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## ***What relation exists between CSR and longevity of firms?***

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### **Abstract**

The relation between company longevity and its performance is undeniable; however the relationship between sustainability and performance remains the subject of multiple studies which seem to confirm a positive link. But what type of relationship exists between a firm's longevity and sustainability management? In this paper, we demonstrate that the adoption of corporate social responsibility (CSR) principles explains this link. Therefore, sustainable development policies can create a rampart wall which protects firms against crisis through its three pillars (environmental, social and economic) and thus limit the number of enterprises which go bankrupt. This rampart wall would be even more effective if the principles of sustainable development which companies adopt were guided by a suitable mix of soft law and hard law.

**Keywords:** longevity, CSR, crisis, performance, sustainable development.

## **I. Introduction**

Increasing profits has been a truism for firms since the beginning of the industrial revolution<sup>1</sup>. Obtaining good financial performances was generally more important than worrying about how these results were reached. However, several factors have changed this rule: a series of environmental catastrophes, bankruptcies due to flaws in ethics or governance, an increase of sustainable development practices, as well as the rise of shareholders' engagement. Over the last decades, the multiplication of crises (financial, economic, social, food and climate) have showed that the prosperity and welfare of firms cannot be dissociated from social and environmental contexts. Thus, more and more companies have decided to incorporate sustainable development principles, referred to as "Corporate Social Responsibility" (CSR) into their strategy. For firms which want to grow, or just thrive and survive in a period of economic crisis, when the rate of companies going bankruptcy rate of companies is strongly increasing, various long-term contributions such as human, financial and natural resources (including materials and energy) are necessary. Today, after a recession and with an economy which is having difficulties rebooting itself, shouldn't the objective of firms consist in ensuring their own long-term viability, by maintaining a durable access to financial, social and human resources ? In other words, what relation exists between the sustainability and the performance of firms, but also between their longevity and their sustainability? Moreover, putting forward the existence of a strong relation between the longevity and the sustainability of firms should make it possible to show that the integration of CSR in the strategy of firms will give them a stronger aptitude of surviving in a changing environment and crisis.

## **II. Is there a relationship between longevity, sustainability and performance ?**

The link between the performance of a company and its longevity is obvious. Indeed, only high-performing firms over a long period are able to overcome an evolving environment, the

risks of market and crisis. Thus, centenary firms represent a minority that share, whatever the branch of industry, some common characteristics and values that we try to highlight. In parallel, many studies have investigated the relationships among social performance, and financial performance (Scholten, 2008). In particular, the meta-analysis of Wu (2006) made the synthesis of 121 empirical studies and proved the positive link between corporate social performance (CSP) and corporate financial performance (CFP) even if the results strongly depend on the type of measures chosen: “market-based measures are weaker predictors of CSP than other financial measure and, perceptually based measures reported a stronger CSP-CFP relationship than performance based measures”. Taking into account the apparently positive relation between CSP and companies' financial performance, we then consider the link between longevity and sustainability.

#### **A. Explanatory factors of the firms' longevity**

Studies attempting to explain longevity of firms (and identify the explanatory factors) are relatively few, in comparison to the importance of the economic issues which arise from understanding this phenomenon. Moreover, research is mainly focused on the lifespan of new firms because of their high bankruptcy rate in the first years. In France, 320.000 companies are created on average each year, but 33% disappear at the end of the first three years and only 50% exceed five years<sup>ii</sup>. Studies explaining the longevity of companies over several decades are scarce, even if some authors like Geus (1997), Simon (1998), and Collins and Porras (2004) have made it possible to identify a certain number of characteristics, that we put into six categories:

\* a strong company culture based on ethical, human, or social values. This culture, initiated by its creator, is a determining factor for the future life of the firm. The stronger it is, the longer it will survive him, and resist change from managers. One of the signs of the cultural

strength of a firm is expressed through its governance and in particular the stability of management. Moreover, this stability of management protects the shareholders from short-term earnings management practices. We can generally observe it in family-held companies, but also in several big firms listed on stock markets. For example, L'Oréal had only five CEOs in one century, all recruited by internal promotion;

