



CONDITIONS AND STRATEGIES OF CREATING COMPANY VALUE ON THE BASIS OF CORPORATE SOCIAL RESPONSIBILITY – SYNTHETIC PRESENTATION

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Abstract

The aim of an enterprise is to increase its value. This growth can be achieved if initiated socially responsible activities improve the value drivers. The company's specificity, type of its environment and their mutual reactions create conditions conducive to improvement of the driving forces of value by being socially responsible. Bearing this observation in mind we can formulate five strategies of creating value based on social responsibility. These are strategies of perfection, positive selection, surroundings modification, transformation and transposition.

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Introduction

Sustainable development poses a challenge of intensifying activities for the environment and society so that the economic development did not take place at the cost of social and natural systems. Such actions need to be taken by enterprises (which was reflected in the concept of corporate social responsibility). Taking into account the importance of sustainable development implementation, we should not forget the essence of an enterprise, which is obliged to strive at achieving its economic goals. This paper will attempt at synthetic presentation in what conditions and how the activities directed at environment protection and realization of social goals may contribute to the realization of economic goals of an enterprise.

The goal of an enterprise

The contemporary theory of finance sees the goal of an enterprise in creating value for its owners (management of an enterprise focused on creating this value is known as value based management – VBM). The company value grows if, in the long run, the company is able to generate positive financial flows exceeding the cost of engaged capital. Such growth logic is presented by some of its measurements, such as, for example, EVA, which represents economic surplus generated in a given single period, and MVA, which measures the value generated in the market in relation to invested capital base, and reflects the value of all future

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economic surpluses that investors expect the company to generate in its whole life (Michalski, 2001, p. 104, quoted after: Mikołajek - Gocejna, 2010).

EVA components enable us to identify key driving forces of the company value. These are: NOPAT (net operating profit after tax), WACC (weighted average cost of capital), and IC (invested capital)². Proper modification of these forces (for example lowering WACC or increasing NOPAT) results in increasing company value for its owners³.

In the context of initiating activities for the environment and the society, we should mention a competing concept of the enterprise goals: namely the concept of stakeholders. Interest-holders are communities and individuals who have legitimate interests in procedural or substantial aspects of company activities, and each interest has its own internal value (Donaldson and Preston, 1995, p. 67), for example: capital providers, employees, clients, suppliers, local community, etc. The realization of the stakeholders concept requires (and it is its main attribute) concentration of the Board's decisions on legitimate interests of all legitimate stakeholders (Donaldson and Preston, 1995, p. 67). Such concept of the company goals justifies undertaking actions for the environment protection and for the society, however, its drawbacks⁴ account for the fact that such activities may take place at the expense of company value. This, in turn, is tantamount to the destruction of resources engaged in the enterprise and (sooner or later) must lead to its fall.

Specialist literature emphasizes a specific complementariness of the interest-holders concept to the VBM concept, the phenomenon known as "enlightened VBM". The promoters and supporters of "enlightened VBM" underline that the assumption that the interests of owners and all other interest-holders must be contradictory, is wrong, and that value maximization for the owners cannot take place without respecting the interests of other groups (Smith and Lenssen, 2009, p. 224-225; A. Cwynar and W. Cwynar, 2007, p. 13-14; Brigham and Houston, 2005, p. 41).

However, some opinions appearing in specialist literature, including Polish research, as well as in public discussion, can only be attributed to an excessively free interpretation of the "enlightened VBM" concept. These opinions state that taking care of the environment and local society should lead to increased company value. Such opinions should be considered as not fully justified (they often lack evidence or are based on selected examples or research which does not meet methodological requirements⁵). They assume that the environment and

² The above-mentioned driving forces of company value are shaped by other factors, analyzed by A. Rappaport (1986).

³ More information on shaping driving forces of company value in order to create its growth can be found in M. Wieczorek-Kosmala (2009, p. 88 – 89).

