Does CSR Boost Shareholder Value?

Ivey’s Caroline Flammer Sheds Light on the Link Between CSR and Financial Performance

For decades research has suggested that corporate social responsibility (CSR) improves corporate financial performance (CFP). Dr. Caroline Flammer of Western University’s Ivey Business School provided the first empirical evidence that this relationship is indeed causal.

The Chicken or the Egg?

Traditionally research has looked at whether adopting CSR improves financial variables like return on assets (ROA), return on equity (ROE) and Tobin’s Q (the ratio of a company’s market to book value). The two seem to increase in tandem, suggesting CSR drives financial performance.

Dr. Flammer questioned whether this correlation truly inferred causation: Do companies that adopt CSR activities become richer, or can richer companies afford to take on more CSR initiatives?

Ask the Shareholders

New CSR activities proposed by the firm’s shareholders are often put to a shareholder vote. Dr. Flammer looked at 2729 CSR proposals put to shareholder vote in U.S. publicly traded firms between 1997 and 2012, covering both social responsibility and environmental performance. She compared the financial effects of proposals that passed or failed by a small margin of votes (“close call proposals”), as these reflect very minimal differences on how shareholders viewed proposed activities.

Financial performance was measured with variables such as the stock market reaction on the day of the shareholder meeting, ROA, ROE, net profit margin and Tobin’s Q.

Shareholder Value Increases When Firms Implement CSR

Dr. Flammer found that passing a close call proposal led to a 0.92% increase in shareholder value, as measured by stock market reaction on the day of the vote. This confirms the historical assumption that CSR activities indeed improve financial performance.

Dr. Flammer also discovered that:

*Value gains are stronger in industries with higher levels of CSR* - Stakeholders of companies operating in socially-conscious industries tend to have stronger interests in CSR. They therefore respond more favourably to new CSR activities, leading to higher returns.

*CSR programs improve operating performance* – Dr. Flammer found that increased shareholder value happens because of improved operating performance. The increase in operating performance can be attributed to improvements in labour productivity and sales growth, suggesting CSR improves employee satisfaction and appeals to customers.
CSR has decreasing marginal returns - Initial financial benefits of CSR activities may be significant, but returns will eventually decrease. This is consistent with the findings of Wang and colleagues (2008) who found that firm-level CSR engagement plotted against financial performance initially rises but eventually tapers off, creating an inverse U-shaped curve.

Key Takeaway

This study provides the first empirical evidence of a causal link between CSR and financial performance. The results indicate that implementing CSR leads to higher shareholder value, along with improved operating performance, happier employees and strengthened stakeholder interest.

About the Author

Dr. Flammer’s paper entitled "Does Corporate Social Responsibility Lead to Superior Financial Performance? A Regression Discontinuity Approach, was awarded the 2013 Moskowitz Prize for Social Responsible Investing from the Center for Responsible Business at UC Berkeley’s Haas School of Business. Read more about Dr. Caroline Flammer and her award here: http://sites.ivey.ca/blog/2013/11/04/CSR-finding-earns-caroline-flammer-global-award-for-research/.