Hellenic Observatory Athens Lectures

Building Social Capital and Trust: The Role of Corporate Social Responsibility

Speaker: AneTamayo, Professor of Accounting, LSE

Discussant: Sophie Daskalaki- Mytilineou, President of the Corporate Social Responsibility (CSR) Committee of MYTILINEOS

Chair: Kevin Featherstone, Director of the Hellenic Observatory, Eleftherios Venizelos Professor of Contemporary Greek Studies, LSE

#CSR

lse.ac.uk/ho

Building Social Capital and Trust in Corporations:

The Role of Corporate Social Responsibility

Prof. Ane Tamayo

LSE Hellenic Observatory and
National Bank of Greece – May 2019

Introduction

- Neoclassical model of the firm:
  - Managers combine capital and labour in the production process to maximise profits

- Large literature on capital investments (tangible and intangible, including intellectual capital) and human capital

- There is another type of capital that has received much less attention, but may be as important as the other ones: ***Social Capital***

Social Capital

General perspective:

- What is social capital?
- What is the (macro)economic impact of social capital?

Corporate perspective:

- How can corporations build their social capital?
- Do those investments pay off?
- What prevents companies from investing optimally in social capital?

Social Capital: Definition and Components

- Broad concept – different authors provide different definitions
- Putnam: "*The propensity of people in a society to cooperate to produce socially efficient outcomes*"
  - Social networks, reciprocity, trust
- Coleman: "*A resource available to individuals that emerges from social ties*"

Social Capital:
Definition and Components (cont.)

Common components:

i. *Networks*

ii. *Ease of cooperation – reciprocity*: "I will be good to you because I believe you will be good to me at some point in the future"

iii. *Trust*: "Expectation that another person (or institution) will perform actions that are beneficial to us regardless of our capacity to monitor those actions"

Social capital builds trust and cooperation

(and vice versa)

Early Work:
Social Capital and Economic Outcomes

- Initial focus on society as a whole or on various regions within countries

- Most common proxies:
  - Civic engagement
  - Willingness to trust people

- Social capital is <u>related</u> to many economic outcomes:
  - GDP growth
  - Financial development (stock market size, company size)
  - Lack of corruption
  - …

Recent Work: Social Capital and Corporate Policies

- Trust is defined at geographic level

- Firms in high trust regions have:
  - Fewer agency problems
  - Higher valuations and profitability

- Firms in low trust regions:
  - Pay more dividends
  - High-dividend paying firms trade at a premium in low trust regions compared to low-dividend paying firms

- ***"Endowed trust"*** – trust a firm inherits due to its location

Social Capital at the Firm Level: Organisational Social Capital

- ***"Earned trust"*** – trust a firm builds through its investments in social capital

- Social capital: A resource reflecting the quality of the relations between a firm and its stakeholders

- A firm's investment in social capital:
  - Engenders cooperation and trust from its stakeholders,
  - Alleviates moral hazard and adverse selection

  which, in turn, can result in positive economic outcomes for the firm.

How to Build Social Capital?

- Social ties
  - Managerial ties
  - Social capital of individuals in an organisation – workers, etc.

- Centrality in suppliers and customers networks

- ***Corporate social responsibility investments***

CSR as a Measure of Social Capital

Corporate social responsibility:

"CSR is the commitment of a business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve the quality of life."

[World Business Council for Sustainable Development]

Academic work: A firm's <u>corporate social responsibility</u> (CSR) activities as an observable measure of a firm's social capital (Sacconi and Degli Antoni 2011).

CSR as a Measure of Social Capital: Practitioners’ View

pwc Global

17th Annual Global CEO Survey: Building trust

17th Annual Global CEO Survey

Building trust

The world in which we live and work is being redefined by fundamental global trends. The impact of these trends is radically changing society’s expectations of business. The extent to which a business behaves in line with these expectations determines how trustworthy it’s perceived to be. This is putting trust high up on the CEO agenda. While the ‘trust deficit’ has narrowed, lack of trust in business is still a major concern for business leaders. Our survey identifies three strategic priorities for CEOs wanting to build trust in business.

CEOs share their insights on building trust in PwC’s 17th Annual Global CEO Survey

Evaluating CSR activities

- Whose perspective? Society? Individuals? Firms?
- Research in economics, finance and accounting takes the perspective of Friedman (1970):

  "*The social responsibility of a business is to increase its profits*"
- Thus, attention is on ***whether CSR activities create value for shareholders***

Does Social Capital Built Through CSR Activities Pay Off?

