The Corporate Social Responsibility of Board of Directors: **A Choice or a Necessity?**

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Outline

1. CSR of Boards : A **legal** perspective

2. CSR of Boards : An **economic** perspective

3. CSR and the risk - adjusted performance of institutional investors are aligned (« The sustainability footprint of insitutional investors», by Gibson Brandon and Krueger, 2017)

4. CSR of Boards: **An ethical** perspective

5. So why isn't **change** happening more rapidly on Boards?

CSR of Boards: A legal perspective

- 1. Under Swiss Law, Art 717.IV.1 of the CO:
- « Les membres du conseil d’administration, de même que les tiers qui s’occupent de la gestion , exercent leurs attributions avec toute la diligence nécessaire et veillent fidèlement aux intérêts de la société»

- There would be an incentive if CSR is in the «interest of the company» but the message remains a rather indirect and vague one.

CSR of Boards: A legal perspective(cont)

2. Under the UK Companies Act of 2006, BODs have 7 key duties among which:

172. DUTY TO PROMOTE THE SUCCESS OF THE COMPANY

Comment:

«Prescribes that BOD decisions should be taken in the interest of members, with regard to long term consequences, the need to act fairly between members and a range of other «stakeholders» such as employees, suppliers, the environment , the general community and creditors (Wikipedia)» →CONTROVERSIAL!!!!

CSR of Boards: A legal perspective(cont)

In both the Swiss and the UK cases, we are far from the UN Global Compact objective:

Make sustainability a Board of Directors' Priority!!!!!

which includes in particular the following responsibility :

Set the strategic course and ambition. Boards of Directors offer **long-term perspective** and symbolic value that can encourage your company to **make sustainability part of your everyday business.**

CSR of Boards: An Economic perspective

- According to Bénabou and Tirole (2010), ***firms*** pursue sustainability policies for one of the following reasons:

1. ***"Doing well by doing good":*** to take a **long-term perspective** and maximize inter-temporal profits
2. ***"Express citizen values":*** to express values on behalf of their stakeholders (**delegated philanthropy**)
3. ***"Managerially driven philanthropy":*** Sustainability reflects managerial and board of directors' self-serving aspirations to engage in philanthropy that is ultimately value destroying **("agency view" of CSR**)

CSR of Boards: An Economic Perspective(cont)

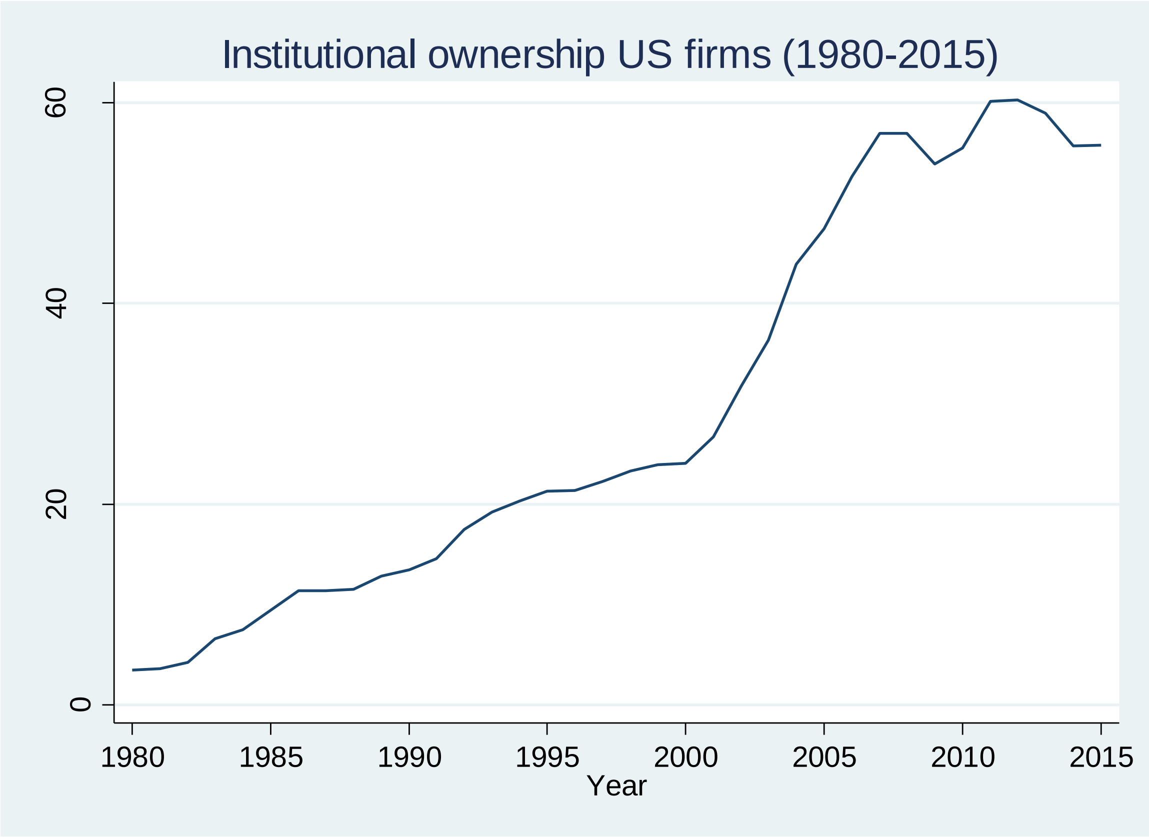
- First and third motivation can be transposed into testable hypotheses:

