Business Case
Teaching Notes

Johnson & Johnson

Is there a connection between being socially responsible and building sustainable competitive advantage?

OVERALL PERSPECTIVE ON THE BUSINESS CASE

The leaders at Johnson & Johnson would develop responses to questions like these by conducting research, crunching numbers, and perhaps even going after voice of the customer to see how they are perceived in these areas. But it should be clear that Johnson & Johnson is driven by *Our Credo*.

Perry Somers, the MBA student in the case, wants to learn how to create value for shareholders. But fundamental to the spirit of *Our Credo* is that the Corporation never creates shareholder value at the expense of product users, employees or communities. That concept in and of itself is strong rationale for the Johnson & Johnson decision to heavily invest in its environmental, health and safety initiatives.

Johnson & Johnson leaders are practical enough to recognize that the company cannot sustain itself as the most comprehensive health care company in the world without feeding the bottom line, and subsequently, the pockets of its shareholders. But it could not have held the pole position for 65 years without putting people before profit. This is especially true in the past few decades as consumers have become increasingly astute in their buying decisions. People have an inherent need to do what's right. Johnson & Johnson leaders believe they too need to do what's right—not just for the company's shareholders, but for every human life their Corporation touches.

Perry's overarching question in the case is: ***Is there a connection between being socially responsible and building sustainable competitive advantage, or are these two objectives, as he thought, at odds with each other?***

Discussion points for the more specific case questions follow (and are included in the accompanying DVD), but the fundamental answer is: The management decisions driven by *Our Credo* over the past 65 years—including those involving environmental, health and safety practices—have consistently yielded increased sales, profits and dividends.

Case Question #1:

Is there a link between being socially responsible and creating sustainable competitive advantage? If so, how is that advantage created?

In an influential article published in December 2006*, Michael Porter and Mark Kramer note:

"For any company, strategy must go beyond best practices. It is about choosing a unique position—doing things differently from competitors in a way that lowers costs or better serves a particular set of customer needs. These principles apply to a company's relationship to society as readily as to its relationship to its customers and rivals." (p. 11)

"Strategy is always about making choices, and success in corporate social responsibility is no different…Efforts to find shared value in operating practices and in the social dimensions of competitive context have the potential not only to foster economic and social development but to change the way companies and society think about each other…NGOs, governments and companies must stop thinking in terms of 'corporate social responsibility' and thinking in terms of 'corporate social integration'." (p. 14)

*Porter, Michael and Mark Kramer, *Harvard Business Review*, "Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility," December 2006.

For Johnson & Johnson, its go-to-market strategy is about innovation. The Company's source of strategic competitive advantage is its ability to innovate and create products that serve vital customer needs. This is done by a staff of extremely talented scientists, managers and operators. Their health and safety is critical to using and maintaining core competencies.

To continue to innovate, it is imperative that Johnson & Johnson acquires, develops and retains human capital. Their commitment to the environment, health and safety contributes to their "employment brand" and attracts significant numbers of applicants. Given the large pool of applicants, Johnson & Johnson can then hire the most qualified and talented employees in the industry. Moreover, given the extensive personal support through the vast benefit programs, employees are less likely to leave Johnson & Johnson, thus contributing to the retention of critical knowledge.

As is discussed in the questions that follow, Johnson & Johnson is distinct for many reasons. Perhaps its most distinctive feature is its reliance on *Our Credo* for making critical choices. While some will argue that its success allows it the freedom to invest in EHS projects, insiders will argue that the logic should be reversed: the Company's investment in EHS differentiates it from competitors in a way that ultimately lowers costs and better serves society.

Case Question #2:

What are the points where the business of Johnson & Johnson impacts society?

The responses to this question are organized around the four components of Our Credo, which guides Johnson & Johnson not in only how it does business, but how it functions as a contributor to society.

Patients/Consumers

As exemplified by the TYLENOL® incident recounted in the case, Johnson & Johnson clearly emphasizes ethical practices—even when it costs the Company a lot of money. Its business is based on consumer trust.

