

# Accountability of sustainability

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## Abstract

*This paper provides a detailed examination of how corporate branding creates value, and more specifically, identifies the role of sustainability in building market capital. Two valuable keys to getting the budgets necessary for a successful corporate social responsibility (CSR) programme are being able to speak the CFO's language, and understanding that the CEO's role is to build corporate value. This is an objective approach to CSR measurement and investment in the corporate brand, which affects everything from recruitment to cash flow, and to market capitalisation. The best way to get senior management to invest is to connect measurable CSR successes with a corporate brand.*

## Keywords

*sustainable, sustainability, CSR, intangible assets, brand value, brand valuation*

## CORPORATE SOCIAL RESPONSIBILITY

The presentation to your CEO went exceptionally well. You conclude with 'corporate social responsibility is simply good business, so we need you to approve our budget'. The CEO replies, 'Prove it to me. Prove that it is good business. Tell me how this benefits cash flow for the organisation. Tell me how it benefits shareholder value.' Silence fills the room, as you see your budget disappear.

Common sense says that having a good reputation in the marketplace is a nice thing. But, does it really have an impact on business results? Furthermore, if the CEO is focused on cash flow and shareholder value, is it possible to connect corporate social responsibility (CSR) to financial performance?

How can one measure CSR performance to provide the same kind of accountability that virtually every other

department in the organisation does? How can it be tied back in to cash flow, or into shareholder return?

Answering these questions requires an in-depth self-evaluation and answers to many more questions. What CSR activities will have the most impact on a business? Is enough being done? How can CSR activities be evaluated? Are we even breaking through to reach our CSR goals? Or, are we wasting our time as far as CSR is concerned? Are actions getting the credit that they deserve? How strong a CSR profile is strong enough? Are promises being made that cannot be achieved, which are going to hurt us in the long run? Is the company doing things that might cause problems for its ability to do business in the future? Is the company involved in inappropriate CSR activities that are outside its expertise and therefore not believable? CSR is not just

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about doing the right thing, because it ties into so many other business issues.

Accountable sustainability is seen as a kind of continuum. When we think about CSR, it is important to understand where we stand. We want to engage the company's constituencies about things that are important to them. What do these core constituencies care about relative to socially responsible activities? How do we develop programmes internally, and externally with our value chain partners in order to evaluate performance in a meaningful and relevant way? And, how can CSR be integrated into everyday business? How does it become part of the company's DNA, part of the things that we do every day?

### KEY DIMENSIONS OF SUSTAINABILITY

When thinking about CSR, there are several key dimensions that are the most important for building the corporate brand consistently.

First, any CSR positioning needs to be true to the history and the future of the organisation. If a company proceeds with a CSR message or plan that does not align with its fundamental values or mission, it is going to ring false.

Secondly, a CSR programme needs to be relevant. If constituencies, internal and external, do not connect with the message or the activities being undertaken, it may be good to do, but it is not relevant, and it will not improve the image of a business.

Thirdly, CSR efforts need to be unique to a company. Are there things that can be done that nobody else can do or deliver? It is fine to do things that are common, that are easy, and that are expected within an industry. But where is it possible to innovate on CSR in a way that nobody else can? These are the things that are going to be important, and set the stage for value creation.

Lastly, a CSR programme needs to be sustainable. Sustainability is a key tenet of CSR. But it is necessary not to approach it from an organisational perspective that says, 'We are going to do this because environmental issues are hot, and when that goes away, we are going to stop doing it'. The same goes for engaging in financially transparent issues because, 'we are required to, and we will make a big deal about the triple bottom-line report, but then we are just going to let it phase out'. It is essential to integrate. It has to be made a key part of the company's DNA.

If these four criteria are not met, ultimately a CSR programme is going to fail to some extent and not be as successful as it could be.

### HOW CSR CONTRIBUTES TO THE CORPORATE BRAND

A corporate brand is a financial asset of the company and something that can be built over time. CSR is a component of that overall asset, and when we think about the brand, there are as many definitions of 'brand' as there are consultants in the world talking about branding. The present paper describes the corporate brand as the sum of experiences that all audiences have with the company across three main areas (Figure 1):

- (1) *business processes*: the products you make or services you provide;
- (2) *culture and behaviour*: how you act with those key audiences and engage with communities; and
- (3) *communications*: the things that you say about yourself and how you communicate with the public.

