Corporate social responsibility and value creation

Determinants and mutual relationships in a sample of European listed firms

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Abstract

The purpose of this paper is twofold: *i)* to point out the determinants of a firm orientation to stakeholders' interests; *ii)* to analyze the relationship between shareholder value and stakeholder value as firm goals. Both issues are empirically verified on a sample of European listed companies.

Empirical evidence shows that time, nationality, industry, size and level of growth of a firm determine its stakeholder ratings. Although the empirical evidence presented concerning the link between the creation of shareholder value and stakeholder value is neither unequivocal nor statistically significant, it can be inferred that a firm pursues stakeholders satisfaction to achieve a better value performance.

Introduction

For the last two decades, the creation of shareholder value has been (Koller 1994) the main goal of corporate activity in most US firms. The diffusion of this approach has changed the way firms compete, their strategy formulation and implementation, their organisational structures, their management systems and their measurements of activity and managerial performance (value based management).

The recent European debate concerning the relevance of this goal encompasses now new issues. Among these issues an unresolved question is whether the creation of value for the main shareholder is consistent with the achievement of other stakeholders' [i.e. current (minority shareholders) and prospective investors, customers, suppliers, employees, creditors and community] objectives. It is argued that shareholder value creation is a short term goal and that benefits one category of stakeholders and overlooks the others.

This critical focus on the short termism of this goal is due to a superficial understanding of both the theory and practice made in U.S. In fact the leading authors of this approach (Rappaport 1986) identify the maximization of shareholders' welfare with the maximization of the firm's whole economic value in a long term perspective, when they measure objectives and outcomes.

The extensive international theoretical and empirical literature about the stakeholder theory has emphasised the conflict between the creation of value for shareholders and that creation for other stakeholders. This literature regards increasing shareholder value as unfair since not all of the stakeholders benefit from it.

Most attentive researchers (Freeman 1984) proved the conflict to be theoretical rather than actual. The needs of minority shareholders, customers, suppliers, employees and creditors are naturally met before those of the majority shareholders. Therefore, to maximise the value of shares would be a firm's ultimate long term target, even from the social standpoint.

To impartially look after the interests of different stakeholder categories also results in a better reputation that is amplified when a firm is qualified as sustainable. This is even more true once the firm becomes included in the stock market *sustainability index* as the standing produces concrete economic benefits, higher standing among investors, increased sales, retention of talented human resources, creation of strategic alliances, etc.

In Europe and Italy, detractors pointed out multiple reasons to explain the failure of an approach that maximises shareholder value. Such faults include the inefficiency of financial markets or the incapacity to reflect the actual economic value of the firm. Whenever the owner of a firm is also manager and the firms is closely held, a change in control at the top is unlikely. A social theory of the firm has also been proposed as an alternative to the shareholder value theory.

The relevance of this topic is clear as it concerns decision making processes as well as systems of performance evaluation and measurement.

This paper intends contribute to this debate by verifying the existence of a link between value for shareholders and value for stakeholders in the European context. From an objective standpoint, shareholder value creation can only be pursued, in a long term perspective, by achieving the goals of all the stakeholders. From a subjective standpoint, as the market assesses a firm it also takes into account the relations of the firm with all the stakeholders.

The fact that shares of companies listed in sustainability indexes (i.e. Dow Jones Sustainability Index and Financial Times Stock Exchange 4Good) outperformed those who are listed in traditional indexes seems reinforcing empirically the hypotheses made.

In order to strengthen the limited research, which has been merely conducted (Copeland 1994 and Bughin–Copeland 1997) by country with little empirical evidence from Italy (weight in the sample of 1,4%), this paper is structured as follows:

- the next paragraph analyzes the stakeholder theory's impact on social responsibility of the firm and aspects that affect its decisions, especially financial ones
- the third paragraph contains a brief review of the international empirical evidence about the relationship between shareholder and stakeholder value
- the fourth paragraph illustrates tested hypotheses, adopted methodology and results of the empirical analysis conducted in this study.

Stakeholder theory and social responsibility: theoretical framework and decision-making implications

The term "stakeholder" was first defined by Freeman (1984) as: "*primary stakeholder groups typically are comprised of shareholder and investors, employees, customers, and suppliers together any group or individual who can affect or is affected by the achievement of organization's objectives*". More recently, Clarkson (1995) expanded the concept of stakeholder by including public stakeholder group defined as: "*the governments and communities that provide infrastructure and markets, whose laws and regulations must be obeyed and to whom taxes and other obligations may be due*".

Generally speaking, stakeholders are groups or individuals who are empowered to affect success or failure of the firm or that have a stake in the firm's decisions.

Freeman and Clarkson's regarded stakeholders as a broad group of people who have a stake in a company although those who are generally accepted as stakeholders include majority shareholders, minority shareholders, customers, suppliers, employees and local community.