1. ***"Overcoming short-termism" hypothesis*****:** Act responsibly over a long-horizon in order to maximize long term financial performance

3. ***"Managerially driven philanthropy" hypothesis:*** Self- and social image concerns of the Board of Directors and Managers drive sustainability strategies, which would lower financial performance.

The sustainability footprint of Institutional Investors (Gibson & Krueger, 2017)

- **Today, stock ownership largely dominated by institutional investors**



Motivation

The sustainability footprint of Institutional Investors

- Surprisingly little is known about institutional investors’ attitudes towards *environmental* and *social* (or sustainability) issues
  - ***Examples:*** environmental pollution, biodiversity, labor- and human rights, safety at workplace, etc.

→ With our study we wish to better understand
  - which types of institutions hold sustainability oriented portfolios and
  - “why” they do so.

What is a footprint?

- ***Merriam-Webster: Dictionary and Thesaurus***
  - *: a track or mark left by a foot or shoe*
  - *: a marked effect, impression, or impact <left a footprint in the field of research>*

- In our paper we consider a footprint to be something **positive**: higher values=better.

Measuring sustainability footprint at the **stock-level**

- Many financial data providers nowadays offer measures of environmental, social and governance (ESG) performance at the stock–level
- Two examples:

MSCI

THOMSON REUTERS

Measuring sustainability at the **<u>stock-level</u>** (contd.)

MSCI

- Focus on **Environmental** and **Social** pillar score

- Use combined MSCI and Thomson Reuters score

Figure 2 MSCI ESG Key Issue Hierarchy

3 Pillars	10 Themes	37 ESG Key Issues	
Environment	Climate Change	Carbon Emissions*	Financing Environmental Impact
		Energy Efficiency	Climate Change Vulnerability
		Product Carbon Footprint	
	Natural Resources	Water Stress*	Raw Material Sourcing
		Biodiversity & Land Use	
	Pollution & Waste	Toxic Emissions & Waste*	Electronic Waste
		Packaging Material & Waste	
	Environmental Opportunities	Opportunities in Clean Tech	Opp's in Renewable Energy
		Opportunities in Green Building	
Social	Human Capital	Labor Management*	Human Capital Development
		Health & Safety*	Supply Chain Labor Standards
	Product Liability	Product Safety & Quality	Privacy & Data Security
		Chemical Safety	Responsible Investment
		Financial Product Safety	Health & Demographic Risk
	Stakeholder Opposition	Controversial Sourcing	
	Social Opportunities	Access to Communications	Access to Health Care
		Access to Finance	Opp's in Nutrition & Health
Governance	Corporate Governance*	Board**	Ownership**
		Pay**	Accounting**
	Corporate Behavior	Business Ethics*	Corruption & Instability
		Anti-Competitive Practices*	Financial System Instability

