CORPORATE SOCIAL RESPONSIBILITY AND FIRMS PERFORMANCE.
AN ANALYSIS ON ITALIAN LISTED COMPANIES.

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Abstract

Corporate social responsibility (CSR) is getting an increasingly important issue for economic agents all over the world, due to a new attention to all the aspects of firms activities and their relationships with stakeholders.

Also in Italy, the number of firms that prepare voluntary corporate social responsibility (CSR) reports (e.g. sustainability reports, environmental reports, environmental and social reports or corporate social responsibility reports) is increasing.

The purpose of this paper is to investigate the impact of the voluntary disclosure about Corporate Social Responsibility on firms stock prices of Italian listed companies in order to analyze if it can somehow contribute to increase the stock market prices.

Our empirical analysis will test the relation, during a period of three years, between corporate social responsibility (CSR) reports and firms stock prices, considering a sample of Italian listed companies.

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1 Introduction

The social impact of big and small corporations is becoming a very important issue in business administration. A "bad" social impact, in fact, could increase the firm's risk, could lead to wrong relationships with many stakeholders and could affect corporate reputation. In most cases, the result is a decrease in firm's value and, sometimes, the end of the corporation itself. The cases of the asbestos sector, of Monsanto and many others are clear examples that ignoring the social impact of a business and a wrong communication about social and environmental policies could be a big mistake.
That's why in recent years, a lot of corporations began to develop and communicate their strategies for reducing conflicts between society and the corporation itself.
Corporate Social Responsibility (CSR) is so becoming an important task, but the problem is in understanding whether CSR is compatible with value creation or not and in understanding which is the best disclosure for CSR's policies.
The question is: how can CSR affect firms performance? And what is the perception of CSR by investors and stakeholders?

2 Objective, scope and hypothesis

The purpose of this paper is to investigate the impact of Corporate Social Responsibility (CSR) on firms stock prices in order to analyze if it can somehow contribute to increase them.

We will empirically investigate the Italian case, with an over three years analysis on all Italian listed companies that realize Corporate Social Responsibility reports (e.g. sustainability reports, environmental reports, environmental and social reports).

Our initial proposition is that CSR doesn't affect at all the stock prices of Italian listed companies, mostly because Italian financial market is not enough efficient and because stakeholders and investors are short-time oriented, while the effects of a "bad" social/environmental attitude are in the long term. Finally, in Italy there is a lack of culture in understanding the real impact of social and environmental facts on a firm's life.

This paper provides a first empirical evidence for this proposition and represents a first partial step in the investigations, with reference to the Italian case, on the relation between CSR and stock prices.

The following paragraphs, after a brief literature review on Corporate Social Responsibility, firm performance and stock price, and finally go through the methodology of the analysis and the empirical results.

3 Corporate Social Responsibility

Corporate Social Responsibility is getting an increasingly important issue for economic agents due to a new attention to all the aspects of firms activities and their relationship with stakeholders.

According to Garriga and Melé (2004) firms social activities are more than a simply way to achieve economic results, because through these activities companies can develop good relationship with stakeholders (Freeman, 1984) and, indirectly, create value for shareholders.

In fact, firms with the attitude toward disclosure related to social responsibility activities appear to be able to develop and maintain better relationship with stakeholders in general (Kitora, Okuda).

Corporate Social Responsibility is a concept with a growing currency around the globe. It frequently overlaps with similar approaches such as corporate sustainability, corporate sustainable development and corporate responsibility.

Moreover, CSR has a wide range of potential meaning: it can be considered as the private sector's way of integrating the economic, social, and environmental imperatives of its activities.

The European Commission (2001) defines it as "a concept whereby companies integrate social and environmental concerns in their interaction with stakeholders on a voluntary basis"

Barnett (2005) focuses on two main characteristics of CSR: social welfare orientation and stakeholders relationship orientation.

As businesses have increased their adoption of corporate social responsibility practices, managers face growing pressure to justify the allocation of scarce firms resources and accurate measures of corporate social responsibility results are required.

