

Corporate Social Responsibility -does it make good business

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Abstract

This paper tries to establish the advantages and disadvantages of CSR from a strategic point of view. What does academic research tell about the overall financial impact of Corporate Social Responsibility? It is found out that current empirical research doesn't tell us anything of interest because of the heavy criticism of its methods. Along with the heavy difficulties of measurement, one major point of criticism is that the current research doesn't control for R&D expenditures which seems to be an underlying factor explaining the correlation. Additionally, the CSR should be divided into two different categories: stakeholder management and social issues. Of these, the former is positively correlated to CFP while the latter is negatively. Direction of causality is also an unsolved question with slack resources resulting from better financial performance explaining large part of the positive relationship. As general relationship discussion is unable to tell anything of interest, a different approach for accessing the level of CSR for a company is represented. McWilliams' and Sieglar's Demand-Supply model of CSR seems to be a more fruitful method for accessing the proper level of company's Corporate Social Responsibility.

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1 Introduction

Corporate Social Responsibility (CSR) has over the last ten years gained increasing amount of attention in business world. As writing this the current number of the Economist features CSR as its cover story (Economist 28th January 2005), International Standardization Organization is working on an International Standard for CSR (ISO 2004a) and companies like the Body Shop have made successes using CSR as their primary strategic asset. A plethora of non-governmental organizations involving both activists and corporate managers have emerged to spread the message of socially responsible companies and trusts investing solely on socially responsible companies have grown in numbers and in investment capital. The public pressure on many companies has enforced them to accept socially responsible standards as part of their business and brand image. In fact, corporate social responsibility has been called “one of the biggest corporate fads of the 1990s” (Economist 22.1.2004)

In this paper I try to establish the advantages and disadvantages of CSR from a strategic point of view. There are those who say that CSR is throwing money in unnecessary things, that it is pure benevolence. Then are others who emphasise the positive impact of CSR to the financial result of the company for example on the grounds that it motivates the employees and has a positive impact on sales. What does academic research tell about the overall financial impact of Corporate Social Responsibility? Leaving ethical issues aside, the management is faced with the question: are the efforts to make the company more socially responsible a wise decision financially. There are many studies that examine this association between corporate financial and social performance, but are the results useful in actual decision-making, that is the question I try to answer.

To establish this, I discuss what corporate social responsibility consists of and how it is defined. Then I move on to take a critical look at the different measurement strategies of CSR. Drawing on empirical studies on the relationship of company economic performance and its social responsibility I try to establish what the consensus is among the researchers today about the economical impact of CSR. As mere relationship is not enough I also examine different theories explaining these associations and also the large criticism that current empirical studies face. In a nutshell, this paper tries to answer the question: What results of use has the current academic research established that might help a decision-making manager to know if it is profitable to invest on corporate social responsibility?

The paper is structured as follows: the second section grasps the concept of Corporate Social Responsibility and defines what is generally meant by it. Thereafter it discusses the different ways that corporate social responsibility and corporate financial performance have been operationalized in the empirical studies. Finally it takes a look at different theories of the relationship between CSR and CFP. Third section is devoted to empirical studies that have been conducted to establish whether CSR is financially beneficial or the contrary. Section four concentrates on the critique of these empirical studies and offers two different approaches to access the problem. The final section discusses the findings and draws a conclusion from it.

2 Theoretical review of CSR

2.1 What is Corporate Social Responsibility

Corporate Social Responsibility is a broad term that has been used for a multitude of uses and lacks a clear, unambiguous definition. In general use it has been used somehow interchangeably with phrases like business ethics, corporate citizenship or corporate accountability. One way to

define it would be as “achieving commercial success in ways that honour ethical values and respect people, communities, and the natural environment.” (BSR 2005) Another way to put it could be ‘actions that appear to further some social good, beyond the interests of the firm and that which is required by law.’ (McWilliams and Siegel 2001) Corporate Social Responsibility is therefore a term that can be used anytime the corporation seems to support society in one way or another. It is about policies, practices and programs that further responsible goals as well as concrete results of the impact of the company in the society. In general, taking some responsibility of your actions beyond financial interests is what Corporate Social Responsibility is about.

Corporate Social Responsibility can consist of a plethora of items including ethical standards against bribery, environmental or child labour issues, investments into community, stakeholder inclusion, development of non-animal testing procedures, workers healthcare improvements or whatever that could be considered as socially virtuous acts of a company. To be socially responsible the company has to meet the legal standards as well as the ethical expectations of a society. Taking into account all possible stakeholders is also one way of describing CSR, although not complete because CSR can also include groups that aren't direct stakeholders of the company. In this sense CSR is integrated into company operations through company values, policies, practices and programs.

Clarkson (1995) argues that much of the confusion with CSR comes from different uses of the word social. He makes a distinction between stakeholder issues and broader social issues. In a discourse analysis Finnish researcher Vehkaperä (2003) finds four different ways of talking about social responsibility in Finnish discussion. The first one concentrates on the interest of the whole society and sees CSR as an obligation, the second one focuses on benevolence towards all

stakeholders, third one sees CSR as only a strategic tool that should not be used over the level that maximizes shareholder profit and the fourth one sees the entrepreneur as utilizing social responsibility through corporate success following Adam Smith's theory of invisible hand. Of these discourses, the second one, where firm takes extended social responsibility towards all its stakeholders, is the most dominant.

