Exploring the Financial Value of a Reputation for Corporate Social Responsibility During a Crisis

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ABSTRACT

Is there financial value in a reputation for corporate social responsibility during a crisis? The existing empirical evidence for a corporate social–financial performance link has been mixed, but perhaps this is, in part, due to most studies' emphasis on a reputation's impact on positive news. What of the opposite case — whether a reputation for social responsibility acts as a 'reservoir of goodwill' during corporate crises? This paper draws on literature from the fields of reputation, strategy, risk and social responsibility to outline the reasons why there might be financial value in a reputation for corporate social responsibility during a crisis and then tests them by examining investor reaction to the 1999 Seattle World Trade Organization (WTO) failure, caused by disagreement among member nations on labor and environmental standards and public protests over the same. Seattle represented apparent heightened demand for corporate social responsibility and an increased risk of stricter, future regulation. It was found that a reputation for social responsibility protected firms from stock declines associated with this crisis, even when controlling for possible trade and industry effects.

INTRODUCTION

Strategic managers have long accommodated the demands of their firms' immediate stakeholders, particularly shareholders. Yet, the pressure exerted on managers by non-investor stakeholders, such as environmentalists and other social activists, has increased significantly. The growing influence of the non-investor stakeholders manifests itself in diverse ways. Some firms, such as Chevron, have adopted differentiation strategies based on being more environmentally responsible than other firms in their industry. The amount of capital in socially responsible investment funds has mushroomed in the past decade. And, in 1990, whereas only seven US firms issued sustainability reports detailing their social (as opposed to financial) performance, by 2004, 745 such reports were released in response to mounting public pressure on corporate managers to do so (Corporate Register.com).

Despite such heightened managerial attention to corporate social responsibility, there remains a dearth of persuasive empirical studies finding evidence that firm investments in corporate social responsibility yield quantifiable financial benefits. The authors hope to add to the literature on a corporate social–financial performance link by drawing upon studies on the value of corporate reputation to provide the foundation for an analysis linking a firm's repu-

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tation for social responsibility with financial benefits accruing from that reputation. Specifically, this paper examines whether there is financial value in a reputation for corporate social responsibility during a crisis, or an insulating effect to an exogenous shock that is likely to financially harm a firm. In this way, this paper takes a novel approach to the issue of how a firm's reputation impacts its bottom line. Most empirical studies of the value of corporate reputation have looked at the financial upside of a good or above-average corporate reputation (Black *et al.*, 2000; Brown, 1998; Deephouse, 2000; Srivastava *et al.*, 1998). Only Jones *et al.* (2000) examine the proverbial flip-side of the reputational coin — which they term the value of 'the reservoir of goodwill' — by examining whether a high score on *Fortune* magazine's Most Admired Firms survey protected firms from declines in shareholder value during the abrupt stock market sell-off in 1987 and 1989.

Methodologically, the authors take advantage of an event uniquely suited to measure the economic effect of a reputation for social responsibility. An event study is conducted of the 1999 failed World Trade Organization (WTO) ministerial meeting in Seattle. WTO ministers gathered in Seattle to launch the ninth round of global trade negotiations, originally begun under the General Agreement on Tariffs and Trade (GATT) in 1947. In Seattle, for the first time in GATT–WTO history, a trade round set to commence failed. The meeting collapsed in less than a week, with no action taken on the agenda for the anticipated Millennial Trade Round. Two events contributed to the meeting's failure. First, internal conflict between developed and developing nation members' goals, especially on the issue of multilateral harmonization of labor and environmental standards, prevented the WTO delegates from agreeing to an agenda. Relatedly, but more visibly, were the massive, often violent, demonstrations by tens of thousands of protesters against the allegedly environmentally and labor abusing practices of multinational firms. With the 1999 WTO meeting, trade issues not only became intertwined with issues of corporate social responsibility as never before, but also were overshadowed by the debate over labor and environmental issues. How did investors react to this development? Specifically, did investors treat firms with reputations for social responsibility differently than firms without a reputation for social responsibility, since demands for more 'responsible' corporate social practices and disagreements over whether and how to pursue this goal led to the meeting's derailment?

The next section draws upon existing literature on corporate reputation, the resource-based theory of the firm, stakeholder theory and financial risk, to develop this main hypothesis. Next, the 1999 *Fortune 500* was used to conduct an event study of investor reactions to the failure of the meetings. The paper concludes with a discussion of the implications and limitations of the results for strategy scholars and managers.

THEORY AND HYPOTHESES

Empirical studies of the corporate social–financial performance link have a reputation for imprecise execution and mixed results (Griffin and Mahon, 1997), despite the emergence of new studies that address the earlier studies' problems of small sample size, biased measures of social responsibility and insufficient theoretical foundation. There is indeed a growing body of credible evidence that firm investments in social performance provide tangible financial benefits (Berman *et al.*, 1999; Dowell *et al.*, 2000; Hart and Ahuja, 1996; Hillman and Keim, 2001; Orlitzky and Benjamin, 2001; Russo and Fouts, 1997;

Waddock and Graves, 1997). Nonetheless, these recent studies do not appear to have had as much impact as they could among managers or management scholars (Rowley and Berman, 2000; Margolis and Walsh, 2001).

Students of stakeholder management and corporate social performance also have increasingly engaged general strategy and management researchers. For example, the recent theoretical and empirical work on the relationship between social and financial performance most often is grounded in the resource-based view of the firm and published in broad management and strategy journals (Berman *et al*., 1999; Hillman and Keim, 2001; Johnson and Greening, 1999; McWilliams and Siegel, 2001; Russo and Fouts, 1997; Turban and Greening, 1997).