Measuring sustainability footprint at the **institutional-investor-level**

- Combine (i) *stock-level sustainability scores* with (ii) *portfolio holdings*
- *Value-weighted* sustainability footprint at institutional investor portfolio-level:

$$Susty\_VW_{jt} = \sum_{i=1}^{N_{jt}} w_{ijt} \times Susty_{it-1}$$

w_{ijt} = value weight of stock *i* in investor *j's* portfolio in quarter *t*

$Susty_{it}$ = average Sustainability score of stock *i* in quarter *t*

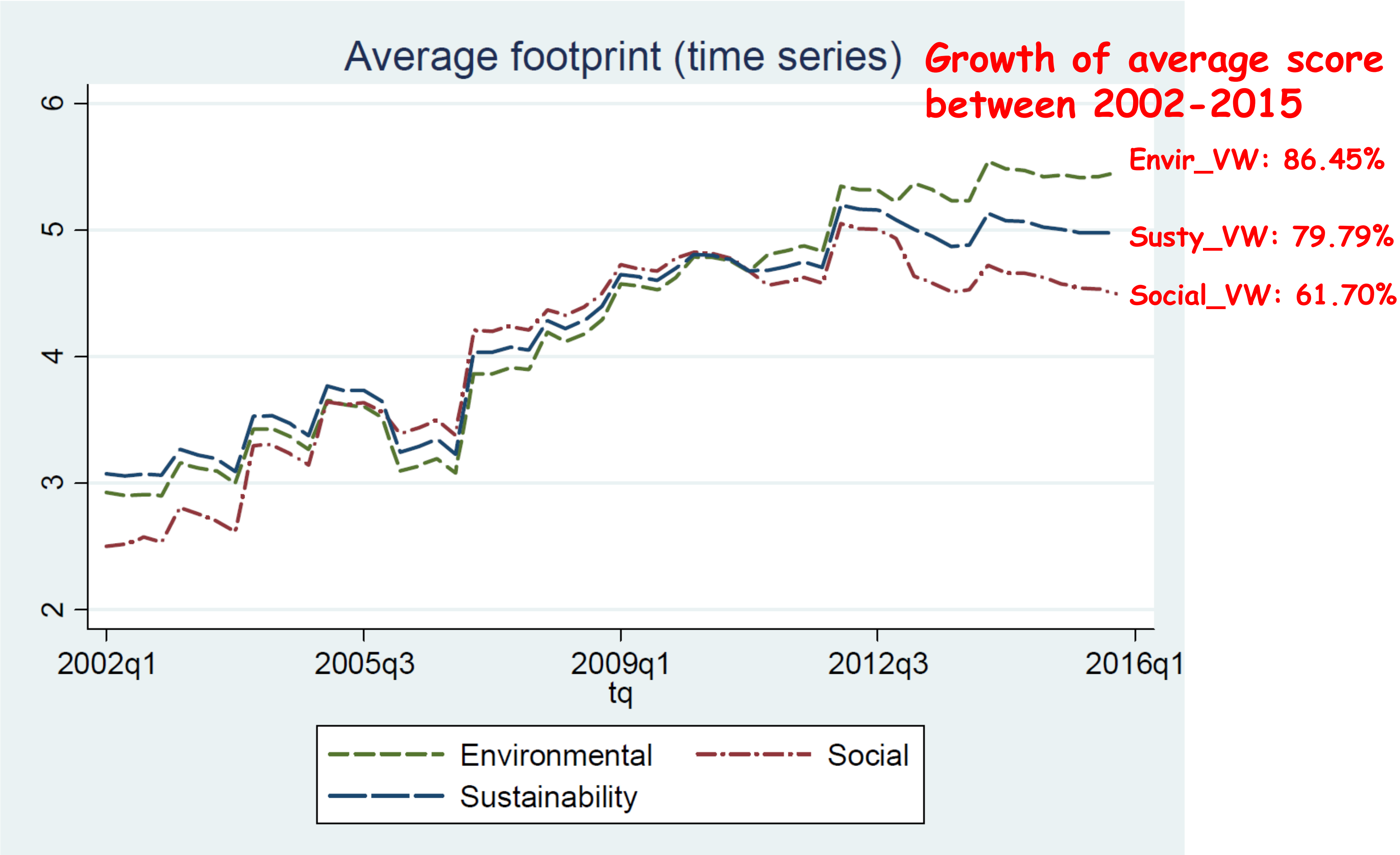


Figure 5

1.) Average footprint increasing over time. 2.) Divergence between E and S footprints since 2010 (BP oil spill?)