2.2 Operationalizing CSR: Corporate Social Performance

As seen Corporate Social Responsibility can take many different forms and include policies as well as practices in various fields. Many times the responsibility of a company appears in intangible, non-calculative matters. To get measurements of CSR some way of operationalizing it is needed. In empirical studies of the relationship between CSR and financial performance there are basically two ways of accessing the problem (McWilliams and Siegel 2000). The event study methodology has been used to access the short-term financial impacts of firms performing a socially responsible or irresponsible act. Due to large inconsistency of results, theoretical and empirical critique towards the method (McWilliams and Siegel 1997) and inability to draw any general conclusions from the results, a more extensive examination of the studies using this method is omitted from this study. The other set of studies uses some measure of corporate social performance in accessing the problem

In academic research a somewhat standardised approach to CSR is needed to get consistent results. To address this problem the researchers have developed Corporate Social Performance (CSP). It can be thought of as a kind of operational definition of CSR that is both more exact and also denumerable. This three-level framework was first proposed by Carrol (1979), but Woods (1991) definition of CSP as 'a business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable

outcomes as they relate to the firm's societal relationships" seems to be the most influential and generally accepted definition in the research (eg. Bansal 2004, Thomas et al. 1995, Orlitzky et al. 2003, Waddock and Graves 1997). In focusing the research and the measurements, it identifies three distinct levels of Social Responsibility.

The Corporate Social Performance Model

Principles of Corporate Social Responsibility

Institutional principle: legitimacy

Organizational principle: public responsibility

Individual principle: managerial discretion

Processes of Corporate Social Responsiveness

Environmental Assessment

Stakeholder Management

Issues Management

Outcomes of Corporate Behavior

Social Impact

Social Programs

Social Policies

Table 1 The Corporate Social Performance Model (Wood 1991)

The first one considers the principles that companies should fulfil to be socially responsible.. It can further be divided into three subcategories first of which is called the principle of legitimacy. This category focuses on company's obligations towards society as defined by different laws and statutes and the simple message is that they are to be obeyed. The second subcategory, public responsibility, sets up behavioural parameters for the company. The key idea is that businesses are responsible for all the outcomes of their operations also beyond law and it is their duty to act affirmatively for social well-being. The third subcategory emphasizes the manager's role as a moral actor. Manager is seen as responsible for the outcomes of their decisions towards the society in whole and therefore obliged to serve the greater interests of it.

The second category, the Processes of Corporation Social Responsiveness, focuses – as the name suggests – on the actual processes involved. In order to be socially responsible towards the

external environment the firm must know something about it. Therefore the first subcategory, environmental assessment, is about scanning and analyzing the environment that is influential towards the company and that the company influences. Stakeholder management then focuses on the relationships between company and all its stakeholders and processes involved in managing these relationships. The final subcategory, Issues Management, has been defined as policies developed to address social issues (Wartick and Cochran 1985) but more recently the emphasis has shifted to involve devising and monitoring of internal and external processes for managing a company's responses to social issues (Wood 1991, Bansal 2004).

Outcomes are the third and final main category of corporate social performance model. Social impacts of corporate behaviour try to measure the actual effects of the company towards society regardless of the motivation of these effects. Corporate social programs take a look at the investment of resources towards social programs while corporate social policy concentrates on the establishment of social policies with socially responsible motives. Another way of dividing this third category would be to see whom different categories do concern. Three subcategories would emerge: effect on internal stakeholders, effect on external stakeholders and effect on external institutions (Hopkins 2003).

2.3 Measurement Strategies of Corporate Social Performance

Even corporate social performance lacks a shared precise definition in the literature (Hillman and Keim 2001) and in empirical studies there seems to be various ways to measure it (Waddock and Graves 1997). Orlitzky et al. (2003) differentiates between four basic categories for measuring CSP: CSP disclosures, CSP reputation ratings, managerial CSP principles and values and - as a final category - social audits, CSP processes and observable outcomes. Additionally, there is the popular KLD index which uses multiple dimensions of CSR to calculate the firms CSP.

Measurement Strategy	Method	Example of target
CSP disclosures	Content analysis	Annual reports etc.
CSP reputation ratings	Expert rating on various attributes	Fortune rating of responsibility, Moskowitz's tripartite rankings
Managerial CSP principles and values	e.g. Forced choice survey	Inherent values of corporate culture
Social audits	Third-party assesment	Firm's actual CSR behaviour
CSP processes	Measurement of actual processes	Processes of company CSR
Observable outcomes	Concrete measurement	Usually environmental issues

Table 2 The different measurement strategies of Corporate Social Responsibility

CSP disclosures

Disclosure measurements consist of content analysis. This analysis is performed usually over annual reports but also letters to shareholders, 10Ks or other corporate disclosures to public have been used. This method has been criticised on the grounds that annual reports and other document reflect impression management rather than accurate corporate responsibility and there might be inconsistencies in the material (Bansal 2004)

CSP reputation ratings

A popular approach to measuring CSP is to rely on some reputation indices. The Fortune magazines rating of corporation's responsibility to the community and environment is the most popular one and has been used by numerous researchers (Griffin and Mahon 1997). In it a group of experts rate the ten largest companies of their respective industries on eight attributes of reputation which then are summed to create an overall corporate reputation index.

Another widely used index is the Moskowitz's tripartite rankings and some researchers have also developed their own reputation indexes. All reputation indexes are based on the assumption that corporate reputation is a good reflection of the underlying CSR values and behaviors. The obvious criticism against these indexes is then the gap between reputation and reality.

Corporation's ability to manipulate the media or hide unpleasant facts from the public eye can create measurement biases. Another problem is that the high association between corporate overall reputation and social reputation might indicate the existence of a halo effect (Harrison and Freeman 1999) meaning that the overall reputation of the firm causes people to overrate the social aspect.

