CORPORATE SOCIAL RESPONSIBILITY:

GROWTH AND HISTORY

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Abstract

This paper concretely defines what corporate social responsibility, or CSR, is and how it has come to be so prevalent in companies today. Many scholars have attempted to define this movement, and still others are trying to discover its origins and its likely future. From Adam Smith to Milton Friedman, many economists have argued the merits and costs of "going green" and the bottom line for the companies that attempt it. This paper will also document what Cisco, held in the UA Foundation's Student Run Portfolio, has done to increase environmental awareness through corporate social responsibility

Definitions of Corporate Social Responsibility

In today's world of "going green", the idea of company's being socially responsible makes sense with the zeitgeist if not financially. But this was not always so. The term corporate social responsibility, or CSR, was first coined in the 1960s. For these definitions throughout the years there is always a distinct difference in the minds of those trying to define it between CSR and a firms profit yielding ventures. A company will be profitable AND be socially responsible as if the two states would not occur organically. Keith Davis, one of the first scholars to define CSR said it was, "Businessmen's decision and actions are taken for reasons at least partially beyond the firms' direct economic or technical interest" (Davis, 1960).

As the years progressed, the definitions became longer and more detailed. Harold Johnson and Milton Friedman voiced their opinions, and each of them represented a distinct school of thought:

> A socially responsible firm is one whose managerial staff balances a multiplicity of interest. Instead of striving only for larger profits for its shareholders, a responsible enterprise also takes into account employees, suppliers, dealers, local communities and the nation (Johnson, 1971).
>
> There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits, so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud (Friedman, 1970).

And so in the past, there was always a disconnect between being able to be profitable, and being able to remain socially responsible. Now, and possibly since the last ten years, that spread between the two ideas has been narrowing. As consumers, we are more aware of green products, and if there is not too much of a difference in price, most people will opt for the greener product. As investors, in looking at and valuing companies, we can see the value added in greener companies in that they typically are more widely held, and have higher long-term growth opportunities. As companies, if nothing else, a greener production or distribution line differentiates you from competitors in a positive way. There is an opportunity cost in choosing to be socially responsible, just as there is an opportunity cost to every decision a business makes. For example, when a firm chooses to invest in a new product line, it is forgoing all other uses for that money with the assumption that the new product line is the best investment for the business. Similarly, when a firm chooses to become more socially responsible, they are weighing the added costs to their bottom line with the added benefit of increased sales, lower costs, or a more favorable marketing directive.

Some scholars say that this added investment in being socially responsible is is something that must be done, despite its relatively lower return. Others, like Friedman, say that a company's only purpose is to maximize shareholder wealth, and that any diversion from his one goal should not be carried out. More recently, Dean Paul Portney from Eller College of Management also tries to define CSR in a more concrete way. Following is his definition.

> CSR is a consistent pattern, at the very least, of private firms doing more than they are required to do under applicable laws and regulations governing the environment, worker safety and health, and investments in the communities in which they operate (Hay, Stavins, & Vietor, 2005).

While Dean Portney's definition is a more concrete definition that explains the end result of being socially responsible, it doesn't explain why the companies would partake in CSR in the first place. I believe Adam Smith has the answer to that question. His idea of the Invisible Hand whereby people, acting in their own self interest to maximize their own wealth, will in turn maximizes the social wealth as well. Likewise for companies, acting socially responsible is actually in their best interest. In this progressive age, being seen as socially responsible can be a competitive advantage, a cost cutting technique, and revenue boosting. CSR may constrain profits in the short term, but in the long term both paths will lead to the same goal. Making higher profits will result with more capital to invest in social responsibility, which will increase revenue, decrease costs, thereby increasing profits.

Dow Jones Sustainability Index

According to the Dow Sustainability website, the index which was launched in 1999, the Dow Jones Sustainability Indexes are the first global indexes tracking the financial performance of the leading sustainability-driven companies worldwide. Based on the cooperation of Dow Jones Indexes, STOXX Limited and SAM they provide asset managers with reliable and objective benchmarks to manage sustainability portfolios. While corporate social responsibility and sustainability are positively correlated, they are not synonymous. Sustainability is the ability for a company to keep creating products and to have a business that can be forecasted to be profitable in the future given current constraints. CSR is more about going above and beyond that and adding value back to society.

The DJSI can be broken into four subindexes. They are as followed:

- Dow Jones World Index: this index is comprised of the top 10% in terms of sustainability out of the 2500 largest companies around the world. The figure below will give a better idea of the sub-index breakdowns.

Dow Jones Sustainability World Index

March 2010

Sector Allocation

Utilities	3.7%
Telecommunications	4.1%
Technology	10.8%
Oil & Gas	9.8%
Industrials	11.2%
Health Care	11.0%
Financials	20.7%
Consumer Services	5.6%
Consumer Goods	14.0%
Basic Materials	8.9%

Country Allocation

USA	26.7%
UK	19.3%
Japan	5.6%
Switzerland	8.1%
Germany	7.8%
France	6.7%
Spain	4.3%
Netherlands	2.4%
Australia	5.5%
Others	13.5%

- DJ STOXX and DJ Euro STOXX Index: these two indexes track performance of leading companies in terms on sustainability only from Europe and the Euro zone. More specifically, the DJ STOXX covers the top 20% in terms of sustainability of companies in the DJ STOXX 600 Index, and the DJ Euro STOXX is the subset of DJ STOXX. It represents the blue chip stocks in Europe just as the Dow Jones Index does for companies in the U.S.

