Doing Good versus not Doing Bad: Does the Market Reflect Impact Investing and Socially Responsible Investing?

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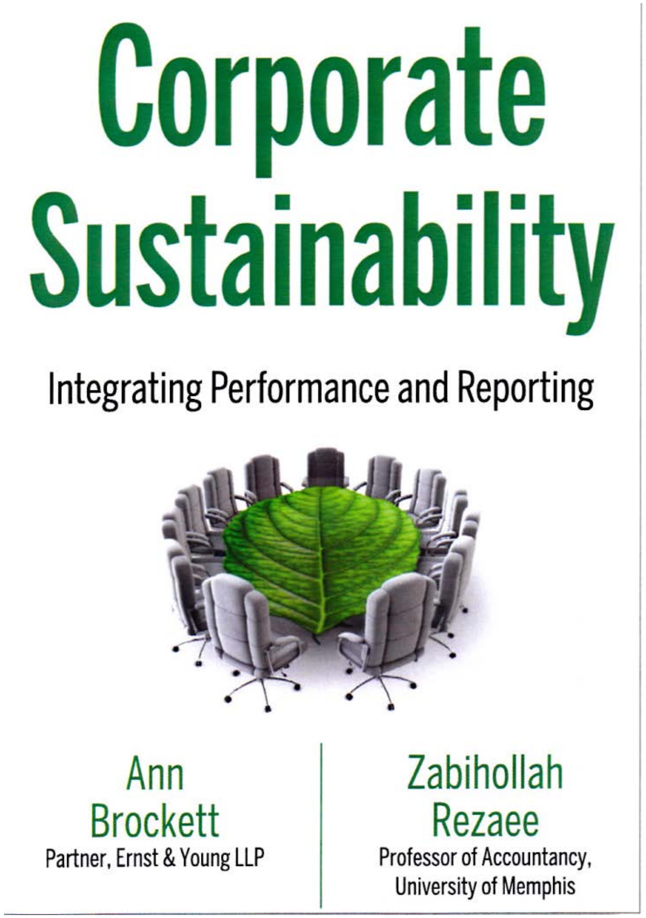
THE UNIVERSITY OF MEMPHIS

Corporate Sustainability: Winner of 2013 Axiom Gold Award

Corporate Sustainability explores business sustainability and accountability reporting and their integration into strategy, governance, risk assessment, performance management, and the reporting process. Written by renowned experts in the field of managing for sustainable performance, this important book also highlights how people, business, and resources collaborate in a business sustainability model.

A significant contribution on how to put sustainability principles to work, *Corporate Sustainability* offers real-life tools and practices for creating an authentic corporate framework for sustainability.

Joel Makowner writes, "Companies seeking to embrace sustainability must navigate a thicket of policies and standards, from ethical performance to environmental protection to executive compensation – and do so transparently, comprehensively, and globally. Ann Brockett and Zabihollah Rezaee have created a valuable field guide to this brave new world of multiple bottom lines, providing guidance on how companies can engender public trust and investor confidence while pursuing their economic goals."

