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"Corporate Social Responsibility and Corporate Financial Performance: evidence from the European banking sector."

RELATORE:

CH.MO PROF.
FRANCESCO ZEN

LAUREANDO/A: FABIANA DEMIRAJ

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Firma dello studente

Fabiana Demiraj

Summary

Chapter 1 – Introduction

Definition of Corporate Social Responsibility

The capitalist society in which we live tends to have as main and fundamentally purpose shareholders' profit maximisation. For many years corporate governance has been focused only on making more money for shareholders. This approach, called *shareholder view*, has been stimulate over time by asymmetric information against stakeholders. The capitalistic model does not give the right value to the resources it uses, like natural resources, and to the surrounding environment. Exactly for these reasons, after many scandals of non-ethics behaviours adopted by companies, the interest for business impact on the environment has risen. (Bisio, 2015) Business activity can have both a constructive and a damaging effect on society; this great influence power has generated public, political and academic discussion and has given life to the concept of Corporate Social Responsibility. (Blowfield & Murray, 2019)

Before going into the analysis of this concept, it might be useful to first give a definition of sustainable development. The best definition is the one elaborated by the World Commission on Economic Development:

> "Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs." (WCED, 1987)

This concept highlights how sustainability is essentially an attempt to balance human needs, that can be potentially unlimited, against limited environmental resources. (Alhaddi, 2015)

Corporate Social Responsibility, instead, is a wider concept and there isn't a unique and universal definition for it because the theme has been debated for years and every author has shaped the concept in a personal way. There are rather plenty of definitions. In one study of 2008, Dahlsrud found 37 definitions from 27 different authors. Despite the multitude of formulations, the definitions can be considered mostly congruent and comparable between them in their core heart (Alhaddi, 2015; Dahlsrud, 2008) because the most of them share the view that companies should be active for the public good and respect human and environmental rights. (Blowfield & Murray, 2019; Borgia, 2010)

The predominant idea behind CSR is that businesses have some obligations toward the society where they operate beyond the pure goal of making profit. Firms should spontaneously decide to incorporate social and environmental issues. (Branco & Rodrigues, 2006) Some argue that CSR is “the product of, as well as a response to, the negative impacts from globalisation”[1] Furthermore, we must not forget that the current level of interconnection of the markets makes companies particularly susceptible to rumours and inaccurate information and for this reason there is a need for a system of values capable of qualifying the company’s actions as ethically responsible and strengthening in this way its reputation and credibility at the eyes of investors. (Borgia, 2010)

Looking at the European framework, the Green Paper published in 2001 can be considered a milestone that outlines the key points of CSR. (Mallin, 2009) The European Union, that is the highest legislative institution in EU, is interested in CSR because it is part of the Lisbon’s strategic goal of becoming the best economy in the world under all aspects. In addition to that, other factors that foster the interest in CSR are the increasing concerns about the environment and the lack of transparency in businesses. (European Commission, 2001)

> “Corporate social responsibility is essentially a concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment.”[2]
> “Being socially responsible means not only fulfilling legal expectations, but also going beyond compliance and investing “more” into human capital, the environment and the relations with stakeholders.” [3]

This is one of the most accurate definitions of CSR for three main reasons: first, it distinguishes CSR from philanthropy and stresses that CSR concerns "how" companies come to generate profit. Secondly, it highlights the importance of involving stakeholders in CSR and finally it does not fail to stress that the CSR should be a voluntary action. (Drauth, 2010)
In a later paper written by the European Commission, CSR is defined as “"the responsibility of enterprises for their impacts on society”[4]. Being more precise, companies:

> “should have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders, with the aim of maximising the creation of shared value for their owners/shareholders and civil society at large and identifying, preventing and mitigating possible adverse impacts."[5]

[1] (Pedersen, 2015, p. 6)
[2] (European Commission, 2001, p. 4)
[3] (European Commission, 2001, p. 6)
[4] (European Commission, 2019, p. 3)
[5] (European Commission, 2019, p. 3)

Probably the best way to fully grasp the definition of CSR is to start with those elaborated in the past. Going back in time, Keith Davis in his article of 1973 defined CSR:

> "[…] refers to the firm's consideration of, and response to, issues beyond the narrow economic, technical, and legal requirements of the firm."[6]

Another interesting work is the framework proposed by Carroll, one of the best that can be used as a starting point for a comprehensive view of the topic. (Blowfield & Murray, 2019)

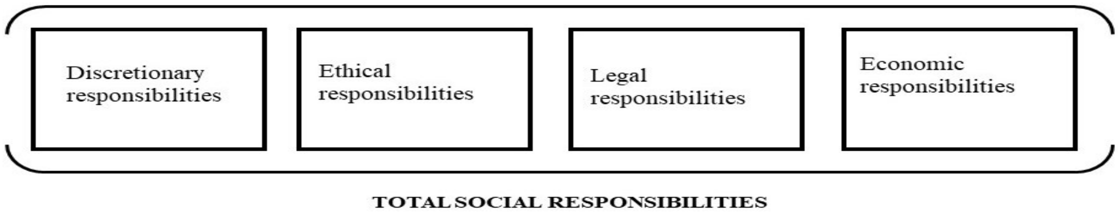

Figure 1: Dimensions of CSR. Source: adapted from Carroll, 1979

Social responsibility can be represented like a combination of four elements: economic, legal, ethical and discretionary responsibilities. All these four responsibilities must be met simultaneously.

The first dimension of the framework is *economic responsibility*. Carroll said in fact that "the first and foremost social responsibility of business is economic in nature. Before anything else, the business institution is the basic economic unit in our society. As such it has a responsibility to produce goods and services that society wants and to sell them at a profit."[7]

The second dimension is *legal responsibility* and what it basically requires is that companies respect the confines of the law that shape their playing field. The most important aspects regulated by the law are employment, corruption, workers' rights, product safety, etc. Unfortunately, law can never fully reflect social expectation and in some cases strong corporations can influence governments and legislation, thus CSR should have also a voluntary nature. (Blowfield & Murray, 2019)

The third dimension is *ethical responsibility.* Carroll said "ethical responsibilities are ill defined and consequently are among the most difficult for business to deal with. […] Suffice it to say that society has expectations of business over and above legal requirements."[8] What the author meant was that ethical responsibilities are those that go beyond regulation and economic rationality where companies do not have a direct economic gain. (Blowfield & Murray, 2019)

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[6] (si veda Carroll, 1999, p. 277)
[7] (Carroll, 1979, p. 500)
[8] (Carroll, 1979, p. 500)

The last dimension is *discretionary responsibilities* that “are those about which society has no clear-cut message for business […] They are left to individual judgment and choice.”[9] These activities are based on the idea of giving back to the society and can be categorized as philanthropy. (Blowfield & Murray, 2019)
Going beyond the division of activities, what the author really wanted to stress was that all responsibilities were equally important. Unlike his idea, in the following years predominated the idea that, depending on the type of company, there are responsibilities more important than others (Blowfield & Murray, 2019) and that different activities can have mixed impacts on organisational outcome. (Galbreath, 2010)

In the same years Thomas M. Jones defined corporate social responsibility as

> “[…] the notion that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law or union contract”[10]

The obligation of which the authors speak about must have two essential elements: it must be voluntary in first place, and must include a vastness of interests, greater than those of the traditionally considered stakeholders. The authors believe that companies must investigate the social consequences of their decisions in order to minimize them and must analyse the process that brings to desirable or undesirable social impact. To implement this process successfully, companies can choose to take different paths: hiring external consultants, adding special purpose directors, etc. (Jones, 1980)

These presented here are just some of the many formulations of the definition of CSR that exist. As it has immediately emerged, CSR is a complex concept and phenomenon that cannot be defined with a single statement. The main reason that makes CSR a complex argument is its intrinsic link with the society: cultural, social and environmental diversity require different actions by companies and therefore corporate social responsibility takes thousands of nuances. (Halme & Laurila, 2009)

CSR or philanthropy?

After having brought the discussion up to this point a question can emerge spontaneously: what is the intrinsic difference between CSR and philanthropy?
CSR is not philanthropy: the main difference lies in the causal direction. When companies engage in philanthropic actions the causal direction goes from social action to economic return, because their philanthropic efforts will bring them returns in terms of reputation. In the second

[9] (Carroll, 1979, p. 500)
[10] (Jones, 1980, pp. 59-60)

case, when a company has understood that its economic return is closely linked to the environment in which it operates, the causal direction goes from economic profit to socially responsible actions. (Zollo, 2004)

In this regard, to better distinguish the different shades of these two concepts which at first sight may present themselves as similar, it is very useful to refer to the distinction proposed by Halme & Laurila (2009). The authors propose an extended definition of CSR distinguishing it into three different categories according to the connection with the core business, the final target and the expected return of the social actions. The categories are philantthorpy, CR Integration and CR Innovation as displayed in detain in the figure below.

	Philantropy	CR Integration	CR Innovation
Connection with the core business	No, because the activity is outside the firm's core business	Attempt to make actions related to the *existing* core business	Environmental or social problems are the starting point for the production of *new* business that can provide sustainable solutions.
Target	Charitable actions, donations, voluntary work	Primary stakeholders like customers, suppliers, etc	Environmental or social problems
Expected return	• No direct benefit • Indirect benefits are possible like improve reputation	• Improve company reputation • Cost-saving • Risk reduction	Research aimed at achieving a win win situation and making a profit

Table 1: Three categories of CSR Source: own elaboration from (Halme & Laurila, 2009)

Starting from this table, the distinction between philanthropy and CSR is now clear: whenever the company takes actions in favour of the environment and the society that can produce also an economic return for the enterprise, then we are talking about CSR and not of simple philanthropy.

Philanthropic actions by the company may seem desirable and without disadvantages, but Porter and Kramer argued that "the more companies donate, the more is expected of them."[11]

The author notes that philanthropic initiatives are used as a form of public relations and advertising but "the majority of corporate contribution programs are diffuse and unfocused"[12]

Contrary to what is commonly done, the authors advice companies to use their philanthropic initiatives to improve their surrounding environment, called *competitive context.* The competitive context depends on four characteristics of the surrounding environment: available inputs, demand, context strategy and rivalry and the presence of complementary companies.

[11] (Porter & Kramer, 2002, p. 56)
[12] (Porter & Kramer, 2002, p. 57)

Each of them is equally important. "Companies […] are increasingly aware that corporate social responsibility can be of direct economic value"[13] and for this reason they should pursue philanthropic initiatives related to their business to have not only a return of image but also a possible economic return. In the long-term social and economic goals may become related and at the end it can be achieved a convergence of interests. CSR may become a source of profit and not just an additional cost because it can enhance reputation, reduced costs and prevent government regulation; the sustainability of the company depends on the sustainability of its relations with the different stakeholders. (Pedersen, 2015; Perrini & Tencati, 2008)

As regards *how* companies can align these two dimensions, in the figure below the authors show the steps that a company should follow.

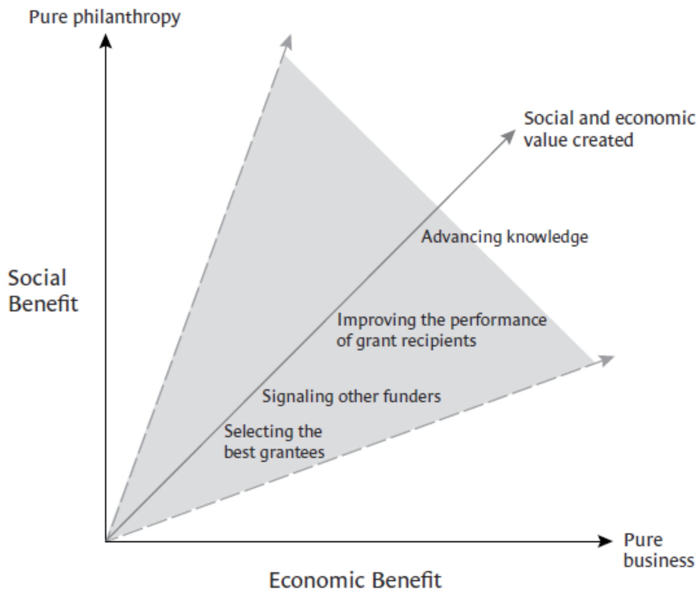

Figure 2: Maximizing Philanthropy's Value Source: (Porter & Kramer, 2002, p. 64)

Historical development of CSR

The discussion on Corporate Social Responsibility should start with an historical review of the concept in order to understand how its meaning has changed during the decades. It is interesting to notice how even if the conceptual evolution of CSR has lasted decades, many US large firms started to engage in CSR activities already in the 1970s. (Pedersen, 2015)

Scholars began to deal with social responsibility in the 20th century, principally in the past 50 years, naming it in different ways depending on the decade. In the first half of the 20th century attention was focused on what business leaders were doing for the society and local

[13] (European Commission, 2001, p. 4)

communities; then in the 1950s more attention was given to the role of companies, overcoming the individualistic point of view. (Blowfield & Murray, 2019) The first writings are from the United States, beginning from the 1950s and widening during the following centuries. (Carroll, 1999)

The roots of CSR can be recognized in the 1950s with the publication of Frank Abrams where the author first stated that businessman "have responsibilities not just to one group but to many".[14] In its view a manager should be able to balance the preference of different groups of people whose interests are involved and mixed with those of the enterprise and maintain with all of them a peaceful relation. The main groups with which the enterprise has to interact are stockholders, employees, customers and the public in general. Stockholders are not only interested in maximizing profit and dividends, but they need public approval as well, for a long-term perspective of prosperity. Employees, from their point of view, aim at achieving not only fair wages and good working conditions but also respect and consideration. The third group involved are customers and they can exercise considerable power and influence on managers, whose decisions are aimed at satisfying their needs and prevent price fluctuation. The last group identified by the author is the one he calls general public. The duty of the management to the general public is to act in accordance with national policies and interest and to participate in its development. (Abrams, 1951)

Moving from here in the same decade emerges the book *Social Responsibilities of the businessman* written by Howard R. Bowen who signs with it the modern era of social responsibility. (Carroll, 1979) The author is one of the first who attempts to give a definition of corporate social responsibility. (Carroll, 1999)

> "It refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society"[15]

Investigation on CSR increased in popularity in the 1960s, in a period of big changes in the social environment with a growing demand for civil rights; Patrick Murphy defined later the 1960s and the 1970s like the centuries of "awareness" for CSR.[16] Despite that, in the 1960s there were still researchers that were against the involvement of businesses in actions aimed at improving the society, like Theodore Levitt who in 1958 clearly stated that "[businesses] should

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[14] (Abrams, 1951, p. 29)
[15] (Bowen, 2013, p. 6)
[16] (si vedano Carroll & Shabana, 2010, p.87)

let government take care of the general welfare so that business can take care of the more material aspects of welfare."[17] For the author, businesses have only two responsibilities that are: to respect the basic rules of civility and to realise gains; social engagement, in the authors perspective, is merely a distraction and a cost for businesses.
On the other hand, researchers like Keith Davis were firmly convinced that social responsibility was proportional to business power and this then went down in history as the "Iron Low of Responsibility". (si veda Carroll, 1999, p. 271) In the same decade also Clarence C. Walton became well known for the definition that he proposed declaring that firms should voluntarily take social responsibility actions without having to be obliged by a higher authority. (si veda Carroll A. , 1999, p.272) One of the reasons that led scholars to have conflicting opinions on the subject was the absence of a precise definition of the concept. (Carroll, 1979)

Passing from the 1960s to the 1970s, a lot of academic studies began to focus more and more on this topic giving life to a substantial literary body.
It is important to mention the essential contribution from the Committee for Economic Development (CED) with its pubblication of *Social Responsibilities of Business Corporations*. From this work emerged that the role of businesses was chaging and society required them to partecipate in life-improvement in addition to the provisionmof goods. In 1971 CED proposed its own model of social responsibility based on three levels:

1. The inner circle that consists of the basic responsibilities for the efficient progress of the economy;
2. The intermediate circle with responsibility toward society (environment, employees, etc);
3. The outer circle with additional responsabilities toward the society (poverty, etc)

(Carroll, 1979; Carroll, 1999)

In addition to the CED's contribution, other authors that enriched the concept of CSR in this decade where George Steiner who implemented some model for determining the social responsibility of business and Henry Eilbert and Robert Parket who focused more on collectiong data on the practical implementation of CSR in businesses. (Carroll, 1999) Again in this century Davis published on the topic arguing both for and against social responsibility of firms. The author suggested that business should allow public examination of their activities and should take into account social costs and beenfits in their business plans. (Blowfield & Murray, 2019)

[17] (Levitt, 1958, p. 49)

An important step forward from the past is represented by the first formulations of the concept of corporate social performance (CSP) in addition to CSR.

One of the first researchers to focus on this differentiation was S. Prakash Sethi that in 1975 developed a structural framework for CSR that had the two following characteristics:

1. stable categories classification over time for comparison
2. stable meaning of the categories.

The author states that " there must be some set of criteria that can serve as a guide for evaluating past and current performance and providing useful indicators for future activities"[18] Before discussing its model Sethi emphasized the importance of contextualizing every business social action in its cultural and temporal dimension for a successful evaluation. The model proposed by the author is based on the concept of "legitimacy" and "we can describe corporate behavior as a three-state phenomenon based on the changing notion of legitimacy from very narrow to broad"[19] The first dimension of CSR is *social obligation* that is corporate behavior "in response to market forces or legal constraints"[20] The second one is *social responsibility* that represents what the firm does for the society voluntarily without any legal obligation. The third and last level is *social responsiveness* and embodies the business actions in response to social needs. (Sethi, 1975)

Eventually in the 1980s researchers focused less on finding new definitions of CSR and more on alternative but related themes like corporate social responsiveness, business ethics, etc. The investigation of the connection between CSR and corporate financial performance took hold solidly in this decade; one good example of this is the attempt of Steven Wartick and Philip Cochran to develop a model which extended the three-dimensions proposed before by Sethi, which were respectively responsibility, responsiveness and social issues. (Carroll & Shabana, 2010) Additionally, in this decade, three out of four US Fortune 500 companies presented a code of ethics. (Pedersen, 2015)

In contrast with the previous decades, in the 1990s there were no new definitions but continued the effort to operationalize the CSR concept. (Carroll & Shabana, 2010)

In the 2000s then a series of scandals increased the concern about business ethics and CSR combined with other themes like sustainable development and continued to grow.

[18] (Sethi, 1975, p. 60)
[19] (Sethi, 1975, p. 60)
[20] (Sethi, 1975, p. 60)

As we said at the beginning of this section, the historical evolution of the concept of CSR is very articulate and has many ramifications; a detailed analysis of it is not the purpose of this work, however the table below shows in a very intuitive way the basic steps of this path.

	1930	1940	1950	1960	1970	1980	1990	2000	2010	2020
First corporate responsibility texts										
New Deal and welfare state										
Nationalization (Europe), state enterprise (former colonies; Communist bloc); post-war consensus										
Return of business and society debate										
Shift from responsibility of leaders to responsibility of companies										
Debate about nature of responsibility										
Introduction of stakeholder theory										
Corporate responsibility as management practice										
Environmental management										
Corporate social performance										
Stakeholder partnerships										
Business and poverty										
Sustainability										
Social Entrepreneurship										
Business in an era of climate change										

Figure 3: Timeline of CSR. Source: Michael & Alan, 2019 p. 42

Why to engage in CSR?

In the process of discovering the motivations behind the decision to engage into CSR activities there are two main reasons that can be identified: the *normative case* and the *business case*.
In the first one, the normative case, firms act responsibly because it is "morally correct to do so"[21] and because they have just altruistic intentions. (Sprinkle & Maines, 2010) The benefits in this case occur at a macro level with environmental improvements and reduction of inequality. (Wu & Shen, 2013)
In the second one, the business case, companies are fuelled by the conviction that they can have an economic return from social behaviours; this economic return can take different forms and occur at the micro-level. (Branco & Rodrigues, 2006; Wu & Shen, 2013) The more common expected advantage is a reduction in their taxable income and cost savings in the value chain. In addition to that CSR may also be used to please a relevant stakeholder category. (Sprinkle & Maines, 2010) Customers seem to appreciate more companies that shows themselves as socially responsible and therefore, many CSR initiatives are made to impress old customers and to attract new one. (Bisio, 2015; Galbreath, 2010) Companies able to well advertise their social effort could also derive a price premium from it. (Sprinkle & Maines, 2010) In fact, it is important to stress how in the current social context every organization needs legitimacy and consensus to operate: each institution is part of a network of relationships from which it obtains resources vital for existence and development. (Perrini & Tencati, 2008)
Furthermore, companies may be stimulated by contracting benefits: CSR can help firms in recruiting and retaining high skilled employees (Sprinkle & Maines, 2010) and reducing turnover due to employees' positive justice perception inside the organisation. (Galbreath, 2010) Finally, CSR can be also part of the risk reduction strategy mitigating legal and regulatory requirements. (Sprinkle & Maines, 2010)
Regardless of what is the main motivation that drives companies to take CSR actions what should now be clear is how it has become vital for companies to consider the needs of the surrounding environment.

Stakeholder theory

In many of the definitions of CSR given so far, it has emerged that this concept is linked to another equally important one that is that of stakeholders. Social disclosure has to do with information transparency towards stakeholders, so it is interesting to carefully identify who are the interlocutors to whom CSR is addressed.

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[21] (Branco & Rodrigues, 2006, p. 112)

Although there are traces of earlier uses of the term, the father of the *stakeholder theory* is identified in Freeman with his work in 1984. Freedman started from the elaborations of the Stanford Research Institute that define stakeholders like “"those groups without whose support the organization would cease to exist”.[22]

Freeman in turn gives his own definitions for stakeholders in 1984:

> “any group or individual who can affect or is affected by the achievement of the organization’s objectives” [23]

What stakeholder theory aims to do is to propose an alternative approach to shareholder theory that has always dominated economic thinking. According to stakeholder theory, all social groups towards which a company has responsibilities must be identified and all of them are equally important. (Cooper, 2004; Freeman & McVea, 2001) The interest of each stakeholder individually has an intrinsic value and “there is no prima facie priority of one set of interest and benefits over another”.[24] All stakeholders can influence company performance but with different mechanisms: market constituents, like employees and customers, can influence directly its economic performance, while non market-constituents like NGOs and the media, can have an indirect power transmitting information. (Galant & Cadez, 2017)

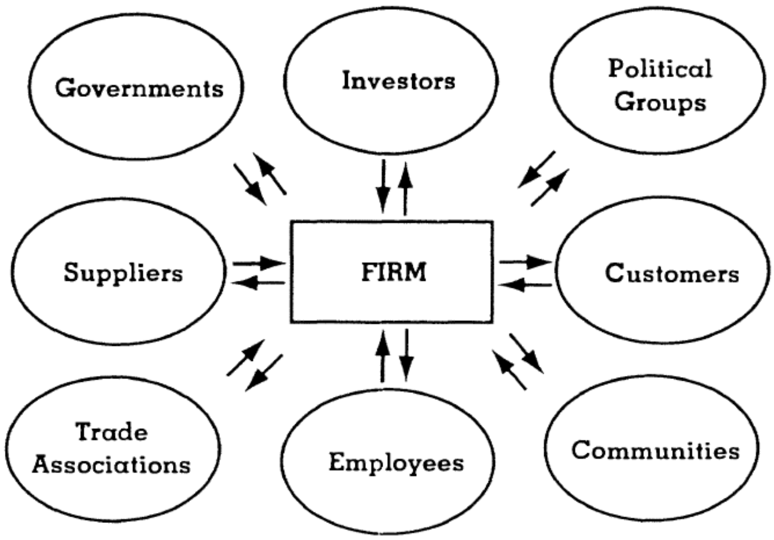

Figure 4: Shareholder theory Source: (Donaldson & Preston, 1995, p. 69)

Comparing these definitions with those of other authors like Clarkson (1995) it is noticeable how they appear quite similar. Clarkson (1995) additional contribution lies in the distinction that he proposes between primary stakeholders and secondary stakeholders. Primary

[22] (SRI 1963, si veda Donaldson & Preston, 1995, p. 72)
[23] (si veda Cooper, 2004, p. 21)
[24] (Donaldson & Preston, 1995, p. 68)

stakeholders are most of the time shareholders, investors, workers and more generally all individuals vital for the existence of the organization; the discontent of one of them will have a negative impact on the organisation. The level of correlation between the organisation and this group is elevated and for this reason the author describes the organisation as "a system of primary stakeholder groups"[25] Secondary stakeholders are also influenced by the company and have the ability to influence it in turn, however the characteristic that distinguishes them from primary group is that they are not essential for the existence of the enterprise but they have a power on public opinion. Secondary stakeholders can come into conflict with the company when it implements policies that affect their interests in favour of those of primary stakeholders.