Accordingly, the authors also position their hypotheses primarily within the resource-based view of the firm's reputation, drawing upon research and treating corporate reputation as an intangible economic asset that contributes to a firm's sustainable competitive advantage (Barney and Hansen, 1994; Black *et al*., 2000; Fryxell and Wang, 1994; Hall, 1992; McMillan and Joshi, 1998; Teece, 1998). Research in this area has shown that reputation provides several intangible benefits. First, reputation allows stakeholders suffering from imperfect information about a firm's product quality or commitment to social responsibility to nonetheless assess a firm's ability to deliver valued outcomes (Fombrun, 2001; Kreps and Wilson, 1982; Weigelt and Camerer, 1988). Secondly, reputation serves as a signal of a firm's past interactions with stakeholders and thus may be difficult for other firms to imitate (Barney, 1991; Hall, 1992). Thirdly, a good reputation may create economic value by improving a firm's ability to recruit and retain its primary stakeholders — investors, employees, customers and suppliers (Black *et al*., 2000; Fombrun and Shanley, 1990; Turban and Greening, 1997). In short, reputation may facilitate complex, long-term stakeholder management which, in turn, ought to enhance a firm's ability to outperform against its competitors, either by increasing revenues or reducing costs (Hillman and Keim, 2001; Russo and Fouts, 1997).

Conversely, there also may be financial value in a reputation for corporate social responsibility during a crisis — where the benefit of a reputation comes not from increases in financial performance, but rather from insulation from negative financial performance. Scholars have previously suggested that firms with good reputations may withstand crises, such as the Tylenol tampering in the 1980s suffered by Johnson & Johnson, with lesser economic losses than firms without good reputations (Fombrun, 1996; Gregory, 1998; Knight and Pretty, 1999). To this end, Fombrun (2001: 24) claims 'reputations have considerable hidden value as a form of insurance — they act like a "reservoir of goodwill"'. Regrettably for both strategy scholars and managers, there is still a dearth of empirical support for this claim. Jones *et al*. (2000) have subjected the crisis theory of value to a corporate reputation to a test on a large sample. They found that firms scoring highly in *Fortune* magazine's annual survey of the 'Most Admired Firms in America' suffered lower market valuation losses in the October 13, 1989 stock market plunge (the S&P 500 declined by 7 per cent on that day), than did firms with lower *Fortune* reputation ratings.

Did this trend also hold in the case of the failure of the Seattle WTO meeting? Were firms with a reputation for social responsibility not penalized by investors as much as firms without a reputation for social responsibility? Such evidence would enhance an understanding of the value of reputation as an intangible asset.

Social Responsibility Effect

It is expected that a reputation for corporate social responsibility would have dampened economic losses stemming from the failure of the Seattle WTO meeting, for at least two reasons. The first explanation focuses on the possible reaction of policy makers to the meeting's failure. Investors may have believed the Seattle protests increased the likelihood of significant environmental and labor, and possibly even other, regulatory changes in the future. After all, disputes among member nations on environmental and labor issues and protests by activist groups on the same issues, together successfully derailed a global trade round in Seattle for the first time in the GATT–WTO's then 52-year history. The probability of future trade negotiations, including provisions requiring firms to implement the stringent environmental and labor standards of developed nations when operating in lesser-developed nations, increased with the derailment of the Seattle meeting, since political pressure for them in developed nations has increased so significantly that policy makers can no longer ignore these constituent demands. Moreover, the demands made by the Seattle activists for multinational trade agreements could easily be made in the future for domestic regulations. Thus, Seattle signaled an increased likelihood of significant regulatory burdens to US firms — either through provisions in trade agreements or through enhanced domestic regulations. This increased likelihood of future environmental and labor regulatory burdens should favor firms with existing practices that exceed legal requirements in these areas (Clarkson, 1995), since these firms would incur lower future compliance costs and thus higher revenues than firms only meeting legal requirements.

Relatedly, the success of the Seattle activists in scuttling a global trade negotiation also increased the likelihood that other social activists could be successful in pressing their agendas for broader corporate social responsibilities in the future. In short, the derailment of the Seattle meeting appears to indicate increased public demand and support for socially responsible corporate behavior, thus suggesting increased regulatory burdens in the future, which should favor firms with existing high levels of investment in social responsibility. In Seattle, the focus of multilateral trade negotiations thus shifted from the relatively well understood and narrow issues of trade and investment liberalization, to trade issues *and* the relatively less well understood and broader issue of firms' multiple social obligations to diverse stakeholders.

The second explanation focuses on the possible reaction of another stakeholder group — consumers — to the meeting's failure. The protests in Seattle increased the risk of future consumer boycotts of firms known for environmentally damaging or labor abusing operations, given the extraordinary publicity that such practices received in the weeks prior to and during the meeting. Consumers formerly ignorant of many corporate labor and environmental 'abuses' are likely to have been educated as a result of the highly visible Seattle protests. Thus, investors may have believed that firms with a reputation for social responsibility were less likely to face potential future consumer boycotts, and thus potentially decreased future revenues, than firms either without reputations for social responsibility or associated with irresponsible practices. Relatedly, the Seattle WTO protests may have increased the demand for skillful stakeholder management, a quality that is often assumed to be present in firms with reputations for social responsibility, to the extent that Seattle signaled an increased likelihood of future consumer boycotts. For example, firms with difficult-to-imitate experience and capabilities in

successfully addressing the demands of diverse stakeholders would be likely to suffer lesser economic losses (perhaps by avoiding a boycott) than firms without skillful stakeholder management skills. In short, firms with expertise in addressing the demands of non-investor stakeholders were probably less likely to become the targets of future consumer boycotts than firms neither known for socially responsible practices, nor with existing firm capabilities for defusing angry stakeholder groups.

