Social Responsibility Does Not Mitigate Negative Market Response Due to Crisis, New Study Finds

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(PhysOrg.com) -- Clients of the major accounting firm Arthur Anderson sustained negative stock-market returns following public announcement that the firm had shredded documents related to its infamous Enron audit in 2002. In a new study, a University of Arkansas accounting researcher reports that corporate social responsibility on the part of some of these firms did not prevent a drop in their market value following the Enron audit failure.

“The Enron audit failure offers a unique opportunity to examine the influence of social responsibility on firm value,” said Manuel Sanchez, assistant professor in the Sam M. Walton College of Business. “The negative returns imply a presumption in the market that financial statements of Arthur Anderson clients were more susceptible to accounting manipulations. The only way to test the claim that social responsibility pays off in a crisis like this is to conduct an event study such as ours in which the market is likely to reassess factors related to firm reputation.”

Crises such as Enron - a large corporate scandal in which company executives reaped millions of dollars from off-the-books partnerships and violated basic rules of accounting and business ethics - present an ideal opportunity to investigate the influence of corporate social responsibility on the market value of a firm. Previous research has demonstrated that a firm’s reputation, affected by the stature of its

auditor, influences market value. But business leaders disagree about the benefit of corporate social responsibility, which one research team defines as a "commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large."

Proponents of corporate social responsibility argue that it fosters and promotes ethical behavior by managers, which has a positive impact on firm reputation. Detractors of corporate social responsibility claim that it is expensive and inconsistent with the preeminent goal of maximizing shareholder returns. Sanchez and colleagues Cheryl Linthicum at the University of Texas at San Antonio and Austin Reitenga at the University of Alabama wanted to use the Enron crisis to shed light on these opposing views.

The researchers identified 147 Arthur Anderson clients with social responsibility data and, based on industry, firm size and auditor, matched each client with a non-Arthur Anderson firm that also provided social responsibility information. To compare firms, the researchers developed an aggregate social responsibility measure, or score, based on qualitative data - strengths and concerns - established by KLD Research and Analytics Inc. The data pertained to firm performance related to community, corporate governance, diversity, employee relations, the environment, human rights and product quality. The final score also depended on whether the company was a member of the Domini 400 Social Index, another positive indicator of social responsibility.

The researchers found no evidence that corporate social responsibility helped the Arthur Anderson firms. In other words, these firms' disclosure of positive efforts related to community development, diversity, human rights and high-product quality did nothing to lessen the market impact of the Enron crisis on other Arthur Anderson clients.

"Our study does not support the contention that social responsibility can burnish the reputation of the firm in a time of crisis," Sanchez said. "The results are more consistent with the critics of social responsibility who claim that expenditures on these efforts do nothing to maximize shareholder returns."

The study has been accepted for publication in the Journal of Accounting and Public Policy.
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Provided by University of Arkansas (news : web)

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