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Corporate Social Responsibility: Is what's Good for Society also Good for Business?

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Corporate Social Responsibility: Is what's Good for Society also Good for Business?

An honors thesis presented to the
Department of Business
University at Albany, State University Of New York
in partial fulfillment of the requirements
for graduation with Honors in Business Administration
and
graduation from The Honors College.
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Abstract

The objective of this study was to determine whether a company engaged in Corporate Social Responsibility (CSR) activities would experience a financial reward or penalty for the strategy. It is imperative that corporations act as partners in the attempt to improve conditions of society and the environment in which we all live. Two competing corporations were selected; one, which has employed green strategies whereas the other appears less, committed. The two firms were analyzed and compared and contrasted to assess the financial implications. It was discovered that green oriented company has a growing return on equity and also return on assets ratio. Abercrombie & Fitch also has a great market value, and also stock price potential. On the other hand, even though the company increases their profit margin from 2009 to 2011, Abercrombie & Fitch experiences a poor profit margin in comparison to their rival, American Eagle Outfitters. Overall, throughout the study it becomes apparent that Abercrombie & Fitch not only show a strong presence currently in the market and clothing industry, but also a strong and promising future as a result of their new social responsibility strategy.

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Throughout my undergraduate years at the University at Albany, I have been fortunate enough to have the opportunity to meet, and also be greatly influenced by wide array of professors and mentors. I first would like to thank Dr. Raymond Van Ness for all of his time and commitment not only to all of his students, including myself; but also for his great wisdom and guidance throughout my thesis. He has been a great mentor, and I could not have completed this paper without him. I would also like to thank Mr. Levato, who has made such an enormous impact on my collegiate career. I would also like to thank Professor Haugaard for always being a trusting resource and guide, and also to all of the other business professors and advisors who have enabled me to get to where I am today. A special thank you to my parents for their constant encouragement and influence they have had on me not only throughout college, but my life. Overall, I want to note to everyone else that has truly made my experience at the University at Albany, and that I am eternally grateful, and could not imagine spending these four years any other way.

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INTRODUCTION:

Over the past decade the severity of climate change has continued to grow progressively worse, and many of these disturbances are due to the “large amounts of carbon dioxide and other greenhouse gases being released into the atmosphere due to human activity.” Environmental scientists indicated “this great buildup of greenhouse gases will potentially change Earth’s climate, and as a result can have dangerous effects to human health and welfare to ecosystems.” These actions have further contributed to the rapid deterioration of our overall global environment, and “the choices being made today will affect the overall environment in the near future, which is why great action is being taken in attempts to reduce the carbon footprint and ways to reduce emissions through simple everyday actions.”¹

Recently, there has been an immense amount of effort and attention being brought in at the corporate level. This new focus is not only towards preventative measures, but also a corporate response in attempt to improve the damage that has already been done within the environment“ Companies have responded to this growing concern by dedicating a portion of their corporate budgets to environmentally friendly initiatives, and many U.S. companies now track their environmental process.”²

Even though these business transformations are constantly being made to better the environment, much of the effort and preventative measures that are taken are not purely selfless. Many of these changes are greatly helping to further

¹ Environmental Protection Agency

² Shortt, Karen- The Leonard N. Stern School of Business

improve a company's bottom line and overall profit. "When customers have a choice, it seems, they gravitate toward companies that do their bit to sustain the planet."³

My concern for the environment and my education in business have led me to wonder whether there is a relationship between a company's efforts to go "green" and its actual financial performance. Thus, my research questions are:

- 1) Will there be a positive correlation between going green and profitability?
- 2) Will there be a beneficial relationship between the market value of a firm and its efforts to go green?
- 3) Will the effort to go green increase the financial leverage of the firm?

The textile industry has been renounced as being one of the world's worst offenders of pollution. This offense is consequently as a result of two main products used throughout the complete process of production and manufacturing of fabric. Chemicals, especially the thousands used throughout the manufacturing process play a great contributing factor. Another main component is the immense use of water, even though water is considered to be a natural resource, with such large amounts needed through each step of the processes water is rapidly becoming scarce.⁴ Abercrombie & Fitch, as mentioned prior, has not always been noted as being one of the most environmentally friendly corporations; however, with a newly restored company outlook great changes are in site and have been continuously occurring.