If business processes, culture, behaviour and communications are in alignment, the chances are that key audiences are

Every audience views your corporate brand through their lens:

1. Business process
2. Culture
3. Communications



**Figure 1** The brand experience

going to understand it and believe it. When these things are done right, they build what CoreBrand calls ‘brand power’, which is measurable. It is hard to measure every experience with every audience across all three dimensions; however, it is relatively easy to measure the impact of those experiences on business decision makers (BDM) and the favourability that they have toward the company. These dimensions are examined in a consistent quantitative research study called the Corporate Branding Index (CBI).

The CBI includes financial information from the markets. Reported financial fundamentals are gathered and analysed, as well as annual projections and how the companies in the index are expected to do in the near and long-term futures. Communications spending data are included in the database to help understand how aggressive these companies are in building their brands and promoting them to the marketplace.

The CBI quantitative research study was started in 1996 and has continued,

uninterrupted ever since. There are 1,000 companies tracked across 54 industries and 10 business sectors. One of the primary findings of this study is the direct correlation between the brand power (familiarity  $\times$  favourability on a weighted scale) of a corporation and its stock performance. On average, across all 54 industries, the corporate brand has an impact on approximately 5–7 per cent of the average company’s stock performance, although this changes by industry. In industries where the brand plays less of a role, the impact will be lower (eg electric utilities). In industries where the corporate brand plays a significant role, the impact will be much higher (eg the beverage industry). An entire book could be written (the author has in fact written several) on this connection, but for now, this paper will focus on the role CSR plays in this equation. Audiences across the board have been looked at, and in some cases, multiple audiences for a company, in order to understand the true dimensions of their CSR actions and their brand.

It is great when clients seeking answers to very important questions start with the words, 'How would we determine...?' It is always a pleasure to engage uncharted challenges. We initiated one such pilot programme with a major client that wanted to know the connection between CSR and corporate brand value. We broke down the request into two questions. First, does CSR have an impact on the corporate brand? Secondly, if the connection to corporate brand exists, can it be tied into the models that link corporate brand to market capitalisation?

As mentioned previously, the CBI offers consistent evaluation of corporate brands since 1996 examining familiarity and three specific attributes of favourability: (1) overall reputation; (2) perception of management; and (3) investment potential of the 1,000 companies in the index. The CBI model connects the corporate brand to stock performance, so this became the base measure for the project. However, the missing link was the need to find similar data that examined CSR attributes across as many companies as possible and to cross-reference the data from those companies

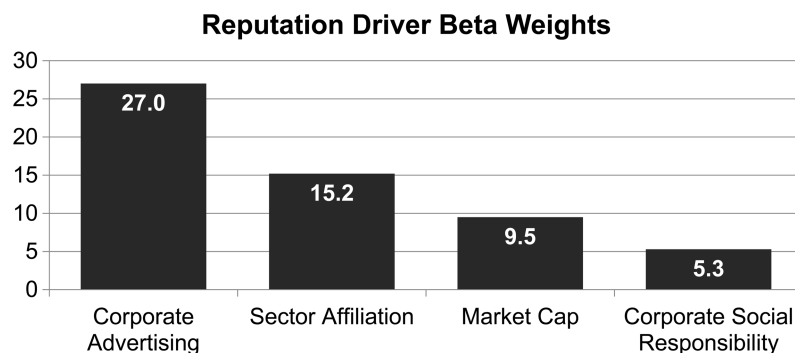
with the data in the CoreBrand database. A partner was found in KL Deitrand's (KLD), which will be described in more detail later in the paper.

The issue was to understand how corporate social responsibility data, brand image data, reputation data and financial data overlap. Where were the commonalities? Where were the differences? Were there any relationships? By combining these databases, it was possible to identify and define specifically the role that CSR plays in driving brand image and reputation; and subsequently, how it influences market capitalisation and the overall value of the organisation.

