

# You Can Do Well By Doing Good

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### Executive Summary

The assumption in the investment world is that there is a trade-off: that social good comes at the expense of corporate returns. In 2016, we decided to test that assumption by measuring companies' values and culture based upon how they interact with their employees, their customers, and the world at large.

Quantitative research, over multiple time periods, was examined to evaluate correlations between positive culture and performance. The result? There appears to be a slightly positive correlation over every time period we tested (2015 data). In addition, we looked at academic research on the subject to understand why this was happening.

We found that company values and culture can be used as positive indicators of above average stock return.

### Methodology

We identified "positive culture" based on three specifically-defined characteristics:

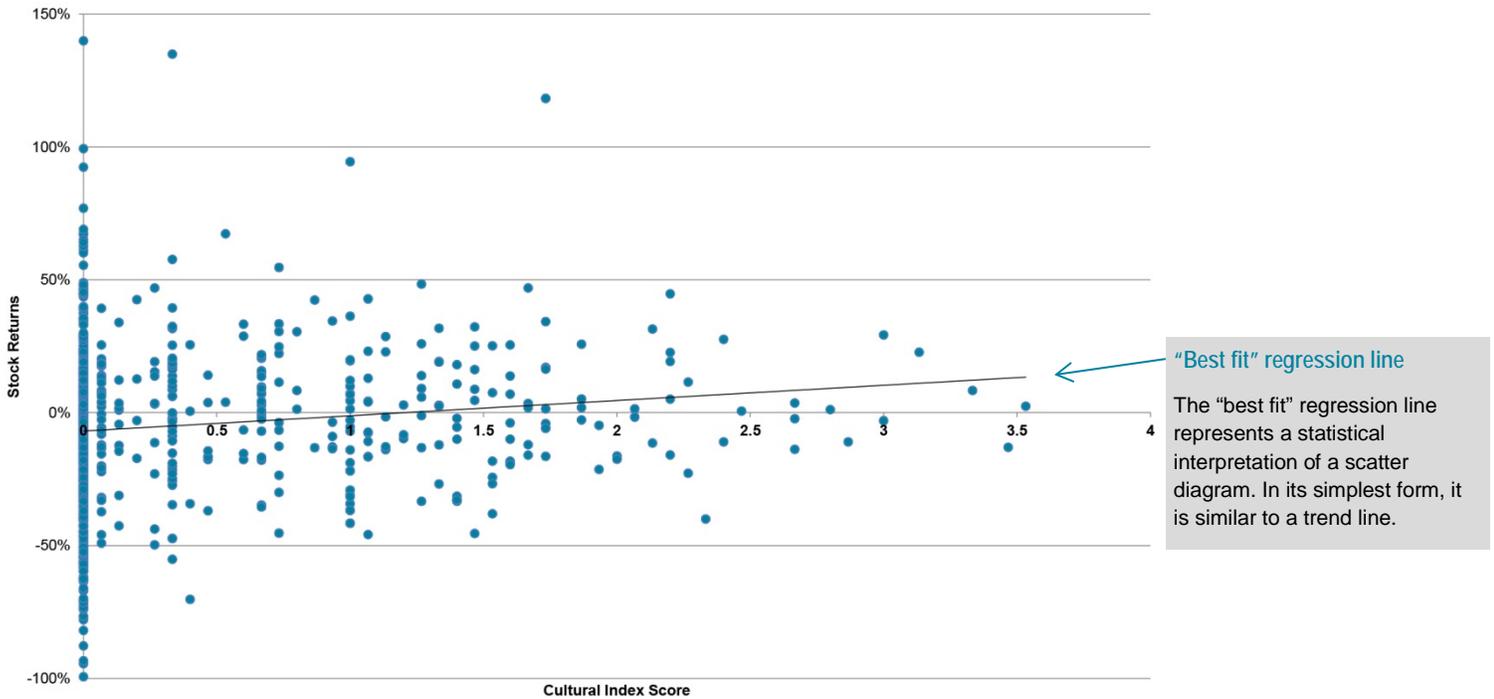
- Companies that are good to their employees
- Companies that are good to their customers
- Companies that give back to their community

We scored every 2015 Fortune 500 public company's culture based on 20+ outside ratings (example: Best Places to Work) and then examined their stock performance over 1, 3, 5, and 10 years.

