Doing Better by Doing Good: Discussing the Value Potential of Selected "Just Companies"

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Abstract

On December 10, 2018, The JUST Capital Foundation, in partnership with *Forbes*, has released the 2018 ranking of the one hundred most socially "just" companies in the United States (Forbes; Just capital Foundation, 2018).This paper aims to discuss the value generation potential of the selected companies in this list by using (Ohlson, 1995) model. Our findings suggest that the in the context of USA, markets value social responsibility efficiently and the impact is visible in various sectors. These results may be of interest for investment analysts, academic researchers, Governments and regulatory bodies. In addition, we suggest that the results may indicate an area into which valuation professionals should invest time and thought as they assess the values of privately-held companies.

Keywords: valuation, corporate social responsibility, just companies

1. Introduction

On December 10, 2018, The JUST Capital Foundation, in partnership with *Forbes*, released the 2018 ranking of the one hundred most socially "just" companies in the United States (Forbes; Just capital Foundation, 2018). This ranking was based on a survey of 81000 Americans who were asked what they thought the most important corporate attributes were: JUST Capital and *Forbes* ranked nearly nine hundred of the largest publicly traded companies in the U.S. on thirty-six of those attributes grouped into seven categories - job creation, worker pay and benefits, customer treatment, product pricing and quality, environmental impact, contribution to community well-being, and ethical leadership. Microsoft ranked first overall, followed by Intel and Alphabet, the parent company of Google (McGrath & Konrad, 2018).

This paper aims to discuss the value generation potential of the selected companies in this list from a different lens. To accomplish this objective, (Ohlson, 1995) model has been used to verify the value generation potential of these selected companies. The goal here is to observe the impact of socially responsible companies on their market price.

The JUST Capital Foundation, Inc. (http://justcapital.com) is an independent, nonprofit 501(c) (3) organization that works to align business practices with the American people to ensure capitalism works for all. Co-founded in 2013 by a group of concerned people from the world of business, finance, and civil society - including Chairman Paul Tudor Jones II, Deepak Chopra, Rinaldo Brutoco, Arianna Huffington, Paul Scialla, and others - JUST Capital ranks how the largest, publicly traded U.S. corporations measure up against the American people's definition of just business behavior, and provides research, indexes, and data-driven tools to help people make more informed decisions about where to invest, work, and buy to direct capital toward companies advancing a more just future. The organization is based in New York City.

Corporate social responsibility (CSR) is known as voluntary actions taken by the company to integrate environmental and social concerns into the business and to achieve sustainability in the long-run (ACCA, 2015). The concept of triple bottom line "People, Planet and Profit" (Zak, 2015) considers the important factors that contribute to a company's success other than the purely financial ones.

According to recent study by CFA Institute (CFA Institute, 2018), many of the emerging trends for the next 5–10 years are based on changing client expectations, as seen in some of the key survey findings among CFA members: 72% expect their firm's future commitment to the research of environmental, sustainability, and governance (ESG) issues to be higher.

CSR activities may benefit companies long term through a better image and good reputation in the public, even if such activities require some near-term sacrifice of profit. Good corporate image may help workers to achieve higher self-esteem and work more efficiently and achieve higher productivity and it helps to attract a good talent (Stubes & Sun, 2010). Good CSR policies could lead to higher stock returns since there is a positive relationship between CSR activities and the return of the adjusted market in the subsequent period. Prior studies have also suggested that commitment to CSR enhances firm's ability to perform better in short and long run (Yu & Choi, 2014; Cheng, Ioannou, & Serafeim, 2014).

We, in this study, employ (Ohlson, 1995) model for the purpose of valuation of "Just Companies". Since its introduction in 1995, (Ohlson, 1995) model has become a reference point in equity valuation and capital market research. The model has been used by academics, practitioners, and policy makers, alike. The beauty of the model lies in its simplicity. This model traces the value of the company in the accounting data by summing two components - accounting book value and the discounted value of future residual income. The latter part captures all the other information that can affect the stock market price of a firm, other than accounting data ((Preinrich, 1938); (Edward & Bell, 1961); (Peasnell, 1982)). In addition, (Ohlson, 1995) depicts price as a linear combination of equity book value and earnings weighted by earning persistence. According to (Ohlson, 1995) there is a direct relationship between persistence of earnings and pricing multiples. The more persistent the earnings reported, the larger the pricing multiples.