4 Corporate Social Responsibility and firm performance. Literature overview

The increasing attention to CSR is firstly based on its capability to influence firms performance. The researches in this field examine how CSR can provide firms with an incremental gain. For example, researchers have considered purchase intentions, increased sales, enhanced image, and improved employees morale as benefits of CSR.

In particular, regarding to this aspect, (relation between CSR and firms performance, see Griffin and Mahon 1997, for a survey), the literature consists of three principal strands:

- the existence of a positive correlation between CSR and financial results;
- the lack of correlation between CSR and financial results;
- the existence of a negative correlation between CSR and financial results.

Some theorists of the first group (Soloman and Hansen, 1985; Pava and Krausz, 1996; Preston and O'Bannon, 1997) find that investments in CSR have a big return in terms of **image** and overall, **financial results**: the related benefits, in fact, are bigger than the related costs.

In particular, Stanwick (1998) and Verschoor (1998), underline that a good CSR **simplifies the relationship with stakeholders**. Finally, Ruf and al. (2001) define the period of years (3) positively affected by changes in CSR (studying the growth in sales and, obviously, the index ROS).

Instead, the idea of the second group of theorists is that a relationship between CSR and firms performance doesn't exist. In this perspective it is possible to analyze Mc Williams and Siegel (2001), Anderson and Frankle (1980), Aupperle et al. (1985) and Freedman and Jaggi (1986).

Finally, the negative relationship between CSR and performance, indeed, is focused on empirical studies and contributions that refer to managerial opportunism hypotheses.

Preston and O'Bannon (1997) point out that managers can reduce investments in CSR in order to increase short term profitability (and, in this way, their personal compensation).

This point seems to be really interesting, due to the fact that other authors (Barnea and Rubin, 2006) suggest the existence of an opposite trend linked to the same phenomena (managerial opportunism).

In this sense, in fact, managers appear to have an incentive to increase investments in CSR because a favorable CSR rating can enhance their reputation; in this case it is possible to have agency costs deriving from conflicts between managers and shareholders (Jensen and Meckling, 1976).

Trying to summarize, the argument against corporate social responsibility and firms performance is that engaging CSR is costly and in this way firms can obtain advantages not really sure and, overall, the potential financial benefits are in the distant future (Henderson, 2002; Walley and Whitehead, 1994).

In particular, a lot of skeptics, first of all Friedman (1962), underline that also in the hypothesis of the relevance of CSR, it is difficult for managers to determine what the social responsibility of their company is.

So, if the costs related to CSR are likely to outweigh the correlated financial benefits, CSR seems to appear inconsistent with the principle of shareholders value maximization.

A big part of literature, instead, underlines the existence of many positive externalities linked to CSR.

In this perspective, in fact, the responsibilities of firms are broader than the value maximization to shareholders and in this sense CSR represents a way of responding to stakeholders requirements.

The firm, as social agent, has multiple stakeholders and the role of management is to create a balance between them: shareholders, employees, suppliers, community, environment and so on.

Satisfying their interests and being accountable to them may actually have a positive impact on all firm dimensions, including financial performance (Clarkson (1995); Waddock and Graves (1997)).

First of all, CSR is nowadays a critical aspect in firm strategy, primarily because of the financial scandals and the drop of investors confidence. CSR, in fact, is strictly connected to the idea of firm reputation. Fombrun et al (2000), Porter and van der Linde (1995) and Spicer (1978), for example, posit that CSR initiatives can lead to reputational advantages as improvements in investors' trust, new market opportunities and positive reactions of capital markets.

Positive reputations have often been linked to positive financial returns. However, their value is tied to the inability for competitors to imitate the reputation. The value of a positive reputation is "precisely because the development of a good reputation takes considerable time, and depends on a firm making stable and consistent investments over time" (Roberts and Dowling, 2002).

Reputation is therefore perhaps the most valuable asset of any firm.