Managerial CSP principles and values

These measurement strategies try to capture the values and principles inherent in a company's culture. A forced-choice survey is one of the options of measuring it. Also other behavioural and perceptual measures have been used in the past (Waddock and Graves 1997)

Social audits, CSP processes and observable outcomes

This last group consist of a number of different measures. In social audits there is a systematic third-party effort to assess firm's actual CSP behaviour. The measurement of concrete observable outcomes is used especially to rate environmental responsibility of the company. There concrete pollution calculations are easier to come about. In social issues measurement of observable outcomes is usually a much tougher problem.

KLD

Perhaps the most used measurement in the more resent research (used in six of fourteen studies conducted since 1994 and four of five studies since 1997) is the KLD index. Developed and provided by the financial analysis firm Kinder, Lydenberg, Domini & Co., Ind. this index assesses the companies on eight dimensions of CSP. First five of these are rated on a four-point scale from major strength to major weakness. These dimensions are community relations, employee relations, environment, product, and diversity (formerly treatment of women and

minorities). Additionally there are two dimensions that can only have negative value. These include military contracts and nuclear power. Formerly there was a separate category for South Africa involvement which is present in the older studies, but it was dropped almost ten years ago. (Waddock and Graves 1997) All these categories are measured using consistent and largely objective set of criteria which is one of its advantages along with its use of multiple dimensions for social responsibility. (Griffin and Mahon 1997) Another advantage of KLD is that it is done by an independent third-party company (Harrison and Freeman 1999). The limitations of the index are lack of a weighing scale between these dimensions and that it only has a coverage of about 650 biggest companies in the US.

Other

Other used measurements include for example a survey of officers each company identified as responsible for any ethics practices and programs in the company combined with a database of abstracts from major American newspapers and registration lists for the Conference Board's ethics meeting (Weaver et al. 1999) Also many more industry-specific measurements of CSP were used in researches.

Measurement Strategy	Number of measurements
Disclosure	97
Reputation Indexes	123
Social audits, corporation behaviours, processes and outcomes	145
CSP values and attitudes	23

Table 3 Frequency of measurement strategies of CSP in different studies (Orlitzky et al. 2003)¹

¹ Many studies used more than one measurement strategy

2.4 Measurement Strategies of Corporate Financial Performance

In line with the multiple measures of CSR there are also a large number of ways to measure corporate financial performance. Griffin and Mahon (1997) list 80 different measures of CFP in the relevant researches of which 57 have only been used once. The most popular financial measures have been the size, return on assets, return on equity, asset age and 5-year return on sales. Orlitzky et al. (2003) divide these financial measures into three categories (number in brackets tells how many researches of each category they identified in their meta-analysis): market based (161) like price per share try to measure the investor returns, accounting-based measures (205) like return on assets or equity try to capture the internal efficiency of the firm and finally there are perceptual measures (22) like surveys submit subjective estimates of firms financial performance. Orlitzky et al. (2003) and Griffin and Mahon (1997) both agree and find proof that the choice of financial performance measure affects the results of relationship studies.

Measurement Strategy	Number of measurements
Market-based	161
Accounting-based	205
Perceptual Measures	22

Table 4 Frequency of measurement strategies of CFP in different studies (Orlitzky et al. 2003)²

2.5 The Impact of CSR on economic Performance

During the many years of CSR research a number of different theories have emerged to straighten out the impact of CSR on firms' economic performance. They have reached very different conclusion about the association between CSR and CFP. Before going to the empirical studies on

² Many studies use more than one measurement strategy

CSR and CFP association, a quick overview of different theories trying to explain the association is appropriate.

2.5.1 Why there should be a positive association between CSR and CFP

Enhanced brand image

Consumer awareness of nowadays make on the surface benevolent looking acts also financially profitable through increased sales. Positive customer perceptions about the company's products, its environmental awareness and its community relationships are increasingly becoming bases of strategic advantages. (Prahalad and Hamel 1994) The segment of consumers that explicitly choose products on ethical terms is increasing and normal consumers are also becoming more sensitive to the ethicality of the company from which they buy. (Harrison and Freeman 1999) Socially responsible acts also affect the overall reputation of the company and increases customer loyalty. Therefore by being socially responsible the company can have a significant positive effect on sales.

Additionally to customers, the positive image CSR can create for the company is becoming more important also with investors, bankers and suppliers which are increasingly taking ethical considerations into account in their decision-making. (Orlitzky et al. 2003) Better access to capital and better supplier relationships can thus also be effects of well-maintained CSR.

Instrumental stakeholder theory

Simply put, instrumental stakeholder theory says that firms that develop better relationships with their various stakeholders outperform financially those firms that don't put as much effort on being on good terms with their stakeholders (Donaldson and Preston 1995) According to the

theory firms stakeholders are essential for its success and therefore maintaining good relationship with them makes the firm better off. One main source of the positive effect for the firm comes largely through that the company builds a better reputation with their stakeholders and thus has better terms of trade when negotiating with them. (Ruf et al. 2001) Better stakeholder relationships also tend to last longer and thus create a more manageable environment for the company where it can build trust and other tacit benefits with its stakeholders.