- Evidence is mixed, although more work suggests a ***positive relation*** between CSR activities and firm value.

- Problems/Challenges:
  1. Measurement problem: CSR expenditures or CSR efforts/outcomes?
  2. Model? Depends on the mechanisms through which CSR affects value – direct or mediating effect?
  3. Evidence on associations (correlations), ***not causality***: I.e., “Doing well by doing good” or “Doing good by doing well”?

In Our Research…

… We have tried to address these problems by:

- ***Consumer channel*** as a mediator

- Exploiting an ***external (exogenous) shock to generalized trust*** (financial crisis) and examining whether/how CSR activities affect stock returns in a period when trust unexpectedly declines

The Impact of Corporate Social Responsibility on Firm Value: The Role of Customer Awareness

Henri Servaes
London Business School

Ane Tamayo
London School of Economics

Management Science, 2013

What We Do

- Challenge the idea that CSR affects directly firm value
- Explore one of the channels through which CSR can add value: consumer channel
- ***Our hypothesis***: CSR can only be valued by a firm’s customers if there is ***customer awareness*** of such activities
- Employ advertising intensity to measure awareness

Findings and Interpretation

- No direct relation between value and CSR once firm characteristics are controlled for

- Positive relation between value and CSR interacted with advertising ⇨ Information about the firm's CSR activities needs to be in the public domain for them to pay off

- The positive relation between CSR and value is stronger for firms at the top of Fortune's "Most Admired Firms List"; for firms at the bottom, relation reverses ⇨ CSR efforts not in-line with a firm's prior reputation do not pay- off

Caveats

- Although we focus on CSR and value changes, we cannot fully establish causality

- Other channels (e.g., employee channel) may act as complements or substitutes of the consumer channel, reinforcing or offsetting the documented CSR-value relation

Social Capital, Trust and Firm Performance: The Value of CSR during the Financial Crisis

Karl V. Lins
University of Utah

Henri Servaes
London Business School

Ane Tamayo
London School of Economics

Journal of Finance 77, 2017

What We Do

- Relate CSR to social capital and trust

- Try to establish causality: Focus on ***a period in which overall trust unexpectedly declined*** (financial crisis) but firm investment in CSR remained constant in the short run – exogenous to individual firms

- ***Our hypothesis***: If firms' CSR efforts help build social capital and trust, those efforts should pay-off more when trust is more valuable

- Focus on (abnormal) stock returns

Did Trust Decline During The Financial Crisis?

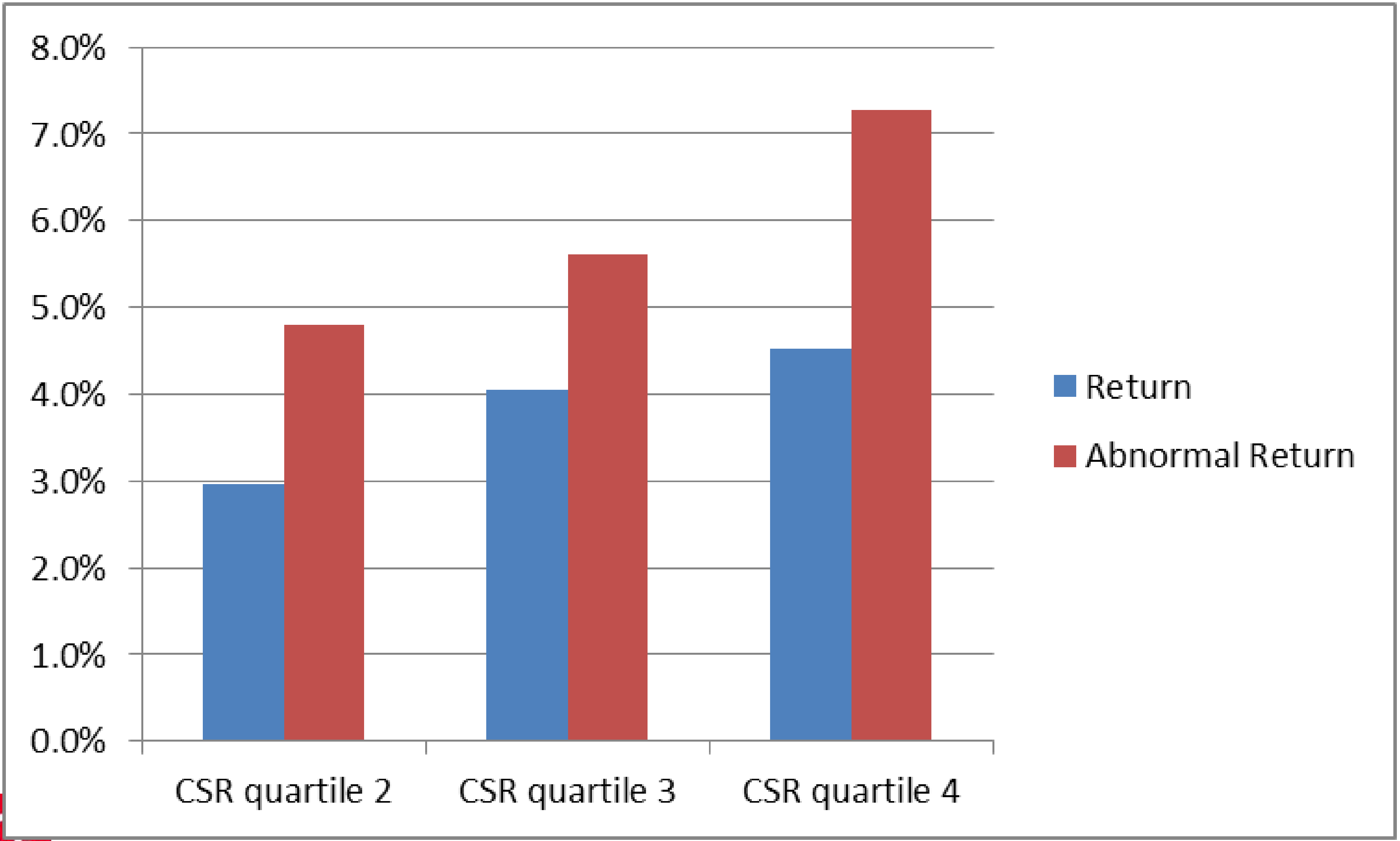
- *Edelman Trust barometer*: survey data showing trust in business declined from 58% in early 2008 to 38% in 2009 in US