Once all the data of these companies had been examined, it was found there are four primary factors that influence brand power (Figure 2). Combined, these factors represent about two-thirds of the corporate brand for the average company — a substantial slice of the corporate brand pie:

- (1) *Corporate communications*: The communication a company puts out in the marketplace is the leading driver of brand power.

Together these factors explain 2/3 of what drives brand



**Figure 2** Four major drivers of the corporate brand  
Source: CoreBrand analysis of 426 companies with full data available

- (2) *Sector affiliation*: Some companies are perceived more positively than others simply by the business that they are in.
- (3) *Market capitalisation*: How big a company is also plays heavily in the perception of it, whether it is good or bad.
- (4) *Corporate social responsibility*: Although relatively small, it does help to drive the overall perception of the company.

So, it is not just that everyone feels that CSR is important — it *is* important. The data support the idea that social responsibility is a driving factor of image and reputation. It is not just a perception — it is reality.

Drilling down a little further into favourability attributes, one finds that investment potential is the most highly correlated attribute of CSR. It is not overall reputation or even perception of management as one might expect, but it has a direct impact on people considering investing in a company. This is tied very closely to the socially responsible indices or investment funds through which people become aware of a company because of the CSR activities that it does

and become more interested in investing in the business because of these activities.

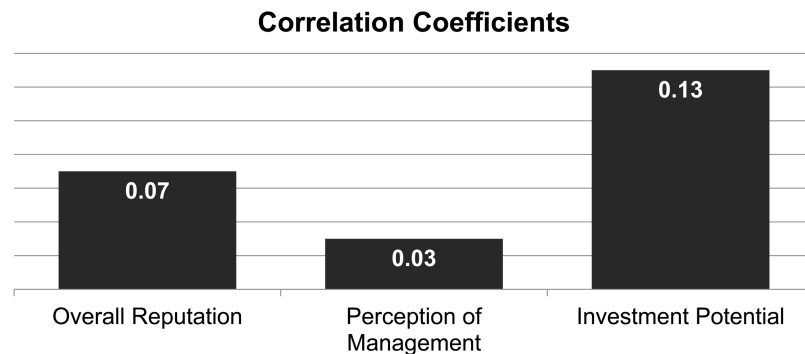
To drill down into favourability, CoreBrand measures three attributes, overall reputation, perception of management and investment potential (Figure 3).

As has been said many times before, CSR has the greatest impact on the financial and government sectors, and it is borne out here too. The strongest impact on brand from CSR is when brand is considered from the perspective of Wall Street.

Notice though how CSR's impact on reputation is growing profoundly — increasing sevenfold in the three years between measurements.

Now that the relationship between CSR and branding has been established, this paper uses the models CoreBrand has developed to understand how this translates back to shareholder value. Figure 4 illustrates the drivers of share price or market capitalisation value. Any financial professional will say that market issues or financial performance issues are the primary drivers of share price, and we would agree with that. About 80 per cent of

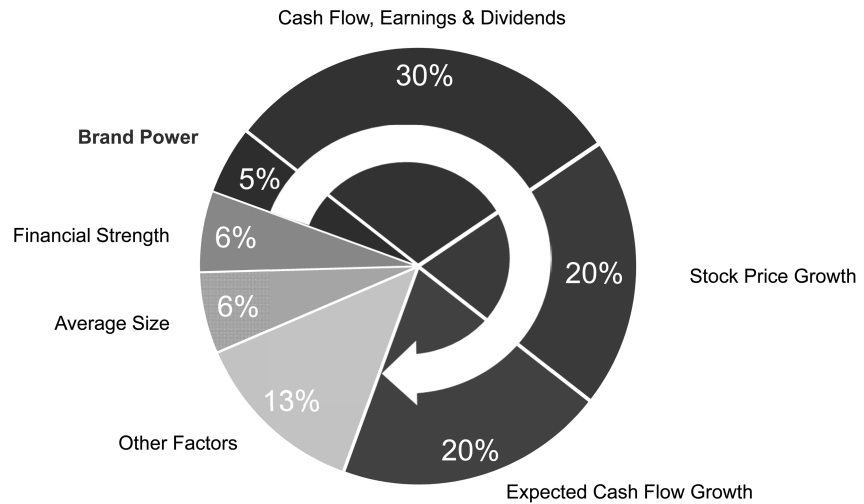
Greatest impact is on investment potential; while the correlations are small they are still meaningful