The structure of our work, in this study, is as follows: Section 2 briefs readers about the literature review and hypotheses; Section 3 brings into light our research design and data collection methodology; and Section 4 unfolds and depicts the results. We conclude and summarize our findings in Section 5. This last section also provides insights, stimulus and motivation for future research.

2. Literature Review and Hypothesis

2.1 (Ohlson, 1995) Model

The roots of Ohlson (1995) model can be found in the basic dividend discount model as expressed follows:

$$P_t = \sum_{t=1}^{\infty} \frac{E[d_{t+\tau}]}{(1+R)^{\tau}} (PVED) (1)$$

Where E [. . .] denotes the expectation operator. This model permits negative d (t) that reflects capital contributions. The d (t) should, in fact, be referred to as dividends net of capital contribution but we will keep referring it to simply dividends for the sake of brevity. PVED is an equilibrium condition. It is a no-interpersonal arbitrage price that results when interest rates are not stochastic, beliefs are homogenous and investors are risk neutral. It is also the first assumption of the (Ohlson, 1995) model.

The clean surplus accounting (CSA) method provides elements of a forecasting model that yields price as a function of earnings, expected returns, and change in book value. The CSA is the second assumption of the (Ohlson, 1995) model and can be stated as:

$$bv_t = bv_{t-1} + x_t - d_t \text{ (CSA)} \tag{2}$$

$$\text{Or } d_t = bv_{t-1} - x_t - bv_t$$

$$\text{Or } d_{t+\tau} = bv_{t-1+\tau} + x_{t+\tau} - bv_{t+t} \tag{3}$$

Where:

bv_t = book value of the firm's equity , date t

x_t = earnings for period $(t-1, t)$

d_t = dividend, net of capital contribution, date t

Moving ahead from this development residual income ($x_t^a \ at \ date \ t$) can be defined as the difference between net income and capital charge at the discount R:

$$x_t^a = x_t - Rbv_{t-1}$$

$$\text{Or } x_{t+\tau}^a = x_{t+\tau} - Rbv_{t-1+\tau} \text{ (RI)} \tag{4}$$

Substituting the value of $x_{t+\tau}$ is from equation 4 to equation 3

(4) in (3):

$$d_{t+\tau} = bv_{t-1+\tau} + x_{t+\tau}^a + Rbv_{t-1+\tau} - bv_{t+\tau}$$

$$\text{Or } d_{t+\tau} = (1 + R)bv_{t-1+\tau} + x_{t+\tau}^a - bv_{t+\tau}$$

Combining PVED($d_{t+\tau}$) and RI ($x_{t+\tau}^a$) we get the residual income valuation model as:

$$P_t = \sum_{\tau=1}^{\infty} \frac{E[(1+R)bv_{t+\tau-1} - bv_{t+\tau} + x_{t+\tau}^a]}{(1+R)^\tau}$$

$$\text{Or } P_t = \sum_{\tau=1}^{\infty} \frac{E[bv_{t+\tau-1}]}{(1+R)^{\tau-1}} - \sum_{\tau=1}^{\infty} \frac{E[bv_{t+\tau}]}{(1+R)^\tau} + \sum_{\tau=1}^{\infty} \frac{E[x_{t+\tau}^a]}{(1+R)^\tau}$$

Residual Income can be written in terms of total income and book value:

$$P_t = bv_t + \sum_{\tau=1}^{\infty} \frac{E[bv_{t+\emptyset}]}{(1+R)^\emptyset} - \sum_{\tau=1}^{\infty} \frac{E[bv_{t+\tau}]}{(1+R)^\tau} + \sum_{\tau=1}^{\infty} \frac{E[x_{t+\tau}^a]}{(1+R)^\tau}$$

$$\text{Or } P_t = bv_t + \sum_{\tau=1}^{\infty} \frac{E[x_{t+\tau}^a]}{(1+R)^\tau} \quad \text{(RIV)} \tag{5}$$

The RIV equation was first presented by (Preinrich, 1938). The point worth noting in RIV is the change of focus from wealth distribution (Dividends) (PVED) to wealth creation (residual income) that take into accounts various operational efficiencies including CSR activities.

