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When social issues become strategic

Article at a glance

The case for incorporating an awareness of social and political trends into corporate strategy has become overwhelming.

Issues such as privacy, obesity, offshoring, and the safety of pharmaceutical products can alter an industry's ground rules, and the financial and reputational impact of mishandling these issues can be huge. But they also create new market opportunities that nimble companies can exploit.

Companies should look for signs of emerging hot topics, be ready to respond to them early, and place a series of small strategic bets that will create value if the social and political landscape shifts.

CEOs must be willing to ensure that different parts of their own organizations are united behind a coherent approach, to engage in external debate, and to consider collaboration with others.





When social issues become strategic

Executives ignore sociopolitical debates at their own peril.

**Sheila M. J. Bonini, Lenny T. Mendonca,
and Jeremy M. Oppenheim**

Executives with lingering doubts about the importance of sociopolitical issues to business will surely be convinced by this year's eye-catching *McKinsey Quarterly* survey on the topic. It's not just that an overwhelming majority of the respondents acknowledged a wider role for corporations than just maximizing investor returns, though this finding is remarkable in itself. More striking still is the way participants in our online poll saw



Chris Jordan

environmental concerns, the offshoring debate, data protection, and other sensitive matters as potential threats to the creation of value and frankly conceded that their companies handled these issues poorly.

Although lobbying—often behind closed doors—is as old as business itself, high-level and concerted corporate activism in the social and political arena has been conspicuous by its absence. That deficiency, executives tell us, is the result of short-term financial pressures, a lack of familiarity with the issues, and the sense that specialists in the public-affairs and legal departments handle this sort of thing.

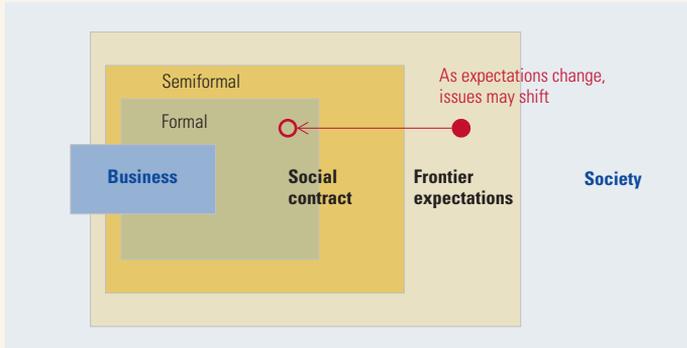
Such thinking, we believe, is dangerous and wrong headed. Business leaders must become involved in sociopolitical debate not only because their companies have so much to add but also because they have a strategic interest in doing so. Social and political forces, after all, can alter an industry’s strategic landscape fundamentally; they can torpedo the reputations of businesses that have been caught unawares and are seen as being culpable; and they can create valuable market opportunities by highlighting unmet social needs and new consumer preferences.

The challenge is to find a way for companies to incorporate an awareness of sociopolitical issues more systematically into their core strategic decision-making processes. Companies must see the social and political dimensions not just as risks—areas for damage limitation—but also as opportunities. They should scan the horizon for emerging trends and integrate their responses across the organization, so that the resulting initiatives are coherent rather than piecemeal.

The social and managerial challenge

Businesses have never been insulated from social or political expectations. What’s different today is the intensifying pressure and the growing complexity of the forces, the speed with which they change, and the ability of

EXHIBIT 1

The social contract**Formal contract**

- Explicit expectations, usually laws
 - Regulation
 - Tax policy
 - Private contracts
 - Intellectual property
 - Shareholder rights
 - Product liability

Semiformal contract

- Implicit expectations
 - Adhere to global labor, environmental standards
 - Follow industry norms, codes of conduct
 - Fulfill brand promises
- Violations result in swift action by stakeholders—eg, nongovernmental organizations (NGOs), local and global communities

Frontier expectations

- Issues that could over time become expectations of business (eg, health implications of obesity create expectations for food and beverage companies)

For an interactive version of this exhibit, visit www.mckinseyquarterly.com/links/21216.

activists to mobilize public opinion. Yet even as the social contract evolves, the typical corporate response appears to have become increasingly flat footed.

