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Profiling CSR in Argentinian public companies

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Abstract

We present a working project that explores the possibility of conducting fundamental research on CSR issues regarding listed stocks in the Argentinian capital market. The paper presents some problems that the research group is currently facing, some of them are conceptual while others are more practical ones. Later we present a very brief literature review and some normal research practices. Finally, we describe the research project and its intended final outcome.

1 – Introduction

We intend to measure the Corporate Social Responsibility (CSR) profile of Argentinian companies and to identify the basic issues needed in order to develop a Sustainable Index for the Argentinian capital market.

2 – What is CSR?

Corporate Social Responsibility (CSR) can be considered as an enlightened managerial vision that tries to acknowledge for three key aspects: economic profit, environmental improvement and the pursue of higher social equity. However, this is only one of the different available definitions

of CSR. Only to name a few, we present some of them[1]:

- "Managerial style defined by an ethical relationship with all stakeholders", Ethos Institute, Brasil.

- "CSR is the responsibility that people, institutions and corporations have in order to promote the welfare of society..." Fundación Prohumana, Chile.

- "Corporate citizenship makes reference to the way a company integrates its core social values along its commercial and operational practices", The Corporate Center for Corporate Citizenship, Boston College, US.

- "Corporate commitment to contribute to sustainable development, working with employees, their families, local community and society in order to enhance quality of life" WCSD, World Council for Sustainable Development.

- "Company relationship with each stakeholder, in order to sustainably enhance business performance and the quality of life of society as a whole", "División RSE" de IDEA, Instituto Desarrollo Empresarial Argentino, Argentina.

- "Firm´s ability to sustainably manage Economical, Social and Environmental resources applied to its activity"" , IARSE, Instituto Argentino de Responsabilidad Social, Argentina.

- "Continual progress of business responsibility, mainly in its products and in its value chain, in social, economical and environmental issues, with report and dialogue with stakeholders" , Fundación El Otro, Argentina.

As we may see, there is not an absolute, encompassing definition of CSR. CSR as such may mean different things to different people. Perhaps this fact is merely due to the novelty of CSR. But it may also be that societal demands change along time and place. For instance, CSR in Argentina (and perhaps Brazil) is more connected to philantropy and commitment to help the poorer people in society. However, in Chile, CSR is more focused on employee welfare. Why do we have these differences?

Perhaps an influential article written by Ian Davies[2] may help us. In this article, the author remarks the long-term business impact of social issues. For instance, the food and restaurant sector in America is becoming influenced by the debate about obesity, and similar trends can be spotted in the pharmaceutic and in the tobacco industries. As Davies points out "billions of dollars of shareholder value have been put at stake as the result of social issues"

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[1] The IARSE (Instituto Argentino de Responsabilidad Social Empresaria) has presented some definitions of CSR in its page www.iarse.org. I have selected some of them. The translation is mine

[2] Davies, Business and Society, The Economist, may 2005

3 – A relative concept

As a consequence, we have a concept of CSR that is not absolute, but relative to societal demands and emerging society forces. These demands may change and can be different according to the geographical area. Some populations in Latin America are worried about unemployment and consequently tend to be more lenient on polluting firms, as long as these firms provide work opportunities for the community. Thus, it may prove difficult to pursue a CSR conceptual model valid for all places and circumstances.

Moreover, what we call "society" or "community" is not a consolidated, homogeneous reality. There may be contradicting, colliding demands in the same society. In Argentina, there was a recent case, at Esquel, Patagonia, where an international company was interested in developing a gold mine. Esquel has an important tourist industry that could have been menaced by the potential pollution of the mining activity. For one side, unemployed people (and tax collectors) were eager to see the mine in operation. For the other side, people working in the tourist industry were anxious about the risks of mining. Eventually, a referendum was held and the result was a landslide against the mine.

Even geographical borders may have an influence in the development of societal demands. For instance, another recent case in Argentina took place in Gualeguaychú, Entre Ríos, when a popular revolt tried to stop the construction of a potentially polluting paper factory on the other side of the Río Uruguay, in the neighbouring country of Uruguay. Some cinics argue that it is not that people in Gualeguaychú were instant converts to the "green cause", but that they saw their profitable tourist industry at stake while they could not receive any benefit from a plant that was being built in another country.

4 – Profiling companies: some potential problems

When we are thinking about profiling companies, we are in fact trying to discriminate among companies on the basis of their CSR commitment or results. As we have seen, we can't have a clear-cut approach to CSR and perhaps the best bet could be to define a set of valid criteria.