This distinction seems in contrast with the basic assumption that all stakeholders are equal and equally important and in fact not all academics share this belief. (Cooper, 2004)

Another interesting distinction is that proposed by Atkinson et al. in 1997 where the authors divided stakeholders in *environmental stakeholders*, that are owners and community, and *process stakeholders* that are employees and customers. The first group has the power to shape the environment and the enterprise strategy while the second one is responsible for the product creation. Under his view the most important group of stakeholders are the owners which define the company's primary objective and then negotiate with all the other actors involved to achieve them. Other stakeholders are the implementors of the secondary objective, that are all those actions necessary to achieve the primary ones. (Atkinson, et al., 1997) The approach proposed by Atkinson et al. (1997) falls within a wider category called *instrumental perspective*. (Cooper, 2004) In fact, stakeholder theory has been presented and discussed under many different perspectives that can be all reconducted to three main types: descriptive approach, instrumental approach and normative approach.

Under the *descriptive approach* stakeholder theory serves as the basis necessary to explain some features and mechanisms that exist in enterprise like managers considerations, the managerial process, etc. This approach points out that the theory's concepts coincide with reality. (Donaldson & Preston, 1995)

Under the *instrumental approach* stakeholder theory can be accorded with the profit maximization objective of shareholders theory and become in this way an instrument for wealth increase. (Cooper, 2004; Donaldson & Preston, 1995)

Lastly, there is also the *normative approach* that investigates which conducts can be considered moral or ethical in order to provide some guidelines for managers and owners. A significant

[25] (Clarkson, 1995, p. 107)

amount of stakeholder literature has a normative approach that calls on essential concepts like social rights or utilitarianism. (Donaldson & Preston, 1995)

These three aspects described above are not separated but on the contrary, there is a hierarchical order for them as shown in the figure below. Externally it can be found the descriptive approach because the theory is used as an explanatory framework for the outside world. In the centre then there is the instrumental approach that gives practical guidelines and connects stakeholder theory with profit. Ultimately at the heart there is the normative approach that provides the moral values for operating.

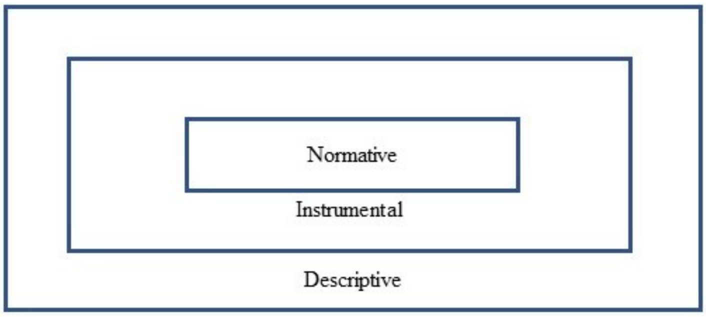

Figure 5: Hierarchy Source: adaption from (Donaldson & Preston, 1995)

Since Freedman's publication in 1984, his model has been frequently discussed among researchers and it still represents a pillar of business management. One of the most studied aspect on which several scholars disagree remains the equal weight that Freedman assigned to all stakeholders. Post et al. in 2002 suggested, like many others, a new stakeholder view that identifies some categories of critical stakeholders classifying them in relation to three dimensions: resource base, industry market and social-political arena. Stakeholder in the first circle, that are investors, employees and customers, are those who provide resources and are thus the most important for the company. (Post, et al., 2002) Then proceeding from the centre to the periphery, in the second layer we find regulatory authorities and partners. In the last level there are local communities and private organization. "Within the firm's stakeholder network, *all* relationships matter, although all are not of equal relevance or priority for every specific situation or issue."[26]

This framework is just one of many proposed over the years that highlights how stakeholder theory continues to be fundamental and constantly evolving.

[26] (Post, et al., 2002, p. 25)

Triple bottom line

The term “Triple Bottom Line” (3BL) was first used by the organisation AccountAbility in the mid 1990’s but it became widespread after the publication of Elkington’s article in 1997; nowadays it is used by big companies, like Shell or British Telecom, or by funds for screening investment possibilities. (Wayne & MacDonald, 2004) At first instance, the 3BL can be defines as a system for measuring the environmental performance of an organisation linking them with the economic achievements. (Alhaddi, 2015) A company wellbeing and prosperity should be measured looking not only at the financial statements but also at social, ethical and environmental performance. (Wayne & MacDonald, 2004)
The Triple Bottom Line has three pillars:

1. **economic line:** the ability to generate profit necessary for a business survival and for the prosperity of future generations.
2. **environmental line:** ability to limit the environmental impact due to the business activity and to return value to the society in which the company operates: in particular it refers to labour, human capital and community.
3. **social line:** the ability to satisfy present companies needs without compromising future generation’s resources; this can be viewed also as the ability to consider all stakeholders’ needs.

(Alhaddi, 2015; Bisio, 2015; Branco & Rodrigues, 2006)

In this regard, Porter and Kramer in 2006 said: “in other words, companies should operate in ways that secure long-term economic performance by avoiding short-term behavior that is socially detrimental or environmentally wasteful.”[27]
The most valuable feature of this system is that it is a consistent sustainability-related construct because each of the three components is integrated and equally important. (Alhaddi, 2015) Sometimes researches mention the Triple Bottom Line as the “practical framework of sustainability”. [28]
One of the reasons why companies must report according to the logic of the triple bottom line is the development of technology and internet. Internet has facilitated the dissemination of information and has made more immediate the comparison between the work of different companies. The consequence of all this is a greater customer awareness because customers are now more conscious of the impact that companies’ actions have on society; the three

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[27] (Porter & Kramer, 2006, p. 4)
[28] (Alhaddi, 2015, p. 8)

dimensions listed above cannot be treated separately anymore, as the consumer today is careful not only to the final product but also to the process. Companies must create a dialogue with their stakeholders. (Bisio, 2015)
The man who could be considered the father of 3BL, John Elkington, in one of his most famous articles in 1998 suggests that to fully apply 3BL during the sustainability transition, companies need to create new partnerships; these partnerships can be between public and private or between private and environmental organisations. The author underlined that environmental concerns can no longer be ignored by companies because they are becoming a priority especially for the new generations of university graduates and of environmentalists. Today nongovernmental organizations, unlike those of the past, are prepared for direct collaboration with companies. In this regard the author conducted a survey and found that on the one hand NGOs recognize the key role of companies and on the other are heartened by the growing corporate environmentalism. (Elkington, 1998)
The author continued to be active on environmental issues and in 2018 published a new article proposing a review of what was said many years before. According to the author managerial concepts should undergo periodical checks to see whether they are still effective. In particular, the author stresses that the concept of 3BL has been followed by the creation of numerous accounting standards to produce sustainability reports but that the authenticity and usefulness of the information present in them has never been checked. (Elkington, 2018) "The Triple Bottom Line has failed to bury the single bottom line paradigm"[29] that prioritizes profit. In Elkington's original idea, 3BL was not a mere accounting principle but was to be an engine of change for the current capitalist system as we know it.

Resourced Based View: internal and external dimension of CSR

Resource based view is an area of studying that investigates whether there is a connection between a firm's internal features and its financial performance. In case some differences are found, these are due to the existence of firm-specific resources that are difficult to mimic by competitors. (Branco & Rodrigues, 2006)
Under the Resource Based View approach, "a firm may outperform its competitors by developing resources that are rare, valuable, difficult for rivals to imitate, and not easily substitutable".[30] In this perspective, CSR initiatives can benefit both the internal and the external dimension of a corporation. (European Commission, 2001)

[29] (Elkington, 2018, p. 4)
[30] (Fischer & Sawczyn, 2013, p. 30)

On the internal side, social and environmental reporting helps companies in the development of new competences and intangible resources like know-how. (Branco & Rodrigues, 2006) More precisely the internal dimension deals with *human resource management, health and safety at work, adoption to change* and *management of environmental impacts and natural resources*.
On the *human resource management* side, what companies want is to retain skilled workers; in order to succeed in this objective and be at the same time compliant with social requirements companies should offer their employees life-long learning, better work-private life balance, equal pay and career prospects for women and job security. On the *health and safety at work*, alongside the traditional measures imposed by law, companies are becoming more selective in the choice of their external suppliers evaluating them on the bases of health and safety criteria and making an increasing use of certification schemes and labelling schemes to document and communicate the quality of their products. *Adoption to change* refers to the moment when companies need to restructure in order to remain competitive. "Restructuring in a socially responsible manner means to balance and take into consideration the interests and concerns of all those who are affected by the changes and decisions."[31] To achieve this objective and to safeguard employees' rights, collaboration between public authorities, companies and employees is necessary. Last aspect of the internal dimension of CSR is the *management of environmental impacts and natural resources* that includes every effort made to reduce the consumption of resources and pollution. Companies should establish a working relationship with the government and all the stakeholders involved to find the most cost-effective approach. (European Commission, 2001)

What is more surprising is that CSR initiative can bring internal improvement even when they are not disclosed to outside stakeholders and public. (Branco & Rodrigues, 2006)

In addition to the internal dimension, every company is connected also with the surrounding world and it is precisely for this reason that there is also an external dimension. CSR brings about an improvement of corporate identity, that is represented by corporate reputation: good social reputation can enhance interactions with external players like customers, suppliers and employees which may become more motivated and loyal. (Bisio, 2015) The external dimension includes *the local community, business partners, suppliers and consumers, human rights and global environmental concerns.*

[31] (European Commission, 2001, p. 10)

The relationship that enterprises have with the *local community* is bidirectional: local community provides work, skills and stability to the company which reciprocates with jobs, wages and tax revenue. In addition to that companies influence and are influenced by the physical environment of the community. Given this strong co-dependency the development of positive relationship with the local community are vital.

The second element of the external dimension are the *relationships* that the company builds with *partners, suppliers and customers*; good connection with partners can reduce complexity and costs while lastly relationship with customers requires the ability to get as close as possible to their needs.

The *human right* component of the external dimension is probably the most complex one because it involves political, legal and moral subjects. A widespread practice for dealing with external pressures and improving firms' reputation is to embrace codes of conduct on working conditions, human rights and environmental protection that have to be applied at every level of the organisation. The base for codes of conduct is the ILO fundamental Conventions combined with the OECD guidelines for multinational enterprises.

Last element of the external dimension are *global environmental concerns.* The global nature is due to the fact that many companies operating multinational have an impact not only in their principal country but all over the world. (European Commission, 2001)

Regulatory framework of CSR

The nowadays interconnections level implies that local events can have a worldwide resonance. Many of today's problems have crossed national borders and internationally relevant questions like CSR are regulated at a global and European level. (Drauth, 2010)

The attempt to create international standards in CSR field is justified, on the one hand by the need to harmonize the various CSR initiatives at national level and on the other, with the intention of creating an international monitoring systems that compensate and strengthen those at national level. (Sacconi, 2005) In the most economically advanced states, there is not one specific regulation for CSR but there is a set of regulations governing the different aspects. On the other side, developing states can rely only on fragmentary and sometimes absent regulation on CSR; by exploiting that difference in regulation some companies can take advantage of the legislative weakness of developing countries obtaining competitive costs of raw materials and labour and sometimes causing serious damage to the human communities of the host States of productive activities. (Borgia, 2010)

All CSR regulatory initiatives belong to soft law, except for corruption laws. Soft law is based on the absence of a legal prescription and the spontaneous adherence by companies to the content of the guidelines. (Borgia, 2010; Sacconi, 2005) Faced with the high number of international transactions, it appears difficult to develop control systems that can ensure transparency; more than the search for an effective company control system, it is necessary to develop and adopt a system of reference values. (Borgia, 2010)

The main actions that have been taking place since the 1990s and have been carried out by intergovernmental organizations are: (Borgia, 2010; Drauth, 2010; OECD, 2008)

- United Nations Global Compact
- the OECD guidelines on multinational companies
- the ILO tripartite declaration
- European Green Paper and subsequent publication

In addition to this short list, in the table below are displayed most of the internationally recognised norms, guidance and principles on CSR.

Instrument and Role	Examples
International Conventions and Declarations. • Reflect agreed international normative principles. Directed mainly to government for domestic implementation. These can help business understand *what* to do.	Universal Declaration of Human Rights. UN Framework Convention on Climate Change. ILO Conventions. ILO Declaration on Fundamental Principles and Rights at Work. UN Millennium Development Goals. World Summit on Sustainable Development Plan of Implementation. OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions.
Officially-agreed or recognised guidance. • Offer authoritative guidance to the business sector on expectations of behaviour. Also help understand *what* to do, and sometimes also *how*.	ILO MNE Declaration. OECD MNE Guidelines. UN Global Compact Principles. International Finance Corporation Performance Standards. Extractive Industries Transparency Initiative (EITI) Principles.
Privately developed principles. • Offer business/civil society developed guidance on expectations of behaviour. These sometimes also provide guidance on *how* to implement such standards. These may or may not be derived from international norms.	ISO standards (*e.g.* 14000 series). GRI Sustainability Reporting Guidelines. Responsible Care Guidelines. ICMM Sustainable Development Principles. Electronic Industry Code of Conduct.

Figure 6: CSR framework Source: (OECD, 2008, p. 240)

As we can see from the table the CSR initiatives are abundant and this is an advantage because offers flexibility to companies; the hope is that this wide choice of framework will entice companies to engage voluntarily in environmental and social disclosure. (Drauth, 2010)

United Nations Global Compact

The United Nations is one of the most important international players.

The first initiative of the United Nations in the field of corporate social responsibility dates back to the 1970s and in particular in 1974 when the United Nations Economic and Social Council (ECOSOC) established the United Nations Centre on Transnational Corporations (UNCTC) with the task of collecting information on the impact that multinational companies had on social development and to draw up a Code of Conduct. Unfortunately, although pursued with determination for more than ten years, this first attempt at international regulation failed mainly because of ideological conflict between states. (Sacconi, 2005)

A new attempt began in the 90's, having this time a different approach: several partnerships with the private sector were developed with the main goal to broaden the spectrum and to include not only multinational companies. (Sacconi, 2005)

The most important initiative was the Global Compact, proposed by Kofi Annan on the 31st January 1999 at the World Economic Forum in Davos and then made official in 2000 within ECOSOC. (Sacconi, 2005) The Global Compact was an uncommon initiative that derived from the constant improper conduct of companies with respect to human rights. (MacLeod, 2007) The initiative provided for voluntary adherence by companies to 9 principles concerning human rights, workers right and environmental protection; on the 24 June 2004, during the first "Global Compact Leaders" summit, Kofi Annan announced also the tenth principle against corruption. (Bisio, 2009) The principles are shown in the figure below.

THE TEN PRINCIPLES OF THE UNITED NATIONS GLOBAL COMPACT

Human Rights

1 Businesses should support and respect the protection of internationally proclaimed human rights; and

2 Make sure that they are not complicit in human rights abuses.

Labour

3 Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

4 The elimination of all forms of forced and compulsory labour;

5 The effective abolition of child labour; and

6 The elimination of discrimination in respect of employment and occupation.

Environment

7 Businesses should support a precautionary approach to environmental challenges;

8 Undertake initiatives to promote greater environmental responsibility; and

9 Encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

10 Businesses should work against corruption in all its forms, including extortion and bribery.

The UN Global Compact's Ten Principles are derived from: the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

Figure 7: The 10 principles of the UNGC Source: (United Nations Global Compact, 2014, p. 11)

The aim of this proposal was to promote mutual learning by sharing best practices and promoting transparency and bidirectional dialogue. (Sacconi, 2005) Companies that want to adhere to these principles can do so through an express and individual declaration of adherence sending a written communication to the appropriate United Nations service. Companies must then pay an annual membership fee and report their progress on CSR. In case a company stops joining the global Compact it should stop using the use the emblem of the GC. (Borgia, 2010)

The United Nations Global Compact Communication on Progress (COP) is the annual report that companies must submit; there is not a standard format for CoP, but it must include:

1. "A statement by the Chief Executive expressing continued support for the UN Global Compact and renewing the participant's ongoing commitment to the initiative;"[32]
2. "A description of practical actions the company has taken or plans to take to implement the Ten Principles in each of the four areas (human rights, labour, environment, anti-corruption);"[33]
3. "A measurement of outcomes;"[34]

With the goal of spreading the knowledge of the principles, there are more than 60 Local Networks all around the world where are proposed services like training and advisory on how to correctly implement the principles. In addition to these services, external users can benefit also from online services, like templates to follow and additional instructional material. (Tschopp & Nastanski, 2014)

UN has proposed the Global Reporting Initiative as report mechanism in the CoP although it is not mandatory, and companies can freely choose their own method of reporting. (Tschopp & Nastanski, 2014)

The OECD guidelines on multinational companies

The OECD has for a long time been involved in corporate social responsibility with initiatives specifically aimed at multinational companies. In 1976 it proposed the Guidelines for Multinational Enterprises that are part of the OECD Declaration on International Investment and Multinational Enterprises. (Burchell, 2008) All 31 OECD countries joined the guidelines, as well as Argentina, Brazil, Egypt, Estonia, Israel, Latvia, Lithuania, Peru, Romania and Slovenia. (Drauth, 2010)
The first version of the guidelines was intended to be a tool for maximising profits and reducing risks through the harmonisation of requirements and conditions for multinational companies to invest abroad. (Sacconi, 2005) Guidelines were revised in 2000 and since then every year a report on operation is published. (MacLeod, 2007)
The guidelines promote a participation model and aim to help multinational companies to operate in a socially responsible manner respecting aspects such as human rights, workers' rights and environmental rights in the states in which they are present; in order to do so, the

[32] (UNGC, 2020)
[33] (UNGC, 2020)
[34] (UNGC, 2020)

guidelines require companies to make available complete and detailed information on every aspect relevant to their social impact. (MacLeod, 2007)
Guidelines cannot replace national law, but their scope is to be an instrument of integration into national legislation. While it is true that the guidelines are not legally binding and there is any mechanism for ensuring compliance to them, national governments are required to create National Contact Points (NCPs) in their territory to facilitate the dissemination and implementation of them and to reach in this way the higher number of stakeholders and parties involves. (MacLeod, 2007) Those responsible for the successful implementation of the OECD Guidelines thus are not single companies but the adhering member states. On their side, multinational companies are induced to follow the guidelines because NCPs act like "watchdogs" and can publish a compliance against them in the public statement that is issued every year: firms need to compare the cost of facing a public compliance with that of being compliant. (Drauth, 2010)

ILO Declaration

ILO was founded in 1919 and since then it reconciles governments, employers and workers of 187 member States. Its main purpose is to "set labour standards, develop policies and devise programmes promoting decent work for all women and men." (ILO, 2020)
ILO operates with the involvement of three bodies that represent governments, employers and workers: the International labour Conference, the Governing body and the International labour office.
The first one, *the International labour Conference*, meets annually in Geneva and discusses the International labour standards and other policies of the ILO. The second, the *Governing body* meets three times a year again in Geneva and its role is to deliberate on ILO policy and budget, which are then submitted to the Conference. The third and last part is the *International Labour Office* that is the permanent secretariat of the International Labour Organization. (ILO, 2020)
ILO not only proposes the standards, but it regularly takes care to check that they are applied to the best and provides support through social dialogue and technical assistance.
One feature that differentiates the ILO Declaration from OECD Guidelines is the fact that ILO does not have an implementation mechanism. For the ILO Declaration to achieve its objective effectively, there are several conditions to be met. (Drauth, 2010) First of all the content of the statement must be useful for companies, it must be pragmatic in nature and add value to their CSR strategy. Secondly, companies need to be aware of the existence of these recommendations

so that they can be consulted when developing companies' CSR policies. Lastly, ILO Declaration will have success only if it is widely accepted among stakeholders. (Drauth, 2010)

European Union

Along the road to sustainable development in Europe, much importance has been given to the creation of new regulations concerning CSR as part of the greater sustainable development strategy. (Yıldız & Özerim, 2013)

The first step made by the European Commission was the Green Paper published in 2001. (European Commission, 2001)

In 2002 then, there was the attempt to increase convergence of CSR across the European countries by creating the EU Multi-Stakeholder Forum. The main role of the Forum was to highlight points of agreement and disagreement between the numerous categories of stakeholders but still there was no unanimity on reporting requirements and disclosure. (Yıldız & Özerim, 2013)

In 2003 then the Directive of the European Council made a initial attempt to increase non-financial disclosure by requiring companies to inform the public about their social and environmental impact but failed to provide a specific framework for reporting, therefore the request was interpreted and applied in many different ways and this led to the failure of the initiative. (Yıldız & Özerim, 2013)

Unfortunately, this proactive regulation was partly abandoned in the mid-2000s, leaving each state to deal with this issue almost individually. (Pedersen, 2015)

The following years starting from 2006 were characterized by a new willingness to give a greater political visibility to CSR and to encourage European enterprises to commit more to it. "Europe does not need just business but socially responsible business that takes its share of responsibility for the state of European affairs".[35]

The European Commission states that the addition of further legal requests would run counter the nature of CSR. CSR nature is mainly voluntary thus, the commission decided to adopt a centralised approach launching the European Alliance on CSR. All enterprises are invited to the Alliance, that aims to be a "political umbrella"[36] for all CSR initiatives. There were no formal requirements for being part of the Alliance and the essence of the initiative was to create partnerships for the development of CSR. The Alliance has three main areas:

[35] (European Commission, 2006, p. 3)
[36] (European Commission, 2006, p. 6)

1. “Raising awareness and improving knowledge on CSR and reporting on its achievements”
2. “Helping to mainstream and develop open coalitions of cooperation”
3. “Ensuring an enabling environment for CSR” [37]

Continuing then in chronological order, in its report of 2011 the European Commission lists some of the progresses made since 2006 also thanks to the implementation of the European Alliance for CSR. One of the most remarkable result was the fact that companies that started to disclose sustainability reports following the GRI guidelines went from 270 in 2006 to over 850 in 2011. (European Commission, 2011)

In 2011 the European Commission presented also a new definition for CSR as “the responsibility of enterprises for their impacts on society”.[38] Together with the definition, it was introduced also a new strategy with the objective of increasing the declining consumer’s trust and creating an encouraging environment for responsible business behaviour. The main problem at the time was that many companies still struggled to include environmental and social attention into their core strategy and only 15 out of 27 member states created national policy frameworks to promote CSR. (European Commission, 2011) In response to this problem the European Commission explicitly identified how authoritative guidance the OECD guidelines for Multinational Enterprises, the 10 principles of UNGC, ISO26000 standard, ILO and the UN guiding principles on Business and Human Rights.

The European Commission states that, on the one hand enterprises should be willing to adopt one of the proposed frameworks to implement CSR disclosure and on the other hand public authorities should play a supportive role, implementing complementary regulation when necessary. (European Commission, 2011)

On the 25th October 2014 the European Parliament and the Council published the directive 2014/95/EU, amending the directive 2013/34/EU. This new directive entered into force in 2017 and required large public-interest companies with more than 500 employees to disclose information regarding their actions for environmental protection, social responsibility, employees, human rights and anti-corruption. Companies have very large flexibility for the presentation of these information, and they can choose which framework best suits their needs.

From 2011 until now the European Commission has not stopped its effort undertaking several actions. In particular it has published a CSR Handbook for SMEs and promoted some network events in June 2012 and Marche 2013. In 2013 the Commission published also three Sectorial

[37] (European Commission, 2006, p. 11)
[38] (European Commission, 2011, p. 6)

Guidance for the ICT, Oil&Gas sectors and for Employment and Recruitment agencies. (European Commission, 2019)

In 2020, Europe can be defined as a leader in CSR and CSR policies, with UK holding the primate. (Pedersen, 2015)

Comparison between the main CSR initiative

After having quickly analysed what are the main initiatives carried out by international organizations in the field of CSR, in this section is presented a comparison between three of them with the purpose of understanding the similarities and differences: the ILO declaration, OECD guidelines and UN Global Compact. These three frameworks are those mainly preferred by organisations because are often taken as examples. (OECD, 2008)
Despite their relevance, the academic literature is extremely poor in comparative analysis among these three instruments. (Drauth, 2010)

The different standards present points of convergence on certain aspects while on others a significant conceptual distance. (Bisio, 2015)

These three instruments have the same final objective, that is promoting social responsibility among enterprises. However, the OECD attempts to do so by making public the name of the companies that have wrong behaviours and by creating negative reputational consequences for them. On the other hand, the UN Global Compact aspires to promote mutual learning. The ILO Declaration instead adopts a norm-setting approach. (Drauth, 2010)

Another difference between the three frameworks regards to the audience to which these frameworks are addressed. UN Global compact is intended for awareness increase in multinational businesses while OECD Guidelines are intended to be a support for governments and organisations in monitoring behaviours. ILO Declaration is a complementary framework for the other two, especially with respect to labour issues. (Drauth, 2010)

Looking at the elements that unite these three texts, first of all there is the convergence in the topics treated, in particular with regard to issues related to the workers' rights. The three of them deal with issues like freedom of association, elimination of compulsory labour, abolition of child labour and non-discrimination. ILO and OECD go into even more detail also addressing other aspects like employment promotion, training, wages, etc. (OECD, 2008)

In addition to that, the three of them have a direct link with governments, businesses and worker organization. All of them have been derived from previous existing treaties and have the Universal Declaration of Human Right like common background. (OECD, 2008) Further common elements are shown in the figure below.