\* a relevant and fair valuation of human capital. On a company level, the collective human capital also includes not only individual human capital but also the capital resulting from interactions between individuals. This valorisation requires companies to invest continuously in the development of individual and organisational competences, to remunerate the employees equitably but also to interest them in the firm's profits. It results in increased competitiveness, commitment and loyalty of employees, which are a crucial source of the firm value's creation;

\* a capacity to rapidly adapt to change. This reactivity is closely related to the company's culture. It results from a long term vision, close monitoring of the internal and external environments (in order to perceive the evolution of customer needs), an important innovation policy, a flexibility in how resources are allocated (for example in order to define priority projects, or to pull out of activities) and a latitude left to managers for developing new activities with strong potential, even if they are far from the core activity of the firm. For family-held companies, this reactivity is explained partially by their financial independence which enables them to be more focused on the long run;

\* a controlled growth and financial prudence. These two elements are based on a long term vision of the target markets and firm's performance. Thus, perennial companies grow in stability, i.e. by privileging investments financed by internal funds.

They place greater importance on performance over longer periods, rather than performance which provides short-term earning management practices, and on the conservation of good

financial health (in particular by respecting strict ratios of debt). For example, in 2000, Bouygues Telecom (via its founder Martin Bouygues), contrary to France Telecom and Vivendi Universal, refused to acquire a license of 3<sup>rd</sup> generation mobile telephony (UMTS) due to the price tag (4.9 billion euros) which would have obliged the company to re-examine its development plan and to be massively financed by debts as was France Telecom. Finally, this price was re-examined in 2001 and fell to 619 million euros plus a royalty of 1% of the incomes generated by UMTS, and the duration of the license was lengthened from 15 to 20 years. These new conditions were more acceptable for Bouygues Telecom which financed the operation by capital increase. This vision of a controlled growth is much more present in family-held firms, because it exists a certain moral duty to continue what their ancestors created;

\* strategic alliances with customers, suppliers or other firms, in order to create synergies, to explore new markets or to diversify;

\* a good governance, i.e. a balance of power between the principal stakeholders of firms; shareholders, board members, managers and other employees, in order to guarantee that no actor can extract benefits to the detriment of others. In particular, the more the property is disseminated between a large number of shareholders, the more the top managers (CEO and others) are likely to manage the company in their own interest. Indeed, the managers have objectives and temporal horizons which are different from those of the shareholders. As they have a privileged access to information, they can use it in order to realize their personal objective. In addition, managers are also able to support certain investments compared to others, according to their preference and their risk (Charreaux, 1991). Good governance has 8 major characteristics<sup>iii</sup>: “it is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It

ensures that corruption is minimized, the views of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making”.

In fact, these elements are closely dependant. It does not make it possible to precisely measure the impact of each factor and limit the range of the conclusions of univariable studies on firms' long-term performance and the reasons for their longevity. Indeed, the most powerful companies in the field of human capital show good performances in terms of innovation, growth, governance and they also have a strong culture.

## **B. What is the relationship between sustainability and performance?**

Faced with the environmental risks that are currently occurring worldwide (climate change, dwindling natural resources, drastic loss of biodiversity, natural and industrial disasters, etc) and the pressure of public opinion, some companies have recently integrated sustainable development into their strategy, which includes three pillars: economic, social, and environmental. This brought about the concept of “Corporate Social Responsibility” (CSR) as a manifestation of the principles of sustainable development (or sustainability)<sup>iv</sup>. The implementation of a CSR approach does not basically modify the objectives of the company, but adds a number of constraints on how to make that profit (respecting future generations) and how to distribute it (between employees and shareholders).