**Figure 3** The impact of CSR on key attributes

Source: CoreBrand analysis of 426 companies with full data available

Individual industry trends and company variables calculated



**Figure 4** The corporate brand explains 5–7 per cent of market capitalisation  
 \*Data Source: Value Line Investment Survey, Competitive Media Reporting and Corporate Branding Index annual survey

share price can be explained by financial factors. These financial factors include cash-flow earnings, dividends, stock price growth, expected future cash flow and financial strength. These are the financial factors that drive the stock value of companies.

Corporate brand power contributes to market capitalisation in a consistent manner. The contribution itself, however, varies significantly from industry to industry (see Table 1). On average across all industries, brand power represents approximately 5–7 per cent of share price.

For example, the Coca-Cola Company’s share price is dependent on a meaningful corporate brand equity level of about 20 per cent. In the beverage industry, because it is consumer facing, the average corporate brand contribution to market capitalisation is 8.6 per cent. Clearly, Coke enjoys a premium value over industry competitors.

The same holds true for industries that are more commodity driven, such as the electric utilities industry, which has historically very low brand equity value. An electric utilities company with a brand equity of 5 per cent would actually be considered very high for the industry because, on average, only about 1.2 per cent of share price can be expected to be brand related.

**Table 1** Understanding one’s business within identified industry ranges

Industry	Average BEV	BEV range
Electric utilities	1.2%	0 ~ 4%
Home builders	1.4%	0 ~ 6%
Banking	3.8%	0 ~ 13%
Computers and peripherals	4.1%	1 ~ 16%
Beverages	8.6%	3 ~ 20%
Retailers	9.7%	2 ~ 18%
Food manufacturers	10.9%	1 ~ 20%

Data source: CoreBrand’s directory of brand equity  
 BEV: brand equity value as a percentage of market capitalisation

Breaking down these factors helps understanding of this premium effect and the role that brand plays in market value — a role that most financial analysts traditionally ignore. Understanding these connections is the first step to managing them and creating corporate capital.

The next step is to examine the percentage of total brand equity that can be explained by CSR. Remember, if the role CSR plays in familiarity or favourability is understood, it is possible to use the model to explain its impact on market capitalisation.

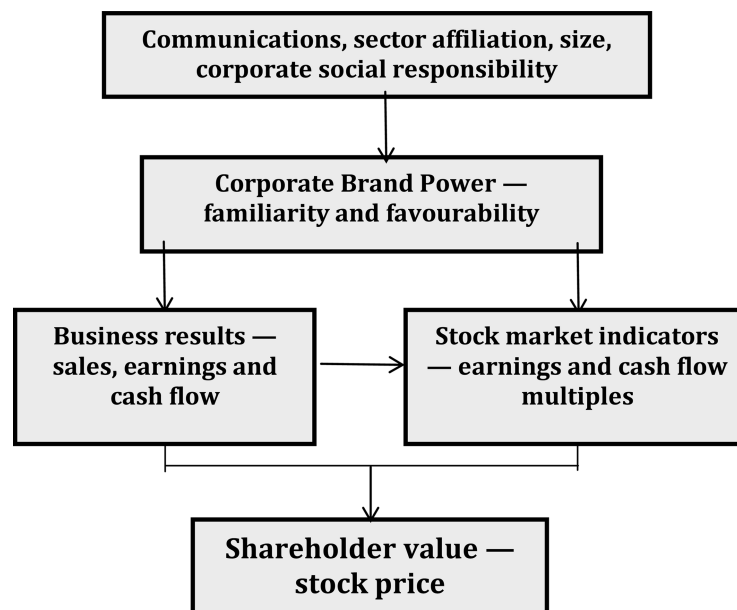
### **CALCULATING THE ACCOUNTABILITY OF SUSTAINABILITY**

There are a number of challenges in developing a model that connects CSR to stock performance. CoreBrand has done an enormous amount of work in understanding how the brand affects

market capitalisation, as well as how communications have an effect on the brand. When the regression analysis was conducted, the results indicated that CSR is a small but important factor that helps to drive brand image. Other factors driving brand image include corporate communications, sector affiliation, and size of company (as explained elsewhere in the paper). Already knowing that CSR can have an impact on brand image, one can then calculate the ROI measures for investments in CSR (Figure 5).