³ Fisher, Anne - Fortune Magazine

⁴ Business Week- Environmental Hazards of Textile the Industry

LITERATURE REVIEW

Abercrombie & Fitch especially within the last few years have placed a great amount of emphasis on their newly designed A&F Cares Corporate Responsibility Report. This report not only specifies what the company has accomplished so far, but also more importantly highlights what Abercrombie & Fitch hopes to achieve in the near future. Abercrombie & Fitch have generated four principal efforts, diversity, philanthropy and social and environmental sustainability. Each effort contains both a commitment explaining what the company hopes to do, and also a strategy illustrating how the company is going to accomplish it.

Environmental sustainability has become a major focus for the company, the reason being that Abercrombie & Fitch “have recognized the importance of environmental stewardship, and we are committed to understanding the constantly evolving impact that our business and operations have on the communities where we make and sell our products.”⁵

The company continues to strive to make even more dramatic changes for the overall greater good of the environment. One of the company’s more current policies established is to help reduce their carbon imprint with their approach to follow The Three R’s Concept: Reduce, Reuse, and Recycle. Some reduction efforts made in order to be more eco-friendly has been to reduce pollution, company water use, and also engaging in energy conservation. Energy conservation has been a great importance of reduction efforts. From 2008 to 2010 Abercrombie & Fitch was able

⁵ A&F Cares- Corporate Responsibility Report, pg. 20

to reduce their gas uses by 40% and also their electrical use by 25%.⁶ Both of these saving percentages are exceptional progressions towards achieving company goals of being more environmentally responsible. The second R concept, Reuse, has also been deemed as a challenge A&F has been willing taken on. The company has not only begun to reuse and redistribute, but have also made additional efforts to start their own Free-Cycle board on campus to continue their efforts on reusing.

Recycling completed the R Concept, and has gained some of the greatest amounts of attention. Recycling has been another focus especially placed on headquarters campus. Numerous recycling bins have been scattered throughout common areas to help further promote going green, and as a collective group the company has helped to save over 21,180 cubic yards of landfill space and the efforts still continue.

Aside from the R Concept, A&F also associated with The Carbon Disclosure Project (CDP), designed to help accelerate solutions in reference to climate changes and water management. This Project has only continued to take an even strong hold within the company, and has consistently motivated the company to make further improvements to better the environment. The company did not limit their involvement to just domestic matters, but also engaged themselves internationally. In 2010, Abercrombie & Fitch became a part of the 2010 Environment, Health and Safety (EHS) Summit in Bangalore, India. Soon after, the company's continuous influences on the environment did not go unnoticed. In 2011, A&F received the Solid Waste Authority of Central Ohio (SWACO) EMERALD Award due to their yearly efforts. Even though Abercrombie & Fitch faced great criticism in the past, not only

⁶ A&F Cares 2010/2011 Corporate Responsibility Report, pg. 21

has the company taken many leaps to help revamp their image as being environmentally responsible, but have also gone above and beyond to extend their services abroad as well.

In correspondence to Abercrombie & Fitch continuing to maintain a more environmentally accountable image, it is also just as important for the company to innovate efficiently especially being in the fashion industry. In Fashion, there is a vital need to be able to stay ahead of the styles and trends, and also be able to adapt quickly in this ever-changing market. Due to such criteria of the industry, Abercrombie & Fitch has built a new state of the art Innovation & Design Center. Abercrombie & Fitch Co. is able to easily have a unique competitive edge on rival retailers, all the while continuing to make strides towards their environmental objectives. This one of a kind center provides Abercrombie & Fitch Co. with all the needed essentials in order to research and develop, apply new techniques, and also explore new wash and fabric ideas to continue producing quality products. This center is allowing the company to react to emerging trends faster than any other competitor, and also helping the company become more environmentally friendly. "Cutting edge facilities, technology, and resources are available at your fingertips, making our Home Office a retail playground."⁷

The main goal Abercrombie and Fitch hope to achieve is to overall "reduce waste through conservation, collaboration, and carbon emissions programs." In order for the company to continue their efforts and progress forward they have established The Three R's Concept: reduce, reuse, and recycle. The company also has

⁷ Abercrombie & Fitch- The Home Office

incorporated The Carbon Disclosure Project, to which external consultants help track and report their progress of carbon emissions. Abercrombie & Fitch Co are going to great lengths to not only reduce their environmental footprint, diversify their work environment, and also positively impact communities.