In order to succeed in the long run, organizations need cultures that adapt continuously to new environmental conditions. The Johnson & Johnson focus on staying close to the customer (e.g., the customer is the first priority in *Our Credo*) requires that the firm be outward focused rather than inward focused. This helps keep an appropriate balance with the other constituents listed in *Our Credo* (employees, communities, shareholders). The Company's extensive programs for health, safety and the environment are vital to its wellbeing but always subordinate to the key mandate of taking care of customers. The value of these programs must be justified financially and must square with *Our Credo*; otherwise they will be eliminated.

Employees

Clearly, employees are important constituents at Johnson & Johnson. Because their individual success is so important to the enterprise collectively, Johnson & Johnson makes large investments in programs that promote, protect, and empower employees. Strong employers make important civic contributions. Indeed, that is one reason that corporations are granted special rights under U.S. law (e.g., limits to liability of owners).

Environment/Community

Johnson & Johnson is the fifth largest purchaser of renewable energy in the U.S. and the largest corporate user of on-site solar power. Both of these claims are very impressive in the context of a business world increasingly being held accountable for its eco-friendliness. Being able to hold these positions over time earns not only respect, but prestige from consumers, other industry leaders, and the government. The unique status of Johnson & Johnson as the only green power purchaser to earn the EPA's Green Power Leadership Award for six consecutive years makes it an honor student in the eyes of the government, which gives the company status in Washington that may not be quantifiable, but is certainly potentially useful if ever needing governmental support. The case also presents some impressive statistics: 39% of The Johnson & Johnson Family of Companies' energy comes from renewable resources, and a $100 million investment in clean energy projects has yielded a 16.3% rate of return. Even the EPA website (http://epa.gov/greenpower/awards/winners.htm#johnson) presents a positive perception of the corporation:

> *Johnson & Johnson is participating in EPA's Fortune 500 Green Power Challenge and ranks among the largest of the campaign's Fortune 500 purchasers. The size of the company's green power purchase, along with its willingness to share its experiences, makes Johnson & Johnson a leader in green power procurement.*

The website includes these benefits of partnership: EPA assistance in communicating the environmental benefits of purchasing energy; credibility of a company that meets nationally accepted environmental standards; and a way to differentiate the company from its competition. The site leads the reader to dozens of articles, some published on CNN.com and MSNBC.com and in the *Wall Street Journal*, *USA Today* and *The Washington Post*.

Over time, Johnson & Johnson may be able to quantify dollars saved due to using renewable energy. Until then, it cannot ignore the value of positive public relations and good will for being a good corporate citizen. It may not be quantifiable, but it helps the Company demonstrate its Credo commitment to the environment: "*We are responsible to the communities in which we live and work and to the world community as well…We must maintain in good order the property we are privileged to use, protecting the environment and natural resources*."

Investors

JBWere, the Australasian arm of Goldman Sachs, issued a research report in October 2007* that answered the question, "Is share price performance linked with WHS (Workplace Health and Safety)?" Goldman Sachs JBWere analysts expressed: "We find that investors could have profited by using WHS measures as a signal for an investment strategy…" (p. 3). Though the findings of their study are based on correlation not causation, they develop the following logic to explain the results they found

- *"With regards to causation, it is logical to assume that companies that manage their capital correctly, including human capital, should provide better performance. WHS is likely a key indicator as to how well a company is managing its human capital…*
- *With regard to association, WHS is likely a proxy for general good management and governance, with logic and other research suggesting that these are linked to company performance."* (p. 5).

*Goldman Sachs JBWere, "Good Workplace Health & Safety = Good Investment Returns," Research Report, October 2007.

Case Question #3:

How do society's expectations affect the ability of Johnson & Johnson to compete?

Robert Wood Johnson wrote *Our Credo* in 1943, the year before the company went public. He knew 65 years ago that companies have a social responsibility to their constituents, and if they don't fulfill that responsibility, they forfeit the freedom to be in business. Following the quote in the question from *Or Forfeit Freedom* Johnson writes:

> *"The day has passed when business was a private matter—if it ever really was. In a business society, every act of business has social consequences and may arouse public interest, Every time business hires, builds, sells, or buys, it is acting for the…people as well as for itself, and it must be prepared to accept full responsibility for its acts…"*

Reputation

The public trust and consumer acceptance are critical to the future success of Johnson & Johnson. If society were to perceive a lack of integrity among Johnson & Johnson leaders (e.g., financial misdeeds) or the self-interested promotion of dangerous drugs or intentionally poor product quality, there would be many costs to be born by the firm. Society's acceptance of Johnson & Johnson is the basis for long-term success.

