

CORPORATE SOCIAL RESPONSIBILITY, THE STAKEHOLDER APPROACH AND BEYOND: IN SEARCH OF THEORETICAL EXPLANATIONS FOR “DOING WELL WHILE DOING GOOD”

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Resumen

El artículo argumenta que existe el soporte en la investigación teórica y empírica entre el desarrollo social de la empresa y su situación financiera. Esta conexión puede estar creada, principalmente, para los propósitos de los *stakeholder*, aunque en formas modificadas que tienen en cuenta el desarrollo teórico que se incrementa en varios campos de las ciencias administrativas. Así, la Responsabilidad Corporativa Social (CSR, por sus siglas en inglés) debe ayudar a las empresas para mejorar el aprendizaje organizacional e innovación que les permita afianzar recursos escasos y limitados que son críticos para su competitividad, o puede usarse como un mecanismo para señalar su potencial a las partes interesadas.

Palabras claves: Responsabilidad social corporativa, enfoque de grupos interesados.

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Abstract

The paper argues that there is theoretical and empirical research supporting the view of a link between superior social performance of the firm and its financial performance. This connection can be largely framed out for analytical purposes by means of the stakeholder approach, albeit in modified forms that take into account theoretical developments arising from a number of fields of the administrative sciences. Thus, CSR may help firms to improve organizational learning and innovation allowing them to secure rare and unique resources that are critical for competitiveness, or may be used as a device to signal its potential to interested parties.

Keywords: Corporate social responsibility, stakeholder approach.

Introduction

There are mounting pressures on managers to be responsive to societal demands, even if those demands lead firms to establish policies that go beyond the obligations prescribed by the law. In all likelihood Corporate Social Responsibility (CSR) will remain an important issue for both scholars and practitioners, even a pressing one, in the years to come.

According to the paper, the stakeholder approach can be effectively used to frame out analysis of the links between CSR performance and Corporate Financial Performance (CFP), by complementing it with theoretical developments arising from a number of fields in the administrative sciences. CSR may help firms to improve organizational learning and technological innovativeness and to secure rare and unique resources that are critical for competitiveness; or firms may use CSR as a device to signal their potential to partners, employers, particularly in a context of bounded rationality or asymmetry of information. The paper summarizes as well empirical research that sustains those hypotheses.

The remainder of paper goes as follows. A second section discusses the growing importance of the issue of corporate social responsibility and socially responsible investment, subjects that are usually examined by researchers by means of the stakeholder approach. A third section summarizes results regarding the link between CFP and CSP. The fourth section presents

major traits of the stakeholder approach. A fifth section suggests that CSR may be a driver of financial results, as it may impulse organizational learning, innovativeness and securing of resources that are critical for competitiveness. CSR may be regarded as well as a signaling device, with equally positive results on financial performance. That section discusses empirical research that supports those roles of CSR. A final section presents the conclusions of the paper.

The Growing Importance of Corporate Social Responsibility

During the last two decades the notion of corporate social responsibility (CSR) has gained in recognition in the world of practitioners, as well as in academic quarters. The related movement of socially responsible investing (SRI) has witnessed a similar upward development. Available data on SRI trends shows that more than US \$ 2 trillion invested by professional money managers are socially screened in the United States alone (out of a total of \$ 19,2 trillion). Accordingly, more than one out of nine dollars in the United States managed by major investing institutions are placed in (partial) accordance to the social performance' attributes of the security issuers (Social Investment Forum 2003). Statman (2000) sustains that SRI may grow even more in the US if Social Security funds are invested in the market and if stocks for the Social Security are screened for social responsibility. In fact, as Guenster et al. (2005) noted, some of the world's largest institutional asset managers both in the US and Europe are publicly demonstrating their commitment to investing in companies that are deemed socially, morally, and environmentally responsible. Moreover, the authors remarked, some governmental organizations are introducing corporate reporting standards. For instance, an amendment to the UK Pension Act in 2000 requires pension funds to disclose how they consider social and environmental issues.

Some observers see a connection between these trends and the collapse of the Soviet Union and most of the State-controlled economies. The world seems to have conceded an increasing importance to the marketplace as a source of solutions for societal problems (Lydenberg 2002; Ogliastri 2003). A good example of firms facing pressure from societal issues is illustrated by new concerns on labor standards and monitoring in international

operations. An important number of firms, such as Levi's, Disney, Wal-Mart and H&M have established codes of conduct to guide actors in their supply chain. The Gap company, for instance, has a 100-strong department to monitor compliance of their suppliers. These efforts constitute a market-based corporate response to societal concerns regarding fair labor conditions. Moreover, this is increasingly accompanied with non-governmental organizations' supply of the needed monitoring of compliance (O'Rourke 2003).