The changing social contract

Companies have always had a contract with society. The contract embraces not just direct stakeholders (such as consumers, employees, regulators, and shareholders) but also, and increasingly, a broader set of stakeholders (such as the communities where companies operate, the media, academics, and the nonprofit sector).

Part of this contract (Exhibit 1) is formalized in laws and regulations, and violating them has obvious legal ramifications. Part of it is semiformal: the stakeholders' implicit expectations, which if ignored can bring about swift action. Most multinationals in the United States, for example, are expected to maintain at least some labor standards along their global supply chains, even if they aren't legally required to do so. Violations of that semiformal contractual obligation can seriously harm a company's reputation as well as consumer demand for its products. Ask Nike.

This social contract is by nature a fluid one. Often, issues that lead to legislation start out as semiformal expectations about business; likewise, some aspects of the formal contract are "deregulated." Companies in

Europe, for example, are still expected to uphold certain employment guarantees with their workers, despite their greater flexibility in deploying labor.

More challenging are the “frontier” issues that have not yet entered the formal or semiformal contracts but could, over time, become social expectations—something that business might not even realize. Take obesity. It had always been widely believed that the responsibility for avoiding it lay with individuals, who choose what they eat, not with the companies that make or sell fattening products. But the blame is shifting, much as the debate around tobacco shifted the responsibility from individuals to an industry perceived to be aggressively marketing addictive products. Food companies may not be forced to modify the fat and sugar content of their products, but the momentum on this issue could already be so great that lawmakers or regulators will step in and formalize social expectations by imposing new legal restraints.

EXHIBIT 2

Shaping expectations			
Trend	What it means for business (selected examples)	Trend	What it means for business (selected examples)
Blurring boundaries between responsibilities and laws	<ul style="list-style-type: none"> Responsibility for obesity shifting from individuals to companies in food and beverage sectors Provision of insurance benefits shifting from employer to employee 	Rising inequality	<ul style="list-style-type: none"> Globalization, economic development create unprecedented but unevenly distributed wealth, power Pharmaceutical companies called on to provide drugs at discount prices to remedy unequal access to drugs in Africa
Butterfly effect (issues that were once peripheral or local now have global impact)	<ul style="list-style-type: none"> Local livestock contaminations (eg, mad cow disease, avian flu) threaten stability of global health and global food supply chains 	Shifting values, social norms	<ul style="list-style-type: none"> Principle of environmental stewardship creates demand for hybrid cars Protection of indigenous land and mining rights raises cost of extraction Consumer-lending rates reduced because of ‘usury’ claims
Discontinuities in demographics and resources	<ul style="list-style-type: none"> Major shifts in population sizes and age distribution, coupled with climate degradation and depletion of fundamental resources, are transforming traditional social organization and practices (eg, pension provision) Responsibility for negative implications of offshoring shifts to business 	Ubiquity of technology	<ul style="list-style-type: none"> Exposure to/fear of identity theft leads to increased compliance costs in financial-services industry Technology enhances stakeholders’ ability to coordinate, communicate, raise funds for specific causes
Growing safety and security concerns; sensitivity to risk	<ul style="list-style-type: none"> Restrictions on nuclear power downplay long-term risks of fossil-fuel-based power generation Drugs approved by US Food and Drug Administration later pulled from market because of potential health risks to small portion of population 		

For an interactive version of this exhibit, visit www.mckinseyquarterly.com/links/21216.

Rising expectations

Increasingly, a company's sources of long-term value (for example, its brand, talent, and relationships) are affected by a rising tide of expectations among stakeholders about the social role of business. Two forces are colliding: an emerging set of sociopolitical megatrends (Exhibit 2) that are upending the lives of people, communities, and societies, as well as ever-more-powerful stakeholders wielding wide influence.