On the other hand, Abercrombie & Fitch is not the only corporation moving forward with actions in order to improve the environmental impact of the textile industries. American Eagle Outfitters also have established their own form of progressions towards protecting and improving the environment. American Eagle's commitment is "their environmental program is built on three pillars: conserving resources, minimizing waste, and improving out-products and packaging."⁸

American Eagle also engages in a Carbon Offset Program that has partnered up with the Student Conservation Association. This allows for donations to be made to purchase trees; all the while American Eagle Outfitters will match whatever is donated. Aside from their matching efforts the corporation continues to make environmentally friendly improvements on their corporate headquarters, and distribution centers. Whether be reducing energy and water use, or a reduction in carbon emissions, American Eagle is also continuing their mission of helping to better the environment.

⁸ American Eagle- Corporate Website

Hypotheses:

H-1 It is hypothesized that firms with a commitment to going green will experience lower current term profits.

H-2 It is hypothesized that firms that have implemented “going green” programs will be positively correlated with a stronger price to earnings ratio (PE) and a lower Beta (market volatility).

H-3 It is hypothesized that firms engaged in a “going green” effort will have a lower debt to asset ratio (measure of financial leverage) (D/A).

Results:

Hypothesis 1 was supported.

During the period of 2009 through 2011 the profit margins of Abercrombie & Fitch began at 0 increasing to 4.3% in 2010 and then declining to 3.1% in 2011. On the other hand rival company, American Eagle, had a 2009 profit percentage of 6.1%, decreasing to 5.7% in 2010 and continuing a decline in 2011 to 4.7%. (See tables 1 & 2).

Table 1

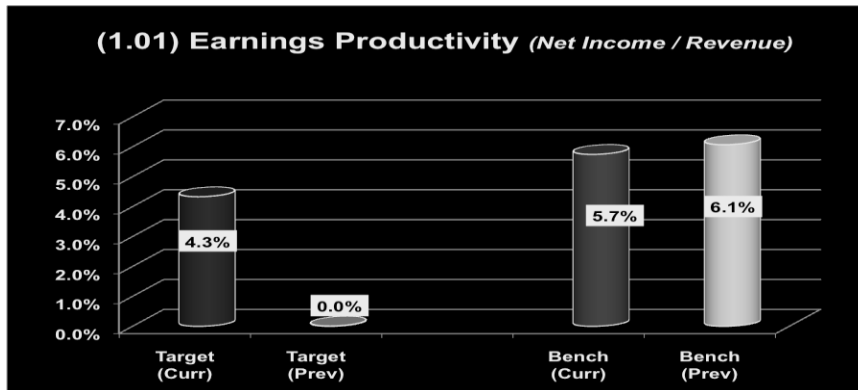
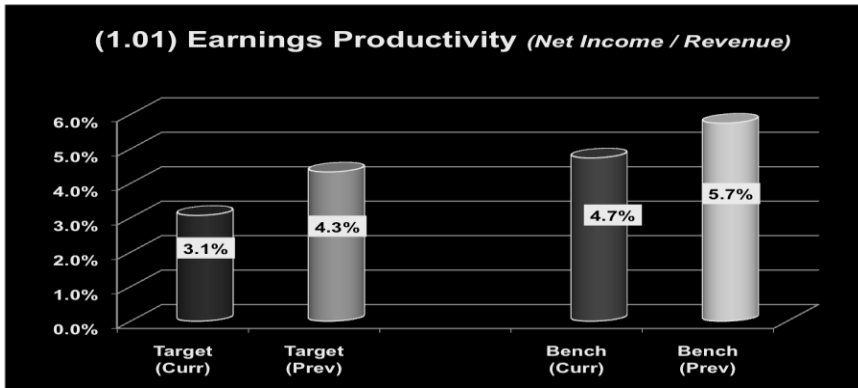


Table 2



The Return on Equity (ROE) looking at the time frame of 2009-2011 of Abercrombie & Fitch was 0 in 2009 to 7.9% in 2010. While their competitor American Eagle went from 12.7% in 2009 to 10.7% in 2010. The following year in 2011, Abercrombie & Fitch had an ROE of 6.9% where as American Eagle had a 10.4%. (See table 3 & 4).