Thus, the question is "valid for whom?" If we are developing an index fund catering to foreign investors, perhaps we should consider which values must be stressed. For instance, local farmers may not be especially concerned about animal well being, but there are many (or at least some) international investors worried about this issue. The same fact could happen with religious beliefs, as we may see some investment funds whose stock selection policy especifically follow defined sets of religious values.

Furthermore, we could have a different "weighting of worries", as different potential

investors, even acknowledging the same set of "causes", can assign a diverse "weighting" to each of them. For instance, I may be focused on climate change and consequently orientate my investments primarily with this point in mind without paying much attention to other issues, even if I knew about them.

5 – The Argentinian capital market

However, this discussion may prove to be far-fetched considering the current situation of the local stock market. In fact, the Buenos Aires stock market[3] is not yet a large market, even by emerging market standards. There are merely a hundred listed companies, while only half of them have everyday trading. There are two market indexes: "Panel General", that includes 50 companies, and "Panel Líder" that considers only 25 companies. The trading volume is not amazing. For instance, on 2nd. September 2006, Buenos Aires´stock exchange traded for a total of roughly 70 MM US$ (this figure includes stocks, bonds and derivatives of which 7.5 US$ are stocks). We may compare this trading with that of Santiago de Chile´stock exchange, in a country with quite fewer population than Argentina's (and a lower income per capita), that traded on the same day more than 500 MM US$ (66 MM US$ stocks).

Clearly, this allows us little opportunity to stock selection, as there may be scarce chances to spot "green" stocks (there are only a few stocks). On the other side, it may be argued that such an illiquid market can help stock misvaluation in the short run, making it difficult to spot CSR's "intangible assets or liabilities". However, the same illiquidity may attract risk-prone investors in search for "alpha"[4].

Furthermore, there is little public information about listed companies. Of course, quarterly financial reports are filed on the local Government control agency[5] but there is not much public information besides that. Companies do not usually provide public statements about their operations, there is no available research on CSR issues, and the data about environmental facts is scarce and scattered among different public offices. It should be noted that there is not an "EPA-style" agency on the federal level, but a combination of a federal agency along with one agency per province (24 provinces) and municipal agencies in each major city. There is not yet any agency focused on corporate social issues (excluding environmental issues).

As a consequence, an investor interested in assessing the CSR exposure of Argentinian stocks in order to improve his portfolio formation may have trouble in determing how to do this assessment.

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3 A complete description of the market can be seen at www.bolsar.com
4 Investment returns that derive from stock selection instead of taking more risk ("beta")

6 – Literature review

The main insights for this research come from two recent articles, both of them written by researchers from the World Resources Institute. The first, "Pure Profit, financial implications of environmental performance[6]", analyzes the pulp and paper industry in the US in relation to the environmental risk that the industry faces. The authors, using a thoroughful analysis, establish a link between environmental risk and financial risk.

The second article, "Changing Oil-Emerging Environmental Risks and Shareholder Value in the Oil and Gas Industry", is very similar in its approach and deals with the impact of environmental risk on energy stocks´ value. Here, a panel of experts is consulted about the main risks that could affect the Oil and Gas industry regarding climate change. With this information, different scenarios are built, along with their probability and outcome.

Thus, investors could determine the exposure of each stock to environmental risk. The crux of the matter is that the risk of a company is assumed not to be included in the historical beta, mainly because the environmental risk is a prospective one. We may conclude that as societal demands change in the time, the past is no longer a useful guide for tomorrow's CSR risk.

In another research, Soyka and Feldman[7] points out that the environmental management system of a firm determines its environmental performance, that lastly corresponds with controlled and non-controlled signals. In fact, it may be argued that investors are able to watch these signals in order to do the CSR profiling of companies. We will turn later to this signalling issue.