⁴ These drawbacks are: first of all, quite poorly developed instruments of these concept. On the other hand, its weaknesses are also underlined by M. Jensen (2010, p. 32 – 34) who claims that an enterprise must have a clearly defined single goal in order to function properly; the concept of interest-holders empowers managers to make decisions based on their personal preferences, which may lead to wasting resources, and there are no precise instructions on how to solve contradictory interests of stakeholders.

⁵ For example, some research on financial results of companies listed in Dow Jones Sustainability Group Index (DJSGI, the index which shows the results of companies after analyzing their effect on environment and society) consists in comparing these enterprises with other enterprises listed in New York Stock Exchange, which may be seen as a mistake, as most DJSGI companies are 'outstanding' enterprises. Therefore a better method was adopted by D. Chang and L. Kuo (2008, p. 365-380), first singled out 2500 best companies from those listed in New York Stock Exchange and divided them into those listed by the DJSGI index and those which are not there. The comparison of these two groups of companies did not show any positive or negative relation between



local societies are company's interest-holders, who, affecting the company, unconditionally award its positive influence in the way that leads to the increase in company value. In addition, such points of view may be considered harmful, as making a statement that the activities of an enterprise for the environment and local communities positively affect the company value, without justifying it with definite examples of shaping value on the basis of corporate social responsibility, may encourage economic experiments, whose failure will discourage enterprises from taking care of the environment and/or the society. This, in turn, is a highly unwelcome effect. Therefore, we should analyze the conditions and possibilities of transforming socially responsible activities into company value.

Conditions of transforming socially responsible activities into company value

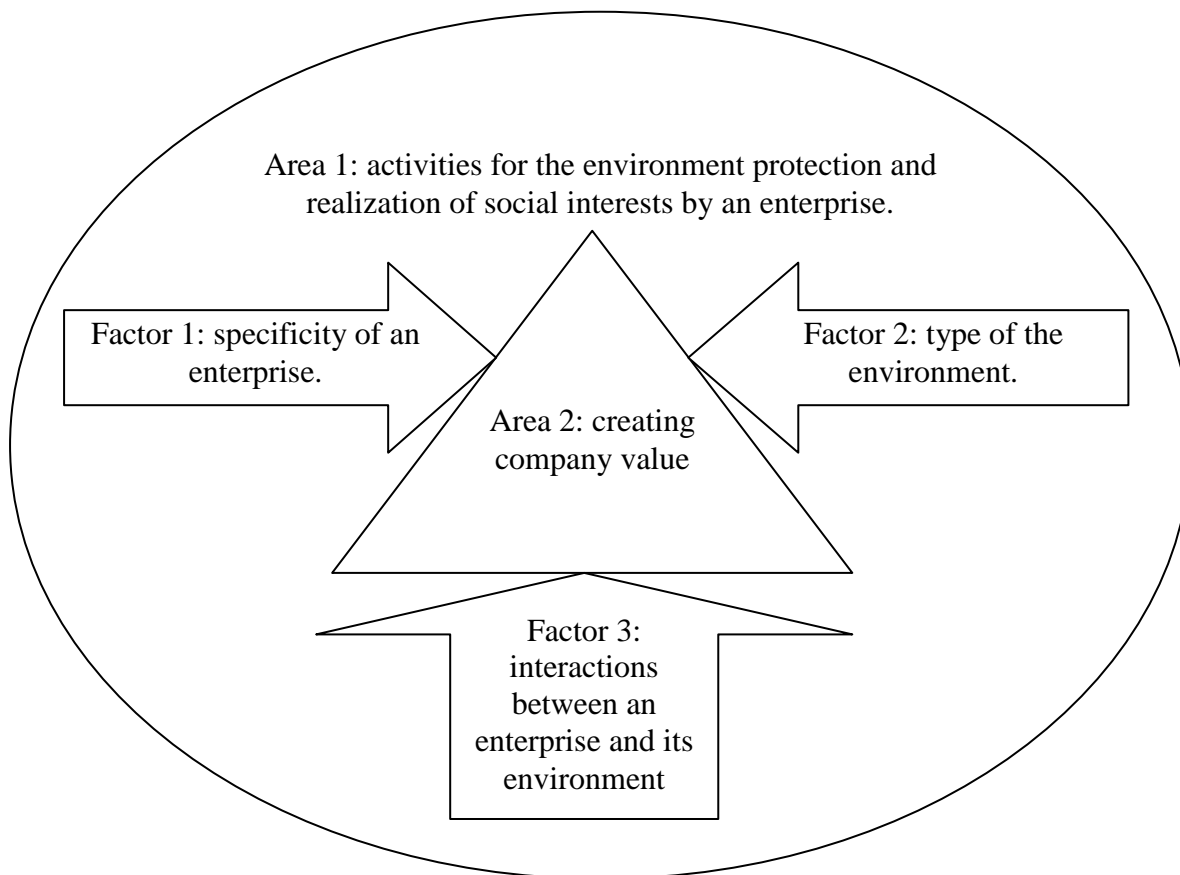
The analysis of the possibilities of creating company value on the basis of taking care of the environment and society should be preceded by the observation of the factors determining the level of driving forces of company value (NOPAT, WACC and IC). An enterprise functions as a system in its environment, which should be understood as the elements, which do not constitute parts of the enterprise, but which are somehow connected with it, that is, they affect the condition of the enterprise and the enterprise affects them (Kozmiński, 1979, p. 15). We should therefore emphasize that **the driving forces of company value are the outcome of the enterprise activities and the type of its environment and their mutual interactions.** That is why in the analysis of opportunities offered by activities for the environment and local society for creating company value, we should include:

- 1) specificity of an enterprise,
- 2) type of the environment,
- 3) interactions between an enterprise and its environment.

This issue is presented in figure 1.

undertaking activities for the environment and society and selected financial indicators, which finally translate into company value.

Figure 1: Areas and factors determining the possibilities of influence of activities undertaken by an enterprise for the environment and society on company value



Source: Own work

It is essential to notice that the influence of an enterprise on its environment and society does not have to be connected with the reaction of these elements of the enterprise environment which will modify the company value. It should also be noted that the influence of an enterprise on the environment and society may lead to the reaction of other elements of the enterprise environment, which will have real essentially affect the level of company value. Therefore we should differentiate the main elements of the enterprise environment which will exert the biggest pressure on the enterprise and which are sensitive to the influence of the enterprise on its environment and society. These are: capital providers, the state, customers and suppliers. The interactions between the enterprise and those selected elements of its environment may, following the fulfillment of certain conditions, transform socially responsible activities of the enterprise into the improvement of driving forces of its value. These processes and determining factors are presented in figure 2.



Figure 2: The influence of selected elements of the enterprise environment on its value as a result of improved influence of the enterprise on the environment and society

Element of the enterprise environment	Possible reaction of the selected element of the environment on the improved influence of the enterprise on its environment and society	Condition in which such reaction takes place	Modification of driving forces of the enterprise value as a result of interaction of a particular element of the enterprise environment on the improvement of the influence of the enterprise on its environment and society
STATE ⁶	<ol style="list-style-type: none"> 1) Decreasing taxation, punishment, fees and other burdens connected with the functioning of economic instruments of environment protection. 2) Abolishment of duties connected with the functioning of administrative instruments of environment protection (for example monitoring the emission levels). 3) Granting a subsidy. 4) Decreasing the responsibility for caused damages. 5) Purchasing the enterprise products. 	<ol style="list-style-type: none"> 1) Practical realization of the stimulating function of public income and expenditure (the aspect of stimulating enterprises to actions for the environment protection and for the society). 2) The functioning of the system of administrative instruments of environment and society protection. 3) Regulating the responsibility for damages to the environment and negative influence on the society. 4) Integration of environment and social aims with the system of public purchase. 	<ol style="list-style-type: none"> 1) Lower costs – higher NOPAT. 2) Lower taxation – higher NOPAT. 3) Increased sales – higher NOPAT. 4) Lower risk of activity – lower cost of capital (WACC) and increased availability of capital (possible growth of IC).

⁶ The reaction of the state to the improved influence of the enterprise on its environment may be automatic or discretionary, which should also be reflected in the analysis of possibilities of increasing the company value through initiating actions benefiting the environment and society.