Measuring investors' horizon

a) **Legal type classification** from Abarbanell, Bushee, & Raedy (2003, JB)

→ examine how sustainability footprint varies by legal type (fiduciary duties)

b) **Portfolio turnover**

- High portfolio turnover=proxy for short term horizon

→ examine how sustainability footprint varies with portfolio turnover

a) Legal type classification

1. **Bank trusts**
2. **Insurance company**
3. **Corporate pension fund**
4. **Public pension fund**
5. **Investment company** (mutual fund management companies)
6. **Independent investment advisor** (mainly individual mutual funds, hedge funds, etc.),
7. **University and foundation endowments**
8. **Miscellaneous**

Institutions with longer investment horizons have higher (i.e. better) footprints

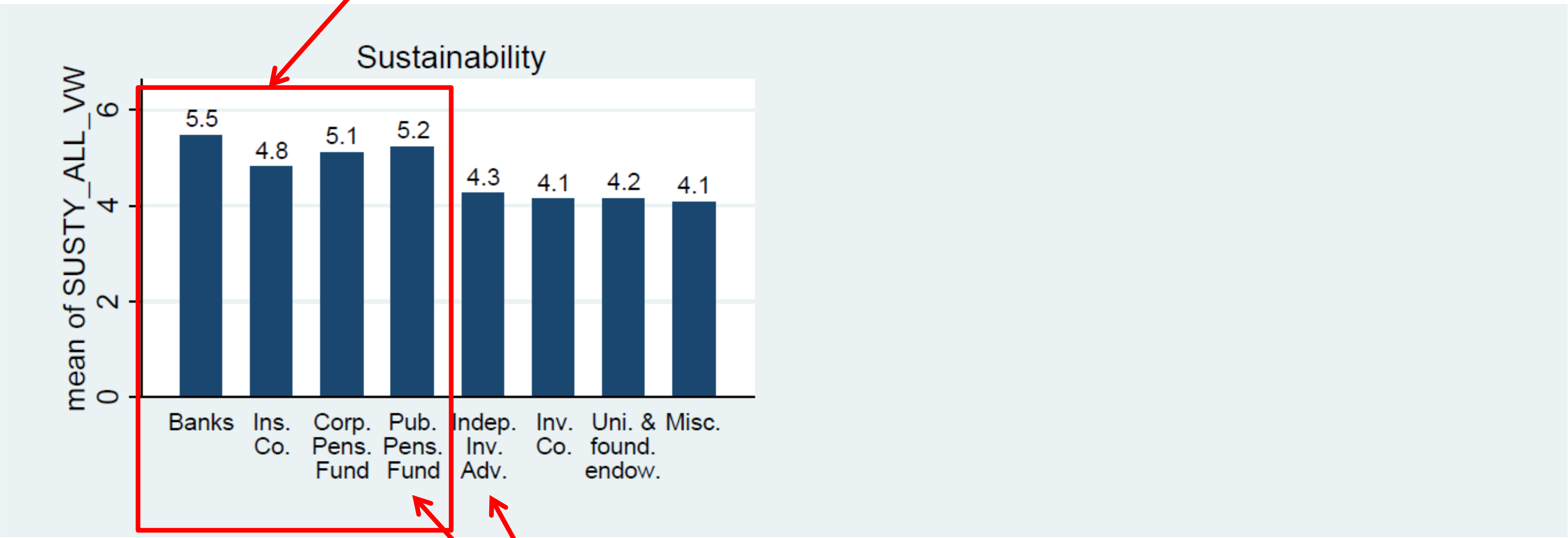


Figure 3, Panel A

Differences economically meaningful!

For example, the average Public Pension Fund has a 21% (=5.2/4.3-1) better footprint than the average independent investment advisor.