It's paramount for a modern company to analyse and assess the firm's performances from a social, environmental and ethical perspectives as well as to communicate them accurately and expansively.
The increasing correlation between economic and social performance creates the need for complete and reliable information. Managers also need increasingly sophisticated budgeting systems to plan activities and enable stakeholders to measure how the firm achieves goals linked to their own interest.
Economic and financial indicators need new criteria to define the nature and the boundaries of stakeholders interests. According to those criteria, entrepreneurs and managers devise strategies and assess the performance. This approach is rooted in the idea that stakeholders, in the same way as shareholders invest their capital, invest resources, competences and knowledge in the company and have a right for to a fair compensation for their investments. Then corporate strategies should take into account the stakeholder value.
Lately, corporate social responsibility (CSR) has spread, reflecting the necessity to protect "secondary stakeholders". By expanding the purpose of a firm beyond the creation of profits for the owners, the firm becomes an organism that interacts with a number of individuals and groups that can contribute to pursue corporate goals but that depend on the firm to achieve their own private goals. The EU Commission (2001) defined social responsibility as "*a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.*"
As a consequence, firms adopt a corporate governance system capable of matching different interests through global quality and sustainable development.

The spread of CSR strengthens the theoretical framework presented above, leading the firm toward a sustainable development that results in economic growth. This approach embraces social equity, environmental protection as well as generating economic competitiveness to create wealth, while respecting the environment.

To understand social responsibility one needs to look at how relations with the stakeholders become involved in the corporate governance. Corporate governance shall encompasse not only the relations between principal-agent but also firm-stakeholder. In other words corporate governance should be seen as the sum of relations existing between managers, the board of directors, and shareholders as well as the remaining stakeholders (OECD 1999).

The consequence of the debate between VBM and stakeholder theory is controversial and affects conspicuously the strategic choices and goals of a firm (i.e. shareholder value versus stakeholder value). VBM supporters commonly believe that a goal that a measurable goal affects positively firms' behaviours and secures the achievement of both primary and secondary stakeholders needs.

Although, in the last decades Italian firms have achieved this goal by cutting labour costs through rationalization and outsourcing of non-core business services. The stakeholder theory recommends a balanced satisfaction of the interests of all people involved in the business and rejects such radical choices. The maximization of shareholder value, (and the related social cost), shouldn't override employee interest.

In order to assess the social impact of a firm's behaviour and strategies, it is crucial to identify which interests are involved. 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, to improve the quality of life and to use efficiently the resources it invests.

The interests and rights of the company's "secondary" stakeholders appear to be residual, but in fact they are not. Value maximisation can be maintained as the main goal of the firm while considering social aspects. The concepts of ownership and residual stake that underlay the criteria of value maximisation, still hold up despite the use of stakeholder management approach.

The following are the advantages of a sustainable company concerning image and reputation:

- capacity to boost sales as stakeholders perceive a firm responsive to meet their interests, expanding to new market segments (e.g. more demanding consumers, interested not only in quality ad price but also in ethical codes adopted)
- increased fidelity of customers and suppliers
- capacity to retain talented people and cut turnover
- creation of alliances and strategic partnerships
- access to subsidies and financing at a lower interest rate.

An improved image will result in both tangible and intangible benefits that help the firm in pursuing it's economic and financial goals. Sustainable companies enjoy good risk/return trade-offs due to the conviction that sustainability means a successful management, being leader in strategic areas and the high visibility of positive results that may be achieved. Sustainable companies make the most of intangible assets through better relationships with stakeholders, as evidence shows that their stock outperforms those of non sustainable companies.

A firm that aims at sustainability faces the challenge of creating indicators to measure the degree of stakeholders satisfaction. Financial markets adapted to the new informational needs through market indexes, that factoring not only economic but social and environmental variables in order to provide sustainable companies with benchmarks. The admission of a firm to such an index is subject to rating companies' judgment whose criteria are:

- economic (corporate governance, relationships with investors, risk and crisis management, economic stability and financial solvibility);
- environmental (environmental policies, reporting and performance);
- social (indicators for internal procedures, human capital development, appeal for talents, involvement of stakeholder).

International empirical evidence

In corporate finance the empirical research about stakeholder theory and social responsibility is due to researchers'attention to firms's interaction with respective stakeholders. The debate is whether or not shareholders' wealth is maximised at the expense of other stakeholders.

Several international studies, that did not test the link between stakeholder and shareholder value directly, reported a positive impact of more social oriented policies on a firm's success.

Through an event study, Frooman (1997) documented a negative reaction of the market to illegal or reckless behaviour of companies. In those instances, market values decreased significantly.

