

BUSINESS INSIGHT

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Corporate Reputation

Does Being Ethical Pay?

Companies spend huge amounts of money to be 'socially responsible.' Do consumers reward them for it? And how much?

By REMI TRUDEL AND JUNE COTTE

May 12, 2008; Page R1

For corporations, social responsibility has become a big business. Companies spend billions of dollars doing good works -- everything from boosting diversity in their ranks to developing eco-friendly technology -- and then trumpeting those efforts to the public.

But does it pay off?

Many companies hope consumers will pay a premium for products made with higher ethical standards. But most companies plunge in without testing that assumption or some other crucial questions. Will buyers actually reward good corporate behavior by paying more for products -- and will they punish irresponsible behavior by paying less? If so, how much? And just how far does a company really need to go to win people over?

To find out, we conducted a series of experiments. We showed consumers the same products -- coffee and T-shirts -- but told one group the items had been made using high ethical standards and another group that low standards had been used. A control group got no information.

In all of our tests, consumers were willing to pay a slight premium for the ethically made goods. But they went much further in the other direction: They would buy unethically made products only at a steep discount.

What's more, consumer attitudes played a big part in shaping those results. People with high standards for corporate behavior rewarded the ethical companies with bigger premiums and punished the unethical ones with bigger discounts.

Finally, we discovered that companies don't necessarily need to go all-out with social responsibility to win over consumers. If a company invests in even a small degree of ethical production, buyers will reward it just as much as a company that goes much further in its efforts.

Below, we'll look at these tests in more detail. But first, a definition -- and a caveat.

For our purposes, "ethically produced" goods are those manufactured under three conditions. First, the company is considered to have progressive stakeholder relations, such as a commitment to diversity in hiring and consumer safety. Second, it must follow progressive environmental practices, such as using eco-friendly technology. Finally, it must be seen to demonstrate respect for human rights -- no child labor or forced labor in

overseas factories, for instance.



GOOD BUSINESS?

- **The Question:** Companies spend billions of dollars doing good works -- such as developing eco-friendly technology -- and then trumpeting them to the public. But does it pay off?

- **The Test:** In a series of experiments, consumers were shown the same products -- coffee and T-shirts -- but one group was told the items had been made using high ethical standards and another group that low standards had been used.

- **The Result:** Consumers are willing to pay a small premium for ethically produced goods. But they'll punish an unethically made product even more harshly, by buying it only at a steep discount.

Now the warning, which may not come as much of a surprise. Even though we think ethical production can lead to higher sales, not all consumers will be won over by the efforts. Some may prefer a lower price even if they know a product is made unethically.

With that in mind, here's a closer look at our results.

HOW MUCH ARE ETHICS WORTH?

Our first experiment asked two questions. How much more will people pay for an ethically produced product? And how much less are they willing to spend for one they think is unethical?

To test these questions, we gathered a random group of 97 adult coffee drinkers and asked them how much they would pay for a pound of beans from a certain company. We used a brand that's not available in North America, so none of the participants would be familiar with it.

REWARD AND PUNISHMENT

What consumers were willing to pay for a pound of coffee based on what they were told about the company's production standards

Ethical standards \$9.71
Unethical standards 5.89
Control (no information) 8.31

Source: Remi Trudel and June Cotte

A MATTER OF DEGREE

How much consumers were willing to pay for all-cotton T-shirts based on what they were told about the proportion of ethical production

100% organic cotton \$21.21
50% organic cotton 20.44
25% organic cotton 20.72
Unethical behavior* 17.33
Control (no information) 20.04

**Production harms environment*

ATTITUDE ADJUSTMENT

Consumers with high ethical expectations of companies doled out bigger rewards and punishments than consumers with low expectations. What each group was willing to pay for a pound of coffee based on production standards:

Consumers with high expectations:
Ethical standards \$11.59
Unethical standards 6.92
Consumers with low expectations:
Ethical standards \$9.90
Unethical standards 8.44

But before the people answered, we asked them to read some information about the company's production standards. One group got positive ethical information, and one group negative; the control group got neutral information, similar to what shoppers would typically know in a store.