Table 6.2. **Government and stakeholder involvement in ILO Declaration, OECD Guidelines and UN Global Compact**

	Global?	Government?	Treaty derived?	Social Partner?
ILO MNE Declaration	Yes.	Yes. The revised Declaration was adopted in 1977, and revised in 2000 and 2006 by the ILO.	Yes. References include the Universal Declaration of Human Rights, the ILO Declaration of Fundamental Principles and Rights of Work, the ILO fundamental conventions, as well as a number of other ILO instruments.	Yes. The ILO is a tripartite body, where employer and worker organisations are formal partners.
OECD MNE Guidelines	Yes.	Yes. All 30 OECD member countries subscribe to the Guidelines. A further 10 countries have also subscribed to them. The OECD Guidelines are part of a Declaration which was adopted at Ministerial level and their implementation by adhering governments is governed by binding OECD decisions.	Yes. Referenced are: The Universal Declaration on Human Rights; the ILO Declaration of Fundamental Principles and Rights at Work; the Rio Declaration on Environment and Development and Agenda 21; and the Copenhagen Declaration for Social Development.	Yes. The business and trade union bodies were involved in developing the Guidelines and have formally endorsed them as an important reference point.
UN Global Compact	Yes.	Yes. Initially an initiative of the UN Secretary-General, the UN Global Compact has since been repeatedly recognised by the UN General Assembly. In the most recent GA resolution addressing the UN Global Compact (A/RES/62/211), the Global Compact Office was given a strengthened mandate. Every two years the Global Compact Office prepares the Secretary-General's report to the General Assembly on global partnerships, which also addresses the role of the UN Global Compact.	Yes. Referenced are: *The Universal Declaration of Human Rights*; *The Rio Declaration on Environment and Development*, and the UN *Convention Against Corruption*. The four labour principles of the UNGC come from the ILO Declaration on Fundamental Principles and Rights of Work.	Yes. Business, employee organisation and other civil society organisations are involved in governance and advisory roles. Overall, the business sector represents the greatest number of participants.

Figure 8: Common elements between ILO MNE, OECD MNE and UNGC. Source: (OECD, 2008, p. 241)

As we can see from the table below OECD Guidelines are those that provide the most comprehensive approach.

	OECD Guidelines	ILO Declaration	UN Global Compact
General Principles	YES	YES	YES
Disclosure	YES		YES
Employment	YES	YES	YES
Human Rights	YES	YES	YES
Environment	YES		YES
Bribery	YES		YES
Consumer Interests	YES		
Competition	YES		

Taxation	YES		

Table 2: Comparison between frameworks Source: (Drauth, 2010)

What makes these frameworks among the most used is their complementarity: for example, if there are gaps in the ILO Declaration a company can always refer to the other two documents and vice versa. Given the great degree of complementarity, several initiatives have been taken over the years to highlight the points of encounter between these three frameworks such as the ILO training package. (OECD, 2008)

To reinforce even more the effectiveness of these tools could be useful a formal strategic alliance. (Drauth, 2010)

Chapter 2 – Regulatory framework

Social and environmental reporting standards overview

The most difficult aspect of corporate social responsibility was not so much its definition as its application, because there is a "problem of vagueness inherent in the social responsibility doctrine."[39] While academics for many years have focused on a theoretical definition of CSR, business managers need to focus on its practical implementation: numerous problems can be listed in the process of transition from theory to practice. For example we may ask ourselves who are the relevant shareholders groups? Do some shareholders interest have a hierarchical priority over others? How much funds should be dedicated to CSR? (Jones, 1980)

The completeness and transparency of information for stakeholders has been undermined by two elements: firstly, the information asymmetry enjoyed by companies, which can model socio-environmental contents to highlight more their areas of interest. Secondly, the fact that companies have often replaced national bodies in defining the development of some territories where they were located. (Bisio, 2015)

Investor have started asking more transparency and accountability, focusing the spotlight on all existing gaps in the reporting system. (Bisio, 2015)

Information that companies make available to their audience needs to be relevant not only to one, but to many and various categories of stakeholders. In addition to that, this information must be comparable among similar organisations. In order to reach this goal, since the beginning of the '90s, efforts to define reporting methodologies and standards have multiplied. Many different standards have been created but the features they have in common are:

- the objective of providing the stakeholders with adequate, reliable and verifiable information;
- to promote dialogue between companies and stakeholders;
- promote social responsibility within the organisation. (Bisio, 2015)

In the process of creating standards there were two key moments:

1. the transition from an approach focused on individual aspects or agents to a broader approach addressed to the multitude of stakeholders;
2. the transition from general models directed to at all companies to increasingly customised and specific tools (Bisio, 2015)

[39] (Jones, 1980, p. 62)

Despite the standards and guidelines that have emerged are numerous, the main to refer to because recognized internationally are: (Bisio, 2015)

- Global Reporting Initiative (GRI)
- UNI ISO 26000
- AA1000 standard
- GBS Association

Global Reporting Initiative (GRI)

The Global Reporting Initiative model is an international initiative promoted in 1997 by the Coalition for Environmentally Responsible Economies (CERES) and the United Nations Environment Program (UNEP). The goal was the development and dissemination of globally applicable reporting guidelines. (Bisio, 2015) There was a revision of the guidelines in 2000, 2002 and 2006 and they can be consulted in fifteen languages (Tschopp & Nastanski, 2014)

> "Sustainability reporting, as promoted by the GRI Standards, is an organization's practice of reporting publicly on its economic, environmental, and/or social impacts, and hence its contributions – positive or negative – towards the goal of sustainable development." (Global Reprting Initiative, 2016)

Introduced in 2000, GRI arrived at their fourth formulation (G4) in 2013, and 93% of the world's largest 250 corporations adopt GRI standards in their reports. (Blowfield & Murray, 2019; Global Reporting Initiative, 2020)

As declared in their official website, GRI's vision is to be "a thriving global community that lifts humanity and enhances the resources on which all life depends."[40]

Their mission is "to empower decisions that create social, environmental and economic benefits for everyone." [41]

GRI objectives are declared in their website and they include the creation of international standards, the reconciliation of all the existing rules and the creation of a unique body of efficient and effective principles. (Global Reporting Initiative, 2020)

The figure below represents the structure of the principles.

[40] (Global Reporting Initiative, 2020)
[41] (Global Reporting Initiative, 2020)

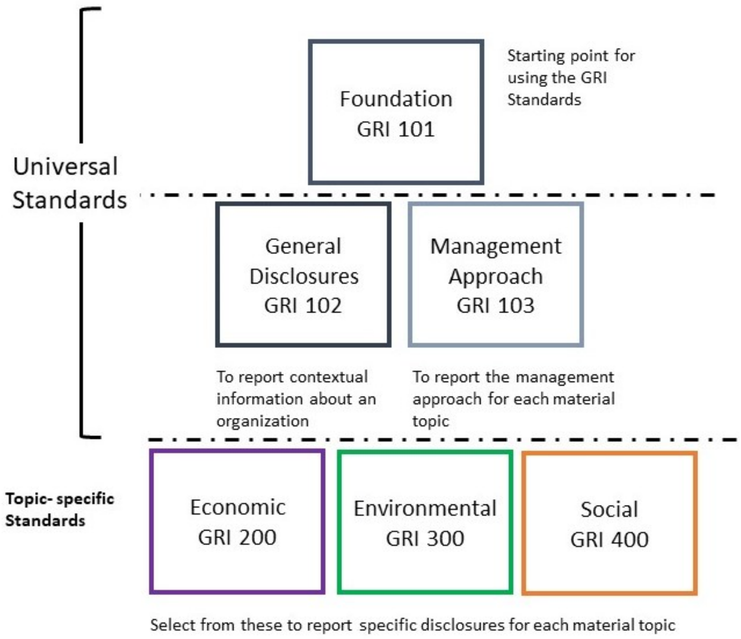


Figure 9: GRI Standards Source: adapted from Global Reprting Initiative, 2016

As we can see from the figure, GRI Standards are organized into four series:

1. The 100 series: contains GRI 101, GRI 102 and GRI 103.
2. The 200, 300, and 400 series that teat about specific topics.

Looking more carefully at GRI 101, in it section there are the fundamental rules to achieve transparency. It is divided into *principles for defining reporting content*, that describe the process to be applied in order to bring out the contents that must be highlighted during reporting and *principles for defining reporting quality* that have the scope to assist in the selection of information for the preparation of a report with high quality information. (Global Reprting Initiative, 2016)

The principles on which GRI101 is based are illustrated in the diagram below. These principles should be taken as a model by reporters and all organizations should aim at applying them rigorously. Strict application of the principles does not necessarily imply the implementation of all of them but should show the underlying reasons for the chosen approach. (Burchell, 2008)

Principles for defining reporting content	
	Description
Stakeholder inclusiveness	The reporting organization shall identify its stakeholders and explain how it has responded to their reasonable expectations and interests.
Sustainability context	The report shall present the reporting organization's performance in the wider context of sustainability.
Materiality	The report shall cover topics that: 1.3.1 reflect the reporting organization's significant economic, environmental, and social impacts; or 1.3.2 substantively influence the assessments and decisions of stakeholders.

Completeness	The report shall include coverage of material topics and their Boundaries, enough to reflect significant economic, environmental, and social impacts, and to enable stakeholders to assess the reporting organization's performance in the reporting period.

Table 3:Principles for defining reporting content Source: adaption from Global Reprting Initiative, 2016

Principles for defining reporting quality	
	Description
Balance	The reported information shall reflect positive and negative aspects of the reporting organization's performance to enable a reasoned assessment of overall performance.
Comparability	The reporting organization shall select, compile, and report information consistently. The reported information shall be presented in a manner that enables stakeholders to analyze changes in the organization's performance over time, and that could support analysis relative to other organizations.
Accuracy	The reported information shall be sufficiently accurate and detailed for stakeholders to assess the reporting organization's performance.
Timeliness	The reporting organization shall report on a regular schedule so that information is available in time for stakeholders to make informed decisions.
Clarity	The reporting organization shall make information available in a manner that is understandable and accessible to stakeholders using that information.
Reliability	The reporting organization shall gather, record, compile, analyze, and report information and processes used in the preparation of the report in a way that they can be subject to examination, and that establishes the quality and materiality of the information.

Table 4: Principles for defining reporting quality. Source: adaption from Global Reprting Initiative, 2016

AccountAbility 1000 (AA1000)

AA1000 is a standard created in 1999 and updated in 2000 by I.S.E.A. that is the Institute of Social and Ethical Accountability.
This principle is based on the broader concept of *accountability* because sustainability and accountability are complementary: accountability creates good processes inside an organization that in turn make possible a sustainable outcome. (Beckett & Jonker, 2002)

Accountability is defined as "the principle of owing accounts to those with a legitimate interest"[42]. A second and more comprehensive definition states that "accountability is the state of acknowledging, assuming responsibility for and being transparent about the impacts of an organisation's policies, decisions, actions, products, services and associated performance."[43]

[42] (Beckett & Jonker, 2002, p. 36)
[43] (AccountAbility, 2018)

A greater accountability brings with it improved transparency, greater quality of decision and a clearer distribution of responsibilities. (Beckett & Jonker, 2002)

In contrast to the so-called content standards, which are primarily concerned with the structure of reports and the information to be provided to stakeholders, the AA1000 is a private voluntary process standard. The process standards are focused on the construction of social reports stating what should be the principles underlying its drafting and the procedure to be followed to achieve stakeholder involvement. The strong point of AA1000 is that despite it is a process standard, it can be combined and can integrate other standards such as GRI or ISO1400 an it can be applied by organizations of different size. (Bisio, 2015) (Beckett & Jonker, 2002) Another peculiar feature of AA1000 is the fact that it is not a certifiable standard, which means that there are not a set of minimum requirements by which the company can obtain a social certification. AA1000 does not impose a particular structure of the reporting model or a minimum level of reporting information, it aims at increasing the quality of social reporting for stakeholders. (Bisio, 2015) Despite being born as a unitary standard, nowadays the standard developed in the AA1000 Series, which includes three parts:

1. AA1000APS - AccountAbility Principles: it is the basis for the other two modules.
2. AA1000AS - Assurance Standard.
3. AA1000SES – Stakeholder Engagement Standard. (Bisio, 2015)

AA1000APS - AccountAbility Principles

With respect to the first part, it contains all the basic principles for all the other documents in the series.

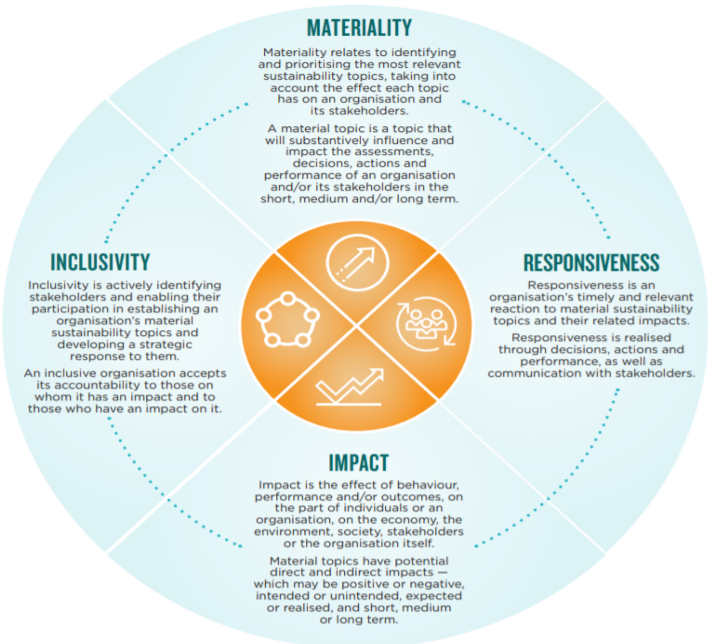


Figure 10: AccountAbility Principles Overview Source: (AccountAbility, 2018, p. 30)

AA1000 AS – Assurance Standard

The purpose of this second section is to apply the principles of Inclusivity, Materiality, Responsiveness and Impact present in AA1000AP. (AccountAbility, 2020)

AA1000AS is an industry-independent standard that foresees a verification process that ends with an observation aimed at increasing the quality of social measurement and sustainability. In 2021, the previous version AA1000AS (2008) will be replaced by AA1000AS v3 that will become the only recognised AA1000 Assurance Standard. (AccountAbility, 2020)

In operational terms, this set of rules provides the means to verify, in addition to the data provided, the way in which organizations manage sustainability. (Bisio, 2015)

The prerequisite that all reports must have is unique and essential: credibility.

To ensure compliance, a verification of compliance with the standards is carried out by the so-called *assurance practitioners* who, if they operate in the form of organizations, are called *assurance providers*.

These individuals are required to control the nature and degree of adherence of the organization to the three principles of the AA1000APS. The first level of investigation, however, does not guarantee the reliability of the information provided by companies but only their consistency with the guiding principles of the first section; as regards the reliability of the information, this is verified in the second level of control by the assessor.

Figure 11: The AA1000AS v3 Assurance Process Source: (AccountAbility, 2020, p. 11)

As we can see in the left side of the figure above, there are several preconditions that must be met. First of all there should not be any conflict of interest between the assurance provider and the organisation or any of its stakeholders. Secondly, "an assurance provider shall accept an assurance engagement only if it possesses the necessary competencies to deliver all aspects of the assurance engagement."[44]As third and last requirement, the assurance provider must ascertain that the engagement subject matter is appropriate and that he can have access to all the necessary information.

There are two possible levels of assurance: high or moderated. A combination of the two levels can be used, depending on the subject.

In case all these preconditions are satisfied, the assurance provider can proceed to planning and performing the assurance engagement and issue the final statement.

AA1000SES – Stakeholder Engagement Standard

The third standard is the basic document of the AA1000 series. The modern challenges of the markets have made necessary a new involvement of the stakeholders, in addition to the consideration of entities without a voice:

"The AA1000 Stakeholder Engagement Standard (AA1000SES) is a generally applicable framework for the assessment, design, implementation and communication of quality stakeholder engagement."[45]

The relevance of the standard derives from the relevance of stakeholder engagement both in terms of *performance* and *accountability* (Bisio, 2015) and its purpose is to establish the benchmark for good-quality engagement. (AccountAbility, 2015)

The AA1000SES is applicable to different types of stakeholder involvement, namely on functional, specific or transversal issues across the organization. (Bisio, 2015)

The reporting process standardized by the AA1000SES standard has four main steps, each of which is articulated in a step-by-step approach:

1. plan;
2. prepare;
3. implement;
4. act, review and improve. (AccountAbility, 2015)

It is possible to say that only by using this standard the organization can have a comprehensive view of the principles of social performance and therefore is able to direct resources in the right direction. (Bisio, 2015)

[44] (AccountAbility, 2020, p. 14)
[45] (AccountAbility, 2015, p. 9)

GBS Association

The birth of GBS is due to the need to provide Italian companies with a series of principles that can constitute a reference point for the development and dissemination of social reporting processes in Italy. GBS has its origins in 1997, when took place an international workshop on CSR organized in Taormina with the participation of the Business Economics Institute of the University of Messina and the Bonino-Pulejo Fundation. In October 1998 then, GBS constituted a Study Group for establishing the Social Reporting Standards, with the involvement of 32 participants on behalf of 13 Italian universities but the principles for drawing up the social financial statements were not definitively formulated until 2001 and then updated in 2013. (Bisio, 2015; GBS, 2020)

The aim of GBS standards is to provide all stakeholders with a complete picture of the company's performance and valuable information in order to promote transparency, consensus and social legitimation. The social report that GBS has developed is a fiscal balance sheet that must be drafted periodically by all businesses. The quality of the social balance sheet is guaranteed by the observance of the following 17 principles: (GBS, 2013)

1. Responsibility
2. Identification
3. Transparency
4. Inclusion
5. Coherence
6. Neutrality
7. Third-parties' autonomy
8. Accruals basis of accounting
9. Prudence
10. Comparability
11. Comprehensibility, clarity and intelligibility
12. Periodicity and continuity
13. Homogeneity
14. Utility
15. Significance and relevance
16. Verifiability of information
17. Reliability and fair representation

After listing all the principles that must be at the basis of the preparation of the social balance sheet, the document presented in 2013 provides a detailed description of what should be the structure of the social document.

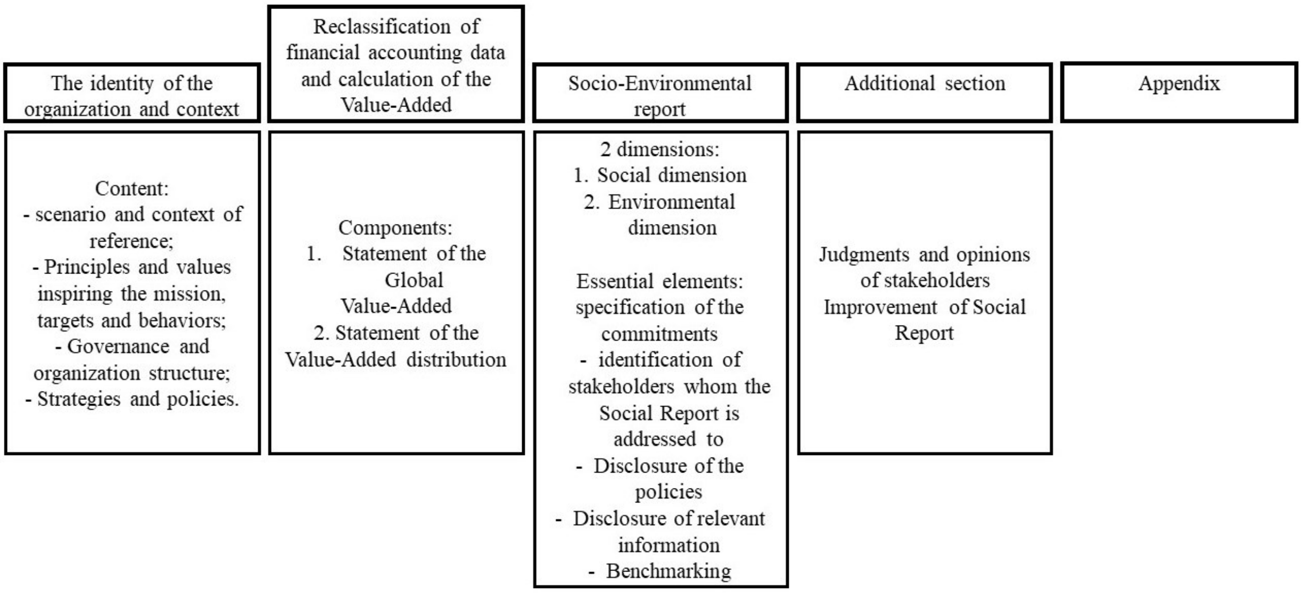


Figure 12:Figure 11: GBS social document Source: own elaboration from GBS, 2013

ISO 26000

The International Organization for Standardization is an independent, non-governmental organization with the participation of 165 national standards bodies all over the world. It officially started in 1947 with 67 technical committees, and since then it has been expanding. (ISO, 2020) The standards proposes by ISO often become law through multilateral agreements or national standards. (Tschopp & Nastanski, 2014)

ISO from several years devotes a specific attention to the theme of social responsibility and published in November 2010 the ISO26000 containing guidelines for reporting socially responsible behavior. The creation of the standard took five years of negotiations between many different stakeholders across the world and was coordinated by a working group of about 500 experts. What is very peculiar about this standard is that ISO 26000 does not provide requirements like ISO9000 or ISO14000, but only recommendations that can help organisations in clarify what social responsibility is and take effective actions. (ISO, 2018) "ISO 26000 seeks to promote a common understanding of social responsibility."[46]

The structure of the guidelines is divided into seven points illustrated in the table below.