Researchers paid much attention to the degree of satisfaction of the customers of a firm and its financial performance especially with respect of the impact of illegal/reckless managerial practises on market value. For instance some studies recorded a remarkably negative reaction to the announcement of a product recall

(Bromiley-Marcus 1989, Davidson-Worrel 1988, Hoffer-Pruitt-Reilly 1988). Conversely, it seems that a positive perception of a firm's product quality and fair behaviour is apt to increase sales (Waddock-Graves 1997). A number of empirical and theoretical studies documented that human resources management can affect a company's financial performance (Delery-Doty 1996, Huselid 1995, Pfeffer 1994, Youndt-Snell-Dean-Lepak 1996), and it can be concluded that human resources are a source of competitive advantage. A successful human resources management can cut down turnover and absenteeism as well as improve productivity and workers commitment. Allegedly the possibility for workers of a professional growth would also promote a better financial performance. A firm would also attract more competitively the most talented resources (Robinson-Dechant 1997, Thomas- Ely 1996).

How firms deal with their external environment may also have an impact on their value. Social responsibility can cut down operative costs (Russo-Fouts 1996) and improve efficiency. For instance, environmentally friendly products are more inviting to customers and may generate a competitive advantage. A proactive attitude can also secure a positive image and boost loyalty (Dechat-Altman-Downing-Keeny 1994, Hart 1995).

Recent studies (Copeland 1994, Bughin-Copeland 1997) seem to confirm that the creation of value in a firm goes hand in hand with increased hiring rates, better working conditions, higher revenues for the fiscal system, better products and services, than competitors. These findings may be sufficient to defeat the assumption of an ever-present trade-off between the goals of different stakeholders.

This does not necessarily mean that value creation is solution for all the conflict of interest existing between stakeholders, but it does demonstrate that firms creating value in the long term can better meet the needs of all stakeholders. The more value a firm created, the more benefits it has available and divisible.

Several studies related to this issue (Berman-Wicks-Koth-Jones 1999, Hillman-Keim 2001; Ruf et al. 2001) tested the hypothesis that maximisation of value meet the interests of all stakeholders. Researchers adopted a regression between a proxy of the wealth created for shareholders (i.e. dependent variable) and a proxy of the degree of satisfaction of other stakeholders (i.e. independent variable). In these studies, researchers adopted an index called KLD (e.g. Kinder, Lydenbur, Domini) as measure of stakeholder performance. KLD is adopted by a rating company that assesses social performance of 800 US firms through questionnaires, annual reports, annual statements, and articles from journals and a number of external sources of information. In the assessment of a firm‘s social performance a number of aspects are factored: the existing relationship with local community, employees, customers, suppliers, as well as the quality of the products and the attention to the weakest categories of citizens. The results obtained confirm that firms that create higher market value added (MVA) are more oriented to look after all of the categories of stakeholders and show higher KLD rates. Yet cited studies don’t illustrate methods adopted to calculate rating thoroughly thus leaving some elements unsaid (e.g. measures of the performance, scoring criteria, weights for different criteria) and room to subjectivity aspects.

An empirical test in European context

The present research partially follows the studies illustrated above. In addition it tries to broaden the spectrum of analysis in order to identify the features of the firms more aware of all stakeholder categories needs.

Variables

The crucial point of this analysis is defining a sufficiently objective set of proxy capable to measure the satisfaction degree of each category of stakeholders. Some indicators come in handy for this purpose. RSI is a compound index that, built for a sample of European firms, is determined for social responsibility and devised through data attained via survey. Author of such index is the SiRi group[1], whose KLD is a member. The compound rating is made up according a firm's handling of issues related directly to stakeholder categories. For each shareholder category a corresponding rating is measured (i.e. *community*, *corporate governance*, *customers*, *suppliers*, *employees*, *environment*, *business ethic*, *controversies*). The total rating averages out the eight ratings above. The following aspects are considered in measuring each rating: *i)* voluntary disclosure of impact of firm activities on stakeholder interests; *ii)* principles, rules and management systems utilized in order to meet stakeholder needs; *iii)* quality/effectiveness of managerial systems adopted to protect each stakeholder category.

The following are the issues that determine the ratings:

<u>Community</u>

This rating evaluates the attention of the firm to the community. To score positively, a firm must:

- show a willingness to disclose activity through public reports and communication, forging a solid relationship with the local community
- establish behavioural tenets and policies concerning the community
- constitute a formal system and/or department to manage public relations.

Corporate Governance

Corporate governance is instrumental in protecting shareholders' rights, namely those of minority shareholders. A firm's willingness to have specific tenets of corporate governance and then to fully disclose their effectiveness will gain points for the company. The organization of a firm's decision making bodies is also a parameter in the assessment, as it reflects the respect for minority shareholders. Organisational qualities include the following:

- the number of directors including non-executive and independent
- the number of board meetings
- the presence of auditing committee and practices
- a compensation system for the directors
- the voting rights of shareholders' classes
- any existing disputes arising from voting rights or directors' compensation issues

Customers

This rating measures a firm's attention to customers ex-ante and ex-post the purchase of the product/service. Attention ex-ante means investigating in order to identify customers' needs and any product attributes to fit them. Attention ex-post concerns the measure of customer satisfaction. The following activities have a positive score in rating measure:

- market research and a relationship built with the general public
- certified quality warranties
- marketing campaign actuation
- a relationship established with acquired customers
- safety guarantees for products

- research to verify the degree of customer satisfaction.