Corporate Social Responsibility and Profits: Is There any Stable Connection?

CSR is a theoretical construct that designates all the efforts or investments that a firm incurs in order to keep a good relationship with society at large, communities where it operates or the stakeholder groups it deals with. A firm excels in social terms, if it advances actions in a systematic manner to attain a social goal, beyond the requirements of the law. As McWilliams and Siegel (2001, pp. 117) pointed out, a company that avoids discriminating against women and minorities, for instance, is not engaging in a social responsible act; it is merely abiding to the law. Two questions at least arise at this point. Firstly, does corporate "virtue" pay in financial terms? Secondly, if there is an affirmative answer, which is the underlying theoretical justification for that prime going to the good corporate citizen? This article pretends to shed light on those issues.

Since the publication of the seminal work by Moskowitz (1972) a substantial corpus of literature has emerged; focusing on the empirical analysis of the link between CSP and corporate financial performance (CFP). Three groups of methodologies have been envisaged by researchers to deal with the issue: event studies related to news concerning CSR achievements of individual firms arising to the market; statistical examination of the links between selected proxies for CSR and CFP; and analysis of SRI portfolios vis-à-vis conventional, i.e. non-socially screened investments. In our view, the accumulation of studies suggests the existence of a link between the firm's social performance and its bottom line. At the moment, the available evidence does not allow researchers to establish a causal relationship between CSP and CFP, though. In spite of that, the accumulated evidence warrants

in our opinion further theoretically inquiry into the possible causal links between CSP and CFP.

We must concede to the skeptics of CSR, that most researchers examining empirically the relationship between corporate social/environmental performance (CSP) and corporate financial performance (CFP) conclude that available evidence is too fractured or too variable to draw generalizable conclusions. Margolis and Welsh (2001) for instance, surveyed 95 articles. According to their study, nearly half of those studies (53%) point to a positive relationship between CSP and CFP. 19 papers exhibited no relationship between the two constructs (25%) and 4 studies even show a negative relationship. Similar mixed results are coincident with those offered by the survey of Griffin and Mahon (1997).

A more recent study by Orlitzky et al. (2003), employing rigorous meta-analysis methodologies, however, suggests the existence of a positive correlation between different proxies of CSP and CFP. Orlitzky et al. (2003) contend that most reviews of the literature that arrived to that conclusion are actually ill-advised from a methodological point of view. The authors assert that reviewers of the literature that have questioned the meaningfulness of the CSP-CFP link (as Griffin and Mahon 1997) have done so on the basis of the so-called 'vote counting' technique. The 'vote counting' method permits the integration of research, by means of the accumulation of significant results, or in the simplest case, by the tabulation of significant and non-significant findings. However, according to Orlitzky et al. a number of statistical experts are very critical regarding this procedure. 'Vote counting' in fact tends to draw false inferences because it does not correct for sampling and measurement error, two important study artefacts. Moreover, statistical error in the vote counting literature may be even more serious, since the statistical power of the vote counting procedure decreases with the increasing number of studies reviewed. Orlitzky and co-authors use rigorous meta-analysis procedures to integrate research conducted on the issue of the CSP-CFP link. This methodology is supposed to control for the shortcomings of the vote counting procedure.

In total, 52 studies were retained by Orlitzky et al. for integration using meta-analysis procedure. Those studies comprised 388 correlations and a total sample size N of 33,878. For being retained, studies should have examined quantitatively the CFP-CSP link, by means of the Pearson's product-moment correlation r , a t -statistic or effect size d .

In opposition to conclusions drawn on the basis of the 'counting vote' procedure, Orlitzky et al. found that the mean observed correlation (r_{obs}) for the total set of 388 correlations and a total sample size N of 33,878 is .18, with an observed variance of .06. The study artefacts of sampling and measurement error in CSP and CFP explain 24 percent of the cross-study variance of r_{obs} . After correction for sampling and measurement errors, the true score (corrected) correlation (r) was .36, which is twice the size of the observed correlation, with a variance that is slightly more than three times the size of the observed variance. However, the authors could not reject the hypothesis that previous financial performance explains subsequent social performance (the so-called 'slack resources hypothesis'). The study supports the instrumental stakeholder (i.e. superior CSR creates market value) and slack resources theories at about the same degree. Specifically, prior CFP and subsequent CFP subsets yielded observed correlations of .15 and corrected correlations of .29. Concurrent studies yielded observed and corrected correlations of .22 and .44 respectively. Orlitzky et al. conclude that taken together, these findings suggest a virtuous cycle with quick cycle times, or concurrent bidirectionality.