[46] (ISO, 2018, p. 7)

Clause n°	Title and Description
Clause 1	Scope
Clause 2	Terms and definitions
Clause 3	Understanding social responsibility
Clause 4	Principles of social responsibility
Clause 5	Recognizing social responsibility and engaging stakeholders
Clause 6	Guidance on social responsibility core subjects
Clause 7	Guidance on integrating social responsibility throughout an organization

Figure 13: ISO guidelines structure. Source: own elaboration from (ISO, 2018)

Among those, clause 6 is the most important and it is where the basic subjects are highlighted. It is subdivided into six core subjects and for each of them an organisation should identify and address all those aspects relevant or significant to its decisions and activities in the light of its medium- and long-term objectives. The themes are:

1. Organizational governance
2. Human rights
3. The environment
4. Fair operating practices
5. Consumer issues
6. Community involvement and development

Harmonization of the standards

Given the proliferation of numerous accounting standards, both IASB and FASB are trying to implement a harmonisation process in order to increase comparability. This multitude of standards serves as a barrier to cross-state trade, and could also become an impediment to environmental and social disclosure because investors may struggle in comparing reports. (Tschopp & Nastanski, 2014) Standard metrics for corporate responsibility can ease the benchmarking progress for internal objective and external competitors. (KPMG, 2017)

The main arguments against a harmonization are that it cannot exist a standards that perfectly fits the needs of all stakeholders located in different countries: the difficulty of harmonisation increases in a direct way with the increase of stakeholders involved (Tschopp & Nastanski, 2014)

Comparing the CSR disclosure with the financial disclosure that all companies are required to do it can be said that the former is 100 years behind the latter: currently there are no strict legal constraints that impose social and environmental disclosure by companies thus enterprises tend not to highlight the negative impacts of their business. In addition to that the absence of mandatory reporting rules on CSR led to the creation of very different reports for length, scope and depth of accountability with a strong country-of-origin effect. (Fortanier, et al., 2011)

However, in the last years market players have increased their level of social awareness and are asking for greater disclosure because of the recent scandals. Now, we find ourselves in the third stage of CSR reporting, dominated by a multi-stakeholder with a great influence (Tschopp & Nastanski, 2014) In respond to these new stakeholders' need companies are showing a rising disposition to account for their contribution on key social issues: 93% of the G250 companies reported their CR activities in 2017. (KPMG, 2017)

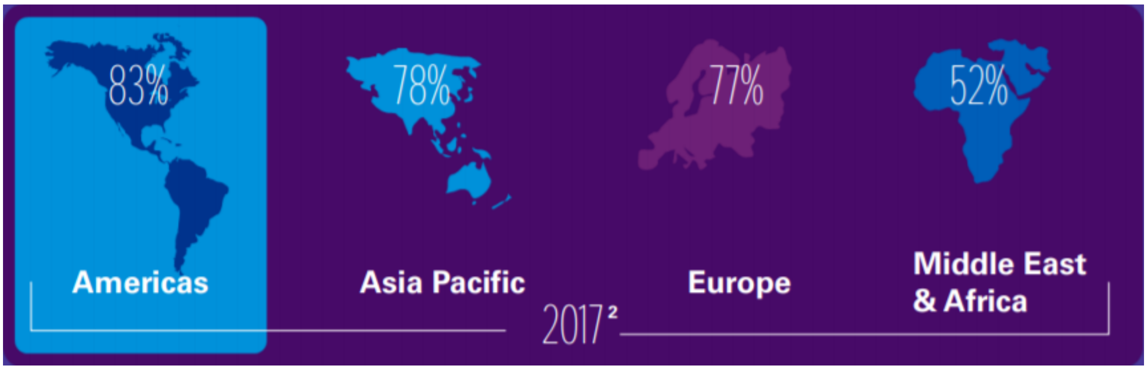


Figure 14: CR activity in G250 companies. Source: (KPMG, 2017)

The purpose of the table below is to make a quick comparison of GRI, AA 1000, UN Global Compact and ISO26000 because these may become in the future the global mandatory standards. Among those, the GRI standard has directed its efforts more towards the promotion of standards, with particular attention to America and Cine, and as a result it was adopted by 89% of G250 companies in 2017 and will probably become the main reference standard in a near future of harmonization. (KPMG, 2017)

Standard	Date	Governance	Scope	Content
GRI	First guidance in 1997 Review in 2000,20002 and 2006	Multi-stakeholder steering committee	• Economic • Labour • Environment • Human rights • Society • productions	Principles and indicators
AA1000	First framework in 1999	AccountAbility council	• accountability • responsibility • sustainability	Principle-based standards
UN Global Compact	Launched in 2000	United Nations	• human rights • labour standards • environment • anti-corruption	10 key principles
ISO26000	Published on November 2010	ISO Working Group	Social responsibility and guidance for integration	Guidance standards with a reporting component . Not valid as certifications.

Table 5: Key CSR standards Source: own elaboration from (Tschopp & Nastanski, 2014)

Fortanier et al (2011) found that with the increase of multinational companies that adhere to global standards decrease cross-country diffenreces and increase harmonization; this means the international commitment to create global standards of responsible behaviour is paying off.

There are a multitude of different approaches also regarding the way in which the CR reports are presented and many companies still find it difficult to communicate efficiently with their stakeholders. Among the different formats there are single reports, dedicated sections in the main financial report or special-purpose CR website. What is positive is that in 2017 only 20% of G250 companies rely only on a stand-alone report while the remaining try to stimulate readers to explore the CSR information made available. (KPMG, 2017)

Chapter 3 – CSR and Corporate Financial Performance

A new way of seeing CSR: strategic CSR.

CSR is increasingly becoming a priority of large companies' managers due to the proliferation of indices that classify companies according to their social commitment.

As an example of that, Peterson & Hermans (2004) used content analysis to investigate how television commercials made by U.S. banks for socially responsible advertisements were evolving in 1992, 1997 and 2002. They found that banks were spending an increasing amount of money on advertisements about environment, equal opportunity for women, safety of the public and similar subjects. Already in those years the authors commented on this fact saying that "much of this effort can be attributed to an interest on the part of bank management to improve the image of the organization as a socially responsible institution."[47] This, like other evidences, show that companies are constantly exposed to external judgement from shareholders, stakeholders and society in general. In fact, it often happens that activist organizations focus the spotlight on large companies to give visibility to a specific problem. (Porter & Kramer, 2006) Activists can exercise their influence on economic activity through public politics or through private politics. In this second case they directly try to influence the economic activity of firms for their redistribution goals. (Baron, 2001)

All this attention on CSR could turn into a dangerous financial risk for companies if they do not respond adequately to the external pressures. Firms can engage in CSR policies for many reasons: to increase profit, for altruistic motivations, to avoid external pressure from activists. (Baron, 2001) In recent years it has gained ground the idea that companies engage in social initiatives for profit-maximizing objectives and their benefits will offset the costs. (Siegel & Vitaliano, 2007) However, in many cases the social effort does not pay off. In this respect, Porter and Kramer (2006) identify two main reasons why companies' social efforts do not give the expected returns:

1) "they pit business against society"[48]
2) they use a generic approach to CSR instead of a targeted one.

If companies thought of CSR as an activity equal to others of their core business, they could obtain a competitive advantage from it and strategic CSR will be aligned with the historical profit-maximization objective. (Nollet, et al., 2016) Instead, companies look at CSR as a way to calm pressures and they often address issues by focusing on public relations and issuing

[47] (Peterson & Hermans, 2004, p. 208)
[48] (Porter & Kramer, 2006, p. 2)

sustainability reports. This way of approaching the problem results in uncoordinated and useless efforts. With this With these assumptions, the value that CSR can create for enterprises is very low, as the benefit for the business itself. (Porter & Kramer, 2006) To be effective, social initiative should be "integrated into the company's business-level product differentiation strategies."[49]

Porter and Kramer (2006) identify four main justifications to engage in CSR:

1. **moral obligation**: companies should "do the right thing";
2. **sustainability:** represents the environmental and social care;
3. **license to operate**: every company needs the approval of the surrounding environment to operate;
4. **reputation:** CSR initiatives will have a positive impact on image and reputation.

Despite these justifications offer a good starting point for understanding the motivations that drive enterprises' behaviours, none of them is individually enough. The common weakness lies in the fate that "they focus on the tension between business and society rather than on their interdependence."[50] The starting point to advance in CSR is to make it clear that companies and society need each other. Many examples to explain this can be made: companies need a stable economy, educated and skilled workers, primary resources, a good law system and standards. For their part, individuals need prosperous companies to have work, primary goods and progress. (Porter & Kramer, 2006)

"The mutual dependence of corporations and society implies that both business decisions and social policies must follow the principle of *shared value*" otherwise "a temporary gain to one will undermine the long-term prosperity of both"[51]. The social problems are innumerable, and it would make no sense for any company to take full charge of them. Companies must choose the causes that create the highest shared value benefit both society and business. These causes can be divided into three categories as shown in the figure below. (Porter & Kramer, 2006)

On the one hand we have responsive CSR that means acting as a good corporate mainly through money donations or initiative. Responsive CSR however remains incidental to the company business. Every company should focus on the red area of the chart called "strategic CSR" where negative value chain impacts are reduced. (Porter & Kramer, 2006) Baron in 2001 already

[49] (Siegel & Vitaliano, 2007, pp. 774-775)
[50] (Porter & Kramer, 2006, p. 7)
[51] (Porter & Kramer, 2006, p. 8)

defined "strategic CSR as "profit-maximizing strategy that some may view as socially responsible." [52]

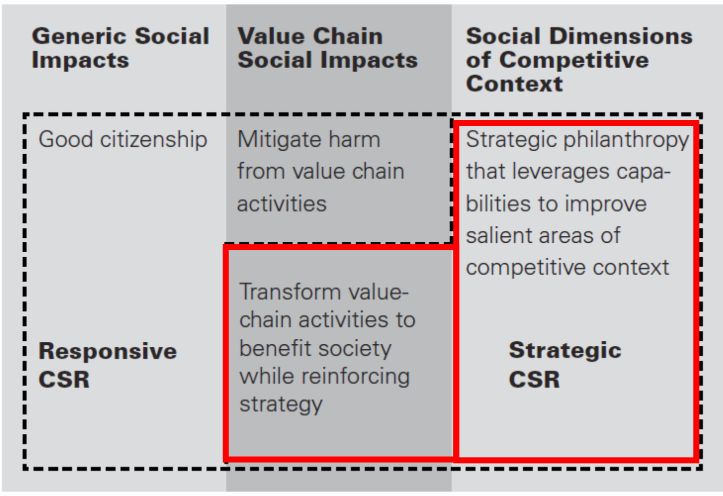


Figure 15: Strategic Approach to CSR Source: (Porter & Kramer, 2006, p. 9)

Following Porter and Kramer suggestions, steps to implement strategic CSR are:

1. Sort social issues following these three categories
2. Rank social issues based on the shared value
3. Create a corporate social agenda

Companies must now prioritize substance over image in order to have a return from their initiatives. Baron (2001) shared this view saying that "firms should seize any opportunities for strategic CSR just as they seize market opportunities to improve profits.[53]"

Sustainability ratings

The need to create CSR measuring instruments led to the birth of sustainability index. In fact, different forms of social screening can be found in the last 100 years mostly associated with religious groups and trade unions such as the Quakers and the Lutheran Brotherhood. More recently the specialists speak about Socially Responsible Investment identified under the acronym SRI. (Fowler & Hope, 2007) SRI consists in the selection of financial investments in light of social responsibility criteria. (Barnett & Salomon, 2006) PAX World Fund was the first SRI mutual fund created in contrast to the Vietnam War in 1971. At the beginning, most of these funds adopted negative screening that consists basically in the avoidance of enterprises belonging to critical industries like tabaco, army, defence, etc. In recent years also positive screening is adopted. (Fowler & Hope, 2007) Much research has been devoted to investigating

[52] (Baron, 2001, p. 17)
[53] (Baron, 2001, p. 41)

whether performance differences exist between SRI funds and other types of funds but still no consensus has been found. (Barnett & Salomon, 2006) Continuing this way, in 1990 there is the presentation of Domini 400 Social Index, that was the first sustainable index. After that, some other indexes were developed and the most famous are Down Jones Sustainability Indices, FTSE4Good Index Series, E.Capital, Ethibel and Humanix, Jantzi. As for funds, performance comparison for social indices is challenging mainly due to their short life. However, the great attention given to them in academic studies is because they can be used to investigate the relation between CSR and corporate performance. (Fowler & Hope, 2007)

Indices	Index tracked	Methodology
Dow Jones Sustainability Index	Dow Jones Global Index	- Positive Screening Criteria: - Includes companies that score highest on a comprehensive list of sustainability criteria.
FTSE4Good	Fortune 500	Mixed Screening Criteria: - Excludes companies operating in: tobacco, nuclear systems, weapons systems, and uranium. - Includes companies based on qualitative judgments about: environmental sustainability, relations with stakeholders, and human rights.
Domini 400 Social Index	Fortune 500	Negative Screening Criteria: - Excludes companies operating in: weapons, alcohol, tobacco, nuclear power, and gaming. - Also excludes companies based on qualitative judgments about the environment, diversity, employee relations, and product.

Table 6: Sustainability indices. Source: adaption from (Fowler & Hope, 2007)

Down Jones Sustainability Indices

Sustainable Asset Management (SAM) is a fund management firm operating in Zurich which in September 1999 created the DJSI family in collaboration with the Swiss Stock Exchange, STOXX Limited and Dow Jones. SAM was animated by the firm conviction that sustainability carries positive effects on business performance. In the DJSI are included only companies that belong to the list of the largest 2,500 companies, by free-market float capitalization in the DJGI. This choice is driven by the willingness to include only industry leaders because those are the most likely to devote financial resources to CSR. Companies that want to be part of the index must complete a questionnaire providing a wide range of information on them. SAM explicitly declares that their index is unbalanced in favour of social and environmental components as it is shown in the table below.

DJSI weightings: corporate sustainability assessment criteria

Dimension	Criteria	Weighting (%)
Economic: 30.6%	Codes of Conduct/Compliance/Corruption	3.0
	Corporate Governance	5.4
	Customer Relationship Management	3.0
	Financial Robustness (1)	3.6
	Investor Relations	2.4
	Risk & Crisis Management	3.6
	Scorecards/Measurement Systems	4.2
	Strategic Planning	5.4
	Industry Specific Criteria (2)	Industry dependent
Environment: 9.2%	Environmental Policy/Management	3.2
	Environmental Performance	4.2
	Environmental Reporting (1)	1.8
	Industry Specific Criteria (2)	Industry dependent
Social: 20.4%	Corporate Citizenship/Philanthropy	2.4
	Stakeholders Engagement	4.2
	Labor Practice Indicators	3.0
	Human Capital Development	1.8
	Knowledge Management	3.0
	Social Reporting	1.8
	Talent Attraction & Retention	2.4
	Standards for Suppliers	1.8
	Industry Specific Criteria (2)	Industry dependent
Industry Criteria & Media/ Stakeholder analysis: 39.8%		39.8
Total		100.0

Table 7: DJSI weightings: corporate sustainability assessment criteria. Source: (Fowler & Hope, 2007, p. 248)

The Dow Jones Sustainability Index family comprises: DJSI World, DJSI North America, DJSI Europe, DJSI Asia Pacific, DJSI Emerging Markets, DJSI Korea, DJSI Australia, DJSI Chile, DJSI MILA Pacific Alliance. The sector breakdown is shown in the figure below.

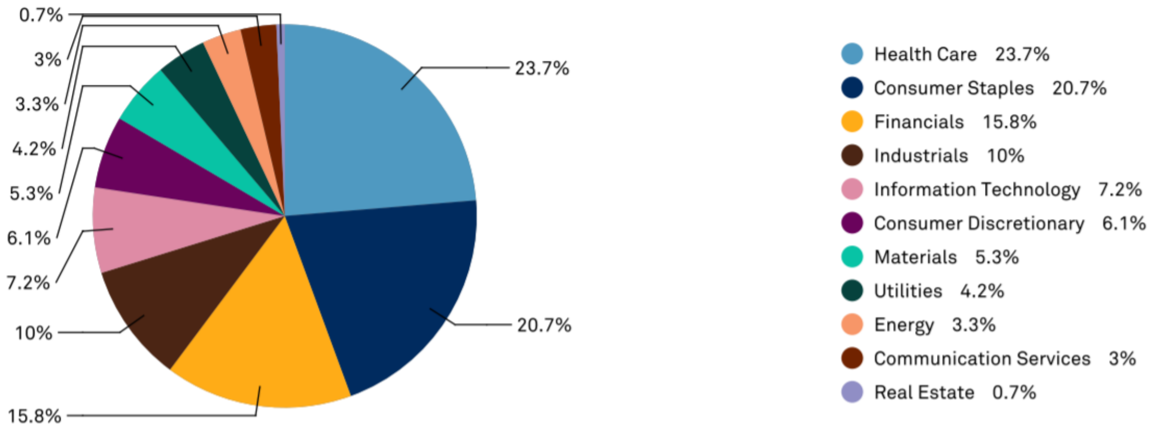


Figure 16: DJSI Europe sector breakdown Source: (SAM, 2020)

Dow Jones sustainability index family has been sometimes appointed as the best-in-class due to their coverage of all industry sectors. (Galant & Cadez, 2017)

FTSE4Good Index Series

FTSE4Good Index Series was presented in 2001. Companies can be qualified to entry in one of the four FTSE4Good indices only if they are already listed in one of the four starting indices.

In case this condition is satisfied, then the inclusion in one of the four FTSE4Good indices is defined by the FTSE4Good Advisory Committee based on the information on five main areas. Every company has its ESG rating that can range from 0 to a maximum of 5 and companies in a developed market can be included in the index only if they have an ESG rating of 3.3 or above. Moreover, there are some companies that are excluded because they belong to sectors considered unethical like tobacco, nuclear, weapons and coal. (FTSE Russell, 2020)

The four indices are grouped based on the geographical region and each of them is presented in two forms. "First, a benchmark index is calculated; this represents the performance of all companies from given regions that meet the inclusion criteria. Second, a tradable version of each index is published based on a representative sample of shares in the FTSE4Good benchmarks. The returns of every version of the indices are made up of the share performance of each constituent weighted by its market value. For the tradable index, a smaller and more manageable number of securities are selected to mimic the performance of the benchmark but with a much lower level of transaction cost for the investor.[54]"

The Advisory Committee constantly reviews the criteria. In addition to that, every two years it issues a review to investigate whether new companies deserve to be included.

All this is outlined in the scheme below.

Starting indices

- FTSE All Share Index
- FTSE All-World Europe
- FTSE US Index
- FTSE All World Developed

Selection process by FTSE4Good Advisory Committee based on information about:

- environmental sustainability
- relationships with stakeholders
- attitudes to human rights
- supply chain labor standards
- the countering of bribery

Index name	Type	Base universes
FTSE4Good UK Index	Benchmark	FTSE All-Share Index
FTSE4Good UK 50 Index	Tradable	FTSE All-Share Index
FTSE4Good Europe Index	Benchmark	FTSE All-World Europe Index
FTSE4Good Europe 50 Index	Tradable	FTSE All-World Europe Index
FTSE4Good US Index	Benchmark	FTSE US Index
FTSE4Good US 100 Index	Tradable	FTSE US Index
FTSE4Good Global Index	Benchmark	FTSE All-World Developed Index
FTSE4Good Global 100 Index	Tradable	FTSE All-World Developed Index

[54] (Collison, et al., 2008, p. 15)

MSCI 400 Social Index

The MSCI KLD 400 Social Index is an index made exclusively of 400 U.S. companies with positive Environmental, Social and Governance characteristics. Its counterpart is the MSCI USA. This index is based on three components: MSCI ESG Ratings, MSCI ESG Controversies and MSCI ESG Business Involvement Screening Research. The first one MSCI ESG Ratings is an overall company ESG rating with a seven-point scale from “AAA” to “CCC”. Companies that are already in the index need to have a rating equivalent to B or above while companies that aim to enter in the index need to have a rating above BB. Also in this case some companies are excluded because of their business, in particular alcohol, gambling, tobacco, nuclear weapons and others. The index is reviewed on a quarterly basis and companies that fail to meet the eligibility criteria are eliminated. (MSCI, 2018)

ESG Rating

Thomson Reuters ESG Scores were intended to clearly and objectively measure a company’ performance across 10 themes related to environment, governance and social issues. These scores replace and integrate the previous one called ASSET4 ratings. All the measurements are built on data provided by companies in their financial statements, analysed by more than 150 research analysts that work in collaboration with local language experts. Data quality is ensured by a combination of algorithms and human process. The database contains scores for over 9,000 companies all around the world starting from 2002. Every six months companies belonging to the database undergo a review process and new ones can be added. (Refinitiv, 2020)

These scores are expressed both in percentages and letter ranging from A+ to D-. Each of the 450 ESG measures passes a standardization process in order to make all the information comparable. A strong point of this database is the frequency with which the information is updated, about every week, with continuous recalculations of the scores. (Refinitiv, 2020)

The hierarchical structure of the scores in shown in the figure below.

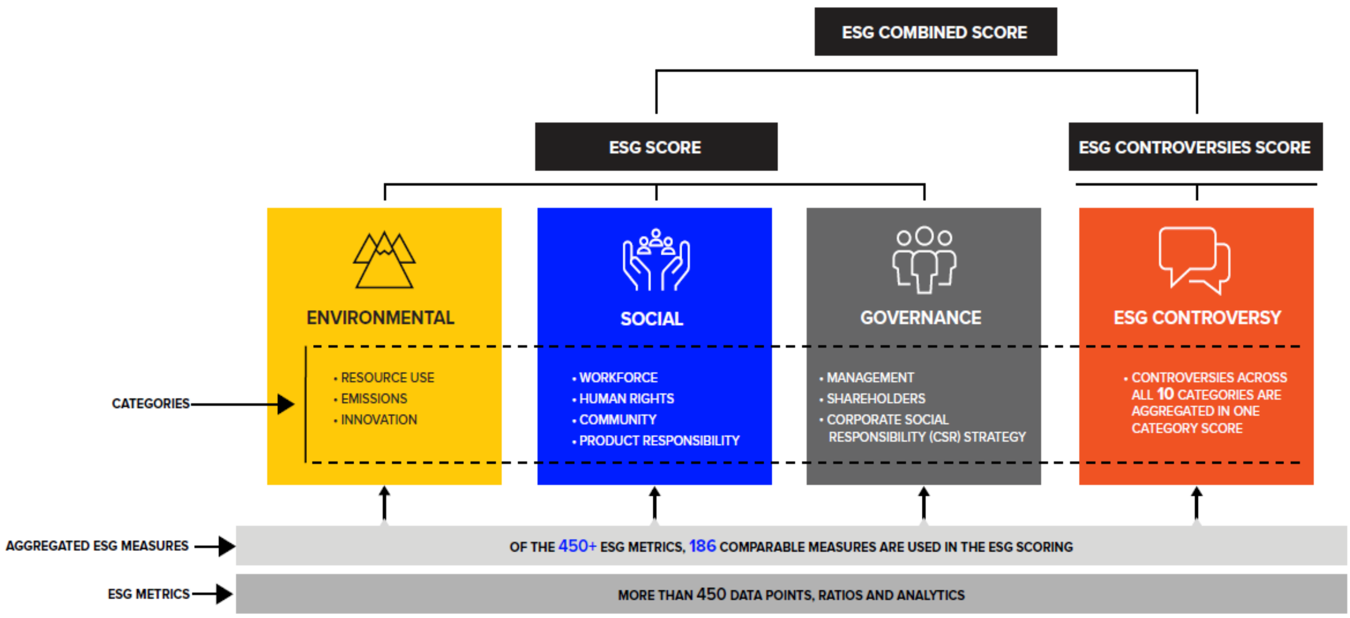


Figure 17: Refinitiv ESG Score. Source: (Refinitiv, 2020, p. 3)

There are two important ESG scores:

1. ESG score: it measures the company's performance on environmental, social and governance issues using data publicly available.
2. ESG Combined (ESGC) score: it overlays the ESG score with ESG controversies.

ESG Score

There are 450 company-level ESG measures grouped in 10 categories; "the category scores are rolled up into three pillar scores - environmental, social and corporate governance. ESG pillar score is a relative sum of the category weights which vary per industry for the Environmental and Social categories. For Governance, the weights remain the same across all industries."[55]

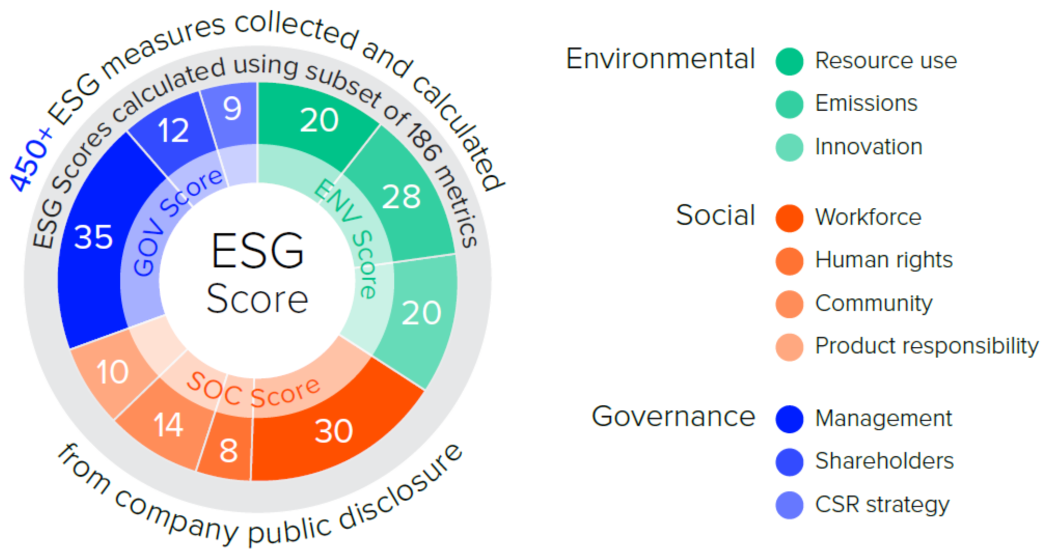


Figure 18: ESG categories. Source: (Refinitiv, 2020, p. 6)

[55] (Refinitiv, 2020, p. 6)

ESG Combined (ESGC) score

ESGC score combines the ESC score with company specific information about controversies. The goal of this additional score is to weight the ESG score with negative media information. The ESGC score is the average of the ESG and ESG controversies score. However, when there is any new about controversies in a fiscal year, the ESGC score is identical to the ESG score. There are 23 ESG controversy topic considered.