Suppliers

Firm scores a higher rating if it implements the following:

- formalised procedures to select suppliers
- periodical visits to suppliers
- fair negotiation with suppliers
- any existing relationship with third world companies
- supplier certification.

Employees

This rating takes into account whether a firm adopts rules, policies and managerial systems concerning the following aspects:

- health and safety in the workplace
- respect for young labour
- freedom of words and association
- participation in unions
- employee participation in decision making and profit sharing
- employee training programs.

Environment

A firm's attention to the environment is assessed with respect to the following:

- formal procedures meant to protect the environment (e.g. plans to reduce water consumption, cut down pollution, to recycle raw materials, etc.)
- certified managerial systems
- allocation of responsibilities
- compliance with existing laws
- any past adverse sentences and fines
- production with low environmental impact

Business ethic

This rating deals with mechanisms adopted by the firm in order to prevent corruption, immorality and illegal behaviours and to promote virtuous practices.

Controversies

This indicator reflects current suits involving a firm's environmental practices or questionable product quality. For instance, disputes over the production of GOM foods or emission of polluting agents will negatively affect the rating.

The present study uses the ratings above to measure the degree of stakeholder satisfaction. It can be inferred that a higher rating indicates greater attention paid by the firm to each aspect considered. As a consequence, related stakeholder categories may attain a higher degree of satisfaction.

In regard to performance variables, the following indicators measure whether companies − all listed on a stock exchange − create value in terms of market value created:

- market value/book value ratio
- total shareholder return (which includes both dividends and capital gains)
- market value added (market value – capital employed).

To identify which factors affect ratings, the following aspects are taken into account: year, country, industry, size and growth rate.

Table 1 lists the variables included in the empirical test (i.e. performance and firm specifics variables) and how they are measured. Market and accounting information are provided respectively by Datastream and World Scope databases.

Tab 1

Samples, tested hypotheses and methodology

The empirical analysis is conducted on a sample of listed companies − mostly from Europe − , whose SiRi group ratings are available.

The 716 samplings of data were extracted from 330 European, Canadian and Asian firms. Some bias in the comparison of variables in the three-year period can stem from varied composition of the sample, which changes from year to year. The distribution of data by country and year is described in Table 2.

Tab 2

Empirical analysis involves the following issues:

a) factors that influence the ratings can include the year of sampling, the country and industry a firm belongs to, and the size and growth rate of a firm
b) the degree of correlation between ratings
c) the degree of correlation between ratings and performance measures for the shareholder.

In regard to point *a*, the following are hypotheses tested:

- ratings have a consistent trend. The hypothesis is grounded in the increased attention to stakeholders' interests in the analyzed period, along with a growing interest around sustainability of a firm's activities and social responsibility (recommendations of OECD in 1999 and EU Commission in 2001). The variability of firms that comprise the sample may bias the analysis
- The country a firm belongs to − in terms of legal system and degree of investor protection − influences a firm's behaviour toward some stakeholder categories. Such hypothesis is grounded in La Porta et al. conclusions (1998 and 2000), pointing out that a country's legal system

influences the capital market efficiency and managerial decisions in finance and corporate governance. Sample firms were clustered according to legal systems (Nenova 2000) in the following groups: *common law* countries (United Kingdom, Canada and Hong Kong), *civil law* countries with German origins (Belgium, Germany, and Switzerland), *civil law* countries with Scandinavian origins (Sweden and Finland). The last cluster comprises the remaining European countries (France, Ireland and Spain); Italy is analyzed in isolation in order to compare with the other clusters.

- The kind of industry a firm belongs to affects ratings. This hypothesis tests whether a link exists among industry, its degree of competition, a firm's success key-factors and stakeholders with greatest impact on performance. In other words, when stakeholders greatly affect firm performance, a higher protection of their interests is expected. The industry impact is analyzed according to more broadly defined sectors (manufacturing, banking, etc.) and to the Pavitt taxonomy for manufacturing firms
- The size and growth rate of firms affect ratings. It is assumed that the larger the firm, the more attention is given to stakeholders for the sake of reputation. Size also spurs economies of scale and scope in managing formalized relationships with stakeholders. Conversely, the link between growth and ratings is less certain. It is hypothesised that more attention given to certain stakeholders over others hinders or promotes growth. However, a high growth rate improves a firm's image and market appreciation, leaving the pursuit of stakeholder satisfaction negligible.

In regard to the analysis of point *b*, it is questioned whether a firm's social responsibility concerns all stakeholder categories or only some and why.

Analysis of point *c* received the utmost attention from international literature, as described in § 3 above.