- *"The present financial crisis springs from a catastrophic collapse in confidence … Financial markets hinge on trust, and that <u>trust has eroded</u>."* (Stiglitz, 2008)

- *"The fundamental problem isn't lack of capital. It's <u>lack of trust</u>. And without trust, Wall Street might as well fold up its fancy tents."* (Reich - Former US Labour Secretary, 2008)

- *"The global financial and economic crisis has done a lot of <u>harm to the public trust</u> in the institutions, the principles and the concept itself of the market economy"* (Gurria – OECD Secretary, 2009)

Crisis (Aug 08 – March 09) Return Differentials with Respect to Lowest CSR Quartile



Findings from Further Tests

- CSR does not affect returns before or after the crisis
- The CSR effect is stronger in high trust regions than low trust regions (endowed trust and earned trust are complementary)
- Similar effects if we focus on the period around Enron/Worldcom Fraud Scandals

CSR, Operating Performance and Capital Raising

What are the sources of the excess returns earned by high-CSR firms?

CSR, Operating Performance and Capital Raising – Quarterly Data

Effect of increasing CSR from its 25th to its 75th percentile

	Mean 2007-2013	Crisis Mean	CSR Effect in the Crisis	CSR Effect in the Post-Crisis
(1) Operating Return on Assets	3.10%	2.20%	+0.28%	+0.10%
(2) Gross Margin	40.10%	38.30%	+0.55%	+0.44%
(3) Sales Growth	3.24%	-6.91%	+2.33%	+0.45%
(4) Accounts Receivable / Sales	58.57%	59.16%	-0.17%	+0.22%
(5) Sales per Employee	$131,484	$116,990	+$13,413	+$6,836
(6) Debt Issuance / Assets	2.61%	2.26%	+0.17%	+0.10%
(7) Equity Issuance / Assets	0.34%	0.17%	-0.02%	-0.01%