### **METHOD FOR MEASURING THE IMPACT OF BRAND ON MARKET CAPITALISATION**

Financial factors for modelling a brand's impact on market capitalisation are based upon the actual factors that drive stock performance for a specific industry. The extent of a company's opportunity to



**Figure 5** Calculating the ROI measures for investments in CSR

improve its economics by strengthening its brand varies widely, depending on the industry and the existing level of strength within a company's brand. Unrealised value might be available based on the company's brand strength and market dynamics. By understanding how much value is available and defining how much it costs to realise that value, equations can be generated on a case-by-case basis for individual companies. This methodical process takes the emotion out of the brand budgeting and planning process and puts it into a business context.

Brand value is dependent on the strength of four areas:

- familiarity and coherence of the brand;
- reputation of the company;
- respect that external audiences extend to corporate leadership and brand ambassadors (employees);
- confidence that financial audiences hold for the company's stock performance.

The model that will be presented and discussed has the following attributes related to its database:

- tracking of 1,000 leading US corporate brands across 54 industries;
- consistent research methods and historical data since 1996;
- survey of 10,000 VP level and higher executives in the top 20 per cent of US businesses each year to measure familiarity and favourability with corporate brands;
- interviews conducted continuously throughout the year;
- 400 different respondents rating each company each year.<sup>1</sup>

The brand communications ROI model has two key regression equations:

- The first measures the factors that drive changes in brand power (familiarity and favourability).
- The second measures the factors that drive changes in stock price.

In the first model, *brand power* is the dependent variable, and independent variables are advertising investment, corporate size, dividend, stock price growth and earnings volatility. Approximately 78 per cent of brand power variance is explained by this equation.

The dependent variable in the second model is *stock price*. Independent variables are cash flow, earnings, dividend, expected future cash flow growth, company size, financial strength and brand power. Between 85 per cent and 90 per cent of stock price variance is explained by this equation.

## ELEMENTS FOR A BRAND COMMUNICATIONS ROI MODEL

The factors having an effect on corporate brand power are advertising investment, corporate size, earnings volatility, stock price growth, dividend payout, public relations, corporate communications and investor relations.

The brand communications ROI model is used to identify the return in increased market capitalisation for increased communications (or the calculated equivalent CSR) investment. The model assigns weights to the factors that cause change in both brand power and stock price. Once weights are assigned to each of the variables, the model can measure the impact that changes in investment can have on brand power and, in turn, stock price. The model holds all other variables (mostly financial) constant in order to isolate the impact that spending will have and measure its return in terms



of market capitalisation. Thus, the analysis is focused on the sensitivity of a company's stock price to changes in communications investment. This level of sensitivity is called the benefit-to-cost ratio (B/C ratio) — the change in shareholder value divided by the cost.

