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Doing Well While Doing Bad? CSR in Controversial Industry Sectors

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Abstract

In this article, we examine the empirical association between firm value and CSR engagement for firms in sinful industries, such as tobacco, gambling, and alcohol, as well as industries involved with emerging environmental, social, or ethical issues, i.e., weapon, oil, cement, and biotech. We develop and test three hypotheses, the window-dressing hypothesis, the value-enhancement hypothesis, and the value-irrelevance hypothesis. Using an extensive US sample from 1995 to 2009, we find that CSR engagement of firms in controversial industries positively affects firm value after controlling for various firm characteristics. To address the potential endogeneity problem, we further estimate a system of equations and change regression and continue to find a positive relation between CSR engagement and firm value. Our findings support the value-enhancement hypothesis and are consistent with the premise that the top management of US firms in controversial industries, in general, considers social responsibility important even though their products are harmful to human being, society, or environment.

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Notes

1. According to the management literature summarized by Margolis and Walsh (2003), over 120 studies between 1971 and 2001 examine the empirical relation between CSR and corporate financial performance (CFP), and the results are largely inconclusive. They suggest that assessments of previous studies are complicated due to various imperfections in these studies, such as measurement problems related to both CSR and CFP, omitted variable problems, a lack of necessary analyses of causality and/or endogeneity, a lack of methodological rigor, and a lack of theory. Nonetheless, these studies stress that bad social performance is detrimental to a firm's financial performance.

2. More recently, Porter and Kramer (2006, 2011) argue that because traditional CSR activities mainly focus on corporate reputation and are so disconnected from the core business, it is often difficult to sustain CSR programs and to benefit society over the long run. Porter and Kramer (2011) further claim that the principle of corporate shared value (CSV) is essential to a company's profitability, competitive position, and the best interest of wider stakeholder groups including government and non-profit organizations. Porter and Kramer (2011) conclude that because CSV leverages the unique resources and expertise of the firm to create economic value by creating social value, CSV should supersede CSR in guiding firms to plan their CSR programs.

3. Similarly, El Ghoul et al. (2010) find that the participation of CSR in two sinful industries including tobacco and nuclear power increases cost of equity capital, while CSR engagement decreases the cost of equity capital for all the other industries.

4. Toyota Prius is a good example—the increasingly popular hybrid car—is an intersection between Toyota's core business and environmental benefits (less emissions, happy customers, cleaner roads, cleaner air, etc.).

5. Hong and Kacperczyk (2009) exclude adult entertainment industry and

weapon industry from their list of sin industries. While they focus on the so-called triumvirate of sin (alcohol, tobacco, and gaming), two other classes of stocks are sometimes thought of as sinful. The first is the adult entertainment industry. However, there are very few publicly traded companies with heavy operations in adult entertainment. Indeed, when we check adult entertainment industry firms in KLD, there was no single adult entertainment firm covered in the KLD data. Therefore, omitting these companies will not affect our results in any significant way. The second is the weapon industry. Following Hong and Kacperczyk (2009), we decide against including weapon or defense as a sin industry in our main analysis because it is not perfectly clear whether weapon or defense is considered a sin by many American people. Instead, we include weapon industry in other category (see Table 2). In addition, when we check the KLD data, nuclear industry firms are not covered either.

6. While it is true that the CSR actions of the firm's competitors drive, at least, part of firm's CSR strategy, our empirical method and our sample do not permit us to explore such a possibility.

7. When we run the regression on sin industry only, the sample size is only 186 in 3SLS, and 165 in change regression, and none of the CSR coefficients on firm value is significant, similar to the results reported in Table 5. These results are available upon request.

8. To assess the quality of the KLD data, Chatterji et al. (2009) use the KLD environment ratings to predict toxic releases reported in the government's Toxic Releases Inventory (TRI) and compliance with environmental regulations including the number and amount of penalties imposed. They conclude that the KLD ratings do not reflect all the information available on environmental performance but are a good predictor of firms with the worst environmental performance. TRI emissions are a much narrower measure of environmental performance than that in the KLD Environment category and hence are not a good proxy for the KLD strengths or concerns.

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Appendices

Appendix 1

See Table 8.

Table 8 List of the strength and concern items in the KLD database

Appendix 2

See Table 9.

Table 9 Calculation of the CSR index

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