LSE

The Bond Market Benefits of Corporate Social Capital

Hami Amiraslani
INSEAD

Karl V. Lins
University of Utah

Henri Servaes
London Business School

Ane Tamayo
London School of Economics

What We Do

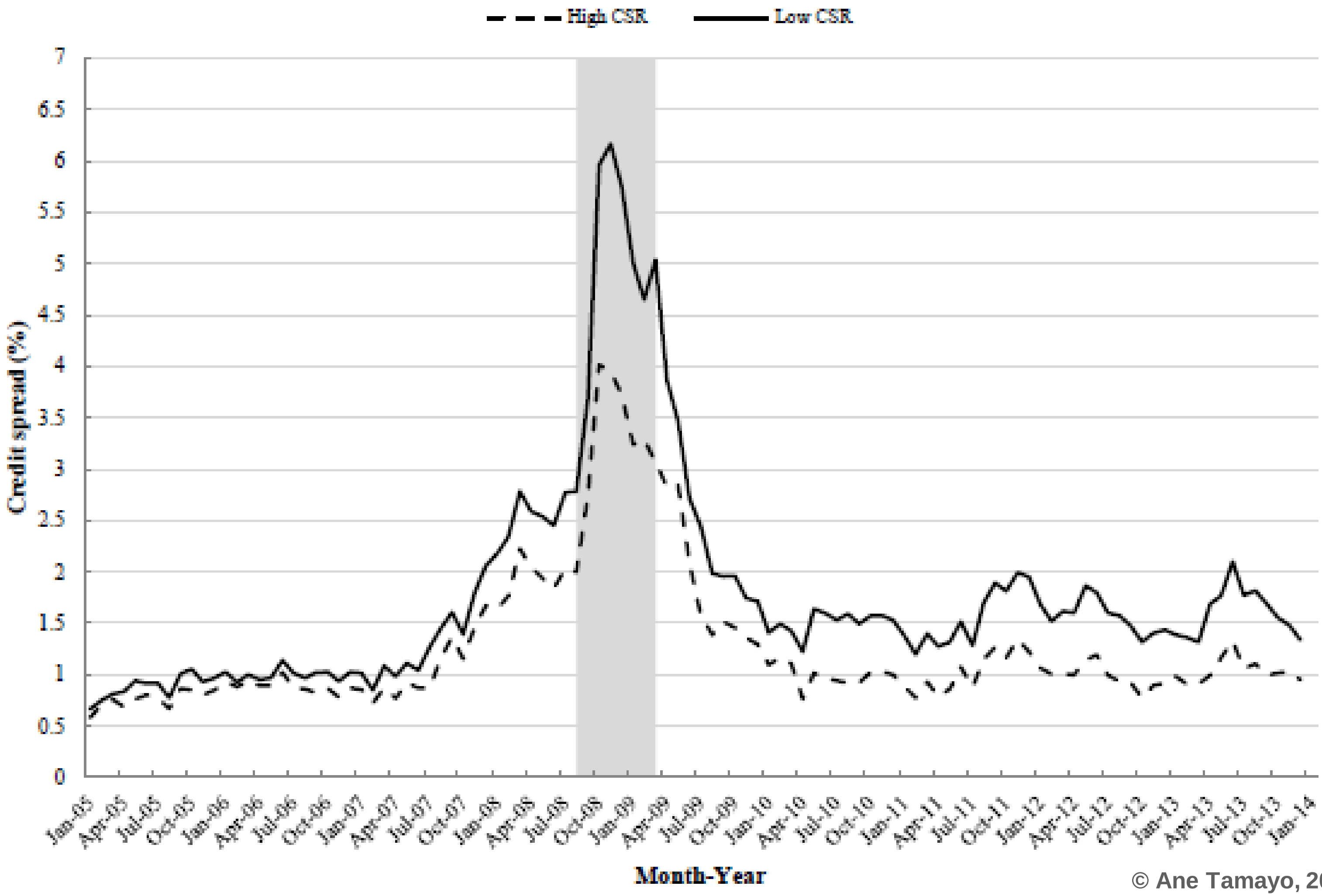
- Examine the importance of a firm's social capital investments through CSR activities on the bond market
- Why the bond market?
  - Size of the market
  - Moral hazard is of particular concern: risk shifting / cash diversion when companies are in financial distress
- ***Our hypothesis***: If firms' CSR efforts help build social capital and trust, those efforts should pay-off more when trust is more valuable

What We Do (cont.)

- Two channels:
  - – Direct channel: reduction in the agency costs of debt
    - Less risk shifting
    - Less cash diversion
  - – Indirect channel: through reciprocity from stakeholders:
    - I will be good to you because you have been good to me

- Focus on bond spreads, access to the bond market and terms of contracts

The Results in One Slide



Cross-Sectional Differences and Interpretation

- Effects are stronger for firms with more opportunities for risk shifting and asset diversion
  - Firms with more debt
  - Firms with more intangible assets (low tangibility)
  - Firms incorporated in states without restrictions on dividend payments in distress

- Interpretation: Firms CSR activities reduce the perception of agency costs when trust is low

Primary Market Effects

During the crisis period, high CSR firms:

- Have greater access to the bond market
- Are able to borrow more cheaply (given their risk)
- Are able to issue bonds with longer maturities
- Obtain relatively better credit ratings

Conclusions from Our Research

- CSR activities can increase firm value by engendering trust and cooperation

- Effect is not direct but indirect through:
  - Consumer channel
  - Employee channel

- CSR activities may be costly activities for some firms (e.g. if the firm reputation is at odds with its CSR activities)

Given the Benefits, Why Do Not All Firms Engage in CSR Activities?