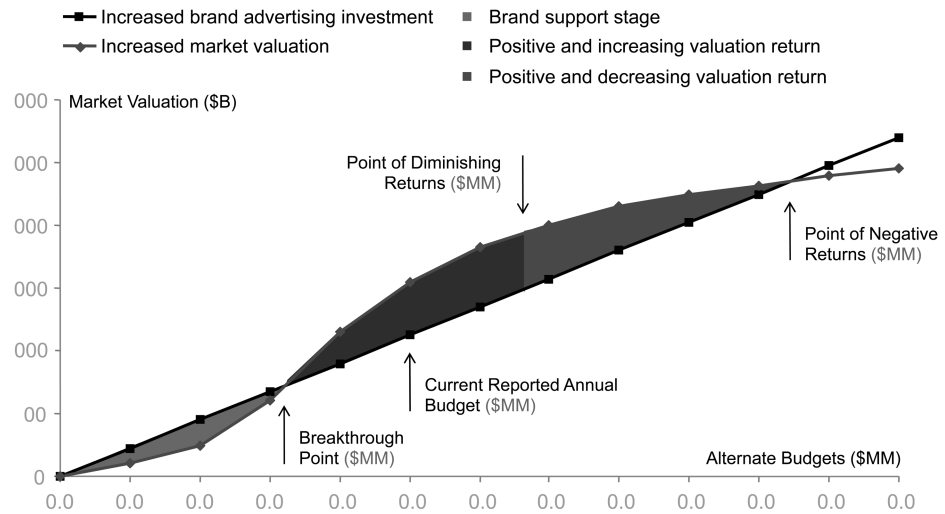
The results of the brand communications ROI model are expressed as marginal revenue versus marginal cost analysis. In Figure 6, the straight line indicates incremental increases or decreases in the advertising spending level, and the curved line represents the corresponding expected impact on market capitalisation for each spending level. This 'valuation' line is curved because there are both increasing and diminishing marginal return relationships between advertising investment and stock price impact. The key objective of the model is to identify, statistically, at which advertising budget level shareholder value increase exceeds investment by the greatest amount.

In other words, at what point is the positive 'spread' the greatest. The model also

reveals the breakthrough point (that is, where increased market value occurs), the point of diminishing returns (positive but a decreasing rate) and the point of negative returns (where additional investment is counterproductive and results in decreased value).

This approach is judged to be optimal for analysing corporate communication spending as it is consistent with the concept of evaluating ROI on the basis of their 'spread' versus either the weighted average cost of capital or cost of equity capital, and then using this 'spread' as a predictor of how the market price of total or equity capital relates to the book value (of total or equity capital). This ratio is the market-to-book (M/B) ratio. Thus, the brand equity model is consistent with accepted financial theory and practice. Another aspect of consistency is that existing and expected cash flows are key inputs to the model.

Figure 6 provides a graphic illustration of this concept of increasing and decreasing marginal returns, taking into account the statistics that have been gathered and



**Figure 6** Communications ROI: diminishing returns curve  
Source line from figure

analysed to show the impact of changes in spending on market capitalisation.

### ADAPTING CSR DATA INTO COREBRAND'S FINANCIAL MODELS

As mentioned earlier, it was possible to use KLD's CSR data because the information was very compatible with CoreBrand's corporate brand research. KLD Research & Analytics, Inc. is a research index provider for environmental, social and governance factors in the USA. KLD was recently purchased by MSCI, which is a leading provider of investment decision support tools. While KLD's data offered continuous research, the key element was adapting their measures to CoreBrand's valuation model.

Companies were rated on each of the following CSR dimensions:

- community (strengths and concerns);
- corporate governance (strengths and concerns);
- diversity (strengths and concerns);
- employee relations (strengths and concerns);
- environment (strengths and concerns);
- human rights (concerns);

- product (strengths and concerns);
- military (concerns); and
- nuclear (concerns).

CoreBrand included all issues tracked by KLD where there were enough data to make statistically significant observations. In order to adapt their data into the model, a CSR score was created (Table 2). The CSR score is a relatively simple calculation based on the nature of the tracked media coverage.

In scoring CSR, positive mentions are considered strengths and are scored as a +1; negative mentions are considered concerns and are scored -1. All mentions are summed, and this combined figure is considered a company's CSR score.

CSR scores range from +9 through to -9 based on media coverage on each of the tracked dimensions; each dimension is worth one point. For example, if a company is rated positively on four dimensions and negatively on one dimension, its net CSR score = 3.