A large part of corporate social responsibility is taking into account the different stakeholders needs and gains around you. Therefore it is strongly associated with instrumental stakeholder theory. By improving the positive impact the company has on its employees, the society around it and other stakeholders the company, according to instrumental stakeholder theory, benefits also itself. (Clarkson 1995)

Employee relations

A more indirect benefit from CSR can be seen in firm's relations towards its own employees. Good employee relations are expected to enhance moral, productivity and satisfaction of the workforce. (Waddock and Graves 1997) Small enhancements can have large refreshing and motivating power for employees who thereafter become more effective and productive for the company. CSR companies can have additionally lower employee turnover, less absenteeism and attract better employees by having a better reputation among job-searching professionals. (Greening and Turban 2000). Better working conditions may also lead to better quality. (BSR 2005)

Mediating effects

Additionally to benefits gained from increased employee relations and other stakeholder accommodation there are also other mediating effects that can make CSR investments profitable. Investments in CSP may help managers to build better scanning skills, processes and information systems through better employee involvement (Orlitzky et al. 2003). Taking care of community relations might lead to reduced regulation, improved education and competition-enhancing tax breaks (Waddock and Graves 1997) There might also be other less significant benefits (BSR 2005) CSR can thus be seen as an organizational resource that provides many kinds of more indirect benefits.

Good management theory

So there are many reasons to see CSR as a potential strategic asset. Waddock and Graves (1997) label all these promoters of good effects of CSR under good management theory. They see CSR as a tool with quite low costs but potentially great benefits. On this view CSR is seen as part of well advised strategic management.

Slack resources theory

Slack resources theory is another key explanation theory for the positive association. (Waddock and Graves 1997) It simply indicates that better financial performance results in there being slack financial and other resources that makes it possible for companies to invest on such secondary matters as CSR. In this theory CSR is seen as a result of improved financial performance and not a cause of it. Therefore empirical evidence in support of it doesn't say anything about the profit of CSR.

If these both theories of good management and slack resources would be at least partially correct it would create a kind of virtuous circle (Waddock and Graves 1997). In it good CFP would lead to investments in CSR and that would then again improve further the CFP.

2.5.2 Why there should be a negative association between CSR and CFP

The main point of those that think a firm's social performance and financial performance should be negatively related to each other is that firms involved in CSR have a competitive disadvantage (Aupperle et al. 1985). This is so because they are incurring costs that might otherwise be avoided or be borne by other groups like individuals or government. (Waddock and Graves 1997) Because of their social commitments, firms are obliged to do more than less socially responsible firms which naturally lead to increased expenditure.

2.5.3 Why there should be a neutral association between CSR and CFP

Some researchers like Ullman (1985) are inclined to think that there are so many intervening variables between CSR and CFP that there should be no reason to expect any relationship at all. Additionally, the measurement problems are still so wide that it alone can mask any real linkage that could exist (Waddock and Graves 1997).

3 Empirical Results

Many empirical relationship studies of the association between Corporate Social Performance and Corporate Financial Performance have been carried out through the years since the concept was developed. The results have varied significantly. Indeed, there are many studies to support all three hypotheses of positive (eg. Waddock and Graves 1997, Orlitzky et al. 2003), negative (eg. Bansal 2004) and neutral relationship (eg. McWilliams and Siegel 2000).

In one largely-cited work Waddock and Graves (1997) gathered data from 469 companies in the Standard and Poors 500 to address the problem. To address also the problem of direction of causation, two hypotheses were made to be tested. 1. Better financial performance results in improved CSP, *ceteris paribus*. 2. Improved CSP leads to better financial performance, *ceteris paribus*. They used KLD's eight attribute rating scheme to access CSP. Return on assets, return on equity and return on sales were then used to access CFP. Additionally, to answer the criticism that has disturbed many earlier researches, they used company size, risk and industry as control variables to be able to eliminate the effect caused by them. In order to test the first hypothesis relationships were tested between 1989 financial data and 1990 CSP. Second hypothesis was then tested by using 1990 CSP and financial controls and profit from 1991. They calculated the relationship matrices for different variables and performed a regression analysis on them.

The results strongly supported the first hypothesis with all three financial performance measures significantly related to CSP and control variables not showing signs of complicating the matter. Thus they could conclude that good financial performance was a cause of good CSP. This effect they explained by the slack resources theory. The second hypothesis also received a little less strong support. CSP predicted improved financial performance, the relationship being significant ($p < 0.01$) between ROA and CSP, a little less significant ($p < 0.05$) for ROS but not significant for ROE although the direction of the relationship was the same. They thus concluded that good CSP somewhat predicted financial performance thus supporting the good management theory (Waddock and Graves 1997). Taking both results together they found support for the virtuous circle theory.

Author	Year	Sample size	Observed Correlation	Measure of CSP	Measure of CFP
Bansal	2004	45	-.12 to -.05	Annual reports analysis of sustainable development	ROE

Greening	1995	131	.01 to .22	CSP reputation, Demand-Side management Programmes	ROA, EPS, dividend yield
Griffin & Mahon	1997	7	-.59 to .51	Fortune rating, KLD score, Toxics Release Inventory, philanthropy	ROS, ROE, ROA
McWilliams & Siegel	2000	524	-0.062	KLD ratings	Average annual value
Pava & Krausz	1995	14	-.22 to .66	Dichotomization based on Council on Economic Priorities rankings	Market return, P/E ratio, market-to-book value, ROA, ROE, EPS, dividend payout ratio
Russo & Fouts	1997	486	.13, .16	Franklin R&D corp. Environmental performance ratings	ROA, firm growth
Simerly	1995	48	.59	Dichotomized Fortune survey measure	ROE
Turban & Greening	1997	160	-.07 to .25	KLD ratings, reputation	Profitability (ROA)
Waddock and Graves	1997	469	.08 to .17	KLD dimensions	ROA, ROE, ROS

Table 5 The empirical studies available made since 1995 (Bansal 2004, Griffin and Mahon 1997, McWilliams and Siegel 2000, Orlitzky et al. 2003, Waddock and Graves 1997)

Looking at all the empirical studies done during the years any general conclusion is hard to draw.