Examination of the performance of socially screened portfolios constitutes another way to test the financial consequences of excellence in firm's responsiveness to societal concerns. The beginning of 1990s witnessed the first attempts to study the question of performance of such funds, vis-à-vis non-socially screened, conventional funds. As Kurtz (1997a; 1997b) suggested, if modern financial portfolio management theories hold true, socially-screened portfolios should exhibit lower yields. Holding some number of randomly selected stocks can diversify away most unsystematic risk. The problem is that the impact of social screens is decidedly non-random. As a result, social screens can create uncompensated risks, even in large portfolios. The pool of selectable stocks available to SRI is considerably smaller than the unscreened universe of stocks. Wilson (1997) cites opinion surveys to assess that 40 percent of the universe of public firms in Britain can be eventually picked up by SRI. If SRI portfolios do well, or at least, if differences are not statistically significant vis-à-vis financial yields of socially un-screened portfolios, it would suggest the existence of an underlying social factor driving up share prices.

Most empirical research on the subject tends to confirm the view that there is no cost associated to invest “with a social conscience”, or that in any case it is not substantial (Statman 2000; Diltz 1995; Kurtz 1997b, Hamilton et al. 1993; and Reyes and Grieb 1998).

A number of the studies included in the Margolis and Walsh’ survey were based in the event study technique. To the best of our knowledge, Frooman (1997) conducted the only meta-analysis of event studies related to CSR available in the literature. Using the results of 27 event studies, he showed that illegal and unethical behavior resulted in substantial shareholder losses. His findings, however, are of limited use for our study. In fact, our paper focuses on the economic consequences of the opposite corporate behavior, i.e. actions related to improve relations with communities, workers and other stakeholders. As we will see, however, the technique has been employed to study the appraisal by the market of events related to corporate social responsibility. We will discuss punctual applications of the event study technique in the section devoted to analysis of the extensions of the stakeholder approach.

The picture that emerges from the available literature discussed above suggests the possibility for a firm of creating shareholder value, by excelling in social performance. This conclusion calls for refined theoretical discussion of the mechanisms by which an outstanding social performance may be transformed into superior financial performance, at the firm level.

Nowadays, most researchers advocating the existence of a link between CFP and CSR tend to resort to the stakeholder approach as a framework for their analysis. Stakeholder analysis, it is argued, allows researchers to focus on relationships that can be tested empirically. Our argument is that the stakeholder approach may benefit from a number of theoretical tools developed in the fields of organizational economics, business strategy and finance.

The Stakeholder Approach

There is a clear trend among scholars interested in CSP to use the stakeholder approach as the major framework to guide research on CSP. Within this view, firms that excel socially are those capable of satisfying demands of

stakeholders. As Moir (2001, pp. 18) puts it, "By far the greater number of commentators that propose active CSR do this by means of stakeholder analysis".

Stakeholders have been defined as "persons or groups that have, or claim ownership, rights, or interests in a corporation and its activities, past, present, or future. Such claimed rights or interests are the results of transactions with, or actions taken by the corporation, and may be legal or moral, individual or collective" (Clarkson 1995, pp. 259).

Stakeholders with similar interests, claims, or rights can be classified as belonging to the same group: employees, shareholders, customers, and son on. Some scholars separate stakeholders in two groups: primary and secondary. A primary stakeholder group is one without whose continuing participation the corporation cannot survive as a going concern. Clarkson states that primary stakeholders groups are typically comprised of shareholders and investors, employees, customers, and suppliers, together with what is defined as the public stakeholder group: the governments and communities that provide infrastructure and markets, whose laws and regulations must be obeyed, and to whom taxes and other forms of obligations are due.

The main feature of the primary stakeholder is that if it withdraws its support to the company, because of dissatisfaction, the corporation will be seriously damaged or unable to continue as a going concern. The secondary stakeholder groups are defined as those who influence or affect, or are influenced or affected by, the corporation, but who are not engaged in transactions with it and/or they are not essential for its survival.