Institutions with lower portfolio turnover have better footprints

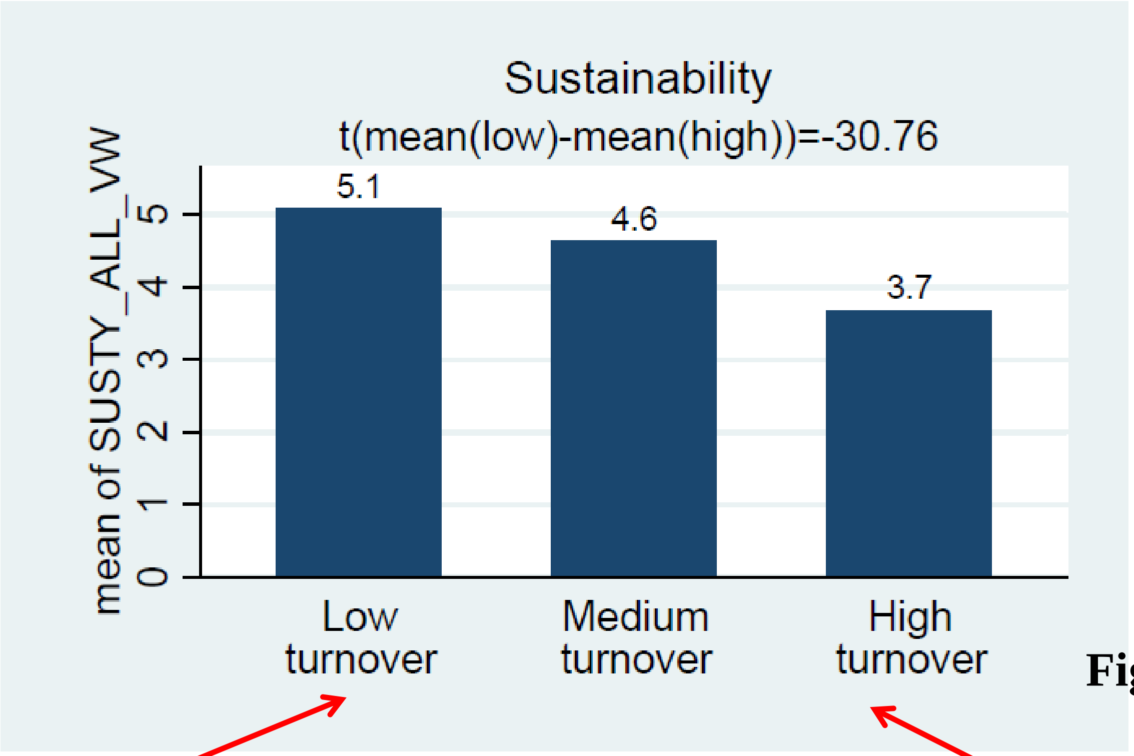


Figure 3, Panel B

Low-turnover institutions have a 38 % better sustainability footprint than high turnover institutions

Key Messages (1/2)

- Proxies for investment horizon correlate strongly with sustainability footprint:
  1. Institutions with **longer investment horizons** have **better sustainability footprints**
  2. Institutions with **shorter horizons** have **worse footprints**
  3. Institutions with **high portfolio-turnover** exhibit **worse sustainability footprints**

Relation between risk-adjusted performance and sustainability footprint

- *“Curbing-short termism”:*
  - Risk-adjusted performance should be **higher** when sustainability footprints are better

- Alternatively, *“Managerially driven philanthropy”:*
  - Risk - adjusted performance should be **lower** when footprints are better

- Examine the relationship between risk-adjusted performance and sustainability footprints of institutional investors.