Klein and Dawar (2004) proposed that CSR has value for the firm as a form of insurance policy against negative events. Specifically, they found that consumers perceptions of a firms' CSR moderated their attributions of blame for a product failure, and argued that CSR may have value to the firm even if it does not immediately increase profitability because it can help to mitigate the effects of a damaging event. Their study demonstrates that consumers are more willing to punish the bad behavior of firms than to reward their good behavior.

The idea of CSR as an element of firm strategic advantage isn't new.

According to the strategic stakeholders approach (Freeman, 1984) firms may engage in CSR activities in order to develop and maintain good relationships with various stakeholders (in this sense, also Roberts (1992) and Belkaoui and Karpik (1989).

In order to assess the social impact of firm's behaviors and strategies, it is crucial to identify the involved interests. According to Venanzi and Fidanza (2006), a firm is sustainable as it sets not only financial goals but also social and environmental goals and it aims to create value for its shareholders, in order to improve the quality of life and to use efficiently the invested resources.

Moreover, the creation of a sustainable firm image can generate (indirectly) economic advantages as:

- expansion to new market segments where consumers are interested not only in quality and price but also in the adopted ethical codes (this phenomenon can increase sales);
- increased fidelity of customers and suppliers;
- capacity to retain talented people (reputational benefits for managers, i.e.) ;
- lower interest rate;
- creation of alliances and strategic partnerships.

Moreover firms with a higher corporate social performance have a better quality or quantity of disclosure (Cormier and Magnan, 1999, Gelb and Strawser, 2001).

Also in these terms CSR disclosure can have an impact on firms performance.

5 Performance measurement.

Fombrun et al. (2000) define two forms of potential financial return for the firms deriving from CSR: a positive incremental gain as a reward for positive behavior, that they call "opportunities" and a mitigation of consequences from negative firms behaviors or "safety nets".

Previous studies (Knox and Maklan, 2004) used two methods for establishing the CSR-corporate financial performance (CFP) relationship:

1. the correlation between the level of investment in CSR and some measures of CFP;
2. the examination of some financial index of performance, such as stock price.

The first method doesn't appear applicable to our case, due to the fact that investments data about CSR are not easily available for Italian listed companies. For this reason we decided to test the relation between CSR and firm performance using stock prices.

Generally, in order to measure firms performance, the traditional focus of analysts is on the concepts of:

- Profitability;
- Liquidity;
- Solvency;
- Financial efficiency
- Repayment capacity.

Firms current profitability, their risk, growth (which is a proxy of the potential future earning streams), solvency, liquidity and financial ratios are the major factors that impinge upon the market valuation of a firm.

There are, however, arguments (Brief & Lawson, 1992; and Peasnell, 1996) that accounting-based measures of financial performance are a sufficient predictor of a firm market-based valuation and returns.

In our analysis we stress the concept of financial performance, measured by stock market price.

Stock market price should reflect the fundamental expected value of the stock (i.e. the discounted sum of the expected dividends accruing to the owners of shares).

According to Brealey and Myers (1993), stock price for the period "t" is related to:

- expected dividends for the period "t+1";
- expected price in "t+1" and
- return of the investment (r)

$$P_t = \frac{DIV_{t+1} + P_{t+1}}{1 + r}$$

Increasing the observation period, the prior formula can be expressed as:

$$P_t = \sum_{t=1}^{n} \frac{DIV_t}{(1 + r)^t}$$

Regarding our analysis, the empirical literature about stock performance and its relation with environmental component of CSR can be separated in three main subsets (Guenster et al. 2006):

1. event studies that explore the immediate effects of social or environmental performance proxies on short-term stock price variability;
2. cross-sectional regression analysis that attempts to establish a longer-term relationship between CSR and stock returns;
3. portfolio studies that investigate the benefit of embedding CSR into investment decisions.

In order to simplify the scenario of the firms and to measure the financial return easily, our hypothesis states that firms performance is measured by stock market prices trend during the three years of analysis (2004-2005-2006).