In table 4 are gathered the empirical studies of the last ten years that were available. As can be seen even from this small sample, the variety of results is wide and the different measurement strategies make different studies incomparable. To draw any conclusion from this pool of researches some other approach is needed than going through all the researches and the results one at a time.

A large meta-analysis of CSP and CFP relationship was conducted by Orlitzky, Schmidt and Rynes (2003). Searching for all the relevant studies since 1970 they combined together data from 52 previous researches to find out could any consistent results be drawn from them. Correcting the studies for some now-known sampling and measurement errors they performed an effect-size meta-analysis for these studies. The results they acquired supported the hypothesis that a positive relationship exists between company's CSP and its CFP (Appendix 1). This result remained consistent also through a number of tests for different biases and errors including file-drawer

analysis, removal of studies with a possible response bias or halo. On a temporal approach, the research found positive associations for both prior and subsequent CFP with CSP. This supports the hypotheses of instrumental stakeholder and slack resources. These two together then support the virtuous circle hypothesis. Further their meta-analysis showed that this positive association was more due to reputation and other external factors than the internal benefits of CFP although both of these played a role in building up the positive relationship. They also examined the variance between different studies and came to the conclusion that a large amount of it is explained by different operationalizations of the CSP and CFP. Most significantly, accounting-based CFP measures were more positively correlated to CSP than market-based and CSP reputation indices are more highly correlated with CFP than other indicators of CSP.

If we are to believe on the findings of this meta-analysis, the conclusion should be that there is a positive relationship. Next chapter focuses on a number of criticisms towards the whole empirical framework of relationship between CSR and CFP and questions the fact that even if this result is correct, does it tell anything of interest.

4 Criticism of the Empirical Approach

4.1 Lack of control for R&D expenditures

One central criticism of current relationship studies comes from McWilliams and Sieglar (2000). They establish that one particular flaw of existing studies is their lack of control for investment in R&D. There is strong empirical evidence linking investment in R&D to improvements in long-run economic performance. Therefore any variable that is strongly positively correlated with R&D will be overestimated when expenditure on R&D is not controlled in the study. They go on to argue that CSR and R&D are strongly positively correlated due to a number of reasons like

that many aspects of CSR create either a product innovation, a process innovation, or both and that CSR is attached to product differentiation. Additionally they argue that the intensity of advertisement in the industry as an estimate of entry barriers should be included into the model as another control variable. They make the hypothesis that when R&D expenditures and advertising intensity of industry are controlled for there should be neutral relationship between CSR and CFP. To test this they went through 524 firm's average annual values between 1991-1996 using ratings provided by KSD as an estimate of CSP and financial information provided by Compustat as an estimate of CFP.

The results supported their hypothesis. When R&D and advertisement intensity were excluded from the model they reported a positive relationship between CSP and CFP which is consistent with many former researches. However, R&D was also strongly positively correlated with both CSP and CFP. When R&D and advertisement-intensity were included into model and statistical analysis done there still remained a small positive relationship between CSP and CFP but it was no longer statistically significant.

This result of R&D being the explaining link between CSP and CFP casts the previous researches on topic into a doubtful light. Have they been able to tell anything of interest between the link of CSP and CFP when they have forgot such a crucial underlying factor? It is quite interesting to note that the meta-analysis carried out by Orlitzky et al. (2003) while citing this very article of McWilliams and Siegel (2000) on other occasions, don't even mention the word R&D once in their paper, let alone control for it. Taking this point of view seriously we are inclined to think that present research isn't able to resolve the question of relationship.

4.2 Two separate categories of CSR: Stakeholder management and social issues

Second major criticism against current empirical studies comes from Hillman and Keim (2001). They follow Clarkson (1995) in dividing CSR into two distinct categories: Stakeholder management and social issues. The argument is that while traditional conception of CSR involves both of these aspects they are clearly different in their nature. The first one, stakeholder management, is about managing your stakeholder relations optimally for your overall long-term business profitability. Especially your primary stakeholders - customers, shareholders, employees, other resource suppliers, community residents and natural environment (Clarkson 1995) - satisfaction is vital to the survival of your business. Many times to be effective on this aspect involve intangible, socially complex actions of which benefits are not easily calculable. These actions, while on the surface looking benevolent, are at bottom pure profit-maximization.

Social issue participation, on the other hand, is an element of CSP that fall outside the direct relationship with primary stakeholders. These issues might be avoiding nuclear energy, refusing to sell to military or refraining from doing business with countries with known human rights violations. This broader look at CSR then goes beyond mere primary stakeholder relationship optimization to more normative look of CSR.

Hillman and Keim argue that while stakeholder management should be positively correlated with financial performance, the social issue participation, involving costs but no clear revenues, should be negatively correlated with financial performance. To test these hypotheses, they took the KLD measurement categories and divided them into two parts of which the first one consisted of those parameters that are associated with stakeholder management and second one of those which fall out of scope of it. Thus they got two different measures for CSR, one measuring the stakeholder

management and the other social issues. Comparing these to financial performance (with appropriate control parameters) they could confirm their hypotheses. Stakeholder management was significantly (0.244, $p < 0.01$) and positively correlated with good financial performance and regression analysis showed that it also led to improved financial performance both on 1-year and 3-year lag. On the contrary, social issue participation was found to be significantly (-0.286, $p > 0.01$) and negatively correlated with shareholder value creation. It also had a modest, although not significant negative effect on future shareholder value creation.³ With these results Hillman and Keim make a strong case for the need to separate CSR into two different categories.

