The Dark Side of Philanthropy: the challenge for governance

Corporate governance, corporate social responsibility and philanthropic giving

Professor Chris Mallin
Introduction

- What is corporate governance?
- What is corporate social responsibility?
- Philanthropic giving
- Links between corporate governance and corporate social responsibility
- Examples
- How can corporate governance help?
- Recent studies
- Concluding comments
Corporate Governance

- Cadbury ‘the whole system of controls, both financial and otherwise, by which a company is directed and controlled’.

- OECD ‘a set of relationships between a company’s board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives, and monitoring performance are determined’.
Corporate governance

- Sir Adrian Cadbury (1999) “Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals....the aim is to align as nearly as possible the interests of individuals, corporations, and society”.
Corporate Governance

- Systems of controls within the company
- Relationships between the company’s management, board, shareholders and stakeholders
- Ensuring that the company is managed in the interests of the shareholders and/or stakeholders
- Transparency and accountability
Drivers of corporate governance

- Collapses of prominent businesses
- Greater concentration of share ownership in the hands of institutional investors (particularly in UK and US)
- Institutional investors diversifying their portfolios and investing overseas
- Technological advances in communications and markets impacting on the development of common views on key aspects of investment, eg. corp.gov.
Public companies

- In a number of countries, especially UK and US, public companies are predominantly owned by institutional investors.

- Key features are:
  - Separation of ownership from control of the company.
  - Resultant problems that may arise with sub-optimal behaviour of managers/directors means that there is a need for accountability to the shareholders and a need for monitoring.
  - Influence of institutional investors through various means of 'voice'.
  - Corporate governance codes issued by countries (relevant to all companies), and also by individual institutional investors (relevant to their investee companies).
  - Disclosure levels in company annual reports tend to be comprehensive.
Importance of corporate governance

- Ownership structure of firms varies across the world BUT corporate governance is important whether a firm’s shares are held by institutional investors, family-owned or state-owned: WHY?

- Fundamental to well-run firms:
  - Controls exist to ensure that individuals or groups within the firm have not adverse influence
  - Assets of the firm are safe-guarded
  - Firm operates to its best economic efficiency
Corporate governance and corporate social responsibility

• Two opposing views:

‘Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible’ (Milton Friedman, 1982)
‘The broadest way of defining social responsibility is to say that the continued existence of companies is based on an implied agreement between business and society’ and that ‘the essence of the contract between society and business is that companies shall not pursue their immediate profit objectives at the expense of the longer-term interests of the community’ (Sir Adrian Cadbury, 2002)
Corporate governance and corporate responsibility

‘In the global economy, sensitivity to the many societies in which an individual corporation may operate can pose a challenge. Increasingly, however, investors in international capital markets expect corporations to forego certain activities – such as use of child or prison labour, bribery, support of oppressive regimes, and environmental disruption – even when those activities may not be expressly prohibited in a particular jurisdiction in which the corporation operates’ (OECD, 1998)
CSR and corporate governance

- Why now?
- The economic crisis and its social consequences have damaged consumer confidence and levels of trust in business, and have focused public attention on the social and ethical performance of enterprises. Therefore renewing efforts to promote CSR should help to create conditions favourable to sustainable growth, responsible business and employment.
- Encourage institutional investors to sign up to the UNPRI.
CSR and corporate governance

- Corporate governance has gained a much higher profile in the last decade in the wake of various corporate scandals and collapses.
- CSR is now becoming much more a part of mainstream corporate governance.
- Recognition that a company cannot – in the long-term – operate in isolation from the wider society in which it operates.
CSR and philanthropic giving

• Both CSR and corporate philanthropy can help define a company's reputation and image and create goodwill with its stakeholders.

• However CSR is generally more about the core business functions of a company. Shareholders will often be more understanding about a company spending money on CSR related to the core activities, rather than on peripheral activities.

• The wider stakeholder community are also making increasing demands that companies be held accountable for the social and environmental impacts of their operations.
CSR and philanthropic giving

- Philanthropic giving is often in the form of donations to favourite charities or causes, sometimes via a foundation established by the company.