- Capital constrained: unlikely
- Lack of information on the part of companies:
  - Possible, but should dissipate over time as merits of building social capital become known
- Lack of information on the part of investors:
  - Investors do not understand the merits, so the benefits are not immediately incorporated in stock prices. As they materialize, performance is better than expected, yielding excess stock returns
  - This effect should also dissipate over time (as investors learn and firms communicate more effectively)

Given the Benefits, Why Do Not All Firms Engage in CSR Activities? (cont.)

- Lack of information across various stakeholders:
  - If one group of stakeholders rewards the firm for treating another group of stakeholders better, then they need to be aware of this
  - E.g. customers cannot be reward firms for being good to employees if the information is not available
  - Firms optimally refrain from engaging in CSR
  - Maybe the firm information environment matters

⇒ For some firms may not be optimal to invest in CSR

Given the Benefits, Why Do Not All Firms Engage in CSR Activities? (cont.)

- Lack of commitment from managers:
  - Market inefficiency, combined with poor incentives
    - If it is not reflected in market prices and has no immediate payoffs, managers do not engage in CSR because they are not rewarded for long-run returns
    - Short-termism
  - Market for corporate control:
    - Firms do not feel they can take the long-term view, because they will be taken over

- Lack of committed (long-term) capital – investors are not behaving like owners

Is There Underinvestment in Social Capital?

- Firms investing substantial amounts
  - In 2013, firms in Fortune Global 500 spent $19.9 billion.
  - Largest spending: Oracle average annual spending $2.3bn (R&D spending: $4.8billion; Capital spending: $751m)

- Is this enough? Jury is still out

- Costs and benefits of social capital are not well understood
  - If all firms were to engage in high CSR levels, would they all reap the benefits? Or A “rat race” leading to overinvestment?
  - The cost and benefits are likely to vary across firms/industries

Final Thoughts

- Without social capital, payoffs to (tangible and intangible) capital investments are likely reduced
- Social capital builds trust, which in turn, improves cooperation within the firm without the need for formal (and surely incomplete) contracts
- CSR is currently the/our preferred metric to capture social capital at the firm level, but others should be explored
- Some arguments that firms may not be doing enough, but we urge caution and call for more research before making firm recommendations

LSE

Contact Details

a.m.tamayo@lse.ac.uk
+44 (0)20 7849 4689
http://www.lse.ac.uk/accounting/people/ane-tamayo

References

- Servaes and Tamayo, 2013, The Impact of Corporate Social Responsibility on Firm Value: The Role of Customer Awareness, *Management Science* 59.
- Servaes and Tamayo, 2017, The Role of Social Capital in Corporations: A Review, *Oxford Review of Economic Policy* 33.
- Lins, Servaes and Tamayo, 2017, Social Capital, Trust, and Firm Performance: The Value of Corporate Social Responsibility during the Financial Crisis, *Journal of Finance* 72.
- Lins, Servaes and Tamayo, 2019, Social Capital, Trust, and Corporate Performance: How CSR Helped Companies During the Financial Crisis (And Why It Can Keep Helping Them, *Journal of Applied Corporate Finance*, forthcoming.
- Hamiraslani, Lins, Servaes and Tamayo, 2019, The Bond Market Benefits of Corporate Social Capital, Working paper.

Discussant:

Sophie Daskalaki – Mytilineou

President of MYTILINEOS's CSR Committee

Building Social Capital and Trust: The Role of Corporate Social Respons

INPUTS

Financial Capital
- *Cash flows from operating activities and investments*
- *Total Equity*
- *Loans*

Industrial Capital
- *Industrial production & Renewable Energy Sources (RES) plants*

Human Capital
- *Number of employees (direct & indirect)*
- *Employees abilities and capabilities*

Natural Capital
- *Raw & other materials*
- *Air*
- *Water*
- *Land use*

Social Capital
- *Social investments*
- *Social license to operate*
- *Disclosure Policy*
- *MYTILINEOS's Reputation*