Linear information model (LIM) is the main contribution to valuation theory by Ohlson. A simple linear information model formulates the dynamics of residual income and information "other than" residual income, ϑ_t.

$$x_{t+1} = \omega x_t^a + \vartheta_t + \epsilon_{1t} \tag{6}$$

$$\vartheta_{t+1} = \gamma \vartheta_t + \epsilon_{2t} \tag{7}$$

Where the disturbance terms ϵ_{1t} and ϵ_{2t} are two non-zero random variables and where the parameter ω

and γ are fixed and known in the sense that the firm's accounting principles and economic environment determine their values.

Equation no.7 is also known as the third assumption of the (Ohlson, 1995) model. According to this assumption, both abnormal earnings and non-accounting information are autoregressive. To be precise ϑ_t can be written as:

$$\vartheta_t = E[x_{t+1}^a] - \omega_t^a \tag{8}$$

And, this is interpreted as unpredicted growth.

Finally, the (Ohlson, 1995) linear function is given as:

$$P_t = bv_t + \alpha_1 x_t^a + \alpha_2 \vartheta_t \quad \text{(OM)} \tag{9}$$

Where:

$$\alpha_1 = \frac{\omega}{1+R-\omega} \; ;$$

$$\alpha_2 = \frac{1+R}{(1+R-\omega)(1+R-\gamma)}$$

$$\vartheta_{1t} = '\text{Other information'variable at time t}$$

$$\omega = \text{Persistence of abnormal earnings } (0 < \omega < 1)$$

$$\gamma = \text{Persistence of 'Other information'} (0 < \gamma < 1)$$

It is important to note that in this paper, we consider that Ohlson 1995 model can only be applied to the firm with abnormal profits. If the model is used for firms with abnormal losses, the resulting intrinsic value would be lower than the book value of equity.

From the empirical standpoint, the (Ohlson, 1995) demands three variables ($bv_t, x_t \text{ and } \vartheta_t$) and three parameters ($\omega, \gamma \text{ and } k$) to be known.

In this study, we employ the methodology of (Dechow, Hutton, & Sloan, 1999) for the estimation of these parameters and variables. Consistent to their work, we consider ϑ_t i.e., other information to be zero. This consideration leads the parameter of other information $'\gamma'$ to be zero, as well, and in OM equation, this hypothesis make $\alpha_2 = 0$. This assumption yields the following empirical version of (Ohlson, 1995) model:

$$P_t = \alpha_o + \alpha_1 bv_t + \alpha_2 x_t^a + \varepsilon_{1t} \tag{10}$$

The above valuation function has been scaled by assets to avoid a size effect. Hence, our required valuation equation in this study would be:

$$\frac{P_t}{Total\ assets} = \alpha_o + \frac{\alpha_1 bv_t}{Total\ assets} + \frac{\alpha_2 x_t^a}{Total\ assets} + \varepsilon_{1t} \tag{11}$$

2.2 Corporate Social Responsibility and Valuation of Firms

Corporate social responsibility and its relationship to valuation of the firm has been the focus of many research studies published recently. Companies, investors and research scholars have asked one fundamental question: does it increase entity value to engage in social responsibility? The results obtained by various research work are mixed for both developed and developing countries but three main dimensions emerge from the literature (positive, negative and neutral). These mixed results are due to differences in approaches and focus of the studies (Park, 2017).