Pool of talent available and attracted to Johnson & Johnson

Society provides the pool of qualified workers that Johnson & Johnson requires. If the quality of education in the society declines, if the safety of the community is diminished, or if environmental conditions make a place in which Johnson & Johnson is located unhealthy or undesirable, the company is harmed in the long run. Top talent is critical to R&D, manufacturing, service and sales.

Regulatory relations

Relationships with regulators, activists, and community opinion leaders matter. So, while Johnson & Johnson carefully quantifies the value of being a good citizen in society, there is no one-size-fits-all answer to the question of how long it takes to realize the gain on green investments. A global energy expert at Johnson & Johnson asserts that solar projects begin to pay back in 8-9 years, taking into account government incentives, reduced electric costs, and in some cases the income generated from renewable energy credits. Ultimately it depends on the type of energy and the size of the investment. Johnson & Johnson does know that a $100 million investment in clean energy projects yielded a 16.3% rate of return over a few years (case section on Renewable Energy & Waste). It is too soon to say how long it will take to return 100% or more.

Business Week published an article on October 29, 2007 called "Little Green Lies" that directly questions the profitability of environmentally friendly corporate efforts. It refers to environmental stewardship as a "centerpiece of corporate image-crafting." It goes on to say that:

> *"Companies continue to assess most green initiatives with the same return-on-investment analysis they would use with any other capital project. And while some environmental advances pay for themselves in time, returns often aren't as swift or large as competing uses of corporate cash."*

Despite being unable to do a clean ROI analysis of installing solar panels or purchasing methane gas from a landfill, Johnson & Johnson will continue to adhere to its Healthy Planet Goals. *Our Credo* demands it, and the decision-makers live by *Our Credo*. Perhaps just as important, shareholders expect it of Johnson & Johnson.

Case Question #4:

How does excellence in environment, health and safety contribute to the achievement of corporate goals?

The case does not divulge the cost of any of the environment, health or safety programs. Surely the EHS business leaders know the bottom line costs of installing energy-saving devices, operating on-site fitness centers, outfitting facilities with high-tech lifting mechanisms, and providing behind-the-wheel driver training classes to their sales reps. But what they are likely held accountable for is showing measurable results in reduced incidents, cost avoidance, improved performance, and more.

For the number-crunching business students, let's itemize some of those positive, quantifiable results:

EHS Initiative	Annual Savings
One company modified a process to reduce emissions and waste. Besides savings, it also eliminated the need for retrofitting later, which was an unmeasured cost avoidance.	$2 million
A new HVAC cleaning system in a Puerto Rican facility saved $83,900.	$83,900
Site in Belgium reduces CO_2, and saves in energy costs and annual maintenance costs.	$417,000
Reduced packaging in India means less materials and cheaper shipping.	$27,000
Converting scrap rather than landfilling it in Italy.	$215,000
Health & Wellness Program data is not up-to-date, but it has historically shown, on average, a savings of $224.66 per employee each year. Given that the current program (Healthy People) is even more robust, one can assume savings are at least comparable. [$225 x 41,000 US employee participants]	$9.2 million
Employee Assistance Program expected to yield $4,000 per client (3,000 participating)	$12 million
Insurance costs (worker's comp) were avoided because of an extremely low recordable rate (1.14) compared with industry standards (2.4).	$2.6 million

In only the initiatives listed above, the Johnson & Johnson Family of Companies can comfortably say that these programs have resulted in financial savings of $26,542,900 annually. The case reflects only a small portion of measured results. Collectively, the EHS initiatives show measurable value, even without knowing their overall cost.

