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Beyond corporate social responsibility: Integrated external engagement

Companies must incorporate interaction with stakeholders into decision making at every level of the organization.

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Traditional corporate social responsibility (CSR) is failing to deliver, for both companies and society. Executives need a new approach to engaging the external environment. We believe that the best one is to integrate external engagement deeply into business decision making at every level of a company. In this article, we show how to make that kind of integrated external engagement (IEE) a reality. We set out to answer three questions. Are companies doing well at external engagement? Where might they be going wrong? How can they do better?

Are companies doing well at external engagement?

Properly understood, external engagement means the efforts a company makes to manage its relationship with the external world. This relationship can and should include a wide variety of activities: not just corporate philanthropy, community programs, and political lobbying, but also aspects of product design, recruiting policy, and project execution. In practice, however, most companies have relied on three tools for external engagement: a full-time CSR team in the head office, some high-profile (but relatively cheap) initiatives, and a glossy annual review of progress.

That traditional approach has had some positive effects. Companies certainly consider the external environment more carefully than they did in the past, and their philanthropic programs have helped many people. But in a majority of cases, CSR has failed to fulfill its core purpose—to build stronger relationships with the external world. The Occupy movement in the United States is the most visible sign of discontent, but polls show that levels of trust in business are below 55 percent in many countries. A significant minority views business executives as villains, enriching themselves at the expense of society. Even firms with the glossiest CSR reports have found themselves cast as public enemies. Take major Wall Street firms in the aftermath of the financial crisis or BP after the Gulf of Mexico spill: their relationships with the external world have been shattered, and they have lost billions of dollars of value as a result.

Many executives recognize that their current approach is inadequate. In a recent McKinsey survey of more than 3,500 executives around the world, less than 20 percent of the respondents reported having frequent success influencing government policy and the outcome of regulatory decisions.[1] This problem creates an opportunity for significant competitive advantage. In marketing or operations, companies struggle to raise their performance a few percentage points above that of their competitors. But as leading-edge companies such as Statoil and Unilever have discovered, effective external engagement can set you far above your rivals.

Where are companies going wrong?

Executives should not blame themselves alone. One reason they struggle is that the expectations of citizens and governments have never been higher. Companies are expected not only to obey the law or meet certain standards within their own businesses but also to ensure high standards across their supply chains. Large companies are expected to go further still, helping to solve major economic, environmental, and social problems—even those unrelated to their businesses. Moreover, as the expectations of citizens have increased, so has their power to scrutinize. Digital communication has enabled individuals and nongovernmental organizations (NGOs) to observe almost every activity of a business, to rally support against it, and to launch powerful global campaigns very quickly at almost zero cost. High expectations and scrutiny are here to stay. Successful companies must be equipped to deal with them.

What is wrong with CSR? Why have well-resourced teams, backed by the authority of CEOs, failed to deliver on their core purpose? In our experience, that centralized approach has four serious flaws.

First, head-office initiatives rarely gain the full support of the business and tend to break down in discussions over who pays and who gets the credit. Without the active participation of the big-spending functions—typically, production and marketing—the ambitions of a central team are difficult to realize.

Second, centralized CSR teams can easily lose touch with reality—they tend to take too narrow a view of the relevant external stakeholders. Managers on the ground have a much better understanding of the local context, who really matters, and what can be delivered.

Third, CSR focuses too closely on limiting the downside. Companies often see it only as an exercise in protecting their reputations—to get away with irresponsible behavior elsewhere. Effective external engagement is much more than that: it can attract new customers, motivate employees, and win over governments.

Finally, CSR programs tend to be short-lived. Because they are separate from the commercial activity of a company, they survive on the whim of senior executives rather than the value they deliver. These programs are therefore vulnerable when management changes or costs are cut.

Michael Porter and Mark Kramer summarize the result: "a hodgepodge of uncoordinated CSR and philanthropic activities disconnected from the company's strategy that neither make any meaningful social impact nor strengthen the firm's long-term competitiveness."[2]

How can companies engage more profitably?

In response to this problem, a number of observers have proposed new intellectual frameworks to analyze how businesses manage their relationships with the external world. Almost all of these frameworks, including Porter and Kramer's "shared value"[3] and Ian Davis's "social contract,"[4] share a core idea: companies must deeply integrate external engagement into their strategy and operations.

The logic is simple and compelling. The success of a business depends on its relationships with the external world—regulators, potential customers and staff, activists, and legislators. Decisions made at all levels of the business, from the boardroom to the shop floor, affect that relationship. For the business to be successful, decision making in every division and at every level must take account of those effects. External engagement cannot be separated from everyday business; it must be part and parcel of everyday business.

