Australian National University

Excellent work!

27/30 HD

Topic 4

Corporate Social Responsibility and Corporate Financial Performance: Spotlighting the unexplored effects of firm power

[redacted]

[redacted]

Organisational Behaviour

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Contents

Abstract

Scholarly research into the relationship between CSR and CFP is marked by great variety in method and approach. There is mounting evidence of a positive relationship between the two concepts; however, limited attention has been paid to the host of variables that might moderate the translation of socially-oriented action into financial rewards. The explanatory and predictive powers of select key CSR-CFP models have been examined and described to provide insight into the state of knowledge on the subject, and to frame areas for future research, with an aim to developing both theoretical CSR understanding and the pragmatism of practitioner advice.

short, powerful statement that introduces us to the gap

Keywords: CSR, CFP, instrumental stakeholder, cost-benefit, differentiation, firm power

Introduction

The debate around corporate social responsibility (CSR) action stretches back to the mid-1950s (Carroll, 1999). On the one side, authors argue that the benefits corporations derive from using societal resources morally oblige them to offer remittance; on the other, it is claimed that corporations are "inefficient and inappropriate agents of social change", and further, that such contributions represent "misappropriation of shareholders' funds" (Barnett, 2007, p. 794) (see Friedman, 1970, for further discussion). The ethical equivocacy of CSR has prompted many scholars to focus their attention on questions grounded in business logic- most notably, the financial pros and cons associated with undertaking socially responsible action. → general relevance/importance of topic

Overview of 2 opposing views on CSR ⇓ introducts of major issues/controversies

In recent years, there has been a growing body of empirical and theoretical support for a positive relationship between CSR, as a measure of firms' moral conduct, and corporate financial performance (CFP), as a measure of firm wealth; yet, myriad variables affecting the relationship have not been explored in depth. The potential impact of firm power on the translation of CSR action into CFP results, for one, has been sidestepped. This represents an important omission in both theoretical and practical CSR approaches, and has vital implications for managers, concerning business sustainability and resource optimisation.

good to clarify

justifies the importance of this gap

introduces us to a gap

The following literature review considers a suite of influential writings on the topic of CSR and CFP, concentrating on three key frameworks: instrumental stakeholder theory, cost-benefit analysis, and differentiation theory. Their premises and interconnectivities are highlighted, as are gaps in their respective models. Finally, a brief overview of theories surrounding the interested variable is offered, with room for future research clearly outlined.

provides us w/ background informing current research and overview of literature review

(*) Excellent introduction:
(1) - to-the-point
(2) - justifies significance of topic
(3) - provides readers with background understanding

CSR-CFP Theory and Analysis

Constructs of Firm Wealth and Moral Conduct

identified issue in this research topic

'Moral conduct' and 'wealth' are two terms key to navigating and interpreting the literature surrounding the present debate; yet, each is conceptualized and defined in a slew of exclusive and inconsistent ways. Moral conduct, in particular, is variously aligned with corporate social responsibility (CSR) or corporate social performance (CSP), depending on the sub-topic of investigation. Notwithstanding this, de Bakker, Groenewegen and den Hond's (2005) bibliometric analysis of the CSR-CSP field revealed "complete overlap" between the two literatures until 1990, with two-thirds of CSP-tagged publications also appearing in the CSR dataset for the period 1969- 2002 (p. 292).

Provides def'ns of key terms used in literature

Throughout the management literature, one of the most popular definitions of CSR comes from McWilliams and Siegel (2001), being the "actions that appear to further some social good, beyond the interests of the firm and that which is required by law" (p. 117). The equivalent definition of CSP comes from Wood (1991): "a (firm's) configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to (its) societal relationships" (p. 693). A narrow majority of the literature reviewed employs the term 'CSR' to denote firms' socially-oriented activity, thus, it is used in preference to CSP in subsequent discussion.

By contrast, the representation of firm wealth by corporate financial performance (CFP) is uncontroversial. CFP is frequently scored against one of: market-based (investor), accounting-based, or perceptual (survey) scales (Orlitzky, Schmidt & Rynes, 2003). Both market-based and accounting-based measures of CFP are considered highly valid: more so than common gauges of CSR, which incorporate values-based judgements (e.g., company disclosures, third-party reputation ratings, and social audits) (Orlitzky, Schmidt & Rynes, 2003).

