

# The uneven benefits of CSR efforts

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When reaping benefits from environmental and social activities, not all firms are created equal. Tangible asset-intensive industries do better than intangibles-heavy ones, SMU research has found. Credit: Singapore Management University

Whether they are in the technology or oil sector, selling shoes or healthcare products, for many companies, green is the new black. While maximizing profit might have been the sole priority for most businesses a decade ago, these days it is common for mission-oriented companies to pursue the "triple bottom line" of people, planet and profit, particularly through corporate social responsibility (CSR) efforts.

While such efforts are commendable, some investors remain primarily concerned about whether firms can do well by doing good; in other words, whether CSR actually can increase a company's value. For instance, CSR activities could enhance brand image and improve customer loyalty, or even make it easier to attract and retain talent, leading to higher future stock returns. However, the wide-ranging and vague quality of these CSR efforts—which can encompass everything from donations to charities to promoting volunteerism among company staff—have typically presented a problem for academics trying to quantify their impact.

To determine the effect of sustainability-related activities on firm value, academics from SMU and INSEAD have embarked on a research project that effectively narrows the scope of CSR efforts to concrete and measurable environmental and social (E&S) activities; for example, redesigning factory processes to reuse water. By zooming in on observable improvements in future operating performance and stock returns, the researchers were able to quantify how E&S activities led to benefits for some—but not all—firms. Interestingly, the impact of E&S activities on future operating performance was largely dependent on company-specific factors such as the nature of assets owned by the business, SMU Assistant Professor of Accounting Grace Fan shared at the SMU/NUS/NTU Accounting Research Conference on April 17, 2021.

## A tale of two firms

Crunching the data for more than 4,000 US public companies from 1995 to 2016 including corporate heavyweights such as Apple and Chevron, Professor Fan and team focused on E&S scores in five main categories: Environment, community, diversity, employee relations and human rights. They found that in general, E&S activities are related to future improvements in operating performance, but only for firms in tangible asset-intensive industries such as manufacturing, utilities, energy and chemicals. For companies in sectors that are more intangible asset-intensive, which rely more heavily on assets such as intellectual property to derive profits, there was no such beneficial effect.

"For the tangible asset-intensive companies, they have a lot of fixed and heavy assets and processes. We imagine they would derive more benefits from improving their process efficiency and making their workers happier as a result of E&S activities," Professor Fan shared, citing case studies of such process improvements in China, India, the Czech Republic and more.

For instance, US-based conglomerate Honeywell redesigned its chemical cleaning process in a Czech Republic-based plant, which helped reduce its production of chemical waste and consumption of natural gas. Not only did worker safety improve due to reduced handling of toxic chemicals, production time was shortened and the plant saved the company an additional \$15,000 a year. Similarly in India, workers at a Honeywell plant implemented an energy conservation program that allowed it to save an extra 5,000 kilowatt-hours of energy a month, and almost \$900,000 a year, Professor Fan explained.

Provided by Singapore Management University

### **Tracing correlation to causation**

Further tracking the impact of E&S activities on stock returns, Professor Fan and team found that E&S activities did in fact correlate with positive stock returns. However, this relationship again occurred mainly in tangible asset-intensive industries. The significant boost in stock returns also disappeared once the researchers controlled for improvements in operating performance, suggesting the positive stock returns were likely due to better internal processes and increased operational efficiencies in these tangible asset-heavy firms.

"It's possible that the stock market does not value the E&S ratings of firms in intangibles-intensive industries such as technology and consumer nondurables as much," Professor Fan said. "Or, the stock market has already incorporated the E&S activities of these firms when determining their value, since their E&S activities may be more easily observable through consumer branding and advertisements compared with tangibles-intensive firms who may embark more on internal process innovations which are more difficult to observe."

Wrapping the virtual session up, Professor Fan delved into the limitations of the study, including the difficulty of claiming causality between E&S ratings and firm value instead of mere correlation. To further investigate this issue, the team will work on collecting more specific data on firm operations, such as the level of carbon emissions and waste production, in addition to E&S ratings.

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