Siiri Busch

THE IMPACT OF CORPORATE SOCIAL RESPONSIBILITY SCANDALS ON COMPANY'S FINANCIAL PERFORMANCE

Case United Airlines Holdings

International Business 2019


Tapausyrityksen tunnuslukuja verrattiin kolmen muun lentoyhtiön tunnuslukuihin skandaalin aikana. Kaikki tutkimuksessa mukana olleet lentoyhtiöt toimivat Yhdysvalloissa. Tutkimustulokset osoittavat ristiriitaisia tuloksia, sillä skandaalin vaikutuksena tuottavuudessa havaittiin joitain negatiivisia vaikutuksia jotka ovat yritysvastuu teorioiden mukaisia, mutta tunnuslukujen perusteella ei voitu tehdä merkittäviä johtopäätöksiä tai pitkäaikaisia vaikutuksia taloudelliseen tulokseen ei huomattu.

Avainsanat     Yritysvastuu, tuottavuus, skandaalit
ABSTRACT

Corporate social responsibility (CSR) has quickly grown to be a phenomenon among the companies. The rapid growth can be seen in awareness of responsibility among societies companies are operating in, but also in headlines of corporate scandals. Companies are able to utilize corporate social responsibility to improve financial performance. Often poor operation in social performance could lead to corporate scandal, which can affect financial performance negatively.

The relationship between corporate social responsibility and corporate financial performance has been frequently studied, however the relationship remains uncertain. Especially, concerning the effects of corporate scandals on financial performance. This thesis tries to find the main effects on financial performance after the occurrence of a scandal. Additionally, this thesis tries to discover how companies are able to recover from these scandals. This study utilizes financial performance indicators such as ROA, Current Assets, Earnings per share and Price-to-book ratio to find a solution for the relationship. The empirical study is based on the before mentioned financial metrics for airline companies, while taking one scandal incident as a baseline for comparison.

The financial metrics for the case company was compared against three other airlines operating in the United States of America during the time frame of the scandal. The study findings show contradictory results, as some negative effects were found for the financial performance which are in accordance with the theories, still no significant conclusion or long-term effects for the financial performance can be drawn from the data, without impacting the data reliability.

Keywords
CSR, CFP, Scandals
## CONTENTS

### ABSTRACT

1 INTRODUCTION .................................................................................................................. 7

2 BACKGROUND ..................................................................................................................... 9

2.1 Research questions ......................................................................................................... 9

2.2 Purpose of the thesis ....................................................................................................... 9

3 THEORY ............................................................................................................................ 10

3.1 Concept of CSR .............................................................................................................. 10

3.2 Stakeholder Theory ........................................................................................................ 11

3.3 Shareholder Theory ........................................................................................................ 12

3.4 Carroll’s CSR Pyramid .................................................................................................. 13

3.5 The Shared value theory ................................................................................................. 14

3.6 The Triple bottom line .................................................................................................... 15

3.7 Stakeholders .................................................................................................................... 15

3.8 Motivation for CSR ....................................................................................................... 16

3.9 Measurability of CSR .................................................................................................... 17

3.10 Measurability of CFP ................................................................................................... 18

3.11 Relationship between CSR and CFP ............................................................................ 20

3.12 Positive Relationship of CSR and CFP ....................................................................... 22
3.13 Negative Relationship of CSR and CFP ................................................. 24
3.14 CSR Scandals ............................................................................... 24
  3.1.14 Occurrence of CSR Scandals .................................................. 26
  3.1.15 Preventing CSR scandals ...................................................... 27
  3.1.16 Recovering from CSR Scandals ............................................. 28
3.15 Theoretical Framework .................................................................. 29
4 EMPIRICAL RESEARCH METHODOLOGY ........................................ 31
  4.1 United Airlines Holdings ............................................................. 31
  4.2 Data Collection ........................................................................... 32
  4.3 Data Description and Reliability .................................................. 33
5 RESULTS ......................................................................................... 34
  5.1 Return on Assets ......................................................................... 34
  5.2 Price-to-Book ............................................................................. 36
  5.3 Current Ratio ............................................................................... 38
  5.4 Earnings Per Share ..................................................................... 39
6 CONCLUSION .................................................................................. 42
  6.1 Main Findings ............................................................................. 42
  6.2 Limitations and Future Research ................................................ 45
REFERENCES ..................................................................................... 47
LIST OF FIGURES AND TABLES

Table 1. Quarterly return on assets. p.34
Table 2. Quarterly price-to-book. p.36
Table 3. Quarterly current ratio. p.38
Table 4. Annual earnings per share. p.40

Figure 1. Carroll’s CSR pyramid. p.13
Figure 2. Quarterly return on assets. p.35
Figure 3. Quarterly price-to-book. p.37
Figure 4. Quarterly current ratio. p.39
Figure 5. Annual earnings per share p.41
1 INTRODUCTION

Corporate social responsibility (CSR) is a rising topic among local and global companies, due to CSR scandals happening around the globe which society and customers are paying close attention to. The scandals are the consequence of neglecting social, environmental or ethical responsibilities. One of the most well-known incidents was Volkswagen's emission scandal that took place in 2015, in which the company cheated on emission tests. The company experienced a major public backlash from the markets as well as from the society. Due to the scandal Volkswagen suffered a 16 billion euros’ losses (Kollewe & Davies 2016). These world-wide scandals have resulted in companies taking big initiatives in order to be socially responsible, as many examples show that there are significant consequences otherwise. However, are there also financial benefits for the companies for being responsible in addition to contributing to a sustainable society?

Awareness of CSR is growing rapidly among various companies, but is there a link between corporate social responsibility and corporate financial performance (CFP)? This relationship has been researched repeatedly and it has been suggested that no direct link between these two exists, however CSR might increase personnel motivation, customer loyalty and improve efficiency among others (Robins 2011). Even though, the relationship between CSR and CFP has been researched, the effects of a CSR scandal from financial performance perspective is still a bit unclear. Especially the reasons which have led to the scandal, the effects and recovery after the scandal.

In addition, as social media is enabling fast distribution of information, public concern of environmental, social and ethical issues arise and leads to critical examination of companies. These concerns have also affected investor’s investment decisions, as CSR scandals can lead to significant losses of both monetary and brand equity. CSR scandals have been one major reason for the rising popularity of socially responsible investing (SRI) (Broadhurst, Marshall & Watson 2003, 13).

Companies requires financing and investments in order to develop, grow and run the daily business. As investments and investors are a crucial part of the company’s success, there is a significant importance of maintaining good investor relations (IR). These investor
relations include sustaining a solid and transparent relationship with the investors. (Corporate Finance Institute).

This thesis is divided into five main chapters. The first chapter is the introduction, and the second chapter is representing the background information of this topic. The third chapter represents the theories and previous research regarding CSR and CFP. The fourth chapter focuses on the empirical part of the study, in which the case company as well as the financial ratios used in the research are introduced. The fifth chapter presents the financial data presented with the key ratios, while analyses of the key ratios is presented. The last chapter concludes and ties the theoretical and empirical study together, as presenting the results of the study.
2 BACKGROUND

2.1 Research questions

The main research questions revolve around the effect of CSR scandals and the relationship between CSR scandals and CFP. In particular, this study tries to find out what kind of effect CSR scandals have on a company`s financial performance. The first question is as follows:

“Does CSR scandals have an effect on a company financial performance?”

After considering the relationship between CSR and CFP from a scandal perspective, this study will continue to find out factors that might contribute to recovery from scandals. The second question is expressed as follows:

“What kind of factors contribute to recovery from CSR scandals?”

2.2 Purpose of the thesis

The purpose of this study is to research the relationship between corporate social responsibility and corporate financial performance which is researched from a scandal perspective. As the case company is a substantial corporation, there might be a chance that the scandal has not influenced the financial performance, the research focuses on trying to discover these factors that might contribute to this matter.

The research questions are examined using both theoretical framework and previous researches as a background, which are then utilized in the empirical part of the study, in order to draw a broad conclusion to answer the research questions.
3 THEORY

This chapter of the thesis presents the most common theories behind the study corporate social responsibility. Even though the relationship between CSR and CFP has been frequently studied, there is still some controversy around the reliability of these researches, while the diverse definitions of CSR contribute to this inconsistency. First this chapter starts with trying to clarify the definition of CSR and benefits for being a socially responsible company. Then moving forward to corporate financial performance and what kind of link there is between these two.

3.1 Concept of CSR

The history of corporate social responsibility can be tracked down to 1938, when Chester Barnard came out with a publication bringing a clarification to CSR, in which he combines the organizational behaviour with executive functions. This publication can be seen as the first reference to social responsibility of executives and companies. In 1953 when Howard Bowen published his book “Social Responsibilities of the Businessman”, in which he presents the phrase “corporate social responsibility”. Bowen defined CSR as “it refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society” (Bowen 1953, 6). Bowen describes CSR as a continuous effort from the business to consider stakeholders involved and impacted when making both business and private decisions.