In our experience, most executives share that objective, but many do not know how to achieve it. What can you do to integrate external considerations into decision making across a business? To build on our own experience at BP and McKinsey, we spoke to seven leaders who excel in this area. We conclude that you need to do four things: define what you contribute, know your stakeholders, apply world-class management, and engage radically. We discuss each element in turn.

Define what you contribute

"We are finding out quite rapidly that to be successful long term we have to ask: what do we actually give to society to make it better? We've made it clear to the organization that it's our business model, starting from the top." —Paul Polman, CEO of Unilever

Every company makes a significant contribution to society. At the most basic level, businesses offer goods and services people want. In the process, they provide capital, jobs, skills, ideas, and taxes. But many companies don't emphasize that contribution. Internally, they focus on what they can get *from* society: cheaper inputs, higher prices, and kinder regulation. Externally, they promote their tiny CSR-related contributions—vaccines they've donated, say, or playgrounds they've built—ignoring the vast contribution made by the day-to-day business.

This focus creates two serious problems. Externally, it undermines credibility. If your company exists to extract value from society and tacks on a few CSR initiatives to "give back," no one will believe a word you say. Citizens, NGOs, and regulators will tend to view your efforts to engage—even genuine ones—as cynical and selfish maneuvers. In that climate, cooperation is very difficult. Internally, the same mind-set hinders the integration of external engagement into daily activities. The goal, as BHP Billiton's outgoing CEO Marius Kloppers describes it, is for "every single employee, contractor, and supplier to take responsibility for social issues." That is very difficult to achieve if these parties behave as if their relationship with the external world was essentially extractive.

Companies that succeed in building a profitable relationship with the external world tend to think very differently: they define themselves through what they contribute. This approach does not mean changing purpose; it means being explicit about how fulfilling that purpose benefits society. Nor does it mean abandoning a focus on shareholder value; it means recognizing that you generate long-term value for shareholders only by delivering value to society as well.

That point may seem to be an intellectual or linguistic distraction, but a CEO's vision for a company has a powerful practical impact. Take Paul Polman, whose bold strategy we quoted above. His approach has been formalized in the Unilever Sustainable Living Plan (USLP), which sets a clear goal: to double the company's sales while reducing its environmental impact. The plan explains why that goal makes business sense, what targets the company must hit en route, and how it will do so. Every employee can understand what the company wants and how he or she fits into that goal. Like other companies following similar strategies—AstraZeneca, GE, and PepsiCo, for example—Unilever hasn't got there yet. But with the USLP, Polman has laid the foundation for external credibility and internal transformation.

Redefining the way a company thinks about itself requires leaders to promote their vision again and again with unremitting energy, both internally and externally. Duke Energy's Keith Trent emphasizes this point: "Whether it's the CEO or his or her senior leaders, the biggest job is creating that vision for the company." That involves a significant personal risk because you have to take on incumbents who benefit from the status quo. All of the leaders we spoke to had met with resistance from other executives, shareholders, and competitors. Daniel Vasella, the former chairman of Novartis, puts it well: "When people believe change will only cost them, you can be sure they will do everything to make change fail or not even start." Leadership requires you to put your reputation on the line and to bring people with you. Make it clear that they can choose to engage with the world—or they can leave.

Know your stakeholders

"Companies often focus on speaking about our needs and our business, trying to persuade people about the soundness of our activities. We would be more effective if we understood stakeholder dialogue as an exercise to listen and understand." —Helge Lund, CEO of Statoil

Our second maxim of integrated external engagement is to know your stakeholders. That idea may sound obvious, but many executives do not take it seriously. Knowing your stakeholders means more than writing down a list of risks they could pose, having a cup of tea with some NGO heads, and holding a few focus groups. It means understanding your stakeholders as rigorously as you understand your consumers.

The McKinsey survey found a strong correlation between the in-depth profiling of stakeholders and success at engaging with them. Sixty-seven percent of respondents from successful companies report that they are very effective at understanding the priorities and objectives of the stakeholders, versus 28 percent of respondents from less successful companies.

Effective marketing relies on a detailed knowledge of the preferences and resources of consumers. Likewise, effective external engagement relies on a detailed knowledge of the preferences and resources of stakeholders. That means learning, on an individual and institutional level, what they want, when they want it, how much they are prepared to compromise, how your activities affect their goals, and what resources and influence they can bring to bear. Companies can gain such a detailed understanding only through a rigorous and exhaustive process, including personal conversations with stakeholders, expert analysis (from external sources where necessary), and specialist monitoring of the Internet and social media. Research may sometimes take place at the corporate level—to develop an overview of strategic social issues—but more often at the level of a single facility, market, or project. As we discuss later, line managers must have the skills, incentives, and resources to conduct that research.