4.3 Other criticism

There are also several other more or less heavy criticism that apply to at least part of the empirical researches. Every industry has its own characteristics considering CSR and thus measurements should be made industry-by-industry (Clarkson 1995, Griffin and Mahon 1997). Many older studies didn't take this into account and thus got defective results (McWilliams and Sieglar 2000)

The specific flaws and deficiencies of different operationalizations of CSP were discussed earlier. To be noted is that practically all measurement strategies of CSP were far from perfect and additionally no consensus prevails among researchers of the appropriate measurement strategy. Additionally some criticism has been directed against too much dependence on the relatively

³ To be noted is that these calculations were based on a Market Value-Added (MVA) operationalization of shareholder value creation. Same analysis using more account-based financial calculations as some past studies have done showed no significant relationships. Hillman and Keim argue forcefully why MVA was chosen.

small amount of data currently available. (Harrison and Freeman 1999) Theoretical development seems to be restricted to those ideas that can be readily tested.

One problem of focusing on individual firm's CSR is the possibility of problem shifting and problem displacement. (Korhonen 2003) Instead the performance focus should be on the complete product flows and network of firms.

Also the culture can pose some problems to the measurement of CSR (Rohweder 2004). All general scientific studies seem to be concentrated to U.S. corporations. Different cultures have different conceptions and emphasizes of CSR. Therefore in some countries CSR is more explicitly stated and in some more naturally integrated as part of the business culture in general. This makes indicators of CSR country-specific. As current research is concentrated almost exclusively to United States, the applying of these results in European or other markets is somewhat questionable.

The question is also would even a positive association tell decision-making managers anything of interest. The dominant explanation theory for the association seems to be the slack resources theory which indicates that good financial performance leads to availability of extra resources which can then be used for social performance domains. This causality from superior CFP to above-average CSP was the dominant statistical explanation of the relationship. Unfortunately, this explanation is of no use in making profit-maximizing decisions about the resource-usage of firms for it doesn't tell anything of the benefit of CSR. The other causal explanation, the good management theory received only modest support from empirical data.

Major Criticism of Current Empirical Research
Lack of control for R&D expenditures
Division of CSR to Stakeholder Management and Social Issues

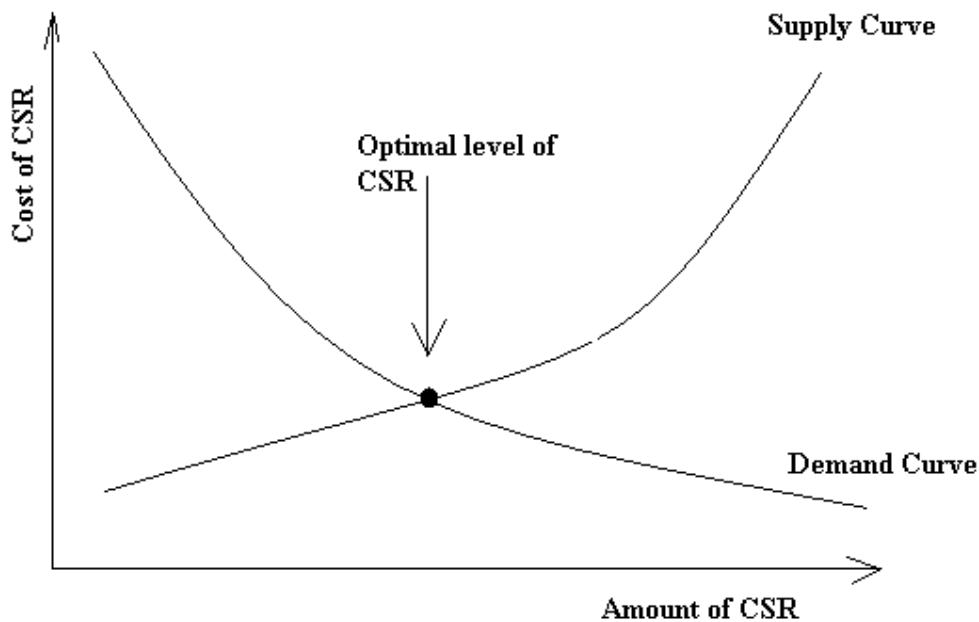
Direction of Causality
Inconsistency of Measurement Strategies
CSR characteristic are industry-specific
Dependence on the relatively small amount of data
Current research almost exclusively concentrated to U.S. market

Table 6 Criticism against current empirical research

Putting together all this strong criticism against current empirical ways of studying relationship between CSR and CFP suggests that the current state of the research is unable to answer satisfactorily to the question of relationship between CSP and CFP. The general positive relationship found by Orlitzky et al. (2003) can be explained by a multitude of things instead of CSP causing it. Clearly, no consensus or final answer has been reached thus far.

4.4 Demand-Supply model of CSR

To challenge the whole point of calculating general relationships between corporate social responsibility and corporate financial performance McWilliams and Siegel (2001) have developed a demand-supply model of CSR. First they make a clear distinction between two general questions to be answered. First one is do socially responsible firms outperform or underperform other companies that do not meet the same social criteria? This is the one question that all CSP-CFP relationship research has thus far mostly tried to answer. However, to be of any relevance to actual decision-making managers, another important question should also be answered: Precisely how much should a firm spend on CSR? To answer this question, they borrow the demand-supply model from economics.