BUSINESS ACTIVITIES & PROCEDURES

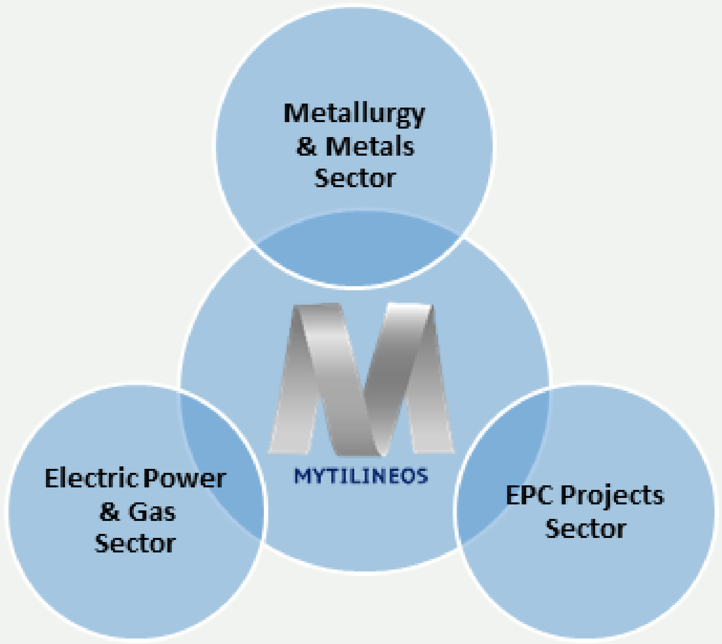
Vision – Mission - Corporate Values

Corporate Governance, Code of Business Conduct, Policies

Strategy & Resources allocation

Financial & Non-Financial risks & opportunities

Stakeholder Dialogue



Central Services

HUMAN RESOURCES MANAGEMENT – LEGAL & REGULATORY – FINANCE - TRESURY - MERGERS & ACCUISITIONS – INVESTOR RELATIONS - CORPORATE COMMUNICATION & MARKETING

Support Services

OCCUPATIONAL HEALTH & SAFETY – ENVIRONMENTAL MANAGEMENT SYSTEM – SUPPLY CHAIN MANAGEMENT – CORPORATE SOCIAL RESPONSIBILITY – QUALITY STANDARDS & POLICY - SALES SYSTEMS & CUSTOMER MANAGEMENT – RECEARCH & DEVELOPMENT

OUTCOMES
VALUE CREATION ON SUSTAINABLE DEVELOPMENT ISSUES

Financial Value Creation
- *Financial ratios of return ROCE, ROE & EVA*
- *Net Profit*
- *Financing capability and development of operations*
- *Dividends distribution to shareholders*
- *Payouts to capital providers*
- *Logistics expenditures*

Products & Services
- *Total exports*
- *Aluminum product sales*
- *EPC Projects backlog*
- *Energy produced from Renewable Energy Resources*
- *Retail Energy market share*

Development of Human Capital
- *Healthy & Safe working environment*
- *Low turnover ratio of specialized employees*
- *Stable workplace environment*
- *Productivity improvement*
- *Effective management*
- *Skills development*
- *Women in positions of responsibility*

Respect of Natural Environment
- *Fully compliance with environmental rules & regulations*
- *Stabilization of air emissions*
- *Responsible management of water resources*
- *Waste recycling*
- *Mining sites rehabilitation*

Social Contribution
- *Job creation & local employment growth*
- *Cooperation with local communities and regional administration*
- *Support of local communities infrastructure*
- *Taxes payments*
- *Support of local suppliers*
- *Responsible operation respecting employment and local communities rights.*

HOW WE BUILD OUR SOCIAL CAPITAL

Stakeholder Relationships

Main objectives:

Identifying
material issues,
managing
risks & opportunities

Social Investments

Main objective:

Enhancing
local communities
well-being

Disclosure Policy

Main objectives:

Promoting
Transparency,
Building
Trust

THE 3 MAIN PILLARS OF MYTILINEOS SOCIAL CAPITAL

Stakeholder Relationships

Identifying **material issues,** managing **risks & opportunities**

MYTILINEOS since 2010 has implemented **13 local open dialogue events, 4 thematic and 3 online consultations,** exclusively on issues related to sustainable development.

Stakeholder Consultation Process Principles

- ✓ **Open consultation for all**
- ✓ **Emphasis on material issues**
- ✓ **Consistency in implementation**
- ✓ **Ongoing evaluation**
- ✓ **Balanced response**

THE 3 MAIN PILLARS OF MYTILINEOS SOCIAL CAPITAL

Social Investments

Enhancing
local communities
well-being

According to our social investments policy, we focus on:

- ✓ **Boosting local employment:** In 2018, the 80% of our employees comes from our local communities.
- ✓ **Supporting the local economy:** In 2018, we spent more than 525 million euros (the 44% of our total suppliers budget) to our local suppliers.
- ✓ **Its Social Contribution strategic plan (2016-2019) titled "IN PRACTICE":** Since 2016, we have invested 6 million euros in social programmes and relative actions & initiatives.