Table 3

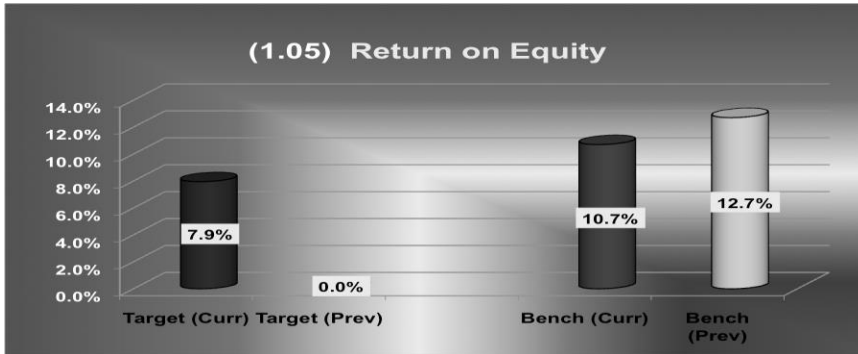
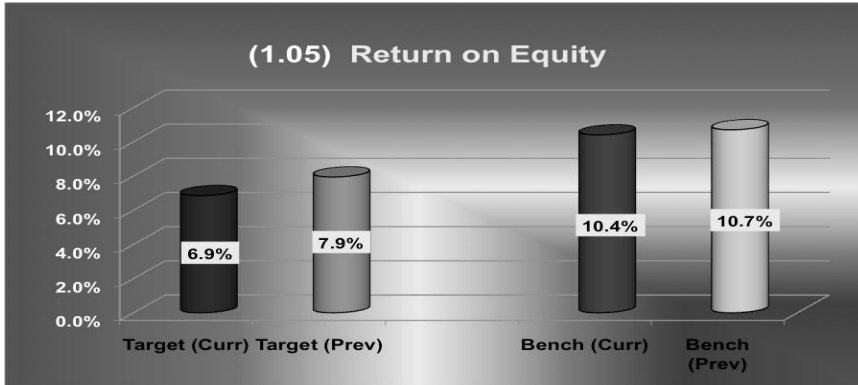


Table 4



The Return on Assets (ROA) from 2009-2011 also varied for both firms. For Abercrombie & Fitch from 2009 to 2010 was again 0% in 2009 and increased to 5.1%. While American Eagle ranged from 9.1% to 7.9% that same time frame. From 2010 to 2011, Abercrombie & Fitch's ROE decreased from 5.1% to 4.2%, American Eagle also followed the same declining pattern, just not as extreme going from 7.9% to 7.6%. (See table 5 & 6).

Table 5

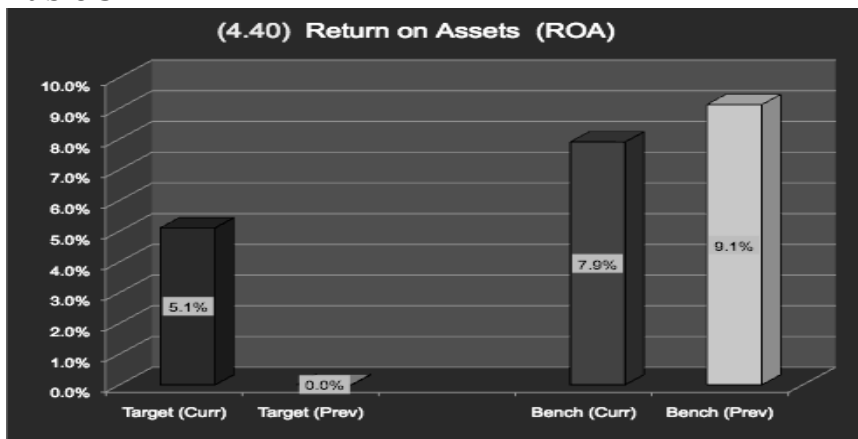
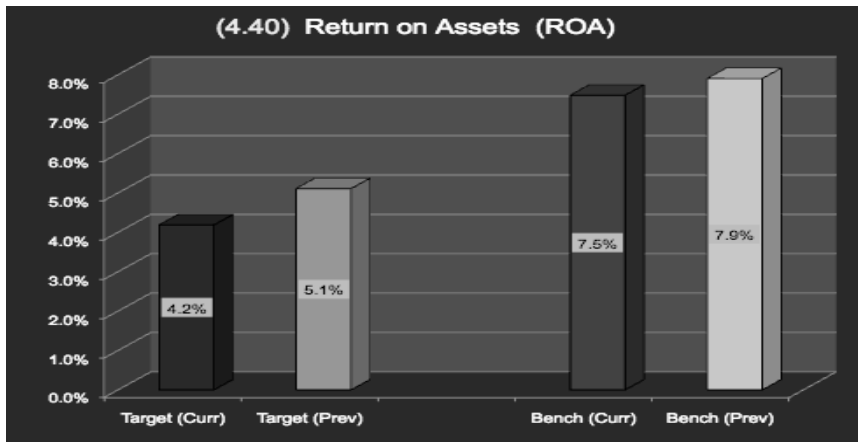