Methodology relies on a nonparametric ranking (Kruskal-Wallis test) in order to compare similarities/dissimilarities of ratings with respect to determinants listed above. Nonparametric tests do not require assumptions about the shape of underlying distribution (in this study, only total and *employees* ratings appear to be normally distributed) and also remain strong in small samples as it is the case of sub-samples considered in the empirical analysis. The continuous variables (performance, size, etc.) are grouped and ranked in deciles or in commonly accepted categories. The respective ranks are used in the analysis, since a non linear relationship between these variables can be hypothesised.

To analyze correlations, the Spearman Rho coefficient is adopted since it fits the rank-variables.

Results

Results follow for the three types of analysis presented above.

<u>Determinants of ratings</u>

In respect to different years (2000-2003), ratings grow significantly as legal *controversies* ratings show an opposite trend (Table 3). Both trends show more widespread attention over time to the sustainability issue.

Tab. 3

A firm's nationality notably affects ratings when control variables are included in the analysis. Statistically significant differences are found (Table 4) between groups of countries defined above, with respect to the main ratings.

- Italy scores minimum values, except for its *corporate governance* rating, which is nearly equal to other EU countries. Attention to current and prospective minority shareholders has the greatest impact on market appreciation of shares. While the Italian firms seem to show less attention to social responsibility "tout court", the growing attention to *corporate governance* may be due to the following occurances in the analyzed period: the growing diffusion of economic value as a company's main goal, the growing role of financial markets in firms' financing and their process of globalisation, the evolution of Italian regulation on corporate transparency, on minority shareholders protection and on corporate control contestability.
- Common law countries show the highest *corporate governance* ratings.
- Remaining civil law countries, excluding Italy, show similar values in all ratings besides two: *corporate governance*, low in German and Scandinavian countries, and the *customers*. The latter depends significantly on the kind of industry, therefore a country's rating is affected by the kind of industry specialization existing in that country.
- The highest *environmental* ratings are observed in the historically environmentally concerned German and Scandinavian countries.
- *Business ethics*, *controversies*, *suppliers* and *employees* ratings are statistically non dissimilar by country.

Tab 4

Results above show the relevance of a firm's nationality as a determinant of ratings related to the country's legal framework, namely to the legal and statutory constraints and protections. This confirms La Porta's hypothesis that ownership structure and corporate governance systems differ due to varied investor protection in legal systems. *Corporate governance* and *community* ratings show higher protection granted to investors in common law countries. These ratings are lower in all civil law countries, namely those with German origins.

The firm's industry is the most crucial determinant for *customers* and *environment* ratings (Table 5). Energy sectors show the highest ratings due to the relevance of environmental issues and the obvious connection with the natural resources.

Tab 5

The most important determinant for the *customers* rating is the kind of business, higher in manufacturing than in financial and non-financial services. Within the manufacturing category (Table 6), the variable scored higher in specialized manufacturing sectors thanks to the impact of customer relations on a firm's performance. Products in these industries are often tailored for single customers who usually have an exclusive relationship with the firm.

Tab 6

According to such results, customers might not be (or appear to not be) as crucial for financial and non-financial services as they are for manufacturing firms. This thought could be attributed to the smaller size of service companies, which cannot sustain a customer-oriented approach or to a lower degree of competition in the financial services industry and therefore less customer care. It might also be alleged that the *customers* rating regards as customer-oriented some formalized procedures of forecasting and analyzing customer needs and satisfaction before and after the service delivery. The rating therefore fails to see that the personal interaction between the firm and the customer at the time of service delivery is "naturally" customer-oriented.

Firms with many employees score higher in the *employees* rating, with labour regarded as a key-factor for success and having employees a significant contractual-power.

A firm's size positively affects all ratings except for *controversies*, which is in fact negatively associated. Both the whole sample and sub-samples clustered by industry confirm that conclusion. The banking sector is the only exception, as it shows no correlation of size with ratings that are respectively the highest (*corporate governance* and *business ethics*) and the lowest (*customers*), regardless of the size.

In regard to the growth (Table 7), there is a statistically significant negative correlation between the growth rate and the stakeholders ratings, except for the *customers* and *controversies* ratings. These two ratings show respectively a positive and a U-shaped correlation.

Tab 7

There are two possible explanations:

- Growing firms focus on financial performance and cannot pay attention to aspects other than customers, that crucially influence growth. Also, *controversies* ratings show a negative relationship with growth rates, except for very high growth rates, that are not favoured by a contentious environment.
- Just as stakeholder value is instrumental in positively impacting shareholder value, a high growth alone can positively affect economic performance (value of growth opportunities), making all other factors negligible.

Correlation between ratings

In regard to the entire sample of firms, ratings are statistically positively associated with one another (Table 8). *Environment*, *business ethic*s, *community*, *customers* and *employees* ratings are more correlated, affecting a firm's image of social responsibility.

Tab 8

Yet there is an inverse correlation between *corporate governance* and *customers* ratings that may be linked to the whole sample's stratification by country and industry (e.g., the high values of the former and low ones of the latter in financial firms sub-sample). In addition, the fact, however, that the whole sample ratings are de facto interchangeable with respect to the impact on market value may account for the inverse correlation. Customer satisfaction is a crucial driver of growth and of the impact that growth has on a firm's value.