### Results

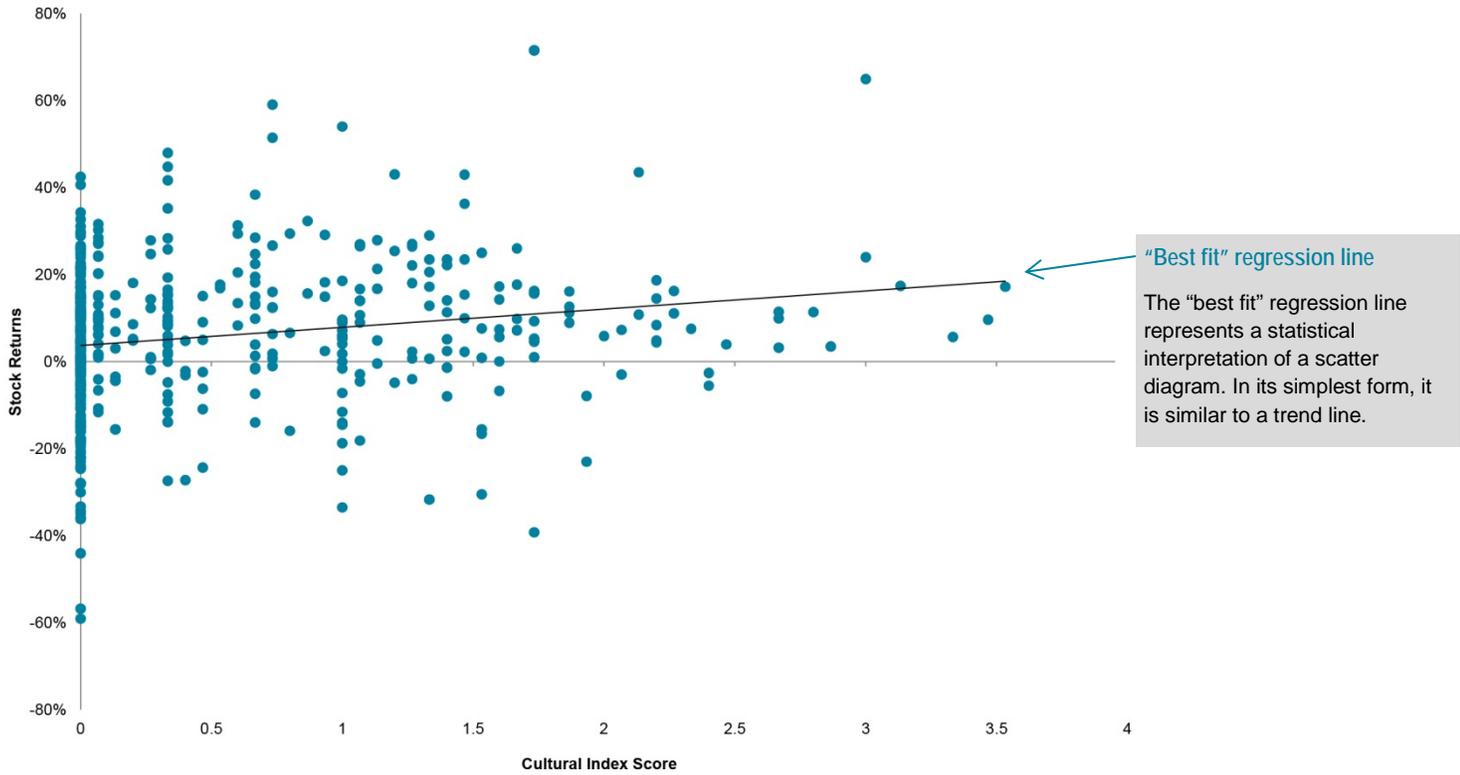
We found that company values and culture can be considered indicators of above average return. While there is great variability of stock market returns, our research indicates a slightly positive relationship between a company's culture and their stock market returns.