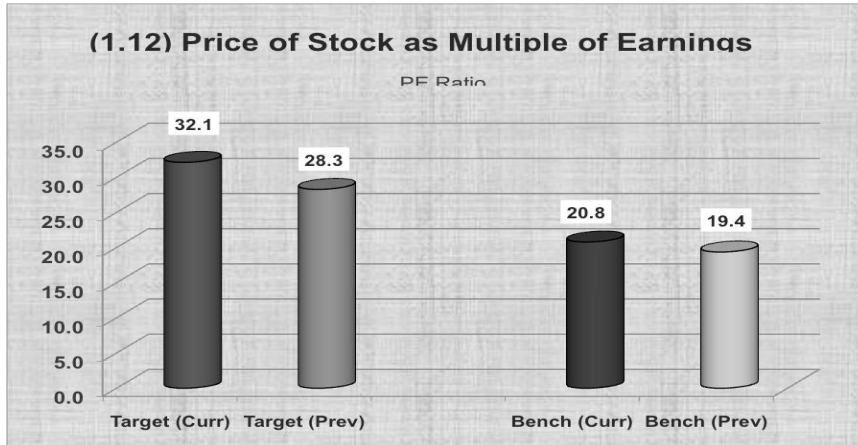
Table 6



Hypothesis 2 was partially supported.

Looking at the Price Earnings Ratio (P/E) during 2009 to 2011 Abercrombie & Fitch have a PE 32.1 in 2011; where as American Eagle have a P/E of 20.8. (See table 7).

Table 7



The Beta of Abercrombie & Fitch is 2.07, whereas their rival American Eagle Outfitters is a lower .87. (See table 8).

Table 8



The market value of Abercrombie & Fitch is \$47.23 in 2011; and American Eagle only have a value of stock of \$14.56. Therefore Abercrombie & Fitch as you can see in the 2011 Stock Price Potential chart they have a potential of \$41; American Eagle, on the other hand have a stock price potential of \$12. (See table 9 & 10).