In sub-samples clustered by country, no correlation can be found in common law countries, Scandinavian and other European countries between *corporate governance* and other ratings, whereas such correlation exists within Italy and German civil law countries, confirming what is found in the determinants. In the former group of countries, due to the specifics of the financial markets and of the ownership and financial stucture of the firms, the attention to corporate governance issue is shaped by financial markets and related regulation rather than caused by the degree of social responsibility of the firm. On the other hand, in the latter group, investors are only an aspect of the broader group of stakeholders. The role of bank financing in this group of countries accounts for such difference in the level of protection: the corporate governance systems in these countries are relationship-based, not market-oriented, and the regulation systems offer lower investor protection.

Shareholder value towards stakeholder value

The correlation existing between the creation of shareholder value and ratings is statistically weak (Table 9). Only RI shows a statistically significant correlation. However, RI measures the total shareholder return, but it does not factor the opportunity cost of capital and overlooks the operating and financial risk. It fails to measure value creation or destruction, as it is confirmed by absence of correlation with levered beta. RI (ranked by deciles) has a positive correlation with the total rating (two-tailed 5% significance) and with *community*, *corporate governance*, *suppliers*, and *business ethics* ratings in a decreasing order (two-tailed 1% significance) and it has a negative correlation with *customers* (two-tailed 1% significance) and *controversies* (two-tailed 5% significance).

Tab 9

Such a positive correlation between RI and *corporate governance*, *business ethics*, and *community* ratings confirms the effectiveness of these ratings as a general measure of the shareholder satisfaction, directly and indirectly (through the image of socially responsible behaviour). High values of these ratings result in higher values of RI as a deliberate consequence of the firm’s strategy and as an indirect effect of capital market appreciation.

A good relationship with suppliers has a positive impact on shareholder return, due to both the results of firm decisions (ex ante) and market evaluation (ex post), while a good relationship with customers has a negative one. In addition, RI is generally low for growing companies, whereas MVBV and MVA are significantly and positively associated with growth.

Lacking a statistically significant correlation between MVA and ratings means that neither the hypothesis of coherency, nor of the existence of conflict between shareholder value and stakeholder value are verified.

Conclusions

The empirical evidence presented shows that time, nationality, industry, size and level of growth of a firm determine its stakeholder ratings. A firm's attention to different stakeholders and respective ratings, while variably significant according to the different stratification of the sample, happens to be instrumental in achieving either a directly or indirectly better performance.

Although the empirical evidence presented concerning the link between the creation of shareholder value and stakeholder value is neither unequivocal nor statistically significant, it can be inferred that a firm pursues stakeholders satisfaction to achieve a better value performance.

The empirical analysis has some limits. Defining and measuring a set of proxies capable of reasonably approximating stakeholder satisfaction was a critical part for the research. Rating measures are subjective and incomplete, and both aspects investigated and criteria adopted in measuring ratings are only partially disclosed.

A merely supply-side perspective on measuring stakeholder satisfaction is an additional limit. Those ratings measure the attention of the firm to stakeholders and fail to do so from a demand-side perspective. Nevertheless, the latter requires a very complex data collection method with a high degree of subjectivity.

A solution to such limits may be to create ratings that mix the supply and demand approaches. It could measure the satisfaction for the different categories of stakeholders through its direct and indirect effects on a firm’s fundamentals (results, relationship quality and continuity, reputation, trade-offs between price and quality, etc.). Such a logical framework could be tested on a limited panel of firms in order to verify the strength of hypothesized links and to measure the fundamentals’ impacts on ratings. Therefore, the most statistically significant model (tested on a wide set of different samples) could be widely and generally utilized in measuring ratings through key effect-variables.

Notes

[1] Avanzi srl, the member for Italian firms, has supplied the ratings utilized in this study.

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Table 1 – *Variables utilized in the empirical analysis*

performance variables	acronym	formula
	MVA	$\frac{\text{market value - net assets (at book value)}}{\text{net assets (at book value)}}$
	MTBV	$\frac{\text{equity market value}}{\text{ordinary shares (at book value)}}$
	RI	return index (RI_t) in period t, that takes in account both capital gains and dividends: $RI_t = RI_{t-1} \cdot \frac{PI_t}{PI_{t-1}} \cdot \left(1 + \frac{DY_t}{100} \cdot \frac{1}{N}\right)$ RI_{t-1} = return index in t-1 PI_t e PI_{t-1} = price in t and t-1 respecitvely DY_t = dividend yield % in t N = number of working days in the given period

determinants	acronym	formula
year	YEAR	year
country	COUNTRY	country of share listing dummy variable that classifies countries according to legal environment index by La Porta (1998) and Nenova (2000)
industry	DUMMYSET	dummy variable has the following values in function of the type of industry: 1 = energy, 2 = manufacturing, 3 = services, 4 = banking/insurance
	DUMMYPAVITT	dummy variable defined according to PAVITT taxonomy: 1 = traditional sectors, 2 = scale sectors, 3 = specialized products, 4 = high technology
size	TOTAL SALES	net sales
	TOTAL CAPITAL EMPLOYED	net fixed assets + net working capital
	TOTAL ASSETS	total assets
	NUMBER OF EMPLOYEES	number of employees
growth rate	INVESTMENT RATE	capital expenses/fixed assets
	SALES GROWTH RATE	sales(t)/sales (t-1) -1