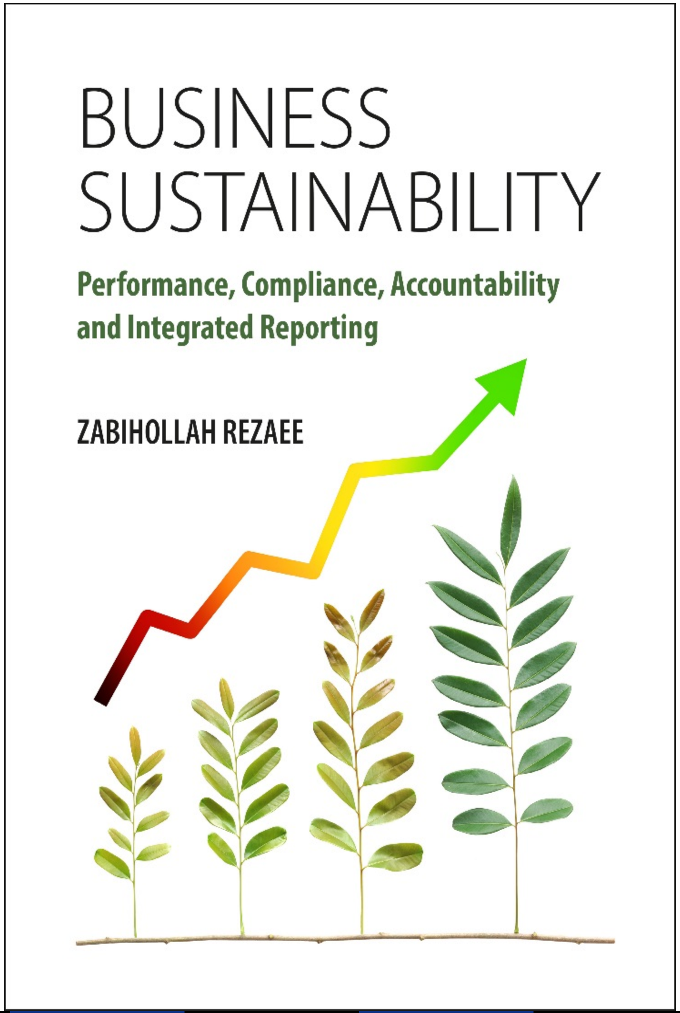


Business Sustainability, Greenleaf, October 2015

Review by O.C. Ferrell:

Rezaee takes a more inclusive approach to sustainability performance and reporting by recommending that businesses use a multiple bottom line (MBL) approach rather than the more basic triple-bottom line approach. An MBL approach examines economic, governance, social, ethical, and environmental performance of an organization's activities to determine sustainability. This approach expands the definition of sustainability beyond environmental or economic indicators to advocate for a holistic methodology that factors in the well-being of the organization and its impact on stakeholders.

Rezaee's view of sustainability takes a multidimensional approach incorporating organizational value, long-term performance, and stakeholder theory through the use of financial and nonfinancial measures. This unique way of viewing sustainability and the emphasis on accountability and integrated reporting has the potential to change the way researchers, companies, and public policy makers view this increasingly important field.



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Business Sustainability in Asia

THE GLOBAL MOVE TO SUSTAINABILITY HAS ARRIVED IN ASIA

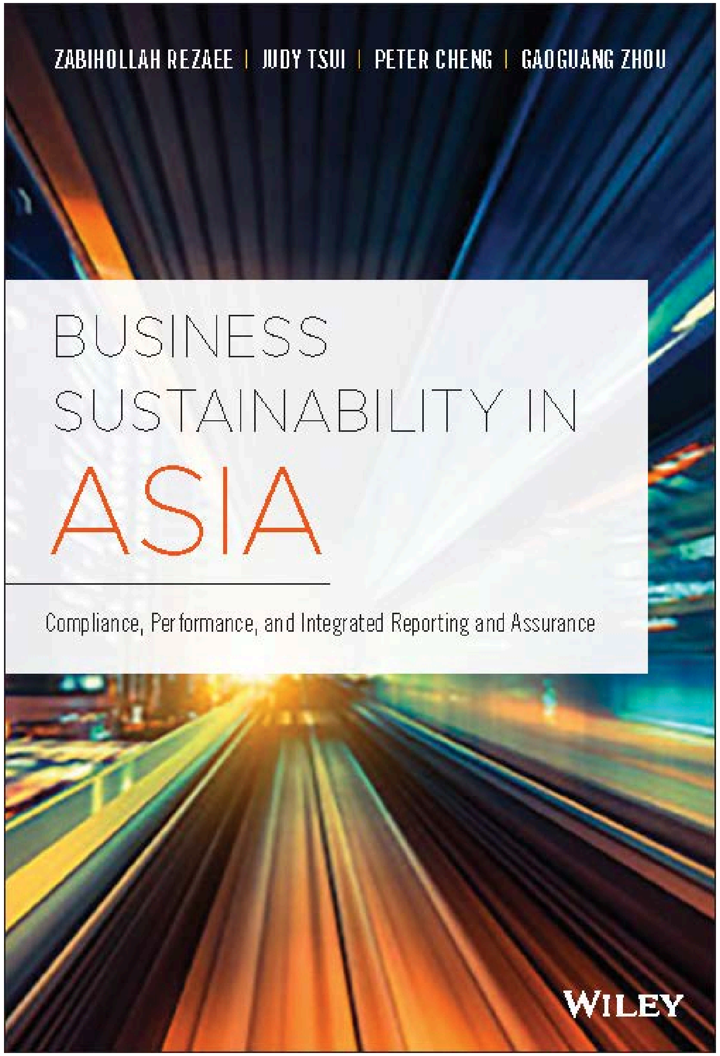
In Asia, sustainability practices have grown substantially over the past decade, and the continent's business leaders are poised to become global leaders in sustainability initiatives. Following the global trend, Asian businesses focus on economic, governance, social, ethical, and environmental (EGSEE) sustainability dimensions. Business Sustainability in Asia applies this paradigm to the economic powerhouses in Asia, from Japan and Mainland China to India and Vietnam. For each jurisdiction, the authors consider:

