When do Appointments of Corporate Sustainability Executives affect Shareholder Value?

An Emerging Trend

Over the last two decades, firms have been appointing sustainability executives to be part of their top management teams (TMTs). Denning (2011) labels this trend as "sustainability reaching the C-suite," and attributes it to the breadth, complexity and rapid evolution of sustainability issues. The number of firms with sustainability executives in TMTs doubled between 1995 and 2003, and again between 2003 and 2008 (GreenBiz 2013). Indeed, *Forbes* (2016) lists "sustainability leadership" that combines operational efficiency with optimal resource use as one of the four supply chain career paths for 2025. Titles for sustainability executives include Chief Sustainability Officer, Chief Responsibility Officer, Corporate Social and Environmental Officer, and Executive or Senior Vice-President of Sustainability, etc. (Strand 2013). For the purpose of our study, we refer to these executives as Corporate Sustainability Executives (CSEs).

Research Objectives and Contributions

There is an extensive body of literature investigating the shareholder value effects to firms' socially and environmentally responsible actions such as philanthropy and equal employment opportunities (Margolis and Walsh 2003); environmental management in the form of process redesign, investment in new environmental technologies, and reduction in emissions of hazardous pollutants into the natural environment (Klassen and McLaughlin 1996); ISO 14000 certification (Corbett and Kirsch 2000); environmental initiatives and awards (Jacobs et al. 2010); and corporate social responsibility (CSR) communications (Yu et al. 2013). The work by Flammer (2013, 2015) posits that engagement in eco-friendly corporate initiatives generates new and competitive resources for the firm and finds a positive stock market reaction when firms announce eco-friendly initiatives or pass CSR-related proposals in their annual board meetings. Research has also established a positive link between CSR engagements of a firm and its environmental and social performance (Kroes et al. 2012, Toffel and Short 2011). Although there is a vast literature on CSR practices and strategies and their relationships with various measures of firm performance, little is known about the nature of the empirical link between CSE appointments and financial performance.

The empirical work linking CSE appointments and financial performance that we are aware of is by Wiengarten et al. (2015), who examine the association between appointments of chief officers of corporate social responsibility and improvement in operating performance as measured by change in return on assets. We add to the understanding of this link between CSE appointments and financial performance by using a stock price based performance measure. More, specifically, we examine the abnormal stock market reaction attributable to announcements of CSE appointments. We also investigate how the stock market reaction depends on the following firm-specific factors: *(i)* appointments to newly-created as compared to existing positions; *(ii)* outsider versus insider appointee; *(iii)* appointments announced subsequent to an adverse sustainability-related event; and *(iv)* whether the responsibilities specified for the CSE appointee are focused versus broad.

The TMT of a firm comprises a group of executives who are usually one or two levels below the CEO and are responsible for formulating, propagating, and executing the corporate strategy of the firm. Given that these executives have a strong influence in firms' strategic decision–making, it is of interest to study how appointments to TMTs affect financial performance. The extant literature has examined the stock market reactions to appointments of senior executives in various functional areas, including Chief Financial Officers (CFOs; Mian 2001), Chief Marketing Officers (CMOs; Boyd et al. 2010, Nath and Mahajan 2008), Chief Information Officers (CIOs; Chatterjee et al. 2001), and Supply Chain and Operations Management Executives (SCOMEs; Hendricks et al. 2015). We contribute to this literature by examining the stock market reaction to appointments of CSEs – a relatively recent phenomenon. We also contrast the market reaction to appointments of CSEs with the reactions to appointments of senior executives in the aforementioned functional areas.

Methodology

Our empirical analyses are based on a sample of 106 announcements of CSE appointments made by publicly listed firms over the period 2000–2015. We use event-study methodology to estimate the stock market reactions associated with these announcements followed by regression analysis.

The event study methodology estimates the stock market's reaction (referred to as "abnormal" returns) to events, while adjusting for both industry and market-wide influences on stock prices (see Brown and Warner 1980, 1985). We use the announcement day, or Day 0, as the (one-day) event period to measure the stock market reaction. To test our hypotheses, i.e., to examine the differences in stock market reaction under the four firm-specific factors, we regress the announcement day (Day 0) abnormal returns on the explanatory and control variables.

Results

We find that the stock market reaction to CSE appointments is insignificantly different from zero, indicating that such appointments are overall value-neutral. Our finding is encouraging in the sense that it suggests that these appointments, which are intended to help improve firms' social and environmental performance, do not hurt shareholder value. Furthermore, many stakeholders, including customers, regulatory agencies, communities, NGOs, and environmental and social activists are increasingly placing emphasis on the social and environmental performance of the firm (Sarkis et al. 2010). The appointment of a CSE can help address the ongoing demands of this important set of stakeholders.

Although the stock market reaction to CSE appointments is overall value neutral, we find that the stock market reacts more positively under certain firm-specific conditions. We find evidence of a more positive market reaction in instances where the announcing firms faced a prior adverse sustainability-related event. Firms faced with an adverse sustainability-related event in the year prior to the announcement of CSE appointment, have a 0.69% higher mean market reaction relative to announcing firms that did not face such an event. We also find evidence of a more positive market reaction when announcing firms specify focused as opposed to broad responsibilities for the CSE appointee. On average, firms announcing CSE appointments with focused responsibilities have a 0.94% higher mean market reaction as compared to firms announcing CSE appointments with broad responsibilities. However, we do not find evidence of more positive stock market reactions to announcements of appointments to newly-created versus existing CSE positions or to announcements of CSE hires from outside versus inside the firm. Our findings continue to hold when we account for potential self-selection bias and are also robust to alternative methods to estimate the stock market reaction.

Our findings demonstrate nuances in the market reactions to CSE appointments depending on various firm-specific factors, thereby helping executives and stakeholders better understand the shareholder value effects of appointing CSEs to TMTs.