Social performance data in the context of the stakeholder approach can be linked to a description of what a company is doing regarding issues of interest for stakeholders. Issues can be empirically identified, and scales of performance developed and applied. The question of the link between CSP and CFP can be reframed in terms of the enhancement of financial performance as a consequence of a greater satisfaction of primary or secondary stakeholders, or one group among them (Ruf et al. 2001; Key 1999).

Our discussion leads us to identify two major areas that, by extending the stakeholder approach, have proven to be promising ways to frame out for research on the connection between social and financial performance. Firstly, firms excelling in stakeholder satisfaction may create unique

competences or resources to boost their financial performance. Secondly, they can use CSR to signal to stakeholders their value as partners or employers, in a context of bounded rationality, or asymmetry of information. A number of researchers have pursued these two avenues of inquiry. Empirical results seem to give support to the validity of these hypotheses. Arguably, most fruitful theoretical and empirical research will be related to unearthing ways for organizations to improve their competences/resources vis-à-vis competitors and to signal their potential for stakeholders. An overview of key papers within these perspectives is offered in next section.

Outstanding Stakeholder Management, Signaling and Competence/Resource Development

Transaction costs, bounded rationality and signaling

Drawing on Coase (1952), an important body of literature has examined the role of transaction costs in explaining firm's behavior. According to Ruf et al. (2001) the theoretical basis for this extension of stakeholder approach is the work of Williamson (1975, cited by Ruf et al. 2001). Williamson had recognized the importance of establishing relational contracting, whereby firms acknowledge that an individual contract is in fact one portion of a stream of recurring contracts with another party. Depending on the stakeholders' profile and demands, contracts can prove costly to write, monitor and enforce. As contractual costs increase, firms possess greater incentives to engage in opportunistic behavior. Stakeholders that recognize the dilemma will actively monitor compliance, or possibly lobby for legislation/regulation, which requires mandatory compliance. Stakeholders may use other ways to confront the firm's opportunistic behavior, like imposing boycotts, or going into strikes. Because of stakeholder confrontation (even if only potential), firms can undo their opportunism. Moreover, they can build a reputation among stakeholders of closely monitoring performance to guard against future opportunism. As Ruf et al. (2001, pp. 145) summarized it, "firms that voluntarily adopt socially responsible actions strengthen their reputation as a desirable transaction partner". Theoretical arguments from the literature of signaling in finance will lead to a similar conclusion. If one economic actor does not have access to information that

is critical to his decision-making (as it could be the purchase an item of unknown quality), he must look for 'signals' intended to be associated with greater quality of the item. To be effective, these signals must be costly and difficult to replicate by low-grade competitors. Thus, CSR may serve as such signaling device.

Actions associated to CSR, may be regarded thus as signaling efforts that can be used by individuals as an information-processing short-cut or heuristic while making evaluations of or decisions that concern the firm. Literature on cognitive processes in decision making shows that individuals are likely to simplify their evaluative decisions, through the use of uncomplicated tools.

Jones and Murrell (2001) hypothesize that the presence of such a signaling device, may explain the abnormal returns associated with firms named for the first time to Working Mother magazine's list of "Most Family-Friendly Companies". Since 1986, Working Mother has published a list of approximately 75 to 100 firms selected according to a number of criteria. Among other: salaries vis-à-vis those of the firm competitors, advancement opportunities available to women, or availability of family-friendly benefits, including leave for childbirth, job sharing, flexible time and work- at-home options.

Jones and Murrell found support for this interpretation. They identified a set of 51 publicly traded firms that entered for the first time to the list prepared by Working Mother magazine between 1989 and 1994, and exhibiting no confounding effects. Firms that made the list for the first time experienced significant positive, abnormal returns following the announcement, in the order of 0.89 percent for the window (-1-1), i.e. one day before and one day after the announcement.

Wright et al. (1995) arrived to similar conclusions while studying the impact on stock price of firms receiving the US Department of Labor Exemplary Voluntary Efforts Award. Broadly, the requirements to being nominated for the award include a commitment to equal employment opportunity with demonstrated results, a desire to go beyond "business as usual" practices, and the initiation of programs that are replicable by other corporations. Approximately six awards are presented annually. For the announcement day itself they uncovered an excess mean return of 0.467 percent, significant at 10 percent.

In line with the previously mentioned papers, Turban and Greening (1996) investigated the relationships between firms' corporate social performance based on ratings obtained from the KLD database, and firms' reputations and attractiveness as employers. Ordinary least squares estimates indicate that firms with a higher CSP rating have more positive reputation and are more attractive employers than firms with lower CSP ratings.