Both of these potential explanations of why a reputation for social responsibility may have protected firms from losses in shareholder value as a result of the Seattle WTO's failure are stakeholder-specific ways in which corporate social responsibility can decrease firm-specific risk and volatility. Cornell and Shapiro (1987) provide the most compelling theoretical argument for this possibility, relying primarily on transaction cost reasoning (Coase, 1960). Firms that focus not only on explicit contractual claims (the easy-to-specify-contractual claims of investors or bondholders on firms), but also on implicit claims on non-investor stakeholders (such as the promise of continuing service or product quality to customers, or job security to employees) will realize higher market valuations than firms which ignore or discount the implicit claims of non-investor stakeholders on future revenues. Applying this reasoning to the Seattle WTO failure, Seattle may have increased the probability of non-investor stakeholders causing firms financial distress by exercising their implicit claims on firms to, for example, improve their environmental and labor policies when operating globally. In this way, firms that manage non-investor stakeholder claims may lose less business than firms which ignore the implicit claims of these stakeholders (Klein *et al.*, 1978; Kreps and Wilson, 1982).

This interpretation receives some support from Jarrell and Peltzman (1985) who found that the drop in shareholder value related to drug and auto recalls was much greater than the direct costs of the recalls — the additional cost may represent lost future purchases by the non-investor stakeholders, such as consumers, who exercised implicit claims on these firms for safe products. Additionally, some empirical support for the reasoning that corporate social responsibility is inversely related to a firm's financial risk has been found. Orlitzky and Benjamin (2001) found that higher levels of corporate social performance were significantly correlated with lower levels of risk, particularly market measures of risk (as distinct from accounting measures of risk).

These factors collectively motivate this first hypothesis:

H_1: *The failure of the Seattle WTO talks will have a greater negative effect on the market value of US firms without a reputation for social responsibility than it will have on the market value of US firms with a reputation for social responsibility.*

Industry Effect

There are at least two compelling reasons, other than a reputation for social responsibility, for why investors may have driven down the stocks of some firms more than others in response to the 1999 WTO meeting's failure. The first is the industry effect. Most of the Seattle protesters were associated either with labor unions or environmental organizations. Labor organizations claimed that trade agreements without labor provisions harmonizing labor standards between the US and signatory countries encouraged the export of American jobs to countries with cheaper wages and lower labor standards, thereby harming American workers and violating the labor rights of workers in lesser-developed

nations. Similarly, environmentalists demanded that trade agreements not become licenses for developed countries to export their pollution to less developed countries unable to 'afford' the strict environmental regulations and compliance efforts of wealthy countries (Baldwin and Magee, 2000; Schott, 2000). Indeed, Epstein and Schnietz, 2001 found that firms in industries that were the specific focus of the 1999 Seattle protests experienced greater declines in shareholder value than firms in industries that were not specifically targeted for protest. The specifically-named targets of protest in Seattle were the mining, steel, chemical, pulp and paper and energy industries, with reputations for unusually environmentally-damaging operations and the toy, apparel and footwear industries with reputations for unusually labor-abusing operations.

If investors penalized firms primarily for being in an 'irresponsible' industry, then firms in the 'irresponsible' industries with a reputation for social responsibility should have faced the same change in shareholder value as firms in 'irresponsible' industries without a reputation for social responsibility. The same reasoning would hold for firms in 'responsible' industries. On the other hand, if a reputation for social responsibility does provide financial value during a crisis, then firms with reputations for social responsibility in 'irresponsible' industries should have experienced smaller stock declines than firms with no such reputation. The same reasoning would hold for firms in 'responsible' industries. Thus:

H_{2a}: *In a portfolio of US firms from industries with reputations for 'irresponsible' environmental and labor practices, the failure of the Seattle WTO talks will have a greater negative effect on the market value of the firms without a reputation for social responsibility than it will have on the market value of the firms with a reputation for social responsibility.*

H_{2b}: *In a portfolio of US firms from industries with reputations for 'responsible' environmental and labor practices, the failure of the Seattle WTO talks will have a greater negative effect on the market value of the firms without a reputation for social responsibility than it will have on the market value of the firms with a reputation for social responsibility.*

Trade Effect

The final alternative explanation explored here is the trade effect. If investors penalized firms primarily for anticipated declines in revenues associated with stalling trade and investment liberalization — the trade policy outcome of the Seattle meeting failure — then the most global of firms should have experienced the largest declines in shareholder value, regardless of the firms' reputations for social responsibility. On the other hand, if investors valued a firm's reputation for social responsibility, then firms with such reputations should have experienced smaller stock declines than firms without a reputation for social responsibility. This should be particularly true of a portfolio of firms with no economic reliance on foreign markets for sales or investments, where a trade effect should be irrelevant. After all, firms with no foreign direct investment (FDI) or export sales (which are concentrated in industries such as utilities, HMOs, insurance and some retail sectors), should not have been penalized for the trade-dampening effect of the Seattle WTO failure, since they are immune to international trade issues. If, however, investors were driving down the stock prices of firms based on their reputation for social responsibility (rather than trade), then this could best be seen in a segment of purely domestically-oriented firms.