Table 2 – *Sample investigated*

	2001	2002	2003	Total
Belgium	5	10	2	17
Canada	3	8	4	15
Finland	6	1	2	9
France	37	44	43	124
Germany	30	34	12	76
Hong Kong	4	3	4	11
Ireland	3	6	1	10
Italy	22	29	7	58
United Kingdom	74	78	26	178
Spain	9	4	6	19
Sweden	12	4	3	19
Swizerland	56	60	64	181
total	261	281	174	716

Table 3 – *Ratings per year*

year		*total rating*	*business ethics*	*community*	*suppliers*	*corporate governance*	*customers*	*employees*	*environment*	*controversies*
2001	number of cases	261	261	261	261	261	261	261	261	261
	mediane	4,71	3,42	4,27	2,96	6,47	4,91	5,51	6,00	-0,54
2002	number of cases	281	281	281	281	281	281	281	281	281
	mediane	5,01	5,58	5,07	2,64	7,01	5,12	6,02	6,16	-0,61
2003	number of cases	174	174	174	174	174	174	174	174	172
	mediane	5,31	6,87	5,86	2,83	7,32	6,38	6,48	6,70	-0,86

Table 4 – *Ratings per country (average rank and Kruskal-Wallis test)*

		average rank								
country dummy	number of cases	BUSINESS ETHICS	COMMUNITY	SUPPLIERS	CORP_GOV	CUSTOMERS	EMPLOYEES	ENVIRONMENT	CONTROVERSIES	total rating
civil law German origin	274	333,88	302,50	338,30	243,50	407,09	353,56	364,22	389,30	331,08
Italy	58	298,51	268,40	278,52	311,99	282,53	245,14	196,46	310,82	210,50
other EU countries	153	385,21	343,12	378,54	348,03	396,02	380,03	336,86	271,41	324,42
common law	204	382,24	482,10	385,28	551,04	279,58	383,52	395,40	383,52	451,03
civil law Scandin. origin	28	417,61	289,50	430,05	247,45	423,11	354,52	500,41	434,46	458,20
total	717									
	chi-square	16,5146	107,7352	20,2642	275,1304	60,5710	22,1984	57,0271	50,7299	85,7556
	asint. sign.	0,0024	0,0000	0,0004	0,0000	0,0000	0,0002	0,0000	0,0000	0,0000

Table 5 – *Ratings per industry (average rank and Kruskal-Wallis test)*

		average rank							
industry dummy	number of cases	BUSINESS ETHICS	COMMUNITY	SUPPLIERS	CORP_GOV	CUSTOMERS	EMPLOYEES	ENVIRONMENT	CONTROVERSIES
energy	33	401,06	505,89	431,67	446,53	370,89	495,95	521,86	179,53
manufacturing	394	361,05	336,27	362,66	317,44	392,31	352,57	390,64	372,20
services	158	317,68	378,90	345,90	394,33	319,95	341,39	320,06	375,64
banking-insurance	134	396,69	371,55	351,14	423,35	309,53	370,31	277,15	344,99
total	719								
	chi-square	12,2462	23,1755	5,1763	39,4843	23,5429	16,2663	55,8096	33,0923
	asint. sign.	0,0066	0,0000	0,1593	0,0000	0,0000	0,0010	0,0000	0,0000

Table 6 – *Ratings per Pavitt sectors (average rank and Kruskal-Wallis test)*

		average rank							
Pavitt dummy	number of cases	BUSINESS ETHICS	COMMUNITY	SUPPLIERS	CORP_GOV	CUSTOMERS	EMPLOYEES	ENVIRONMENT	CONTROVERSIES
traditional	71	157,68	194,14	217,74	208,23	169,49	172,99	166,77	169,59
scale	137	188,17	198,91	182,48	194,61	182,98	200,41	192,68	173,71
specialization	78	158,19	131,78	150,21	140,86	212,88	146,73	171,26	242,70
high tech	83	228,33	204,23	193,85	190,75	175,40	205,81	200,83	160,25
total	369								
	chi-square	23,8427	25,0010	16,0627	18,2588	7,6204	16,9824	5,9091	36,8639
	asint. sign.	0,0000	0,0000	0,0011	0,0004	0,0545	0,0007	0,1161	0,0000