THE 3 MAIN PILLARS OF MYTILINEOS SOCIAL CAPITAL

Disclosure

Promoting
Transparency
Building
Trust

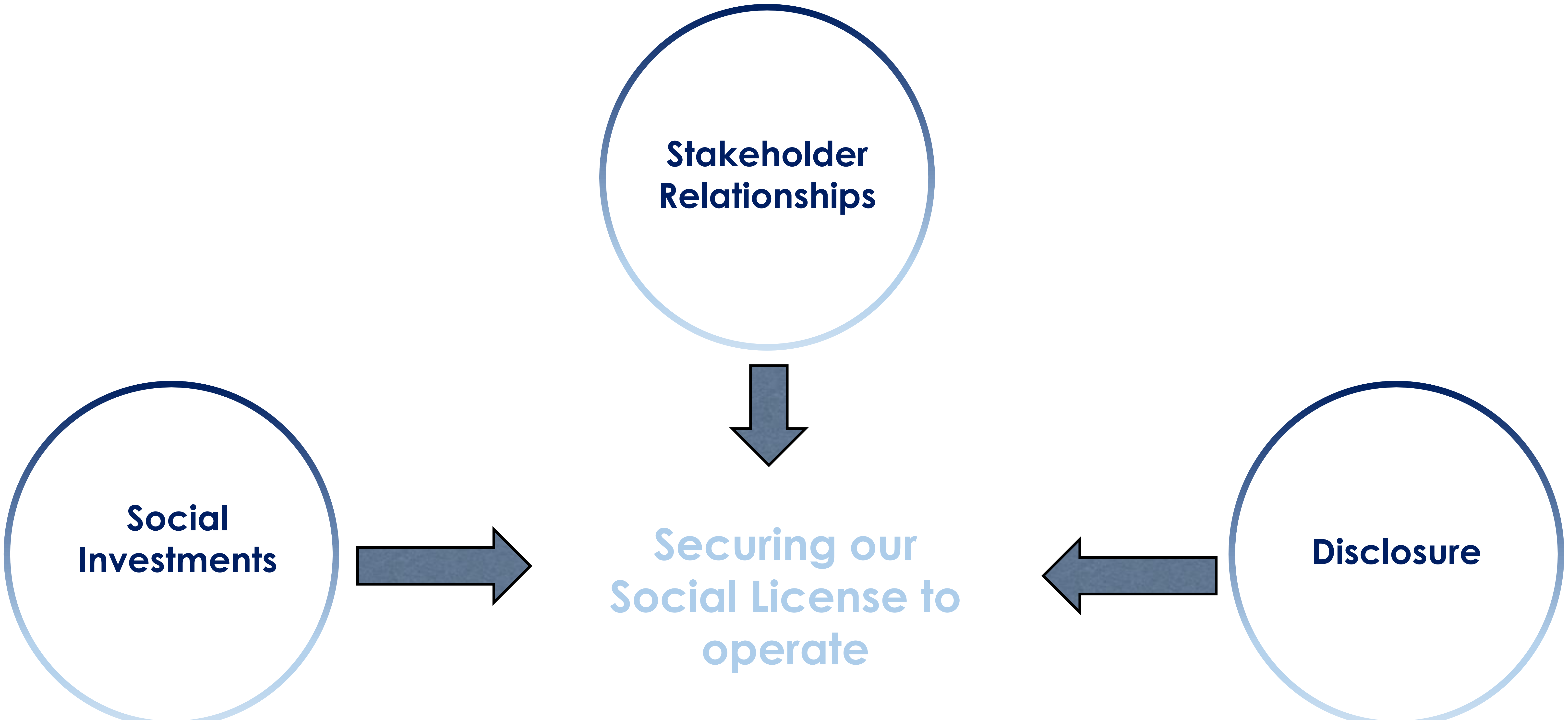
Achieving conformance with international reporting initiatives, MYTILINEOS reports on its sustainability strategy and activities under the following disclosure scheme:

- **Integrated Value Creation Scorecard (IIRC guidelines)**
- **Sustainable Development Report (GRI Standards – Core level)**
- **UNGC - Communication on Progress Report (Advanced level)**
- **Carbon Disclosure Project - Water Security Report (level B)**
- **ISO 26000 Social Responsibility International Standard Report**
- **Greek Sustainability Code Report (level A)**