The positive relationship between CSR and firm value/performance can be found in stakeholder theory. (Alikaj, Nguyen, & Medina, 2017) found that when correlation between CSR and financial performance is analyzed using accounting-based, market-based and investor-based measures, engagement in CSR may raise the firm valuation. Research indicates that CSR builds good reputation which translates into positive valuation for the firm. (Cheung, 2010). Investment in CSR can provide "insurance-like" benefits (Godfrey, Merrill, & Hansen, 2009)). Reducing waste, for instance, is a way to avoid environmental disasters, financial lawsuits and consumer boycotts as well as to reduce costs.

The neoclassical economic school of thought and utility theory argue that CSR activities do not enhance the value of the firm. According to (Famiyeh, 2017), CSR related cost could be retained or the same resources could be allocated to other agents e.g., customers and governments. Thus, the economic advantages of spending on CSR related activities are limited. (Weber, 2008) argues that financial implications of doing good are mixed. Doing good is profitable for a firm if the financial benefits from this behavior are higher than its costs. The link between CSR and firm value is therefore strongly theoretically grounded in a discounted marginal cash flow analysis. What impact does CSR have on the discount rate? As investors estimate that risk decreases when social behaviors are undertaken, the discount rate also decreases, increasing firm value.

(Oeyono, Samy, & Bampton, 2011) state that the relationship between CSR and financial performance is neutral, where additional costs incurred by implementing social responsibility are exactly matched by gains arising from it. (Horváthová, 2010) found that the positive and negative views of CSR are called into question by a third stream of literature, which postulates an inverted U-shaped relationship between performance and CSR practices((Lankoski, 2000), (Wagner, 2001)). Investing in CSR can be rewarding until profit is maximized. After this point, costs increase more than profits, which lead to fewer benefits. For other authors like (McWilliams & Siegel, 2001), there is a neutral relationship between CSR and performance.

2.2.1 Valuation of "Just Companies"

Table 1 below that covers the issues that were considered for selection of "Just Companies" by Just Foundation. In this context, we investigate the following hypotheses in this paper:

1- Markets do not value corporate social responsibility at all

2- Markets value corporate social responsibility efficiently

3- Markets value corporate social responsibility but do not value it efficiently

Table 1. Issues covered in the selection of "Just Companies" with their scoring weights

Issues	Explanation	Scoring Weight
Workers	Workers are the top priority for just companies, according to the American public,	25%

	who believe employees should receive benefits, earn fair and equal pay, and work in a safe environment.	
Customers	Americans believe that companies should do right by their customers, whose weight is second only to workers' in our scoring model. According to our survey, fair treatment, customer privacy, and truthful advertising are essential to just business behavior.	18%
Products	The products and services offered by a company are an essential measure of its just business practices, according to Americans. They believe that companies should offer fair pricing, accurate labeling, and products that benefit health, environment, or society	14%
Environment	Americans see the planet as a key stakeholder, and agree that corporations play a role in protecting our planet - minimizing pollution, reducing waste, and implementing robust environmental management systems.	13%
Jobs	The creation of quality jobs is central to just business practices, with Americans agreeing that companies should create and maintain jobs both globally and in the United States.	12%
Communities	Americans believe that companies should support the communities they impact, both at home and abroad. Through addressing the negative social impacts from supply chains (such as labor rights abuses and conflict minerals), supporting local suppliers, and giving back through charitable giving and volunteering, companies should foster and protect the communities they impact and the people who live there.	11%
Company Leadership & Shareholders	Americans prioritize just and ethical leadership within companies, including fair CEO-to-Worker pay ratios and adherence to laws and regulations, as well as long-term financial growth and value creation for shareholders.	8%

We, accomplish this objective by selecting representative firms from each industry sector in the USA that are already part of "Just Companies" and checking their value generation potential.