• Global, regional, and local sustainability requirements and expectations

• Best practices for maximizing firm value by improving sustainability

• Balancing short-, medium-, and long-term sustainable performance

• The interrelated nature of financial performance and long-range sustainability.



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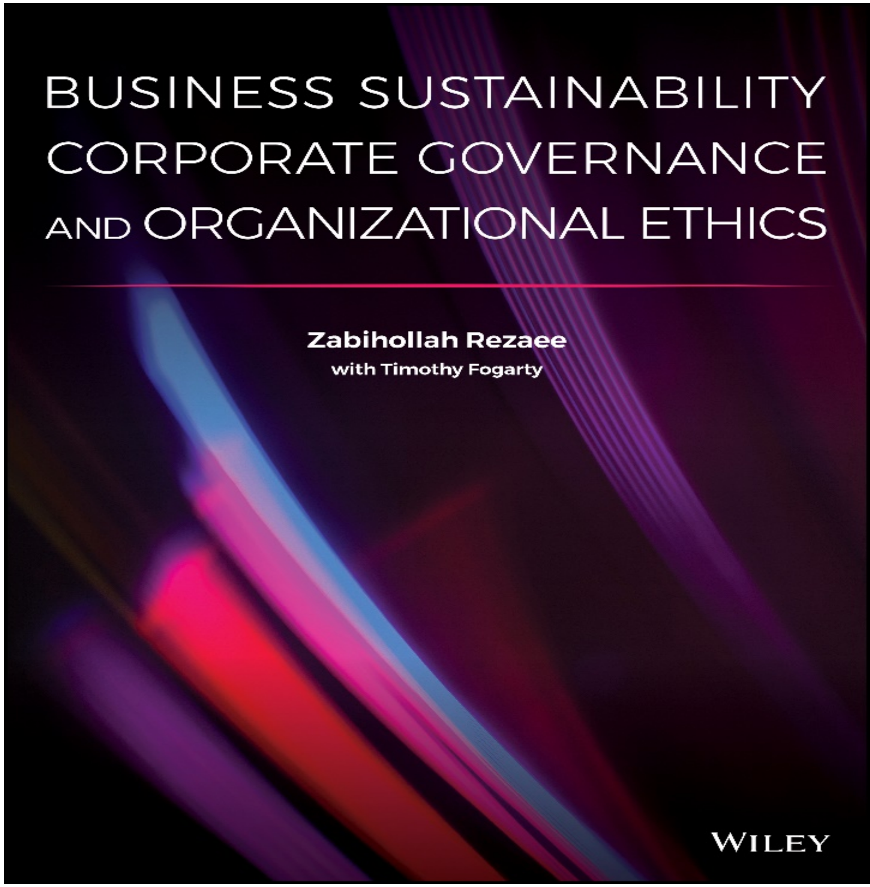
Text Book

This book is a superior reference for all business schools and other college programs that offer business sustainability, corporate governance, and professional ethics education as well as professionals who need an up-to-date understanding of emerging areas in business. The book can be used in a three-credit hour course designed to develop an awareness and an understanding of the main themes, perspectives, frameworks, and issues pertaining to corporate governance, organizational ethics, and business sustainability. Alternatively, different modules of the book can be separately used in a variety of accounting and business courses. The 30 chapters of this book are organized into four modules with the first module provides three introductory chapters. Module two covers business sustainability performance, reporting and assurance, and sustainability research and education. The third module explores corporate governance—including its oversight, managerial, compliance, advisory, auditing, and monitoring functions—and discusses its integration with accounting research and business curricula. The importance of organizational, business, professional, and workplace ethics is illustrated in the final module.