In addition, there are multiple CSR definitions in different sources from both the governmental and non-governmental sector. In order to combine these sources Dahlsrud attempted to clarify the CSR definition from biased confusions. The research demonstrates that all studied CSR definitions, revolves around five different dimensions: stakeholder, social, economic, voluntariness and environmental dimension. The stakeholder dimension is the most popular and the environmental is the least popular dimension. The environmental dimension means the natural environment. The social dimension is the relationship between the company and the society. The economic dimension means the financial aspect including CSR. The stakeholder dimension is the
stakeholders of the business. Lastly, voluntariness dimension are actions that are not defined by the law (Dahlsrud 2006).

Even though these CSR dimensions have been defined, they do not provide any description of optimal business performance Dahlsrud (2006). These dimensions do not directly assist in creating a functional CSR strategy, whereas a business must create a CSR strategy which is suitable for the applicable industry and the stakeholders (van Marrewijk 2001). While focus has been on defining CSR, finally it is not about defining CSR, but for businesses to recognize how CSR can be used in a specific setting as making business decisions (Dahlsrud 2006).

Interestingly, according to Dahlsrud’s (2006) research, the most popular CSR definition is from the European Commission: “A concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.” (Commission of the European Communities, 2001). According to European Commission renewed CSR strategy for 2011-2014, the above mentioned CSR definition has not been modified. (European Commission 2011).

Even though the minimum foundation for CSR has been laid down in the legislation, such as Employment Acts, regulations regarding pollution and Health and Safety at Work Act. Still CSR is a voluntary act for companies to do more that is required by the law. For CSR to remain a popular topic among companies, it should remain to be voluntary, as companies can develop and shape a functional CSR strategy themselves in order to create a competitive advantage and gain financial benefits themselves as well. If CSR was changed to be included in legislation rather than based on voluntary acts, it would restrain business activities and decrease CSR to a lowest possible level. CSR should be carrot-led rather than stick-driven obligation (Tool & Broomes).

3.2 Stakeholder Theory

Stakeholder theory has been introduced already in 1960’s and brought to public attention in the 1980’s (Freeman 1983). Stakeholder theory states that businesses responsibility is towards all stakeholders involved with the business and to create value as much as possible to these stakeholders. It signifies that businesses successes and failures are reliant
on different stakeholders, which can include almost anyone who is affected by the business operations. Additionally, no isolation between different stakeholders should be made and therefore different stakeholder groups interest must be combined. This signifies the managerial task, as business executives as they have to find a business strategy in order to combine these interests.

Freeman stated that the civil rights, women rights and the rise of consumer and environmental concerns was a significant reason why stakeholder theory was researched between 1960’s and 1970’s. To further clarify stakeholders, Freeman suggested wide and narrow sense on stakeholders. In a wide sense stakeholder is a recognized group or an individual who can and is affected of organizations achieving their objectives. In a narrow sense stakeholder is a recognised group or individual which the organization is reliant on for its survival. It is also stated that the wide sense of stakeholders is compulsory for companies to comprehend, as some business only wants to identify employees, suppliers and customers as its stakeholders, but there can be significant potential to identify adversary groups as stakeholders as well, such as public interest groups, unions and protest groups among others (Freeman 1983).

A research completed 1995 stated that there are three different types of stakeholder theories. The first one is Descriptive/Empirical theory, which is used to describe business characteristics and reasoning for business behaviour. The second one is instrumental theory, which considers the business performance effects with stakeholders. The third one is normative theory, which takes into consideration the moral decency of business guidelines and behaviour (Donaldson & Preston 1995). These three theory concepts have been summarized as: What happens? What happens if? And What should happen? (Jones 1995).

### 3.3 Shareholder Theory

In contradiction, to Freemans stakeholder theory, Milton Friedman introduced the shareholder theory. The theory argues that businesses cannot have responsibilities, only individuals can be seen as responsible for the society. Businesses and business executives have one and only one responsibility and that is to conduct business as their employer desire, which is generally to increase and maximise profits for the shareholders, therefore
philanthropy is not the purpose of a business therefore engaging in such activities should be avoided. Businesses should only engage in philanthropic activities, if the monetary benefit is larger than the donated amount. As employers or shareholders usually choose business executives themselves, businessmen are only responsible to their employers. Businessmen can have their individual responsibilities towards the society, therefore they can use their own money and spare time to fulfil these responsibilities but not employer’s resources (Friedman 1970).

3.4 Carroll’s CSR Pyramid

Archie Carroll stated that a business is divided into four obligations and responsibilities: economical, legal, ethical and philanthropic. The main foundation for all business obligation derives from economic responsibility, as without the foundation other responsibilities are irrelevant. These four levels can be represented in a pyramid. At the bottom of the pyramid is businesses economic responsibility to be profitable, which lays the foundation for the rest the obligations. Next is legal responsibilities, as law is society’s codification of what is acceptable. Ethical responsibilities are to do what is fair. At the top of the pyramid is philanthropic responsibilities, or otherwise stated to be a “good corporate citizen”, such as promoting human welfare. Even though CSR includes philanthropist responsibilities, which are highly desired, but less important than other elements in the pyramid. Or as Carroll states: “Philanthropy is the icing on the cake” (Carroll 1991). In the below picture Archie Carroll’s CSR pyramid is illustrated.

**Figure 1.** Carroll’s CSR Pyramid. (Khuram 2011)
3.5 The Shared value theory

Michael Porter (2011) created the shared value theory, in which the purpose of businesses is to create shared value with the surrounding stakeholders and community, rather than focusing on the profits. By creating shared value company focuses its resources in those areas where it can make a difference to benefit the company itself while creating a social value.

Although, the shared value theory has similarities between the stakeholder theory, it is merely a new regime to gain economic success. As comparing it to traditional view of CSR, it can be seen as a reputation management tool and efforts made can be difficult to link, justify and maintain in the long term without a viable CSR strategy. The shared value theory maintains the idea that a business should create economic value by collaborating and innovating, therefore creating societal value. Integrating close operations, such as helping suppliers and providing supportive functions can advance the economic and the society while business is able enhance their competitive positioning. Shared value theory is a business strategy model, although relationship with CSR exists. (Porter & Kramer 2011)

Shared value can be created with three distinctive steps,
1. Reconceiving the products, requirements and customers, in which the product is created to serve societal needs also for underserviced and unserved customers.
2. Redefining productivity in the value chain, in which resources are allocated better in the value chain to improve overall productivity.
3. Building industry cluster, to improve available institutions and skills in the community to increase businesses productivity. (Porter & Kramer 2011)

3.6 The Triple bottom line

To further expand corporate social responsibilities. In 1995, John Elkington suggested that companies should turn their focus from the financial bottom line to the triple bottom line, which takes into account profits, people and the planet. If companies only focus on profits from a financial point-of-view, they lack a comprehensive knowledge about the true effects of the business on both people and the planet.

The people concept can include everyone from the suppliers, to labour force to the society. Everyone’s wellbeing should be taken into account, to reveal the true cost of the business. Planet concept might focus on striving for sustainability and being more ecological for the planet, therefore focusing on the entire life cycle of the business actions. The profit concept is familiar for all businesses, but utilizing the concept from triple bottom line perspective, it should sustain the society as entirety. The triple bottom line can be used as a reporting concept, for the company to focus on three elements of the business and recognize the impacts and possible adaptation possibilities. However, monitoring people and the planet bottom lines might require closer monitoring and coordination than the profit concept (Elkington 1995).

3.7 Stakeholders

Stakeholders have been identified broadly as an individual or group of people who can affect and is affected by the achievement of organizations objectives, these include both friendly and hostile stakeholder groups. Stakeholders are those who have a stake in the company, affecting both company’s success and failure (Freeman & Reed 1983, 91). Stakeholders can vary from the customer, to employees until to competitors. Stakeholders can be divided into internal and external stakeholders. Internal stakeholders are entities
within the company and external stakeholders are those who are not within the company, such as customer and suppliers (Freeman 1983).

To identify and serve stakeholders, businesses should apprehend each stakeholder’s needs and fulfil these needs. Freeman (1983) concludes the following; understand stakeholders political influence. Practise methods that support taking an initiative rather than reacting to events and use resources based on the importance. Identified stakeholders should be included in the strategic business making process at least for some parts, and the business should move from passive to active, and appreciate the available strategies that include stakeholders as well, while it benefits not only the business but also the stakeholders (Freeman 1983).

3.8 Motivation for CSR

Motivation for being socially responsible is multilateral, some companies might participate in socially responsible operations with altruistic reasons, other companies might have incorporated their CSR strategy into their daily operations while obtaining some advantage. Motivation for CSR can be both intrinsic and extrinsic (Graafland, Mazereeuw-Van Der Duijn Schouten 2012).