This scoring system allowed CoreBrand to evaluate individual companies versus peers versus industries in the model, and measure the impact that CSR can have on business performance. After

**Table 2** Tracking performance and tying to brand equity

	3Q, Year 1	4Q, Year 1	1Q, Year 2	2Q, Year 2	3Q, Year 2	4Q, Year 2
Share price, \$/share	44.00	58.00	62.14	56.65	57.87	59.87
Sales revenue, \$bn	11.90	12.00	12.40	12.40	12.40	12.40
Shares outstanding, m	247.90	250.30	253.00	253.00	253.00	253.00
Familiarity	52.00	52.90	53.80	55.20	55.70	56.00
Favourability	58.40	57.80	58.80	59.30	60.40	59.10
Total mkt. cap., \$bn.	10.90	14.50	15.70	14.30	14.60	15.10
Brand equity, \$m	881.00	1185.00	1320.00	1253.00	1308.00	1345.00
% of mkt. cap. added by brand equity	8.10	8.20	8.40	8.70	8.90	8.90
CSR score	3	5	4	4	6	5
Portion of brand equity added by CSR	0.25	0.41	0.32	0.33	0.48	0.42

Note: The analysis is examined over time to track performance and calculate return on investment

all the variables were calculated, 426 companies were found in the KLD research that could be included in the CoreBrand model.

### EXAMPLE

A particular company happens to be in the transport industry, a commodity business. It is doing pretty well in terms of brand equity in general at 8 per cent, which is just above the average for its industry. The company has seen an improvement in its brand equity score that is directly attributed to CSR over this measurement period. About 0.25 per cent of its total market capitalisation was driven by CSR, and just about a year and half later, it is now almost 0.5 per cent of the company's total market capitalisation (see Table 3). This can be translated into real dollars at any point in time. So, when the CEO asks about the financial impact of CSR, they will have the proof. CoreBrand's data can go as deep as any financial professional wants to. The key is not creating a black box that they will not embrace, but helping them see that intangible assets, like the corporate brand and CSR, are contributing and growing factors to corporate value.

In this case, a two-point increase in the CSR score will grow brand power by 0.53. This will increase market capitalisation by 0.16 per cent:

- 0.16 per cent change in market capitalisation is equal to US\$157m;

- the company invested US\$22m; in CSR programmes;
- the ROI is US\$135m;
- US\$6 return for every US\$1 spent.

So, when this particular company is further examined, a change in its CSR score of two points is found. It does not seem like a lot, but it is enough to add almost two points to the company's total market capitalisation, a significant increase. This model can be used to understand what it really means financially. How does one put a dollar value on this? For this particular company, a two-point change in social responsibility translates to US\$11m in communications spending. If a company can improve its CSR image by two points, that is the equivalent of going out and buying US\$11m of national advertising. Then the questions the CEO will be asking are 'Should we do it? Is it the right thing to do? Will we benefit from the investment?'. The answer is, 'Yes. The benefits are clear. We should do it.'

### CONCLUSION

The key is to determine what CSR dimensions are most important to the company. Pick the dimensions that can be influenced, the things that are believable, the things that are true to the organisation, and the things that are relevant to the company's stakeholders. Commit to the long term. CSR has got to be integrated into the company's DNA. It has got to be part of business. It is not something that is just an add-on. It is not just something nice to do. It has got to be a key component of what the company does every day. But, it is also necessary to adapt as the market adapts. It is vital to understand what is important. It is vital to understand how the market influences your role and your implementation of

**Table 3** Calculating CSR's market capitalisation impact

	Change	Old level	New level
Added social responsibility	2	4	6
Brand power	0.53	47.83	48.36
Brand equity, % of mkt. cap.	0.16	9.56	9.72

CSR as it moves. And lastly, measure the progress, define new targets and hold not only the managers, but also leadership, accountable for supporting the effort. Why? Because, if the managers are going to be held accountable for implementing CSR efforts, then leadership has to be held accountable for how it gets funded and how it gets supported over time.

This paper started with the assertion that 'CSR is simply good business'. To this, the following can now be added:

'CSR contributes to the total brand experience, it builds familiarity and favorability,

it improves key attributes especially investment potential, and it contributes measurably to brand equity value. Future potential return can be estimated for budgeting, and ROI can be calculated for this important CSR investment.'

### **AUTHOR'S NOTE**

Financial data were collected from sources such as Value Line, Bloomberg and others, covering both financial fundamentals and analyst rankings; advertising spending data collected from Kantar Media Intelligence to track brand investments.