Third party ESG analysis

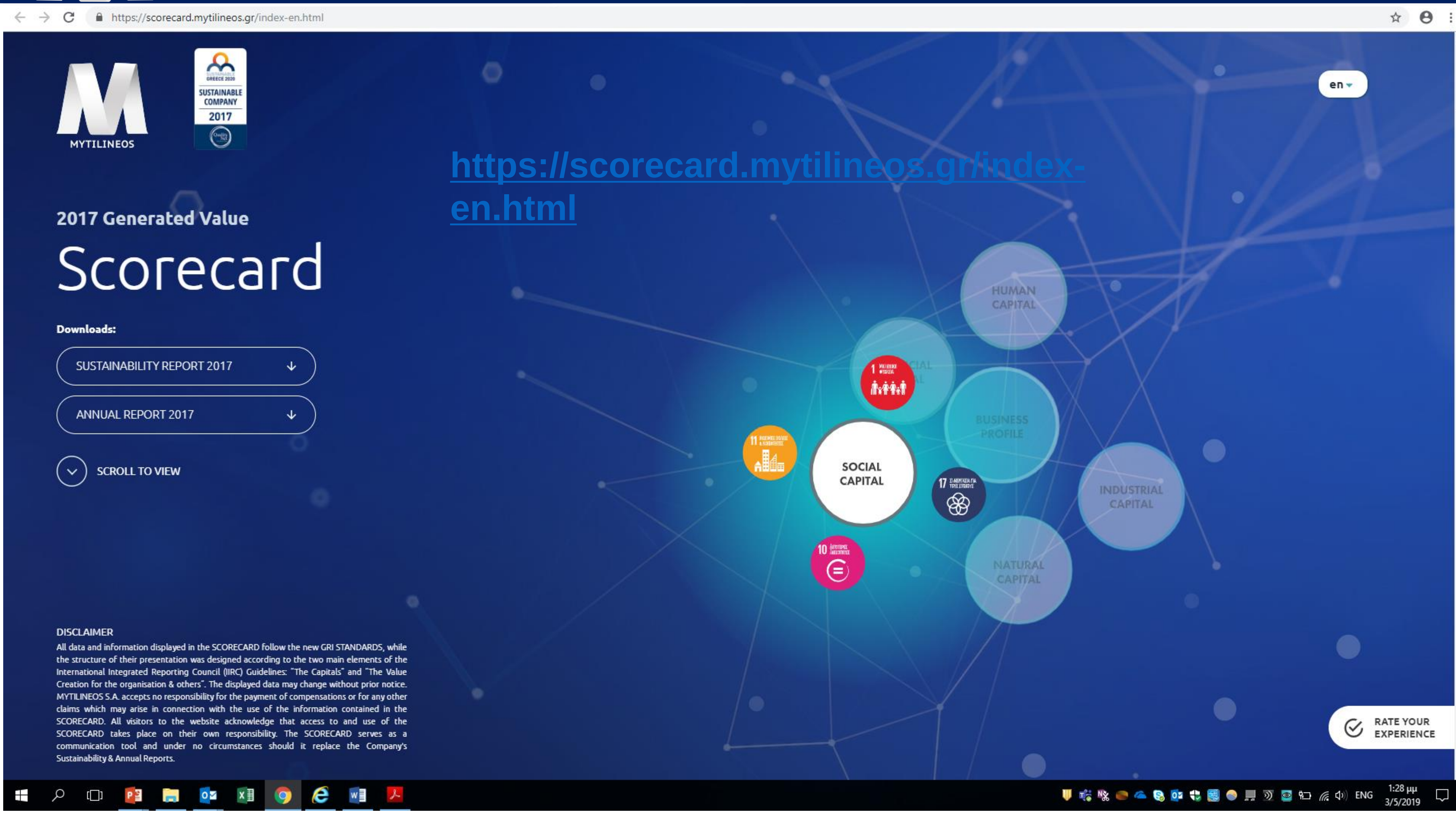
CDP DRIVING SUSTAINABLE ECONOMIES
Bloomberg
arabesque s-ray
ISS
THOMSON REUTERS
CSRHUB

BUILDING OUR SOCIAL CAPITAL IS ABOUT TO....



Building Social Capital and Trust: The Role of Corporate Social Responsibility

https://scorecard.mytilineos.gr/index-en.html



THANK YOU FOR YOUR ATTENTION