Sometimes it takes more innovative methods to acquire the necessary knowledge. In 2002, BP began developing the vast Tangguh gas field, in West Papua, Indonesia. The area was rife with social issues: political separatism, land disputes, human-rights abuses, and environmental degradation. Construction required the relocation of one village to two new resettlement sites. An independent advisory panel was established to hear community concerns, encourage debate, examine BP's activities, and report its findings publicly and fully—all without influence from BP. That gave the panel's reports credibility and gave the company's leadership a far greater understanding of the issues than would have been possible if the research had been left to executives caught up in the project's technical challenges. BP's approach may seem expensive and even dangerous, but it is essential, and far cheaper than misunderstanding social issues, making mistakes, and being driven out by local resistance, government decree, or international pressure. To act in ignorance is to take a huge risk.

Thorough stakeholder research not only summarizes issues and interests as they stand today but also identifies potential problems and opportunities before they arise. That allows a company to act before its competitors do. Paul Polman describes how a lack of foresight hurt Unilever: "We missed the issue of obesity and the value of healthy and nutritional food. We were behind, while Nestlé was riding that wave. Not being in tune with society, with the benefit of hindsight, can cost you dearly." The closer your relationship with stakeholders, and the greater your expertise, the more likely you are to spot the trends that seem so obvious in hindsight.

Apply world-class management

"There are the guys and girls sitting at the top who are wrestling to ensure that in the long term they do the right thing. Then there are the people who are asked to deliver. The question is how do they react and behave?" —Martin Sorrell, CEO of WPP

Companies that succeed at integrating external engagement into their businesses see it as a critical contributor to profitability, not as some woolly qualitative activity. They manage it like any other business function, using the three core tools of great management: creating capabilities, establishing processes, and measuring outcomes.

Creating capabilities

Employees need the right skills to include external considerations in their decision making. That starts at the top, as Statoil's Helge Lund explains: "We have to have 360-degree leaders. They have to be good businesspeople who can develop talent and build business relationships, but they also have to genuinely understand the requirements and the expectations of external society." CEOs are responsible for ensuring that their senior teams are as capable at external engagement as at internal management and that the necessary skills are valued, promoted, and developed throughout the organization.

Companies can develop their external-engagement skills through a mixture of on-the-job experience and formal training for employees. In many cases, particularly at senior levels, these skills are best developed in several areas of the business—experience in marketing, for example, equips executives to analyze and communicate with stakeholders, experience in operations to deliver change on the ground. Formal training is a useful supplement, particularly for more specialized skills, such as negotiation. For example, BP held master classes with leaders such as Madeleine Albright and Henry Kissinger, people who really know how to align diverse interests effectively. At the lower levels of the company, training helps every employee and contractor to understand the importance of relationships with the external world and to know the company's policy on social issues.

Establishing processes

Putting capabilities in place is not enough; companies must formally incorporate external engagement into business processes at all levels. Every process—whether it helps a company to set corporate strategy, design products, or plan projects—must include efforts to consider its impact on stakeholders and consequences for the business. Helge Lund describes this approach at Statoil: "Stakeholder interests, dialogues, risks, and opportunities are deeply integrated in every business decision that we take. Every single project or investment decision comes with reflections, risk maps, and mitigation actions around the particular topic that we're discussing."

When companies develop processes, clarity is essential: conflicting policies, standards, guidelines, and initiatives can be counterproductive, creating overload and confusion. BHP Billiton has worked hard to avoid all this by replacing its old forms of guidance with what Marius Kloppers describes as "a series of group-level documents that clearly articulate the minimum standards that must be in place at all company assets, to ensure that all managers and employees fully understand the company's corporate expectations."

The risk in practice is that business lines will treat external engagement as an afterthought and a hoop to jump through to satisfy the head office. Each recommendation in this article—setting the vision, creating capabilities, and measuring outcomes—reduces that risk, but ultimately it is a risk that executives must take. Only business lines have the resources, the influence, and the knowledge to transform a company's relationship with the external world.

It is worth cautioning against a common error. Some companies publicize their internal processes, holding them up as evidence for their responsibility and expecting praise in return. Those details should remain behind the curtain: stakeholders generally care about results and results alone.

Measuring outcomes

Results should also be the only thing executives care about. In external engagement, perhaps more than in any other business function, it is easy to be diverted from a focus on outcomes to a focus on processes or, even worse, an ill-defined sense of "doing good." To retain a focus on outcomes, companies must set targets, measure progress against them, and link incentives to their achievement. The saying "what gets measured gets treasured" is as true for external engagement as for any other area of business. Ideally, companies should measure outcomes in terms of value added to the business, a challenging standard—less than 20 percent of respondents to the McKinsey survey reported that their companies measure the financial impact of external-affairs activities. The difficulty arises because their financial benefits are often indirect and far in the future or can be quantified only against an unobserved counterfactual.