Looking at SAFE Fleet separately, one can use Exhibit 8 from the case to estimate how many accidents were avoided each year due to the initiative. Calculating this estimate conservatively assumes that the number of accidents would remain constant in subsequent years if SAFE Fleet were not in place. That number of accidents multiplied by $5,500 provides cost avoidance figures. The chart below turns the numbers of Exhibit 8 sideways, and fills in calculated information **in green** using the 2002 APMM as a baseline (as directed in the case).

Year	# of Vehicles	Miles (millions)	# of Accidents	APMM	APMM Reduction	Acc. Avoided	Acc. Costs Avoided	Expected Acc. At 5.74 APMM
2002	30,803	678.85	4,014	**5.74**				
2003	34,183	764.38	4,219	**5.52**	**4%**	**169**	**$929,500**	4388
2004	34,467	776.34	4,027	**5.19**	**10%**	**429**	**$2,359,500**	4456
2005	35,382	795.00	3,862	**4.86**	**15%**	**701**	**$3,855,500**	4563
2006	36,056	799.65	4,253	**5.32**	**7%**	**337**	**$1,853,500**	4590
2007	36,383	754.94	3,932	**5.21**	**9%**	**401**	**$2,205,500**	4333
					Total	**2037**	**$11,203,500**	

In 2005 there were 35,382 vehicles participating in SAFE Fleet worldwide. Combined, they drove 795.00 million miles. There were 3,862 accidents. With each accident potentially costing $5,500, Johnson & Johnson may have lost over $21 million to vehicle-related accidents in that one year. But without SAFE Fleet (assuming accidents were similar to the previous year), there could have been 701 more, costing an additional $3.86 million in 2005. Using a more conservative calculation, fleet accident costs avoided due to SAFE Fleet has ranged from over $929,000 in 2003 when they began using this measurement, to a projected $2.2 million in 2007. On average, over the course of those five years, Johnson & Johnson avoided $2.24 million annually ($11.2 mil/5). Operating companies are typically charged an amount per driver to cover the costs associated with the program (amount varies depending upon region), which they see as an investment in avoiding additional accident costs if their associates were not practicing the safe driving performance they are taught in SAFE Fleet.

The final page of the case presents information about worker's compensation costs. Just using the data presented for 2006, one can calculate insurance costs avoided by having a lower recordable rate than the industry average.

Cost Avoidance per 100 Full-Time Employees	Johnson & Johnson (2006 data)	Industry Standard (SIC 2834)
Total Recordable Rate	1.14	2.4
Client Average Incurred per Claim	$4,539	$4,539
Total Cost per 100 FTE (rate x client ave cost)	$5,174	$10,894

In 2006 alone, Johnson & Johnson avoided an average of $5,720 ($10,894 - $5,174) per 100 employees when compared with the industry standard. With 46,000 Johnson & Johnson Family of Companies U.S. employees, the total cost avoidance in worker's compensation costs for 2006 is $2,631,200 ($5,720 x 460).

Case Question #5:

Given commitment to and attention from senior managers on environment, health and safety issues, what is the risk that EHS issues will crowd out more important management matters (e.g., driving existing business, pursuing mergers and acquisitions, etc.)?

The only way that EHS issues will become more important than any other issue on the table is if there is a tragedy attached to the issue. This is not likely because the key reason Johnson & Johnson invests in the many EHS initiatives is to prevent tragedies. However, EHS issues are taken into consideration when making strategic decisions. For instance, the corporate leaders would certainly consider the risk of acquiring a company burdened with environmental violations. There is both a financial cost to cleaning it up, and a cost to the Johnson & Johnson reputation of being environmentally responsible.

Johnson & Johnson is structured such that EHS decisions are part of the strategic planning and decision-making processes. Under the section "Principles Drive Practices" it is apparent in Exhibit 4 that the organizational structure is designed to incorporate EHS considerations into decisions made at the levels of Executive Committee, Chairman and Board of Directors. The Public Policy Advisory Committee provides an ongoing monitoring role to keep the corporate decision-makers tied to the EHS goals.

Case Question #6:

Johnson & Johnson is spending considerable resources to enhance performance on environmental performance as well as workplace safety and health. The company is already recognized as being in the very top tier of global companies with respect to EHS performance. How do the leaders of Johnson & Johnson know when they've hit the point of diminishing returns? When does the cost cease to justify the return?