Since 1990, more than 100,000 new citizens' groups have been established around the world. Even in China, a country not known for freedom of political expression, the number of social protests increased from just under 10,000 in 1993 to more than 58,000 in 2003.¹ The balance of power has shifted in favor of individuals and small single-issue groups increasingly armed with tools and tactics that can easily be deployed through the Internet. Trust in nongovernmental organizations (NGOs), citizens' groups, and online information sources has risen as inexorably as faith in business—Enron, WorldCom—has declined.

Management's slow reaction

Large organizations must shift their thinking in this area. Typically, businesses are taken by surprise when faced with negative press and stakeholder pressure. After all, they provide plenty of benefits to society—products of good quality or low prices—and employ vast numbers of people. Yet the rising tide of expectations means that companies must now strive to anticipate and understand those expectations and to embed them in their business strategy.

In the banking industry, for example, money center banks have been caught out by higher expectations. Criticized for making loans to companies that damage the environment, several have now pledged, in different ways, to restrict their lending and underwriting for industrial projects that would have an adverse environmental impact. These moves were largely reactions to protests coordinated by the Rainforest Action Network.

Companies are often on the defensive because CEOs and others in the top team find it difficult to wield what Harvard's Joseph Nye calls "soft forms of power"² or to deal with players, such as NGOs, that trade in emotional arguments. By comparison with the hard skills and in-depth knowledge

¹ Kathleen E. McLaughlin, "Chinese protesting more as social problems grow; Beijing may find it hard to retake the reins," *San Francisco Chronicle*, May 1, 2005 (www.sfgate.com).

² Joseph S. Nye Jr., *Soft Power: The Means to Success in World Politics*, Cambridge, MA: PublicAffairs, 2004. While Nye's ideas are more commonly understood in the geopolitical arena, they have strong implications for the business world as well, particularly in regard to sociopolitical issues.

of most senior executives, sociopolitical issues require statesmanship, the fostering of relationships with stakeholders, and the nurturing of assets that could be called “reputational.” Irritatingly for many executives, the arguments of pressure groups are frequently low on evidence. Furthermore, estimating the impact of most sociopolitical trends on corporate value requires executives to make assumptions and test sensitivities that MBA textbooks generally don’t discuss.

How to manage these forces

We believe that the case for adopting a wholeheartedly strategic approach to the sociopolitical agenda is threefold. First, these forces can alter an industry’s landscape in fundamental ways. In pharmaceuticals, for instance, social concerns about the cost and safety of the industry’s products, as well as access to them, have made the regulatory environment tougher during the past decade. CEOs should take part in the debate so that they, their employees, and their investors have a stable set of rules.

Second, the immediate financial and longer-term reputational impact of social issues that backfire can be enormous. Ask Monsanto, which lost significant market value in the backlash against genetically modified organisms (GMOs) in the European Union, or ExxonMobil, whose cleanup costs for the Exxon Valdez oil spill amounted to \$2 billion—on top of \$5 billion in lawsuits.

Finally, new product or market strategies can emerge from changing social and political forces. Toyota Motor’s success with the Prius can be attributed to a growing interest in environmentally friendly products. Unilever’s innovative product offerings in developing countries, such as its Wheel detergent brand in India, were a response to the unmet needs of lower-income consumers there.

At the practical level, a company can take a number of steps aimed at making its approach to sociopolitical issues more strategic. It can develop “radar” systems to anticipate future risks and opportunities, master the range of options available for dealing with them, engage in the external debate, and ensure that the entire organization takes part in a coherent and forceful way.

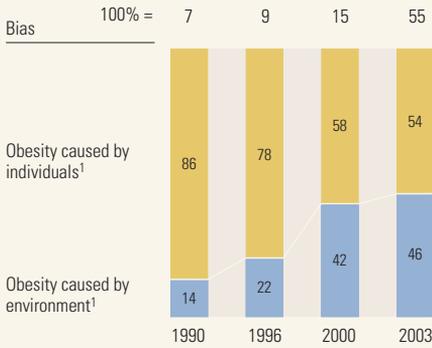
Develop reliable radar

Sociopolitical issues and regulatory shifts may appear to come out of the blue. But the success of savvy newcomers such as Whole Foods Market confirms the fact that companies can indeed spot new trends and that early-warning signs of imminent change are plentiful. Not all issues, of course,

EXHIBIT 3

Responsibility shifts

New York Times articles on obesity by causation bias, % of new editorials or page-1 articles



Growing concern around obesity was evident as early as 1996, ~5 years earlier than 1st announcement by US Surgeon General that obesity had become national epidemic

¹Individual causes are biological or behavioral factors (eg, overeating, lack of exercise); environmental causes are systemic factors (eg, corporate marketing, lack of government guidelines on healthy eating).