These predictions are supported by research on earlier trade agreements. Prior analyses of the US-Canadian and North American Free Trade Agreements and the 1993 Uruguay Round found modest increases in the stock prices of multinational firms upon the completion of these trade-liberalizing agreements (Hanson and Song, 1998; Harrison *et al.*, 1997; Thompson, 1994). These results are consistent with neoclassical trade theory's prediction that trade liberalization is nationally welfare enhancing. Conversely, there are few empirical examinations of trade-contracting agreements, since the post-Second World War period has been dominated by multilateral agreements that were broadly trade liberalizing. In response to the 1997 denial of fast-track trade negotiating authority (which prohibits Congress from amending Presidentially negotiated trade agreements — Congress may only vote yea/nay), however, investors bid down the stock prices of the most global of the *Fortune 300* firms (Oxley and Schnietz, 2001). Moreover, investors also bid down the value of a portfolio of the entire *Fortune 500* by almost 2 per cent when the Seattle WTO meeting failed (Epstein and Schnietz, 2001). Thus:

H_3: *In a portfolio of US firms with no foreign sales or assets, the failure of the Seattle WTO talks will have a greater negative effect on the market value of the firms without a reputation for social responsibility than it will have on the market value of the firms with a reputation for social responsibility.*

METHODS

Event study methodology was employed to compare the abnormal returns accruing to investors as a result of changes in market value for US firms with a reputation for social responsibility versus those with no such reputation. Formally, this model assumes that the return on an individual stock is linearly related to the market return (Brown and Warner, 1980; Fama *et al.*, 1969; McWilliams and Siegel, 1997). This relationship is expressed as: $R_{it} = \alpha_i + \beta_i R_{mkt} + e_{it}$, where R_{it} is the return of the stock for firm i, at time t, available from the Center for Research in Stock Prices (CRSP); R_{mkt} is the return for the overall market portfolio at time t, as defined by the CRSP equally-weighted stock market index; α_i and β_i are firm-specific and time-independent parameters obtained by longitudinally regressing 255 trading days of stock price data for firm i on the market portfolio during the estimation period (one year prior to the event date); e_{it} is a normally distributed, zero mean, constant variance error term for stock i at time t.

The abnormal stock return is the difference between the actual return at time t, during the event interval and the return predicted from the estimation period. This relationship is expressed as: $AR_{it} = R_{it} - (\alpha_i + \beta_i R_{mkt})$, where the notation is the same as in the prior equation. Abnormal returns are cumulated over the event interval (CAR_i), providing a measure of how much the market value of the firm changed as a result of the event. To reduce the potential impact of individual firm estimation errors, the abnormal return for each firm in the sample was averaged across all stocks to obtain an average abnormal return for the portfolio of firms for each day surrounding the event date (AR_t). A one-tailed t-test was calculated by dividing the cumulative average daily abnormal return by the standard deviation calculated from the 255-day pre-event interval estimation period.

Samples

Firm-level data was drawn from the 1999 *Fortune 500*, restricting the present sample to those publicly traded firms for which complete stock price data from the CRSP was available for this period of study. This

resulted in an initial sample of 426 firms. In event study analysis, one must guard against spurious abnormal returns, caused not by the event of interest, but by firm-specific confounding events occurring during the event interval. This possibility was controlled for by searching *Dow Jones News Retrieval* for announcements of mergers, management changes, new product announcements, lawsuits and other events. Ten firms had a confounding event announcement during this event interval and thus were omitted from the sample.

The remaining 416 *Fortune 500* firms were segmented into two samples: firms with a reputation for social responsibility and firms without such a reputation. The former sample consists of the 155 *Fortune 500* firms that were also traded in the *Domini Social Index* (DSI) mutual fund, a socially screened counterpart to the S&P 500, in November, 1999. The DSI consists of 400 firms selected by Kinder, Lydenberg and Domini (KLD) on the basis of high performance in the following social dimensions: community relations, employee relations, product quality and safety and treatment of women and minorities, environmental performance and involvement with nuclear power. The DSI, established in 1991, is one of the oldest and largest socially and environmentally screened stock index funds with US$1.3bn in assets under management (www.domini.com). Moreover, it is constructed to mimic the performance of the S&P 500 index as closely as possible. The inclusion or exclusion of firms from the fund is widely publicized. The second sample of firms without a reputation for social responsibility consists of the 271 remaining *Fortune 500* firms that were not in the DSI in 1999. Although this segmentation does not account for possible variations between firms in their level of social responsibility, the paper will later account for such variations with a continuous variable measuring social responsibility in an ordinary least squares (OLS) regression analysis of the cumulative abnormal returns. Descriptive statistics for the two samples are shown in Table 1.

Event Anchor and Window

A fundamental assumption of the event study model is that the event of interest is unanticipated. The developments examined here suit this condition. In early November, WTO delegates met in Geneva to set the agenda for the Seattle talks. The inability to agree on an agenda in Geneva added this task to the list of projects for the Seattle meeting. Although reports speculated on whether the failure to set the agenda in advance would hinder the meeting's progress, no one predicted complete failure. At a minimum, observers expected a preliminary agenda and timetable for the Millennial Round to emerge from Seattle (*Wall Street Journal*, 1999a; *Washington Post*, 1999a). Of course, since no previous trade negotiation commencement meeting had failed, the expectation of at least modest 'success' in Seattle was consistent with history.

The meeting was scheduled to begin on Tuesday, November 30. On Friday November 26, protesters began converging on Seattle in numbers far greater than earlier predictions and the press began speculating whether the protests would disrupt the meetings (*Seattle Times*, 1999a). The outlook over the weekend for a successful meeting grew increasingly bleak (*Financial Times*, 1999; *New York Times*, 1999a). On Monday, a bomb threat closed the Convention Center (*Seattle Times*, 1999b). On Tuesday, protests turned violent, particularly against retailers allegedly using sweatshop labor, such as Nike and Gap, whose stores were looted. Many WTO dignitaries were unable to get out of their hotels. Finally, the opening ceremonies, scheduled for that evening, were canceled, as the Mayor of Seattle called in the National

Table 1: Descriptive Statistics (all values in US$m unless noted)