**Table 1: Corporate Culture vs. 2015 Stock Market Returns**



Notes: Stock Market Returns are based on Fortune 500 public companies. The Cultural Index score is based on 3 criteria: (1) companies that are good to their employees, (2) companies that are good to their customers, and (3) companies that give back to the community. Past performance is not indicative of future results.

Table 2: Corporate Culture vs. 10 YR stock market returns



Notes: Stock Market Returns are based on Fortune 500 public companies. The Cultural Index score is based on 3 criteria: (1) companies that are good to their employees, (2) companies that are good to their customers, and (3) companies that give back to the community. Past performance is not indicative of future results.

## Social Impact Results

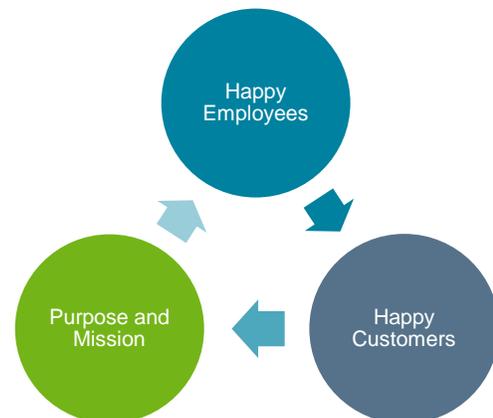
The positive culture companies (as defined by our methodology) are making the lives of their employees, customers and communities better. Examples of specific actions include:

- Donation of > \$150 million to support STEM education<sup>1</sup>
- Greater than 490,000 hours of volunteer community work<sup>2</sup>
- Development of an entrepreneurship program for girls, engaging and inspiring over 10,000 girls across 100+ countries; 26% of alumni go on to major in computer science<sup>3</sup>
- Donation of >\$850,000 to fight cancer, including research grants, donations, and fundraising<sup>4</sup>
- Donation of 1% on all gift card sales to local communities, and provision for tens of thousands of new shoes to children in need<sup>5</sup>
- Development of a high tech camp for children, designed to dispel stereotypes of the high-tech industry<sup>6</sup>
- Grants to businesses that are helping people and communities with limited resources gain access to the internet<sup>7</sup>
- \$5 million cash pledge to support families vulnerable to homelessness<sup>8</sup>
- Fulfillment of >10,000 wishes every year in partnership with Make-A-Wish<sup>9</sup>
- Allotment of 40 hours per year of paid community service time for all employees<sup>10</sup>
- Partnership with Plan Water Foundation to provide clean water to >20,000 people in Cambodia<sup>11</sup>
- Feed students in Ghana<sup>12</sup>

## We believe that a better culture can translate into better investment performance

We believe that:

- 1 Companies that treat their employees well will end up with a superior workforce.
- 2 Companies that treat their clients well will result in more loyal clients that refer business.
- 3 Companies that give back to their communities will end up with purpose and mission as well as attracting those superior employees and clients.



1 <https://www.prnewswire.com/news-releases/texas-instruments-commits-5-million-to-advance-stem-education-in-plano-isd-133047958.html>

2 <http://www.ti.com/pdfs/shared/citizenship/volunteerism.pdf>

3 <http://www.salesforce.org/technovation-taught-us/> and <http://www.salesforce.org/grants/>

4 <http://images.nvidia.com/content/crr/2017/sustainability/pdf/2017-NVIDIA-Sustainability-Report-Final.pdf#page=25>

5 <https://shop.nordstrom.com/c/nordstrom-cares-non-profit-support>

6 <https://www.microsoft.com/en-us/diversity/programs/digigirlz/hightechcamp.aspx>

7 <https://www.microsoft.com/en-us/affordable-access-initiative/grant-fund>

8 <https://www.zillowgroup.com/the-home-project/>

9 <https://www.thewaltdisneycompany.com/wp-content/uploads/2017disneycsrupdate.pdf>