Reflecting the most current and cutting-edge information in the field, this book:

•Addresses the latest revisions to the AACSB Accreditation Standards.
•Discusses the role business schools play in promoting integrity, competency, and ethical conduct in financial reporting and auditing processes.
•Covers five dimensions of business sustainability performance: economic, governance, social, ethics, and environmental (EGSEE) as well as integrated sustainability reporting and assurance.
•Provides a framework for discussing important functions of corporate governance such as oversight, managerial, compliance, auditing, advisory, and monitoring.
•Discusses current trends in business sustainability, corporate governance, and ethics research and education.
•Presents profit-with-purpose corporate concept of creating shared value for all stakeholders.



INTRODUCTION

- There have been considerable efforts to encourage business organizations to pursue profit-with-purpose goals and for investors to integrate environmental, social, and governance (ESG) sustainability into their strategic and investment decisions.
- Recent anecdotal evidence (BRT, 2019) and research (Ng and Rezaee,2020) suggest that business organizations move away from the shareholder primacy of maximizing shareholder and toward the stakeholder primacy of achieving desired financial returns for shareholders while securing social and environmental impacts.
- The Global Impact Investing Network (GIIN) refers to impact investing (II) as "investments made with the intention to generate a positive, measurable, social, and environmental impact alongside a financial return,"
- Although the II concept has often been used interchangeably with socially responsible investing (SRI), the two concepts have important differences. SRI is commonly referred to as the investment strategy that maximizes financial returns while minimizing any negative impact on the society or environment whereas II is a deliberate investment strategy to achieve both financial returns and social and/or environmental impacts (Hebb, 2013; Rezaee and Fogarty, 2019).
- We examine whether the market values II ("doing good") and SRI ("not doing bad") strategies by examining the relationship between stock performance and sustainability strengths and concerns using a system of linear equations approach.

Synopsis

What did we do in the paper? We examine whether the market values impact investing (II, "doing good") and socially responsible investing (SRI, "not doing bad") strategies by examining the relationship between stock performance and sustainability strengths and concerns using a system of linear equations approach.

Why did we do? The distinction between II and SRI investment strategies is important because:

For II strategies, the investment managers are trying to maximize financial performance as well as to have positive and measurable effects on the environment and society (positive screening, investing in employees, communities, and environment) and thus requires additional investment and resources be allocated to II strategies.

SRI strategies, on the other hand, entail a systematic consideration by firms and their directors and executives to minimize the possible negative impacts of business operations on communities, society and the environment and thus SRI does often not require corporate managers to allocate resources to ESG initiatives.

Synopsis (Continue)

How did we do? We perform our analyses in two stages. In the first stage, we examine the association between the existence of sustainability strengths and lack of sustainability concerns on stock performance. Following prior studies (e.g. Dhaliwal et al., 2011, 2012, 2014; Ng and Rezaee 2015), we use the provisions included in the MSCI KLD to proxy for corporate investment strategies. We map the different KLD ESG sustainability dimensions and attributes into the II and SRI strategies. Strengths are related to provisions that have a positive impact on the prescribed areas of interests. The absence of these concerns is consistent with our definition of SRI strategies,

What did we find? Drawing on a sample of 21,884 firm year observations in the 1991-2015 period we report three main findings:

(1) Stock performance is negatively (positively) associated with existence of sustainability strengths (absence of concerns) as proxies for II and SRI strategies respectively

(2) The relationship between stock performance and financial (non-financial) sustainability performance is weakening (strengthening) over time;

(3) The relationship between stock returns and corporate investment strategies depends on resources availability and level of institutional ownership.

(4) The relationship between investment strategies and stock performance is marginally weaker for corporations with lower institutional ownership.

(5) the positive relationship between stock returns and the absence of sustainability concerns disappears when the resources to invest in sustainability are lower (when the firm is small).

What is our Contribution? We contribute to the literature by examining the asymmetry between “doing good” and “not doing bad” by distinguishing between II and SRI strategies and examining the differences of the impacts of these investment strategies and thus contribute to the extant literature on ESG/CSR.