On a practical level, the voluntary adoption of additional constraints, related to CSR, and not governed by the rules or standards of an industry, results either in:

- \* a real commitment of the company which promotes certain values,
- \* a “marketing” or “strategic” approach aimed at stakeholders with the aim of improving company performance or justifying it. Indeed, the firm can use sustainable development to attract consumers (e.g., with fair trade), current and potential employees (e.g., a charter on integration of handicapped workers), governments (e.g., to win tenders), suppliers (by

negotiating quality or prices), or shareholders. In the last case, as CSR is reflected in the search of long-term performance, it can be used to justify, for example, short-term financial results below the expectations of investors.

Thus, whatever the reasons firms adopt CSR, the question remains about its impact on their performance. Indeed, increasing numbers of investors are not only analyzing the financial performance of firms but are also assessing how these firms face their social responsibilities (Barnett and Solomon, 2006). According to stakeholder theory, the greater the satisfaction of all stakeholders involved the better the control of the implicit costs of the company resulting in a higher financial performance (Waddock and Graves, 1997). A firm is thus required to be held "accountable" for its social performance, in addition to its financial performance (Gössling, 2003). However, according to Friedman (1970), CSR leads to expropriation of shareholders profits, for the benefit of the community. In addition, non-profit maximization for the firm involves a loss of efficiency for the firm as a whole.

To clarify this debate, numerous empirical studies have documented an association between corporate social performance (CSP) and corporate financial performance (CFP). Several meta-analysis (Wu, 2006; Maron, 2006; Margolis & Walsh, 2003) show that the relationship between CSP and CFP seems positive. However, their syntheses relate to periods before the year 2000. Cohen and Winn (2007) and Schubert and Lang (2005) specify that although the Bruntland<sup>v</sup> report (1987) is considered the high point in the awareness of CSR by firms, stakeholders as well as financial analysts, it is only at the beginning of the years 2000, that sustainable development became installed as a major issue of corporate government. Firms have had to take into account the shift in value systems of its shareholders, its employees, its customers..., etc, by implementing the social and environmental objectives of all its stakeholders. Henceforth, the meta-analysis Margolis, Elfenbein & Walsh (2008)<sup>vi</sup>, but especially that of Van Beurden and Gössling (2008) seems more relevant insofar as they are



primarily focused on studies completed between 1990 and 2007 and take into account these changes of societal values. They show that the majority of studies found a positive relationship between CSP and CFP. While in these various studies, the results are often mixed, it is mainly because of performance measures and methodological problems, especially as social and financial performance are endogenous. The social performance of firms is generally understood through pollution indices, reputation, social rating agencies such as KLD<sup>vii</sup>, the content analysis of their annual report, their philanthropic activities, or inclusion in a market index called “socially responsible” such as the DSI 400 for the USA (Decock-Good, 2001). Some researchers such as Belu (2009) even propose DEA<sup>viii</sup> indices reflecting a measure of the commitment by firms to the practices of sustainable development (or sustainability). The financial performance includes measures resulting from accountancy (e.g., return on investment or return on assets) and others such as market (price or stock return). The relationship is much more significant for social performance with indices of reputation, and for financial performance with accounting measures. Besides the intensity of the stronger relationship, measures derived from accounting have the advantage of providing a more relevant measurement of the firm's economic performance. The only disadvantage is that they are more prone to managerial manipulation (McGuire *et al.*, 1988).

These measures, which are the basis of differences observed in the results, lead us to question the concept of firms' long-term performance, that financial performance alone can not capture. Besides these performance measures, the industry in which a firm belongs must be taken into account in the intensity of the positive relationship between sustainability and performance. Indeed, firms operate in different industries and must face social, environmental and financial concerns which are quite distinct. A bank will not have the same concerns in terms of sustainable development as a petrochemical company. However, most studies cover several

industries and tend to mask the effects of a specific industry. As proposed by Chand (2006), these studies on the relationship between CSP and CFP should focus on a single industry.

This positive relationship between sustainability and performance is increasingly shared by professionals, as shown in the study of McKinsey-BCCC (2008)<sup>ix</sup> in which two-thirds of the managers and three-quarters of investment professionals interviewed in U.S. believe that CSR creates value for shareholders, in a stable economic environment.