The financial motive is an extrinsic motive for CSR. The foundation for this has been laid by defining that businesses responsibility is only to increase profits (Friedman 1970). The extrinsic motive for CSR is purely to gain a long-term financial advantage, as companies might utilize their CSR strategy to improve business reputation, differentiate themselves from competitors and investing in R&D (Graafland et al. 2012). These methods can affect business economics indirectly, as good reputation may result in customer and employee loyalty and market resistance might be lower in good CSR reputation companies.

In addition to the extrinsic motive, Graafland discovered two intrinsic motives, CSR as a moral obligation and altruistic motivation. Intrinsic motives can emerge from a CEO’s own values which affect the company’s CSR strategy. The moral obligation for CSR can originate from for example ethical principles, but not because it is pleasing. On the other hand, the altruistic motive can originate from it being enjoyable to help the society. Altruistic motivation for CSR is an unselfish concern for wellbeing and happiness of the
society. Altruistic CSR actions might not directly benefit the company at least the benefit is not the main focus (Low & Ang 2013). Although, the financial motive for CSR is an extrinsic motive as it has countable value for the business. (Graafland 2012).

3.9 Measurability of CSR

CSR is complex to measure due to missing theoretical definition of CSR (Dahlsrud 2012), missing CSR reporting standardisation and CSR reporting is not mandatory in many countries (Galant & Cadez 2017). Four approached to measure corporate social responsibility have been detected. Reputation indices, Content analysis, Scales and Single and multiple issue indicators (Turker 2009; Galant & Cadez 2017, 680).

3.1.1 Reputation indices

Reputation indices is the most common method used when measuring CSR; it utilizes listed data gathered by rating agencies. One commonly used reputation indices is MSCI KLD 400 Social index, which compares companies based on environmental, social and governance risk -and opportune criteria’s. However, MSCI excludes businesses that operate outside the common set of values, such as tobacco or gambling (MSCI 2019). Reputation indices is commonly used due to availability and prominent data, although some weaknesses also occur, businesses own agenda for compiling indices and limited coverage of firms (Galant & Cadez 2011, 682)

3.1.2 Content analysis

Content analysis has raised their popularity as companies pay more attention to social disclosure in which companies inform about their practises regarding environment and community among other. From these CSR reports, selected attributes and data is derived. (Turker 2009, 415). However, it has received some criticism of the data reliability.

3.1.3 Single and multiple issue indicators

Single and multiple issue indicator method is used when one or multiple attributes is chosen, then the attribute is monitored from business actions and strategy. One example is choosing corporate crimes as an attribute and then following and comparing how companies manage and clarify possible obstacles. However, some attributes are not
comparable within different industries due to different variety of businesses (Turker 2009, 414).

3.1.4 Scales

Another CSR measurement is scales, which measures CSR insight of individuals. The main idea is to choose individual value which is then scaled to organizational level, for example the manager’s individual values can be compared against the organizational values. However, organizations CSR values should not be based on individual manager’s values, therefore utilizing scales measurement can give contradictory results if organizations objectives are based on individuals objectives and not the other way around (Turker 2009, 415).

3.10 Measurability of CFP

In contradiction to measuring corporate social responsibility, measuring CFP is far more straightforward. Typically, corporate financial performance is measured with aggregate of financial ratios abstracted from financial statements, these include balance sheet and income statement among others. Measuring CFP is typically effortless, due to availability of financial statements and standardized and comparable numerical values. Businesses financial ratios can be compared within the industry to reveal financial health and growth between companies in specified timeframe (Kenton 2019).

3.1.5 Return On Assets

Return on assets (ROA) is a profitability ratio used to measure how well its generating profits compared to its resources. A higher number indicates a better utilization and efficiency of economic assets. It is typically used in comparison between different time periods or between similar companies in size and industry. Airline companies can be considered as asset-intensive, as more assets are required in order to generate profit. ROA has been used as a measure in several other researches regarding the relationship of corporate social responsibility and corporate financial performance (Orlitzky et al. 2003; Preston et al. 1997). Therefore, ROA is chosen for the research to create consensus to previous researches. The formula can be seen below in which the net income represents amount left after subtracting all costs related doing business in a specified timeframe.
Average assets is the amount of assets recorded in the same timeframe (Corporate Finance Institute).

\[ \text{ROA} = \frac{\text{Net Income}}{\text{Average Assets}} \]

### 3.1.6 Current Ratio

Current ratio is a short-term liquidity ratio which gives an indication if a company can cover its current liabilities with its current assets. It is a measure if a company is capable to cover its short-term obligations, such as accounts payable and taxes. To be counted as a current assets or liabilities, these need to transfer to cash within one year, such as inventory or short-term loans due within one year. As the current ratio is an indication of possible financial problems or improvements when compared to the industry standards, therefore it is included in the research. Ratio below 1 specifies that a company can have a problem covering its short-term obligations, therefore higher ratio indicates that a company is better maintaining liquidity. The formula is presented below in which current assets are divided with current liabilities (Peavler 2019).

\[ \text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} \]

### 3.1.7 Earnings Per Share

Earnings per share (EPS) is a market prospect ratio or profitability ratio which measures the amount of company’s net income earned for each outstanding share. The result represents the amount that would be distributed to each share end of the year in case of all profits were distributed. The results illustrate how profitable a company is from shareholder point-of-view, therefore EPS can be compared between different sized companies in the same in industry. As EPS is an efficient profitability ratio as it gives a fair indication of the company’s actual earnings. As EPS is commonly used by investors therefore chosen for the research as the ratio gives as indication what investors might think of the company as an investment. Higher the result indicates a more profitable company, although steady growth is considered as a more reliable investment. The calculation formula can be seen below, in which preferred dividends are subtracted from
net income which is then divided with the total amount of common shares outstanding (Corporate Finance Institute).

Earnings per Share = (Net Income – Preferred Dividends) / Weighted Average Common Shares Outstanding)

3.1.8 Price to Book Ratio

Price to book ratio or market to book ratio is a measure of company’s current market value in relation to its total book value. It indicates the market’s perception of a particular share’s value as well as it is an efficient indicator of the company’s current financial performance. This presents the reason why price to book ratio was chosen for the research. In addition, price to book ratio is sensitive to bigger scale market activities such as crashes (Lund 2019). Additionally, price to book ratio does not include goodwill, equity, know-how or other in-tangible assets in the calculations, even though these are considered to bring real value to the business (Borad 2019). The formula is shown below in which the market value is the current share price of all outstanding shares and the book value is the amount left if everything was liquidated and liabilities paid (Corporate Finance Institute).

Market to book ratio = Market Capitalisation / Total Book Value

3.11 Relationship between CSR and CFP

Detecting the relationship between CSR and CFP is problematic due to different perspectives in measurability. Two problems arise, first the lacking theoretical definition of CSR and secondly missing standardized and mandatory of CSR reporting.

As Freeman introduced his stakeholder theory in 1984, the relationship between CSR and CFP has received a lot of attention both from researchers and businesses. According to instrumental stakeholder theory relationship between CSR and CFP exists (Freeman 1984; Donaldson & Preston 1995; Jones 1995). It is mandatory for corporate financial performance that various stakeholder groups are satisfied (Donaldson & Preston 1995), although to do so, it requires the foundation from Carroll’s CSR pyramid, the business
must be profitable. Shared value theory also suggest the same, it must be profitable for businesses to invest in CSR, as financially unsustainable business is not able to create shared value or invest CSR if it does not create value for them (Porter & Kramer 2011). Research conducted by Preston and O’Bannon (1997) acknowledged six different hypotheses for the relationship between corporate social responsibility and corporate financial performance. Social impact, Slack resources, Trade-off, Managerial opportunism, Positive synergy and Negative synergy. These hypotheses will be presented in the below subheadings.

3.1.9 Social Impact

The social impact hypothesis concludes that understanding and fulfilling the needs on different stakeholders will have a positive impact on financial performance, this hypothesis functions also the other way around and therefore if the needs of the stakeholders are not met it will have a negative impact on financial performance. Additionally, this hypothesis proposes a lead-lag relationship, in which the social performance and fulfilment will occur first, and the financial performance will then follow (Preston & O’Bannon 1997).

3.1.10 Available Funds

Available funds hypothesis propose that a positive relationship exists but it is a lead-lag relationship, in which the financial performance will come first and the social performance will follow. This means that a company might have more available resources to invest in socially responsible activities if their financial performance and economic position is improving (Preston & O’Bannon 1997).

3.1.11 Trade-off

The trade-off hypothesis suggests that there is a negative relationship exists. As investments towards CSR, will make the financial performance to decline and vice versa. This hypothesis therefore suggests that there are financial costs for the company if they engage in socially responsible activities and financial performance will decrease if compared to competitors (Preston & O’Bannon 1997).
3.1.12 Managerial Opportunism

Managerial opportunism proposes that managers might reach for their personal objectives with the expense of different stakeholders. The hypothesis assumes that high financial performance will lead to low social performance, as the managers want increase their own private profits. Whereas, low financial performance will lead to high social performance, as managers want to hide or justify the weakening financial performance (Preston & O’Bannon 1997).

