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Investors Shun Companies That Play ‘Robin Hood’

Wall Street likes tax avoidance practices, and it likes corporate social responsibility. But it doesn't like companies that practice both, study finds

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That companies do well by doing good has been a persistent theme among students of corporate management during the past few decades. The theme was resoundingly reinforced by last month’s **Business Roundtable statement**, in which 181 leading chief executives affirmed their commitment not just to their shareholders but to “all stakeholders … for the future success of our companies, our communities and our country.”

With that notable statement as a backdrop, some new research is timely. It suggests that companies seeking to enhance their reputation through corporate social responsibility (CSR) may contribute more to the public well-being by making less effort than they might otherwise make to lower their taxes.

A paper in the summer issue of the **Journal of Management Accounting Research**, a peer-reviewed publication from the **American Accounting Association**, concurs with earlier research concluding that investors approve of both CSR and tax avoidance.

But combining them, the new study finds, is another matter.

“Higher levels of CSR and tax avoidance negatively interact to affect firm value,” write the study’s authors, Kerry Inger and Brian Vansant of Auburn University. “Investors place less value on firms that appear to be playing Robin Hood by taking from the government in the form of avoided taxes in order to distribute funds to society via corporate philanthropic giving.”

In sum, combining the two diminishes the benefits of both, as far as Wall Street is concerned. As the professors explain, “CSR activities may signal to investors that cash generated by tax avoidance has not been used toward investments that will generate a return sufficient to offset the risk associated with tax-planning strategies.”

In addition, “investors may view tax avoidance as inconsistent with a firm’s reputation-building strategy, which in turn could mitigate the potential positive effect on future profits stemming from improved reputations with other stakeholders.”

The study, “Market Valuation Consequences of Avoiding Taxes While Also Being Socially Responsible,” also finds that investor disapproval does not apply equally to everything labeled as CSR.

The CSR classification takes in a wide range of activities, including some that can directly enhance profitability (such as improving workplace conditions, product quality, and corporate governance) and others of a philanthropic nature (volunteer initiatives or charitable contributions for health, education, or human rights).

Distinguishing between these two broad categories, the professors find that it’s the philanthropic activities that drive the negative effect of CSR’s interaction with tax avoidance.

The findings may come as a wake-up call to many corporate leaders, just as some were likely caught off guard several years ago when a prominent Member of Parliament in the UK drew wide acclaim for chastising multinationals that were “using the letter of tax laws … to immorally minimize their tax obligations.”

Such was the subsequent public outrage at perfectly legal tax-dodging that Starbucks, a company heavily invested in CSR, promised to pay approximately 10 million pounds in each of the following two years, regardless of the company’s financial results.

Drawing on data from about 3,000 public companies over a 14-year period, the researchers analyzed the relationship among:

Companies’ yearly CSR scores in a large social-ratings database
Their average tax avoidance over a given year and two prior years, determined by cash taxes paid divided by pretax income
Their annual Tobin’s Q scores, a common measure of companies’ appeal to investors based on the ratio of market value to book value
The study found that philanthropic CSR has a significant negative effect on Tobin’s Q.

The research controlled for many variables that can affect the association among the three factors, including companies’ size, growth, foreign income, value of intangibles, and stock volatility.

The professors also tested whether the results obtained when tax avoidance is combined with CSR are seen when tax avoidance combines with two other kinds of managerial spending about which investors sometimes have doubts: capital expenditures and R&D.

Neither was found to have such negative effect. “From investors’ perspective, funds gained via potentially risky tax strategies should be invested in projects with higher net present value potential, as opposed to reputation-building CSR activities that have weaker links to profit maximization,” the professors write.