Corporate executives, community activists, and academics have long debated whether firms should spend money on improving social and environmental performance. Supporters of an expansive role for the corporation in society base their opinions primarily on moral grounds. In contrast, opponents argue that taking care of broad stakeholder groups, other than firms’ immediate owners and employees, is the role of government—not business. This debate is disappearing, however, as new evidence emerges that corporate social and environmental responsibility pays off.

Most managers currently justify corporate expenditures on social and environmental improvements as the duty of a good corporate citizen. Sometimes firm expenditures on social obligations is in reaction to concerns from consumers, shareholders, employees, and various community activities; often it is as a means of carrying out an enlightened corporate mission statement.

Regardless, such “discretionary” expenditures on corporate social or environmental issues are still among the first to be reduced when hard times hit. Although social activists and researchers have long suggested that social responsibility positively impacts communities and long run corporate profitability, skepticism remains among many managers that there is a tangible payoff to corporate investments in social and environmental issues. We now have some conclusive evidence demonstrating that a reputation for corporate social responsibility pays off handsomely.

Many difficulties kept prior researchers from finding events and data that allowed for careful tests of whether there is a financial benefit to corporate social responsibility. But senior executives and corporate directors often ask whether there is a payoff from these expenditures in either increased long term profitability or improved stock price. The Seattle World Trade Organization (WTO) talks provide an excellent setting for measuring the stock price value of a reputation for corporate social responsibility.

The talks failed due to massive public protests against the allegedly environmentally and labor abusing practices of multinational firms. Demonstrators assumed the export of polluting operations and sweatshop labor to lesser-developed nations presumably would have been furthered by a new global trade agreement. How did investors react to this development? Specifically, were firms with a reputation for responsibility to the community, its employees, and the environment protected from a significant decline in market value in response to the Seattle WTO’s failure, more so than firms without a reputation for social responsibility?
We examined stock market reaction in the *Fortune 500* to the WTO failure using standard financial economics research methods (and all results reported here are highly statistically significant). We compared the stock returns of the *Fortune 500* segmented into two portfolios: firms in environmental and labor abusing industries that were the focus of the protest versus those firms in other, “less-abusing” industries. We also compared firms that were also in the *Domini Social Index Fund*, the oldest and largest socially-screened investment fund in the U.S., with the rest of the *Fortune 500* firms. This research yielded five significant conclusions:

1. The Seattle WTO meetings really had a negative, long-term impact on stock price and market capitalization.

2. The *Fortune 500* firms in environmental (energy, chemical, steel, mining) and labor “abusing” (apparel, footwear, toys, sporting goods) industries lost $121 million more in market value than the remaining firms in “non-abusing” industries. Thus, the stock price of firms in industries perceived to have irresponsible environmental or labor practices were particularly hard hit.

3. A reputation for social responsibility does, indeed, pay off: the difference in impact of the WTO protests on firms with such a reputation was $378 million less in reduction of market capitalization than those firms without such a reputation.

4. The value of a reputation for corporate social responsibility as a form of “crisis insurance” was particularly pronounced for firms in “abusive” industries. Social responsibility has a big effect on market capitalization whether a firm is in an “abusive” or “non-abusive” industry, but its biggest payoff is to firms in “abusive” industries.

5. Companies not even directly involved in global environmental or labor issues – those with no foreign sales or assets, who arguably should not have experienced trade-related effects of the WTO – were affected. Those firms without reputations for social responsibility saw their market capitalization drop while firms with such a reputation did not.

So, what should senior corporate managers conclude from this research?

The fact that the stock market declined as a result of the Seattle WTO failure is not surprising. The interesting result -- and the one with dramatic managerial implications -- is that investors drove the market capitalization of companies without reputations for social responsibility down by $378 million, but did not penalize firms with a reputation for social responsibility. Further, the greatest beneficiaries of investments in social responsibility were firms in industries with the worst reputations for labor and environmental practices.

With a payoff to shareholder value in the hundreds of millions of dollars, an investment in social and environmental responsibility clearly pays off. Indeed, investing in a reputation for corporate social and environmental responsibility
can be analyzed like other corporate investments. This research conclusively shows that being socially and environmentally responsible is not only good for society, but can also be very good for increasing and preserving shareholder value. It may be that, if properly analyzed, investments in corporate social responsibility will yield such high ROIs that they are recognized as among the best investments firms can make.

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