Score calculation and conversion from letters to percentile

ESG scores are calculated using the following formula and based on the result a specific score is assigned. The scores are represented in the table.

$$\text{score} = \frac{\text{no. of companies with a worse value} + \dfrac{\text{no. of companies with the same value included in the current one}}{2}}{\text{no. of companies with a value}}$$

Score range	Grade	Description	
0.0 <= score <= 0.083333	D -	"D" score indicates poor relative ESG performance and insufficient degree of transparency in reporting material ESG data publicly.	ESG Laggards
0.083333 < score <= 0.166666	D		
0.166666 < score <= 0.250000	D +		
0.250000 < score <= 0.333333	C -	"C" score indicates satisfactory relative ESG performance and moderate degree of transparency in reporting material ESG data publicly.	
0.333333 < score <= 0.416666	C		
0.416666 < score <= 0.500000	C +		
0.500000 < score <= 0.583333	B -	"B" score indicates good relative ESG performance and above average degree of transparency in reporting material ESG data publicly.	
0.583333 < score <= 0.666666	B		
0.666666 < score <= 0.750000	B +		
0.750000 < score <= 0.833333	A -	"A" score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly.	
0.833333 < score <= 0.916666	A		
0.916666 < score <= 1	A +		ESG Leaders

Figure 19: Conversion from ESG letters to percentile. Source: (Refinitiv, 2020, p. 7)

CSR and Financial Performance

The study of the relationship between CSR and corporate financial performance (CFP) has been going on for years and some trace this research back to Friedman. According to his companies should focus only on making profit. (si veda Galant & Cadez, 2017, p. 676)

The conventional view looks at CSR as a competitive disadvantage because it increases costs and worsen profits. (Barnett & Salomon, 2006) In addition to that *agency theory* argues that managers may have incentives to over-invest in CSR initiative aimed by reputational reasons. (Nollet, et al., 2016) On the other hand, the more recent *stakeholder view* suggests that even the dissatisfaction of some key stakeholder group is equally dangerous for the company. (Galant & Cadez, 2017) Furthermore, a firm with good social performances can gain legitimacy and attract better resources. (Callan & Thomas, 2009) Under the *Resource Base View* and the *good management theory* corporate social activities can add both tangible and intangibles assets to the firm like reputation. (Esteban-Sanchez, et al., 2017; Tang, et al., 2012)

Despite empirical research on this field started at the beginning of the 1970s (Miras-Rodríguez, et al., 2015), the considerable number of studies, no clear consensus has yet been reached on the nature of this relation and results vary from negative, inconclusive or positive relationship with a predominance of the last one. (Fischer & Sawczyn, 2013)

Griffin and Mahon (1997) in their review found that the number of studies in favour of a positive relationship between CSR and CFP was the majority. In addition to that the authors identified three main issues in the 51 articles they analysed published in the period between 1970s and 1990s: the use of multi industry samples, the disagreement on the measure used for measuring corporate financial performance and the difficulties in measuring corporate social responsibility. With respect to the first one the authors stated that a possible motivation for divergences in results is the use of samples containing companies from different industries. Every industry has its uniqueness, internal and external pressures and relevant topic, thus the multi-industry samples may "mask individual differences"[56] Looking at the second problem, the authors found that over the years every researcher has chosen arbitrarily the way of measuring financial performance and for this reason "it is difficult to develop validity or reliability checks for most of the financial measures."[57] Lastly, in order to solve the third issue they used five different sources of information to construct their CSR measure. (Griffin & Mahon, 1997) The last consideration made by the authors was that early empirical investigations often presented the defect of focusing only on one dimension, like environment, neglecting all the others. (Simpson & Kohers, 2002)
Despite the major improvements in recent years, "questions about the efficacy of empirical research on the CSP-FP link remain"[58] due to the lack of a unique theoretical framework. (Miras-Rodríguez, et al., 2015)

The survey of Griffin and Mahone stops at studies of the 1990s therefore, despite it represents an important job used as a reference by many other authors, it can currently be considered old. For this reason, we will make our own short literature review comparing some relevant studies.

[56] (Griffin & Mahon, 1997, p. 10)
[57] (Griffin & Mahon, 1997, p. 11)
[58] (Simpson & Kohers, 2002, p. 98)

Positive relationship

The two main theories that sustain a positive relationship between CFP and CSR are the *social impact hypothesis* and the *trade-off hypothesis.* The former assumes that a positive economic result can be achieved when there is a coincidence between the company's actions and stakeholders' interest. Contrary to the first, the second theory states that the cost of social and environmental initiatives exceed its benefits. (Miras-Rodríguez, et al., 2015)

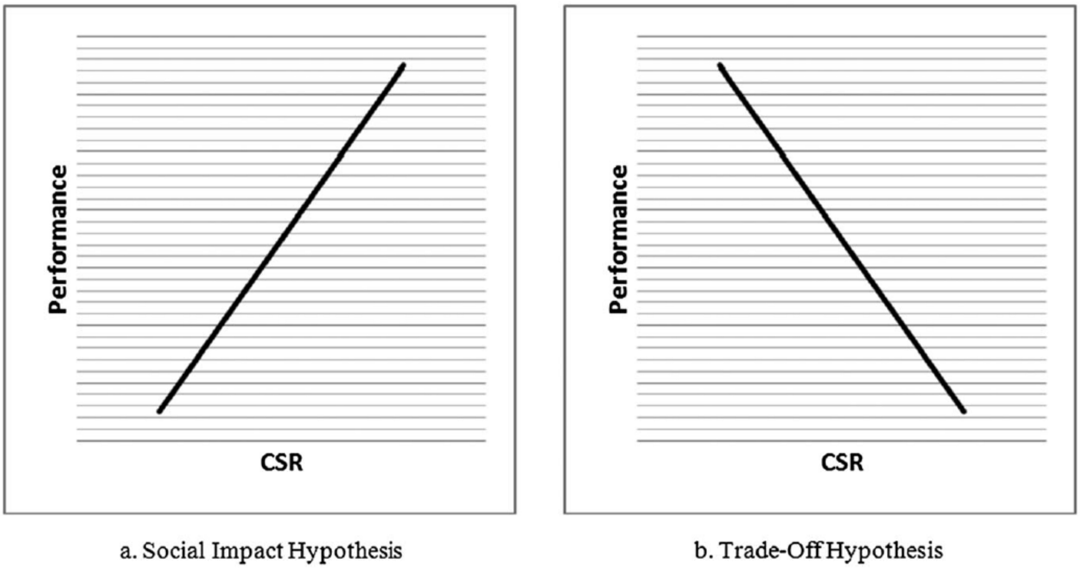


Figure 20: CSR/Performance relationship. Source: (Miras-Rodríguez, et al., 2015, p. 822)

Tang, et al. in 2012 conduced a research using Morgan Stanley Capital International (MSCI) data for the seven major CSR dimensions (corporate governance, diversity, employee relations, community, environment, human rights and product) while the financial data were obtained from the Compustat database. The final sample was made of 130 firms observed during the period 1998-2007. Their research question was to investigate if the pace, consistency, relatedness and path of CSR alter the CSR-CFP relationship. First of all, authors confirm that ROA has a positive relationship with CSR and thus corporate social activities positively affect profit. Moreover, the study finds out that "when a firm engages in related rather than unrelated CSR dimensions, the positive contribution of CSR to ROA will be enhanced[59]." It is important to focus on one dimension at a time and to choose related dimensions so as not to squander the financial resources of the firm. Also, the consistency of the approach is important and in fact an inconsistency approach to CSR will hurt firm performance and disrupt the learning process highlighting as occasional CSR activities are counterproductive for companies. The best approach to CSR, according to the authors, is to start from internal CSR rather than external

[59] (Tang, et al., 2012, p. 1290)

activities and to master those first. The main internal dimensions are Governance, Employee relations and Diversity and these can improve financial performance as well. (Tang, et al., 2012) The findings of Tang et al. (2012) were supported also by the study of Michelon, et al. in 2013. Michelon, et al. examined 188 companies between 2005 and 2007 using KLD Social Ratings as a proxy for seven areas of CSR. Their research objective was to understand whether CSR activities that are closely related to stakeholders' interests could influence financial performance. Most of the time companies have limited resources to spend on CSR activities, thus directors should channel firm's funds based on the preferences of the most relevant stakeholders. In this context, CSR activities become real strategic investments because they may led to future potential growth. From the panel data analysis emerged that employee and diversity-related activities are positively associated with financial performance measures. In conclusion the authors stated that "[…] merely participating in social issues leads to diminished financial outcomes, while corporate social initiatives directly tied to the preferences of stakeholders may not only benefit stakeholders but also increase shareholder wealth." [60]

Negative or Neutral relationship

The second possible relationship between CSR and CFP that some authors found is a negative relationship supporting the view proposed by Friedman in 1970. (si veda Galant & Cadez, 2017, p. 676) Cardamone, et al., in 2012 used a sample of 178 Italian companies listed on the Milan Stock Exchange to investigate whether the information reported in the sustainability report are valuable for investors and can influence stock price. In order to do so, they included in their regression model a dummy variable equal to 1 if the company issues sustainability reports and 0 otherwise. Surprisingly, they found that "the stock price of a company that publishes a SR is €2.5 lower than that of a company that does not."[61] The authors put forward two possible explanations to this: first of all the drafting of sustainability reports may be seen as a waste of resources that the company could have dedicated to its core activities. Secondly, the investors may not like the content of the sustainability reports. (Cardamone, et al., 2012)

McWilliams & Siegel (2000) were interested in the nature of CSR/CFP relationship as well, with a particular attention in models' misspecification. Starting from the assumption that many models in literature have been constructed omitting variables related to corporate profitability, they turn their attention to R&D as a control variable. They used KLD data from 524 firms for the years 1991-1996. In their research R&D, CSP and financial performance are strongly

[60] (Michelon, et al., 2013, p. 92)
[61] (Cardamone, et al., 2012, p. 262)

correlated. In the cases when R&D is not included there is an overestimation of the effect of corporate social performance on CFP. Specifically, the authors said that "when R&D and industry factors are added to the model, the magnitude of the (CSR) coefficient diminishes dramatically and is no longer significant. Additionally, the "fit" of the model improves, as shown by the increase in the adjusted R^2."[62] Based on the findings of their investigations, the authors argue that CSR has a neutral effect on financial performance. (McWilliams & Siegel, 2000)

U-shaped relationship

Another kind of relationships that may exist between CFP and CSR is the U-shaped relationship. The non-linear relationship has rarely been considered compared to the linear one but in recent years it is becoming increasingly studied. In addition to the disagreement on the linear or quadratic nature of the relationship between CFP and CSR, there is also no agreement on whether the curve is concave or convex. (Miras-Rodríguez, et al., 2015)

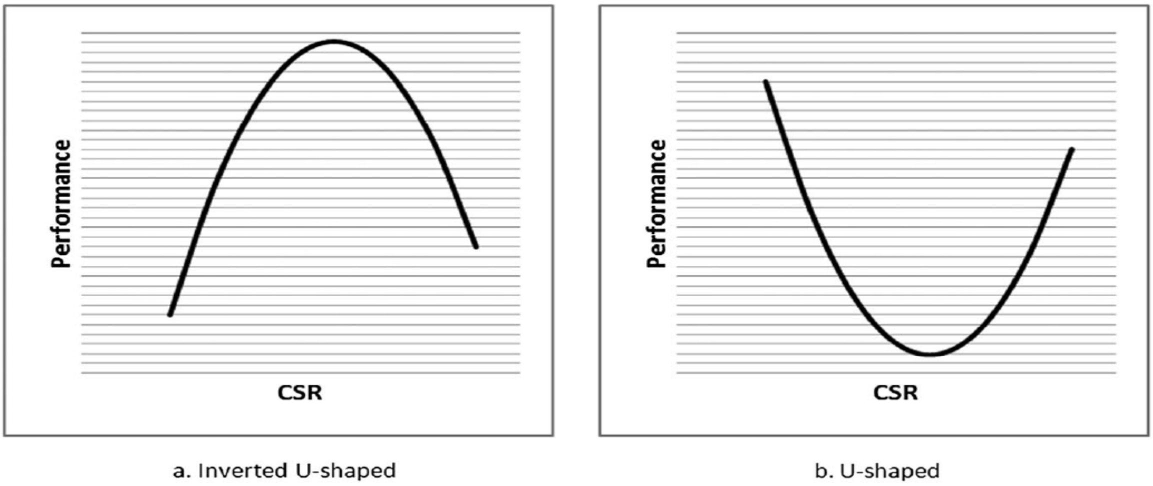


Figure 21: U-shaped relationship. Source: (Miras-Rodríguez, et al., 2015, p. 822)

Barnett & Salomon (2006) in their study investigated the nexus between financial and social performance in SRI funds and their conclusion was that "even though social screening forces a narrowing of investment choices, if adequately implemented, social screening can lead to an increase in financial returns".[63] What scholars found was that those funds that applied a greater number of social screening criteria ended up achieving better financial performance. What is more, also funds that chose to use a little number of social screening criteria obtained improvements in financial performance from increased diversification. Only those funds in the middle that adopted an ambiguous policy couldn't better their performance. What emerges is

[62] (McWilliams & Siegel, 2000, p. 607)
[63] (Barnett & Salomon, 2006, p. 1117)

that funds must adopt an "all or nothing" approach because the relation between CFP and CSR is U-shaped. (Barnett & Salomon, 2006)

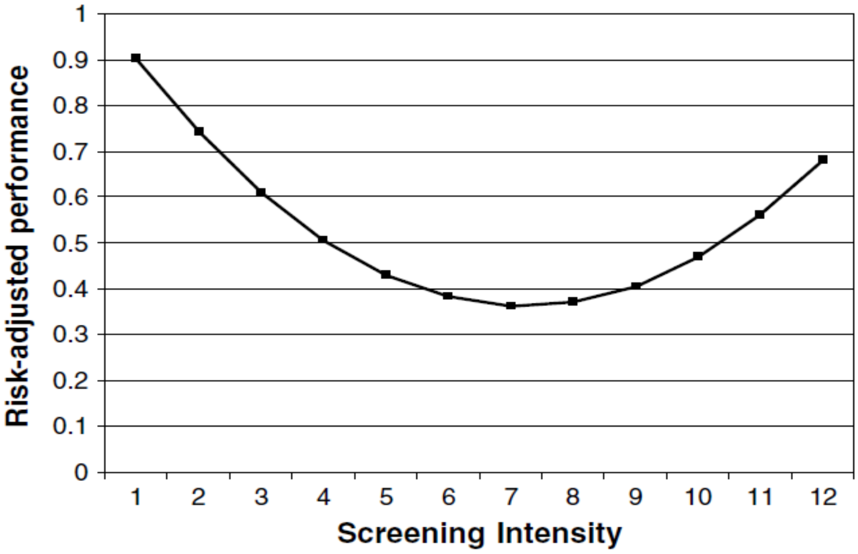


Figure 22: U-shaped relationship in SRI funds. Source: (Barnett & Salomon, 2006, p. 1115)

Motivated by the work of Barnett and Salomon, also other authors started to investigate the non-linear relationship between CFP and CSR. Nollet, et al. in 2016 started from Barnett and Salomon and using the Bloomberg's Environmental Social Governance (ESG) Disclosure score, tested the validity of their conclusion observing firms from the S&P500 between the years 2007-2011. The authors stated that "[…] CSR engagement does not pay off immediately, but only after a crucial point of CSR investment is crossed."[64] The most important news in their study is that only one of the three dimensions of the CSR, the governance, followed an U trend while for the other two no meaningful relationship was found. The managerial suggestions of Nollet et al. were the development of a long-run planning and the dedication of an adequate amount of resources to CSR initiatives. (Nollet, et al., 2016)

Callan & Thomas (2009) noted that "linearity is typically assumed in the CSR literature, which may be a shortcoming that generates biased results"[65] and for this reason they used nonlinear specifications for all the size control variable. They study examined data from 441 firms using KLD data for the year 2004-2005. In order to make their study more complete they used four measures for corporate financial performance, ROE, ROA, ROS and Tobin's Q. In addition to that, they paid much attention to control variables to include those that in the literature are identified as the most significant. First, they confirm the existence of a positive relationship between CFP and CSR independently of the measure used for CFP. Firms are encouraged to not look at CSR and CFP as opposed and competing goals; they suggest that a firm may benefit

[64] (Nollet, et al., 2016, p. 401)
[65] (Callan & Thomas, 2009, p. 67)

from its social actions if those are rewarded by key stakeholders. In addition to the linear model, the authors test a quadratic relationship between CFP and control variables. They find that "total assets are quadratically related to financial performance in both the ROS and ROA models."[66]

Lastly, we found interesting also the study conducted by Miras-Rodríguez, et al. in 2015 that focused on 89 electrical companies located in 26 countries. The main reason that led the authors to turn their attention to this sector was the high environmental impacts of these companies and their strategic role in developing countries. Their social actions are usually labelled as "greenwashing" and attempts to gain legitimization and improve their reputation rather than aimed by true values. Authors tested four different models considering both the linear and the curvilinear approach and considering CSR both as an aggregate measure and in all its six components. They found that for electronic companies the relationship is better explained by a U-shaped curve. Moreover, in the regression models proposed, each separate measure had a different impact on financial performance. Especially, it does not exist a relationship between the environmental measure and profitability meaning that the great commitment that electric companies put in these activities is motivated by legitimization and reputational goals. Dimensions that instead have an impact on ROA were actions oriented to community, diversity, corporate governance and product responsibility.

Summery tables

The table below shows all the studies that were analysed in the short literature review divided according to the type of relationship they found. What is particularly visible is how many scholars share the idea of a positive relationship or a quadratic relationship between CSR and CFP.

Positive relationship	**Negative or Neutral Relationship**	**U-shaped relationship**
Tang, et al., 2012	Cardamone, et al., 2012	Barnett & Salomon, 2006
Michelon, et al., 2013	McWilliams & Siegel, 2000	Nollet, et al., 2016
		Callan & Thomas, 2009
		Miras-Rodríguez, et al., 2015

Table 8: Short literature review on CSR-CFP relationship. Source: own elaboration.

A short summery of all of them is reported in the additional table below.

[66] (Callan & Thomas, 2009, p. 76)

Authors	**Years considered in the study**	**Main investigation subject**	**Conclusion**
(Barnett & Salomon, 2006)	1972- 2000.	CFP-CSR relation in a panel of 61 SRI funds	U-shaped relationship
(Nollet, et al., 2016)	2007-2011	S&P500 firms. Bloomberg data for ESG.	U-shaped relationship in the quadratic model.
(Miras-Rodríguez, et al., 2015)	2008-2011	Worldwide sample of electric companies in 26 countries. The aim is to investigate the reasons that drive companies to act in a socially responsible way.	U-shaped relationship confirmed.
(Tang, et al., 2012)	1998-2007	CFP-CSR relation; how peace of adoption, relatedness of CSR activities, consistency and the path affect the outcome. Sample of 130 firms from different sectors. ESG data from MSCI	Positive relationship between ROA and CSR.
(Cardamone, et al., 2012)	2002-2008	Value relevance of social reports for investors and impact of social information on firm's value. Sample of 178 Italian companies.	Negative correlation between sustainability reports and stock price.
(Michelon, et al., 2013)	2005-2007	188 companies using KLD ratings to investigate whether targeted CSR activities can influence performance.	Positive relationship of employee and diversity related initiatives with CFP measures. Environmental dimension showed a negative association with intangibles and human rights a negative association with capital expenditure. CSR initiatives base on stakeholders' preferences enhance CFP.

(Callan & Thomas, 2009)	2004-2005	441 firms. Four accounting dimensions were used: ROA, ROE, ROS, Q ratio. KLD data. The goal was to present an undated study on CSF-CSR using both a linear and a quadratic model.	positive CSP–CFP relationship and that some of the control variables are quadratically related to CFP.
(McWilliams & Siegel, 2000)	1991-1996	KLD data from 524 firms. The authors tested the importance of R&D as control variable in the CSR/CFP relation.	When models are properly specified, and R&D is included as a control variable then there is a neutral effect of CSR on CFP.

Table 9: Detailed summary of the literature review. Source: Own elaboration.

What about the banking sector? Review of the literature

The studies we have analysed so far are extremely useful as a starting point for the understanding of the CSR-CFP relationship nature. However, this research is focused on the banking sector and for this reason in this section the literature review has been further refined looking only at studies that deal with the banking sector. In comparison with researches that consider multiple sectors, empirical evidence for the banking industry alone is rare.

Proceeding in chronological order, in 2002 Simpson & Kohers analysed a sample of 385 U.S. commercial banks. Authors' choice to focus on the banking sector was guided by the abundance of studies on CSR-CFP relationship which used mixed samples from multiple industries while, in their opinion, "unique characteristics of an industry make the nature of CSP unique based on different internal characteristics and external demands"[67]. In the study they used ROA and Loan Losses/ Total Loans as accounting-based measures of CFP. CSR was measures starting from the ratings introduced in U.S. by the Community Reinvestment Act of 1977 for every commercial bank. These ratings were originally thought to prevent lending discrimination, but they included many concerns about community problems thus they can be considered as an indicator of banks' social responsibility toward community wellbeing. The study confirmed the existence of a strong positive relationship between CRA ratings and corporate financial performance in U.S. banks signalling that bank's actions in favour of the community ultimately improved its performance. (Simpson & Kohers, 2002)

[67] (Simpson & Kohers, 2002, p. 99)

A more recent and interesting study is the one of Wu and Shen (2013). The authors took up the questions advanced previously by Simpson & Kohers in 2002 and used them as a starting point. They worked on global banking data with a sample of 162 banks from 22 countries, considering the period 2003-2009. The authors stated that there are mainly three reasons why corporates engage in CSR: *altruism, strategic choices* and *greenwashing*. In their study banks are classified into four types with a rank that goes from 1 to 4 based on their degree of engagement in CSR, which was assessed by EIRIS[68]. This choice allows the authors to include not only "best-in class" banks but also banks with a medium level of CSR. The CSR index used in the research is constructed starting from the EIRIS database and in its final form it is a four-point scale. Financial performance instead was quantified using five measures: ROA, ROE, Non-Performing Loans, Net Interest Income and Non-Interest Income. The results show a significant and negative effect on NPL and a positive effect of CSR on ROA, ROE, NII and NonII, supporting the hypothesis that CSR improves performance. "When a bank engages in CSR, although costs increase, revenues increase even more.[69]" From the results of the regression model the authors completely exclude the greenwashing motive in favour of the strategic and altruistic ones with the strategic motive being the strongest among the two. Banks with higher CSR scores can attract more creditworthy borrowers, achieving higher earnings and asset quality. In addition to that, strategic CSR con increase customers' loyalty, build reputation and increase differentiation, gaining in this way customers from competitors. (Wu & Shen, 2013)

Regarding the banking industry, also Esteban-Sanchez, et al. in 2017 were interested in the understanding of which CSR dimension could have the greatest impact on CSF and, how CSR practices were perceived by stakeholders during the crisis. Their study used a sample of 154 financial entities from 22 countries and covered a six-year period from 2005 to 2010. In this case CFP was measured using ROA and ROE while CSR was represented using four CSR dimension: corporate governance, relations with employees, relations with community and product responsibility. Their study did not consider the environmental dimension for banks. What is interesting about their work is that they included also the moderating effect of crisis using a dummy variable: 2005-2007 were pre-crisis years while 2008-2010 were crisis years. From the regression model emerged that corporate governance and relations with employees had a positive effect on both ROA and ROE while relations with community had a non-clear effect on financial performance. Finally, product responsibility may exercise a negative effect on CFP. According to the authors, shareholders and employee may be identified as the most

[68] EIRIS - Ethical Investment Research Service
[69] (Wu & Shen, 2013, p. 3540)

strategical stakeholders in the banking industry. With respect to the crisis variable, the direct effect was null, but the moderating effect was found to be significant. Crisis negatively moderated the effect of Corporate Governance on CFP suggesting failure in corporate governance mechanisms but positively moderated the effect of Relations with Community. This last result may suggest that CSR activities helped banks to regain reputation after the critical crisis phase. (Esteban-Sanchez, et al., 2017)

In the same year also Forcadell & Aracil (2017) conduced an empirical research on the performances of European banks listed in the DJSI. In their study the dependent variable was only ROA while the CSR variable was a dummy variable with the value of 1 if the bank belonged to the DJSI in a given year and 0 otherwise. The authors were also interested in testing the effect of crisis on the financial performance of banks engaged in CSR; in order to do so they considered the years 2003-2007 as pre-crisis and 2008-2013 as crisis including an interaction term between CSR and year dummies. The results of the panel data analysis showed that CSR had a positive effect on ROA. With respect to crisis, banks engaged in CSR activities during the crisis years were not rewarded with a higher ROA. As a confirmation of that the authors used also a rolling window model to control the changes of the crisis effects over time. From this test emerged that from 2003 to 2008 the effect of CSR on ROA was positive and significant while from 2009 to 2013 it was negative. (Forcadell & Aracil, 2017)

The last study that we will examine is the one of Gangi, et al. (2019) that investigated the relationship between CSR and CFP from a knowledge-based perspective. The conceptual framework on which the study is based distinguishes between *internal CSR* and *external CSR*. Internal CSR regards employees and their management: a good level of employee attention can result in higher information sharing, cooperation and learning, ultimately creating a competitive advantage of the bank over those that do not pay enough attention to employees' wellbeing. External CSR regards community, customer relations, environmental and human rights and the authors also call it citizenship performance. Citizenship performance has the power to influences banks' image and reputation which can generate better financial performance. Starting from this conceptual framework the authors conduced an empirical analysis on a panel of 72 banks from 20 European countries focusing on the years 2009-2015. CSR performance was represented using two variables: *internal CSR*, that was the average of employment quality, training and development, diversity, health and safety, and *external CSR* that was the average of community, customers relations, human rights, environment. Data were taken from Thomson Reuter Datastream. For financial performance the authors used Net Interest Income/Total Assets, Intermediation Margin/Total Assets, NPL/Total Asset and NPL (avg. 5 years)/Equity.

