

**FINANCE AND SOCIETY:  
ON THE FOUNDATIONS OF CORPORATE  
SOCIAL RESPONSIBILITY**

**HAO LIANG AND LUC RENNEBOOG  
TILBURG UNIVERSITY**

# Motivations: The World Our Grandchildren Will Inherit



# Main questions

- What fundamental forces steer companies to behave as good citizens rather than as pure profit maximizers?
- Is protecting stakeholder rights in conflict with protecting shareholder rights?
- What are the implications to societal sustainability?

# Baseline hypothesis

- Conceptual link:

*Corporate Social Responsibility (CSR) => Sustainability*

*CSR: measured by firm's environmental, social, and governance (ESG) performance*

- What determines CSR: mixed empirical evidence on corporate financial performance and constraints (“*doing good by doing well*”, “*doing well by doing good*”, or the opposite, or no relation)
- Fundamental latent factors may determine both “*doing well*” (financial performance) and “*doing good*” (CSR)
  - **Laws and Institutions**

# Laws - Legal Origins

- Legal origins: English common law, French civil law, German civil law, Scandinavian law, Socialist law
- The “law and finance” view
  - Corporate laws aim to address the agency conflict between managers and shareholders, and between controlling shareholders and minority shareholders
  - Common law is superior in providing fertile ground for shareholder protection
  - Shareholder protection → financial development → efficient resource allocation → Better economic development and social welfare
- The stakeholder view
  - A firm has the responsibility not only to shareholders, but also to broader stakeholders (employees, customers, suppliers, community, etc)
  - Civil laws are superior in providing fertile ground for stakeholder protection
  - Stakeholder protection → reducing market externalities → social welfare

# Institutions – Democracy and Constraints

- The institutional view (“conventional wisdom”)
  - Political institutions shape corporate governance structure and aggregate social preference (Pagano & Volpin, 2005; Perotti & von Thadden, 2006; Acemoglu & Johnson, 2005)
  - In order to foster CSR and sustainability, democracy and constraints on government need to come first
- The development view
  - Institutions are the *consequence*, rather than the *preconditions*, of economic development (Glaeser et al., 2004)
  - Democracy and executive constraints may sometimes even hinder good economic outcome – such as CSR and sustainability, due to difficulty in consensus building

# Data and Empirical Strategy

- CSR data (Dependent variable):
  - Firm-level CSR: **Vigeo corporate ESG**
- Country-level data (Ind. variables):
  - Legal origin: LLSV
  - Political institutions: World Bank, Polity IV, Vahanen democracy, Polity IV democracy, Polity IV executive constraints, corruption control
  - Economic development: GDP per capita, Globalization
- Corporate governance and financial performance (controls):
  - Ownership and board structure: *Orbis (BvD independence indicator)*
  - Financial performance and constraints (“*doing well*”): *Compustat & Datastream*
- Empirical strategy:
  - Cross-country GLS
  - Random-effect ordered probit (DV is ordinal rating)
  - Quasi-natural experiments

# Results – Descriptive

	English origin	French origin	Socialist origin	German origin	Scandinavian origin
<b>Overall CSR Rating</b>	3.72 (1.74)	4.10 (1.73)	2.26 (1.21)	3.83 (1.72)	4.93 (1.74)
<b>Ecology Score</b>	2.65 (1.77)	2.92 (1.78)	1.20 (1.21)	3.59 (1.85)	3.88 (1.70)
<b>Social Score</b>	2.75 (1.73)	2.99 (1.75)	1.40 (1.36)	2.84 (1.63)	3.85 (1.66)
<b>Labor relations</b>	5.26 (1.85)	5.62 (2.03)	4.25 (2.25)	5.51 (1.76)	6.13 (2.01)
<b>Carbon exhaust</b>	4.35 (2.59)	4.39 (2.75)	3.66 (2.35)	4.84 (2.54)	5.33 (2.38)
<b>Environmental score</b>	5.14 (1.89)	5.17 (2.09)	4.17 (1.62)	5.59 (1.90)	6.09 (1.83)