Picture 1 Demand-Supply model of Corporate Social Responsibility

Demand for CSR comes from two different major sources. Consumers are the first group. There is strong evidence that many consumers value CSR attributes and therefore CSR can be an effective differentiation strategy used successfully by companies like the Body Shop and Ben & Jerry. Additionally a number of labels and certificates are available and the general reputation of the company affects the sales. McWilliams and Siegel make quite reasonable hypotheses of there being a positive relationship between provision of CSR attributes and a number of issues. They conclude that key determinants of the demand for a product with CSR attributes are the product's price, advertising to promote consumer awareness of CSR, the level of consumer's disposable income, consumer's taste and preferences, demographics and the price for substitute goods.

The other demand-creating group consists of employees, investors, community and other stakeholders. Some investors demand certain levels of CSR or prefer responsible corporations. Community can create certain pressures on company's CSR. Nowadays, employees seem to have

a growing interest for firms CSR. Therefore McWilliams and Siegel suggest that CSR would be positively correlated with both unionization of workforce and shortage of skilled workers in an industry.

These demand groups then create a certain demand for CSR for a company. The demand is greatly dependent of the company's industry and characteristics of the market, its size and a number of other attributes including company's own differentiation strategies. To answer this demand the company has a possibility to supply CSR. This it can do through various measures. Common to these measures is that they usually require extra resources. It can be in the form of higher wages and benefits for the workers or hiring additional workers to enhance social performance. It can be higher-costing materials and services from suppliers who are socially responsible or even special equipment, machinery or real estate devoted to increasing the CSR. All of this is more expensive to the company; otherwise it wouldn't be responsibility, only usual business. Therefore firms that provide CSR attributes will have higher costs than firms in the same industry that do not.

This demand and supply approach to CSR implies then, that there would be an optimal level of CSR attributes for firms to provide. This optimal level could then be calculated for each item of CSR taking into account the special demand and the cost to generate them. Because of the number of various attributes affecting the demand and varying costs for supplying different CSR attributes, every firm's situation is unique and therefore the optimum levels of CSR vary greatly. McWilliams and Siegel only present this theoretical framework for accessing the optimal level of CSR, they don't provide any measures of actually calculating it. They only suggest that you are likely to find CSR attributes in industries with highly differentiated products, such as food, cosmetics, financial services or automobiles. Central strength of the economic approach to CSR

is its emphasis on the efficiency of resource allocation (McWilliams 2001). This model appears to be a more reasonable approach to CSR than only calculating general relationships. Following this model the ideal level of CSR can be calculated using cost-benefit analysis. Profit-maximizing level of CSR can be simply found by offering precisely that level of CSR for which the increased revenue (from increased demand) equals the higher costs.

This model also draws new light on the relationship between CSR and CFP. If all firms were to maximize their profits in an optimum way, there should be no relationship between CSR and CFP. In this equilibrium some firms would focus more on the CSR and some less all reaching the same level of profit. Any other result of one firm earning more than others would cause these others to switch product strategies. Therefore there should be a neutral relationship between CSP and CFP.

Panapanaan et al. (2003) offer a framework that can be used in accessing company's level of social responsibility. It resembles the RDAP scale (Clarkson 1995) which classifies firms CSR efforts into four categories but is more useful in this context. In it, a three-level distinction of the degree of awareness and commitment of a company is made. First level – the compliance – is about following the laws without enough involvement into CSR. Here the company would gain of more investment into CSR. The second level – the proactive – is opportunity driven and seeks to optimize the social responsibility of the company for The third one – socially and ethically responsible – then is about idealism and doing even more than what could be justified from business perspective. From a financial perspective this third level is harmful because the costs overrun the benefits. Since the second level is the optimum for profit-maximization, a general positive relationship between CSP and CFP would tell that there are more companies on the compliance side than responsible side from the optimum. Indeed this is true of Finnish companies

that Panapaan et al. (2003) examined. Of those 75% were considered proactive and 25% to be on compliance stage.⁴

4.5 Responsiveness vs. Responsibility

Windsor (2001) criticizes the supply and demand model of CSR arguing that it has a general misconception of what is meant by social responsibility. As McWilliams (2001) self admitted, this approach doesn't consider managers as moral actors but sees profit-maximizing as the only purpose of management (McWilliams and Siegel 2001)

He goes on to display a clear distinction between corporate social responsibility and social responsiveness made by Frederick (1994). Corporate social responsiveness means the capacity of a corporation to respond to social pressures. It is thus a action-oriented managerial as well as strategic concept of optimizing social responsibility to a level that is most beneficial for the company. On the other hand there is social responsibility which in this context is a philosophical-ethical concept of corporation's obligation to work for social betterment. Social responsibility should therefore go beyond mere strategic thinking even to levels that could be harmful to the overall profit maximizing of a company.

Following this distinction, there are clearly two fundamentally different discourses of corporate social responsibility. The first discourse, CSR1 looks at social responsibility as only one strategic asset that should be taken into account when making resource allocation decisions. Recent developments of increased consumer and investor awareness, the activism of NGOs and globalization has made it a topic to be taken seriously among decision-makers. Awareness of it

⁴ The sample was very small and consisted only of 12 large Finnish companies

should be increased and depending on the company's situation and industry, different measures should be initiated to find an optimal level of social responsibility as suggested by McWilliams' and Siegel's (2001) model. Beyond that profit-maximizing level of CSR, however, the company shouldn't advance.