Development of new competences/resources

According to the resource-based view of the firm (RVF), differences in a firm performance are the direct result of the collection of resources that they acquire (Ruf et al. 2001). Firms enjoy sustained competitive advantage if they possess resources that are valuable, rare, inimitable, and non-substitutable. Resources include both tangible and non-tangible assets, such as leadership, responsiveness to market changes, and a positive social reputation. In fact, one can make the case that non-tangible assets tend to matter most, as tangible assets are more likely to be bought in the open market. Direckx and Cool (1989, cited by Ruf et al. 2001) contend that resources are both path-dependant and cumulative; one builds a reputation over a long period of time, a timeframe that cannot be easily shortened by competitors. In a similar fashion, know-how or expertise requires years to develop, limiting the ability of competitors to copy it.

Assuming that all firms in a specific industry must satisfy the same stakeholders, meeting stakeholders' demands does not necessarily confer competitive advantage. Compliance with current regulations will not certainly add at all any significant advantage.

Nevertheless, moving beyond mere compliance, into active support of a stakeholder demand can create such advantage. Russo and Fouts (1997, cited by Ruf et al. 2001) provide an example where a firm has two choices to meet the stakeholder demand for reducing pollution: either they can install filtering equipment or they could change their design process to reduce pollution. Installing the filtering equipment will result in compliance. However, the resource-view of the firm considers that the firm may enjoy sustained competitive advantage by changing their design process (active support). Compliance becomes the norm in the industry, and therefore it

can not provide a competitive edge. A similar argument can be made regarding stakeholders other than the environment.

There is empirical support for this line of reasoning. Dowell et al. (2000) analyzed the consequences for firms' valuations of the global environmental standards of a sample of US-based multinational firms. These firms, by moving operations into emerging nations, may avoid the strict environmental regulations which are pervasive in industrial countries. Conventional economic logic suggests that, *ceteris paribus*, there are incentives for multinational firms to move their more pollutant activities to emerging nations, defaulting to local standards with lax regulation or enforcement. The annual cost of complying with environmental regulation in the US has been estimated to be around 2.1% of GDP, in contrast to a fraction of 1% in developing nations. Moreover, by delocalizing their production in that kind of countries, multinational firms may be able to recapitalize old equipment.

Examining stock market performance of 89 S&P firms, they found that firms adopting a single astringent global environmental standard have much higher market values, as measured by Tobin's *q* than firms defaulting to less astringent, or poorly enforced host country standards. Authors conclude that their results also suggest that externalities are incorporated to a significant extent in firm valuation.

While studying the economic consequences for firm valuation of eco-efficiency, Guenster et al. (2005) arrive to a similar conclusion. These authors used a database (Innovest) that provides scores for environmental performance of firms. The authors studied the relationship between scores provided by Innovest and proxies for financial performance. Under several scenarios, the coefficient for the main variable of interest, Eco-efficiency, is positive and significant at the 1% level.

Empirical results are consistent, thus, with theoretical perspectives that underline the capacity of CSR in helping firms to strengthen to one of the most critical resources: organizational learning and innovativeness, a point that have been stressed by a number of commentators. For instance, Kurtz (1997a) suggests that top management attempt to move the social performance of the firm beyond the request of the law may induce to the achievement of operational efficiencies. He states that there is some anecdotal evidence of this phenomenon, particularly in the environmental area. Meyers

and Nakamura (1980, cited by Kurtz 1997a) have developed a theoretical framework to explain why increased environmental regulation can lead to greater capital and turnover, offsetting the apparent costs of such policies.

Conclusions

The paper summarizes a number of theoretical and empirical contributions in the literature that examine the existence of a positive link between superior social performance of a firm (i.e. going beyond compliance of the law in serving its stakeholders) and diverse indicators of financial performance. The review of that literature sustains that enlightened self-interest does have a positive connection with financial results.

The basic claim of the present paper is that the stakeholder approach, combined with theoretical developments arising from the literature in the fields of finance and business finance, may be particularly useful for researchers interested in exploring the connection between social and financial performance.

We argue that firms engaging in CSR may get access resources that are critical for competitiveness, or bolster organizational learning and innovation capacities that enable them to ensure such resources. Also, in a context of bounded rational, or asymmetry of information, CSR may be used as a signaling device by firms, in order to attract employees or business partners.

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