10 <https://www.vmware.com/company/foundation.html>

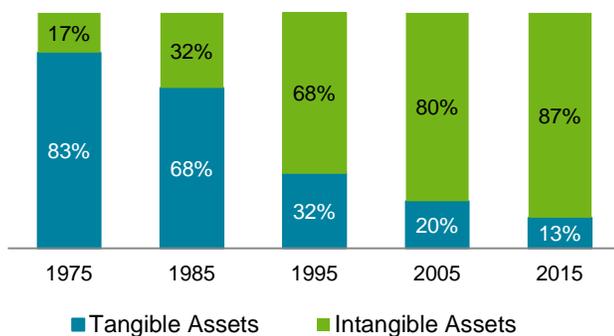
11 <https://www.vfc.com/news/company-news/detail/57682/vf-partners-with-planet-water-foundation-to-bring-water-to>

12 [https://www.thehersheycompany.com/en\\_us/responsibility/nourishing-minds.html](https://www.thehersheycompany.com/en_us/responsibility/nourishing-minds.html)

## Academic research on corporate behavior and performance

At Mesirow, we believe that our founder Norman Mesirow's values for employees, clients, and giving back to the community continue to be instrumental ingredients to our success. And, there appears to be academic research on the subject that agrees.

One of the most interesting statistics, as reported by Ocean Tomo, an intellectual capital firm, is that the value of a company is heavily dependent on intangible assets like corporate culture, reputation, and brand recognition. In fact, their 2015 research findings suggest that 87% of a company's market value is determined by the perceived worth of their intangible assets. To compare, that number



only amounted to 32% in 1985 and 68% in 1995.<sup>13</sup>

### Components of S&P 500 Market Value

Source: Ocean Tomo LLC

## Companies that treat their employees well

Companies with high job satisfaction outperform their peers by 2.3% – 3.8%. This was the major finding from a Wharton School of Business at University of Pennsylvania study called “The Link Between Job Satisfaction and Firm Value, with Implications for Corporate Responsibility.”<sup>14</sup> The study concluded that job satisfaction leads to higher retention of employees, higher motivation among employees, and employees who go “above and beyond the formal requirements of the job, internalizing the firm's objective function as his/her own.” In another study, researchers discovered that the way in which employees are recognized for their work ethic and effort can increase employee engagement by 6% – 21%.<sup>15</sup>

## How gender and ethnic diversity correlate with better financial performance

Other studies by the Center for Talent Innovation (CTI) and McKinsey & Company provide insight into the impact diversity within the workforce increases performance. CTI analyzes what they call “two dimensional diversity,” which includes inherent diversity (gender, race, etc.) plus acquired diversity (global experience, language skills, etc.) and how it affects a company's performance. Their key takeaway was that 80% of diverse businesses showed improvement in business performance when the level of diversity and inclusion were high. Diverse companies are better suited in talent recruitment, customer orientation, employee satisfaction, and innovation. The CTI study states, “Homogeneity stifles innovation.”<sup>16</sup>

McKinsey's latest report *Diversity Matters*,<sup>17</sup> examined proprietary data sets for 366 public companies across a range of industries in Canada, Latin America, the United Kingdom, and the United States. In this research, they looked at metrics such as financial results and the composition of top management and boards. The findings were clear:

- Companies in the top quartile for racial and ethnic diversity are 35% more likely to have financial returns above their respective national industry medians.
- Companies in the top quartile for gender diversity are 15% more likely to have financial returns above their respective national industry medians.
- In the United States, there is a linear relationship between racial and ethnic diversity and better financial performance: for every 10% increase in racial and ethnic diversity on the senior-executive team, earnings before interest and taxes (EBIT) rise 0.8 percent.
- Racial and ethnic diversity has a stronger impact on financial performance in the United States than gender diversity, perhaps because earlier efforts to increase women's representation in the top levels of business have already yielded positive results.

<sup>13</sup> Annual Study of Intangible Asset Market Value from Ocean Tomo, LLC, March, 2015.