3.1.13 Positive Synergy and Negative Synergy

Positive synergy assumes that high CSR will lead to higher level of financial performance, which creates additional resources that could be invested in socially responsible activities. Whereas, negative synergy proposes that high level corporate social performance will lead to lower level of financial performance, therefore limiting the future investment on CSR (Preston & O’Bannon 1997).

3.12 Positive Relationship of CSR and CFP

One significant research contributing to detecting the relationship of CSR and CFP has been conducted by Marc Orlitzky, which is a meta-analytic evaluation and aggregating quantitative studies of the relationship of CSR and CFP. Meta-analytic research method allows broader and detailed evaluation of previous publications regarding CSR and CFP, while correcting statistical research findings such as sampling errors (Orlitzky et al 2003; Schmidt & Rynes, 2003, 404). The meta-analysis proves that positive relationship between CSR and CSP exists, in addition it strengthens causality of previous researches. As well overturns some researches that has found negative relationship, as the research proves that the relationship of CSR and lagged CFP is not negative, but in reality they seem to endorse each other, as companies with high corporate social responsibility has high corporate financial performance. On the other hand, companies with high financial performance has more resources to invest in corporate social performance (Orlitzky et al. 2003, 424).

Allouche and Laroche (2014) conducted a meta-analysis of the relationship of CSR and CFP as well, which also included much newer literature reviews and researches than
Orlitzky’s research. The research’s results support Orlitzky’s conclusions and states that strong evidence of positive relationship exists (Allouche & Laroche 2014, 22).

Many academic reviews that have found a positive relationship between CSR and CFP are consistent with the stakeholder theory, in which businesses success and failure is dependent on stakeholders. Satisfactory relationship with different stakeholders can create a competitive advantage and therefore improve the financial performance of a business. This is summarized in social impact hypothesis, as meeting the needs of different stakeholders will lead to better financial performance (Preston & O’Bannon 1997, 421).

One area of stakeholder theory is employees, which is the focus are of multiple research reviews supporting the positive relationship of CSR and CFP. Employee satisfaction is related to the financial performance of the company, as satisfied employees are more motivated to perform better as well as provide better customer service and be innovative resulting in higher sales. Employee-friendly companies were researched in 2014, they provide better work-life balance which affect employee work satisfaction and performance. The results indicate that employee-friendly companies have higher return on both assets and equity, in addition they are less risky compared to other companies (Blazovich, Smith & Smith 2014).

Positive relationship can be explained with business reputation as well. Businesses investing in CSR are more likely to have a higher reputation among customers, which affect financial performance indirectly, as good reputation may affect in customer loyalty (Graafland et al. 2006, 4,10). Corporate social responsibility is highly related to brand building, as it can be used to build a better reputation. A research made in 2005 of brand dominance, suggest that customers evaluate products based on businesses CSR associations (Berens, Bruggen & van Riel 2005). In addition, business who have high CSR performance are able to build a safeguard again CSR scandals, as consumer are more likely to support high CSR companies in case of a scandal rather than low CSR companies (Sickler 2017).
3.13 Negative Relationship of CSR and CFP

Brammer, Brooks & Pavelin argued that there is a negative relationship between CSR and CFP exits (2006). The study was conducted using stock returns as a measure and summarized that businesses with high CSR typically reach lower returns whereas, businesses with low CSR often exceeded the market expectations. The finding was explained mainly from the behavioural point-of-view, as shareholders have altruistic motives. These shareholders do not expect such high returns when in contradiction they only want to support businesses that are socially responsible therefore willing to give up high return expectations. In addition, the research further explained that investors see CSR as an expense that have negative affect on the cash flow (2006).

Makni acknowledged a negative relationship when considering environmental and employee aspects (2009). The research summarized that in short-term high social performance in environmental and employee aspects doesn’t generate big enough profits for the business to be considered as a profitable investment. Yet, these results were found with short-term measure, it is explained that high social performance in the long-term should eventually generate profits (Makni, Francoeur & Bellevance 2009).

3.14 CSR Scandals

A corporate social responsibility scandal can be defined as a set of unethical, illegal or otherwise questionable actions by a company or by a company representative. These actions commonly catch a lot of public attention, both from social media and news agencies (Business Dictionary). As the theory linkage between corporate scandals and financial responsibility is weak, this chapter will further represent the causality between these two matters from example point of view.

From the CSR scandals that have occurred around the world, it is possible to detect different types of scandals. First scandals are usually either financial scandal such as accounting scandal or non-financial scandal such as product safety or customer relations scandal. Next the scandals are divided based on characteristics, therefore three of the biggest types of scandals are accounting, environment and customer service to which majority of corporate scandals belong to. The first one is accounting scandal or fraud in
which corporations or company executives intentionally manipulate financial data usually to achieve some kind of monetary benefit. Accounting scandals commonly deceive multiple stakeholder groups, therefore impacting society broadly. The second one is environmental scandals; these scandals have an impact on the natural environment, such as Volkswagens emission scandal. The third one is customer service scandal in which corporations neglect their responsibility towards customers, and compromises the customer well-being and satisfaction with their own actions and procedures.

In order to visualize the consequences of CSR scandals, one example is the BP’s oil drilling rig Deepwater Horizon, which exploded 2009 killing 11 and injuring 17 workers, while creating an environmental scandal as oil spilled into the Gulf of Mexico, which had major consequences for the sea life and fishing industry. BP’s share price dropped by 54%, and the company was banned for bidding on federal contracts for two years. Fees related to the scandal was 65 billion U.S. dollars (Pallardy 2019).

Another example of a CSR scandal goes back to the 1990’s as Nike was accused of systematic and abusive labour practises in sweatshops. Massive media rally against Nike began, and in 1998 financial consequences started as with falling share prices (Cushman 1998). As a result, Nike acknowledged the problem, took responsibility of it and started to take action in order to improve their practises. Due to their public response to the issue, it has been suggested that it was the reason why Nike was able to recover from the scandal so well (Texin 2016).

Enron’s corporate scandal took place in 2001, in which company’s executives took advantage of their high positions in the company and committed accounting frauds, in order to falsify financial statements and increase profits. In December 2001 the company went into bankruptcy and 16 of their executives were sentenced to prison. Arthur Andersen was an accounting firm, they provided Enron auditing services, consulting and internal auditing. After the scandal the company was found guilty of criminal charges and voluntarily surrendered their accounting licences (Newton 2006 p. 2-4). In addition, banks who loaned money to Enron were sued, and agreed to pay compensation for investors for over 7 billion U.S. dollars (Frayter 2008).
Corporate scandals usually have significant effect on a business brand image. For example, YouGov BrandIndex measured consumer perception after Volkswagen’s emission scandal. The results can vary from -100 to 100, zero is neutral position to the brand. For example, score of 50 means that 50% more individuals said they have more positive perception for the brand than negative. After the scandal the rate was -2, whereas the score has usually been around 10 for Volkswagen (Marzilli 2015).

### 3.1.14 Occurrence of CSR Scandals

Reasoning for why corporate scandals occur can be multidimensional and in some cases there is not one particular reason, as some scandals can be a result of a multiple different steps. Newton (2006) argued that people are the reason why corporate scandals occur, not systems, although systems are invented and modified by people, who usually benefit from the corporate frauds as well. In addition, Newton states that personal characteristics and ethics are the main reason why people have decided to act against the corporate guidelines and education to commit frauds (Newton 2006).

Corporate scandal occurrence has been researched, and the main focus point has been individual’s personality traits. A research conducted in 2013, found that narcissistic personality traits had led the CEO’s to participate in illegal activities, such as falsifying financial statements. Narcissistic people usually need praises from others and will do almost anything to achieve their goals (Rijsenbilt & Commandeur 2013). Tendencies to greed and cooperation are hardwired to us, therefore knowledge and education plays a significant role in occurrence of corporate scandals (Newton 2006, 23).

Profitability expectations and pressures affect businesses to participate in unethical business actions (Mishina, Dykes, Block & Pollock 2010). Although, it has been stated that some individuals participate in illegal activities only because they have the opportunity. A company’s top management, such as CEO’s has little resistance over the corporation, which can lead to more opportunities to commit a fraud (Watts, Maniam & Leavell 2018). However, without generalisation there have been multiple CSR scandals occurring due to wealthy businessman who had responsible positions in companies (Newton 2006, 1).
In order for a corporate scandal to take place, regulatory foundation is missing from the corporation’s side in order to prevent frauds and detect them at an early phase. However, internal audits, formal safeguards and employee training plays a significant role in occurrence of corporate frauds.