Theoretical Framework

- There are two theoretical aspects of CSR/ESG investment, which should relate to how managers proceed with their corporate decisions.
- The first aspect is the traditional "shareholder value maximization" based on the value enhancing theory where management attempts to improve earnings for shareholders in the context of the "shareholder primacy" concept under the agency/shareholder theory (Palladino and Karlsson, 2018; Rezaee and Fogarty, 2019).
- The second aspect is the broader "stakeholder/society value creation" based on the shareholder expense theory where management maximizes the sum of the various stakeholders' surpluses (e.g., creditors, employees, customers, suppliers, society, and the environment) under the "stakeholder primacy" concept in compliance with the stakeholder theory (Palladino and Karlsson, 2018; Rezaee and Fogarty, 2019). The concept of stakeholder primacy suggests that public companies focus on corporate purposes beyond shareholder-value creation and thus management should also consider the interest of every stakeholder who provides capital to the firms including financial, operational, human, societal, and environmental capitals.

Hypothesis Development

- we posit that II and SRI investment strategies that are intended to create social and environmental impacts can have implications for investors by affecting shareholder wealth in the long term.
- Given that the shareholder primacy concept is still prevailing as public companies are under significant pressure to produce near-term returns for shareholders, we posit that II and SRI investment strategies are associated with negative and positive returns respectively and we have the following two hypotheses in alternative forms.

- *HYPOTHESIS 1A. Excess stock returns are negatively associated with corporate impact investing (II) after controlling for economic performance.*

- *HYPOTHESIS 1B: Excess stock returns are positively related to corporate socially responsible investing (SRI) after controlling for economic performance*

Methodology

- The relationships between stock returns, economic performance, II and SRI are complex and endogenous, and have to be captured by a system of linear equations.
- We conduct Breusch and Pagan (1979) tests and find that the residuals from the ordinary least squares (OLS) regressions are not independent.
- We use Seemingly unrelated regressions (SURs) to capture the complex relationship between stock returns, economic performance, II and SRI strategies.
- $Ret/ExRet/AbRet\ = \alpha + \beta_1 ECON + \beta_2 MSCISTR + \beta_3 MSCICON + \beta_4 LNMVE + \beta_5 LEV + \beta_6 DLOSS\ + \beta_7 OCF + \beta_8 BETA\ + \sum Firm\ F.E.\ + \sum Year\ F.E. + \varepsilon)$

Panel A: One Year Return (t=1)

Dep Var.	$AbRet_t$	$ExRet_t$	Ret_t	ECON	MSCISTR	MSCICON
INTERCEPT	-0.2280***	-0.0159	0.0410	-0.6821***	-3.8143***	1.1205***
	(-4.32)	(-0.30)	(0.76)	(-11.99)	(-17.00)	(6.55)
ECON	0.2229***	0.2250***	0.2251***		-0.7230***	0.4892***
	(35.59)	(35.22)	(35.24)		(-27.19)	(24.23)
MSCISTR	-0.0141***	-0.0145***	-0.0145***	-0.0460***		-0.2097***
	(-8.93)	(-9.01)	(-9.02)	(-27.19)		(-41.73)
MSCICON	0.0060***	0.0061***	0.0061***	0.0542***	-0.3652***	
	(2.87)	(2.86)	(2.87)	(24.23)	(-41.73)	
LNMVE	0.0421***	0.0439***	0.0439***	0.0522***	0.6822***	-0.3168***
	(15.59)	(15.93)	(15.95)	(17.91)	(66.23)	(-38.14)
LEV	0.0348**	0.0348**	0.0348**	-0.0339**	-0.3439***	-0.0961*
	(2.20)	(2.16)	(2.16)	(-1.98)	(-5.07)	(-1.87)
DLOSS	-0.1088***	-0.1144***	-0.1145***	0.0404***	0.2438***	-0.2164***
	(-11.62)	(-11.99)	(-12.00)	(3.99)	(6.08)	(-7.13)
OCF	0.0458	0.0390	0.0388	0.9094***	0.4113***	0.6239***
	(1.54)	(1.28)	(1.28)	(28.81)	(3.22)	(6.46)
BETA	0.0444***	0.0501***	0.0500***	0.1370***	-0.2287***	-0.0124
	(6.19)	(6.84)	(6.83)	(17.79)	(-7.44)	(-0.53)
Ind. F.E.	Yes	Yes	Yes	Yes	Yes	Yes
Year F.E.	Yes	Yes	Yes	Yes	Yes	Yes
N	21843	21843	21843	21843	21843	21843
Adj. R^2	0.137515374	0.264921055	0.260685359	0.253612792	0.370524664	0.386572185
F-Value	47.43***	105.96***	103.69***	101.29***	174.74***	187.01***