Source: Regina G. Lawrence, “Framing obesity: The evolution of news discourse on a public health issue,” Harvard University working paper number 2004-5, 2004 (www.ksg.harvard.edu); McKinsey analysis

evolve in a way that changes the social contract. Nonetheless, an early awareness of the concerns of NGOs and stakeholders enables companies to join and shape the debate before it turns against them—or at least to prepare themselves for turbulence ahead. Businesses that end up publicly fighting their stakeholders can well damage the brand or destroy the morale of their employees; much better to engage in a minor strategic foray than to be forced into a full-scale war.

In fact, our survey suggests that executives already know that they need to anticipate social pressure much more successfully. In our view, they should use systematic methods, including trusted techniques such as economic analysis and scenario planning, to evaluate the strategic impact of sociopolitical trends. If companies had tracked topics such as the obesity debate in the media, they would have become aware that reports on those issues were appearing more and more frequently in the mid-1990s. But volume alone isn’t a sufficient guide. New evidence from, say, a well-respected academic can quickly change the dynamics of an argument. The obesity debate is one of those that took a significant turn during the 1990s. We can measure the change by following articles in the *New York Times* (Exhibit 3): blame for the problem shifted from individuals (overeating, lack of exercise) to “environmental” causes, including corporate marketing. The new outlook was at least in part the result of research by Harvard’s Walter Willett showing a link between childhood obesity and the marketing of junk food.

Local antennae are also vital. Large-scale problems generally start as small regional issues before they are championed by larger, typically Western NGOs that have the clout and media contacts to launch global campaigns. The triggers are often practices—for example, working conditions that are below Western standards or “facilitation payments” to local government officials—that seem acceptable in some countries but not others. These practices may have a detrimental effect on corporate reputations when activists highlight and replay them for a global audience.

Large-scale problems generally start as small regional ones before Western NGOs champion them

What’s more, the damage will be done notwithstanding any ethical policies that may have been promulgated throughout a business. Most companies become aware of the risks only at this late stage,

when their direct stakeholders have already started to change their behavior. Mapping the landscape of different stakeholders is therefore important for a company’s sociopolitical radar system. An understanding of the influence of various groups, their agendas, and their level of activism is a vital first step before a company chooses the best partners for its sociopolitical strategy.

Companies should aggregate this information to identify where they are most at risk and the economic implications of potential actions by stakeholders—particularly when they face a number of issues all at once. To evaluate what’s at stake, companies must scan the whole value chain, looking, for example, at the way they source raw materials and make and sell their products. They should develop potential future scenarios that take into account the reaction of competitors, shifts in consumer patterns, and the possibility of litigation and regulation. Governments, for instance, may ultimately regulate the sale of fast food in schools through legislation or enhanced nutritional requirements for any foods sold in them (this issue is currently under debate in the California legislature). Alternatively, the success of several class action lawsuits could force the food and beverage industry to negotiate multiyear settlements. At the consumer level, educational campaigns and articles in the media will likely promote healthier options for food.

Place strategic bets

Armed with a more solid approach to the management of social issues, companies can not only reduce the risk to their reputations by anticipating new regulations but also create value by making the most of social and political shifts.

Indeed, companies should place bets on opportunities that emerge from their radar-tracking activities. Toyota's Prius is an example: the car's initial success puts the company in a position to move hybrid technology toward profitability faster than its competitors can as well as to augment its reputation by helping to address environmental issues—even if the jury is still out on the technology's effectiveness. GE's ecomagination initiative, reinforcing the company's commitment to clean products and reduced emissions, is a relatively low-cost, low-risk way of anticipating products and services that might be built on the back of emerging sociopolitical trends.