### 3.1.15 Preventing CSR scandals

In conclusion CSR scandals can cause a lot of harm to businesses and in order to prevent corporate scandals from rising, education of ethical standards and corporate governance is crucial for all employees from the blue collar, until the top management. Dolson (2018) suggests that business ethics and ethical training is critical in order to attain success and longevity for all corporations, for employees to understand the corporation’s social responsibility as well.

Newton (2006) suggests that it is crucial that everyone “knows the stories”, referring to previous corporate scandals. People should be educated but also have the knowledge and understanding of previous scandals that have occurred. It is a good learning for people to acknowledge corporate scandals and their consequences for the whole society.

As looking in to Carroll’s CSR pyramid, the second obligation for businesses is to obey the law, which was not the case in corporate scandals. Therefore, Newton (2006), suggests that law and economy must be a reflection of society’s interest and actual needs, consequently society must reform a legal framework that will restrain businesses participating in any harmful operations. It is crucial that no matter how rich someone is, everyone should abide the law (Newton 2006).

Education is a significant factor affecting occurrence of corporate scandals. Investment in comprehensive technical education and business competence will assist on extracting incompetence. With better education, the world is able to learn from the past and move forward to a better society (Newton 2006).

In addition, businesses are able to support the previous guidelines with their own policies, such as functional employment practises, monitoring the company culture, employee segregation and risk management (Laitala 2014). Auditing is one of the measures to
prevent scandals from occurring. The audit process evaluates effectiveness of internal controls. It is critical for achieving business objectives, as well as for reliable financial reporting and preventing frauds. Internal control is to prevent and detect frauds from happening, and to modify business operations in such ways frauds cannot occur without detection. In addition, reputation of solid audit system and internal control itself can be counted as preventive measure as well (Clement 2019). Businesses should develop formal safeguards and publicly endorse these safeguards on a regular basis, in addition to employee training.

3.1.16 Recovering from CSR Scandals

Research made in response to CSR scandals and Nike’s recovery from a corporate scandal, suggests that there are three significant factors how companies could recover from corporate scandals. First is taking responsibility and publicly acknowledging the scandal, as for Nike the CEO understood that there is a problem and thereafter they were able to move forward addressing the issue (Texin 2016). It is seen as an important step to acknowledging the problem and taking full responsibility rather than avoiding the truth (Loh 2017).

Second is taking action to improve the problem, as Nike started to implement similar working practises in Asia as they do in the U.S. (Texin 2016). In addition, research review on corporate scandal recovery states, that after a scandal it is crucial to steadily implement a strong corporate governance and move forward towards better corporate culture (Loh 2017).

The third factor is being transparent with all practices and wanting to be held accountable for their actions, as Nike learned from their scandals and now continues to publish information of all of their manufacturing locations (Texin 2016). Loh (2017) suggests the same, transparency is the key to determine success.

Companies implementing a socially responsible strategy are able to build a buffer against scandals, as media can fill up with articles of good deeds instead of negative and in addition consumers have more a positive image of companies who implement socially responsible strategy, but these efforts must be promoted by the company to public to raise
public awareness (Sickler 2017). CSR statistics suggests that 63% of the society would
rather support socially responsible companies than companies obviating social
responsibility in case of a crisis, therefore it can be said that socially responsible
companies could recover from CSR scandals, although if CSR is taken seriously by
businesses they should be more aware of the issues and problems that may arise as well
(Sickler 2018). To conclude, companies utilising corporate social responsibility to their
daily operations and seeing it as a carrot instead of stick-driven obligation are additionally
able to build a buffer against corporate scandals.

3.15 Theoretical Framework

Dahlsrud’s (2006) states that the most popular CSR definition is from the European
Commission: “A concept whereby companies integrate social and environmental
concerns in their business operations and in their interaction with their stakeholders on a
voluntary basis.” (Commission of the European Communities 2001). To clarify these
operations Carroll (1991) constructed a CSR pyramid in which main foundation for all
business is to be profitable. Next is legal responsibilities and thereafter ethical
responsibilities to do what is fair. At the top of the pyramid is philanthropic
responsibilities, or otherwise stated to be a “good corporate citizen”. Freeman (1983)
published his stakeholder theory which signifies that businesses successes and failures
are reliant on all stakeholders involved with the business therefore businesses are
responsible for all stakeholders and to create value as much as possible to these
stakeholders.

The relationship between corporate social responsibility and corporate financial
performance has been frequently studied, but the theoretical link between corporate
scandals and financial performance is still unclear. Preston and O’Bannon (1997)
discovered six different hypotheses of the relationship, from which the social impact
hypothesis states that understanding and fulfilling the needs on different stakeholders will
have a positive impact on financial performance, this hypothesis functions also the other
way around and therefore if the needs of the stakeholders are not met it will have a
negative impact on financial performance, in which the financial performance will follow
social performance.
Multiple research has been conducted which have found a positive relationship between corporate social responsibility and corporate financial performance (Orlitzky et al. 2003; Allouche & Laroche 2014). These researches supports the social impact hypothesis. In addition, the positive relationship has been explained with employee satisfaction, which is related to higher financial performance due to better customer service (Blazovich et al. 2014). However, business reputation and brand value affects the financial performance indirectly as it can result in customer loyalty (Graafland et al. 2006, 4,10; Berens et al. 2005).

Multiple factors can contribute to the recovery process of corporate scandals. Taking responsibility, implementing new procedures to improve operations and to avoid similar situation from happening again and being transparent of all business operations (Texin 2016; Loh 2017). However, business reputation and brand value have a significant effect on the recovery process (Sickler 2018). Multiple researches states that strong brands have an advantage compared to weaker brands in case of a corporate scandal (Brady et al 2008; Huang 2011).

Measurability of CSR is complex due to missing definition of CSR and as social responsibility activities are based on voluntariness, therefore the comprehensive measurability of CSR is challenging (Dahlsrud 2012; Galant & Cadez 2017). Corporate financial performance is usually measured with an aggregate of financial ratios. Profitability, liquidity and market prospect ratios are chosen for the research to get a comprehensive understanding to the company’s financial performance. Financial ratios chosen for the research are; return on assets, current ratio, earnings per share and price-to-book ratio.
4 EMPIRICAL RESEARCH METHODOLOGY

The empirical research section of this thesis studies how corporate scandal affects corporate financial performance. The selected company is United Airlines Holdings. This study utilizes financial ratios, such as ROA, EPS, Current Ratio and Book-to-Price ratios to reveal how the company is affected and how they are able to recover from the scandal. The main idea is to compare United Airlines Holdings to three other airline companies with above stated financial ratios. One corporate social responsibility scandal occurrence is chosen to be the basis of this research, which is then closer examined with the different types of financial ratios to reveal holistic outlook of the financial performance and disclose possible effects of a scandal.

4.1 United Airlines Holdings

United Airlines Holdings is a publicly traded airline holdings company under Nasdaq and they are one of the largest airlines in the world after company mergers besides American Airlines and Delta Air Lines (Lucky 2019). The case company was first known as a UAL Corporation but after mergers with United and Continental Airlines, they changed the name to United Continental Holdings. In June 2019 the parent company changed the name to United Airlines Holdings, Inc. The company and its subsidiaries owns numerous additional subsidiaries, from which the biggest is United Airlines. United Airlines and United Express operates 4900 flights daily, primarily in the U.S.A (United).

United Airlines has been the centre of a lot of controversy since 2017, due to various scandals. Since then several pets have died on plane, passengers have received unsatisfactory customer service and gotten kicked-off the plane. Again it is unclear in what extent United Airline Holdings are responsible, as some of these incidents might be a results of misunderstandings (News.com.au 2018).

The most significant scandal occurred in April 2017, in which one airline passenger was forcibly dragged off the plane after four airline employees needed seats on the plane. At the beginning, passenger David Dao volunteered to leave the plane, but after he heard the next flight was not until the following day, he refused to leave pleading that he has patients the next day and has to be at work. The airline managers offered travel vouchers
to volunteers but as no one volunteered, they were forced to select four passengers to deboard involuntarily. David Dao was the selected to be the fourth one but did not agree on leaving. Chicago Department of Aviation Security Officers were requested to remove David Dao from the plane, during the accident the officers were violent which ended up in David Dao getting injured with two cracked front teeth and a broken nose (Piacenza 2017).

Although overbooking policy is fully legal and United has the right to it but using violence towards customers is unlawful but also insensitive. The confrontation went immediately viral as other passengers filmed the incident and loaded the videos to social media and customers were disappointed how United handled the situation. Consumers started to despise United, with public protests and boycotting (BBC 2018). The scandal expanded as company CEO Oscar Munoz replied to the scandal with a company report, in which he described passengers as “disruptive and “belligerent” and did not see any problem with the company actions. The backlash began and thousands of people signed a petition for Munoz resignation. Munoz was forced to reply with a second apology. The passenger David Dao sued the company but the airline settled with him with undisclosed amount (Matousek 2018; BBC 2018).