Table 9

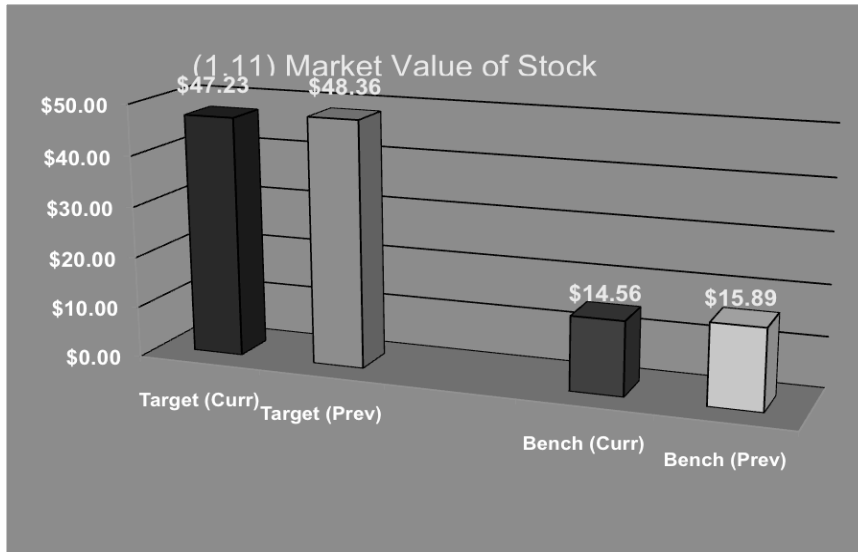
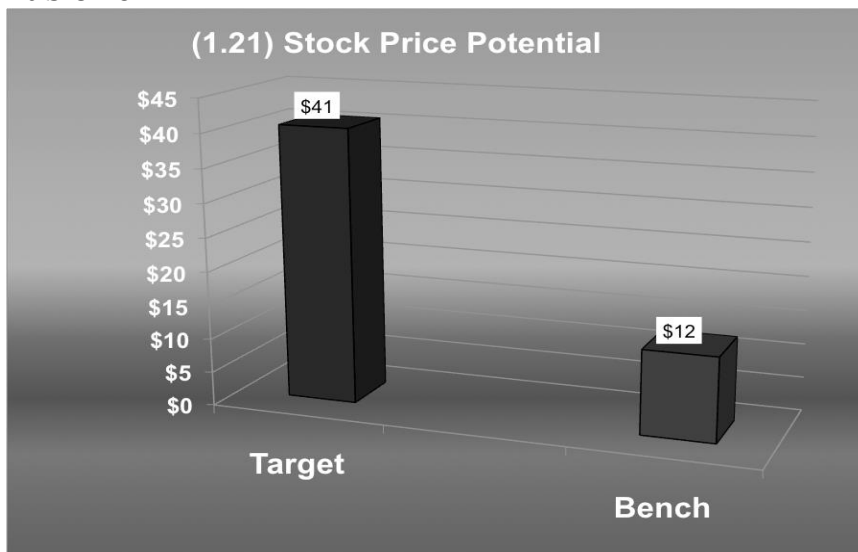


Table 10



Hypothesis 3 was supported.

The total debt to total assets ratio (D/A) for Abercrombie & Fitch in 2009 to 2010 went from 35.2% and increased slightly to 35.7%. American Eagle decreased from 28.2% to 26.2%. In 2011, Abercrombie & Fitch increased their D/A ratio to 38.9%; while American Eagle also increased slightly to 28.1%. (See table 11 & 12).

Table 11

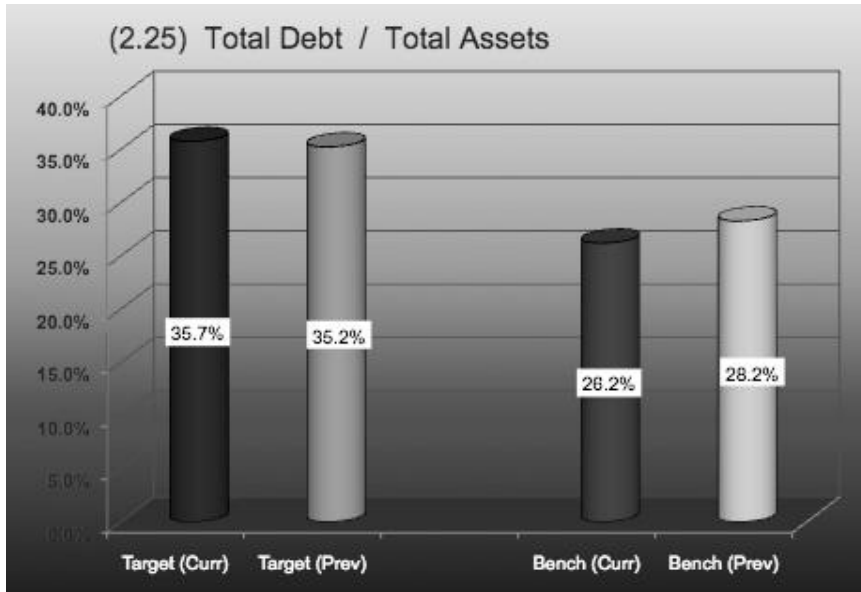
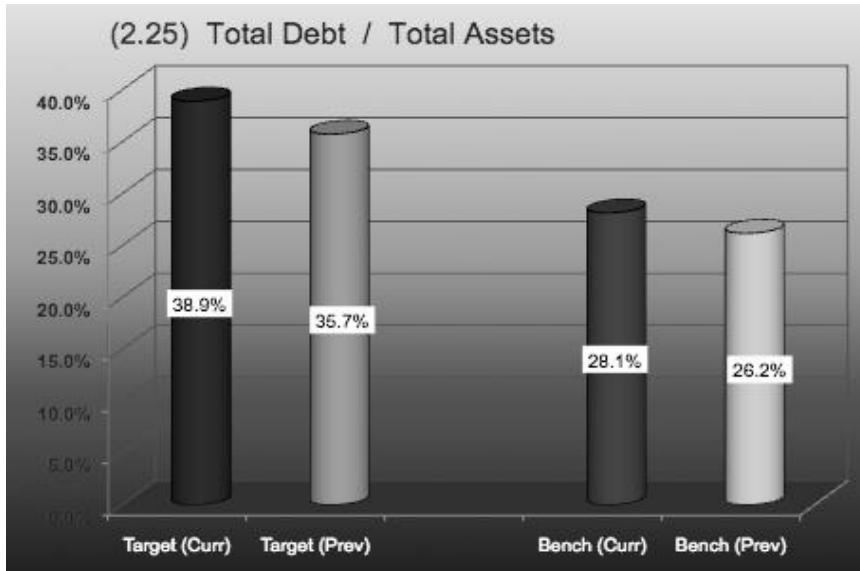


