CSR and the Financial Crisis: Taking Stock

By Wayne Visser

The scale of the crisis

There is nothing small or trivial about this financial crisis. According to the Bank of England's recent Financial Stability Report, governments worldwide have already pledged more than $7 trillion in loans, guarantees, capital injections, and other assistance in their coordinated effort to prop up the global financial system. And the ILO estimates the crisis will cost 20 million jobs by next year.

This is not the first financial crisis the world has seen over the past century. The worst, of course, resulted in the Great Depression in the 1930s. But there have been numerous others, all of which carried painful economic and human costs. For example, the crises in Argentina (1981-1990), South Korea (1997-1999) and Thailand (1997-2000) all cost more than 30% of those countries' GDPs.

But even by historical standards, the 2008 crisis is BIG. In what's been dubbed "Wall Street's Red October", the S&P 500 plunged 16.9%, or 198 points, for the month. That's the worst-ever monthly point decline for the S&P 500. The Dow similarly dropped 14.1%, or 1,526 points. And the ILO estimates that the crisis will bring the total unemployed to more than 210 million for the first time in history.

The key difference is that, unlike the Asian and Latin American crises in the 1980s, this crisis is truly global. Some countries, like Iceland andPakistan, are threatened by bankruptcy. Others, like Japan, have been hit by huge volatility in the markets. And even the cash-rich, high-flyers like China are seeing their growth suffering as a result. But what does any of this have to do with corporate social responsibility (CSR)?

The links to CSR

Irresponsible banking

I'd like to suggest a multi-level approach to this. At the first and most obvious level, we can say the financial crisis is a direct result of irresponsible banking. According to the Mortgage Bankers Association, the number of sub-prime loans offered to risky borrowers increased more than 15 times since 1998. Essentially, the banks got greedy and compromised good banking practices of credit risk assessment.

Irresponsible financial markets

At another level, the crisis is the predictable consequence of irresponsible financial markets. Since the deregulation of the 1980s, the derivatives market has grown to around $600 trillion dollars, almost 10 times the value of global GDP. This speculative trading (which some call the "casino economy") is meant to hedge risk, but it also increases the volatility and systemic risk of financial markets.

We would do well to recall economist John Maynard Keynes' warning: "Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done."

Irresponsible corporations

Others argue that the crisis is the inevitable consequence of irresponsible corporations. This is linked to the short-termism of shareholder value driven public companies. At the extreme, authors like Joel Bakan suggest that corporations have "a legally defined mandate to relentlessly pursue—without exception—its own self-interest regardless of the often harmful consequences it might cause to others." This behaviour in humans, he notes, would be characterized as pathological.

Irresponsible executives

The financial crisis has been further inflamed, some claim, byirresponsible executives, as evidenced by their outrageous pay packages. In 2007, the CEO of a Standard & Poor's 500 company received, on average, $14.2 million in total compensation, according to The Corporate Library. United for a Fair Economy reports that, in 2006, CEOs received more than 364 times the pay of the average U.S. worker (up from 42 times in 1980).

More specifically, it seems the leaders of Wall Street's top banks are still in line to receive pay deals in 2008 worth more than $70bn, a substantial proportion of which is expected to be paid in discretionary bonuses. "Many critics of investment banks," reports The Guardian, "have questioned why firms continue to siphon off billions of dollars of bank earnings into bonus pools rather than using the funds to shore up the capital position of the crisis-stricken institutions."

Irresponsible capitalism

Some would even go so far as to say that the current financial crisis represents a systemic failure of shareholder-driven, free market capitalism. Among such critics is European Central Bank President Jean-Claude Trichet, who argues that the current financial crisis is partly a result of the demise of the original Bretton Woods' agreement, after deregulation since the 1970s.

Trichet's conclusion is unequivocal: "It's absolutely clear that financial markets need discipline: macroeconomic discipline, monetary discipline, market discipline." British Prime Minister Gordon Brown and French President Nicolas Sarkozy agree, stating that the turmoil has shown the world's post-Second World War financial architecture is not fit for the task of controlling today's global financial system.