- Whilst philanthropic giving may involve a select group within the company e.g. the directors; a company’s CSR is more company-wide and therefore effective implementation of CSR often requires a much higher level of commitment and engagement beyond that which is required for corporate giving programs.
Ben & Jerry's uses hormone-free milk and cage free eggs
PUMA’s environmental profit and loss account
Shell’s Sustainability Report 2012: 'As we work to help meet the world’s growing energy needs, we aim to reduce the environmental impact of our operations.' However Shell has polluted the Niger Delta and seems to fight against taking responsibility for oil spills.
Monsanto’s CSR/Sustainability Report 2011 states it ‘is working for a better tomorrow by putting the right tools in the hands of farmers today. By equipping growers with better seeds, we can help protect our natural resources, fight hunger, improve nutrition and provide economic benefits to everyone involved in an improved system of agriculture.’

However their products have included Agent Orange, dioxin, recombinant bovine growth hormone (rBGH)… and genetically modified seeds.
Primark Ethical Trading statement on Values: ‘We do not own the companies or factories that produce our goods, but we do have a responsibility to the workers in those factories, to our customers and shareholders, to ensure that our products are made in good working conditions.’
Role of corporate governance

- **Directors**

  - accountable to shareholders but should consider the views of other stakeholders
  - in the UK, the Companies Act (2006) expects directors to disclose more information relating to the risks affecting the company, an analysis of the performance of the company over the year, and consideration of shareholder and stakeholder interests.
Role of corporate governance

- Shareholders

- UK has Stewardship Code (2012) for institutional investors:

‘instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company’s strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters’ (Guidance to Principle 4).
Institutional investors’ policies: example

• Hermes Corporate Governance Principles:

  Principle 5 includes the statement ‘we consider socially, ethically and environmentally responsible behaviour as part of the management process that companies should undertake in order to maximize shareholder value in the long term rather than as an end in itself’.

  Principle 9 includes the statement ‘companies should behave ethically and have regard for the environment and society as a whole’.
Shareholders’ Bodies

• Institutional investors representative bodies eg. Association of British Insurers (ABI); National Association of Pension Funds (NAPF).

• ABI (Feb 2007), issued its ‘Guidelines on Responsible Investment Disclosure’

• Main focus of the guidelines was the identification and management of risks arising from social, environmental and ethical issues that may affect either short-term or long-term business value. The flip side of this is that appropriate management of these risks may mean opportunities to enhance value.
• In relation to the Remuneration Report:
  - whether the Remuneration Committee is able to consider corporate performance on ESG issues when setting remuneration of executive directors, and if not, why not.
  - whether the Remuneration Committee has ensured that the incentive structure for senior management does not raise ESG risks by inadvertently motivating irresponsible behaviour.
Role of corporate governance

• Stakeholders
  - including employees, customers, suppliers, local community, interest groups, government, etc.
  - may lobby directors, shareholders, governments, etc.
Recent studies

- Masulis and Reza (2013) ‘Agency Problems of Philanthropy’ find:
  - the choice and level of corporate giving is positively associated with CEO personal ties to charities and negatively associated with the strength of corporate governance.
  - CEOs use firm donations to support their preferred and affiliated charities and to strengthen their social ties to independent directors by supporting their charity preferences.
  - negative average stock price reaction to initial disclosures of charity donations where executives/directors have personal ties.
Recent studies

- Shapira (2012) ‘Corporate Philanthropy as Signaling and Co-Optation’ has two main findings:
  - firstly, cash donations can signal financial strength
  - this finding shifts the focus from the ‘buying goodwill’ explanation for corporate philanthropy to one of signaling, i.e. such donations mitigate asymmetric information about a firm’s fundamentals
  - secondly, corporate philanthropy can decrease firm value
  - this occurs when corporate governance mechanisms are co-opted (neutralised or over-ridden), e.g. when companies donate to charitable causes affiliated with independent directors.
Conclusions

• Corporate governance and corporate responsibility are intertwined

• Influence of shareholders (particularly institutional investors); and influence of other stakeholders

• Corporate responsibility may maintain/increase shareholder value

• BUT good intentions can sometimes have bad outcomes; firms may exploit being good; and sometimes CSR is more like greenwash or a PR activity.

• Devinney (2009) ‘The notion of a socially responsible corporation is potentially an oxymoron because of the naturally conflicted nature of the corporation.’
References

