



Original analysis on the latest happenings in the CFO industry

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BRIEF

Investors punish companies that combine philanthropy and tax avoidance



Dive Brief:

- Companies that invest heavily in their image as responsible corporate citizens tend to be valued higher by investors than those that do not. Likewise, companies motivated to lower their tax burden as far as laws permit are valued more highly. But companies that do both are not rewarded by investors.
- "Higher levels of corporate social responsibility (CSR) and tax avoidance negatively interact to affect firm value," Kerry Inger and Brian Vansant of Auburn University wrote in their paper, published this week by the **American Accounting Association**. The study looked at data from about 3,000 public companies over a 14-year period.
- "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."

Dive Insight:

The researchers analyzed the relationship among three factors: yearly corporate social responsibility score in a social-rating database; average tax avoidance over a period of time; and annual Tobin's Q score, a common measure of companies' appeal to investors based on the ratio of market value to book value.

The researchers found both corporate social responsibility and tax avoidance — separately — boost firms' market value but that combining the two lowers it significantly.

"While the positive main effect of corporate social responsibility shows that investors value CSR activities, the negative interaction with tax avoidance suggests that investors do not believe managers should take on the risk of negative tax outcomes in order to have funds available to invest in CSR," the researchers said.

What's more, they said, the corporate social responsibility 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 might view tax avoidance as inconsistent with a firm's reputation-building strategy to the extent it "mitigates the potential positive effect on future profits stemming from improved reputation with other stakeholders," they said.

Type of social effort matters

The impact of combining social responsibility with tax avoidance is only considered negative by investors if the socially responsible activities are defined as those that are considered philanthropic such as volunteer initiatives or charitable contributions for health, education or human rights, the researchers found.

If the socially responsible activities are directed inward and have an impact on company profitability, such as improving workplace conditions, product quality and improved corporate governance, investors tend not to punish companies for combining that with tax avoidance.

These internally directed activities, the researchers said, protect "shareholder interests and should alleviate investor concern that managers are investing in CSR activities unwisely."