(*) good to first clarify the def'ns of key constructs before proceeding to review the literature => excellent work!

CSR-CFP Relationship Models

relevant theories and frameworks

excellent summary of nature of r'ships

major issues/controversies of topic

Each of the three most cited papers[i] in de Bakker et al.'s (2005) CSR-CFP dataset uses stakeholder influence theory to frame analyses of CSR antecedents and outcomes. Other theories, which have grown in popularity in the past decade, derive from cost-benefit and product differentiation principles of economics (Orlitzky, Siegel & Waldman, 2011). Within these frameworks, researchers have differentially identified positive (Griffin & Mahon, 1997; Margolis & Walsh, 2003), neutral (Besley & Ghatak, 2007; Crisóstomo, de Souza Freire & de Vasconcellos, 2011), bounded (Mintzberg, 1983; Reinhardt, 1998), and non-significant (Saleh, Zulkifli & Muhamad, 2008) relationships between CSR and CFP indicators, some bidirectional and simultaneous (Orlitzky et al., 2003). Possible explanations for these mixed results - summarised by Barnett (2007) - include: deficiencies in data, 'stakeholder mismatching' (see Wood & Jones, 1995), inappropriate definition of terms, failure to manage variables like industry nature and risk level, and conceptual differences among CSR and CFP measures.

shows currency of research but also acknowledges the downside

Since 2000, meta-analyses have tended to find majority support for a positive correlation between CSR and CFP (Golicic & Smith, 2013); however, some have argued that methodological weaknesses undermine the reliability and validity of patterns deduced (see Orlitzky et al., 2003; Barnett, 2007).

Instrumental Stakeholder Theory

Understanding and applications of instrumental stakeholder theory have been greatly influenced by a paper of the same name by Jones (1995), who built on pioneering work from Freeman (1984) to propose a model integrating stakeholder concepts, economic and behavioural science theories, and ethics. Its central argument holds that firms achieve competitive advantage (and by extension, economic profit) by cultivating relationships with key stakeholder groups based on cooperation and mutual trust (Jones, 1995).

Barnett (2007) expanded on the theory by introducing the concept of stakeholder influence capacity (SIC); that is, "the ability of a firm to identify, act on, and profit from opportunities to improve stakeholder relationships through CSR" (p. 803). The SIC construct encompasses factors including the likelihood that a firm's CSR activity will be noticed by its stakeholders, potential positive interpretations of such activity, and potential positive reactions to those interpretations (Barnett, 2007). According to the theory, both firms' actions and stakeholders' responses are path-dependent, i.e., based on prior relationships (Barnett, 2007). The unique characteristics and environment of each firm determine their variable outcomes from CSR activities, debarring a common or standard rate of return per unit of social investment (Barnett, 2007).

Cost-Benefit Analysis

Cost-benefit approaches to the CSR-CFP relationship aim to aid calculation of the 'optimal level' of CSR action for a given firm. CSR projects are assumed to be normal goods - i.e., products for which demand increases with income - with a market-clearing price (expenditure) and quantity at the intersection of (firm) supply and (community) demand (Orlitzky, et al., 2011). Influential supply side variables identified by Orlitzky et al. (2011) include R&D and advertising spend, firm diversification, organisation size, average consumer income, and industry life cycle status. Earlier writings by Orlitzky and Swanson (2008) highlight the indirect and implicit costs of CSR action considered in cost-benefit analysis, which raise the total economic cost of a given project. Some examples are resources (equipment, person-hours) spent identifying key stakeholders, evaluating their wants and needs, and monitoring their satisfaction levels (Orlitzky & Swanson, 2008).

Marom (2006) integrated work by many prominent CSR scholars - including Graffland (2002), Jones (1995), and Waddock and Graves (1997) - to develop a comprehensive framework for revealing firm-specific CSR equilibria, based on an hypothesised curvilinear model of returns to social responsibility products[ii]. According to the rules of profit maximisation, firms are advised to generate social products up to the point where the marginal benefit gleaned from the last unit provided equals its marginal cost of production (Marom, 2006). Moreover, it requires investment in social products that optimise utility for the dominant stakeholder group (or subset largest in aggregate) to engender the greatest rewards (Marom, 2006).