In practice, businesses can observe various proxies, of varying degrees of accuracy, for the value external engagement adds. The closest proxy is satisfaction among stakeholders, weighted according to their importance to your business. Independent panels, such as BP's in Tangguh, are a good way to get a fair appraisal, and standard polling may be useful in some circumstances. When it is not possible to measure stakeholder satisfaction, a company can look at specific impacts on society and the environment. Unilever's Sustainable Living Plan, for example, sets about 60 targets for seven metrics, including total water consumption and greenhouse-gas emissions. In some cases, such as political engagement, companies cannot track the satisfaction of stakeholders or the impact on society. The only possibility is to measure activities (such as the number of meetings with politicians), though companies must take great care to ensure that these activities are not undertaken for their own sake. In general, the issue in question will determine which measures are possible and appropriate.

Engage radically

"I have an aversion against missionaries. I don't like to go out as a

missionary and preach, and then be accused of preaching for my own parish. This is a negotiation, and it can be a very tough one." —Daniel Vasella, Former chairman of Novartis

The final hallmark of integrated external engagement is a radical approach to communication with the external world. In our experience, and the experience of the executives we spoke to, companies must guard against three pervasive errors.

First, a lot of companies start engagement too late. The natural temptation for many busy and cost-conscious executives is to delay acting until something hits them. That can be fatal. Integrated external engagement requires you to sit down with stakeholders early and often. The discussion should be ongoing, constantly building goodwill, understanding, and connections, so that companies stay informed and establish a reserve of trust to draw down in times of crisis. As Helge Lund puts it: "Gaining stakeholder trust is not something that you achieve once and for all. You can lose it very quickly. We have to be continuously working on this subject, even when we do not necessarily have big issues to deal with. It has to be developed as part of the DNA of the company." The McKinsey survey found that 65 percent of executives think they should proactively engage with governments but that only 38 percent actually do so. As for regulatory bodies, 63 percent of executives acknowledge the need to engage with them but only 33 percent follow through.

The second error, alluded to by Daniel Vasella above, is to treat stakeholder engagement as a propaganda exercise. Repeatedly saying how responsibly your company behaves is not credible and achieves very little. Rather, engagement should be understood as a negotiation with intelligent and often powerful operators. As in any negotiation, your bargaining position determines your strategy and style. That's why it is so important to know your stakeholders and their payoffs and resources in advance. Negotiating with them is an ongoing game, and establishing trust is therefore important. You may be able to fool a regulator or an NGO once, but that is liable to backfire the next time you interact. In most cases, if you are prepared to change your business in a significant way, you can achieve mutually advantageous outcomes and thus real collaboration.

That does not mean the aim is to please everyone—the third common error. Sometimes, a mutually advantageous solution is impossible, collaboration will not yield your best outcome, and a stronger negotiating strategy is to attack. For example, in a dispute with a regulator, if the law is on your side, there may be no point in seeking compromise. If activists make ridiculous demands that will win no sympathy with the broader society, it may be best to show them the door. As Iglo Group's former CEO Martin Glenn puts it: "You don't have to manage all of your stakeholders equally. Some people who think they are stakeholders might not be. You have to decide whether Stakeholder X is truly critical to the long-term health of your business or not."

Selective cooperation applies not only to stakeholders but also to competitors. When it would be ineffective or too costly to act alone in addressing an issue, cooperation with them may be in the best interests of all players. For example, an industry may sometimes seek intelligent regulation to shut out free riders that undermine its reputation. But in certain cases, the first-mover advantage is considerable, and it is best to act alone. As Martin Glenn told us, "For big initiatives which we want to own, we'll take a risk, and then we will seek advantage from that."

From CSR to IEE

A good relationship with NGOs, citizens, and governments is not some vague objective that's nice to achieve if possible. It is a key determinant of competitiveness, and companies need to start treating it as one. That does not mean they have to initiate philosophical inquiries into social responsibility and business ethics. But it does require them to recognize that traditional CSR fails the challenge by separating external engagement from everyday business. It also requires them to integrate external engagement deeply into every part of the business by defining what they contribute to society, knowing their stakeholders, engaging radically with them, and applying world-class management. In other words, it requires the same discipline that companies around the world apply to procurement, recruitment, strategy, and every other area of business. Those that have acted already are now reaping the rewards.

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Notes

1 "Engaging and understanding governments: McKinsey Global Survey results" (PDF–561 KB), mckinseyquarterly.com, January 2012.

2 Michael Porter and Mark Kramer, "Strategy and society: The link between competitive advantage and corporate social responsibility," *Harvard Business Review*, December 2006, Volume 84, Number 12, pp. 78–92.

3 Michael Porter and Mark Kramer, "Creating shared value," *Harvard Business Review*, January–February 2011, Volume 89, Number 1–2, pp. 62–77.

4 Ian Davis, "The biggest contract," *Economist*, May 26, 2005.