- Corporations in countries with English legal origins underperform those in countries with civil law origins (except current/former Socialist countries)



# Results – Non-parametric tests

(Wilcoxon-Mann-Whitney Test Statistics)

<i>Dependent Variable</i>	<i>Overall CSR rating</i>	<i>Ecology score</i>	<i>Social score</i>	<i>Labor Relations</i>	<i>Carbon exhaust</i>	<i>Environm. Score</i>
<b>Civil vs. common law</b>	18.676***	58.391***	19.059***	23.905***	22.369***	34.366***
<b>French vs. English</b>	16.044***	15.241***	12.046***	16.333***	1.855*	4.907***
<b>German vs. English</b>	3.994***	58.977***	5.906***	13.480***	22.050***	33.680***
<b>Scandinavian vs. English</b>	29.299***	40.474***	32.592***	24.327***	24.112***	33.527***
<b>French vs. German</b>	11.026***	-30.546***	6.623***	5.194***	-13.318***	-18.235***
<b>French vs. Scandinavian</b>	-18.879***	-28.764***	-23.121***	-12.277***	-19.137***	-25.728***
<b>German vs. Scandinavian</b>	-26.137***	-8.600***	-29.329***	-17.580***	-11.923***	-16.326***
<b>Capitalist vs. Socialist</b>	16.994***	27.184***	22.259***	12.920***	10.496***	19.474***

## Regression results: GLS (DV = Overall CSR score)

	(1) RE GLS		(2) RE GLS		(3) RE GLS		(4) RE GLS		(5) RE GLS	
<i>Law</i>										
French origin	0.753**	(0.347)	0.616*	(0.346)	0.813***	(0.146)	1.364**	(0.547)	0.758*	(0.440)
German origin	0.576**	(0.277)	0.797***	(0.283)	0.758***	(0.149)	1.649***	(0.339)	0.823**	(0.403)
Scandinavian origin	0.677**	(0.292)	0.935***	(0.235)	0.784***	(0.208)	1.440***	(0.457)	1.503***	(0.536)
<i>Political institutions</i>										
Democracy index	-0.053	(0.045)	0.015	(0.097)			-0.004	(0.020)	-0.057**	(0.024)
Corruption control			-0.278	(0.190)			0.913**	(0.400)		
Executive constraints					0.182	(0.146)	0.095	(0.260)	0.456**	(0.174)
<i>Economic development</i>										
Ln(GDP per capita)	0.809***	(0.217)	0.490**	(0.239)	0.395***	(0.142)	-0.655**	(0.268)	-0.035	(0.283)
Globalization index	0.034**	(0.015)	0.048***	(0.015)	0.041***	(0.009)	0.047	(0.029)	0.072***	(0.023)
<i>Ownership and governance</i>										
Ownership dispersion			0.043*	(0.024)	0.038**	(0.017)	-0.002	(0.161)	0.087	(0.142)
Supervisory board			0.371	(0.244)	0.321*	(0.182)	0.742**	(0.298)	1.109***	(0.273)
UO – state							-0.479	(0.547)	-0.645	(0.443)
UO – families							-0.378	(0.626)	0.185	(0.422)
UO – foundation							0.043	(0.384)	1.637*	(0.808)
UO – financial							0.568	(0.513)	-0.269	(0.489)
UO – pension							-1.31***	(0.467)	-0.777*	(0.434)
UO – VC/PE							1.139	(1.346)	1.480	(0.991)
<i>Controls</i>	Yes		Yes		Yes		Yes		Yes	
No. observations	45789		26124		26124		2436		3185	
R-squared adj.	3.6%		7.3%		7.4%		60.0%		51.9%	
Year FE	No		Yes		Yes		Yes		Yes	
Industry FE	No		No		No		Yes		Yes	