3. Research Design and Data Collection

This section describes the data and methodology used to empirically investigate the link between corporate social responsibility and equity asset valuation. We selected top five representative firms (from "Just Companies" index) covering 33 industrial sectors of USA economy. Relevant data (stock prices) were collected for each firm for years (2013-2018). This data is used to get graph from Yahoo finance. In total 165 leading companies from each sector were selected with 990 firm years for the purpose of this study. The selected companies with their respective tickers are listed below:

Table 2. Name and tickers of selected "Just Companies" from all the industry sectors of USA

1	**Aero Space**	**Ticker**	**8**	**Chemicals**	**Ticker**
1	Northrop Grumman	NOC	1	DowDuPont	DWDP
2	Boeing	BA	2	Avery Dennison	AVY
3	Raytheon	RTN	3	International Flavors & Fragrances	IFF
4	Lockheed Martin	LMT	4	Albemarle	ALB
5	Huntington Ingalls	HII	5	Ecolab	ECL
2	**Automobiles & Parts**	**Ticker**	**9**	**Commercial Support Services**	**Ticker**
1	General Motors	GM	1	Accenture	ACN
2	Ford Motor	F	2	Johnson Controls	JCI
3	Valvoline	VVV	3	PayPal Holdings	PYPL
4	Aptiv	APTV	4	Xerox	XRX

5	Lear Corp	LEA
3	**Banks**	**Ticker**
1	Bank of America	BAC
2	Comerica	CMA
3	JPMorgan Chase	JPM
4	Citigroup	C
5	Regions Financial	RF
4	**Basic Resources**	**Ticker**
1	Freeport-McMoRan	FCX
2	Alcoa	
3	Newmont Mining	NEM
4	Domtar	UFS
5	Nucor	NUE
5	**Building Materials & Packaging**	**Ticker**
1	Owens Corning	OC
2	Ball Corp	BLL
3	Fortune Brands Home & Security	FBHS
4	AptarGroup	ATR
5	Sherwin-Williams	SHW
6	**Industrial Goods**	**Ticker**
1	Keysight Technologies	KEYS
2	3M	MMM
3	Agilent Technologies	A
4	Fluor	FLR
5	General Electric	GE
7	**Capital Markets**	**Ticker**
1	Bank of New York Mellon	BK
2	State Street	STT
3	Legg Mason	LM
4	Charles Schwab	SCHW
5	Voya Financial	VOYA
15	**Food, Beverage & Tobacco**	**Ticker**
1	General Mills	GIS
2	Kellogg	K
3	Campbell Soup	CPB
4	PepsiCo	PEP
5	Hershey	HSY
16	**Health Care Equipment & Services**	**Ticker**
1	ResMed	RMD
2	Varian Medical Systems	VAR
3	Edwards Lifesciences	EW
4	Baxter International	BAX
5	Medtronic	MDT
17	**Health Care Providers**	**Ticker**

5	Alliance Data Systems	ADS
10	**Consumer & Diversified Finance**	**Ticker**
1	S&P Global	SPGI
2	Visa	V
3	American Express	AXP
4	MasterCard	MA
5	Synchrony Financial	SYF
11	**Household Goods & Apparel**	**Ticker**
1	Nike	NKE
2	PVH Corp	PVH
3	Hasbro	HAS
4	Stanley Black & Decker	SWK
5	Whirlpool	WHR
12	**Restaurants & Leisure**	**Ticker**
1	Hilton	HLT
2	Marriott International	MAR
3	Starbucks	SBUX
4	Expedia	EXPE
5	TripAdvisor	TRIP
13	**Energy Equipment & Services**	**Ticker**
1	Baker Hughes	BHGE
2	ONEOK	OKE
3	Schlumberger	SLB
4	Halliburton	HAL
5	Williams	WMB
14	**Food & Drug Retailers**	**Ticker**
1	Cardinal Health	CAH
2	CVS Health	CVS
3	Sysco	SYY
4	Walgreens Boots Alliance	WBA
5	McKesson	MCK
29	**Software**	**Ticker**
1	Microsoft	MSFT
2	VMware	VMW
3	Adobe Inc	ADBE
4	salesforce.com	CRM
5	Intuit	INTU
30	**Technology Hardware**	**Ticker**
1	Cisco Systems	CSCO
2	Apple	AAPL
3	HP Inc	HPQ
4	Juniper Networks	JNPR
5	Pure Storage	PSTG