	Fortune 500 firms with a reputation for social responsibility (DSI-included firms), n = 155	*Fortune 500 firms without a reputation for social responsibility (DSI-excluded firms), n = 261*
1999 Revenues		
Average	US$13,748	US$11,247
Range	US$3,037 (Reliastar Financial) to US$165,013 (Wal-Mart)	US$429 (Kinder Morgan) to US$189,058 (General Motors)
Median	US$7,620 (Suntrust Banks)	US$6,423 (Saks Corporation)
1999 Assets		
Average	US$23,752	US$21,960
Range	US$1,034 (Kelly Services) to US$328,071 (Merrill Lynch)	US$293 (Adams Resources) to US$405,200 (General Electric)
Median	US$7,423 (Colgate-Palmolive)	US$8,400 (Ingersoll-Rand)
1999 Market capitalization		
Average	US$31,630	US$16,013
Range	US$409 (Yellow Truck Corporation) to US$453,879 (Cisco)	US$36 (Adams Resources) to US$417,175 (General Electric)
Median	US$8,485 (Staples)	US$4,320 (Florida Progress)
1999 % Foreign assets		
Average	13.7%	12.4%
Range	0% (44 firms) to 87.2% (AFLAC)	0% (84 firms) to 99% (CHS Electronics)
Median	5.2% (3Com)	5.9% (Oracle)
1999 % Foreign sales		
Average	19.8%	19.4%
Range	0% (46 firms) to 81.5% (AFLAC)	0% (93 firms) to 99% (CHS Electronics)
Median	12.7% (Household International)	11.3% (Edison International)

Guard and imposed a curfew (*New York Times*, 1999b; *Wall Street Journal*, 1999b). On Wednesday, President Clinton arrived in Seattle and announced that all future trade agreements should include the abolition of child labor. The 77 developing nation delegates threatened to walk out of the meetings if the USA and other developed countries insisted on including discussion of this issue in the Millennial Round (*Wall Street Journal*, 1999c). On Friday, the ministerial meeting ended in complete failure — no agenda had been agreed to and there were no concrete plans for a resumption of negotiations (*New York Times*, 1999c; *Washington Post*, 1999b).

Based on this event timeline this event window is anchored on Friday, November 26, the first day on which there was widespread speculation about whether the Seattle meetings would end in failure. Used here is an event interval of 0 to +1 to capture investor reaction to the developments that occurred on the Friday and following Monday. Certainly, by the time the protests became violent on Tuesday, investors could

have foreseen the meeting's eventual disintegration. Thus, using the formal meeting commencement date of Tuesday as the event date would violate the model requirement that the event be unanticipated. The event window of Friday and Monday captures the first days on which investors could have reasonably predicted the ultimate failure of the Seattle talks and acted on those predictions in their stock purchases or sales, but is not so long as to sacrifice statistical power. Specifically, negative cumulative abnormal stock returns were predicted in each of the samples of firms across the two-day window, with reactions of lesser magnitude for the sample of firms with reputations for social responsibility.

RESULTS

Results of the event study are presented in Table 2 and are consistent with the first hypothesis. The portfolio of *Fortune 500* firms with a reputation for social responsibility (DSI-included firms) declined by slightly more than 1 per cent, although this decline was not significant. In contrast, the portfolio of *Fortune 500* firms without a reputation for social responsibility (DSI-excluded firms) declined significantly by 2.36 per cent. This decline translates into a US$378m loss of shareholder value for the average firm in the sample, in comparison with no statistically significant decline in the sample of firms with a reputation for social responsibility.

Despite these results, it is possible that the cumulative abnormal returns reported in Table 2 are driven by the industry effect. This paper thus divides the sample of *Fortune 500* firms into those in industries with reputations for 'irresponsible' environmental or labor practices and those in the

Table 2: Results of Event Study Analysis for 1999 *Fortune 500*, Segmented by Reputation for Corporate Social Responsibility[a]

Event date	*Daily abnormal return*	*Cumulative abnormal return*	*t-value*	*Per cent negative CARs[b]*	*Binomial Z statistic on CAR[c]*
Firms with reputation for social responsibility (DSI-included firms)					
Friday, November 26	–1.10	–1.10	–1.51†		
Monday, November 29	–0.00	–1.10	–1.08	74.0	–5.34★★★
Firms without reputation for social responsibility (DSI-excluded firms)					
Friday, November 26	–1.17	–1.17	–2.34★★		
Monday, November 29	–1.19	–2.36	–3.33★★★[d]	82.0	–9.82★★★

[a]For firms with a reputation for social responsibility, $n = 155$. For firms without a reputation for social responsibility, $n = 261$. *t*-tests were one-tailed in accordance with the hypotheses.
[b]The percentage of negative cumulative abnormal returns is a test based on the assumption that, if an event has no significant effect on returns, then the abnormal returns would be normally distributed, with half the companies experiencing positive abnormal returns and the other half, negative abnormal returns. McWilliams and Siegel (1997: 635–636) suggest all event studies in management research should include this test statistic, as well as the Binomial Z statistic, which follows.
[c]This statistic tests whether the proportion of positive to negative returns exceeds the number expected from the market model.
[d]*p*-value of difference between the CARs of the two sub-samples (those with a reputation for social responsibility and those without) = –0.05.
†$p < 0.10$; ★$p < 0.05$; ★★$p < 0.01$; ★★★$p < 0.001$.

remaining 'responsible' industries, according to the classifications adopted in empirical studies examining links between investments in 'green' manufacturing and financial performance (Klassen and McLaughlin, 1996; Konar and Cohen, 2001; Russo and Fouts, 1997; Waddock and Graves, 1997), or 'labor-abusing' industries (van Tulder and Kolk, 2001; Waddock and Graves, 1997). The two-digit standard industrial classification (SIC) codes included in the environmentally 'irresponsible' industry sample are 10 (iron mining), 12 (coal mining), 13 (oil and gas extraction), 14 (non-metallic mining), 26 (pulp and paper products), 28 (chemicals), 30 (rubber and plastic manufacture), 33 (steel), 46 (petroleum pipelines) and 49 (electric and gas utilities). The two-digit SIC codes included in the labor 'irresponsible' industry sample are 23 (apparel manufacture), 31 (footwear manufacture) and 39 (toy manufacture). The two industry samples were then further divided into a portfolio of firms with reputations for social responsibility (DSI-included) and a portfolio of firms without reputations for social responsibility (DSI-excluded). The event model was applied to each of the four samples.