# Robustness checks

- Other CSR sub-dimensions → results still hold
- Random-effect ordered probit estimation → results still hold
- Other political institutions variables → results still hold
  - Democracy Ranking Index
  - Economist Intelligence Unit (EIU) Democracy Index
  - Freedom House Political Rights Index
  - United Democracy Score
  - Polyarchy Democracy Index 2000

# Robustness checks

- Control for legal protection on investors → results still hold
  - Anti-director rights index (LLSV, 1998; Spamann, 2009)
  - Anti-self-dealing index (DILLS, 2008)
  - Martynova-Renneboog minority shareholder protection index
  - One-share one-vote
- Control for culture (Hofstede culture dimensions) → results still hold
  - Power distance, Individualism, Masculinity/ Femininity, Uncertainty avoidance, Long-term orientation
- Replacing CSR with country-level sustainability rating
  - Civil law countries outperform; political institutions do not matter

## Robustness: Other CSR samples

	Vigeo ESG			
<i>Dependent Variable</i>	<i>Corporate Governance</i>	<i>Human Resource</i>	<i>Consumer Supplier</i>	
	(3)	(4)	(5)	
<i>Laws</i>				
French origin	-18.87***	7.74*	2.09	
German origin	-22.42***	6.40***	-1.62	
Scandinavian origin	-17.85***	7.59**	5.07***	
<i>Political institutions</i>				
Democracy index	0.100	-0.00	-0.29**	
Corruption control				
Executive const.	1.24	-1.17	2.83	
Controls	Yes	Yes	Yes	
No. of observations	4283	4283	4283	
R- square adj.	44.2%	28.5%	5.1%	

# Establishing Causality – Quasi-Experiments

- Apparently we cannot control for country fixed effects (legal origin is time-invariant)
- We have conducted a few quasi-natural experiments and Diff-in-Diff analysis to further establish causation
  - Cross-listing of the company across legal regimes (e.g., from Common law to French civil law) as the treatment
  - Reaction to 2008 Chinese milk scandal by firms in food-related industries from different legal regimes (treatment = civil law)
  - Corporate donations as a reaction to 2004 Asian tsunami by firms from different legal regimes (treatment = civil law)
  - Environmental performance upgrade by firms in energy-related industries from different legal regimes as a reaction to 2010 Deepwater Horizon oil split (treatment = civil law)

# Quasi-Experiments (Cont.): Scandals & Disasters

## Panel B.

### *The Effect of China Milk Scandal on Customer & Product Responsibility in Food-Related Industries Across Legal Origins*

	Civil × 2009	Civil law	Q	CF rights	CF rights <sup>2</sup>	ROA	Ln(Assets)	Ln(age)	Ln(GDP)	Globalization
<i>Product Responsibility</i>	7.654* (4.580)	31.39*** (11.82)	0.756 (0.597)	-0.0970 (0.200)	0.00143 (0.00232)	-3.572 (6.854)	1.653 (1.221)	1.854 (1.687)	-2.906 (8.219)	-0.134 (1.044)
Country, Year, Industry fixed effects:						Yes	R-squared:	15.9%	Obs:	1087

## Panel C.

### *The Effect of Asian Earthquake and Tsunami on Corporate Donations in All Industries Across Legal Origins*

	Civil × 2005	Civil law	Q	CF rights	CF rights <sup>2</sup>	ROA	Ln(Assets)	Ln(age)	Ln(GDP)	Globalization
<i>Corporate Donations</i>	4.976* (2.875)	23.92 (24.39)	0.361** (0.162)	-0.0890 (0.0709)	0.00107 (0.0009)	-4.468** (1.862)	6.415*** (0.387)	2.285*** (0.577)	4.993* (2.705)	-0.426 (0.315)
Country, Year, Industry fixed effects:						Yes	R-squared:	24.6%	Obs:	10353

## Panel D.

### *The Effect of Deepwater Horizon Oil Spill on Corporate Environmental Performance in Energy-Related Industries Across Legal Origins*