Although, the backlash took some time to settle as United`s policy towards scandals was unsatisfactory and sluggish according to consumers. United started to make improvements. Full compensation was offered to all passengers on board, in addition to settlement with David Dao. United started a “Flex-schedule” program in which they inform and inquire in advance if passengers are willing to move their flight schedule for compensation (Popken 2017).

4.2 Data Collection

In order to find a solution for the research questions data must be gathered for an accurate conclusion to be drawn from the results. Data for the research is collected from different sources in order to rearrange the data to support the above defined financial ratios. Data is retrieved from various internet companies and sites that provide readily available financial data, financial ratios and news. Additionally, worldwide database Orbis is used to retrieve financial data and verify the data attained from other statistic sites.
4.3 Data Description and Reliability

To reveal the effects of a corporate scandal to financial performance, comparison companies must be assigned in such way that they support the accuracy of the research conducted. As United Airlines Holdings operates from the United States of America therefore complying by U.S. laws and regulations, such as Generally Accepted Accounting Principles. For the comparison companies only U.S. airlines are chosen for the research. In order for the financial ratios to reveal consistent data only airlines companies are chosen that are similar in size. Based on the information retrieved from Bureau of Transportation Statistics three airlines are chosen besides United Airlines: American Airlines, Southwest Airlines and Delta Air Lines (Bureau of Transportation Statistics)

Comparison companies were researched to solve if any corporate scandals have occurred in their operating history of the research time frame. As scandals with comparison companies could aggravate with the consistency of financial data. No scandals were detected that could have influenced the data reliability.
5 RESULTS

In this chapter, financial data is presented in yearly or quarterly form, the form is chosen to suit the financial ratios character, the format chosen is presented below in each subheading. Each year has four quarters therefore each consist of three months. The scandal occurred in April 9th 2017, therefore it is placed within the beginning of second quarter. Data is presented in the form of both table and chart. Additionally, data is analysed after each financial ratio to create a holistic view for the research section.

5.1 Return on Assets

In this section quarterly data for return on assets is presented from 2015 to the second quarter of 2019 for the research company as well for the comparison companies. In the table below the data is presented with the accuracy of two decimals, additionally the return on assets is presented as a percentage.

Table 1. Quarterly return on assets. (Ycharts; Orbis)

<table>
<thead>
<tr>
<th></th>
<th>United Airlines Holdings (UAL)</th>
<th>American Airlines (AAL)</th>
<th>Delta Airlines (DAL)</th>
<th>Southwest Airlines (LUV)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1/2015</td>
<td>5.94</td>
<td>7.49</td>
<td>2.61</td>
<td>7.02</td>
</tr>
<tr>
<td>Q2/2015</td>
<td>6.93</td>
<td>9.2</td>
<td>3.54</td>
<td>7.64</td>
</tr>
<tr>
<td>Q3/2015</td>
<td>16.79</td>
<td>10.67</td>
<td>5.32</td>
<td>8.85</td>
</tr>
<tr>
<td>Q4/2015</td>
<td>18.56</td>
<td>16.19</td>
<td>8.47</td>
<td>10.44</td>
</tr>
<tr>
<td>Q1/2016</td>
<td>17.72</td>
<td>15.27</td>
<td>8.86</td>
<td>10.48</td>
</tr>
<tr>
<td>Q2/2016</td>
<td>16.11</td>
<td>13.47</td>
<td>9.05</td>
<td>11.33</td>
</tr>
<tr>
<td>Q4/2016</td>
<td>5.52</td>
<td>5.13</td>
<td>8.06</td>
<td>9.71</td>
</tr>
<tr>
<td>Q1/2017</td>
<td>4.98</td>
<td>4.34</td>
<td>7.37</td>
<td>8.75</td>
</tr>
<tr>
<td>Q2/2017</td>
<td>5.5</td>
<td>4.12</td>
<td>6.71</td>
<td>8.29</td>
</tr>
<tr>
<td>Q3/2017</td>
<td>4.67</td>
<td>3.95</td>
<td>6.51</td>
<td>8.76</td>
</tr>
<tr>
<td>Q4/2017</td>
<td>5.13</td>
<td>2.44</td>
<td>6.16</td>
<td>13.95</td>
</tr>
<tr>
<td>Q1/2018</td>
<td>5.15</td>
<td>2.08</td>
<td>6.08</td>
<td>14.2</td>
</tr>
<tr>
<td>Q2/2018</td>
<td>4.75</td>
<td>1.5</td>
<td>5.71</td>
<td>13.86</td>
</tr>
<tr>
<td>Q3/2018</td>
<td>5.13</td>
<td>0.9</td>
<td>5.92</td>
<td>13.88</td>
</tr>
<tr>
<td>Q4/2018</td>
<td>4.82</td>
<td>2.5</td>
<td>7.09</td>
<td>9.47</td>
</tr>
<tr>
<td>Q1/2019</td>
<td>4.96</td>
<td>2.5</td>
<td>7.19</td>
<td>9.08</td>
</tr>
<tr>
<td>Q2/2019</td>
<td>5.57</td>
<td>2.61</td>
<td>7.68</td>
<td>9.05</td>
</tr>
</tbody>
</table>
Return on assets forms from net income which is divided with average assets, it gives an indication how well a company is able to utilize their assets in order the create income. Declining ROA can either mean decreasing sales resulting in lower net income or declining usage of company assets (Vaidya).

Analysing the quarterly return on assets for United Airline Holdings while comparing the results with the comparison companies. Return on assets for United Airlines Holdings has been consistent through the years with the comparison companies. ROA for UAL in first quarter of 2017 was 4.98 and 5.6 for second quarter. UAL was able to increase their return on assets after the scandal although comparison companies ROA has decreased in average with 0.4 during the same time frame. Although, return on assets for UAL at the end on third quarter plummeted to 4.67. No direct changes in return on assets have occurred or cannot be detected from the data during or after the scandal.

In below chart quarterly return on assets data has been imported from the above table. In the chart development of return on assets can be seen in a visual form. The progress of ROA for United Airlines Holdings during and directly after the scandal is moderate in both directions. To further explore the ROA’s development into longer time frame after the scandal, UAL has been consistent with the development of return on assets and no irregularities can be detected from the data.

Figure 2. Quarterly return on assets.
5.2 Price-to-Book

In this section price to book ratio is described in a quarterly format starting from the beginning of 2015 until the second quarter of 2019. Price-to-book ratio is presented with the accuracy of two decimals.

Table 2. Quarterly price-to-book. (Stockrow; Macrotrends)

<table>
<thead>
<tr>
<th></th>
<th>United Airlines Holdings (UAL)</th>
<th>American Airlines (AAL)</th>
<th>Delta Air Lines (DAL)</th>
<th>Southwest Airlines (LUV)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1/2015</td>
<td>2.38</td>
<td>13.30</td>
<td>3.67</td>
<td>4.33</td>
</tr>
<tr>
<td>Q2/2015</td>
<td>4.91</td>
<td>7.61</td>
<td>3.67</td>
<td>3.07</td>
</tr>
<tr>
<td>Q3/2015</td>
<td>2.38</td>
<td>6.93</td>
<td>3.45</td>
<td>3.81</td>
</tr>
<tr>
<td>Q4/2015</td>
<td>2.38</td>
<td>4.74</td>
<td>3.67</td>
<td>3.81</td>
</tr>
<tr>
<td>Q1/2016</td>
<td>2.74</td>
<td>5.25</td>
<td>2.97</td>
<td>3.66</td>
</tr>
<tr>
<td>Q2/2016</td>
<td>2.66</td>
<td>6.34</td>
<td>2.97</td>
<td>3.17</td>
</tr>
<tr>
<td>Q3/2016</td>
<td>2.00</td>
<td>6.34</td>
<td>2.97</td>
<td>2.99</td>
</tr>
<tr>
<td>Q4/2016</td>
<td>2.66</td>
<td>6.34</td>
<td>2.97</td>
<td>3.66</td>
</tr>
<tr>
<td>Q1/2017</td>
<td>2.63</td>
<td>6.17</td>
<td>2.59</td>
<td>4.05</td>
</tr>
<tr>
<td>Q2/2017</td>
<td>2.34</td>
<td>6.60</td>
<td>2.93</td>
<td>4.40</td>
</tr>
<tr>
<td>Q3/2017</td>
<td>2.05</td>
<td>5.89</td>
<td>2.49</td>
<td>3.80</td>
</tr>
<tr>
<td>Q4/2017</td>
<td>2.34</td>
<td>-31.33</td>
<td>3.23</td>
<td>4.05</td>
</tr>
<tr>
<td>Q1/2018</td>
<td>2.27</td>
<td>-23.61</td>
<td>2.92</td>
<td>2.63</td>
</tr>
<tr>
<td>Q2/2018</td>
<td>2.28</td>
<td>-19.95</td>
<td>2.73</td>
<td>2.98</td>
</tr>
<tr>
<td>Q3/2018</td>
<td>2.52</td>
<td>-33.33</td>
<td>2.86</td>
<td>3.46</td>
</tr>
<tr>
<td>Q4/2018</td>
<td>2.27</td>
<td>-87.28</td>
<td>2.50</td>
<td>2.63</td>
</tr>
<tr>
<td>Q1/2019</td>
<td>2.20</td>
<td>-22.18</td>
<td>2.74</td>
<td>2.95</td>
</tr>
<tr>
<td>Q2/2019</td>
<td>2.25</td>
<td>-660.12</td>
<td>2.71</td>
<td>#N/A</td>
</tr>
</tbody>
</table>

Price to book or market to book ratio is a forward looking market valuation ratio. It compares the current market price or the value market places on the stock to the company’s book value of the stock. Therefore, is combines investors’ expectations with actual accounting valuations. A higher ratio is usually an indication of more overvalued stock, additionally, if price-to-book ratio is below 1 the stock is considered to be undervalued and it is possibly a good investment.

