Holy Grail Found

Absolute, Definitive Proof CSR Pays Off

MUSINGS • BY MARJORIE KELLY

OK, YES, IT'S TRUE THAT researchers don't speak this way: They'll never say "absolute, definitive proof" of anything has been found—not even that the sky is blue. Theirs is the language of positive correlations, statistical significance, and other somnolent phrases. I'm no statistician. I am instead someone who's observed the socially responsible investing (SRI) field for 17 years, and in that time I've seen countless theorists attempt to scale the Everest of SRI, reaching for the summit of certainty: Do socially responsible companies perform better financially? The answer has long been the statistical Holy Grail: eagerly sought, ever out of reach.

Thirty years and 112 studies later, it's been proven: CSR goes hand-in-hand with financial outperformance.

I'm here to announce the search is over. The evidence is in. And even the statisticians are saying it's conclusive. Social and environmental responsibility does go hand in hand with superior financial performance—that's the finding of two "meta-studies" in recent months.

A meta-study is distinguished by being a study of studies—it rolls up years of research by various theorists, using various lenses, studying different industries, different time periods, different definitions of social responsibility, and so on. This lends such studies an outsized authority.

The most impressive of these is the rigorous and groundbreaking study that in October won the *Moskowitz Prize* of the **Social Investment Forum**, awarded for outstanding research in social investing. It was conducted by Marc Orlitzky of the **University of Sydney**, Australia, and by Frank Schmidt and Sara Rynes from the **University of Iowa**. Their meta-analysis, "Corporate Social and Financial Performance," was a study of 52 studies over 30 years. They thus reviewed in one fell swoop three decades of attempts to answer the perennial question. And they proved that a statistically significant association between corporate social performance and financial performance exists, which varies "from highly positive to modestly positive."

The researchers offered ideas on what might be behind this correlation. One theory is that corporate social responsibility (CSR) is an indicator of good management—a kind of flag saying sophisticated, cutting-edge managers are at work. A second theory sees the causation going the other way: financially successful firms have more resources for social activities. The study supported both theories. In a virtuous cycle, "financially successful companies spend more because they can afford it, but [corporate social responsibility] also helps them become a bit more successful."

It's not rocket science to see why CSR firms perform better financially. CSR helps companies develop new competencies because it engages employees organization-wide, calls for a "forward-thinking managerial style," and leaves responsible firms better prepared for "external changes, turbulence, and crises," study authors wrote. It builds reputations and enhances relations with bankers and investors. It helps firms attract better employees and increase employee goodwill. It helps firms run better.

In November 2004, just a month after the Moskowitz Prize was announced, a second major meta-study was released, commissioned by the **UK Environment Agency**. Its resounding conclusion was similar: Companies with sound environmental policies and practices are highly likely to see improved financial performance. The analysis looked at 60 research studies over the last six years, finding that 51 of them (85 percent) showed a positive correlation between environmental management and financial performance. Again, we have rigorous proof that good environmental management delivers financial benefits.

This second study, "Corporate Environmental Governance," was conducted by **Innovest Strategic Value Advisors**, an international social research firm with over $1 billion in funds it sub-advises. The Innovest report offered many anecdotes of superior financial returns being paired with good environmental management:

▶ The Winslow Green Growth Fund has consistently outperformed its peer growth funds, with average annual returns above the benchmark index by 20 percent, 6 percent, and 11 percent over one, three, and five years respectively.

▶ Forest and paper products companies with

above-average environmental performance had 43 percent better share-price performance over four years than those with below-average environmental ratings.

▶ In the oil and gas sector, the top environmentally rated firms outperformed laggards in share price by 12 percent over three years.

Though the evidence is clear, not everyone will believe it. As Matthew Kiernan, the CEO of Innovest, commented in the UK Environment Agency report, the misconception remains that tracking environmental performance "is at best a waste of time for investors, and at worst actively harmful to financial returns." Indeed, when the Environment Agency asked analysts to spontaneously name the factors they considered in investing, just 3 percent mentioned environmental factors.

While doubters remain, they may unwittingly create opportunity for SRI investors. Knowing that responsible companies outperform, savvy investors have a head start in locating future winners before the broad market does. The future of SRI may lie in searching for undiscovered indicators that lead to superior stock selection. This has already been done, for example, by McBassi & Co., which is creating a niche for itself by buying stocks in companies that invest the most in human capital. Its portfolio of such firms created in late 2001 has outperformed the S&P by nearly 7 points over two years (see Business Ethics, Summer 2004).

As some folks pretend the jury is still out, we might liken their stance to "doubts" over global warming. What they're disputing is not a scientific question but an economic worldview. Statistically speaking, the perennial question has been answered. CSR does indeed go hand-in-hand with financial outperformance. Thirty years and 112 studies later, the Holy Grail has been found.