	Civil × 2010	Civil law	Q	CF rights	CF rights <sup>2</sup>	ROA	Ln(Assets)	Ln(age)	Ln(GDP)	Globalization
<i>Environmental Score</i>	7.041** (3.124)	15.56 (16.46)	0.517 (0.432)	-0.303* (0.157)	0.00333* (0.00197)	-0.801 (3.123)	9.226*** (0.806)	1.950 (1.420)	-4.195 (7.711)	1.667* (0.868)
Country, Year, Industry fixed effects:						Yes	R-squared:	62.8%	Obs:	1340

# The Shareholder Value Implication of CSR

- Finally we consider the impact of CSR on shareholder value in a cross-country setting
- Typical endogeneity issue between doing good (CSR) and doing well (shareholder value maximization)
- 2SLS regression: use country-level legal rules as IV for CSR
- Mainly focus on the “labor and social protection” aspect of CSR
  - IVs: A. The labor regulation indices by Botero et al. (2004, QJE “*The Regulation of Labor*”) – (1) employment law, (2) collective relations law, (3) social security law, (4) civil rights law
  - 1<sup>st</sup> stage: regress “labor and social protection” CSR on labor regulation indices
  - 2<sup>nd</sup> stage: regress Tobin’s Q on the fitted CSR values



# The Shareholder Value Implication of CSR

<i>Dependent variable is the Tobin's Q winsorized at 5%</i>	<i>Social rating</i>	<i>Labor relations</i>	<i>Human capital</i>	<i>Stakeholder capital</i>	<i>Human resources</i>	<i>Human rights</i>
<b>CSR (Labor and social protection)</b>	<b>0.042***</b>	<b>0.017***</b>	<b>0.015***</b>	<b>0.024***</b>	<b>0.164*</b>	<b>0.039</b>
<i>(fitted value from the 1<sup>st</sup> stage)</i>	<b>(0.003)</b>	<b>(0.004)</b>	<b>(0.003)</b>	<b>(0.004)</b>	<b>(0.090)</b>	<b>(0.111)</b>
Large shareholders' ownership	0.022*** (0.006)	0.034*** (0.006)	0.032*** (0.006)	0.032*** (0.005)	-0.005 (0.011)	-0.002 (0.010)
Capital Expenditure (scaled)	-0.407*** (0.142)	-0.407*** (0.156)	-0.408*** (0.133)	-0.415** (0.162)	-0.183 (0.134)	-0.173 (0.110)
Dividends payout	0.019*** (0.004)	0.019*** (0.005)	0.019*** (0.005)	0.019*** (0.004)	0.0002 (0.001)	0.0002 (0.001)
Leverage	-0.038*** (0.001)	-0.038*** (0.001)	-0.038*** (0.001)	-0.038*** (0.001)	-0.385*** (0.064)	-0.381*** (0.068)
ROA	-0.244*** (0.028)	-0.202*** (0.028)	-0.215*** (0.033)	-0.205*** (0.032)	-0.395*** (0.089)	-0.402*** (0.099)
Other controls for financial constraints	Yes	Yes	Yes	Yes	Yes	Yes
Industry & Year FE	Yes	Yes	Yes	Yes	Yes	Yes
No. observations	27430	27430	27430	27430	2126	2126
Adj. R-square	43.9%	43.5%	43.6%	43.7%	50.9%	50.8%

# Summary

- Legal origins are the only consistent predictors of CSR and sustainability
  - Civil law firms outperform common law firms in CSR issues
  - Scandinavian firms outperform the rest of the world in CSR
  - French civil law has superior CSR in terms of social/labour; German civil law has superior CSR in terms of environmental policy
- Political “institutions” are mostly insignificantly or negatively related to CSR and sustainability
- Corporate governance (ownership structure & board structure), financial performance, financial constraints, cultures, etc are not strong predictors of CSR
- Globally, **CSR leads to higher Tobin’s Q**
- Policy tradeoff between shareholder protection and stakeholder protection, and between financial development and societal sustainability