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Penalty Zones and International Sustainability Standards

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Increasingly, sustainability standards are recognized as important tools for helping companies navigate the complex sustainability landscape. These standards help companies tackle their social and environmental challenges and serve as credible signals to stakeholders that they are doing the right thing, thus creating potential opportunities for the market to reward these companies.

But what really happens when companies adopt multiple standards? Do companies' sustainability and market performance continue to improve? Not necessarily. [Nicole Darnall](#), [Kostas Iatridis](#), [Effie Kesidou](#), and [Annie Snelson-Powell](#)'s [research](#) shows that adopting multiple sustainability standards becomes "too-much-of-a-good-thing."

Sustainability standards don't always pay off

[Our study](#) challenges the assumption that continuous adoption of sustainability standards always leads to continuous improvement in firm performance. The underlying premise of our research is that sustainability standards serve as powerful signals that allow firms to communicate their commitment to sustainability and showcase their sustainability activities to market participants. However, we argue that the market signals about firms' sustainability benefits and costs are inherently imprecise.

After examining 1,600 publicly traded companies over ten years, we show that the market rewards companies that adopt multiple sustainability standards and improve their sustainability performance. However, after adopting two sustainability standards, these rewards fall, even when companies' performance improves. Market declines are caused by misinformation. Investors tend to overestimate the costs of companies implementing and maintaining sustainability standards while simultaneously underestimating the benefits companies derive from the standards' adoption. Investors worry that companies are spreading their resources too thin. Consequently, after a point, the continuous adoption of sustainability standards is met with financial penalties rather than rewards.

Sustainability standards don't always improve sustainability outcomes

Our research has also revealed that, beyond a certain point, adopting more than three sustainability standards leads to a deterioration in companies' sustainability performance. We believe this occurs because additional sustainability standards also increase administrative burdens, delays, and costs related to training, certification, and audits. They also divert valuable resources from the effective implementation of sustainability practices, thus hindering a company's ability to achieve its sustainability goals.

The Penalty Zone

The "penalty zone" arises because markets are misinformed – it's the place where a firm's market value declines, even when its sustainability performance continues to improve. In this zone, companies that engage in the continuous adoption of sustainability standards face penalties from investors despite the potential for further sustainability improvements to be made. This suggests that there is a point of declining returns and that the continuous adoption of standards becomes counterproductive in terms of financial performance first, and then sustainability performance.

Identifying such a penalty zone highlights a "too-much-of-a-good-thing" phenomenon in adopting sustainability standards. It underscores the importance of finding the right balance and strategic approach to standards' adoption. While early adoption and the integration of sustainability standards can yield positive outcomes and improve sustainability performance, there is a point beyond which additional standards may no longer deliver proportional benefits and could potentially hinder financial performance.

Implications for stakeholders

Our research findings have important implications for companies, investors, and policymakers. Companies need to carefully evaluate the benefits and drawbacks associated with each additional sustainability standard they adopt and consider the potential reactions of investors. Striking a balance between demonstrating conformance through standards' adoption and avoiding potential penalties becomes crucial for long-term sustainability and financial success.

For investors, a more holistic and long-term view of sustainability is essential. Rather than being driven solely by short-term concerns, considering the broader impacts and benefits of sustained standards adoption can lead to more informed investment decisions that align with sustainability principles. These implications are particularly salient given current shifts to 'ESG investing' where investors seek returns linked to positive environmental, social, and governance performance.

Policymakers can also benefit from these findings by crafting policies that encourage and support companies in adopting an optimal number of sustainability standards. This includes providing guidance on the benefits of early adoption, setting benchmarks for sustainability performance, and fostering an environment that encourages continuous improvement while recognizing the existence of penalty zones.

Implications for society and the environment

Finally, this research has notable implications for both society and the environment, especially at this time of growing social inequality and the escalating impacts of the climate crisis. We have discovered that firms' financial motivations lead them to hold back from adopting standards to an extent that optimizes sustainability performance, choosing to make cautious investments with fewer standards instead. This behavior creates a braking effect that impedes more ambitious corporate responses to our rapidly mounting environmental and social challenges.

We are hopeful that our research sheds light on the complex relationship between continuous adoption of sustainability standards, financial performance, and sustainability outcomes. By uncovering penalty zones and highlighting the declining returns associated with the continuous adoption of standards, we contribute to a more nuanced understanding of standards' adoption and implementation. This understanding can inform decision-making processes, guide strategic planning, and promote more effective and sustainable business practices in an era of evolving sustainability expectations.

[Nicole Darnall](#) is the Foundation Professor of Management and Public Policy and Founding Director of ASU's Sustainable Purchasing Research Initiative

[Kostantinos Iatridis](#) is an Associate Professor of Sustainability and Management at the University of Bath.

[Effie Kesidou](#) is a Professor of Economics of Innovation & Sustainability at the Department of Economics, Leeds University Business School, University of Leeds.

[Annie Snelson-Powell](#) is an Assistant Professor of Business and Society at the University of Bath.

This post is adapted from their open access paper, "Penalty Zones in International Sustainability Standards: Where Improved Sustainability Doesn't Pay," available at [Wiley Publishing](#).

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