### **C. Longevity and sustainability**

The empirical studies show that longevity and sustainability are positively related to the financial performance of the firm, even if the intensity of the relation varies with the measurement of selected performance. In fact, this phenomenon is explained rather simply owing to the fact that when one examines in detail the explanatory criteria of the longevity of the companies, one realizes that five of the six factors underlie principles resulting from CSR: a strong corporate culture based on values, a relevant and fair valuation of human capital, a controlled growth and financial prudence, strategic alliances with the stakeholders, and a good governance.

One can thus wonder whether the majority of centenary companies are not quite simply guided by simple principles of ethics and management, leading them to seek controlled growth while respecting the men who contributed to their success. This integration in their genes of certain principles of CSR explains surely part of their longevity.

### **III. Sustainability like a rampart against crises ?**

Economic crises weaken companies. Many are those which end up filing for bankruptcy and cease their activity. In France, company failures increased by 21.3% in the first quarter of 2009 compared to the same period of 2008, in spite of the reinforcement of preventive safeguards<sup>x</sup>. In fact, History teaches us that any economic crisis involves questioning established models, by putting forward their defects; incompatibility with the evolving environment, lack of flexibility and various other dysfunctions. But the crises also provide an opportunity for making radical changes which would be more difficult to implement during stable periods, because economic agents are reticent about change (consumers, firms, employees, etc). The support measures for the economy (revival programs), then set up by governments in the majority of countries, are then as much an opportunity to facilitate the changes induced by the crisis by mitigating their harmful effects on companies and consumers. We will see, in this part, the impacts of the crisis on the failure of firms and the role that concept of sustainability can play to mitigate their effects.

#### **A. Impact of the crisis on company failure**

Any crisis results in an increasing number of company failures, owing to the fact that it affects their effectiveness. These impacts materialize at the following levels:

\* economic (i.e. whether products correspond to the market). It results in a fall in sales (following the fall of consumption) or a structural fall in turnover, because of the behavioral change of the consumers. General Motors going into bankruptcy in June 2009 resulted from the inadequacy of its products (mainly the vans as well as off-road vehicles and sports cars) for the American automobile market, whose demand had changed with the rise in the price of gasoline in 2008, then the crisis ( American consumers now prefer less expensive, more economical cars);

\* organisational. This crisis has been both an indicator of organizational dysfunctions and forced firms to reduce their costs, given the drop of their turnover. This cost reduction inevitably requires a review of their mode of production (including work organization), logistics, as well as inventory management. Organisational dysfunctions also relate to the governance mechanisms, such as risk control or executive compensation, which are in such challenging times followed closely by the press;

\* financial. Crises result in a more or less strong fall in the firm's financial performance. Companies faced with a lack of liquidity, must file for bankruptcy, or even cease their activity. This phenomenon raises two issues; on the one hand the vision of investors performance (a decrease in short-term performance following a crisis does not mean the company cannot be profitable in the long-term), on the other hand, it is at the time when firms need the banks most that they stop lending, which forced the government to set up a credit Mediator, despite of the commitment of the French banks to continue funding the economy<sup>xi</sup>, particularly SMEs, after their rescue by the State. Indeed, “in 9 months (November 2008 - August 2009), over 15,000 firms have complained to the credit Mediator and the flow of new cases has remained stable despite the summer break. 85% of cases were accepted, representing an outstanding credit of 2.91 billion euros<sup>xii</sup>.”

## **B. Sustainability and crisis**

Besides the economic measures (including recovery plans) implemented by most governments around the world, the issue of structural reforms to be adopted to prevent recurrence of such crises remains. The public debate focuses on various topics such as regulation of the financial system, corporate governance, the social behavior of firms, particularly with regard to layoffs and relocations, tax havens, tax fraud, etc.