CAPITAL PROVIDERS	<ol style="list-style-type: none">1) Increased interest in investing in the enterprise.2) Lower expectations concerning return on investment in the enterprise.	<ol style="list-style-type: none">1) Awareness of the level of ecological and social risk of investing in the enterprise.2) Capital providers make a decision concerning their investment on the basis of corporate social responsibility criteria (Social Responsible Investment).3) Taking into account the reputation risk of capital providers connected with investment in a particular venture.	<ol style="list-style-type: none">1) Decreased WACC.2) Increased availability of capital (which may reflect in increased IC).
PURCHASERS (INDIVIDUAL AND CORPORATE) ENTERPRISE PRODUCTS.	<ol style="list-style-type: none">1) Increased interest in company products.	<ol style="list-style-type: none">1) Basing purchasing decisions on the criterion of product's influence (in its whole life cycle) on the environment and society.2) The willingness to purchase healthy and/or safe products.	<ol style="list-style-type: none">1) Increased sales volume – higher NOPAT.2) Possibility of increasing prices – higher NOPAT.3) Possibility of obtaining down-payment for the future sale (higher NOPAT or decreased WACC).



SUPPLIERS	1) Increased interest in sales.	1) Implementation of CSR or environment management based on the product life cycle by a supplier.	1) Lower costs (consequently – a possibility of lowering prices and increasing sales volume or increasing margins – increased NOPAT). 2) Possibility of obtaining open account facility (lower WACC or increased NOPAT).
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Source: Own work⁷

⁷ More on the relationship between the enterprises and the elements of its surroundings affected by the enterprise's influence on the environment in A. Doś (2011, p. 24-38).

The reference of the conditions of reaction of selected elements of the surroundings to the environment and specificity of a given enterprise synthetically presented in figure 2 allows us to identify the determinants of a positive correlation between initiating activities for the environment and society and the increase of its value. It is vital to analyze thoroughly the relations between the costs of these undertakings and the scale of positive changes in the level of driving forces of company value attributed to them.

The presentation shown in figure 2 also allows us to indentify the direction of particular reactions of the enterprise surroundings to its undertakings concerning the environment and society to selected driving forces of an enterprise and their determining factors. The presentation, therefore, creates a map of relations between the company value and the activities which it undertakes following the concept of corporate social responsibility. The map may be used as a base for creating model of financial analysis of CSR. That is because the map shows company's value as function of value drivers, which, in turn, are presented as functions of company's environment reaction to company's action determined by highlighted factors.

It should also be stressed that figure 2 exposes the conditions for positive reactions of selected elements of the surroundings on the improved influence of the enterprise on the environment and society. However, negative reactions are also possible, inducing the decrease in company value due to undertaking socially responsible activities (which should not be omitted in the analysis on the possibilities of creating value on the basis of socially responsible activities), however their consideration does not belong to the scope of our investigation here.

Strategies of creating company value on the basis of socially responsible activities

Taking into account the fact that specificity of an enterprise, the type of its surroundings and interactions between the enterprise and its surroundings are important for the desirable modification of value drivers due to undertaking activities for the environment and society, we can formulate five types of strategies of creating company value on the basis of taking care of natural environment and society.

Strategy of perfection

This strategy concentrates on creating company value on the basis of perfecting the processes taking place in an enterprise, which leads to lower negative influence on the environment and society, which, in turn, due to company specificity and/or the type of its surroundings, brings about improved driving forces of its value. This perfection may take various forms, such as reducing water or energy consumption, which causes lower production costs. These could also be more complex processes, such as improved management of ecological risk, which will bring about lower capital costs⁸. Perfecting the processes, an enterprise may achieve the following effects: lower costs, lower taxation, lower capital cost, increased availability of capital and increased sales. These effects translate into increased company value. However, it should be noticed that the enterprise should make a thorough analysis of opportunities offered by the surroundings to improve driving forces of company value connected with improved influence of the enterprise on its environment and society⁹.