Johnson & Johnson will continue to go beyond compliance in its EHS initiatives until the more than 250 operating companies that make up the corporation no longer are willing to participate.

Johnson & Johnson emphasizes decentralized management as a model of governance. The organization relies on this decentralization to promote faster decision-making in local areas and greater accountability for business-line success. The simplified organizational chart in Exhibit 4 tells us that the Executive Committee includes the Chairmen of each group. The corporate website clarifies how decisions get made in this decentralized structure (http://www.investor.jnj.com/overview.cfm):

> *Johnson & Johnson is organized on the principles of decentralized management. The Executive Committee of Johnson & Johnson is the principal management group responsible for the operations of Johnson & Johnson. In addition, certain Executive Committee members serve as Worldwide Chairmen of Group Operating Committees, which are comprised of managers who represent key operations within the group, as well as management expertise in other specialized functions. These Committees oversee and coordinate the activities of domestic and international companies related to each of the Consumer, Pharmaceutical and Professional segments of business. Operating management of each company is headed by a Chairman, President, General Manager or Managing Director who reports directly to, or through a line executive to, a Group Operating Committee. In line with this policy of decentralization, each international subsidiary is, with some exceptions, managed by citizens of the country where it is located.*

The Executive Committee members know when their operating companies do not buy into a corporate goal. They oversee operating companies around the world that are managed by local residents. Even though each of these leaders follows *Our Credo*, they are prepared to let the Chairman of their Operating Group know when a goal is unreasonable in their company and/or in their particular region.

One area that is an ongoing challenge for Johnson & Johnson is securing the commitment to its EHS goals from the supply chain. The requirements they place on external manufacturers and suppliers, as required by their *Policy on Business Conduct*, means careful screening in procurement, and vigilance in monitoring work practices. The company believes that this extra investment up front reduces the risk of inconsistencies or violations later.

Additional guided discussion question for professors teaching the case…

If an organization lacks a *Credo*, can it also pursue corporate social responsibility? Create shared value? How?

Porter and Kramer's 2006 Harvard Business Review article entitled, "Strategy & Society: The Linkage between Competitive Advantage and Corporate Social Responsibility," is a valuable source of ideas about how to avoid counterproductive corporate social responsibility efforts. While we recommend a careful review of the article, a few key points follow:

- Identify points of intersection between your company and society.
    - In what ways does your organization affect society?
    - How does society affect your competitiveness?
- Select social issues to address.
    - Given your company's and society's impact on each other, how might you address social needs in ways that create shared value—a meaningful benefit for society that also adds to your company's bottom line?
- Mount a small number of initiatives that generate large and distinctive benefits for society and your company.

Conclusion:

William Weldon and the other Johnson & Johnson leaders seem to believe that good environmental, health and safety performance is an indicator of good performance in other areas: quality, productivity, morale and retention, to name a few. The EHS investments do more than just improve environmental, health and safety performance. They are part of the "preventive maintenance" done by Johnson & Johnson to ensure excellent performance in every aspect of its business. *Our Credo* states that commitment clearly.

Our Credo is more than a code of ethics. Former General Counsel of Johnson & Johnson Roger Fine more accurately called *Our Credo* "a statement of character." Michael Josephson, a renowned ethicist, says the Johnson & Johnson name is more of a "trustmark" than a trademark, and is the company's greatest asset. He lists the advantages of the ethical conduct inherent in the Johnson & Johnson name as: competitive edge, credibility, efficiency, loyalty, recruiting, morale, personal satisfaction.

The trustmark of Johnson & Johnson. *Our Credo*. These drive company decisions—including decisions about how to keep employees healthy, how to prevent and treat an injury, and how to fuel a factory. What price do you put on the investments related to these decisions? If calculations showed that the EHS investments did not yield a profitable bottom line return, Johnson & Johnson would not only continue its EHS programming, but likely would seek ways to improve it. That's what *Our Credo* tells the Company's leaders to do. That's what the public expects of the corporation with the Johnson & Johnson trustmark.