From the first regression model, with citizenship performance as dependent variable and internal CSR as independent variable, emerged that higher level of internal CSR at t-1 resulted in higher citizenship performance at t. From the second regression with financial performance as dependent variable and external CSR as independent variable the authors found that external CSR has a positive and significant effect on NII and Intermediation Margin and a negative effect on NPL. Those results indicate that "the higher the overall level of bank engagement in CSR activities directed toward the community, the human rights and the environment, the higher its financial performance [and] the better its credit allocation"[70] (Gangi, et al., 2019)

What clearly emerges from this literature review is that many authors agree on the existence of a positive relationship between CSR initiatives and reputation, relationship with employees and stakeholder in general. Those positive effects reflect on banks financial performance in different ways depending on the variables included.

All the results of this literature review are summarized in the table below.

[70] (Gangi, et al., 2019, p. 125)

Table 10: Summary table of literature review on banking studies. Own elaboration.

Authors	CFP	CSR	Period	Sample	Control Variables	Results
Simpson & Kohers, 2002	1. ROA 2. Loan losses/ Total Loans.	CRA rating: Dummy variable - 0 if CRA rating is "needs improvement" - 1 if the CRA rating is "outstanding"	1993 - 1994	National banks examined for CRA compliance. Final sample of 385 banks.	- Log Total Assets; - Holding company dummy; - Asset per office; - State return on assets; - State personal income; - Population of the city; - Cost of funds; - Capital ratio; - Loan ratio; - Earning assets; - Overhead expenses; - State bankruptcies; - Non-performing assets; - State non-performing assets.	Positive relationship between social responsibility toward the society and financial performance
Wu & Shen, 2013	1. ROA 2. ROE 3. NPL 4. NII 5. NonII	Starting from EIRIS database the authors developed a 4-point scale index for CSR that involves employment, environment, community, human rights, supply chain management, and so on.	2003 - 2009	162 banks, 22 countries.	- Log Total Assets; - Leverage; - Loan to deposit ratio; - Overhead costs/Total income; - Loan loss reserve/NPL; - Institutional factors: restriction on banking activity on securities, insurance and real estate; - Corruption; - Macroeconomic variables.	- CSR positively associates with ROA, ROE, Net Interest Income and Non-interest Income. - CSR negatively associates with Non-performing loans. - Strategic motives drive banks CSR engagement.

Esteban-Sanchez, et al., 2017	1. ROA 2. ROE	ESG measures from Thomson Reuters Datastream.	2005-2010	154 financial entities from 22 countries: - 55 EU banks, - 49 American banks, - 40 Asian banks, - 10 Oceania banks.	- Crisis; - Number of employees; - Leverage. -	- Corporate governance dimension has a positive effect on both ROA and ROE. - Relations with employees has a positive effect on ROA and ROE. - The relations with community dimension have not a clear effect on ROA and ROE. - Product responsibility does not have a positive effect on ROA and ROE.
Forcadell & Aracil, 2017	1. ROA (on avg. assets)	Dummy variable representing the presence of the bank in the DJSI.	2003-2013	18 banks listed in the DJSI.	- Risk as dividend payment; - Logarithm total assets; - GDP annual growth; - Inflation.	- In 2003-2008 CSR positively influenced financial performance. - In 2009-2013 CSR negatively influenced economic performance.
Gangi et al., 2019	1. Net Interest income/TA 2. Intermediation margin/TA 3. NPL/TA 4. NPL/Equity	Thomson Reuters Datastream ESG measures. Internal CSR: - Employment quality - Training and development - Diversity - Health and safety External CSR: - Community - Customers relations - Human rights - Environment	2009-2015	72 banks from 20 European countries	- Leverage - Loan-to-deposits ratio - Size - NPL/Loan Loss Reserve - Degree of restriction on banking activities in securities - GDP per capital - Growth of GDP	- Higher level of internal CSR at time t-1 result in higher citizenship performance at time t. - external CSR has a positive and significant effect on NII and Intermediation Margin and a negative effect on NPL.

Chapter 4 – Preparation for empirical analysis

Which direction of causality?

In parallel with the debate on what is the nature of the CSF-CSR relationship, many scholars discuss also on the direction of causality. In this discussion the main point is on whether CSR is a dependent or independent variable. (Callan & Thomas, 2009)
There are mainly three different causal-effect directions between the two dimensions as outlined in the figure below.

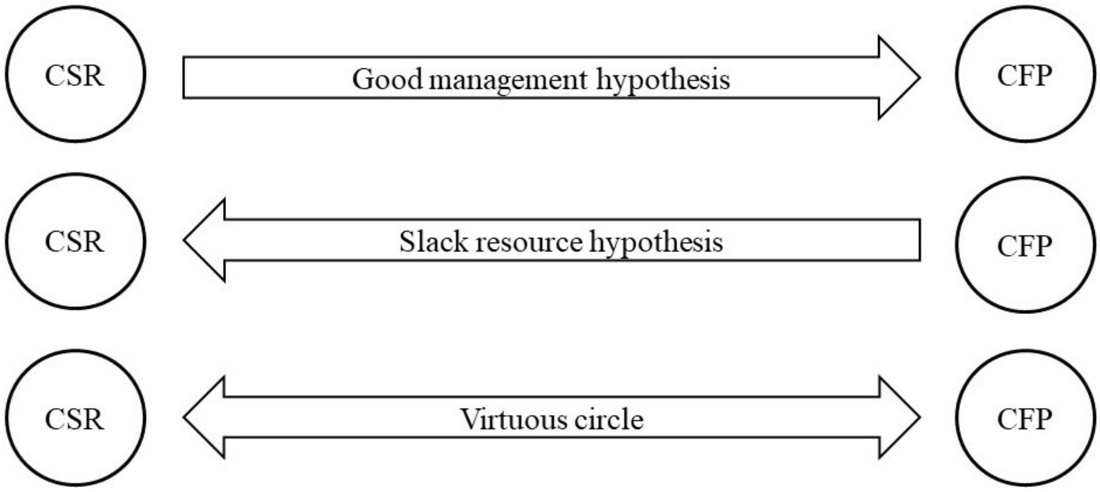


Figure 23: Direction of causality. Source: own elaboration from (Fischer & Sawczyn, 2013)

In the first case, *good management hypothesis*, CSR affects CFP because it helps the firm satisfying stakeholders' needs and improves relations with them, like for example with employees or consumers.
Under the *slack resource hypothesis* is CFP that affects CSR actions undertaken by the firm. In this case the firm engages in CSR actions because it has slack resources.
In the last case, the *virtuous circle*, firms find themselves in a special situation in which they decide to dedicate slack resources to CSR activities, and they obtain a financial benefit from it. Engaging in this kind of activities helps firms gain reputation, improve efficiency, reduce financial risk and thus improve financial performance. Firms enter in a virtuous circle where they get recompensated for their actions. (Fischer & Sawczyn, 2013)
Considering the previous literature review, in our analysis we will postulate that CSR is the independent variable and CFP is the dependent variable.

Dependent variable – Corporate Financial Performance

The dependent variable in our model is corporate financial performance (CFP).
CFP is usually measured with profitability ratios that are standardised and easily obtainable from databases or financial statements. (Galant & Cadez, 2017) There are three main categories

of indicators used to measure corporate financial performance: accounting-based, market-based and a mix of both.

Accounting-based	Market-based	Accounting- and market-based
ROA – return on assets	Stock returns	Tobin's Q
ROE – return on equity	Market value of a company	MVA – market value added
ROCE – return on capital employed	Change in stock returns	
ROS – return on sales		
Net operating income		
Net income		
Zmijewski score		

Table 11: Measures of CFP. Source: (Galant & Cadez, 2017, p. 685)

Starting from *accounting-based measures,* the main reason why researchers choose them is because they are easily available and allow comparability across companies. (Galant & Cadez, 2017) These measures "capture a firm's internal efficiency in some way"[71].

Among those, ROA is the most widespread: it was used in the studies of Tang, et al. (2012), Esteban-Sanchez, et al. (2017), Velte (2017), Griffin & Mahon (1997) and many other.

"Return on assets measures the ability of bank managers to acquire deposits at a reasonable cost, invest these funds in profitable loans and investments, and profitably perform the daily operations of the bank." [72] Following ROA, ROE is the second most common variable used to measure financial performance and it "reflects the profitability of the firm by measuring the investors' return."[73] According to their findings however, Callan and Thomas (2009) suggest that ROE is better suited for long-term analysis. There are also other studies which opted for alternative accounting-based measures, like Michelon et al. (2013) that used EBITDA as a proxy for corporate performance because they considered it less affected by manager's discretionary policy choices. In fact, the main disadvantage of accounting-based measures is that they are the result of managers' decisions being in this way affected by their discretionary and policy choices. (Orlitzky, et al., 2003) For this reason, accounting based measures are often integrated with market-based measures. (Velte, 2017)

Looking at *market-based measures,* the most common ones are stock return, price per share or market value of a company. These measures can be defined as *shareholder centred*. (Orlitzky, et al., 2003) Their main advantage is contemporariness because they reflect the market responses. On the other hand, the main disadvantages are that they are available only for listed companies and they reflect systematic market characteristics because they are connected to the market. (Galant & Cadez, 2017) Michelon, et al. (2013) chose to use company market value as a market-based measure stating that it can reflect tangibles and intangibles gains that may occur

[71] (Orlitzky, et al., 2003, p. 408)
[72] (Simpson & Kohers, 2002, p. 104)
[73] (Griffin & Mahon, 1997, p. 17)

during the year. Other studies use the Tobin's Q ratio. Tobin's Q is usually defined as the ratio of market value to the replacement cost of tangible assets. Since the replacement cost of tangible assets its difficult to define, Tobin's Q ratio is generally approximated in different ways. Velte (2017) approximated it as the ratio between the market values of firm's equity including liabilities to the book value of equity and liabilities. (Velte, 2017) Andersen and Dejoy (2011) used a measure constructed as market value/total assets that was closely related to Q ratio but was easier to calculate while Callan and Thomas (2009) use Tobin's q in their investigation but they suggest that further research is needed on this ratio due to its complex construction and comprehensive nature.

Seen all these, in this study firm financial performance will be measured with ROA and ROE as accounting-based measures. This choice was motivated by all the reasons explained so far and because these measures are widespread among studies allowing comparability of results. In addition, to also consider market-based measure we will used Market value/ Total Assets.

Independent variable – Corporate Social Responsibility

The independent variable in this study is a measure that expresses the company's level of corporate social responsibility. The main problem here lies in the choice of how to operationalise and measure this variable. (Galant & Cadez, 2017) The absence of a universal definition of CSR, has worsened the measurement problem. In addition to that, the variety of data used by researchers to assess CSR and the large number of theoretical approaches have generated lots of ambiguity. (Igalens & Gond, 2005) The most recurrent methods used are:

i. reputation indices
ii. content analyses
iii. survey
iv. one-dimensional measure. (Galant & Cadez, 2017)

Starting from the first one, some of the most famous reputational indices are MSCI KLD 400 social index, Dow Jones Sustainability index, and Thomson Reuters ESG index as we discussed previously. These indices are "data produced by agencies specialised in the assessment of Socially Responsible Corporate Behaviour".[74]The main reason why these are the most used kind of measures is because they can capture the multidimensional nature of CSR. In addition to that, data availability and comparability across firms make them even more appealing. (Galant & Cadez, 2017) The main disadvantage of using these indices is that they can be

[74] (Igalens & Gond, 2005, p. 135)

influenced by the personal agenda of private companies that compute them. Moreover, these indices do not always have a wide geographical or industry coverage; an example of that is MSCI KLD 400 which considers only USA firms. (Galant & Cadez, 2017)
Despite that, KLD ratings are widely used in research and in fact, they can be found in the studies of Michelon, et al. (2013), Andersen & Dejoy (2011), Callan & Thomas (2009), McWilliams & Siegel (2000) and many others.

Looking at the second most common instrument used to measure CSR, it is content analysis. Content analysis is a less complex way of constructing a CSR measure than reputational indices. In this case what researchers do is to carefully analyse the sustainability reports content by counting words or phrases and assigning binary variables if a topic is adequately reported in them. In more advanced content analyses models, not only 0 or 1 indicators are used but also scales that can vary from 0-3 or 0-5. As with every measure also in this case there are advantages and disadvantages: the main advantage is flexibility because every researcher can create his own set of relevant topics and search out for them in the reports. In contrast, the main disadvantage is the lack of information because companies are not obliged to provide comprehensive sustainability reports; moreover, there is also the problem of research subjectivity. (Galant & Cadez, 2017; Igalens & Gond, 2005; Orlitzky, et al., 2003)

The last two methods, survey and one-dimension measure, are less used. The survey method is chosen for unrated companies and in this case the missing information are obtained directly by the managers in charge of this aspect. The one-dimension measure is used when the research is focused only on one aspect, but this usually leads to specification problems since CSR is a multidimensional concept. (Galant & Cadez, 2017) The most common one-dimension measure is environmental activity. (Callan & Thomas, 2009)

Igalens & Gond (2005) identified two additional operationalisation modes for CSR: pollution indices and corporate reputational indicators. With respect to pollution indices they are measurements produced by independent State entities like the Toxic Release Inventory (TRI) of 1986. TRI is made of self-reported information about environmental discharges to the water, air and landfills and limits for the pounds of each chemical were set. (Griffin & Mahon, 1997) The disadvantage of these kind of measure is that they take into consideration only one side of CSR and are biased by external subjectivity. (Igalens & Gond, 2005)
Speaking instead about reputational indicators one of the most famous is the Fortune reputation survey. “Senior executives, outside directors, and financial analysts rate the ten largest

companies in their own industry on eight attributes of reputation, using a scale of zero (poor) to ten (excellent).[75]"

Regardless of which method you choose, measuring CSR always remains challenging because of its multidimensional nature. (Nollet, et al., 2016) Many past studies used a unidimensional aggregated measure of corporate social activities but recently this approach has been questioned. In fact, in order to understand more deeply which are the key drivers CSR it should be decomposed into its main components. (Nollet, et al., 2016)

Considered all the reasons outlined so far, in this work we will use Datastream ESG data. These ratings of CSR have been previously used also by other studies like Patrick Velte (2017) and Miras-Rodríguez, et al. (2015). The main reasons that led to this choice was to not bias the investigation with personally constructed measures of CSR. CSR will be decomposed in its three main components, Environmental, Governance and Social: for each of them there is an individual score obtained as a weighted average of many ESG scores. The scoring system ranges from A+ to D- but it is available also as percentiles. This choice was fuelled by the consideration of Miras-Rodríguez, et al. (2015) who disagreed with the use of a single point construct measure that aggregates unrelated aspects. Depending on their sector, companies can decide to channel their efforts on specific aspects of CSR without considering all of them.

Lastly, although some authors like Esteban-Sanchez, et al. (2017) did not consider the environmental dimension because banks do not particularly contribute to pollution, in our investigation we decided to scrutinize also this aspect for a more comprehensive approach.

Control variables

Over the years and with research proliferation in this field, scholars have succeeded in creating increasingly complex models including several factors used as control variable. (Andersen & Dejoy, 2011) "Without the inclusion of variables that may influence a firm's financial performance, estimated parameters on CSP will necessarily be biased."[76] The use of control variable is essential to get reliable results. (Callan & Thomas, 2009)

Company size has been one of the first control variables used and it is certainly the most common. (Andersen & Dejoy, 2011) Barnett & Salomon (2006) used *total assets* as a control variable in their research; also Velte (2017) used the natural logarithm of total assets for the control variable size. Nollet, et al., 2016 instead uses sales revenue as a proxy of size while Michelon et al. (2013) and Esteban-Sanchez, et al. (2017) chose the natural logarithm of the

[75] (si veda Griffin & Mahon, 1997, p. 14)
[76] (Callan & Thomas, 2009, p. 63)

number of employees. As it is visible there is not one single global measure for size but what it is commonly agreed is that size can influence CSR initiatives. Cardamone, et al. (2012) found that CSR is more frequent in large company because they have higher resources that can be dedicated to it and also because they are exposed to a closer scrutiny by external stakeholders. In addition to that, large companies can use economies of scale or scope for the implementation of CSR initiatives. (Michelon, et al., 2013)
Considered all that in our study we will approximate size as the natural logarithm of total assets.

Following company size, the second most common control variable in literature is *industry*. (Andersen & Dejoy, 2011) Griffin & Mahon (1997) were probably the first to identify it as necessary stating that "individual industries operate within distinctively different contexts and with dissimilar social and environmental concerns, and patterns of stakeholders involvement and activism."[77] Authors supposed that studies in which a sample of multiple companies is used could mask the true effects of CSR on financial performance. For this reason, there are studies like that of Miras-Rodríguez, et al. (2015), that focus only on one single industry.
Despite that, since our sample contains only companies from the banking and financial service sector, we do not need a dummy variable to control for industry effects.

Another common control variable is *risk*. (Andersen & Dejoy, 2011) Risk can be measured in different ways including firms leverage. Firm leverage is commonly used to control for firms' specific characteristic. Debt is usually a proxy of unsystematic risk that can influence firms' financial performance. (Velte, 2017) As Andersen and Dejoy (2011), Miras-Rodríguez, et al. (2015) and Fischer & Sawczyn (2013) did in their studies, in our analysis risk will be approximated as the ratio of total debt to total assets.

Two supplementary variables have been lately identified as potential control variables: *research and development* and *advertising*. The core reason why these two should be included in the model is because they represent discretionary expenditure that can impact the CSP-CFP relation through their effect on profitability. (Andersen & Dejoy, 2011) Firms engage in *R&D expenses* because they believe that they are going to benefit firm's productivity and in turn long-term economic performance. (Callan & Thomas, 2009) In the same way advertising can enhance product differentiation and impact profit. (Callan & Thomas, 2009) Once understood the importance of CSR-driven R&D, advertising costs are the tool with which companies present

[77] (Griffin & Mahon, 1997, p. 25)

their sustainable products to consumers, so their inclusion in the model is very important. (McWilliams & Siegel, 2000)

Unfortunately, in our dataset the costs associated with research & development and advertising were not available because they were incorporated in the voice “other non-operating expenses” that included expenses from several sources; for this reason it was impossible to distinguish them from the total amount. The absence of them as control variables may be a limitation in the results of this study.

The table below shows the variables selected and discussed so far and gives the reference to some empirical studies where they were used before.

Variable	Source	Used in literature
ROA	Datastream	Esteban-Sanchez, et al., 2017; Forcadell & Aracil, 2017; Miras-Rodríguez, et al., 2015; Nollet, et al., 2016; Simpson & Kohers, 2002; Tang, et al., 2012; Wu & Shen, 2013.
ROE	Datastream	Esteban-Sanchez, et al., 2017; Wu & Shen, 2013.
$\frac{MARKET\ VALUE}{TOTAL\ ASSETS}$	Datastream	Andersen & Dejoy, 2011; Michelon, et al., 2013.
ESG	Datastream	Esteban-Sanchez, et al., 2017; Gangi, et al., 2019; Nollet, et al., 2016.
Environment	Datastream	Esteban-Sanchez, et al., 2017; Gangi, et al., 2019; Nollet, et al., 2016.
Social	Datastream	Esteban-Sanchez, et al., 2017; Gangi, et al., 2019; Nollet, et al., 2016.
Governance	Datastream	Esteban-Sanchez, et al., 2017; Gangi, et al., 2019; Nollet, et al., 2016.
Controversies	Datastream	Esteban-Sanchez, et al., 2017; Gangi, et al., 2019.
Size	Datastream	Forcadell & Aracil, 2017; Simpson & Kohers, 2002; Tang, et al., 2012; Wu & Shen, 2013.
Leverage	Datastream	Callan & Thomas, 2009; Esteban-Sanchez, et al., 2017; Nollet, et al., 2016; Wu & Shen, 2013.
NII/total assets	Datastream	Gangi, et al., 2019; Wu & Shen, 2013.

Table 12: Variables and sources. Source. own elaboration.

Panel data

The nature of this work requires panel data analysis, thus before starting the implementation of the empirical analysis, in this section some basic concepts will be clarified.

Panel data is a combination of cross-sectional data and time series data.

- *Time series data* is data collected at equally spaced time intervals and it follows one subject's changes over time.
- *Cross section data* is information about different entities (cities, countries, etc) but for a single point in time. Cross-sectional data is collected by observing many subjects at the same point in time.

In panel data the same cross-sectional components get repeated over time.

The basic Regression Model for Panel Data is:

$$Y_{it}=\beta_{0it}+\beta_{1it}X_{1it}+\beta_{2it}X_{2it}+\ldots+\beta_{kit}X_{kit}+e_{it}.$$

where:

- Y_{it} is the dependent variable for the i-cross-sectional unit and for t time unit;
- β_{kit} is the coefficient of k independent variable in the model related to i-cross sectional unit and t time unit;
- e_{it} is the error term related to i-cross sectional unit and t time unit.

Panel data can be categorised in two types: balanced and unbalanced panel data. A panel data is balanced when there is not missing information for any entity or any time period. Contrary, a panel data is unbalanced when there is information missing.

The special feature of panel data is that they allow control over variables that are not observable or measurable in cross sectional analysis alone, like cultural or ethical elements. Panel data also account also for individual heterogeneity.

Given its characteristics, there will be problems in applying OLS to panel data because there are correlated error terms that violate one of the main assumptions of OLS. In panel data errors terms are most likely to be correlated.

OLS: $Y_i=\beta_0+\beta_1X_1+e$

Panel: $Y_{it}=\beta_{0it}+\beta_{1it}X_{1it}+\beta_{2it}X_{2it}+\ldots+\beta_{kit}X_{kit}+e_{it}.$

In panel data studies there are three different models:

- ***Pooled OLS regression:*** in this model there is no heterogeneity or individuality in cross sectional units like in different firms, countries or states. The estimation is done with OLS and the analysis is like cross sectional analysis when you ignore the time component. It assumes uniform error variance across different cross sections. This technique is not particularly suitable for panel data because usually it bad fits to data. There are better models that allow to have higher R-squares.

- ***Between estimation:*** it calculates the average of the dependent and independent variable over time and does the OLS regression of the former on the latter. What we do is to simply take the average over time so that we have only the cross-sectional components. By doing so we do not have data for the i-years but only for the average of the i-years. Still this are not the best estimations that can be used.
- ***First difference estimation:*** here we start exploiting some features of the panel data. This model finds the association between the individual specific changes in the dependent variables. The regression is done by taking the first differences: it lags the individual-specific variables by one period and takes the difference between the two equations. Thus, individual heterogeneity is eliminated from the model.
- ***Fixed effect model:*** With this kind of model we assume that an individual-specific characteristic may influence or bias the predictor or outcome variables and we need to control for this. This model allows heterogeneity or individuality among all the cross-sectional units by allowing to have its own intercept that is different for every cross-sectional unit but does not vary over time. It treats the unobserved individual heterogeneity (α_i) for each entity as it is correlated with the explanatory variable (X_{it}). Thus the basic assumption is that Corr(α_i, X_{it}) $\neq$0. Fixed effect estimation involves a transformation to remove the unobserved effect α_i prior to estimation.

  Original model: $Y_{it}= \beta_i X_{it} + \alpha_i + u_{it}$ with t=1,2,..,T.

  On average: $Y_i= \beta i X_i + \alpha_i + u_i$ with t=1,2,…,T.

  Subtracting these two equations: $(Y_{it} – Y_i) = \beta_i (X_{it} – X_i) + (u_{it} – u_i)$ with t=1,2,…,T.