Ultimately, the model is intended to transform CSR from a subjective ethical-moral exercise into a scientific management activity (Marom, 2006); however, subsequent authors have questioned its serviceability, owing to dependence on (exogenous) stakeholder utility functions, which are notoriously difficult to predict (Baucells & Sarin, 2010).

Differentiation Theory

With almost 3 500 citations[iii], McWilliams and Siegel's (2001) theory of the firm perspective on CSR is one of the most influential contributions to the modern literature. Their model integrates supply-and-demand and resource-based view (RBV) frameworks to predict profit-maximising levels of CSR activity (McWilliams & Siegel, 2001). Key to the model's function is the assumed transposition of CSR credit to the individual product level: that it manifests as a 'social attribute' (feature) of a good or service, which is valued by a subset of consumers (Orlitzky et al., 2011). Because there are costs associated with undertaking CSR endeavours, it follows that the costs of producing goods and services with social attributes will exceed those without at every level of output (McWilliams & Siegel, 2001). Thus, activities must remain within cost constraints defined to price under target consumers' willingness to pay (McWilliams & Siegel, 2001). Demand for social attributes is believed to be affected by a range of factors - product price; consumers' disposable income levels, tastes and preferences; advertising to promote awareness; prices of substitute products - variously within or outside firm control (McWilliams & Siegel, 2001).

Windsor (2001) cites Banfield (1985) in arguing that the moral choice inherent to CSR action is reduced to "simpl(e) pricing behaviour" (p. 504) by the McWilliams-Siegel model; a process he dismisses as "profit-maximising ethics", rather than "prudential altruism" (p. 504). From this perspective, the similarities between differentiation and cost-benefit theories become clear. Elsewise, the model is attacked for potential short-sightedness, encouraging firms to disregard stakeholders' CSR demands in a moment when they are unprofitable, only to face more costly amendments in the future (Windsor, 2001).

(*) Good overview of the three main theories/frameworks informing the CSR-CFP r'ship
=> each section had a balanced view of the strengths/weaknesses of the theory/framework
=> simple to understand, not overly complex

Preterition/in CSR-CFP Literature

/Gaps

Moderating Effects of Firm Power

indicates that the theoretical frameworks all point to some missing links in the current literature

Each of the above theories differs in the amount of attention afforded to firm and market characteristics as moderators of the relationship between CSR and CFP. Barnett's (2007) SIC construct - under instrumental stakeholder theory - is the least explicit, referring only to 'unique' firm characteristics affecting rates of return from CSR activities. McWilliams and Siegel (2001) note several firm-level variables impacting abilities to initiate CSR, including research and development spending, human resource quality, and product maturity, but neglect to explore external factors influencing the translation of CSR activities into financial results. Finally, Orlitzky et al. (2011) consider some aspects of market structure (firm diversification and size, industry life cycle status), but neither offer insight into the direction or magnitude of impact those might have on financial results, nor acknowledge their interdependencies in any measure.

addresses gap in literature

To the best of knowledge, no published CSR research has directly examined the moderating effect of firm power - stemming from market structure - on the process of deriving financial gains from social responsibility efforts. A number of authors have briefly touched on the topic in cognate studies, however, and their hypotheses are summarised below.

According to Reinhardt (1998), firms are only able to earn positive economic profits from CSR activities if they can prevent others imitating their strategies. Besley and Ghatak (2007) affirm this proposal, arguing that (absent barriers to entry) firms cannot expect *ex ante* profits from CSR in the medium or long term, as new competitors will surely drive down prices to the breakeven point of cost. Crifo and Forget (2015) take the obverse view, suggesting that CSR activities can serve as barriers to entry in and of themselves, limiting market competition by raising potential entrants' costs, and thereby enhancing profit prospects. Finally, Cotrill (1990) suggests an alternative cause-and-effect relationship between CSR and profit, arguing that economic profits are "sine qua non for CSR" (p. 728), and that, therefore, social responsibility projects are more likely to be undertaken by:

a. Larger, more diversified companies with greater internal capital pools to draw upon; and

b. Companies with few competitors to share revenues between.