The results, presented in Table 3, are consistent with the second hypotheses. In both samples of 'irresponsible' and 'responsible'

Table 3: Results of Event Study Analyses, Segmented by Industry and Reputation for Social Responsibility[a]

Event date	*Daily abnormal return*	*Cumulative abnormal return*	*t-value*	*Per cent negative CARs*	*Binomial Z statistic on CAR*
Firms in labor and environmentally 'irresponsible' industries					
(a) With reputation for social responsibility (DSI-included)					
Friday, November 26	–1.10	–1.10	–1.37†		
Monday, November 29	–0.23	–1.23	–1.19	81.0	–3.01**
(b) Without reputation for social responsibility (DSI-excluded)					
Friday, November 26	–1.24	–1.24	–1.96*		
Monday, November 29	–1.82	–3.06	–3.41***[b]	88.0	–6.93***
Firms in labor and environmentally 'clean' industries					
(a) With reputation for social responsibility (DSI-included)					
Friday, November 26	–1.01	–1.01	–1.37†		
Monday, November 29	0.03	–0.98	–0.94	72.0	–4.49***
(b) Without reputation for social responsibility (DSI-excluded)					
Friday, November 26	–1.13	–1.13	–2.02*		
Monday, November 29	–0.82	–1.94	–2.46**[c]	79.0	–7.06***

[a]For firms in 'irresponsible' industries and with a reputation for social responsibility, $n = 27$; for firms in 'irresponsible' industries and without a reputation for social responsibility, $n = 96$. For firms in 'clean' industries and with a reputation for social responsibility, $n = 128$; for firms in 'clean' industries and without a reputation for social responsibility, $n = 165$. Non-parametric binomial tests indicate the analyses are robust to outliers. This robustness check is critical for the sample with only 27 firms (McWilliams and Siegel, 1997: 634–635). *t*-tests were one-tailed in accordance with the hypotheses.

[b]*p*-value of difference between the CARs of the two sub-samples = –0.06.

[c]*p*-value of difference between the CARs of the two sub-samples = –0.14.

†$p < 0.10$; *$p < 0.05$; **$p < 0.01$; ***$p < 0.001$.

industries, the firms with a reputation for social responsibility suffered smaller declines. In the portfolio of firms from 'responsible' industries, the sample of firms with a reputation for social responsibility did not experience a significant decline, while the sample of firms without a reputation for social responsibility experienced a significant cumulative negative return of almost 2 per cent. Similarly, but even more pronounced, in the portfolio of firms from 'irresponsible' industries, the sample of firms with a reputation for social responsibility again did not experience a significant decline, while the sample of firms without a reputation for social responsibility experienced a significant cumulative negative return of slightly more than 3 per cent. This decline translates into a US$418m loss of shareholder value for the average firm in the sample, in comparison with no statistically significant decline in the sample of firms with a reputation for social responsibility. A reputation for social responsibility thus appears to have held particular value for firms in the allegedly most labor-abusing and environmentally damaging industries.

Finally, to test for the possibility of a trade effect, the authors conducted a third series of event analyses on the 124 firms in the 1999 *Fortune 500* that had no foreign sales or assets in 1999. A total of 41 of these firms had a reputation for social responsibility (DSI-included), while 83 did not have a reputation for social responsibility (DSI-excluded). The results are presented in Table 4 and are consistent with hypothesis 3. The portfolio of firms with a reputation for social responsibility did not experience a significant decline in shareholder value, while the portfolio of firms without a reputation for social responsibility experienced a significant decline of 1.77 per cent. This decline translates into a US$85m loss of shareholder value for the average firm, in comparison with no statistically significant decline in the sample of firms with a reputation for social responsibility. This decline is particularly notable, since it occurred within the portfolio of firms that should not have been penalized at all for anticipated trade effects of the failed Seattle WTO meeting.

Regression

The results of the event study analyses

Table 4: Results of Event Study Analyses for Firms with No Foreign Sales or Assets, Segmented by Reputation for Corporate Social Responsibility[a]

Event date	*Daily abnormal return*	*Cumulative abnormal return*	*t-value*	*Per cent negative CARs*	*Binomial Z statistic on CAR*
Firms with no foreign assets or sales					
(a) With reputation for social responsibility (DSI-included)					
Friday, November 26	–0.79	–0.70	–1.03		
Monday, November 29	–0.13	–0.92	–0.85	73	–2.73**
(b) Without reputation for social responsibility (DSI-excluded)					
Friday, November 26	–0.63	–0.63	–1.18		
Monday, November 29	–1.14	–1.77	–2.37**[b]	78	–4.83***

[a]For firms with a reputation for social responsibility, $n = 41$; for firms without a reputation for social responsibility, $n = 83$. *t*-tests were one-tailed in accordance with the hypotheses.
[b]*p*-value of difference between the CARs of the two sub-samples = –0.13.
**$p < 0.01$; ***$p < 0.001$.