⁸ The influence of the management of ecological risk on lowering WACC was proved by, for example M. Sharfmann and C. Fernando, (2008, p. 569-592).

⁹ For example, potentially, an enterprise producing goods on the basis of the best available technologies (BAT – Best Available Technology) may expect more opportunities in procedures on public orders. The Public Orders

An example of the strategy of perfection is ABB Ltd. The modernizations implemented by this enterprise contribute to improved working conditions, lower electrical and thermal energy consumption and streamlined production processes¹⁰.

Strategy of positive selection

This strategy assumes taking as criteria of choice between alternative ways of creating value those which are related to improved influence of an enterprise on the environment and society. The implementation of this strategy requires creating numerous possible scenarios of enterprise development and making analyses of the importance of particular development variants for creating value and for the environment and society. A good example of positive selection strategy implementation is TESCO (Poland) Ltd., which introduces savings in energy consumption and reduction of carbon dioxide emission¹¹, which, due to its type and size of operations, had a possibility of choosing another way, as Jeronimo Martins company (owner of Biedronka shops) did, namely not paying employees for overtime, which gave it million zlotys of savings¹².

Strategy of surroundings modification

If the surroundings in their present shape do not offer any opportunity for improvement of value drivers in relation to its care of the environment and society, the enterprise may attempt at modifying its surroundings. The aim of such modification should be to develop the attitudes placing premium on intensified efforts of an enterprise concerning environment protection and local societies. The modification may be carried out through educational programs at schools, sponsored by enterprises or by proposing and exerting pressure on changing regulations. This strategy is exemplified by the “Protect your environment energetically” campaign by KGHM Ecoren, which through lessons at schools, mobilizes students to recycle electric and electronic waste¹³, which is later used by the enterprise in its production process. Other examples are: educational website dlanatury.pl (for nature), by IKEA, supporting sustainable lifestyle or “Risk Focus” magazine, published by STU Ergo Hestia S.A., which informs stakeholders of the enterprise of the risk and issues connected with its management, which translates into increased interest in company products and gradual improvement of company image.

Law states that the criteria of evaluating offers are: the price or the price and other criteria related to the subject of the order, for example using the best available technologies in influencing the environment (Article 91 of the Act of 29th January, 2004, on Public Order Law, Journal of Law, 2006, number 164, position 1163, with subsequent changes). However, the enterprise should analyze how often such criteria are actually used as criteria of tender evaluation in order to adjust its technologies to the real requirements of the market.

¹⁰ More on this subject at: <http://odpowiedzialnybiznes.pl/pl/praktyka-csr/dobre-praktyki/wyszukiwarka-dobrych-praktyk/baza-dobrych-praktyk/efektywnosc-energetyczna---abb,3472.html>, access on: 08. 03. 2011.

¹¹ More on this subject at: <http://odpowiedzialnybiznes.pl/pl/praktyka-csr/dobre-praktyki/wyszukiwarka-dobrych-praktyk/baza-dobrych-praktyk/strategia-ograniczania-wplywu-na-srodowisko---tesco-polska,2431.html>, access on: 09. 03. 2011.

¹²<http://wiadomosci.wp.pl/kat,1342,title,Wlasciciel-Biedronki-przegral-proces-z-pracownikami,wid,10788812,wiadomosc.html?ticaid=1bea4>, access on: 09. 03. 2011r.

¹³More on this campaign at: <http://odpowiedzialnybiznes.pl/pl/praktyka-csr/dobre-praktyki/wyszukiwarka-dobrych-praktyk/baza-dobrych-praktyk/akcja-„energicznie-chron-srodowisko”---kgm-ecoren,3484.html>, access on: 08. 03. 2011.

Strategy of transformation

The strategy of transformation should be considered by an enterprise also after taking advantage of the strategy of perfection. If an enterprise in present conditions cannot achieve any growth of value together with lowering its negative effect on the environment and/or society, it should consider the possibility of changing its core activity to the one that leads to the growth of company value and assures improved influence on the environment and society. Transformation may be partial or total. Partial transformation consists in transforming selected core processes of the enterprise operations while leaving the remaining ones unchanged. Total transformation, on the other hand, requires changing the subject of economic activity of a given enterprise.