Refer Appendix B for variable definitions. T-statistics are shown right below. ***, ** and, * indicate significance at a p-value of less than the 1% level (2-tailed), 5% level (2-tailed), and 10% level (2-tailed), respectively.

Panel A: Environmental Strengths and Concerns (ESG = ENV)

Dep Var.	AbRet	ExRet	Ret	ECON	ENVSTR	ENVCON
INTERCEPT	-1.45***	-1.37***	-1.32***	0.75***	0.52**	-0.25
	(-7.14)	(-6.56)	(-6.33)	(5.33)	(2.12)	(-1.63)
ECON	0.36***	0.38***	0.38***		-0.05***	0.09***
	(34.57)	(34.91)	(35.05)		(-4.32)	(11.20)
ENVSTR	-0.02***	-0.03***	-0.03***	-0.02***		
	(-2.90)	(-4.22)	(-4.53)	(-4.17)		
ENVCON	0.02*	0.02*	0.02*	0.07***		
	(1.76)	(1.73)	(1.69)	(11.15)		
LNMVE	0.15***	0.14***	0.14***	0.13***	0.09***	-0.04***
	(23.09)	(21.24)	(20.59)	(29.75)	(11.86)	(-8.48)
LEV	-0.06**	-0.08***	-0.08***	0.28***	0.18***	-0.06***
	(-2.54)	(-3.04)	(-3.16)	(16.27)	(6.04)	(-3.37)
DLOSS	-0.06***	-0.07***	-0.07***	-0.09***	0	-0.02**
	(-5.35)	(-6.19)	(-6.30)	(-11.86)	(-0.23)	(-2.55)
OCF	0.13***	0.12***	0.13***	1.1***	-0.21***	-0.08**
	(2.73)	(2.60)	(2.69)	(35.68)	(-3.73)	(-2.13)
BETA	0	0.01	0.01	0.12***	-0.06***	-0.02***
	(0.39)	(1.50)	(1.57)	(19.89)	(-5.52)	(-2.91)
Firm F.E.	Yes	Yes	Yes	Yes	Yes	Yes
Year F.E.	Yes	Yes	Yes	Yes	Yes	Yes
N	21844	21844	21844	21844	21844	21844
Adj. R^2	0.1874	0.2983	0.2916	0.7137	0.4784	0.7480
p-Value	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001

Panel B: Social Strengths and Concerns (ESG = SOC)

Dep Var.	AbRet	ExRet	Ret	ECON	SOCSTR	SOCCON
INTERCEPT	-1.49***	-1.41***	-1.37***	0.66***	-0.89*	0.11
	(-7.31)	(-6.76)	(-6.53)	(4.70)	(-1.88)	(0.34)
ECON	0.36***	0.37***	0.38***		-0.56***	0.1***
	(34.13)	(34.41)	(34.53)		(-22.91)	(5.81)
SOCSTR	-0.02***	-0.02***	-0.02***	-0.05***		
	(-5.84)	(-6.69)	(-6.90)	(-22.94)		
SOCCON	0.0001	0.0001	0.0001	0.02***		
	(-0.09)	(0.06)	(0.14)	(5.93)		
LNMVE	0.15***	0.14***	0.14***	0.14***	0.28***	-0.04***
	(23.41)	(21.57)	(20.92)	(31.51)	(19.20)	(-4.09)
LEV	-0.06**	-0.08***	-0.08***	0.28***	0.27***	-0.02
	(-2.56)	(-3.09)	(-3.21)	(16.33)	(4.73)	(-0.45)
DLOSS	-0.06***	-0.07***	-0.07***	-0.09***	0.05**	-0.04**
	(-5.27)	(-6.08)	(-6.18)	(-11.40)	(2.00)	(-2.18)
OCF	0.13***	0.13***	0.13***	1.08***	0.22**	0.03
	(2.79)	(2.69)	(2.78)	(35.28)	(2.09)	(0.44)
BETA	0	0.01	0.01	0.11***	-0.19***	-0.07***
	(0.02)	(1.11)	(1.19)	(18.02)	(-9.40)	(-5.04)
Firm F.E.	Yes	Yes	Yes	Yes	Yes	Yes
Year F.E.	Yes	Yes	Yes	Yes	Yes	Yes
N	21844	21844	21844	21844	21844	21844
Adj. R^2	0.1883	0.2991	0.2925	0.7153	0.6677	0.5071
p-Value	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001