We obviously know that there are many elements with an impact on performance (and this point can represents a future implementation of our work), but at this first stage of analysis, and due to the characteristics of Italian market capital, we believe that this hypothesis can represent a right way to study performance trend.

6 CSR and stock price of Italian listed companies. The methodology of analysis.

The purpose of our analysis is to study the impact of CSR on Italian listed companies. In particular, we want to investigate if Corporate Social Responsibility affects stock market prices or not.

In order to verify that CSR does not affect firms stock prices we used a sample of Italian listed companies.

In this sample we only considered the firms that prepare CSR reports.

The analysis does not include banks and insurance companies even if they realize CSR reports because, due to their specific core business and risk profile, they would have altered the average results.

In this case, in fact, the environmental variables do not have much importance compared to the other firms and the most important variable is the customer relationship.

Moreover there are some firms that began to prepare CSR reports only in 2006, so that we did not include them in the sample in order to make it homogenous.

According to Brammer, Brooks and Pavelin (2006) we considered three parameters of CSR:

- Employment;
- Environment;
- Community.

The parameter of employee responsibility is based on five measures, that are health and safety systems, systems for employee training and development, equal opportunities policies, systems for good employee relations, and systems for job creation and security.

The environment parameter considers three measures, which are the quality of environmental policies, the environmental management systems, and environmental reporting.

Finally, the indicator of community responsiveness is measured as a single variable.

After that, following Graves and Waddock (1994), we translated each of the text ratings into quantitative variables. We ranked each variable with a scale scores from 0 to 3 or 4. In particular the three measures of social performance are:

• Employee performance: 5 categories (health and safety, training and development, equal opportunities policies, employee relations, systems for job creation and job security) each rated from 0 to 3, yielding a total employee responsibility score out of 15.

• Environmental performance: 3 categories (policies, management systems, and reporting), each rated from 0 to 4, yielding a total environmental responsibility score of 12.

• Community performance, graded from 0 to 3.

Moreover, for all firms and for an horizon time period of three years (2004, 2005 and 2006) there have been considered the following economic-financial parameters:

- market value of the stock on the 31st of December of each year (font: Datastream);
- average market value of the stock of each year;
- annual reported earnings;
- the financial debt;
- the equity;
- the Return on equity (ROE),
- the levered beta (source: Bloomberg);

The methodology of the analysis has the following steps:

- The ranking of all the selected firms according to CSR parameters and the calculation of the mean values, the standard deviations and the medians of each parameter on a 3 years base for the whole sample;
- Test with a regression model of the correlation between stock market price and CSR. The relation has been analyzed controlling with other variables.
- Analysis of the results to test our hypotheses.

The source of data is AIDA database.

The data have been integrated with financial information deriving from "Il Sole 24 ore".

The sample consists of 25 firms operating in different sectors excluding banks and insurance companies and firms that began to prepare CSR reports only in 2006.

6.1 *CSR parameters ranking*

As told before, the sample only considers the firms realizing CRS reports, excluding banks and insurance companies due to their specific core business.

First of all we considered the three CSR parameters:

- employment,
- environment,
- community

Each one of these parameters consists of some measures.

We scored each one of the measures for all the 25 firms for the three years (2004, 2005 and 2006) and summed all the scores for each parameter.

After that, we calculated the mean values of the three parameters, the standard deviations and the medians for each year.

In this way we analyzed the quality trend of CSR reports and firms' increasing attention in preparing them.

6.2 Regression model

The coherence with the hypothesis of no correlation between firms stock price and CSR has been performed through a cross sectional analysis, in particular through a regression model for the three years sample of observations, in order to verify the relation between the stock price and the variables of the model.

In particular the linear regression considers the following variables:

- Stock price as dependent variable;
- CSR parameters (employee, environment, community), debt/equity (D/E) ratio, ROE ratio, Beta levered (as a proxy of firms' risk) as independent variables.

In particular, debt/equity ratio and Beta should have a negative effect on stock price while the ROE ratio should have a positive effect.