<sup>14</sup> Alex Edmans, “The Link Between Job Satisfaction and Firm Value, with Implications for Corporate Responsibility,” *Academy of Management PERSPECT* (November 2012) 26:4, 1-19.

<sup>15</sup> Gallup Q12® Meta-Analysis Report, 2012.

<sup>16</sup> Center for Talent Innovation, *Innovation, Diversity, and Market Growth*, 2013.

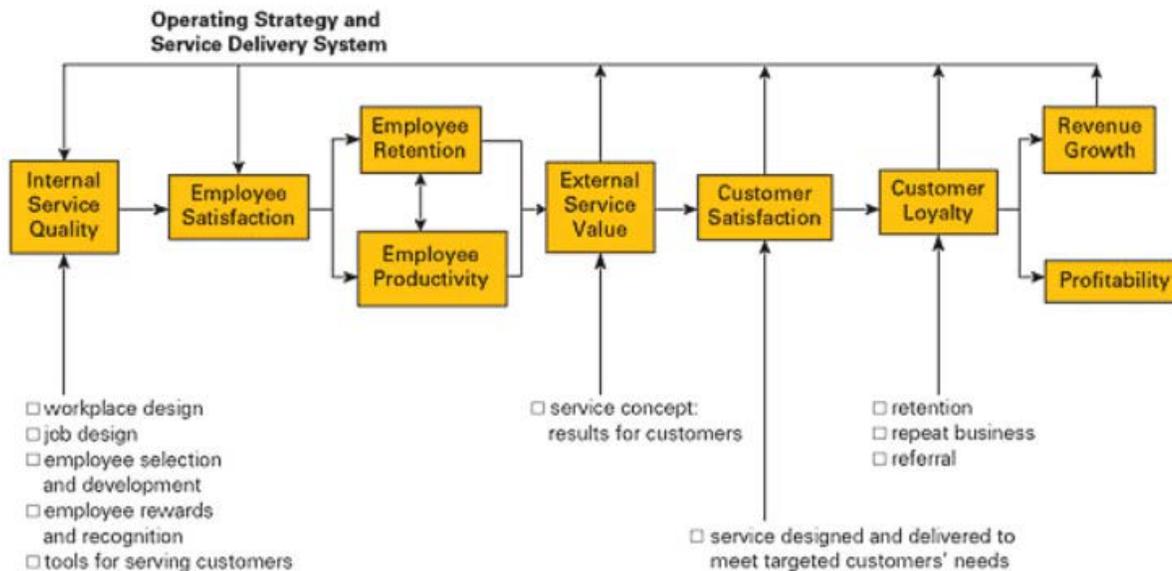
<sup>17</sup> McKinsey & Company, *Diversity Matters*, 2017

### Companies that treat their clients well

Originally published in 1994, a Harvard Business Review study on customer loyalty, "Putting the Service-Profit Chain to Work, lays out the ground rules for building profitability in a service business. After conducting research regarding what top-level executives do to produce outstanding service and productivity, five Harvard Business School professors established what they call the presence of a "Service-Profit-Chain" to be the explanation for successful business. As stated in their article, "successful service managers pay attention to the factors that drive profitability." Their proposition is that internal service quality and employee satisfaction initiate a chain reaction that drives better current results and future earnings.<sup>18</sup>

As the authors state: "Profit and growth are stimulated primarily by customer loyalty. Loyalty is a direct result of customer satisfaction. Satisfaction is largely influenced by the value of services provided to customers. Value is created by satisfied, loyal, and productive employees. Employee satisfaction, in turn, results primarily from high-quality support services and policies that enable employees to deliver results to customers." See Chart 1 below.