1	Humana	HUM
2	UnitedHealth Group	UNH
3	Cigna	CI
4	Anthem	ANTM
5	HCA Holdings	HCA
18	**Personal Products**	**Ticker**
1	Procter & Gamble	PG
2	Kimberly-Clark	KMB
3	Colgate-Palmolive	CL
4	Clorox	CLX
5	Estee Lauder	EL
19	**Insurance**	**Ticker**
1	Prudential Financial	PRU
2	Principal Financial Group	PFG
3	MetLife	MET
4	Hartford Financial	HIG
5	Travelers	TRV
20	**Internet**	**Ticker**
1	Alphabet	GOOG
2	Facebook	FB
3	Akamai Technologies	AKAM
4	Twitter	TWTR
5	GoDaddy	GDDY
21	**Computer Services**	**Ticker**
1	International Business Machines	IBM
2	Hewlett Packard Enterprise	HPE
3	Teradata	TDC
4	Leidos Holdings	LDOS
5	Cognizant Technology Solutions	CTSH

31	**Telecommunications**	**Ticker**
1	AT&T	T
2	Verizon Communications	VZ
3	T-Mobile US	TMUS
4	Sprint	S
5	CenturyLink	CTL
32	**Transportation**	**Ticker**
1	United Parcel Service	UPS
2	Delta Air Lines	DAL
3	FedEx	FDX
4	Southwest Airlines	LUV
5	Union Pacific	UNP
33	**Utilities**	**Ticker**
1	Exelon	EXC
2	NiSource	NI
3	American Electric Power	AEP
4	Vectren	VVC
5	CenterPoint Energy	CNP

4. Applying Ohlson (1995) Model to "Just Companies"

Value generation is the main purpose of a business, i.e., wealth generation for the stakeholders, which results in efficient resource allocation. Value generation is dependent on the prudent decisions made by the management of the company and execution of their strategy. CSR plays an important role in these corporate decisions.

According to the (Ohlson, 1995) residual income valuation (RIV) model, the present non-accounting information affects future abnormal earnings or residual income auto-regressively. In our case, it appears that the Just Capital Foundation's issues selected for ranking companies did affect future abnormal earnings or residual income as reflected in their stock prices The firm's market value equals its book value adjusted for current profitability (as measured by abnormal earnings) and future profitability (i.e., goodwill, as measured by other information). Figures presented below covering five representative companies from various sector of USA economy are the evidence of this.

We can clearly see the rise in the valuation of the company after their entrance in the Just Capital Foundation's "Just Company" ranking. The phenomenon is clearly visible in Aero Space, Automobiles and Parts, Banks, Building Material and Packaging, Industrial goods, Capital Markets, Chemicals, Commercial Support Services, Consumer and Diversified Finance, Household Goods and Apparel, Food and Drug Retailers, Food Beverage and Tobacco, Healthcare Equipment and Services, Health Care Providers, Personal Products, Insurance, Internet, Computer and Services, Commercial Vehicles and Machinery, Media, Pharmaceutical and Biotech, Retail, Software, Technology

Hardware, Telecommunication, Transportation and Utilities. This validates one of our initial hypothesis that markets value social responsibility efficiently. For the purpose of brevity, we are presenting only five graphs covering Aero Space, Automobiles & Parts, Building Materials & Packaging, Capital Markets and Chemicals (interested readers can request the rest of the graphs by contacting the author).
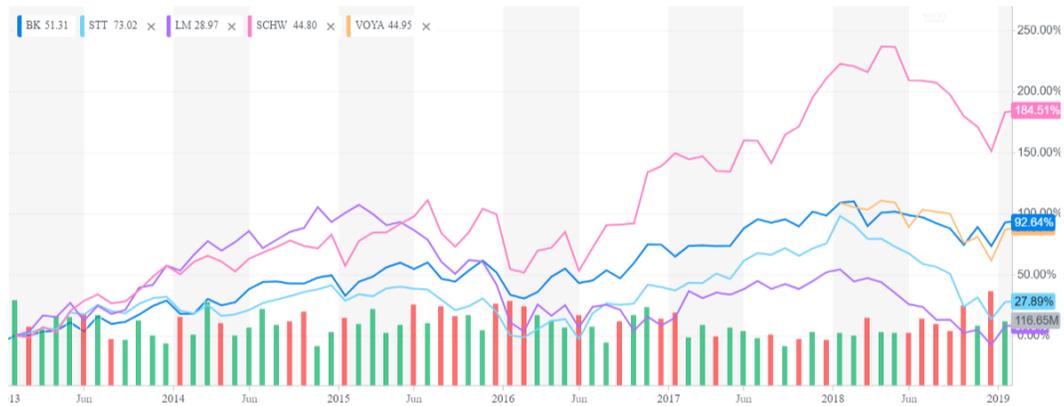
4.1 Aero Space