  By subtracting the two the unobserved effect α_i will get cancelled and we obtain the time-demeaned Y, X and u.

  On the time demented data, we can apply OLS because errors now will not be correlated over time given that now there is only cross-section error. In this case we call it Fixed effect or within estimation.
- ***Random effect model:*** the fundamental difference between the fixed effect estimation and the random effect estimation is that the latter assumes that the individual-specific effects are independent of the regressor meaning that Corr(α_i, X_{it}) = 0. This individual-specific effect is included as the error term. (Baltagi, 2008)

OLS or Random Effect? To decide between a random effect regression and a simple OLS regression we can use the Breusch-Pagan Lagrange multiplier (LM) test. In this test the null hypothesis is that there is no significant difference across cross-sectional units (i.e. no panel effect) implying that the Random Effects model is inappropriate. In case the p-vale is less than 0.05 the null hypothesis in favour of OLS is rejected and the Random effect model is chosen against OLS.

OLS or Fixed Effect? Similarly, the LM test can be used to choose between the fixed effects model or the OLS regression.

Fixed Effects or Random Effects? In this case to select between Fixed effects and Random effects we use the Hausman test. "The Hausman test checks a more efficient model, RE, against a less efficient but consistent model, FE, to see if the more efficient model also gives consistent results."[78]

H_0: random effect model is consistent.

H_1: fixed effect model is consistent.

In case the p-value is less than 0.05 the null is rejected, and the fixed effect method is chosen to model the data. (Baltagi, 2008)

[78] (Tang, et al., 2012, p. 1294)

Chapter 5 – Empirical analysis

Hypothesis

Seen all the literature analysed in the previous sections, we decided to test the positive linear relationship between CFP and CSR. The following hypothesis will be tested.

Hypothesis 1: There is a positive and significant relationship between Corporate Financial performance and ESG score.

Hypothesis 2: There is a linear and positive effect of the Environmental Performance on Corporate Financial Performance.

Hypothesis 3: There is a linear and positive effect of the Social performance on Corporate Financial Performance.

Hypothesis 4: There is a linear and positive effect of the Governance performance on Corporate Financial Performance.

Hypothesis 5: There is a linear and negative effect of the Controversies score on Corporate Financial Performance.

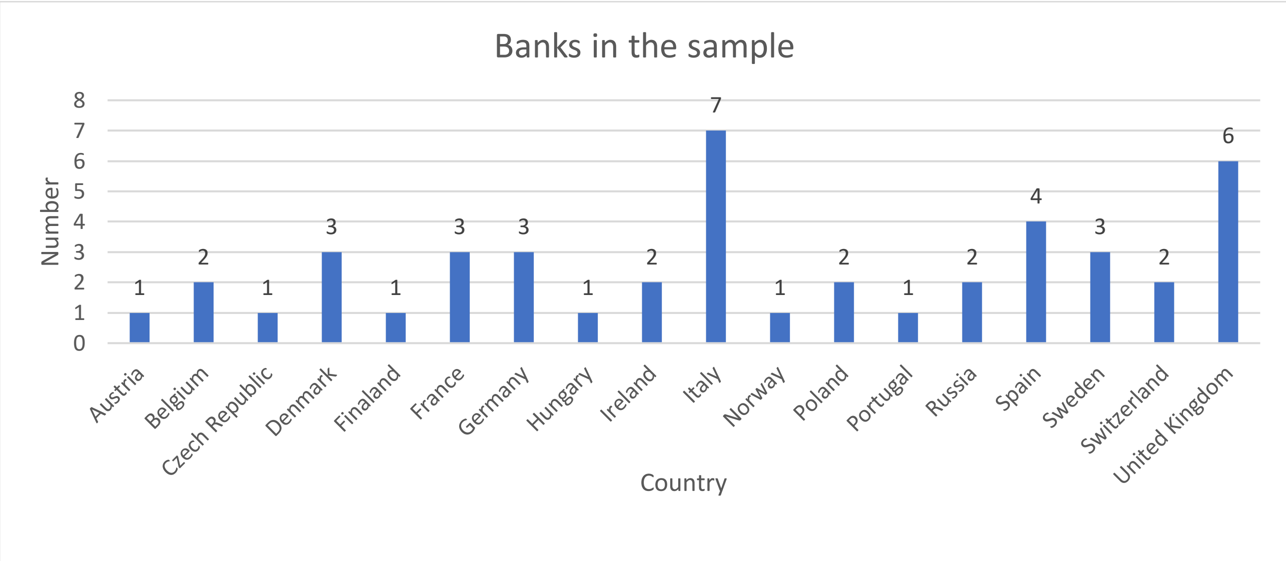
Data description

This work uses annual data of 45 listed companies belonging to the banking sector for the years 2010-2019. The choice of a 10-year time period has been guided by a series of considerations: first, the nature of the survey requires the collection of data over a long period of time. Secondly, the decision to start from 2010 and not to go further back in time takes account of the fact that years like 2009 and 2008 may be increasingly affected by the financial crisis effects and may bias the estimations. In fact, banks are considered primarily responsible for the financial crisis that then spread also to other industries. (Forcadell & Aracil, 2017) As a confirmation of that, some authors decide to include a specific dummy variable for the crisis years like in the research of Esteban-Sanchez, et al. (2017) and Forcadell & Aracil (2017)

Companies were selected from Thomson Reuters database using some filters. First, the study was restricted to European public and private companies. In this study the focus is only on Europe; it was not use a mixed sample with entities from all over the world in order not to obtain mixed results that could be influenced by unique characteristics of each continent. In addition to that, European banks appear more concerned about CSR issues than banks located in other parts of the world. (Forcadell & Aracil, 2017)

Secondly, the filter ICB Supersector "Banks" was applied. ICB stands for “Industry Classification Benchmark” and it is a “detailed and comprehensive structure for sector and

industry analysis, facilitating the comparison of companies." [79] Among all the industries banks were included in the "Financials industry" defined as "companies engaged in savings, loans, security investment and related activities such as financial data and information providers."[80]
The original sample had 254 banks but for some of them there were missing values in ESG scores thus those were deleted. The final sample was made of 45 banks distributed as it is shown in the table below.
Data were obtained from Thomson Reuters database both for financial information and ESG scores.



Country	**Financial institutions**
Austria	- Raiffeisen Bank International AG
Belgium	- KBC Groep NV - KBC Ancora BV
Czech Republic	- Komercni Banka as
Denmark	- Danske Bank A/S - Jyske Bank A/S - Sydbank A/S
Finland	- Nordea Bank Abp
France	- Natixis SA - Societe Generale SA - BNP Paribas SA
Germany	- Commerzbank AG - Deutsche Bank AG - Aareal Bank AG
Hungary	- OTP Bank Nyrt
Ireland	- AIB Group plc - Permanent TSB Group Holdings PLC

[79] (FTSE Russell, 2020, p. 3)
[80] (FTSE Russell, 2020, p. 13)

Italy	- Banca Piccolo Credito Valtellinese SpA - Intesa Sanpaolo SpA - UniCredit SpA - Bper Banca SpA - Banca Popolare di Sondrio ScpA - Banca Monte dei Paschi di Siena SpA - Banco BPM SpA
Norway	- Dnb ASA
Poland	- Bank Polska Kasa Opieki SA - Powszechna Kasa Oszczednosci Bank Polski SA
Portugal	- Banco Comercial Portugues SA
Russia	- Sberbank Rossii PAO - Bank VTB PAO
Spain	- Banco Bilbao Vizcaya Argentaria SA - Bankinter SA - Banco Santander SA - Caixabank SA
Sweden	- Skandinaviska Enskilda Banken AB - Svenska Handelsbanken AB
Switzerland	- Valiant Holding AG - Julius Baer Gruppe AG
United Kingdom	- Close Brothers Group PLC - Natwest Group PLC - Standard Chartered PLC - Lloyds Banking Group PLC - HSBC Holdings PLC - Investec PLC

Table 13: Banks in detail. Own elaboration.

Variables description

Considering the previous literature research and the motivations outlined in chapter 4, in this study are used three different measures for the dependent variable Corporate Financial Performance. The selected measures are ROA and ROE as accounting-based measures while Market value/Total Assets is used as market-based measure.

- ROA = $\frac{Net\ Income}{Total\ assets} * 100$

- ROE = $\frac{Net\ income}{Equity} * 100$

- $\frac{Market\ Value}{Total\ Assets} = \frac{Market\ capitalisation}{Total\ Assets} * 100$

The key independent variable, CSR, is approximated using ESG scores provided by Thomson Reuters database for the Environmental, Governance and Social dimensions. Moreover, the Controversies score variable will be included. The detailed description of the variables used to measure corporate social performance is in the table below.

Variable	Description
ESG	"Thomson Reuters ESG Combined Score is an overall company score based on the reported information in the environmental, social and corporate governance pillars (ESG Score) with an ESG Controversies overlay."
Environment	"The environmental pillar measures a company's impact on living and non-living natural systems, including the air, land and water, as well as complete ecosystems. It reflects how well a company uses best management practices to avoid environmental risks and capitalize on environmental opportunities in order to generate long term shareholder value."
Social	"The social pillar measures a company's capacity to generate trust and loyalty with its workforce, customers and society, through its use of best management practices. It is a reflection of the company's reputation and the health of its license to operate, which are key factors in determining its ability to generate long term shareholder value."
Governance	"The corporate governance pillar measures a company's systems and processes, which ensure that its board members and executives act in the best interests of its long-term shareholders. It reflects a company's capacity, through its use of best management practices, to direct and control its rights and responsibilities through the creation of incentives, as well as checks and balances in order to generate long term shareholder value."
Controversies	"ESG controversies category score measures a company's exposure to environmental, social and governance controversies and negative events reflected in global media."

Table 14:Independent variables. Source: own elaboration from Thomson Reuter Database.

The control variables used are taken from the previous literature review and are *size*, *leverage* and *Net Interest Income/Total Asset*. (Wu & Shen, 2013; Gangi, et al., 2019; Esteban-Sanchez, et al., 2017) Control variables are commonly used to exclude alternative explanations of the model's results and to reduce error. We could not experimentally design the sample to make all the influencing circumstances identical across banks thus we implemented statistical control employing control variables. "Improperly including control variables can produce misleading findings"[81]. These elements directly influence significance levels of the other variables in the model and the estimated size of their effects.(Becker, 2005)

Social engagement by companies is a relatively recent practice and it is very clear that their financial performance cannot be justified solely by their commitment to CSR. For this reason,

[81] (Becker, 2005, p. 275)

we include in the model those that in the literature have been identified as main control variables. Those are expected to explain part of the variability of Y.

- Size = ln(Total Assets)

- Leverage = $\frac{Total\ debt}{Total\ Assets} * 100$

- $\frac{Net\ Interest\ Income\ (NII)}{Total\ Assets} = \frac{Net\ Interest\ Income}{Total\ Assets}$*100

The table below provides descriptive statistics of all the variables.

Variable	Obs	Mean	Std. Dev.	Minimum	Maximum
ROA	450	0.6987316	1.7228	-8.3121	27.2151
ROE	450	6.5420	21.04	-329.8989	73.7698
Market Value/Total Assets	450	9.0863	14.0555	0.2642	132.201
ESG	450	58.4052	20.9577	2.05	93.93
Environment	450	56.9153	31.3507	0	96.63
Social	450	60.3452	22.5959	1.24	97.28
Governance	450	56.4827	23.5890	1.67	97.38
Controversies	450	78.5152	33.1577	0.43	100
SIZE	450	25.8323	1.5455	21.616	28.516
Leverage	450	17.2239	11.6269	0.4829	62.2215
NII/Total Asset	450	1.7293	1.3097	-2.6201	8.2133

Table 15: Descriptive statistics.

From the table of descriptive statistics, we can notice as the Social pillar is the one in which banks realised the highest mean (60.3462) and with the lowest standard deviation if compared with the Environmental and Governance pillars. Looking at its definition, the social pillar measures the trust level between the company and its customers, employees and external stakeholder. The great attention to this aspect can be justified by the need of legitimacy that bank have in order to operate.

Looking at the other variables the minimum value of ROE of -329.89 was registered in 2010 by Allied Irish Banks, p.l.c. (AIB), one of the four biggest Irish banks. This negative result was due to the ongoing financial crisis in Ireland and to bad debts in the Irish businesses.

The minimum value of zero for the Environmental pillar means that there are some banks that do not engage in activities related with resource use, emission and environmental innovation.

Another useful table is the correlation matrix. Correlation measures the relationship between variables. By looking at correlation we can get an idea of how strong this relationship is and its direction. The direction of correlation can be positive when two variables increase at the same time. The direction of correlation is otherwise negative when one variable increases and the other one decreases. In case data do not follow either one of these two patterns then may be no correlation between the two variables considered. No correlation means that no precise pattern can be detected between the variables meaning that no relationship exists or there is a non-linear relationship. Another feature of correlation is its strength. The closer the number is to one, the stronger the correlation is. A correlation coefficient higher than 0.8 signals a strong correlation while a correlation coefficient lower than 0.4 signals a weak correlation.
Looking at our correlation table we can notice a significant negative correlation between ESG total score and financial performance measures like ROA and Market value/Total Assets, but the correlation coefficient is weak. Moreover, also the Environmental, Social and Governance pillars show a negative correlation with financial performance measures, but it is very weak. It is interesting to notice a high positive and significant correlation between Size and ESG overall score, signalling that bigger companies may be able to obtain better ESG scores.
Given the high correlation between size and ESG score our models may suffer from multicollinearity problems. Before continuing in our analysis, we computed the Variance Inflation Factor for our two models as it was done also in the analysis of Tang, et al. (2012) but in any case the VIF exceeds the critical level of 10 thus we can state that both our models do not suffer from multicollinearity.

	ROA (model 1)	ROA (model 2)	ROE (model 1)	ROE (model 2)	Market Value/ Total Assets (model 1)	Market Value/ Total Assets (model 2)
ESG	2.59	-	2.59	-	2.59	-
Environment	-	3.18	-	3.18	-	3.18
Social	-	3.24	-	3.24	-	3.24
Governance	-	1.60	-	1.60	-	1.60
Controversies	-	1.58	-	1.58	-	1.58
Size	2.66	3.43	2.66	3.43	2.66	3.43
Leverage	1.03	1.08	1.03	1.08	1.03	1.08
NII/Total Assets	1.07	1.15	1.07	1.15	1.07	1.15

Table 16: VIF table

Table 17: Correlation matrix

	ROA	ROE	Market value/Total Assets	ESG	Environment	Social	Governance	Controversies	Size	Leverage	NII/ Total Asset
ROA	1										
ROE	0.542***	1									
Market value/ Total Assets	0.481***	0.0490	1								
ESG	-0.152**	0.0703	-0.434***	1							
Environment	-0.210***	-0.0140	-0.374***	0.834***	1						
Social	-0.173***	0.0365	-0.437***	0.922***	0.777***	1					
Governance	-0.0445	0.135**	-0.316***	0.814***	0.517***	0.554***	1				
Controversies	0.167***	0.138**	0.161***	-0.448***	-0.404***	-0.413***	-0.345***	1			
Size	-0.240***	0.00347	-0.495***	0.778***	0.754***	0.754***	0.530***	-0.571***	1		
Leverage	-0.114*	-0.0202	-0.103*	0.0910	0.116*	0.0327	0.120*	0.0544	0.0898	1	
NII/ Total Asset	0.752***	0.525***	0.357***	-0.0585	-0.194***	-0.0710	0.0408	0.216***	-0.181***	-0.137**	1

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Statistical method

The model for the investigation of the relationship between corporate financial performance is panel data regressions. The theoretical model starts from the following general function:

$$CFP_i = f(CSP_{i,} X)$$

where:

CSF_i is a measure of firm's financial performance

CSP_i is a measure of firm's social performance

X is a vector of control variables.

The regression models are:

Model 1: $Y_{i,t} = \alpha_0 + \beta_1 \mathrm{ESG}_{i,t} + \beta_4 \mathrm{SIZE}_{i,t} + \beta_5 \mathrm{LEVERAGE}_{i,t} + \beta_6 \frac{\mathrm{NII}}{\mathrm{Total\ Assets}} + u_{i,t}$

Model 2: $Y_{i,t} = \alpha_0 + \beta_1 ENV_{i,t} + \beta_2 SOC_{i,t} + \beta_3 GOV_{i,t} + \beta_4 CONTROVERSIES_{i,t} + \beta_6 SIZE_{i,t} + \beta_7 LEVERAGE_{i,t} + \beta_8 \frac{NII}{Total\ Assets_{i,t}} + u_{i,t}$

where:

$Y_{i,t}$ is a measure of firm's financial performance in the period t;

$ESG_{i,t}$ is the ESG overall score of bank *i* at t;

$ENV_{i,t}$ is the ESG rating for the environmental pillar of bank *i* at t;

$SOC_{i,t}$ is the ESG rating for the social pillar of bank *i* at t;

$GOV_{i,t}$ is the ESG rating for the governance pillar of bank *i* at t;

$CONTROVERSIES_{i,t}$ is the ESG rating for the controversies score of bank *i* at t;

$SIZE_{i,t}$ is the natural logarithms of total asset;

$LEVERAGE_{i,t}$ is the ratio between total debt and total assets;

NII/Total $Assets_{i,t}$ is the ratio between NII at t and Total Assets at t.

The first model is used to test Hypothesis 1 where CSR is investigated using a single aggregate measure, while the second model is used to test Hypothesis 2,3, 4 and 5 where CSR is divided into its components.

Investigation of individual and time effect

First, we need to look if our dependent variables ROA, ROE and Market Value/ Total Assets have different country means. From the graph we can see that their averages are not the same across countries. This problem will lead to the selection of a model different from OLS because OLS assumes that dependent variable has the same mean across all countries.

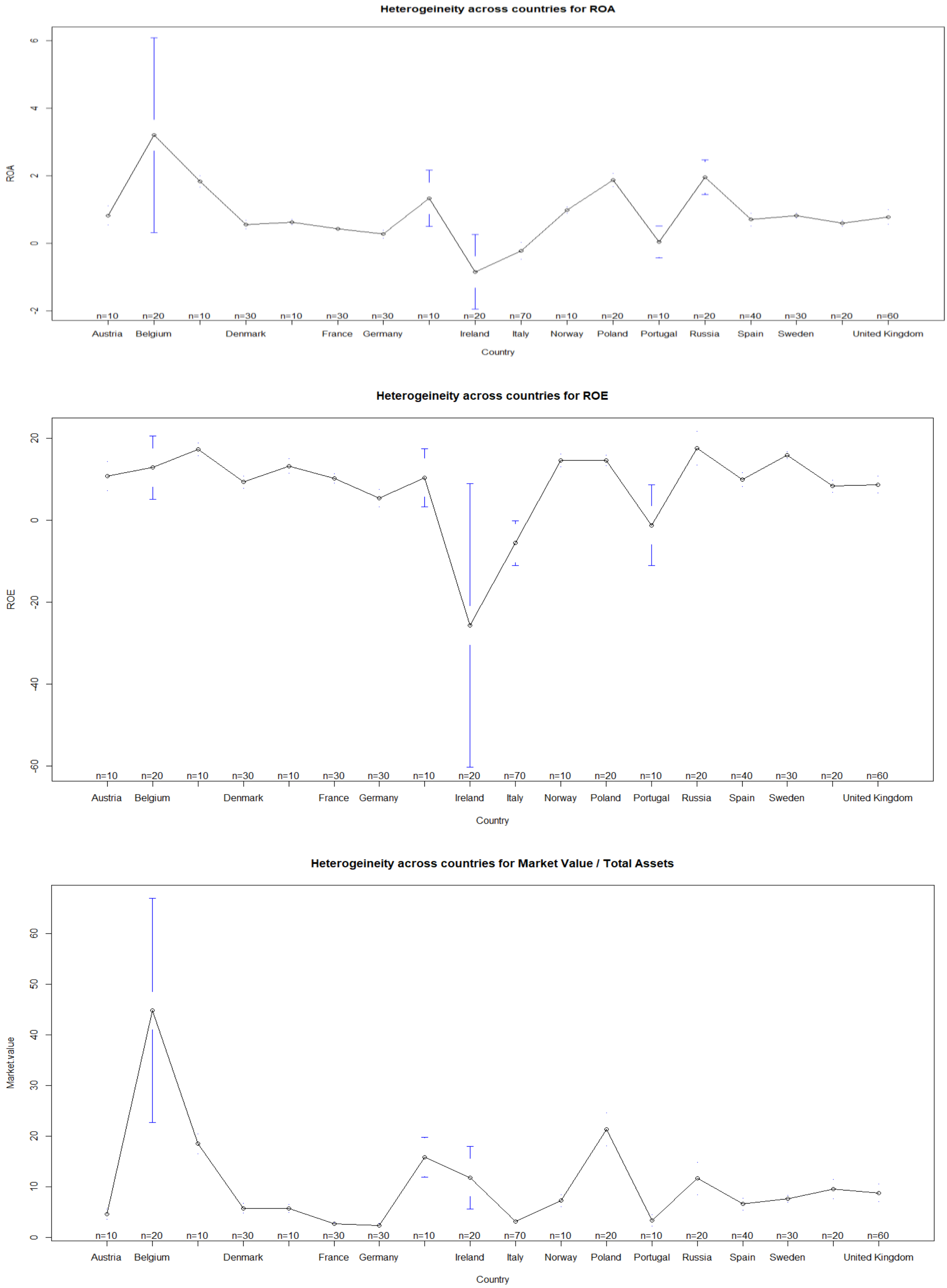


Figure 24: Country means. Source: Own elaboration.

In addition to that OLS assumes also that all countries have the same mean across time. To investigate this, we can look at the graphs below and notice how ROA, ROE and Market Value/Total Assets have also a different mean across time. In accordance with Wu & Shen (2013), OLS is not the appropriate model.

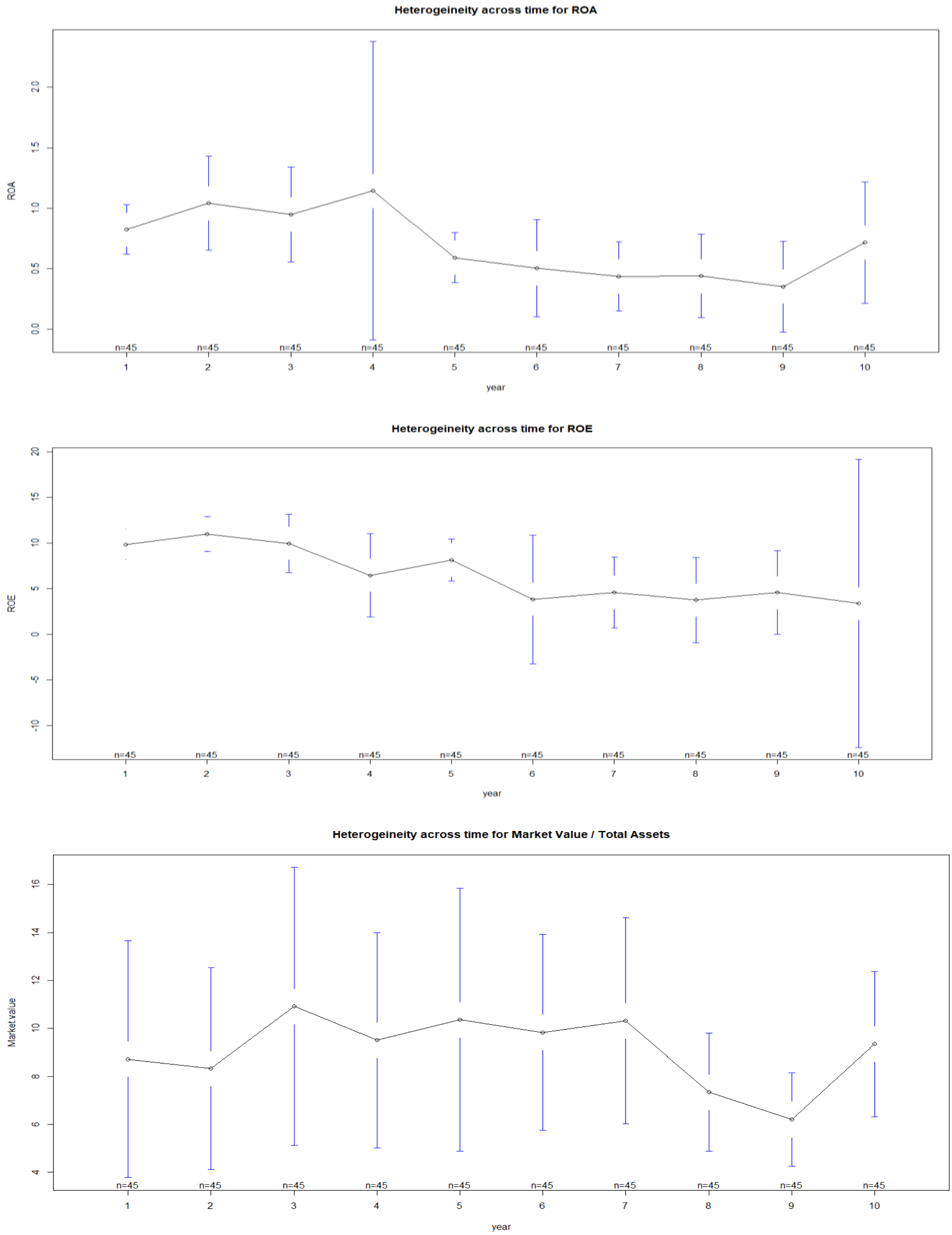


Figure 25: Means across time. Source: Own elaboration.