A more ethical conception of corporate social responsibility, the CSR2, sees all this as only social responsiveness. True social responsibility goes beyond mere economic calculations. On this view, the company should take the ethical responsibility seriously. CSR2 can be further differentiated into four dimensions (Carrol 1995): first two of these are necessarily required: economic profitability and legal obeying. In other words, the company should, of course, obey the laws and be profitable. Note that the economic profitability here doesn't mean profit maximization but merely a positive closing of the accounts. Third dimension, the ethical is expected of a company and fourth one, the discretionary, means desirable but voluntary philanthropy. There is of course a large dispute of what to be included into the third dimension of expected ethicality and what is mere voluntary philanthropy. But the big issue here isn't the exact content of the ethical. The point is that along the intrinsic value of profitability, another intrinsic value of ethicality is added. To be CSR2, the company should also follow some ethical standards for the sake of themselves. Only after accepting this and acting accordingly has the company fulfilled its responsibility towards society in this view.

5 Discussion of the Findings

Looking at the empirical studies through past decades it can be concluded that taken together they have a tendency to find a positive association between corporate social performance and corporate financial performance. This finding should be treated with care because still there is a lot of dispute about the proper way of operationalizing CSP and every method has its problems.

Additionally, the relationship results are also affected by the choice of indicator for CFP with accounting-based indicators acquiring higher relationship values than market-based.

Despite the limits of operationalizing CSP and CFP, the positive relationship seems to hold at least to some degree. Next question is, does this positive relationship tell anything of interest. Firstly there is the problem of direction of causality. The slack resources theory suggested that good financial performance leads to slack resources that can then be devoted to social issues while good management theory has a reverse view of the direction of causality stating that CSR is part of good management practices leading to better financial performance. In addressing the central question of this research - the benefit of CSR for CFP, only the latter form of causality is of interest. Unfortunately, larger part of the relationship is explained by slack resources theory, although also the good management theory gets some support. There is thus still a small amount of proof that CSR might be good for business from a strategic point of view.

This proof is then questioned by McWilliams and Sieglar (2000). They find proof of the positive relationship being explained by an underlying third factor, the R&D expenditure of the company. They indicate that R&D expenditures are strongly positively correlated with CFP and additionally that higher R&D expenditures hang together with higher CSR expenditures because both are aspects of product differentiation. Taking R&D expenditures into empirical relationship research as a control variable, they are able to statistically proof that it is the explaining factor for both CSP and CFP. When R&D and advertising-intensity of the industry were controlled for only a statistically insignificant positive relationship remained between CSP and CFP.

The economic demand-supply model of CSR seems to be a more rational way of accessing the question of how much a company should spend on responsible actions. In it every company has a certain demand for CSR depending on external and internal factors like the industry in question,

chosen differentiation strategy, values of employees and key customer groups. This demand can then be met with certain supply and an optimal level can be found using cost-benefit analysis. Following this model CSR can be seen as one of the strategic dimensions of well-advised management

The distinction of Panapanaan et al. (2003) identified three levels of awareness and commitment to social responsibility of which first one – compliance – was about doing too little, second one – proactive – about doing enough and third one – responsible – about doing too much from the profit-maximization point of view. Combining this view of three levels of awareness and commitment with the results that nowadays there seems to be a slight positive relationship between CSP and CFP we could conclude that nowadays majority of corporations are paying too little attention to social responsibility. It is a strategic asset and the strategically wise ones have been able to outperform their rivals by investing in CSR and thus created above average returns. For a large number of companies it would therefore probably pay off to invest more to socially responsible issues.

My original question was: What results of use has the current academic research established that might help a decision-making manager to know if it is profitable to invest on corporate social responsibility? The brief answer to this question would then be that it can be shown that CSR can be a significant strategic asset and probably the majority of companies lie under the level of optimal CSR for profit-maximization. The optimum level of CSR then depends wholly on internal and external factors of the company in question but it is important to take CSR seriously as one of the strategic dimensions every company have to take into account.

In the end I want to elicit one important distinction. Some researchers have argued that this search of an optimal level of CSR for profit-maximization isn't true social responsibility at all. It

is mere social responsiveness. They suggest that true social responsibility starts only after the corporation has accepted ethical standards as part of their intrinsic values. Only when social responsibility is pursued for its own sake it is truly responsibility and not mere usage of looking responsible as a strategic asset. It goes far beyond the scope of this research to discuss should companies have responsibility beyond economic interests or is it the responsibility of governments to make social responsibility economically cost-effective. For the sake of clarity I wanted nevertheless to mention this distinction between strategic social responsiveness and ethical social responsibility.

6 Glossary

CSR = Corporate Social Responsibility, the firms willingness and ability to further social goals beyond financial interests

CSP = Corporate Social Performance, a operational version of CSR

CFP = Corporate Financial Performance, the financial performance of the company

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8 Appendixes

Appendix 1 Orlitzky et al. 2003 meta-analysis results with different measurement strategies

Measurement Strategy		Number of measurements	Sample-size Weighted Mean
Disclosure		97	.0438
	Market-based CFP	79	.0548
	Accounting CFP	18	-0.0085
Reputation Indexes		123	.3657
	Market-based CFP	45	.3593
	Accounting CFP	69	.3059
	Perceptual CFP	9	.6495
Social audits, corporation behaviours, processes and outcomes		145	.0907
	Market-based CFP	60	.0207
	Accounting CFP	82	.1312
	Perceptual CFP	3	.0767
CSP values and attitudes		23	.1041
	Market-based CFP	0	
	Accounting CFP	13	.0747
	Perceptual CFP	10	.2962