4.2 Automobile & Parts
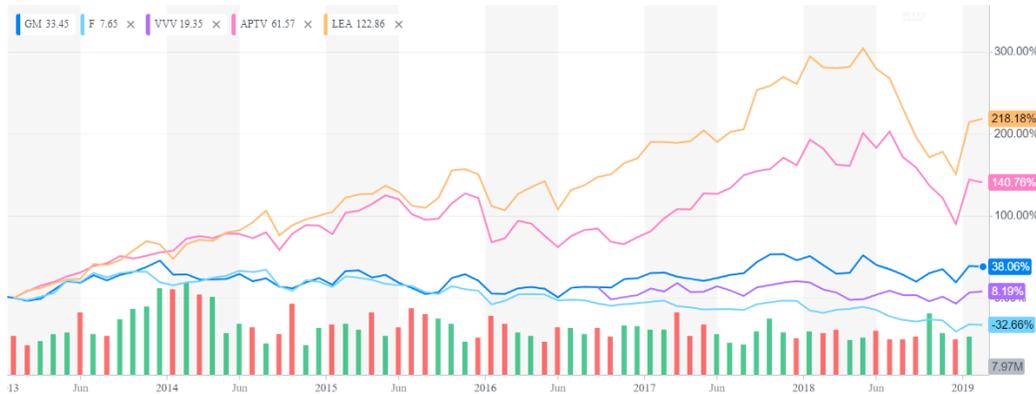
4.3 Building Material and Packaging

4.4 Capital Markets

4.5 Chemicals

5. Summary and Conclusion

In this paper, we present and highlight the importance of CSR to corporate valuation. First, we establish this link through academic literature and later discuss it through corporate examples covering all the industrial sectors of USA economy.

Both the historical performance of a business and its valuation depend on how financial and operating risks are managed. CSR plays a critical role in the identification and management of such risks. This function can improve performance and create intangible value. The intangible value created in the present period is reflected in future market values (see (Ohlson, 1995)). We argue that increase in value, in our case, is due to the listing of companies in the "just Company" index. Hence, in valuing companies without considering the influence of the CSR, we may be ignoring an important source of risk and/or risk mitigation that materially affects value.

This paper highlights the importance of CSR for valuation of companies and documents the fact that benefits gain through CSR are real and may affect valuation. In the age of social media and digital economy, the words of mouth play a vital role in establishing the image of firm among masses. The voluntary CSR activities help companies to improve their image by engaging in social good.

The present work has many limitations. One of them is data accessibility and availability. The present data is from Yahoo!Finance. The results obtained in this work can further be improved by using the data from Bloomberg and Thomson Reutres databases. The results presented in this paper are our initial findings and should be interpreted with caution.

This work sets a stage for researchers to investigate whether the phenomenon of CSR has an impact on valuation of

companies in different economies and geographic regions of the world (e.g., Europe and emerging markets) and whether that valuation impact is the same as in USA.

The results obtained in this paper may be of the interest for analysts, academic researchers, governments and regulatory bodies. In addition, we suggest that the results may indicate an area into which valuation professionals should invest time and thought as they assess the values of privately-held companies.

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