Pacific-Basin Finance Journal 35 (2015) 56–72

Contents lists available at ScienceDirect

Pacific-Basin Finance Journal

journal homepage: www.elsevier.com/locate/pacfin

The value of Saints and the price of Sin☆

SzeKee Koh [a,d,*], Robert B. Durand [b], Manapon Limkriangkrai [c]

[a] Singapore Institute of Technology, Singapore
[b] Department of Finance and Banking, School of Economics and Finance, Curtin University, Australia
[c] Department of Banking and Finance, School of Business and Economics, Monash University, Australia
[d] The University of Western Australia, Australia

ARTICLE INFO

Article history:
Received 7 May 2014
Accepted 4 October 2014
Available online 12 October 2014

JEL classification:
G11
M14
M41

Keywords:
Corporate Social Responsibility
Environmental, Social and Governance
Value relevance
Feltham–Ohlson model

ABSTRACT

Using firms in the MSCI KLD 400 as exemplars of virtuous firms (the "Saints"), and firms in the "Triumvirate of Sin" – alcohol, tobacco and gaming – we utilize a modification of the Feltham and Ohlson (1995) valuation model and quantile regressions to estimate "Saint premiums" and "Sinner discounts". For firms followed by sell-side analysts, the Saint premium is, on average, \$5.77 (a 19.2% premium over the share price) and the Sinner discount is, on average, \$3.91 (a discount of 32.1% of the share price). The evidence supports the notion that CSR creates shareholder value. Practices contrary to social norms destroy value.

1. Introduction

Friedman (1970) dismissed the idea of Corporate Social Responsibility (CSR). That is, the sole social responsibility of any business is to increase its profits.[1] CSR initiatives could decrease firm value. However, CSR practices

☆ We have benefitted from comments made by seminar participants at Curtin University, Eastern Institute of Technology, the 5th Financial Markets and Corporate Governance Conference and the 2014 Accounting and Finance Association of Australia and New Zealand Conference as well as Chandrasekhar Krishnamurti and Terry Walter. We would also like to thank the anonymous reviewer and the guest editor, Robert Faff, for the insights provided. Any remaining errors and omissions are the responsibility of ours.
* Corresponding author at: Singapore Institute of Technology, 10 Dover Drive, 138683, Singapore. Tel.: +65 6592 8635.
E-mail address: SzeKee.Koh@SingaporeTech.edu.sg (S. Koh).
[1] Benabou and Tirole (2010) for example posit that CSR that integrates Environmental, Social and Governance (ESG) components is simply a matter of corporate executives and boards enhancing their own philanthropic abilities.

http://dx.doi.org/10.1016/j.pacfin.2014.10.003
0927-538X/

are becoming increasingly popular among institutional and individual investors, partly due to the increasing awareness of environmental risk[2] and social risk.[3] Investors are actively incorporating Environmental, Social and Governance (ESG) themed investment styles.[4] As of 20th December 2013, there were a total of 1232 signatories (with more than US$34 trillion worth of assets under management, representing 15% of the world's investable assets) to the United Nations-backed Principles for Responsible Investment (PRI).[5]

We seek to quantify the value of CSR. Empirically, there are conflicting findings of both positive and negative abnormal returns. This confusion, however, may be attributable to differing experimental designs.[6] Rather than considering returns, this paper considers if investors value CSR by paying a premium for it. Investors should be willing to pay a higher price for assets which they deem valuable. Conversely, they will demand a discount for assets they perceive to be value-diminishing.

Our study utilizes firms which are exemplars of virtue (hence the use of "Saint") to examine if investors pay for CSR. Investors may pay a "Saint" premium, require a discount to compensate them for holding a Saint or they may be indifferent to firms' CSR initiatives (or lack thereof). A premium/discount implies another "product" against which Saints might be benchmarked. We use two groups for comparison. The first such group is the "Sinners". We follow Hong and Kacperczyk's (2009) definition of Sinners, which focuses on the industries collectively known as the "Triumvirate of Sin": stocks with SIC codes identifying them with alcohol, smoking and tobacco and gaming. If there is a Saint premium (discount) there may be a Sin discount (premium). The remaining group is the other firms which are neither Saints nor Sinners; that is, the rest of the market.

The Saints in our study are the firms recognized as CSR leaders through being chosen as a constituent of the MSCI KLD 400 Social Index, the benchmark for ethical performance. Our use of the constituents of the MSCI KLD 400 Social Index follows Durand et al. (2013a) and Chow et al. (forthcoming). Chow et al. argue "…the use of the MSCI KLD 400 as an industry benchmark for ethical investment suggests that its decisions capture the concerns of the finance industry and the investors it serves" (p. 2). Chow et al. provide information on the decision making determining inclusion to, and removal from, the MSCI KLD 400 index. Denoting Saints as constituents of an index is a crucial point of difference between this study and those which utilize scores or ratings to find firms' ranks (see, for example, Humphrey et al., 2012): either a firm is a "Saint" or it is not. Similarly, either a firm is a "Sinner" or it is not. Our study focusses on clearly delineated cohorts (following Hong and Kacperczyk, 2009; Durand et al., 2013a) which, although arbitrary, are, in the case of Saints, chosen by recognized authorities and, in the case of Sinners, seemingly consistent with a generally recognized consensus (Hong and Kacperczyk, 2009).

We find that firms that are highly ranked for their CSR initiatives, the "Saints", sell at an average premium of $6.528 (a premium of 28% over the share price) relative to other stocks. The share price used to estimate the average premium is the predicted price for each firm in the sample using the estimated coefficients and the observed values from Eq. (3) — see Section 4 for a discussion on how the premium (discount) is calculated. When we re-estimate the Saint premium for a sub-sample of firms followed by sell-side analysts, we find evidence of an average premium of $5.766 (a 19.2% premium over the share price). For firms that are identified as "Sinners", we find a discount, which is consistent with Hong and Kacperczyk (2009) and Durand et al. (2013a). We estimate that the average Sin discount for the full sample is $1.601 (a 5.3% discount to the share price) and, for firms followed by analysts, the discount is an average of $3.908 (a 32.1% discount of the share price). We then extend our analyses by performing quantile regressions to explore if our inferences regarding the value of Saints and the price of Sin vary for firms with high prices from those with low prices. Quantile regression produces estimates of the marginal effect of a one unit change in the predictor variable

[2] For example, climate change leading to higher investor demand for portfolio opportunities in clean and green technology, alternative and renewable energy, green building and responsible property development, and other environmentally driven businesses (Social Investment Forum, 2007).

[3] For example, the crisis in Sudan resulted in investors targeting divestment or active engagement with companies exposed to the risks of doing business in volatile and repressive regimes (Social Investment Forum, 2007).

[4] ESG-themed investment style is an investment style where certain ESG factors are prominent in the chosen investment criteria. Typical applications include negative screening, positive screening and best of sector.

[5] See PRI fact sheet at http://www.unpri.org/news/pri-fact-sheet/.

[6] Evidence supporting positive payoffs to CRS includes Jiao (2010); Guenster et al. (2011); Derwall et al. (2005); Statman and Glushkov (2009); and Chow et al. (forthcoming). Evidence of negative payoffs is found in Becchetti and Ciciretti (2009); Brammer et al. (2006); and Derwall and Verwijmeren (2007). We discuss these papers in Section 2.