The impacts on CSR

Irrespective of its causes, it is likely that the financial crisis will have a substantial impact on CSR. The question is, how will this impact play out? Who will win and who will lose? According to a poll run on the CSR International blog during October, 44% of CSR professionals believe that CSR will increase as a result of the crisis. A further 26% believe it will change, while 22% think it will weaken. This is a slightly surprising result and perhaps masks a more complex answer. In my opinion, the impact on CSR will vary depending on the type of CSR being practiced.
Philanthropic CSR will be worst hit

I have little doubt that those who have adopted an immature version of CSR, in which CSR is primarily about philanthropy (sponsorship, donations, charity and employee volunteering), will suffer substantial cut backs during the coming recession. Irrespective of the fact that those most in need of charity will be worst hit by the crisis, companies around the world will be forced into cost-cutting and philanthropy budgets will be among the first to be trimmed.

Strategic CSR will be less affected

It is likely that Michael Porter and Mark Kramer's concept of strategic CSR will pay dividends for its followers in the aftermath of the financial crisis. They argue that "the more closely tied a social issue is to a company's business, the greater the opportunity to leverage the firm's resources—and benefit society." Hence, companies that have aligned their philanthropic and broader CSR efforts with their core business are more likely to protect these initiatives, even during the recession.

For example, the commitment Coca-Cola has made to become a water neutral company is so closely tied to its core business (which is, after all, mostly about selling huge volumes of sugar water), that they cannot afford to abandon this as a superfluous CSR programme. They know that if they are not perceived to be responsibly managing the scarce water resources of the communities in which they operate, their business will ultimately fail (as they have already found to their detriment in India).

Embedded CSR will be largely unaffected

CSR can only be resilient if it is part of the DNA of an organisation. In other words, CSR will only survive the vagaries of fickle markets, fluctuating profits, financial crises and leadership whims if it is totally embedded in the corporate culture, strategy and governance systems. The impending recession will be the ultimate DNA-test for companies. A year from now, we will have a much better idea of who has driven CSR deep into the heart of their business and who has simply been wearing it as a mask.

One example may be the UK's Co-operative Bank. Although it will not emerge from the financial crisis completely unscathed, its deeply ingrained ethical approach to banking – introduced in 1992 – is unlikely to change and may even have contributed to its robustness over the past 12 months. As Jonathan Porritt, Chairman of the UK's Sustainable Development Commission says, "at the very least, the relative resilience of this business model should prompt both Treasury and the sector's regulators to think again about alternative ownership and governance structures in the financial services sector."

CSR 2.0 will continue to strengthen

For those companies that are alive to the opportunities of the CSR 2.0 revolution, even the recession will present large opportunities for business growth and financial profits. This is because CSR 2.0 is all about the creation of scalable solutions to the world's most urgent and intractable problems, such as water stress and climate change. Unlike the defensive, incremental, risk-based CSR of the past (CSR 1.0), CSR 2.0 rides the wave of emerging responsible and sustainable markets.

For example, the demand for renewable energy and low-carbon technologies now far exceeds the supply. And given the escalating costs of climate change, the high oil price and ambitious political targets (of up to an 80% reduction in greenhouse gas emissions by 2050), companies that have strategically positioned themselves as clean technology solutions providers will continue to benefit from this $284 billion market, which is expected to grow to over $1.3 trillion by 2017.

Conclusion

Hence, the answer to the question, "What is the relationship between the financial crisis and CSR?" is that it depends. It depends on your beliefs about how deep the irresponsibility behind the economic meltdown runs – is it banks simply overextending themselves, or a far more systemic failure in the corporate, financial and capitalist models?

Similarly, the answer to "How will CSR be affected by the financial crisis?" depends on how deep CSR runs within the organisation – is it superficial philanthropic CSR, something more strategic or embedded, or even the more revolutionary CSR 2.0 version? Either way, the recession ahead will not only be an acid test for companies' CSR commitment, but for CSR itself. It may very well be that the time has come for CSR to adapt or die.

Article reference

Visser, W. (2008) CSR and the Financial Crisis, *Wayne Visser Blog Briefing*, 4 November 2008.

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