**Chart 1: The Links in the Service Profit Chain**



Source: Putting the Service-Profit Chain to Work

### Companies that give back to their community

In a joint study by Harvard, The University of California, and the University of Michigan called "Does it Pay to Be Good... And Does it Matter? A Meta-Analysis of the Relationship between Corporate Social and Financial Performance," the authors looked at a number of variables of corporate social policies and found "After thirty-five years of research, the preponderance of evidence indicates a positive relationship between corporate social performance and corporate financial performance."<sup>19</sup>

Similarly, in Ann Turner's piece from the Lisbon University Institute, "The Buy-In to Corporate Culture: Creating Internal Emotional Capital Through Work-Based Volunteering Schemes," found that by volunteering with their co-workers, employees formed a stronger emotional attachment to the company and their company's values.<sup>20</sup>

Along the same lines, in the 2013 Academy of Management Journal's "Finding Meaning Through Volunteering: Why Do Employees Volunteer And What Does It Mean For Their Jobs?" Jessica Rodell found that employees who volunteer received greater meaning and were more engaged at work.<sup>21</sup>

18 James L. Heskett, Thomas O. Jones, Gary W. Loveman, W. Earl Sasser, Jr., and Leonard A. Schlesinger, "Putting the Service-Profit Chain to Work," Harvard Business Review (March-April 1994).  
 19 Joshua D. Margolis (Harvard Business School, Harvard University), Hillary Anger Elfenbein (Haas School of Business, University of California), James P. Walsh (Ross School of Business, University of Michigan), "Does it Pay to Be Good... And Does it Matter? A Meta-Analysis of the Relationship between Corporate Social and Financial Performance" (November 1, 2007).  
 20 Ann Turner, "The Buy-in to Corporate Culture: Creating Internal Emotional Capital Through Work-based Volunteering Schemes", European Conference of Intellectual Capital (ECIC) 2010, Lisbon University Institute.  
 21 Jessica B. Rodell, "Finding Meaning Through Volunteering: Why Do Employees Volunteer And What Does It Mean For Their Jobs?," Academy of Management (October 2013) 56:5, 1274-1294.

### Companies with a culture of integrity

In a joint study by the Institute for Economics and Finance, Northwestern University and The University of Chicago titled “The Value of Corporate Culture,” researchers found that a real culture of integrity — as perceived by the employees and not just on their mission statement — adds value to a company.<sup>22</sup> When top management keeps its word, it validates this behavior as the company norm, facilitating social enforcement of integrity among employees. Businesses that maintain integrity and corporate ideals are not willing to sacrifice customers’ satisfaction. While this may serve to negatively impact short term profits, as companies enact a culture of integrity their stock values tend to rise over the following years.

#### Why doesn’t every company act this way?

Most corporate management has been trained to consider employees as an expense, and that anything they give to employees is at the detriment of profits. Customer service and giving back to the community are “fuzzy” items that take years to pay off and the positive relationship is not directly apparent. Companies and their managers are under tremendous pressure to achieve short term results in profits, growth and share price. The incentives for management are aligned with these short term results. Managers who come in and cut employees and service can show results right away, but the damage they cost may not be apparent for several years.

In the 80’s and 90’s a large home improvement store chain was focused on customer service and hiring experienced and knowledgeable employees like former electricians and plumbers. In 2000, they brought in a leader who decided that the company could replace the knowledgeable full time employees with part time employees (half the workforce). This was a typical capital markets emphasis on cutting costs to improve numbers that resulted in the majority of the senior management defecting. Initially the stock price went up as costs declined, but the culture was destroyed and turnover and service declined allowing competitors to catch up. Six years later he was fired, and the company’s stock was stagnant.

### Investment implications

We believe that a positive corporate culture is a competitive advantage. We wanted to put the theory to the test. In January 1, 2016, we created an investment portfolio that invests solely in companies we deem to be positive culture companies, and we continue to track the performance against its stated benchmark. In addition, we continue to track and report out on how our companies have been practicing good works by treating their employees, customers and the community well.

#### Important note:

This whitepaper is based on research completed in 2016, and originally presented by the following:

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<sup>22</sup> Luigi Guiso (Einaudi Institute for Economics and Finance), Paola Sapienza (Northwestern University – Kellogg School of Management), Luigi Zingales (University of Chicago – Booth School of Business), “The Value of Corporate Culture” (September 1, 2013).

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