In general, more uncertain circumstances warrant a broad set of strategic options, and less uncertain circumstances warrant more narrow ones. To cope with emerging sociopolitical issues, we would expect companies to use a wide range of small investments that should be culled and narrowed as the issues move further into the explicit social contract with business. Given the unpredictable way socioeconomic trends develop, a strategy using a portfolio of initiatives is particularly relevant.³

Participate in the external debate

CEOs should also be prepared to take the lead in socioeconomic debates that could alter the structure of their industries and the rules of engagement in the long term. Business, in essence, involves a series of complex and continually evolving social trade-offs. In the power sector, the goals of low prices, energy security, and environmental friendliness are in permanent tension. So are the affordability of drugs, product safety, and innovation in pharmaceuticals. Business leaders need to raise the public's understanding of these unavoidable trade-offs.

The seminal 1997 speech of John Browne, BP's CEO, on global climate change—when he promised that BP would become an active, concerned participant in dealing with the problem of global warming—was notable as the first time a multinational corporation (other than a reinsurance company) had joined the emerging consensus on the topic. Bruce Bodaken, of Blue Shield of California, was the first health plan CEO to offer a proposal specifically for universal health coverage in his state.

To reduce uncertainty for all players, including investors, businesses need stable guidelines about the future evolution of their industries. An analogy can be made with the technological shifts that occur before industries

³For more, see Lowell L. Bryan, "Just-in-time strategy for a turbulent world," *The McKinsey Quarterly*, 2002 special edition: Risk and resilience, pp. 16–27 (www.mckinseyquarterly.com/links/21111).

adopt common standards. Industry leaders are in a strong position to ensure that a rational, evidence-based discussion of social and political trade-offs takes place. Without such a discussion the social contract remains unpredictable, investors suffer, and the social benefits of finding appropriate solutions are deferred.

Like any strategic shift, calls for change in the social contract involve a degree of risk. But if a company could be seen to have any responsibility for causing a sociopolitical problem, change is a no-regrets move, particularly for an industry leader that has the scale to alter the market. In some cases, change can confer a clear strategic advantage: for example, after the “blood diamonds” campaign,⁴ De Beers helped to develop a global certification system that enabled it to charge a premium for diamonds mined in conflict-free areas. Few companies get involved in a sociopolitical debate at the stage when they might be at risk for being ahead of the curve. The prevalent risk is not getting involved early enough.

Collaborate, cooperate . . .

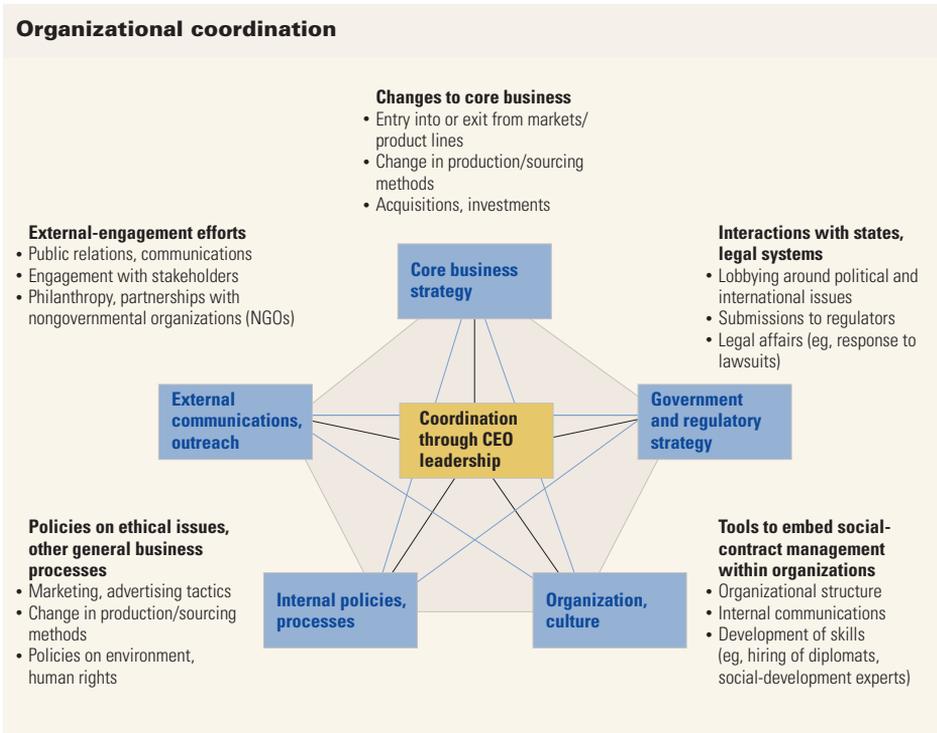
Many sociopolitical issues are intractable and can’t be resolved by a single company or even an industry. The most successful companies see beyond competitive rivalries and look for collaborative ways both to meet social concerns and to find new ways for industries to create value. The difficulty is knowing when to work with others and when to go it alone.