Table 12



Discussion:

Looking at the corporate scorecards from the years of 2009 through 2011 it is apparent with the net profit margin that there is a slight correlation between a company's going green efforts and profitability. The net profit margin is a measure of how much each dollar of sales a company keeps as profit.⁹ When sorting through company statistics of Abercrombie & Fitch, there is a great increase with the profit margin from 2009 to 2010 where it rises from 0 to .043. This significant increase could be in large part due to the newly established corporate responsibility report that was released in 2010. This report established the company's "strong commitment to quality and standards of operations and in addition to our brands and retail experience, this commitment extends to our impact on the communities in which we live, and with which we interact around the world."¹⁰ American Eagle Outfitters on the other hand, also has a social responsibility policy that was first adopted March 10, 2004; to which is annually amended, in order to continuously progress with changes made in society.¹¹ Due to the policy being enacted earlier on, and not in the years of 2009-2011, it makes it difficult to see the impact of the policy on their company's net profit margin; however looking at their ratio, from 2009 to 2010 it goes from .47 to .57. Both of the company's net profit margins can help conclusions be made that when a company extends effort in order to go green and further improve their corporate policies a company also increases their profitability.

⁹ Investopedia- Net Profit Margin

¹⁰ A&F Cares 2010/2011 Corporate Responsibility Report, pg. 1

¹¹ American Eagle- Corporate Governance

Another important calculation to pay attention to is the Return on Equity. The ROE helps to measure “a corporation’s profitability by illustrating how much profit a company generates with the money stockholders have invested.”¹² Looking at the graph containing Return on Equity for 2010-2011; it is apparent that American Eagle does hold stronger return percentages than Abercrombie & Fitch. A conclusion that can be made from only looking at these two years is that American Eagle in the eyes of some stockholders may be a better company to invest in. When reviewing the ROE from 2009-2010 for Abercrombie & Fitch, despite being lower to their rivals, their percentage goes from 0 to 7.9%. Therefore, this measure when looking at only two years may not really give the best direction for stockholders, and a company despite having a lower percentage in comparison to their rivals may not be as important than the progress they are continuing to make.

The Return on Assets is another measure that can help to demonstrate how profitable a company is by looking at how efficient the company is at managing their total assets to generate earnings.¹³ The ROA of 2010-2011 demonstrates American Eagle Outfitters outperforms, and is more efficient in using their assets in comparison to Abercrombie & Fitch in 2010-2011. On the other hand, even looking at the progression Abercrombie & Fitch has made from 2009 through 2010 increasing from 0 to 5.1%, the company still decreases in 2011 to 4.2% while American Eagle continues to remain semi-consistent. This ROA measure may weaken my hypothesis that a company’s profitability is positively correlated to going green efforts. The reason being is Abercrombie & Fitch is not only

¹² Investopedia- Return on Equity

¹³ Investopedia- Return on Assets

outperformed by their rivals, American Eagle Outfitters; but more importantly the company is not showing any improvement and is actually decreasing their efficiency in 2011.