After reading about the company and its coffee, the people told us the price they were willing to pay on an 11-point scale, from \$5 to \$15. The results? The mean price for the ethical group (\$9.71 per pound) was significantly higher than that of the control group (\$8.31) or the unethical group (\$5.89).

Meanwhile, as the numbers show, the unethical group was demanding to pay significantly less for the product than the control group. In fact, the unethical group punished the coffee company's bad behavior more than the ethical group rewarded its good behavior. The unethical group's mean price was \$2.42 below the control group's, while the ethical group's mean price was \$1.40 above. So, negative information had almost twice the impact of positive information on the participants' willingness to pay.

For companies, the implications of this study -- albeit limited -- are apparent. Efforts to move toward ethical production, and promote that behavior, appear to be a wise investment. In other words, if you act in a socially responsible manner, and advertise that fact, you may be able to charge slightly more for your products.

On the other hand, it appears to be even more important to stay away from goods that are unethically produced. Consumers may still purchase your products, but only at a substantial discount.

HOW ETHICAL DO YOU NEED TO BE?

Our next test looked at degrees of ethical behavior. For instance, are consumers willing to pay more for a product that is 100% ethically produced versus one that is 50% or 25% ethically produced?

To find out, we tested consumers' responses to T-shirts from a fictitious manufacturer. We divided 218 people into five groups and presented them with information about the company and its product. One group was told the shirts were 100% organic cotton, one group 50% and one group 25%. Another group -- the "unethical" one -- was told there was no organic component. The control group got no information.

In addition, all the groups but the control were shown a short paragraph detailing the detrimental effects of nonorganic cotton production on the environment.

Then the participants were asked how much they were willing to pay for the shirts on a 16-point scale, ranging from \$15 to \$30. As in the first test, we found that people were willing to pay a premium for all levels of ethical production, and they would discount an unethical product more deeply than they would reward an ethical one.

But consumers didn't reward increasing levels of ethical production with increasing price premiums. The 25% organic shirts got a mean price of \$20.72 -- not much different from the 50% (\$20.44) and 100% (\$21.21).

It seems that once companies hit a certain ethical threshold, consumers will reward them by paying higher prices for their products. Any ethical acts past that point might reinforce the company's image, but don't make people willing to pay more. (Of course, if 100% ethical becomes expected among consumers, anything less may be punished.)

WHAT EFFECT DO CONSUMER ATTITUDES HAVE?

In our final experiment, we looked at the attitudes people bring to the table. If consumers expect that companies will behave ethically, will that change how much they reward and punish behavior? What if they expect that companies are just in it for the money, maximizing profits and not taking ethics into account?

Once again, we tested coffee drinkers -- 84 this time -- and split them into groups that received positive, negative and no ethical information about the manufacturer and its methods. But first we measured the people's attitudes toward corporations and labeled them high-expectation or low-expectation.

Once again we found that -- regardless of their expectations -- consumers were willing to pay more for ethical goods than unethical ones, or ones about which they had no information. Likewise, negative information had a much bigger bearing on consumer response than positive information. People punished unethical goods with a bigger discount (about \$2 below the control group) than they rewarded ethical ones with premiums (about \$1 above the control group).

So, what effect did consumer attitudes have? People with high expectations doled out bigger rewards and punishments than those with low expectations. Those with high expectations were willing to pay a mean of \$11.59 per pound for the ethical coffee, versus \$9.90 for those with low expectations. And the high-expectations group punished the unethical coffee with a price of \$6.92, versus \$8.44 for low-expectations consumers.

The lessons are clear. Companies should segment their market and make a particular effort to reach out to buyers with high ethical standards, because those are the customers who can deliver the biggest potential profits on ethically produced goods.

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