lehman Brothers** is committed to addressing the challenges of climate change and other environmental issues which affect our employees, clients, and shareholders alike. It is critical that we continue to develop initiatives to focus on these challenges facing our environment now and in the future.'* They had corporate responsibility too and noted in 2007 that:

We are also looking inward. In 2007, Charlotte Grezo, an expert in socially responsible business practices, joined the Firm as global head of Sustainability and president of the Council on Climate Change. In addition to overseeing the Council's activities, she will further the development of the Firm's own environmental policy and strategy. Charlotte, as many readers will know, was the former head of CSR at award winning **Vodafone** - but **Lehman'**s announcement showed that their focus was more on environmental concerns than strategic CSR which examines all key stakeholders.

In fact we at MHC International Ltd had suggested to **Lehman Brothers** early in 2007 to carry out a strategic CSR review and to examine *all* stakeholders. Our proposal was not accepted. A careful stakeholder analysis could well have discovered Lehman's problems in the sub-prime market and alerted top management. Yet, as Mallen Baker noted *[3]* *'Bear Stearns produced no CSR report of any sort. Lehman Brothers did not produce a CSR* *report, but they produced a philanthropy report. Even if they had gone further, it seems unlikely that the complex nature of how they created wealth would have been a feature'*.

Recap on what investment banks do.

They earn their money through a mixture of means: trading and broking stocks and shares including short selling and derivatives - providing advice on mergers and acquisitions, and IPOs, investing in private equity deals of one sort or another, and structuring deals such a securitisation and public-private partnerships. They have been responsible, in large measure, for the current financial crisis.

What have they been doing to achieve this? Their private equity investments have stripped companies of jobs, merged them with their competitors, and stacked them up with risky debt provided by eager bankers. The debt has been securitised in tranched revenue deals that ended up with pension funds holding toxic securities they do not understand, and then creating exotic securities with payment profiles that defy even the most complex modelling. When they have not been 'rationalising' companies, they have been pushing companies to accept external equity, or creating market solutions for problems that defy markets.

Carbon trading is an excellent example. CSR would suggest voluntary curbs by individual firms, backed up with strong regulatory control by responsible Governments. What is the investment bank solution? Carbon trading, of course: let the rich buy the right to pollute, and let the poor be obliged to pay transaction fees to investment banks to let it happen!

How could CSR help?

CSR is about companies sliding into the role previous occupied by Governments in taking responsibility for making the world a better place for *all* their stakeholders *[4]*. Ban Ki Moon, recently used his opening remarks at the General Assembly to question the reliance on free markets. *"We need a new understanding on business ethics and governance, with more compassion and less uncritical faith in the 'magic' of markets."* How right he was. The investment banks have been the wizards of market magic. If investment banks are to be truly socially responsible, they need to change what they do fundamentally.
What could investment banks do instead? Clearly, they need to be properly regulated. But more venture capital investment, infrastructure investment with guaranteed maximum rates of return, and more socially responsible investment - and less, much less, private equity, would be a start. The plain fact is that investment in socially responsible business is highly unlikely to exhibit the sorts of returns that the shareholders of investment banks seek, so a compact amongst the investment banks and the analysts will be needed. The new financial architecture, in which CSR could play a major role, will render such attitudes socially unacceptable to stakeholders and even subject to judicial review.

A code of practice amongst investment banks limiting the extent of their involvement in traditional private equity deals that slash jobs would be helpful here - for instance the UN Principles for Responsible Investment. Such a code could also limit the amount of debt injected into any one deal to prevent undue risk creeping back into the system as it did after the failure of the junk-bond market - never again, said the regulators at the end of the eighties - yet look what's happened now. A commitment not to use certain types of security altogether, such junk bonds, could follow on.

More than that, such a code could also be worked out in conjunction with the rating agencies so that there is far more disclosure of risks than hitherto. The rating agency models failed on sub-prime. But if voluntary disclosure by the investment banks were combined with similar constraints on retail bank lending, backed up by stronger regulation, the raw material for the structuring which has led the global economy, at least in the West, into such difficulties would be in shorter supply.

Something also needs to be done about securitisation, structured finance and tranching in general. For instance, a general guarantee by investment banks over all their structured products - effectively forcing them to act as their own insurers? They would charge for these services, of course, but it would prevent them from making money out of securities over which they have no future interest once issued, which has created a situation of moral hazard time and again.

CSR companies should have no truck with moral hazard so this alone as a yardstick of future investment bank behaviour would be useful. Investment bankers have long been able to avoid the responsibility of actual entrepreneurship, so tying their rewards more closely to their deals would be a step in the right direction.
Sadly, however, all this is very unlikely. With all the attention being focused on the demise of larger investment banks, what is being forgotten is the quiet rise of numerous boutique organizations specializing in M&A advice or one particular sector. Such smaller companies don't even need to cloak themselves in the veneer of respectability that the larger ones did, and will be able to continue the relentless pursuit of shareholder value for their often tiny shareholder base without the glare of public attention.

If Ban Ki Moon's vision is to be realized, then governments need to use corporate tax to deflect investment away from financial deals and towards socially responsible investments in such areas as alternative energy, food technology and low-cost housing. Of that, not a word from Congress, not a word from Wall Stree. At times like these, investment banks are not likely to turn to CSR consultancies such as MHCInternational for advice. It's ashame: if they had done when times were good, times would be a lot less bad now.

