Seminar (HS38002)

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Papers Selected For Review:-

1. The Relationship between Corporate Social Responsibility and Shareholder Value: An Empirical Test of the Risk Management Hypothesis Author(s): Paul C. Godfrey, Craig B. Merrill and Jared M. Hansen
Source: **Strategic Management Journal:**SMJ, Vol. 30, No. 4(Apr. 209)[*Financial Times Top 50 Journal*]

2.The Downside of Being Responsible: Corporate Social Responsibility and Tail Risk
Diemont, Dolf; Moore, Kyle; Soppe, Aloy.
Source:-**Journal of Business Ethics**: JBE; Dordrecht Vol. 137, Iss. 2, (Aug 2016)[*Financial Times Top 50 Journal*]

Abstract

What are the upsides and downsides of engaging in Corporate Social Responsibility activities? Does it offer any risks or rewards? Is it likable for the firm management to engage in such activities? The above path breaking articles provide answers to such questions. (Godfrey et al.) relates CSR contributions to share prices in the setting of a negative event and verifies multiple hypotheses that argue on the side of CSR having an insurance like property and that it offers protection to the firm's shareholder value if the firm is seen to engage in a negative event and goes on to prove that investment in CSR is like a purchase of moral capital.
(Diemont et al.) on the other end use extreme value theory and stakeholder theory to argue for a relationship between CSR contributions and financial tail risk, in certain time periods and areas. They also establish a causal relationship for the same.

Introduction

In the past, multiple studies have attempted to measure the depth of relationship between CSR and Corporate Financial Performance(CFP) The overall orientation has been to argue and show that CSR activities generate CFP. However, (Godfrey et al.) attempts to answer a slightly different question, does participation in some types of CSR activities creates a form of goodwill or moral capital for the firm that acts as 'insurance like' protection when negative events occur that preserves shareholder value (CFP)?. Thus, the article investigates a different aspect of the CSR-CFP relationship; which is the protection, rather than generation, of shareholder value(CFP), it also provides a detailed, theoretical rationale for why CSR should preserve CFP. Another distinct characteristic of this article is to match firm-level CSR activities with firm specific, negative events and not using general or industry specific negative events.

Tail risk awareness has risen among risk managers ever since the onset of the 2007/08 financial crisis. At the same time, public sensitivity towards corporate social responsibility has grown. The article by(Diemont et al.) is one of the first academic attempts to combine both subjects by addressing the relationship between extreme negative daily equity returns and a company's level of corporate social responsibility (CSR). They hypothesise that equity of socially responsible com- panies has more stable returns and show less extreme negative daily equity returns resulting in companies with greater CSR having lower downside tail risk. The intuition is that socially responsible companies are less vulnerable to company-specific events that adversely influence the equity price, the study also offers a temporal and international angle.

Conceptual Framework of the Papers

1.1(Godfrey et al.) argues against the theoretical Capital Markets asset pricing model, where portfolio managers do not invest in risk management that come at a price more than expected loss, the reason for this phenomenon is that markets are not always perfect.

1.2.It is believed that CSR is not philanthropy with "no strings attached", rather it can mean buying respect in a sense that it sends a signal that the firm management is not solely devoted to making profits, but also committed to social welfare and this buying of respect acts as a buffer or moral capital in turn of negative events.

2.1(Diemont et.al) assumes that equity returns do not follow a normal distribution, rather they follow a heavily tailed distribution, which leads onto the belief that extreme returns are more probable under the assumption of normality.

The distribution function F is heavy-tailed if its left tail can be approximated by a power law as

$$F(-x) = \Pr(R \leq -x) \sim Ax^{-\alpha}, \quad \text{as } x \to \infty,$$

2.2 Downside tail risk is defined using the VaR(value at risk) measure.

Summary of Papers

1.Hypotheses:- **(i)**In the context of a negative event, the decline in shareholder value is smaller for firms that engage in CSR activities than for firms that do not **(ii)**In the context of a negative event, the shareholder value-loss mitigating property of CSR engagement is greater for institutional CSR activities than for technical CSR activities **(iii)** In the context of a negative event, the shareholder value-loss mitigating property of CSR engagement is greater for firms with higher levels of intangible assets than for firms with lower levels of intangible assets**(iv)**In the context of a negative event, the shareholder value-loss mitigating property of CSR engagement is greater for larger firms than for smaller firms**(v)**In the context of a negative event, the shareholder value-loss mitigating property of

CSR engagement is less for firms with more negative social impacts than for firms with fewer negative social impacts **(vi)**In the context of a competitively based negative event, the decline in shareholder value is unrelated to engagement in CSR activities.**(vii)** In the context of a stakeholder based negative event, the decline in shareholder value is smaller for firms that engage in CSR activities than for firms that do not**(viii)**In the context of an integrity based negative event, declines in shareholder value are smaller for firms that engage in CSR activities than for firms that do not.
Variable Measurements, **CSR Data:-** MSCI KLD Dataset, **Shareholder Value:-** Stock Price, **Negative events:-** Taken from the Wall Street Journal
ICSR:-Community, Diversity CSR **TSCR:**-Governance, Employee relations
Method of Estimation:- Measurement of Ordinary Least Square Regression based statistical significance
Results:-Hypothesis 1-6 and 8 are supported by the data in partial sense. It is found that ICSR activities are beneficial to all firms, however TCSR activities are valuable only to large firms.

2. Objective:- Checking for Relationship between CSR and Financial Tail Risk,Variable Definitions: **CSR Data:-** Dutch Sustainability Ratings, **Tail Risk Estimation:-** Using Stock Price Data(Idiosyncratic returns,which also act as a control for usual market risk), Hill Estimation is used to estimate the A parameter and hence the VaR, leverage, liquidity,size,market to book ratio are controlled for and the securities are divided into homogenous geographies. **Testing for Multicollinearity:-** Using VIFs **Results:-**Most Significant CSR relationships are found, 2007 onwards, Community CSR has a small positive relationship with tail risk, highest in America, Employee CSR has negative relation to tail risk predominantly in Asia, Governance CSR is unrelated to tail risk,Contractors CSR has a positive relationship with tail risk in Europe, Environment CSR has a positive relationship to tail risk in Europe.

Comments/views

- The insurance value of CSR is confirmed by datasets in both the articles, although they are published in different points of time and with different datasets, thus confirming the conclusion.
- Strong Econometric logic has been used in both articles to make results more robust.
- My self analysis on Indian Rep Risk dataset for NIFTY 50 companies yielded results wherein Hypothesis 1-4 of (Godfrey et.al hold)

Concluding Remark
-The articles open scope to remarkable areas of further research into CSR and risk relations in lieu of country regulations relating to CSR and disclosure requirements of CSR

Learning Outcomes
-CSR investments are not forced measures due to government regulation but can act as strategic risk management instruments by firm management.
-Larger firms derive more benefit from CSR activities than smaller firms.
-Investment in certain types of CSR activities can be seen as a tradeoff, which increases tail risk on one hand but has insurance like property on the other.
-Investment in CSR must be based on spatial analysis and must be categorical in nature for profit maximising firms, so as to avoid tail risk but to keep investing in moral capital formation.
- Owing to more community participation in America and more environmental awareness in Europe, their social behaviour is manifested in how CSR affects tail risk.