The price to book ratio for United Continental Holdings before the scandal in Q1 was 2.63, therefore dropped 0.03 points from fourth quarter of 2016. After the scandal the ratio plummeted to 2.34 which represents decline of 0.29 points. In comparison, the other
airline companies price to book ratio increased in average with 0.37 points from first quarter to second quarter of 2017. Additionally, all airline companies except American Airlines the price to book ratio has been somehow stable between the years 2015 and 2019.

The decrease in price-to-book ratio for United Airline Holdings can explicate that the market has believed the assets value is overstated and the scandal has effected the businesses financial performance. Share price development is usually based on the supply and demand theory; therefore, price goes down if less people are willing to buy it (Little 2018). As looking at the stock price development for UAL, stock price plummeted with 4% on Tuesday 11 of April 2017, after the scandal occurring on Sunday and CEO’s company report published on Monday (Shen 2017), this can be the major reason behind the decline of price to book ratio. Against the odds, the share prices of Southwest Airlines and Delta Air Lines dropped as well with 1% on Tuesday 11 of April, but this decline cannot be detected from the research data (Shen 2017).

The below chart is derived from the above table and it visualises the valuations with in the same timeframe, and from the chart were are able to detect the decrease during the scandal due to share price decline of UAL. By the end of 2017 the price-to-book ratio for UAL increased back to 2.34, after two quarters decline.

**Figure 3.** Quarterly price-to-book.
5.3 Current Ratio

In this section financial data is described in quarterly format, starting from the beginning of 2015 until the second quarter of 2019. The data is presented in both table and chart format. Current ratio is presented with the accuracy of three decimals due to only slight deviations.

Table 3. Quarterly Current Ratio (Stockrow).

<table>
<thead>
<tr>
<th></th>
<th>United Airlines Holdings (UAL)</th>
<th>American Airlines (AAL)</th>
<th>Delta Air Lines (DAL)</th>
<th>Southwest Airlines (LUV)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1/2015</td>
<td>0.681</td>
<td>0.993</td>
<td>0.708</td>
<td>0.719</td>
</tr>
<tr>
<td>Q2/2015</td>
<td>0.637</td>
<td>0.938</td>
<td>0.670</td>
<td>0.668</td>
</tr>
<tr>
<td>Q3/2015</td>
<td>0.749</td>
<td>0.968</td>
<td>0.680</td>
<td>0.646</td>
</tr>
<tr>
<td>Q4/2015</td>
<td>0.631</td>
<td>0.734</td>
<td>0.517</td>
<td>0.646</td>
</tr>
<tr>
<td>Q1/2016</td>
<td>0.540</td>
<td>0.707</td>
<td>0.514</td>
<td>0.554</td>
</tr>
<tr>
<td>Q2/2016</td>
<td>0.561</td>
<td>0.750</td>
<td>0.470</td>
<td>0.517</td>
</tr>
<tr>
<td>Q3/2016</td>
<td>0.601</td>
<td>0.760</td>
<td>0.484</td>
<td>0.619</td>
</tr>
<tr>
<td>Q4/2016</td>
<td>0.595</td>
<td>0.744</td>
<td>0.489</td>
<td>0.657</td>
</tr>
<tr>
<td>Q1/2017</td>
<td>0.610</td>
<td>0.695</td>
<td>0.431</td>
<td>0.625</td>
</tr>
<tr>
<td>Q2/2017</td>
<td>0.607</td>
<td>0.684</td>
<td>0.432</td>
<td>0.612</td>
</tr>
<tr>
<td>Q3/2017</td>
<td>0.602</td>
<td>0.653</td>
<td>0.429</td>
<td>0.615</td>
</tr>
<tr>
<td>Q4/2017</td>
<td>0.559</td>
<td>0.569</td>
<td>0.412</td>
<td>0.702</td>
</tr>
<tr>
<td>Q1/2018</td>
<td>0.584</td>
<td>0.569</td>
<td>0.386</td>
<td>0.670</td>
</tr>
<tr>
<td>Q2/2018</td>
<td>0.630</td>
<td>0.550</td>
<td>0.397</td>
<td>0.701</td>
</tr>
<tr>
<td>Q3/2018</td>
<td>0.634</td>
<td>0.581</td>
<td>0.370</td>
<td>0.714</td>
</tr>
<tr>
<td>Q4/2018</td>
<td>0.513</td>
<td>0.477</td>
<td>0.341</td>
<td>0.636</td>
</tr>
<tr>
<td>Q1/2019</td>
<td>0.496</td>
<td>0.436</td>
<td>0.337</td>
<td>0.629</td>
</tr>
<tr>
<td>Q2/2019</td>
<td>0.554</td>
<td>0.489</td>
<td>0.337</td>
<td>#N/A</td>
</tr>
</tbody>
</table>

Current ratio gives an indication of the company’s ability to pay short term debt obligations by liquidating current assets. Higher current ratio is seen as a more favourable situation, although usually a ratio of 1 is seen as a minimum, as a ratio below 1 signifies that a company has more short term liabilities than assets. While analysing the current ratio, industry conditions and circumstances should always be taken into consideration (Bragg 2018), therefore as analysing the above data, current ratio for all airline companies are equally in the level taking into consideration industry modifiers.
The current ratio for United Airlines Holdings before the scandal at the end of the first quarter of 2017 was 0.61 which represents a slight increase from the previous quarter. After the occurrence of the scandal the current ratio experienced a slight drop to 6.07. For UAL the drop was 0.003 points, whereas the average decline for all four companies was 0.0065 points from the first quarter to the second quarter of 2017. Often the decline in current ratio signifies that companies’ ability to generate cash is declining (Bragg 2018).

In the below table we are able distinguish the decline on current ratio for all of the companies. The development of current ratio has been stable for all four airline companies during the scandal, however for United Airlines Holdings the current ratios decline has been the minor.

**Figure 4.** Quarterly current ratio.

5.4 Earnings Per Share

In this section earnings per share is presented in annual format, starting from 2013 until the year 2018. The annual format is chosen to ensure data reliability as companies regularly issue new shares and buy back treasure shares during the year, therefore annual
data provides the most reliable basis for data comparison. The data is presented in both table and chart format, with the accuracy of two decimals.

Table 5. Annual earnings per share (Macrotrends).

<table>
<thead>
<tr>
<th>Year</th>
<th>United Airlines Holdings (UAL)</th>
<th>American Airlines (AAL)</th>
<th>Delta Air Lines (DAL)</th>
<th>Southwest Airlines (LUV)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>1.53</td>
<td>-6.54</td>
<td>12.29</td>
<td>1.05</td>
</tr>
<tr>
<td>2014</td>
<td>2.93</td>
<td>3.93</td>
<td>0.78</td>
<td>1.64</td>
</tr>
<tr>
<td>2015</td>
<td>19.47</td>
<td>11.07</td>
<td>5.63</td>
<td>3.27</td>
</tr>
<tr>
<td>2016</td>
<td>6.76</td>
<td>4.65</td>
<td>5.55</td>
<td>3.45</td>
</tr>
<tr>
<td>2017</td>
<td>7.06</td>
<td>2.61</td>
<td>4.43</td>
<td>5.57</td>
</tr>
<tr>
<td>2018</td>
<td>7.7</td>
<td>3.03</td>
<td>5.67</td>
<td>4.29</td>
</tr>
</tbody>
</table>

Earnings per share indicates the amount of companies’ income divided for each share of common stock. It is generally used by investors to determine a company’s profitability. Higher earnings per share is commonly a more favourable from investor point-of-view but at the same time higher EPS can cause the share price to increase also due to the theory of supply and demand.

The annual data for United Airlines Holdings reveals that in 2016 earnings per share was 6.76 and in 2017 it was 7.06. Additionally, earnings per share continued its stable increase, as in 2018 it was 7.7 for UAL. Comparing UAL’s data to the other airlines at the same time frame, we are able to conclude that EPS has been consistent, although UAL is also performing relatively better than the comparison companies within the earning per share indicator.