Another measure of a firm's effort to go green can also be viewed within a company's Price Per Earnings Ratio. The P/E ratio is the valuation of a company's current share price compared to its per share earnings. Generally, a high or growing ratio implicates investors are anticipating higher growth for that company in the near future.¹⁴ When assessing the P/E ratio for both Abercrombie & Fitch and American Eagle Outfitters it is evident that both are experiencing an increase in their ratios from 2009 to 2011. Abercrombie and Fitch face an increase from 17.5 to 32.1; where as American Eagle does not show as significant of a rise in their ratio, which goes from 16 to 20.8 in the same time frame. This great change Abercrombie & Fitch face with their P/E ratio can be justified by the enactment of their new A&F Cares policy in 2010/2011. The reason being is within their new policy environmental improvements are highly emphasized; and with environmental concerns currently catching the attention of consumers these policies are helping to create more customer support and purchases. Abercrombie & Fitch efforts positively correlate with why the P/E ratio has increased immensely from 2009 to 2011. This impact can also denote that investors believe the company is going to continue to flourish, and with the company's continuous improvements the company will be able to grow and develop as anticipated. The Beta of a firm is also a good indicator of risk of investment in comparison to the market. With Abercrombie

¹⁴ Investopedia- Price per Earnings Ratio

& Fitch having a beta of 2.04, making the company appear to be a greater investment risk in comparison to a more stable .87 beta of their rival company American Eagle. Even though there may appear to be a greater potential risk with investing in Abercrombie & Fitch by looking strictly at their beta measure, their market price per share should also be taken into consideration. The reason this financial record is so important is because Abercrombie & Fitch have a share price of \$47.23 in comparison to American Eagle, which is only \$14.56. The market share price can be a direct indicator of how a company is performing against their competitor. In this particular situation, despite the potential risk with their given beta, the potential gains and financial returns for taking a risk in the investment is greater, and shows a strong future.

The total debt to total assets ratio will help to analyze a company's financial risk and determine how much of a firm's assets have been financed by debt; overall this ratio will help to examine how going green will increase the relative financial leverage of a company.¹⁵ When looking at the assets to debt ratio of Abercrombie & Fitch from 2009 to 2011, it is apparent that their ratio remains somewhat consistent from 2009 to 2010 both remaining around 35. On the other hand, in 2011, the ratio increases to 38.9. This increase helps to prove the hypothesis because once their new policy was adopted helping with efforts for the company to go green their leverage increased.

Abercrombie & Fitch Co. is an infamous American retailer that has not only gained an immense popularity and reputation in the United States, but has also

¹⁵ Investopedia- Total Assets to Total Debt Ratio

achieved international recognition. Over the years the company has faced some setbacks in regard to their image and reputation. In response to such criticisms, and in order to continue to progress forward the company established the new 2010-2011 A&F Cares Corporate Responsibility Report. This new program enacted by CEO Michael S. Jeffries, is a way to revamp and increase company efforts in the areas of diversity & inclusion, philanthropy, and finally social and environmental sustainability.

Despite the limitation of only having two companies to compare financial and policy measures, the overall conclusions of my hypothesis are greatly supported by a wide array of quantitative and qualitative data and results. Looking strictly at financials, American Eagle may look more appealing to investors due to the company appearing to be a more steady and safe investment. On the other hand, what also should be taken into an even greater consideration are the corporate social policies that companies have enacted. These policies will not only contribute to the company's current profits and success in the market, but also illustrate the growth potential of the firm for the near future. When looking at Abercrombie & Fitch, despite being a riskier investment, after analyzing their newly adapted corporate social responsibility policies the company appears to possess a greater potential to have an even stronger and prosperous future. Abercrombie & Fitch and American Eagle may both benefit from engaging in good business practices; however, given the new direction of Abercrombie & Fitch this company possess a greater ability to outshine their competitors not only with their bottom line, but also their presence in the clothing industry.

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