Table 7 – *Ratings per growth rate (average rank and Kruskal-Wallis test)*

		average rank								
sales growth	number of cases	BUSINESS ETHICS	COMMUNITY	SUPPLIERS	CORP_GOV	CUSTOMERS	EMPLOYEES	ENVIRONMENT	CONTROVERSIES	total rating
1° decile	70	404,51	492,62	385,08	553,11	253,21	382,30	397,33	360,21	456,20
2° decile	71	356,49	496,30	400,56	555,61	279,50	396,03	426,35	375,51	454,55
3° decile	71	412,90	391,43	363,96	461,70	364,83	405,25	371,29	320,74	408,97
4° decile	71	359,27	348,29	324,01	330,03	356,16	349,47	353,98	298,75	326,18
5° decile	71	405,06	368,77	353,60	296,37	401,50	401,23	369,85	272,36	359,46
6° decile	71	295,60	299,20	343,36	303,33	314,24	339,25	313,84	334,56	291,89
7° decile	71	293,34	305,99	346,27	264,22	355,16	326,99	287,06	351,33	292,24
8° decile	71	372,10	309,92	376,12	282,11	404,48	340,44	367,32	384,69	348,46
9° decile	71	351,04	281,82	316,88	276,45	437,01	356,63	345,37	403,31	327,65
10° decile	68	282,42	237,73	324,38	208,76	368,11	232,70	301,01	426,63	267,21
total	706									
	chi-square	36,3792	113,2318	12,4393	236,8337	50,0338	38,7352	28,4691	40,7167	68,0083
	asint. sign.	0,0000	0,0000	0,1897	0,0000	0,0000	0,0000	0,0008	0,0000	0,0000

Table 8 – *Ratings correlations*

Spearman Rho	*deciles*								
	BUSINESS ETHICS	COMMUNITY	SUPPLIERS	CORP-GOV	CUSTOMERS	EMPLOYEES	ENVIRONMENT	CONTROVERSIES	TOTAL RATING
BUSINESS ETHICS		**0,4382**	**0,3915**	**0,2136**	**0,3292**	**0,4294**	**0,4185**	**-0,2748**	**0,6247**
2 tailed-sign		0,0000	0,0000	0,0000	0,0000	0,0000	0,0000	0,0000	0,0000
COMMUNITY			**0,3052**	**0,3721**	**0,1667**	**0,5155**	**0,4646**	**-0,3345**	**0,6249**
2 tailed-sign			0,0000	0,0000	0,0000	0,0000	0,0000	0,0000	0,0000
SUPPLIERS				**0,1977**	**0,1458**	**0,3318**	**0,3418**	**-0,2444**	**0,3856**
2 tailed-sign				0,0000	0,0001	0,0000	0,0000	0,0000	0,0000
CORP_GOV					**-0,1287**	**0,2006**	**0,1640**	**-0,1006**	**0,3337**
2 tailed-sign					0,0006	0,0000	0,0000	0,0071	0,0000
CUSTOMERS						**0,3611**	**0,3781**	**-0,1162**	**0,4219**
2 tailed-sign						0,0000	0,0000	0,0019	0,0000
EMPLOYEES							**0,5616**	**-0,3039**	**0,6884**
2 tailed-sign							0,0000	0,0000	0,0000
ENVIRONMENT								**-0,2093**	**0,6990**
2 tailed-sign								0,0000	0,0000
CONTROVERSIES									**0,0205**
2 tailed-sign									0,5843

Table 9 – *Ratings and performance variables (correlation)*

	Spearman Rho		*deciles*		
			MVBV	***RI***	***mva***
deciles	*total rating*	*coefficient*	*-0,083*	*0,090*	*-0,076*
		2-tailed sign	*0,027*	*0,016*	*0,044*
	business ethics	*coefficient*	*-0,039*	*0,099*	*-0,043*
		2-tailed sign	*0,302*	*0,008*	*0,251*
	community	*coefficient*	*-0,024*	*0,230*	*0,040*
		2-tailed sign	*0,530*	*0,000*	*0,290*
	suppliers	*coefficient*	*0,114*	*0,143*	*0,081*
		2-tailed sign	*0,002*	*0,000*	*0,032*
	corporate governance	*coefficient*	*-0,045*	*0,179*	*0,053*
		2-tailed sign	*0,228*	*0,000*	*0,161*
	customers	*coefficient*	*-0,040*	*-0,128*	*-0,070*
		2-tailed sign	*0,289*	*0,001*	*0,062*
	employees	*coefficient*	*0,005*	*0,051*	*0,019*
		2-tailed sign	*0,895*	*0,171*	*0,622*
	environment	*coefficient*	*-0,115*	*0,055*	*-0,144*
		2-tailed sign	*0,002*	*0,145*	*0,000*
	controversies	*coefficient*	*0,015*	*-0,095*	*-0,050*
		2-tailed sign	*0,692*	*0,011*	*0,183*

2-tailed 1% sign. 2-tailed 5% sign.