ESG and company profitability: Are financial intermediaries different?

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Outline

CSR, ESG and company performance

No relationship

- Aupperle et al. (1985): different dimensions of CSR (economic, legal, ethical, and philanthropic responsibilities) and financial performance are not statistically significant related
- McWilliams & Siegel (2000) claim that CSR has a neutral impact on financial performance

Negative relationship

- Friedman (1970) posits that ESG performance has limited financial benefits for companies because of the implementation cost that shareholders have to pay, leading to a misallocation and misappropriation of valuable company resources

CSR, ESG and company performance

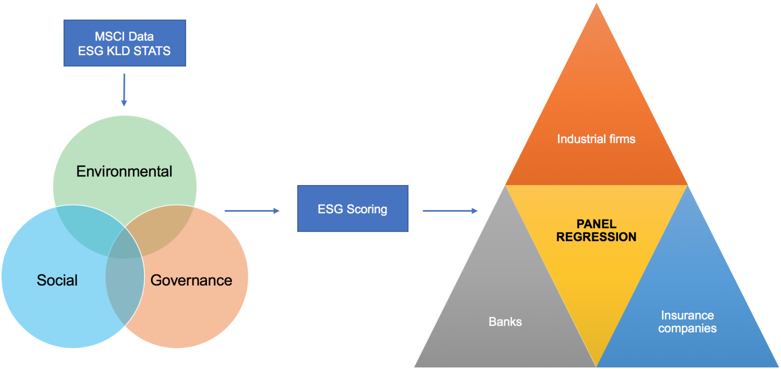
Positive relationship

- Mackey (2005): "a certain amount of corporate philanthropy is simply good business and works for the long-term benefit of the investors"
- Eccles et al. (2014): high-sustainability companies significantly outperform their counterparts, both in terms of stock market and accounting performance
- Waddock & Graves (1997): virtuous cycle linking the implementation of ESG practices and financial performance
- Meta-analysis: Orlitzky et al. (2003); Margolis et al. (2009): ESG awareness is related with high firm performance

Research Questions

- How much is ESG associated with company profitability?
- Which are the dimensions of ESG that drive profitability the most?
- Are there differences and similarities between industrial and financial companies?

Strategy of investigation



ESG Data

MSCI ESG KLD STATS

- Sample: more than 50,000 observations of US companies
- Period: 2000-2016
- **Environment** dimension: Climate Change; Environmental Management Systems; Biodiversity & Land Use; Raw Material Sourcing; and Water Stress
- **Social** dimension: Cash Profit Sharing; Employee Health & Safety; Employee Involvement; Human Capital Development; Human Rights Policies & Initiatives; Product Safety And Quality; Access To Finance; and Supply Chain Labor Standards
- **Governance** dimension: Gender; Corruption & Political Instability; Financial System Instability; Limited Compensation; Ownership Strength; Political Accountability Strength; Public Policy; and Reporting Quality

Financial Data

BvD Osiris

- Observed variable: Return on Assets (ROA)
- Control: Total Assets

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FINAL SAMPLE

- Companies: 3,476
- Observations: 17,358
  - Industrial companies: 16,159 (93% of the total sample)
  - Banks: 848 (5%)
  - Insurance companies: 351 (2%)

Model

Scoring

- $EScore = \frac{1}{n}\sum_{i=1}^{n} E_i$
- $SScore = \frac{1}{n}\sum_{i=1}^{n} S_i$
- $GScore = \frac{1}{n}\sum_{i=1}^{n} G_i$

- $ESGScore = \frac{1}{3}(EScore + SScore + GScore)$

Panel regressions

- $ROA_t = \alpha + \beta_1 ESGScore_t + \beta_2 \ln(TA) + \epsilon$
- $ROA_{t+1} = \alpha + \beta_1 ESGScore_t + \beta_2 \ln(TA) + \epsilon$

- $ROA_t = \alpha + \beta_1 EScore_t + \beta_2 SScore_t + \beta_3 GScore_t + \beta_4 \ln(TA) + \epsilon$
- $ROA_{t+1} = \alpha + \beta_1 EScore_t + \beta_2 SScore_t + \beta_3 GScore_t + \beta_4 \ln(TA) + \epsilon$

Results

Panel 1 – Total sample

	ROA_t	ROA_{t+1}	ROA_t	ROA_{t+1}
ESGSCORE	7.562***	6.361***		
lnTA	1.118***	0.623***	1.101***	0.615***
ESCORE			1.140	1.151
SSCORE			6.609***	4.923***
GSCORE			1.328	1.368*
_cons	-12.16***	-4.442***	-12.00***	-4.421***
N	17,358	12,476	17,358	12,476
adj. RSq	0.31	0.14	0.32	0.14

Panel 2 – Industrial companies

	ROA_t	ROA_{t+1}	ROA_t	ROA_{t+1}
ESGSCORE	6.671***	5.644***		
lnTA	1.407***	0.860***	1.392***	0.851***
ESCORE			0.0331	0.385
SSCORE			6.171***	4.303***
GSCORE			1.893*	1.842*
_cons	-15.75***	-7.405***	-15.68***	-7.413***
N	16,159	11,698	16,159	11,698
adj. RSq	0.41	0.20	0.41	0.21

Results

Panel 3 – Banks

	ROA_t	ROA_{t+1}	ROA_t	ROA_{t+1}
ESGSCORE	10.64***	12.53***		
lnTA	-0.295**	-0.599***	-0.319***	-0.606***
ESCORE			8.299***	5.350*
SSCORE			6.683*	8.560**
GSCORE			0.436	2.353
_cons	5.313***	10.41***	5.942***	10.51***
N	848	541	848	541
adj. RSq	0.22	0.70	0.37	0.75

Panel 4 – Insurance companies

	ROA_t	ROA_{t+1}	ROA_t	ROA_{t+1}
ESGSCORE	18.01**	16.95*		
lnTA	-0.296	-0.223	-0.308	-0.223
ESCORE			5.171	4.955
SSCORE			8.420	7.298
GSCORE			6.070*	5.804*
_cons	6.582*	5.209	6.625*	5.081
N	351	237	351	237
adj. RSq	0.27	0.19	0.23	0.11

Implications for policy makers

- Continue to support companies' ESG activities through the issue of socially responsible standards and principles
- Green Supporting Factor + ESG Supporting Factor

Implications for policy takers

- ESG policies are positively related to profitability
- For industrial companies, the effect on profitability gradually slows during the years
- Growing concern for ESG within banks (and in particular Environmental issue)[1]
- Banks should continue to focus on risks and opportunities from implementing ESG practices to move to a sustainable business

[1] e.g., the top five U.S. banks in terms of market capitalization - JPMorgan Chase, Bank of America, Wells Fargo, Citigroup, and Morgan Stanley - have all adopted programs to steadily improve their environmental performance

Brogi, M., & Lagasio, V. (2019). Environmental, social, and governance and company profitability: Are financial intermediaries different? *Corporate Social Responsibility and Environmental Management*, 26(3), 576-587

Thank you for your attention!

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