Country Allocation

UK	29.1%
Switzerland	17.9%
Germany	15.9%
France	12.6%
Netherlands	5.0%
Spain	9.4%
Italy	3.9%
Norway	1.2%
Finland	2.3%
Sweden	0.9%
Denmark	1.1%
Ireland	0.5%
Portugal	0.2%
Greece	0.1%

Sector Allocation

Utilities	6.2%
Telecommunications	4.9%
Technology	3.0%
Oil & Gas	7.1%
Industrials	10.3%
Health Care	10.6%
Financials	26.5%
Consumer Services	5.7%
Consumer Goods	16.9%
Basic Materials	8.7%

- DJ North America Index and DJ United States: the two indexes cover the top 20% in terms on sustainability out of the 600 largest North American corporations. The DJ United States is the subset of the SJ North America. It is interesting to note that almost 90% of the corporations from the DJ North America index come from the U.S. It is also interesting to know that no companies in this index are from Mexico.

Sector Allocation

Utilities	3.2%
Telecommunications	1.9%
Technology	17.3%
Oil & Gas	11.4%
Industrials	11.9%
Health Care	12.3%
Financials	16.9%
Consumer Services	7.8%
Consumer Goods	12.4%
Basic Materials	4.9%

Country Allocation

USA	87.2%
Canada	12.8%

- DJ Asia Pacific Index: this index track the performance of the top 20% in terms of sustainability of the 600 largest companies in developed countries in Asia specific. Here it is clear that China, even with its double digit growth over the past years, it still has leaps and bounds to go as far as sustainability is concerned. Their use of coal as the primary source of energy indicates that it is still a burgeoning nation.

Sector Allocation

Utilities	4.2%
Telecommunications	2.5%
Technology	10.7%
Oil & Gas	2.2%
Industrials	16.7%
Health Care	0.8%
Financials	24.7%
Consumer Services	6.3%
Consumer Goods	17.9%
Basic Materials	13.9%

Country Allocation

Singapore	0.7%
Japan	54.7%
Australia	28.7%
Taiwan	3.2%
South Korea	11.0%
Hongkong	1.7%

CSR for Current Holding: Cisco

As the lead analyst for the portfolio for this particular security, it is my duty to follow and value the stock. Cisco is a large company that is working diligently at increasing its impact through an increase in corporate social responsibility. Cisco is a part of the DJSI; in fact, it is in the top 40 for US companies. Cisco is working not only to reduce its energy costs, but to reduce the energy consumption of its products, thereby allowing other companies to use more sustainable products. For example, Cisco has created IT servers that require less energy to power and less energy to cool. This allows Cisco to reap the positive publicity of being more energy conscious. It also has the added benefit of reducing costs which increases Cisco's bottom line.

Also, Cisco's TelePresence software allows companies to hold meetings with employees or clients around the world without leaving their office. This, again, benefits both the shareholders and the citizens in their communities. Teleconferencing reduces pollution from traveling, and also the costs usually incurred in either plane fare or gas. It has the added benefit of also making the companies that utilize it more efficient with their work time because they no longer are forced to spend that time on the road. (Cisco)

Cisco has also taken the initiative in their program "One Million Acts of Green" where it has created a community network for instigating greener opportunities around the world. Thus far it has helped save over 450 million pounds of greenhouse gases from being used.(Cisco) These methods allow Cisco to full maximize it's shareholder and human capital.

Cisco Company Valuation

Below it the discounted cash flow analysis, relative analysis, and overall valuation for Cisco, with considerations made for its corporate social responsibility initiatives.

Cost of Equity	0.95
Risk Premium	6.0%
Risk Free Rate (10-yr T Bill)	3.6%
Cost of Equity	9.33%
Current Interest Rate on issuing debt	0.00%
After-tax cost of debt	0.00%
Debt-to-Equity Ratio	6.23%
Weight of Debt	5.40%
Weight of Equity	93.77%
Calculated WACC	9.00%

Sensitivity Analysis Matrix			
	Terminal Growth Rate		
Discount Rate	**3.00%**	**4.00%**	**5.00%**
10.00%	$22.07	$24.29	$27.40
9.00%	$25.80	$29.14	$34.16
8.00%	$31.03	$36.43	$ 45.43

Total PV of Cash Flows:	170,682
Less Market Value of Debt	0
FCF available for Equity	170,682
Shares Outstanding	5,857
Price per Share	29.14
Current Market Price Per Share	26.55
Difference	2.68

It is clear that Cisco's business plan has added value to the company, and is an industry leader in sustainability and corporate responsibility. We have found that Cisco is undervalued relative to its current price, so we will maintain our holdings in it. Also, we believe there is untapped future potential growth not added into the stock price because of growth in sustainability sectors.

Corporate social responsibility is a growing theme among businesses today. And while the idea is growing, the spread between the disconnect of maximizing wealth and maximizing greener ideas is diminishing. All companies will eventually need to take on a larger CSR role if they wish to remain competitive. The cost savings in the long run coupled with the positive marketing in the short run ensure this. Companies will simply not be able to compete as consumers are also becoming more socially responsible. For our portfolio in particular, CSR of a company has become a factor in valuation just like debt ratios, PE ratios, and management techniques have been in the past.

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