Refer Appendix B for variable definitions. T-statistics are shown right below. ***, ** and, * indicate significance at a p-value of less than the 1% level (2-tailed), 5% level (2-tailed), and 10% level (2-tailed), respectively.

Panel C: Governance Strengths and Concerns (ESG = GOV)

Dep Var.	AbRet	ExRet	Ret	ECON	GOVSTR	GOVCON
INTERCEPT	-1.49***	-1.41***	-1.36***	0.69***	-0.07	0.45**
	(-7.30)	(-6.74)	(-6.51)	(4.90)	(-0.47)	(2.34)
ECON	0.36***	0.38***	0.38***		-0.05***	0.11***
	(34.50)	(34.83)	(34.97)		(-6.53)	(10.61)
GOVSTR	-0.0001	-0.0001	-0.01	-0.05***		
	(-0.24)	(-0.44)	(-0.54)	(-7.63)		
GOVCON	0.04***	0.04***	0.04***	0.06***		
	(4.90)	(5.19)	(5.24)	(11.32)		
LNMVE	0.15***	0.14***	0.14***	0.13***	0.02***	-0.07***
	(23.17)	(21.23)	(20.55)	(29.85)	(3.75)	(-11.02)
LEV	-0.07***	-0.08***	-0.09***	0.27***	-0.03	0.01
	(-2.75)	(-3.31)	(-3.44)	(15.66)	(-1.55)	(0.57)
DLOSS	-0.06***	-0.07***	-0.07***	-0.09***	-0.01	-0.05***
	(-5.20)	(-6.02)	(-6.13)	(-11.71)	(-1.38)	(-4.89)
OCF	0.13***	0.13***	0.13***	1.1***	-0.02	-0.05
	(2.81)	(2.71)	(2.81)	(35.64)	(-0.54)	(-1.07)
BETA	0	0.01	0.02*	0.12***	0.01	0.01
	(0.42)	(1.57)	(1.66)	(19.77)	(1.20)	(1.39)
Firm F.E.	Yes	Yes	Yes	Yes	Yes	Yes
Year F.E.	Yes	Yes	Yes	Yes	Yes	Yes
N	21844	21844	21844	21844	21844	21844
Adj. R^2	0.1879	0.2985	0.2917	0.7138	0.2895	0.4443
p-Value	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001

Refer Appendix B for variable definitions. T-statistics are shown right below. ***, ** and, * indicate significance at a p-value of less than the 1% level (2-tailed), 5% level (2-tailed), and 10% level (2-tailed), respectively.

CONCLUSION

- This study examines the relationship between two different corporate investment strategies and stock performance, after controlling for economic performance.
- We define impact investment (II), which is a proxy of “doing good” corporate investment strategy, and socially responsible investment (SRI), which is a proxy of “not doing bad” corporate investment strategy, using the existence of sustainability strengths and absence of sustainability concerns as proxies respectively.
- We find that stock returns tend to be marginally lower (higher) for firms that follow II (SRI) strategies. We also show that stock returns that are associated with II and SRI strategies are significant, but the magnitudes are relatively small when compared to those induced by economic performance.
- We also find the impact of II and SRI are increasing over time and this trend shows that the increasing attention paid to non-financial ESG sustainability has driven managers to consider the benefits of stakeholders when making investment decisions.
- Finally, we show that both corporate resources availability and institutional ownership are key determinants of the importance of II and SRI strategies. Firms with more resources are more likely to be penalized for pursing II. Also, firms with high (low) institutional ownership tend to reward (ignore) SRI.

Questions?

Thank you for your Attention