above were further supplemented with an OLS regression. The three explanatory factors previously considered in the event study analyses were tested, to determine which one best explains the cumulative abnormal returns. Reputation for social responsibility is the KLD rating of each firm for 1999. Kinder, Lydenberg and Domini ('KLD') is the most well established of the agencies assessing firms' social performance and its rating methodology is robust and valid (Sharfman, 1996). Consequently, the KLD ratings of corporate social responsibility have been the most-frequently used measure of social responsibility in empirical research in the past decade (Abramson and Chung, 2000; Dawkins, 2002; Hillman and Keim, 2001; Sauer, 1997; Turban and Greening, 1997; Waddock and Graves, 1997). KLD ranks over 650 firms annually, including all S&P 500 firms, on eight social criteria such as treatment of women and minorities, customers, the environment and employees. The raw KLD ratings were transformed on each dimension (strong positive, positive, neutral, negative and strong negative) into a variable from 1 to 5 and then the eight component scores were averaged into an overall social responsibility rating. Industry is a dummy variable, equal to 1 if a firm was also in one of the 'irresponsible' industries and 0 if the firm was in one of the 'responsible' industries. Internationalization was computed by adding the firm's foreign assets as a percentage of 1999 total assets and its 1999 foreign sales as a percentage of total sales and dividing the sum by two.

If investor reaction to Seattle's failure was driven primarily by concern over stalled foreign trade expansion, then the internationalization variable should be negative and significant, since firms dependent on foreign markets would have the most to lose if access slowed or was restricted in the future. Alternatively, if investors were primarily concerned with the negative publicity that industries with reputations for 'irresponsible' practices received in Seattle and the increased likelihood of regulatory tightening that the publicity brought, then it would be expected that those industries would negatively impact returns. On the other hand, if firms known as socially responsible were believed to face lower costs as a result of the Seattle WTO failure, then social responsibility should positively impact returns.

Also incorporated here are three widely used control variables that may affect a firm's stock return (McWilliams and Siegel, 2000; Russo and Fouts, 1997). Size is calculated as the log of the firm's 1999 revenues. Risk is calculated as a firm's debt to asset ratio. R&D intensity is calculated as a firm's R&D expenditure divided by total sales and was included here because its inclusion materially (and detrimentally) changed Waddock and Graves' (1997) results (McWilliams and Siegel, 2000). The reasoning for the inclusion of R&D is that R&D improves long-run economic performance because it enhances firm knowledge, as do many aspects of corporate social responsibility (McWilliams and Siegel, 2000: 604–605). If R&D has the hypothesized positive impact on firms' performance, then the coefficient of any variables positively correlated with R&D will be overestimated. Data for all variables were obtained from *Compustat* for 1999. Table 5 contains descriptive statistics.

The authors tested three models. The first model includes the three explanatory variables. The second model adds two controls (size and risk) but not R&D intensity, because data limitations on this control variable reduced the sample size from 360 to only 189. On the other hand, since R&D intensity has been an important control variable in other studies examining the link between social and financial performance (McWilliams and Siegel, 2000;

Table 5: Means, Standard Deviations and Correlations[a]

Variable	*Mean*	*s.d.*	*1*	*2*	*3*	*4*	*5*
1 Reputation for social responsibility	0.37	0.48					
2 Internationalization	16.60	17.59	0.01				
3 Industry	0.29	0.45	–0.20★★★	0.09†			
4 Size	8.99	0.81	0.11★	0.19★★★	–0.10★		
5 Risk	0.22	0.14	–0.22★★★	–0.15★	0.16★★	–0.16★★	
6 R&D intensity	0.03	0.04	0.02	0.30★★★	0.18★★	0.09	–0.35★★★

[a]$n = 416$ for variables 1, 3 and 4. $n = 374$ for variable 2. $n = 401$ for variable 5. $n = 204$ for variable 6.
†$p < 0.10$; ★$p < 0.05$; ★★$p < 0.01$; ★★★$p < 0.001$.

Russo and Fouts, 1997), it was felt that it was critical to include in this analysis.

Results of the regression analyses are presented in Table 6. As hypothesized and consistent with the results of the event analyses, corporate social responsibility was positively and significantly correlated with a firm's stock return in all three models.

Table 6: Results of Regression for Cumulative Abnormal Returns

Variable	*Model 1[a]*	*Model 2[a]*	*Model 3[b]*
Intercept	–0.045★★	–0.094★★★	–0.080★★
	(0.018)	(0.029)	(0.037)
Social responsibility	0.011★	0.013★★	0.018★★★
	(0.006)	(0.006)	(0.007)
Internationalization	–0.000	–0.000	–0.000★★★
	(0.000)	(0.000)	(0.000)
Industry	–0.007†	–0.004	–0.002
	(0.004)	(0.004)	(0.005)
Size		0.005★	0.004
		(0.002)	(0.003)
Risk		–0.007	–0.035
		(0.014)	(0.022)
R&D intensity			–0.138★
			(0.056)
R^2	0.036	0.053	0.167
F	3.65★★	3.17★★★	5.01★★★

[a]$n = 360$ due to missing data, primarily for construction of the internationalization variable. Standard errors are in parentheses. *t*-tests were one-tailed in accordance with the hypotheses.
[b]$n = 189$ due to missing data, primarily for construction of the internationalization and R&D intensity variables. Standard errors are in parentheses. *t*-tests were one-tailed in accordance with the hypotheses.
†$p < 0.10$; ★$p < 0.05$; ★★$p < 0.01$; ★★★$p < 0.001$.

Moreover, it was the only one of the three explanatory variables that was robust across all specifications of the model. The impact of a firm's reputation for social responsibility is particularly strong when R&D intensity is not included as a control, as models 1 and 2 illustrate. The addition of R&D intensity, however, causes internationalization to become significant, as model 3 shows and also improves the R^2 of the model estimate, more than the inclusion of the other controls. The signs of all three explanatory variables are in the predicted directions. The results of the regressions thus provide additional support that firms with a reputation for social responsibility appear to have been less harshly penalized by investors than firms without a reputation for social responsibility.