An example of partial transformation could be an enterprise from the energy sector which changes its source of energy from fossil fuels to renewable sources¹⁴. The success of total transformation may be exemplified by Xerox¹⁵, which gradually transformed from production activity (production of copying machines) to providing services related to documentation.

It should be emphasized that the strategy of transformation requires detailed assessment of transformation risk, as it is significant risk that differentiates this strategy from other strategies proposed here.

Strategy of transposition

When an enterprise is already utilizing the possibilities provided by its surroundings and put premium on activities for the environment and society, it may notice a possibility of intensifying these activities, which will not be reflected in the improvement of value drivers due to the constraints of the surroundings. In this situation, an enterprise may consider the option of changing the surroundings. Such change aims at introducing into the surroundings the elements which will 'reward' the intensification of activities for environment protection and society, contributing to the improvement of driving forces of company value. An example of such an activity may be the change of the crediting bank into one that considers ecological threat in its procedure of providing loans and which prefers pro-environment ventures, changing the end market into one in which customers take into account the influence of the product of the environment and society, or, finally – changing the place of the company's residence in order to take advantage of tax allowances or subsidies.

While presenting the strategies of building company value on the basis of corporate social responsibility, we should emphasize that 'greenwashing' and 'socialwashing' do not classify as such strategies. They consist in undertaking some initiatives for environment protection (greenwashing) or for society (socialwashing), which, communicated loudly, aim at changing the company image, while the core activity of the enterprise remains so harmful for the environment (greenwashing) and/or for the society (socialwashing) that these initiatives cannot compensate for this damage. For example, British American Tobacco Polska is

¹⁴ Among the companies surveyed by Deloitte Advisory Sp. z o.o., Deloitte Audyt Sp. z o.o., Deloitte Doradztwo Podatkowe Sp. z o.o., Deloitte Business Consulting S.A. and Deloitte Legal Pasternak i Wspólnicy Kancelaria Prawnicza sp. k. (jointly called „Deloitte Polska”), from energy sector in Poland, 50% are currently realizing some investment in renewable energy sources. See: „Polski sektor energetyczny w świetle międzynarodowych standardów CSR. Badanie.”, s. 12, http://www.deloitte.com/assets/Dcom-Poland/Local%20Assets/Documents/Raporty,%20badania,%20rankingi/pl_PolskiSektorEnergetyczny_a_CSR_2011.pdf, access on: 09. 03. 2011.

¹⁵ An example of Xerox is provided by F. Figge (2005, p. 22).

actively involved in preventing smoking among the minors¹⁶, while its core activity is production of cigarettes¹⁷, whose consumption causes huge social damage¹⁸. The enterprise of this type may create value in a sustainable way if it undertakes the strategy of transformation.

Conclusions

Synthetic presentation of the issue of socially responsible activities taken up by an enterprise shows that special attention should be paid to the conditions related to the company specificity, the type of its surroundings and mutual influence. These conditions must be fulfilled if the result of these activities is to be increased company value. Their detailed analysis allows us to choose appropriate strategy of creating value on the basis of corporate social responsibility (five main strategies have been differentiated here). The form in which the subject was presented allows us only to outline the areas of research which may greatly support the enterprises in creating value on the basis of sustainable development principles.

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¹⁶ More on this issues at:

http://www.bat.com.pl/group/sites/BAT_84BCND.nsf/vwPagesWebLive/DO84BJYF?opendocument&SKN=, access on: 09. 03. 2011.

¹⁷ More on this issue at:

http://www.bat.com.pl/group/sites/BAT_84BCND.nsf/vwPagesWebLive/DO84BDM2?opendocument&SKN=1, access on: 09. 03. 2011.

¹⁸ More on this issue in the document called: „Obciążenie kraju skutkami używania wyrobów tytoniowych: fakty”, http://tobaccofreecenter.org/files/pdfs/po/Poland_tob_burden_po.pdf, access on: 09. 03. 2011.

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