7 – What practitioners do

In order to show the practitioner´s perspective in developed markets, we have selected two well-known approaches. One of them, is that of KLD´s Domini indexes[8,] that are one of the first sustainable indexes created in America. For instance, Domini 400 is a selection of the 400 companies listed in US markets that rank first in an exhaustive matrix of criteria. The selection is conducted on information that is obtained via:

1. Direct communications with company officers.

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5 In the page www.cnv.gov.ar we can see all quarterly financial reports of listed companies
6 Repetto and Austin, "Pure Profit, financial implications of environmental performance", 2002 World Resources Institute
7 Sokya and Feldman, Capturing the Business value of EHS excellence, *Corporate environmental Strategy*, 5, [61-68], mentioned by Tong, Univrersidad del Pacífico, Perú "Research proposal" (not published)
8 See www.kld.com for a complete explanation of Domini´s methodology

2. Research bought for non US equities.

3. Media news reviews.

4. Public documents, like filings, annual reports, proxy statements.

5. Government and NGO information.

Another company, Innovest Group, a research firm based in America[9,] bases its work on the assumption that "companies' ability to handle environmental, social and governance (ESG) risks is a powerful proxy and leading indicator for overall management quality[10]". Consequently, Innovest selects more than a hundred factors that are not usually used in traditional, accounting-based, fundamental research. Innovest presents the idea of the "Iceberg balance sheet" that stands for the supposedly large part of company's value that cannot be grasped through conventional financial analysis.

In Innovest´s value model, four main intangible value drivers are considered:

- "EcoValue", that roughly corresponds to "environmental assets and liabilities" of World Resources Institute's studies.

- Human Capital.

- Stakeholder Capital.

- Sustainable Governance.

It should be noted that KLD's and Innovest's approaches are not exactly the same, as they may include different criteria. Besides, KLD is more focused on portfolio selection while Innovest is more oriented towards offering market research to portfolio managers.

8 – What we are currently doing

Our team at UCEL, Rosario, Argentina is currently reviewing public information about Argentinian quoted companies regarding CSR. We stress that only public information should be used if we assume that the Efficient Market Hypothesis stands in the local market[11]. Public information includes (but it is not limited to) financial statements, triple bottom line reports, issuance of ISO certificates, published analysis and journal reports.

Ideally, this information should be verified by an external party and regular (provided on a

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9 See www.innovestgroup.com for more details
10 From Innovest web page
11 Efficient Market Hypothesis points out that public information helps formulate current market prices. For instance, see Brealey Myers, "Fundamentals of Corporate Finance"

regular basis, no ad-hoc reports)

With that information in hand we will try to assess the signalling value for a prospective "responsible investor". Note that we are not trying to prove a relation among CSR performance and value, but only the possibility of signalling CSR from an investor's point of view.

Even if we have not yet arrived to that step, we think that this kind of signalling may be produced by:

1. ISO 14000 certifications as they stand for a functioning environmental management system.

2. Participation in eco-labelling as a sign to customers of a strong stake in sustainability.

3. Issuance of sustainable reports (environmental, social or triple-bottom line reports).

4. Participation in Carbon-bond schemes.

5. Participation in a formal social certification program (for instance, American-Argentinian Chamber of Commerce Price, Asociación Cristiana de Dirigentes de Empresas Price in Argentina).

Note that, even if we cannot discard any clue yet, some sources of information mentioned in developed markets´ research may not be useful here. For instance, public documents, news releases, NGO information are scarce and sometimes not very trustworthy.

With all the available information, we should be able to define a set of attributes or classifying variables, while each of these variables can assume different possible values. Based upon these values, we could build an analytical matrix that should be the basis of discrimination among "more" or "less" responsible firms.

We remark that this research does not pretend to determine any causative relationship among CSR performance and financial performance, but only to explore the possibility of performing CSR research on listed companies in Argentina with the public information currently available. The former point should be addressed by a future research project.

9 – Intended final outcome of this project

Lastly, this work should cast light upon the opportunities and problems regarding the creation an "Argentinian Sustainable Index". Drawing from our research and the experience of other neighbouring emerging markets in developing local sustainable indexes, we will prepare a critical analysis of challenges that may entail the development of such an index.

Eventually, an action program, considering the necessary steps, could be produced. In our opinion, this last objective will be useful for:

a) Company managers: that may lastly have an insight about the gap between the currently available company data and the potential requirements of the financial community.

b) Stock Exchange Regulation Agency (Comisión Nacional de Valores): The regulation agency will have a reference regarding which environmental and social information should periodically require to listed companies. Thus, the agency could better protect investors´ interests.

c) Local investors (people and pension funds): this research could help to develop a framework to estimate value impact of CSR policies (measuring "CSR exposure" of investments).

d) International investors: international investments are now scarce in Argentina, due to many economical factors. When this situation hopefully reverse, it is possible that some investors may prefer a "sustainable index" as a simple, easy, monitored way to perform Responsible Investing in Argentina.

e) NGOs and community: they could be enabled to better dialogue with companies. Thus, they will know the costs and benefits of their demands to companies.

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