If a new financial system regulation is inevitable, it may be insufficient because of globalisation, the ingenuity of individuals and the complexity of products, will sooner or later bypass it or divert it. In addition to this new financial regulation it seems necessary to imagine, a real behavior change, in particular in banks, to prevent a crisis like subprime recurring. Sustainable development policies can guide the evolution of these behaviors and become a rampart against crises, through its three pillars (environmental, social and economic) as strong enforcement of CSR principles would allow :

\* to reduce the occurrence of crises or their scope. Indeed, the subprime crisis is due to banks that have lent money to insolvent households and which then securitized those loans. However, good governance would have allowed banks to have allocated these funds to better control the risks taken by limiting this variety of credit, as well as the sale of the toxic securitized products, and for the other banks, to limit their exposure to such products. The next crisis will surely be about energy as is suggested by the mid-2008 increase in oil prices. There is an urgent need to take strong measures to reduce the consumption of fossil fuels and to use renewable energy as a worldwide substitute , as advocated by supporters of sustainable development;

\* to better resist crises. Indeed, highlighting the link between longevity and sustainability of firms shows that the integration of CSR into their strategy, would give them a greater capacity for survival in a changing environment and thus help them resist crises. Moreover, the subprime crisis has highlighted that firms rated for their good governance ultimately did better than others. This argument extends equally to the need to strengthen the governance of banks. In fact, this idea may seem simplistic, since the implementation of CRS policies in firms is not new, it is either a voluntary step or an application of laws. In France, article 116 of the Law on New Economic Regulations, known as NRE (2001), requires publicly traded companies to achieve social and environmental reporting. But, the auditors are just required to

review the sincerity of non-financial information disclosed and not their compliance with statutory obligations. The subprime crisis confirmed the shortcomings of current approaches of CSR with firms based mainly on a declarative system with constraints and a myriad of references, which make it possible for firms to build “compliance, avoidance or manipulation strategies” (Scholten, 2008).

The case of large banks worldwide is symptomatic, with the bankruptcy of their system of governance including the level of the risk control and remunerations. Moreover, in France, the large banks say they advocate CSR and disseminate sustainable development indicators according to the NRE, but a detailed analysis of their practices reveals that their adhesion to the principles of sustainable development remains superficial (mostly just talk). Indeed, the search of short-term profitability after the abyssal losses due to this crisis resulted in a tightening of the credit conditions by which SMEs are suffering and an increase in their market activities (for example, 1/3 of incomes and 50% of profits before tax of BNP Paribas, in the second quarter of 2009, come from its investment bank<sup>xiii</sup>). We could also mention “the bonus scandal” that the French government has seized on, as well as the UK regulator, and the presidency of the European Union<sup>xiv</sup>. Finally, their actions against exclusion, poverty alleviation and microcredit<sup>xv</sup> remain marginal<sup>xvi</sup>. By comparison, 20% of outstanding microcredit comes from commercial banks in developing countries<sup>xvii</sup>.

These remarks raise the question of the manner in which it would be possible to encourage companies to adopt the principles of sustainable development. In the financial area, hard law is necessary for two reasons: because of systemic risk, on the one hand, and its limited ability to regulate itself, on the other hand. Indeed, it is in banking that governance dysfunctions are greatest (including the control of risks and rewards). For the remaining firms, a mix of hard law and soft law seems more appropriate. Indeed, the law has the advantage of forcing all

economic agents to comply, but if it is too specific, it may be quickly ineffective due to its lack of flexibility.

A more efficient path in the field of sustainable development would be to use the law to set standards (such as requirements for all companies to publish sustainable development indicators) and let social bodies (NGOs, consumers, employees, business...) the task of explaining these standards (the choice of indicators in our example<sup>xviii</sup>) and how they are implemented. Many citizens want, for example, the law Grenelle II (article 83), currently under discussion, to include the requirements of sustainable development in all firms, while providing an easier implementation for SMEs<sup>xix</sup>, and not just those that employ more than five hundred employees, whose total assets exceed 43 million euros.

