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Does community environment matter to corporate social responsibility?

Dejun Wu[a,1,*], Chen Lin[b], Sibo Liu[b]

[a] School of Accounting, Zhongnan University of Economics and Law, Wuhan, China
[b] School of Economics and Finance, The University of Hong Kong, Hong Kong

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ABSTRACT

How does the preference of local stakeholders shape firm's corporate social responsibility (CSR)? Using a twenty-year U.S. sample, this paper examines the effects of the community demographic and cultural environment on CSR. We find that firms located in counties with more senior residents and/or higher levels of religiosity display higher degree of corporate social responsibility. In addition, we find the positive effects of local seniors and religiosity are stronger for less financial constrained firms. The result is robust after controlling for firm fixed effects, operating state trends and incorporation state trends. Taken together, our evidence supports a stakeholder theory of corporate social responsibility.

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1. Introduction

Corporate social responsibility (CSR) has been embraced by a growing number of firms and gained much public attention in recent years. Most US firms nowadays practice corporate social responsibility in some forms. According to a report[1] by KPMG, 86% of US firms issue social responsibility reports. Some large firms invest hundreds of millions of dollars annually on altruistic endeavors related to employee or community development programs (Hong et al., 2012). Practitioners are assessing the possible channels that CSR can add value to the firm. A survey[2] conducted by McKinsey & Company suggests most of CFOs perceive that CSR increases firms' value. In particular, meeting society's expectations is an important channel.

CSR have been discussed in academic studies for decades. The debate focuses on why firm would invest significant resources on CSR. According to some studies, CSR is considered as a crucial corporate behavior that deals with firms' relationship with their stakeholders, such as employees, communities and etc. The pro-social behavior that provide value to firms stakeholders (Benabou and Tirole, 2010) and therefore gain the support from them. It has been documented that firm's CSR

* Corresponding author.
E-mail addresses: djwu2005@znufe.edu.cn (D. Wu), chenlin1@hku.hk (C. Lin), sibo@hku.hk (S. Liu).
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1 The KPMG Survey of Corporate Responsibility Reporting 2013
2 Valuing corporate social responsibility: McKinsey Global Survey Results.

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level matters for debt financing (Goss and Roberts, 2011), equity financing (El Ghoul et al., 2011), credit rating (Attig et al., 2013) and so on. The stock prices also display different patterns for firms with more CSR concerns (Chen and Gavious, 2015; Erragraguy and Revelli, 2015; Lam et al., 2015). In spite of these extensive discussions, the question on how the preference of stakeholders in the community affects firms' CSR behavior is still less touched.

The demographic and cultural features are fundamental elements of the society reflecting the preference of stakeholders in the community. As shown in the existing literature (Becker et al., 2011), firm's corporate decision, such as dividend payment is influenced by the characteristics of local demographics. Specifically, firms located in area with more senior residents tend to pay more dividends. On the other hand, the cultural environment in the community, frequently proxied by religion, could influence corporate behaviors in many ways. For instance, cultural environment can be used to predict the variation of the investor protection, such as credit rights (Stulz and Williamson, 2003; Baele et al., 2014), the formation of international trade (Cavalcanti et al., 2007; Lewer and Van den Berg, 2007), stock trading behaviors (Grinblatt and Keloharju, 2001) and etc. Building on these important studies, in this paper, we investigate how community demographic and cultural environment shape corporate social responsibility.

In this paper, we examine how the preference of the community affects firm's CSR behavior. We adopt two proxies to quantify the effect of community preference, local seniors and religious residents, as both seniors and religious people are important stakeholders in the community. On the one hand, as documented in the literature (Peterson et al., 2001; Forte, 2004), people's age appears to be positively correlated with ethical behavior. The local seniors have shown to have strong effect on corporate policy, such as payout policy (Becker et al., 2011). On the other hand, religiosity is the common proxy for culture used in existing literature. It has been documented that religion influences the governance quality (La Porta et al., 1999), firm's behavior in earnings management (Du et al., 2014) and etc. And religiosity has also been shown as a strong predictor for ethical business behaviors (Conroy and Emerson, 2004). Therefore, local seniors and religious residents are likely to exhibit a stronger preference for CSR behaviors. And importantly, they are likely to exhibit less tolerance for unethical activities or behaviors harmful for the society. For example, people with strong religious belief are less likely to accept the practices of accounting manipulation (Conroy and Emerson, 2004; Longenecker et al., 2004). And McGuire et al., (2012) document that religious social norms are correlated with lower accounting risk and accounting practices challenged by the shareholder via lawsuit. Building on these arguments, we thus posit the communities with a high degree of religiosity naturally impose more demand for corporate social responsibility and are less tolerant about the corporate activities that will create social concerns.

To mitigate the potential endogeneity issues in our study, we estimate a panel regression model with different combinations of fixed effects. We include firm fixed effect to account for firm specific time-invariant characteristics. The geographical or legal shocks that happen in different states may affect our results. To mitigate this concern, we consider operating state-by-year and incorporation state-by-year fixed effects to control for the possible contemporaneous effects at both operating state level and incorporation state levels.

Using a 20-year panel sample with 3104 unique US firms and 19,580 firm-year observations, we find that the fraction of senior people and religious adherents in the community are both positively correlated with firms' level of corporate social responsibility. In addition, we find that the effects are stronger for less financially constrained firms. It suggests only less constrained firms are able to meet the expectations of the communities.

This paper contributes to the existing literature along several dimensions. First, this paper is among the first to provide the evidence consistent with the notion that CSR as a delegated prosocial behaviors influenced by the preference of local stakeholders. In a related study, Di Giuli and Kostovetsky (2014) document that firms score higher on CSR when they are headquartered in Democratic rather than Republican-leaning states. In our study, we focus on the preferences of stakeholders at county-level and show that firms located in counties with more senior residents and religious adherents have higher CSR scores. Our study adds important texture in this line of research. By proposing local seniors and religiosity to proxy for the effect of community environment, our research is also directly related to the studies on the determinants of corporate social responsibility. Second, this paper contributes to the studies on the influential effect of regional characteristics, such as demographics and culture on corporate policy. As documented in the literature (Becker et al., 2011; Stulz and Williamson, 2003), differences in demographics and culture, can partially explain investor behaviors. In contrast, the evidence in our study reveals that the influence of demographics and culture seems to be critical channels for stakeholder protection. The evidence help us understand the specific mechanisms how the effect of stakeholders interact with corporate behaviors.

2. Hypothesis

Benabou and Tirole (2010) consider the nature of CSR as a delegated pro-social behavior. Firms might consider the stakeholders' preference in deciding investment in CSR. In our analysis, we specifically consider the preference of stakeholders in the community where the firms are located. Our analysis builds on two important reasons. The first one is that some important stakeholders in the community indeed have been shown prefer socially responsible firms. The second one is related to the stakeholder value maximization view (Deng et al., 2013). Specifically, it is beneficial for a firm to invest in CSR because focusing on the interests of stakeholders may increase their willingness to support a firm's operation and improve a firm's business environment.

To jointly satisfy these two arguments, we propose local seniors and local religiosity to measure the effect of community environment. First, senior citizens and religious adherents are important stakeholders for firms operating in the community

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