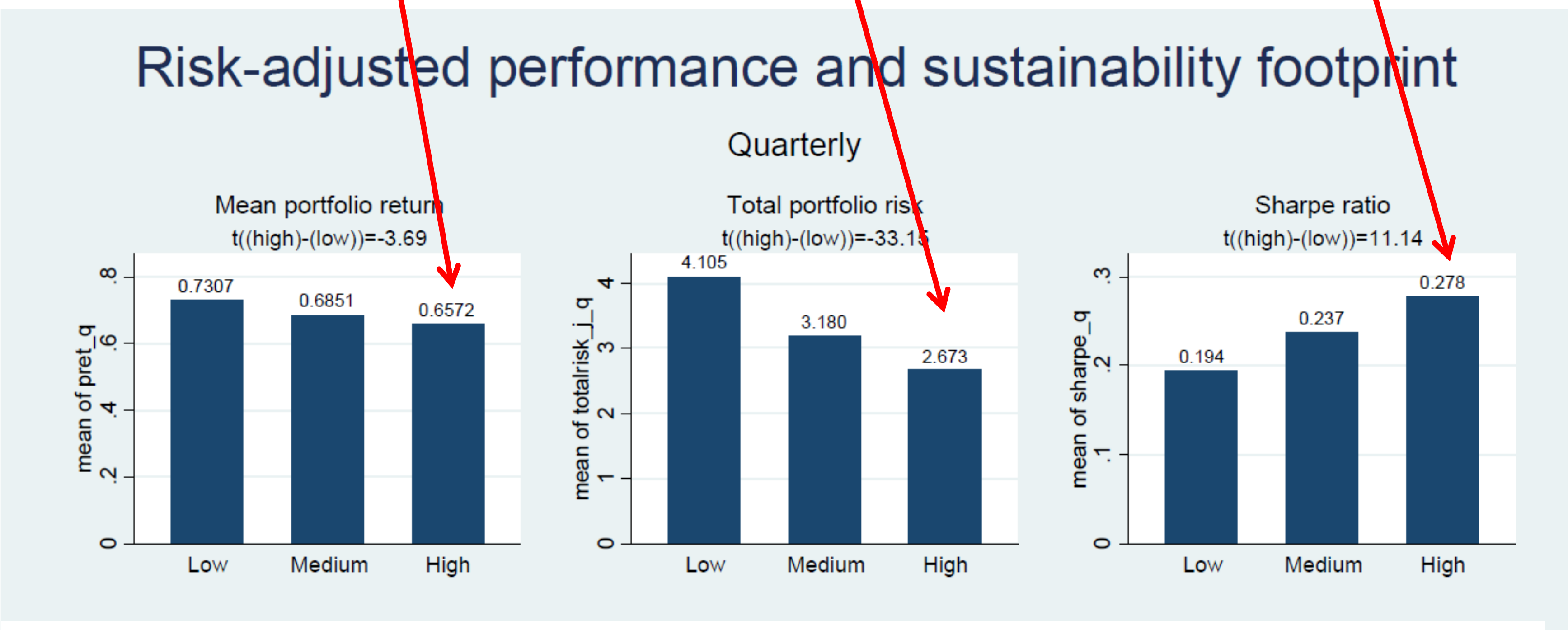
Link between risk-adjusted performance and footprint

Institutions with <u>better</u> sustainability footprints have:

… (i) slightly lower returns

… (ii) lower risk

… *(iii) higher Sharpe ratios*



Key messages so far (2/2)

- Institutional investors with **better sustainability footprints** exhibit **higher risk-adjusted performance**
  - primarily through a **strong reduction** in risk (total risk, idiosyncratic risk, tail risk, etc..)

→ Empirical evidence supports the "**curbing short termism**" hypothesis.

→ Our empirical evidence suggest that CSR is intrinsically related to **sound risk management** which is a core BOD supervisory duty!

CSR of Boards: An ethical perspective

1.CSR is ethically **not a choice** but a **necessary strategy** to be pursued by the BOD to create long term value while accounting for the well- being of firms' stakeholders!!!

2. The BOD **sets the tone** at the top of the company when it comes to ethical behaviors and social engagement !

3. The BOD of the company has the duty to make the company **more resilient**:

→ ***CSR promotes these objectives!!!***

So why isn't change happening more rapidly at the BOD level?

- Overcoming short-termism is hard: peer , investors, analysts, rating agencies' pressure
- BOD members are hired primarily with respect to their technical skills and experience and not with respect to their pro-social orientation
- BOD members lack knowledge and are not educated to think about CSR as a priority
- The current geopolitical and macroeconomic conditions do not help !

How can we **promote** change?

- **Educating** BOD members about CSR , its objectives and its value-added for the **long term resilience** of the firms.
- **Changing hiring policies** for BOD members and recruiting them also based on their ethical values and pro-social orientation.
- **Enlarging the scope of the mandates** of BOD members to integrate CSR objectives into their fiduciary duties.
- **Who can do that?** Regulators, International Organisations (UNGC), NGOs, Institutional Investors, the Media ?...Or, simply **pressure** resulting from the firms‘ **reputation** in the market place?

Thank you for your attention!