#### **IV. Conclusion**

Compliance with the policies of corporate sustainability would increase productivity, effectiveness and efficiency that encourage innovation, but it would also create savings and thus improve firms' performance and consequently their longevity. In addition, it would allow in some cases to attract capital thanks to the improvement of the company's reputation with investors and banks and to facilitate access to new markets. In this context, the emergence of crises and their intensity will be lower as companies would continue to make decisions that take into account environmental and social factors. The emergence of laws on the application of standards in the field of sustainable development heightens the efficiency of decision making and reduces the temptation for companies to reduce commitment to social responsibility, since it is not directly productive. But due to globalization sustainable development policies are not the prerogative of some countries and firms to avoid distortions of competition thus they have no real impact<sup>xx</sup> on the environment.

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<sup>i</sup> According to the famous gibe of the economist Milton Friedman

<sup>ii</sup> <http://www.apce.com/cid73551/la-creation-d-entreprises-en-2007-en-france.html?pid=251&espace=4>

<sup>iii</sup> <http://www.unescap.org/pdd/prs/ProjectActivities/Ongoing/gg/governance.asp>

<sup>iv</sup> [http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/index_en.htm)

<sup>v</sup> The Brundtland Report (The World Commission on Environment and Development (WCED), 1987.

<sup>vi</sup> Their meta-analysis includes 167 studies from 1972 to 2007.

<sup>vii</sup> KLD is the abbreviation for Kinder, Lydenberg, Domini and Co has US based rating agency whose scores social are widely used in empirical studies related to corporate responsibility. Local KLD measures concerning communities, workforce diversity, employee relations or natural environment are used.

<sup>viii</sup> Dated envelopment Analysis, cf. Belu (2009).

<sup>ix</sup> McKinsey-BCCC, 2008, "Measuring the business value of social impact", survey, September.

<sup>x</sup> <http://www.e24.fr/economie/france/article81612.ece/Les-defaillances-d-entreprises-explosent.html>

<sup>xi</sup> <http://www.e24.fr/economie/france/article41436.ece/L-Etat-va-a-nouveau-preter-aux-banques.html>

<sup>xii</sup> <http://www.e24.fr/economie/france/article124866.ece/Le-Mediateur-du-credit-saisi-15.000-fois.html>

<sup>xiii</sup> <http://www.easybourse.com/bourse/actualite/PLUS-BNP-Paribas-performance-sous-jacente-moins-brillante-FR0000131104-713743>

<sup>xiv</sup> <http://www.e24.fr/economie/monde/article129784.ece/Sommet-europeen-sur-les-bonus.html>

<sup>xv</sup> <http://www.lamicrofinance.org/content/article/detail/23538?PHPSESSID=168869>

<sup>xvi</sup> Extract from the 2007 CSR report BNP Parisbas: "The partnership with Adie based on several axes: a provision of a credit line of EUR 5 million, a partial assumption of the residual risk of default and a contribution towards the running costs of Adie rising with 350 000 euros." In parallel, its outstanding loans increased, in the first half of 2009, of 53.4 billion euros in real estate and 13.6 billion euros to support the professionals and entrepreneurs (source: boursier.com). Moreover, BNP Parisbas does not assume completely the residual risk resulting from this credit line used by Adie, which is all the more surprising when one considers that the repayment rate of micro credits are better than other types of credit.

<sup>xvii</sup> According to Sébastien Duquet, CEO of PlaNet Finance France.

<sup>xviii</sup> See for example indicators of Global Reporting Initiative (<http://www.globalreporting.org/Home>).

<sup>xix</sup> The Association for Sustainable Development of the Higher Council of the Order of Chartered Accountants, (CSOEC) also provides that the publication of these indicators will be done in the notes to financial statements. For companies not publishing annexes to the annual statements, this information or actions will be presented collectively at the level of professional branches.

<sup>xx</sup> According to Greenpeace, the curve of global emissions of greenhouse gases is now increasing steadily despite the Kyoto Protocol. This protocol, implemented in 2005, had been ratified by 175 countries except the United States. Moreover, emerging or developing countries are exempted from quantified commitments under the Treaty ratified by them, like China, India and Brazil.