Moreover, it is claimed that the transitory nature of profits in most markets relegates CSR commitments to the domain of temporary, not lasting, allocations (Cotrill, 1990).

Many themes for further research are brought to light by this assessment, among them:

1. Whether firms with limited power (e.g., owing to market structure approximating perfect competition) exhibit similar or dissimilar CSR intentions to firms with more power (e.g., monopoly, oligopoly).
2. Whether firms with limited power undertake CSR activities at greater or lesser frequencies and intensities than those with more power.
3. Whether the rates of return on comparable CSR activities differ between firms with more or less market power.

Although I would have preferred you to write the above in full paragraphs your points are highly relevant and exhibits a high-level of thinking on your part - excellent work!

Conclusion

Myriad interpretations and constructs are intermingled in the literature on CSR and CFP. Despite a growing consensus on the positive relationship between firms' social responsibility activities and financial rewards, the mechanics of the exchange remain something of a mystery. Key frameworks applying instrumental stakeholder theory, cost-benefit analysis, and differentiation theory each offer insight into some of the potential variables affecting the translation; however, none fully or directly addresses the role of firm power in determining profit achievements. Further research along this dimension stands to improve theoretical conceptions of CSR channels, as well as practitioners' abilities to form appropriate decision making guidelines to balance social contributions with profit-seeking imperatives.

+ve

- identified clear & consistent gap
- coherent, logical flow
- introduced us to key theories/frameworks/issues
- pointed us to future research directions
- on the whole, an excellent piece of work with great research potential!

-ve

- need to show how addressing gap would "add" or "extend" current literature
- could have better synthesised and integrated discussion of the three theories/framework rather than discussing them separately

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Correct use of APA referencing / in-text citation

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Good use of A or A* articles
⇒ it really shows in the quality of your work!

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Appendix

Appendix 1

MGMT2007: LITERATURE REVIEW, SUBMISSION CHECKLIST

Please complete the submission checklist and include it as **Appendix-1** of your assignment. Put "Yes" or "No" as appropriate against each criterion. If "No", please comment reason for "no"

MARKING RUBRICS CRITERIA	COMPLETED	NOT COMPLETED	COMMENT
ABSTRACT (100 WORDS)	X		
INTRODUCTION			
Describes general relevance/importance of the topic	X		
Summarise what we currently know and don't know about the topic	X		
Provides overview of literature review	X		
MAIN BODY OF LITERATURE REVIEW			
Describe relevant theories/frameworks	X		
Critically review current research on the topic	X		
Critically review major issues/controversies on the topic	X		
Based on the analysis, provide your own views on the topic	X		
Based on the analysis, specify a 'gap' in the literature	X		
CONCLUSION			
Integrate the issues explored in the literature review	X		
Explain how addressing the research question will 'add' or 'extend' the existing literature	X		
STRUCTURE OF LITERATURE REVIEW			
Ensure logical development of the topic	X		
Have clear organisation and labelling of sections and sub-sections	X		
Ensure a consistent flow between major sections, sub-sections and paragraphs	X		
PRESENTATION OF LITERATURE REVIEW			
Provides clear expression of ideas	X		
Have correct grammar, spelling, punctuation, and lay-out	X		
Have formatted literature review according to APA (6th Edition) (particularly the in-text citations and references)	X		
Have referred to a minimum of 4 A or A* ranked ABDC journal articles (minimum requirement is 4)	X		
Have met total references requirement (i.e., 15 references)	X		

[i] In descending order of citation frequency: Jones (1995), Wood (1991), and Mitchell, Agle, and Wood (1997).

[ii] Marom's (2006) model is represented by the formula: $\mathrm{Profit}_{\mathrm{CSR}} = \mathrm{R} - \mathrm{C} = \mathrm{U}_{\mathrm{S}}^{\mathrm{T}} \times \mathrm{S} - \mathrm{C}$
Where S denotes a single unit of social output, T denotes the stakeholder group affected by S, C denotes the cost incurred to provide S, U denotes T's utility function for S, and R denotes the firm's benefit from providing S.

[iii] Total citations of McWilliams and Siegel (2001): 3 464 across books and peer-reviewed journals, as at 1 October 2015 (Google Scholar metrics).