In the below table visualises the position for earning per share for the past six years. From the table we can see a stable development for the past three years for all of the airline companies. United Airlines Holdings better performance for the earnings per share metric compared to the other airline companies can be detected as well.

Figure 5. Annual earnings per share.
EARNINGS PER SHARE

United (UAL)
American (AAL)
Delta (DAL)
Southwest

UAL Scandal

2013 2014 2015 2016 2017 2018

-7 -2 0 3 8 13 18

United (UAL)
American (AAL)
Delta (DAL)
Southwest
6 CONCLUSION

Corporate social responsibility is a growing topic among many companies, as stakeholders raising awareness of social responsibility creates higher expectations and additional pressure for companies, although improving financial performance due to utilizing corporate social performance is under analysis. The world has developed in to the extent that every mistake and scandal will be instantly shared to the society with the help of social media and other networks. As there have been multiple examples of corporate scandals, such as Volkswagens emission scandal which had a significant impact on their brand image.

The relationship between corporate social performance and corporate financial performance is still under a slight controversy, as researches in this field are missing a cohesion between each other as well as the missing satisfactory definition of CSR and the differences between the measurability of CSR and CFP aggravates the research findings. However, corporations that utilize and combine corporate social responsibility to their normal operations as a routine are able to see it as an advantage rather than a punishment (Tool & Broomes).

This study was to find out the effects on corporate social responsibility scandals on financial performance, as well what factors contribute to the recovery from such scandals. This thesis presented the main theories and previous researches among this topic. The study then proceeds to the empirical part of the research in which the key ratios of case company United Airline Holdings is compared against three other airline companies. Financial performance is measured with key ratios. The key ratios are analyzed based on the time frame of the scandal of United Airline Holdings.

6.1 Main Findings

The financial performance after a corporate scandal for the case company United Airlines Holdings was measured with an aggregate of key ratios. Four key ratios were chosen for the research in order to reveal a comprehensive insight to the financial performance. Return on assets is a profitability ratio. Price-to-book ratio is a market based
measurement. Current ratio is a liquidity ratio and earning per share is a market prospect ratio.

With the return on assets measure the research detected only a minor decrease during the third quarter, but during the fourth quarter increased back to same counts that preceded the scandal. But no direct effect on return on assets after the scandal on the second quarter was detected from the data. The small decline in return on assets during the third quarter is a result of a declining sales revenue, which was mostly due to a rough weather conditions and cannot be directly associated with the scandal (United Airlines 2017).

Price-to-book data revealed a decrease for UAL after the scandal, as price-to-book ratio plummeted with 0.29 point after the scandal, whereas the comparison companies’ price-to-book ratio increased at the same time. The decrease in price-to-book ratio is a result of a stock decline directly after the scandal, as the shares fell approximately 4%, which resulted in loss of 1 billion U.S. dollars in market value (Cox 2017). The reason for the stock plunge was that investors quickly responded to the scandal and to the company’s response to the scandal, as supply and demand –theory largely defines the share prices. This finding is in line with the previous researches that found a positive relationship between CSR and CFP (Preston & O’Bannon; Orlikzky et al. 2003; Allouche & Laroche 2014). However, the effects on the stock decline were not long-term, as Piazenca (2017) concludes that United Airline Holdings recovered from the scandal within six months, as stock, financial performance and customer expectations stabilized.

Current ratio measure disclosed a small decrease for United Airline Holdings after the scandal on the second quarter, however UAL performed slightly better than the comparison companies. The decrease is an indication on declining ability to generate cash, but no conclusion can be made based on current ratio measure as the comparison companies current ratio declined as well. Therefore, the decline can be a result of an industry typical complexity. One example for this could be the fuel costs that has received a lot of controversy during the recent years (Burbaite 2018).

Finally, the earnings per share measurement was studied based on the annual financial data, whereas the other key financial ratios were analysed based on quarterly data. The key ratios indicate a slightly better performance for United Airline Holdings than for the
comparison companies. As United Airline Holdings stable increase on the earnings per share ratio is a positive concern from the investors point of view. However, no conclusion between the financial performance on the earnings per share measure and the scandal can be made as the data is in annual format. As Piazenca (2017) concluded, the effects of the scandal stabilized after six months therefore the annual data should reflect all fluctuations due to the scandal and no long-term effects can be detected.

To conclude the above, no significant long-term financial performance decline can be detected for United Airline Holdings due to the corporate scandal. Only a slight decrease in financial performance was detected from the research data, these declines can be detected immediately after the scandal in the second and third quarter. Industry experts reveals the reasoning behind why no long-term effects occurred for UAL, as consumer’s low customer service expectancies towards airlines has been suggested to be one reason why the scandal was forgotten quite rapidly, although United Airline Holdings owns certain airline routes and hubs therefore making it impossible for consumers to avoid the company. Even though market monopolization is an effective motive, price is considered to be market equalizer for consumers. Research made in 2017 suggest that consumers make decisions based on their wallets, not their hearts (Piacenza 2017).

However only a slight similarity on the scandal’s impacts financial performance between the research and previous researches can be detected. The reasoning is tangible, as airline industry is somewhat unreachable for the society and consumers to aggravate. The occurrence of the scandal is however in line with the Newton’s (2006) theories that suggest that people are the reasoning why scandals can occur. As for United Airline Holdings, the scandal occurred as the personnel and company procedures allowed it to happen. Additionally, also the company CEO made matter worse by publishing a vague company report. Therefore, it remains uncertain what are the consequences of the incident and what are the consequences of the CEO’s initial statement to the scandal, therefore one might wonder what would have been the effects if the company CEO would have acknowledged the problem immediately without having to publish several statements.

The recovery process can be explained with strong brand equity, as United Airline Holdings is a one of the leading corporations in the airline business with a worldwide
brand recognition. Multiple researches states that strong brand equity gives an advantage over smaller brands in case of corporate scandals and in the recovery process. Customers tends to trust more on strong brands as well as it reduces customer uncertainty, therefore weaker brands are more sensitive to corporate scandals (Brady et al 2008; Huang 2011; Sickler 2017).

As expressed previously, the reasoning why no long-term effect on the financial performance for UAL occurred represents also the motive how the company was able to recover from the scandal. Additionally, after the company CEO acknowledged the problem and published a public apology the company was able to start the recovery. United Airline Holdings also started to implement new procedures and customer service improvements in order to avoid such situations from happening again (United Airlines 2017). These steps taken by UAL are in line with the previous researches (Texin 2016; Loh 2017). Although, against the research made by Texin (2016) which suggest that strong corporate governance and concrete improvements on the operational level is required, which might be still missing from United Airline Holdings customer service side.

Carroll’s CSR pyramid suggests that the basis of a company is economic and legal responsibilities. UAL’s operations support these two bottom factors, as UAL’s financial performance has been stable and they have been able to improve their profitability, additionally UAL has fulfilled their legal responsibilities, whereas, according to the scandals ethical and philanthropic responsibilities are missing from UAL’s side. As United Airlines Holdings disappointed the society with the customer service scandal, it supports the social impact hypotheses, as it assumes that meeting the needs of different stakeholders will improve financial performance, and as short-term decline in financial performance occurred for UAL.

6.2 Limitations and Future Research

The most significant limitation for this research was the restricted access to financial databases, from which reliable financial data would have been attained clearly. Therefore, additional procedures were needed to ensure data reliability. As the financial data was
retrieved from different websites, they were compared against each other and to the financial data from the database Orbis in order to ensure the data is correct and comparable. Orbis database provides only annual financial data, therefore it did not suit the research objectives and could be only used for one key ratio analysis. The limitation for the accessible financial database represented also a limitation for the research scope and therefore only four airline companies could be chosen for the research in order to ensure data reliability and to avoid too broad research scope.

As the relationship between corporate social responsibility and financial performance exists, this research aimed to reveal the relationship between a corporate scandal and financial performance. Although the relationship exists the airline industry characteristic had a significant effect on the magnitude of the consequences. Therefore, to further research the topic, another industry could be chosen for the research to reveal industry specific consequences. Additionally, if access to a larger financial database the future research could also be conducted for a larger quantity of businesses, in order to get a more comprehensive and reliable view of the relationship between corporate scandal and corporate financial performance and possible consequences.
REFERENCES


http://www.businessdictionary.com/definition/corporate-scandal.html


Corporate Finance Institute. The importance of investor relations. Accessed 11.5.2019
https://corporatefinanceinstitute.com/resources/careers/jobs/role-of-investor-relations-ir/

https://corporatefinanceinstitute.com/resources/knowledge/finance/return-on-assets-roa-formula/

https://corporatefinanceinstitute.com/resources/knowledge/finance/earnings-per-share-eps-formula/

https://corporatefinanceinstitute.com/resources/knowledge/finance/quick-ratio-definition/