Instead, we aspect that CSR has no influence on stock price.

The regression model can be there represented as follows:

Stock price = Y + A CSR Employment + B CSR environment + C CSR community + D D/E ratio + E ROE ratio, + F Beta levered.

7 Empirical results

The mean values, standard deviations and the medians of all the parameters for the entire sample of firms over the three years are showed below:

	2004			2005			2006		
	Employee	Environment	Community	Employee	Environment	Community	Employee	Environment	Community
Mean values	5,5	6,7	1,9	7,3	8,1	2,0	7,3	8,2	2
Standard deviation	5,1	5,2	1,1	5,3	4,7	1,1	7,0	5,5	1,4
Median	4	9	2	6,5	10,0	2,0	8	6,5	2,0

From a qualitative point of view the results show an increasing attention to CSR issues regarding the employee, the environment and the community.

In fact the mean values grow over time and it means the firms are getting more committed in social responsibility towards all the stakeholders, so that they pay more attention in preparing good CSR reports.

As concerns the regression model used to verify CSR impact on stock price, it is useful to make some considerations.

First of all, only a small number of Italian listed companies settles down CSR reports. In fact, only 25 firms of the italian listed companies (excluding banks and insurance firms) have made CSR reports in the last three years (even less before).

It means that in Italy neither firms nor the stakeholders are so sensitive and interested in these issues and that the stock price is much more influenced by economic and financial performance.

Nevertheless, in 2006 it is possible to see an increasing trend of firms interested in producing CSR reports.

The regression results, performing a cross-sectional analysis over a three years period are the following:

Variables Entered/Removed(b)

Model	Variables Entered	Variables Removed	Method
1	ROE, Beta levered , CSR com, CSR Env, D/E , CSR Emp(a)	.	Enter

a All requested variables entered.
b Dependent Variable: Price

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,387(a)	,15	,031	10,381

a Predictors: (Constant), ROE, Beta levered , CSR com, CSR Env, D/E , CSR Emp

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	22,821	5,666		4,044	
	CSR Emp	,285	,523	,189	,540	,592
	CSR Env	-,538	,445	-,088	,449	,155
	CSR com	-,682	2,126	-,084	-,321	,750
	Beta levered	-11,146	4,725	-,352	-2,359	,022
	D/E	-1,466	2,002	-,172	-1,732	,468
	ROE	,888	2,618	,060	,339	,736

a. Dependent Variable: Price

The analysis shows an absence of correlation between CSR parameters and firms stock price, in fact all the coefficients estimated on CSR (employment, environment and community) have a very low t-statistic.

Moreover the model seems to be quite compliant with the rationale about the impact of other controlling variables on stock price.

In fact the Beta levered and the D/E ratio show a significant t-statistic and an expected negative correlation with stock price.

The ROE ratio, instead, shows the expected positive correlation even if the t-statistic is not that significant.

8 Conclusions and further implementations

The above results give a first empirical evidence that in Italy firms stock prices are not affected by CSR reports even if firms show a greater attention to these issues.

The possible explanations of these results could be the following:

a) CSR is a relatively new issue in Italy, and most investors have a low degree of perception of the matter;
b) The quality of disclosure for CSR is not easily measurable; there is a lack of general accepted principles and most firms use CSR disclosure as an additional instrument of advertising, avoiding to give relevant informations;
c) Most investors are short-term oriented while CSR's impact is mostly in the medium-long term.

Furthermore, the main limitations and further implementations of the analysis are:

- the implementation of other variables influencing firms stock price in order to implement the regression model;
- the enlargement of the sample, considering more companies in the analysis.
- a deeper analysis of the conceptual model and the use of more sophisticated and effective statistical tools;
- the widening of the time-horizon of the analysis;
- the extension of the analysis to other countries.

At the moment, the small number of firms in the sample is due to few CSR reports available. But, thanks to a greater attention to CSR issues, the sample could be enlarged soon.

These aspects could be the main direction of further implementations of our work.

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