Regression results

Model 1: $Y_{i,t} = \alpha_0 + \beta_1 ESG_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 LEVERAGE_{i,t} + \beta_6 \frac{NII}{Total\ Assets} + u_{i,t}$

Table below presents the results of model 1 where the three dependent variables representing corporate financial performance are regressed on ESG overall score and control variables. After performing the test for individual and time effects, we concluded that the Fixed Effect model is more appropriate in this case rather than the OLS or the Random Effect model. After performing the Breusch-Pagan test we detected heteroscedasticity in our data and thus all regressions are presented with robust standard errors. The intercept in the FE model are not shown because this model assumes that all countries have a different intercept. Since we have 45 countries and thus 45 intercepts, for clearance, we did not display all of them in the table.

	Dependent Variable					
	ROA		**ROE**		**Market Value/ Total Assets**	
Independent variable	Estimate	Pr(>|t|)	Estimate	Pr(>|t|)	Estimate	Pr(>|t|)
ESG	-0.0045172	0.5247	0.0038107	0.94984	-0.022965	0.318729
Size	0.3730700	0.4033	-5.3640685	0.54334	-2.581961	0.291609
Leverage	-0.0107441	0.1043	-0.0439219	0.75344	0.042767	0.642061
NII/Total Assets	1.2474132	2.964e-13 ***	10.1960295	0.04932*	2.834084	0.004141**

Model	Fixed Effect	Fixed Effect	Fixed Effect
Dataset:	Balanced Panel T=10, N=450	Balanced Panel T=10, N=450	Balanced Panel T=10, N=450
R-squared	0.47261	0.20772	0.12849
Adj. R-squared	0.40948	0.11288	0.024174

Significance levels: "***" 0 "**" 0.001 "*" 0.05 "†"

In the regression with ROA and Market Value / Total Assets as dependent variable ESG scores have a negative effect on financial performance but this effect is not significant. The regression with the higher R-squared is the one where ROA is the dependent variable while the regression with Market Value/ Total Assets as a dependent variable has the lowest R-squared. From this result we cannot support hypothesis 1 of our study and thus it seems there is not a relationship between ESG scores taken as an overall measure and corporate financial performance.

Given that this first model did not produce significant results we will test the model 2 in which CSR is disaggregated into its main components.

Model 2: $Y_{i,t} = \alpha_0 + \beta_1 ENV_{i,t} + \beta_2 SOC_{i,t} + \beta_3 GOV_{i,t} + \beta_4 CONTROVERSIES_{i,t} + \beta_6 SIZE_{i,t} + \beta_7 LEVERAGE_{i,t} + \beta_8 \frac{NII}{Total\ Assets_{i,t}} + u_{i,t}$

Dependent variable: ROA

The Durbin-Watson test for serial correlation in panel model was run and there was autocorrelation in the error term. In addition to that, there is heteroscedasticity in our data. To solve these problems all models are presented with robust standard errors. Before deciding between the fixed effect model and the random one, the Hausman test was run to understand which of the two was more appropriate.

```
> phtest (randomROA, fixedROA)

        Hausman Test

data:  Y ~ X
chisq = 48.113, df = 7, p-value = 3.383e-08
alternative hypothesis: one model is inconsistent
```

The Hausman test provided support for the Fixed Effect model thus we will not display the results of the Random Effect model.

In the first regression presented in the table below we use the full dataset of 45 companies observed during the 10 years of analysis with N=450. The estimation on the balanced panel shows a R-squared of 47.37% and an Adj.R-Squared of 40.62%. No one of the variables is significant except for NII/Total Assets. Again, the intercept in the FE model are not shown because this model assumes that all countries have a different intercept. Since we have 45 countries and thus 45 intercepts, for clearance, we did not display all of them in the table.

Because of the insignificant results obtained, we investigated further and in order to get a better understanding of the model we did an analysis of residuals. The residuals analysis, shown in the figure below, identified some outliers that may compromise the results.

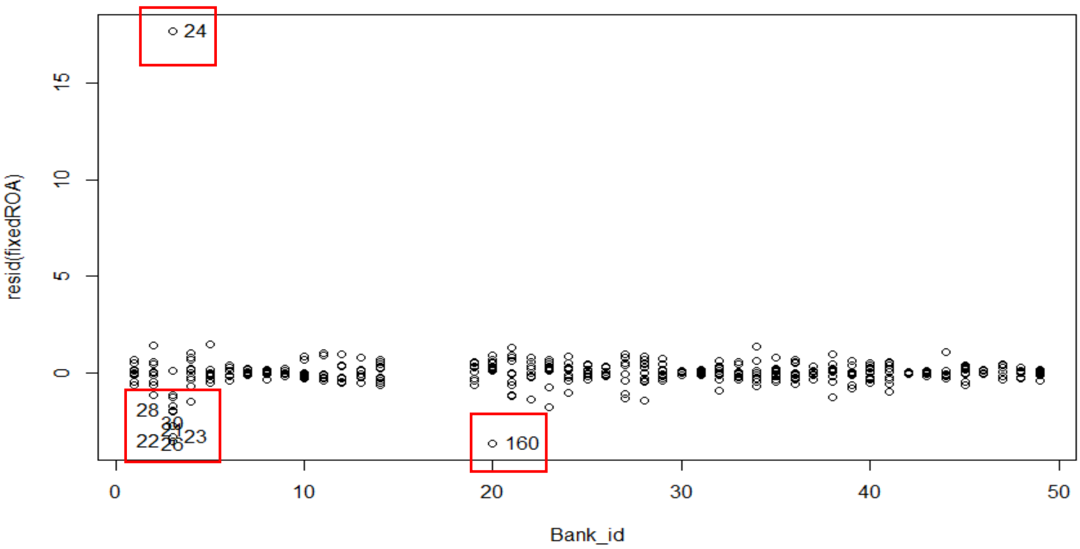


Figure 26: Residuals analysis in the model with ROA as dependent variable. Source: Own elaboration.

After eliminating them from our dataset we obtained an unbalanced panel data with N=442 but with significative effects for the Social variable, for Leverage and NII/Total Assets. In this model we have also an improved R-squared of 65.43% and an adj. R-squared of 60.92% that suggests a better fit of the model. According to the results, the social pillar has a positive and significant (p-value<0.05) effect on ROA, while the leverage control variable shows a negative and significant (p-value<0.5) effect on ROA meaning that higher leveraged banks will have worst values of financial performance. The positive effect of NII/Total Assets is easily explainable because the interest income is the first source of income for banks whose main business is to borrow money to customers.

	Dependent Variable			
	ROA		**ROA**	
Independent variable	Estimate	Pr(>|t|)	Estimate	Pr(>|t|)
Environment	-0.00107807	0.7048	-0.00300814	0.24134
Social	0.00155457	0.7389	0.00623446	0.03823*
Governance	-0.00507264	0.2758	-0.00152147	0.55691
Controversies	-0.00060446	0.7320	-0.00091891	0.33224
Size	0.36555784	0.3847	-0.03933694	0.81688
Leverage	-0.01024628	0.1028	-0.00831480	0.03181*
NII/Total Assets	1.24916598	<1.435e-12 ***	0.85531786	<2e-16***

Model	Fixed Effect	Fixed Effect
Dataset:	Balanced Panel T=10, N=450	Unbalanced Panel T=3-10, N=442
R-squared	0.47373	0.65439
Adj. R-squared	0.40629	0.6092

Significance levels: "***" 0 "**" 0.001 "*" 0.05 "†" 0.1

This first analysis with ROA as dependent variable allows us to confirm hypothesis 3 according to which there is a positive and linear relationship between the Social Performance of a company and its financial performance. Considering these results, we have also to reject hypothesis 2 and 4 stating that it does not exist any positive and linear relationship between the Environment and Governance dimensions of CSR and company's financial performance. Lastly, we reject also hypothesis 5 regarding the negative impact on controversies on corporate financial performance.

Dependent variable: ROE

After analysing model 2 with ROA as dependent variable the second step of our analysis is to change the dependent variable that represents banks' financial performances and see whether results will change. The second accounting-based variable used is ROE. Regression results are presented in the table below.

	Dependent Variable			
	ROE		**ROE**	
Independent variable	Estimate	Pr(>|t|)	Estimate	Pr(>|t|)
Environment	-0.0754425	0.04939*	-0.052421	0.25376
Social	0.0516454	0.25563	0.075502	0.08950 †
Governance	-0.0075454	0.84756	-0.057611	0.20650
Controversies	-0.0242844	0.30405	-0.026838	0.23480
Size	-0.4519421	0.50962	3.645067	0.52163
Leverage	0.0108005	0.86403	-0.166579	0.03786*
NII/Total Assets	8.8287347	3.536E-08 ***	10.455057	6.78e-09 ***

Model	Fixed Effect		Fixed Effect
Dataset:	Balanced Panel T=10, N=450		Unbalanced Panel T=3-10, N=442
R-squared	0.39718		0.40791
Adj. R-squared	0.31835		0.33048

Significance levels: "***" 0 "**" 0.001 "*" 0.05 "†" 0.1

From this second model with ROE we can immediately notice that in overall we have lower R-squared and adj. R-squared than in the previous specification where ROA was the dependent variable. This may be suggesting that ROA is more appropriate as accounting-based measure for financial performance in banks. In fact, Callan & Thomas (2009) suggested that ROE should be used in long-term analysis, thus with a longer period it may have performed better.

Looking then at estimations result, in the first column of the table there is the regression run on the balanced panel data. In this one only the Environment variable and NII/Total Assets are significant. This result is completely in contradiction with the outcome of the model with ROA where only the Social variable seemed to have a positive and significant effect on financial performance while here only the Environmental variable is significant and has a negative effect. However, when the regression is done using the unbalanced panel dataset already used for ROA the results change and the Social variable become again positive and significant (p-vale < 0.1). In addition to that its β is greater than before, 0.08950 in comparison with 0.03823 under the ROA model, suggesting a higher positive effect of the Social disclosure on bank's financial performance.

Also in this case, with ROE as dependent variable, we reject hypothesis 2, 4 and 5 and confirm hypothesis 3.

Dependent variable: Market value/ Total Assets

Finally, in the last step of our analysis we use a market-based measure to represent corporate financial performance. The selected market-based measure is Market Value/Total Asset. Regression results are presented in the table below. The best model between OLS, FE and RE was selected performing some tests.

First was run the poolability test to investigate whether pooled OLS could be applied. The test rejected H_0 thus the OLS model is not the best option.

```
> pooltest (Y~X, data=p.data, model="within")

        F statistic

data:  Y ~ X
F = 2.7606, df1 = 308, df2 = 90, p-value = 3.639e-08
alternative hypothesis: unstability
```

The alternatives were the Fixed Effect model or the Random effect model. At this point the Hausman test was used to decide between Fixed Effects and Random Effects. The result of the test supported the Fixed Effect model.

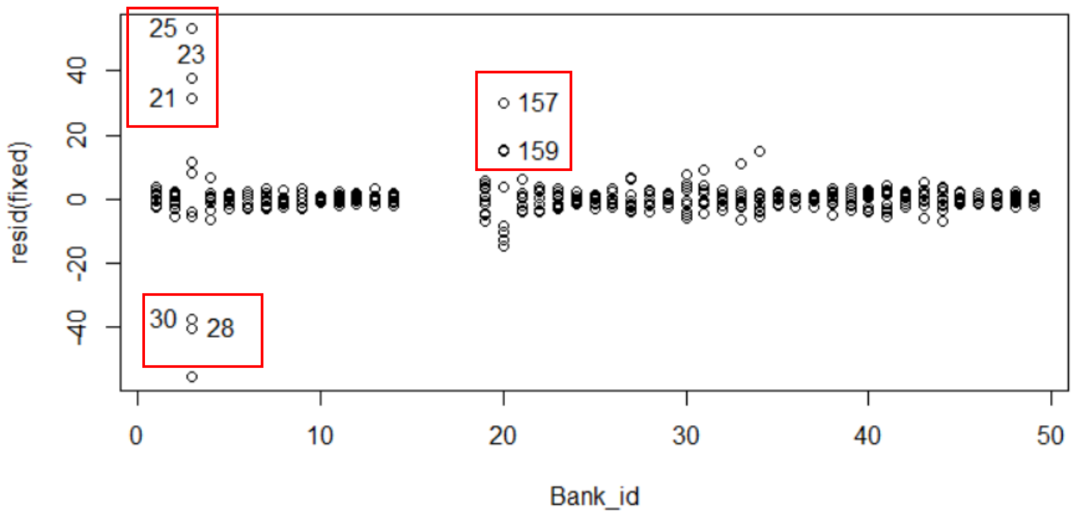
```
> phtest (random, fixed)

        Hausman Test

data:  Y ~ X
chisq = 1443.5, df = 7, p-value < 2.2e-16
alternative hypothesis: one model is inconsistent
```

```
        Durbin-Watson test for serial correlation in panel models

data:  Y ~ X
DW = 1.3352, p-value = 4.723e-13
alternative hypothesis: serial correlation in idiosyncratic errors

> bptest(Y~X, data=p.data, studentize = F)

        Breusch-Pagan test

data:  Y ~ X
BP = 1083, df = 7, p-value < 2.2e-16
```

Then we performed the Durbin-Watson test for autocorrelation, and it emerged that there is autocorrelation in error terms also in this case. Furthermore, the data present also heteroscedasticity. In order to solve these two problems, we will use robust standard errors in our regressions.

The regression results are presented in the table below. What immediately emerged from out estimations is that the model presented very low R-squared of 14.96% and a adj. R-squared of just 4.06%. These levels signal that the model does not fit the data and it is not able to explain not even one fourth of the variability. The regression shows negative and significant effects of the Social variable (p-value<0.05) on Market Value/Total Assets and positive effects of NII/Total Assets. The negative effect of the social variable on financial performance is in contradiction with the previous models with ROA and ROE.

As done before, also in this case we looked at residuals and performed a second estimation excluding them and having in this way and unbalanced panel data with N=442 and T=4-10.



	Dependent Variable			
	Market value/ Total Assets		**Market value/ Total Assets**	
Independent variable	Estimate	Pr(>|t|)	Estimate	Pr(>|t|)
Environment	0.0723530	0.107430	0.0343072	0.10641
Social	-0.1011137	0.042809 *	-0.0475398	0.09561 †
Governance	0.0198564	0.554411	0.0064599	0.79808
Controversies	-0.0049985	0.549704	0.0082186	0.19191
Size	-3.2482387	0.166726	-5.5270774	6.097e-05 ***
Leverage	-0.0450002	0.630479	0.0344932	0.22941
NII/Total Assets	2.9867596	0.000564 ***	1.8562758	3.637e-09 ***

Model	Fixed Effect	Fixed Effect
Dataset:	Balanced Panel T=10, N=450	Unbalanced Panel T=4-10, N=442
R-squared	0.1496	0.28709
Adj. R-squared	0.040628	0.19386

Significance levels: "***" 0 "**" 0.001 "*" 0.05 "†" 0.1

Comparing the two regressions, when we exclude outliers R-squared and adj. R-squared improved. The Social variable is statistically significant also in this case but, it still has a negative effect on corporate financial performance. What is also new in these results using market-based measures rather than accounting-based measures is that the variable Size is positive and significant as in other studies in literature.

Chapter 6 – Conclusions

Conclusion

This research aims to investigate the association, in case it exists, between CSR and Financial Performance in the European banking sector. Even though the banking sector was one of the first to engage in CSR, the studies on this subject are relatively scant. The interest in the banking sector is justified by the key role financial institutions have in economic development because they are responsible for the allocation of financial resources. (Forcadell & Aracil, 2017)

In fact, one common point among all the empirical studies focused on the banking industry is that banks absorb a great amount of resources from society thus they should provide feedbacks to the community. (Gangi, et al., 2019; Wu & Shen, 2013)

There are several reasons that can push banks to undertake CSR actions. To explore this relationship, we used panel data regression on a time period of ten years from 2010 to 2019 and data from the Thomson Reuter database. The choice to focus only on the banking industry and not to use a mixed sample was guided by the numerous recommendations present in literature which warn about the existence of individual industry effects. A sample of multiple companies could mask the true effects of CSR on CFP. (Andersen & Dejoy, 2011; Griffin & Mahon,1997; Simpson & Kohers, 2002)

In this study, the CSR-CFP relationship was investigated using three different financial performance measures, ROA, ROE and Market Value/ Total Asset. In literature Simpson & Kohers (2002), Wu & Shen, (2013), Forcadell & Aracil (2017), Tang, et al. (2012) and many others have used ROA and ROE as accounting-based measures for the banking sector. With respect to CSR, we used ESG rating elaborated by Thomson Reuter databased like previously done by Gangi, et al. (2019), Esteban-Sanchez et al. (2017) for the banking sector and by Miras-Rodríguez, et al. (2015) for the energy sector.

The empirical findings of this research work are contradictory and need a detailed clarification. This study first tests the relationship between CFP and CSR using an aggregated ESG score as the only measure of CSR. Model 1 of our research rejects hypothesis 1 suggesting that there isn't any linear relationship between a bank's financial performance and CSR measured with the aggregated ESG score, both in the case where financial performance is measured with accounting-based measure or with market-based measures. This result is in accordance with Nollet, et al. (2016) which state that "in linear specifications the effect of CSR performance is positive but insignificant for all measures of CFP"[82].

[82] (Nollet, et al., 2016, p. 403)

On the other hand, when CSR initiatives are disaggregated into its three main components, environment, social and performance, some significant results emerge.

In fact, in the second part of our study we use the regression model 2 where CSR is expressed with four distinct variables that are Environment, Social, Governance and Controversies. From the regressions we reject hypothesis 2 and 4 therefore there is not a linear and positive relationship between environmental initiatives, governance improvements and bank's financial performance. Already other studies, like Esteban-Sanchez, et al. (2017), had assumed that the environmental dimension of CSR was not fundamental in the banking sector as for other sectors (energy or consumption) so this result can be considered in line with others. Also, Simpson & Kohers (2002) excluded the environmental dimension in its studies focusing only on the contribution of bank for society. Lastly, Porter & Kramer (2006) suggested that companies should not take charge of all aspects of CSR but only those that create the greatest value for their stakeholders. What is instead surprising is the non-significance of the governance dimension on economic results. However, these results do not exclude that the nature of the relationship may be non-linear, like the U-shape relationship found by Barnett & Salomon (2006) in mutual funds that practice socially responsible investing, or the quadratic relationship found for the governance dimension by Nollet, et al. (2016).

From our results we can state that there is a positive and linear relationship between accounting-based measures of bank's financial performance and *Social* initiatives. Both the models with ROA and ROE as dependent variable confirm this statement with good levels of significance. Thus, there is support for hypothesis 3. Contrary, the third model in which bank's performance was measured with the market-based measure Market value/Total Assets brings to an entirely opposite conclusion where bank's social efforts negatively affect bank's market value.

Trying to give and explanation to these contradictory results, we can say that the first two models with accounting-based measures are more reliable than the last one with a market-based measure. This conclusion can be justified by the fact that exists a broad agreement among academics on how to calculate accounting-based measures and what they represent, while on the market-based measures the discussion on their construction and effectiveness is still ongoing. (Galant & Cadez, 2017)

Looking then at the motivations for significant and positive effects of bank's social engagements on its financial performance many hypotheses can be advanced. From the descriptive statistics of our data we immediately noticed that the variable *Social* was the one with the highest mean which may indicate a greater banks' commitment on social performance rather than on governance or environment. The positive impact of social activities on bank's financial performance finds perfect explanation under the *stakeholder theory* and the *good management hypothesis*. (Fischer & Sawczyn, 2013)

As outlined in the first chapters, primary stakeholders, like employees and customers, are vital for the daily operation of banks and thus can directly influence its economic performance. In our study the variable "social" is defined as the bank's ability to "generate trust and loyalty with its workforce, customers and society, through its use of best management practices.[83]" Given its definition is it clear that higher levels of social performance for banks translate in more satisfied stakeholders. The social dimension includes four different elements: workforce, human rights, community and product responsibility. Those are the groups of stakeholders whose satisfaction can influence banks performance; "corporate social initiatives directly tied to the preferences of stakeholders may not only benefit stakeholders but also increase shareholder wealth."[84] Our intuition confirms also what already discussed by Porter & Kramer (2006) who suggested that companies often engage in strategic CSR activities to gain "license to operate" and "reputation". Tang, et al. (2012) confirmed that companies should focus on one dimension at a time and use a consistent approach starting from internal CSR activities like those regarding employees. Occasional CSR and unfocused initiatived will result in a waste of resources rather than performance improvement. (Tang, et al., 2012)

In this respect, Forcadell & Aracil (2017) stated that "reputation constitutes a strategic resource because it is difficult to imitate [and] it reduces economic uncertainty and investor risk, thereby enhancing a firm's value"[85]. Wu & Shen (2013) confirmed that banks engage in CSR for strategic motive: CSR will allow them to "increase customer loyalty and build reputation"[86]. Reputation in turn will "attract more creditworthy borrowers, which contribute higher profit and better asset quality to the financial institutions"[87] As further confirmation of this Gangi, et al. (2019) affirmed that through external CSR "successful banks provide superior value to customers and are able to differentiate their products from competitors and improve their image within the community"[88]

To conclude, with this study we can say that the relationship between CSR and CFP is probably positive or non-significant when CSR is disaggregated into its main components. This conclusion is in line with previous important reviews of empirical studies like that of Lu, et al.

[83] Thomson Reuter Database
[84] (Michelon, et al., 2013, p. 92)
[85] (Forcadell & Aracil, 2017, p. 2)
[86] (Wu & Shen, 2013, p. 3532)
[87] (Wu & Shen, 2013, p. 3531)
[88] (Gangi, et al., 2019, p. 126)

(2014) or Orlitzky, et al. (2003). In order to gain a deeper understanding of the relationship here investigated and to fill the limitations of this study further research is needed.

Limitations and suggestions for future research

As in every research there are some limitations that need to be underlined.

First of all, this study considers only a limited sample of 45 European banks but does not take into account every European country due to lack of data available; some important countries like Netherlands were excluded. This problem arises because we chose to use ESG scores that are a multidimensional and comprehensive measure of CSR. As already underlined by Simpson & Kohers (2002) comprehensive metrics usually "do not cover enough firms to provide a large sample in one industry."[89] In future research a richer sample should be used in order to make results more consistent and generalizable.

In addition to that it should be considered that every entity is also affected by the characteristics and the legislation of the territory in which it is located. For this reason, in this study it was chosen not to mix financial institutions from different continents like Europe and the USA or banks from developing countries because those present peculiar characteristics that may bias the results. In future research this should be kept in mind. In the cases where is it possible taking samples from one single country may generate better results because country-specific characteristics can be considered.

Secondly, this study considers only the banking sector but as we discussed in the previous chapters each sector is subject to particular internal mechanisms and has to meet the needs of different groups of stakeholders so the conclusions that may be true for the banking industry may not be applicable for other sectors. This problem may be solved conducing separate researches for every industry or by using dummy variables in one single study.

As regards the variables used in this study, we noticed as changes in the dependent variable used to measure corporate financial performance (ROA, ROE or Market Value/Total Assets) affected the results. In particular, we found that models using ROE are less performant than others. It may be interesting to investigate the motivations under that. Furthermore, in future studies the use of more comprehensive measures, like Tobin's q, may generate better results. The problem with market-based measure is that they can be difficult to construct and are not standardized like accounting-based measure.

Finally, in this study we assumed that higher ESG scores may cause better financial performance but also the opposite may be true. In fact, there are in literature studies that

[89] (Simpson & Kohers, 2002, p. 100)

hypotheses the opposite direction of causality considering CSR as the dependent variable. However, no agreement was reached among academics on the direction of causality. In our study we cannot simply switch the dependent and independent variable because considerations also on control variables should be made. In future research it might be interesting to test also models with CSR as dependent variable.

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