What to do next?

There are a number of steps as we noted in an article *[5]* written as far back as 2002!
First, CSR can help. A major stakeholder of a firm is its employees. CSR does not imply that downsizing should be prevented, that would be absurd. What it does imply (and see George Starcher's report to the ILO for more details on this *[6]*) is that companies must make an effort to organise layoffs in a socially responsible manner. This could include early warning, counselling, re-training, temporary financial assistance etc. The tendency of US companies to give immediate notice is both distressing and can be counterproductive once re-hiring starts again. There is no doubt that there is an unequal power between companies and employees. A company can recover; it has its own institutions such as

banks willing to keep it going through hard times. A redundant employee has none of these advantages and is in a very weak position once he or she leaves the confines of an institution.

Second, CSR urges transparency of operations through socially responsible reporting of activities such as informing shareholders and staff about off-balance sheet holding of debts. **Enron**, for instance, may well have been in much better shape today if it had behaved in a socially responsible manner. Even though **Enron** was a lavish donor, Simon Caulkin of **The Observer** (Feb 3rd, 2002) regarded this philanthropic form of CSR as a 'figleaf' and 'of a piece with **Enron's** overall strategy'. In fact, CSR is an overall strategy for systematic management of all of a company's stakeholders and is not confined to philanthropy.

Third, CSR has not been given as much prominence on Wall Street as it should simply because of the legal framework under which most corporations operate. Robert Hinkley argues *[7]* , for the USA, that the law, in its current form, actually inhibits executives and corporations from being socially responsible because the law baldly states that the purpose of the corporation is to make money for its shareholders. Any deviation from that could leave the corporation open to a lawsuit. So Hinkley suggests simply adding a phrase on CSR to corporate law so as to enhance CSR. Law, he advocates, would then read something like - Directors and officers have a duty to make money for shareholders, but not at the *expense of the environment, human rights, the public safety, the communities in which the corporation operates or the dignity of its employees*.

Fourth, CSR has a positive impact on the intangible assets of a company as we argued in a previous MHCInternational Monthly Feature on intellectual capital and CSR *[8]* . There we stated that a company's clear ideas on its identity and long-term goal, can help it to identify two sets of variables: one a 'value creating path' and the other a set of key success factors (KSF) and indicators that are appropriate as performance measurements. Such a process is very similar to developing CSR in a company which, in turn, will have a powerful effect on developing intellectual capital, a significant part of a company'sintangible assets.

Fifth, CSR has a long-term affect on improving a company's bottom line. There is apositive link between social and financial performance especially when looking at the increased relevance of intangible assets such as reputation and knowledge networks. These turn into a source of market value and competitive advantage. Sixth, social responsibility is not confined to corporations. Institutions that have a major impact on the way we live are also expected to behave in a socially responsible manner.
How, therefore, can we explain the continuing focus of the International Monetary Fund (IMF) on targeting inflation and *not* on creating incomes and employment? Nor has the IMF been very active in these turbulent times. As Joseph Stiglitz, the 2001 Nobel Prize winner for economics noted *[9]* *'...rather than providing needed liquidity to developing countries to enable them to pursue full employment policies, typically the IMF provides liquidity to countries only on the condition that they pursue contractionary policies'.*

Contraction in the developing countries or in countries in economic crisis, such was the case at the time for Argentina, leads to smaller markets for a corporation's goods and services.

In times of crises, business history can be a source of inspiration. Consider **Sony** founded *[10]* , 'among the ruins of a defeated and devastated 1945 Japan' in 'an abandoned telephone operator's room in the hollow remnants of a bombed and burned-out old department store..', by the entrepreneurial Masaru Ibuka. He certainly concentrated on his day to day business essentials, yet, he also took the time to formulate his core ideals for the company that led the company for the next forty years and which are today still part of the Sony Pioneer Spirit. His ideals were very much CSR as they embodied a focus on the individual within the company together with a mission that impacted positively and was ntended to continue to impact positively - on the wider society in which the company operated.

Crisis? Recession? CSR is a long range strategic tool that if used and accessed prudently, would give a hard pressed captain the guidelines and support that will help avoid, oweather, the sudden storms of crisis.

Refereences:

[1] http://www.lehman.com/annual/2007/letter/index4.htm, accessed 24 Sept 2008
[2] http://www.lehman.com/annual/2007/sustainability/
[3] Business Respect - CSR Dispatches No#137 - 29 Sep 2008
[4] A full treatise is given in Michael Hopkins *The Planetary Bargain: CSR Matters* (Earthscan, London, 2003)
[5] HTTP://WWW.MHCINTERNATIONAL.COM/CORPORATE-SOCIALRESPONSIBILITY/ PUBLICATIONS/CSR-IN-RECESSIONARY-TIMES.HTML
[6] See George Starcher's MHCInternational *MONTHLY FEATURE ON SOCIALLY RESPONSIBLE RESTRUCTURING*
[7] 'How Corporate Law Inhibits Social Responsibility', Robert Hinkley, *Business Ethics,* Jan. 2002
[8] NEW DIRECTIONS
[9] Joseph Stiglitz, "Employment, Social Justice, and Societal Well-being", Keynote speech to ILO Global Employment Forum, 1-3 Nov 2001 see *WWW.ILO.ORG*
[10] Collins & Porras, *Built to Last* (Random House, 2000), 'More than Profits..', p. 48