DISCUSSION AND CONCLUSION

Managers are responding to increased stakeholder demands for greater corporate accountability and initiative in all aspects of their enterprises (*New York Times*, 2002). Concurrently, strategy scholars increasingly recognize the impact of intangible assets, such as corporate reputation, on firms' performance (Barney and Hansen, 1994; Kaplan and Norton, 1996; Teece, 1998). This paper combines these scholarly and managerial trends to examine whether a firm's reputation for social responsibility mattered to shareholders when the 1999 Seattle WTO ministerial meeting failed. Moreover, the main finding here — that a reputation for social responsibility yielded tangible financial benefit during the crisis of the Seattle meeting — adds to the growing evidence of a positive corporate social–financial performance relationship.

Contributions

This paper makes two important contributions. First, as noted in the beginning, despite recent empirically and theoretically sophisticated studies of corporate social–financial performance (Berman *et al*., 1999; Hillman and Keim, 2001; Waddock and Graves, 1997),[1] there is still insufficient evidence that 'doing good' also can lead to a firm 'doing well' financially. This is not only unfortunate for values-centered managers seeking to convince skeptical shareholders, employees and boards that investments in social responsibility can pay off, but the continuing skepticism over a social–financial performance link is particularly regrettable in the post-Enron corporate world, with increased public and regulatory scrutiny and expectations for businesses to behave more responsibly. Moreover, most empirical studies of corporate social–financial performance (other than ones cited earlier in this paragraph) concentrate on one industry or a small sample that makes generalizing findings difficult, or use only stakeholder theory to motivate hypotheses and theories making theoretical contributions that are relatively more narrow than broad. Both of these tendencies in most existing social–financial performance studies (Griffin and Mahon, 1997) have contributed to the continuing managerial and scholarly skepticism that social responsibility represents anything other than an unnecessary expense or an unfruitful avenue of scholarly inquiry. This study, however, is motivated theoretically by the very broad resource-based theory of the value of intangible assets and is empirically based on a sample spanning all major US industries and including more than 400 individual firms. Moreover, included among these control variables is R&D intensity, the variable that McWilliams and Siegel (2000) found to reduce the significance of Waddock and Graves' (1997) empirical results. In short, this paper provides highly robust empirical support, across an unusually large and diversified sample of firms, of a social–financial performance link.

Secondly, this paper contributes to scholarly knowledge on reputation. In contrast

to almost all other studies examining the value of a socially-responsible reputation (with the exception of Jones *et al*., 2000), the authors do not presume the relationship is only in the direction of social responsibility causing increased payoffs. Rather, the authors examined whether a reputation for social responsibility protects firms during a corporate crisis from financial losses and found strong evidence that it did. Thus, the returns of the portfolio of 1999 *Fortune 500* firms that were also in the *Domini Social Index* did not decline significantly in response to the Seattle WTO failure, whereas the portfolio returns of remaining *Fortune 500* firms not in the *Domini Social Index* declined significantly by almost 2.4 per cent. Moreover, a reputation for social responsibility provided the greatest benefit to firms facing the greatest crises — those firms in the allegedly environmentally damaging and labor-abusing industries. In these industries, firms without reputations for social responsibility saw a 3 per cent decline in shareholder value, while firms in the same industries that were also seen as good corporate citizens suffered no stock price decline attributable to the Seattle WTO's failure.

Limitations

Unfortunately, this study does not trace the reasons why investors penalized the firms not viewed as socially responsible in response to the WTO failure, but not the firms with reputations as good corporate citizens. A study of the reasoning behind investor reaction would make an excellent companion to this paper, as well as providing scholars and managers with much-needed information on how the financial impact of social responsibility is calculated by investors and other stakeholders. For example, this study cannot conclude whether investors drove down the stock prices of firms not seen as socially responsible because of the estimated costs of future regulations, consumer boycotts, some combination of both, or reasoning that has not even been anticipated. In short, despite this study's findings that investors clearly punished firms without reputations for social responsibility, the processes that produced this effect remain a 'black box'.

Part of this limitation comes from the restrictions of the methodology used here. While the event study measures relatively well investors' estimate of the financial impact of the Seattle WTO failure on the future returns of the *Fortune 500*, it does not survey investors for their reasoning. Moreover, the methodology rests on several, very strict assumptions: investors are perfectly rational and markets perfectly efficient. Therefore, when new information becomes available (such as that the Seattle WTO is likely to fail), investors instantly and accurately quantify the financial impact of that event on the future revenues of the firm and trade stocks consistent with those financial calculations. The growing field of behavioral economics demonstrates quite clearly that such strong, efficient-market assumptions are unrealistic. Thus, the cumulative abnormal returns reported in the tables of this paper should not be interpreted as exact figures of how much investors drove down the market capitalizations of firms without reputations for social responsibility, but rather as broad estimates of the financial relationship between corporate social responsibility and the 1999 WTO failure.

Finally, while this study provides strong evidence that investors valued corporate social responsibility in the case of the 1999 Seattle WTO failure, this result applies only to this specific event. More research is needed to test whether similar reactions have occurred in response to other crises. And additional empirical studies need to be interpreted together with existing and future process-rich case studies of corporate social responsibility in order for scholars

and managers to truly understand the relationship between a firm's reputation for corporate social responsibility and its financial performance. No one study can do this; it is the work of an entire field of study.

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Note

1 There are also recent, excellent empirical studies of a corporate environmental–financial performance link (Dowell *et al*., 2000; Hart and Ahuja, 1996; Russo and Fouts, 1997), but cited here are only the recent social–financial performance studies, in part because they are more rare than the environmental studies. This is no doubt also, in large part, because of the greater ease of measuring environmental responsibility.

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