Working across different organizations with different cultures can be time consuming and slow moving; Nike and other branded marketers took seven years to establish the Fair Labor Association to strengthen labor rights in the supply chain. Industry associations often lack the capabilities to tackle broad issues across a sector, as well as the power to mobilize enough support. That’s why CEOs of mining companies recently set up a new body, separate from the existing industry association (the International Council on Mining & Metals), to take on the sociopolitical issues facing them.

Coca-Cola and PepsiCo have benefited from a common approach to marketing to children under 12: both have a clear policy not to market their core carbonated soft drinks to this group. For other collaborative efforts, the attractions are the potential revenue upside and the ability to share costs. As a rule, companies should consider responding on their own if they think they can capture the first-mover advantage (as BP did in acknowledging the dangers of global warming), if they are a target, or if a

⁴During the 1990s, revenues from diamond mining were used to finance civil conflicts in some African countries, including Angola, Liberia, and Sierra Leone. The Western NGOs Global Witness and Partnership Africa Canada mounted a campaign demanding an end to sales of “conflict diamonds,” focusing on De Beers as the biggest diamond producer.

EXHIBIT 4



collective approach is too difficult or costly. Collaboration can be attractive if the stakeholders regard all companies as equally culpable, if regulation is imposed on an entire industry, or if isolated, individual action would clearly destroy value.

... and coordinate

As our survey indicates, most business executives expect CEOs to take the lead in managing the corporate sociopolitical agenda. What's more important, though, is how well companies integrate such issues not just into the making of strategy but also across all dimensions of the business (Exhibit 4). A piecemeal approach runs the risk of misalignment—a CEO saying one thing, the rest of the company failing to translate these fine intentions into practical action. A company whose external-communications strategy emphasizes the search for more environmentally friendly products and processes, for example, probably won't make much headway if the company's government and regulatory functions are simultaneously fighting limits on carbon dioxide emissions.

Without a CEO's personal involvement, sensitivity to the sociopolitical agenda probably won't become embedded in an organization's culture and values. Neither will organizational coordination—always difficult to achieve across different divisions and functions—for the CEO plays a vital

role orchestrating departments (such as PR, legal, regulation, and marketing) that ordinarily wouldn't act in concert. When CEOs such as BP's John Browne and GE's Jeff Immelt show their personal commitment, the response from stakeholders is remarkably positive.

Sociopolitical trends will increasingly affect the strategic freedom of companies, which just can't ignore the rising tide of expectations resulting from these trends and the power and influence of the stakeholders who mobilize around them. For stakeholders, companies are, in many ways, already agents of social change and must become much more deliberate in understanding the way they affect society. Businesses that follow the approach we outline and proactively understand and engage with social issues will benefit most. They will be better able to shape the social contract and to identify ways of creating value from the opportunities and risks arising from sociopolitical issues. *Q*



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