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Corporate socially responsible investments: CEO altruism, reputation, and shareholder interests☆

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ABSTRACT

Corporate managers often invest in activities that are deemed to be socially responsible. In some instances, these investments enhance shareholder value. However, in other cases, altruistic managers or managers who privately benefit from the positive attention arising from these activities may choose to make socially responsible investments even if they are not value enhancing. Given this backdrop, we investigate the various factors that motivate firm managers to make socially responsible investments. We find that larger firms, firms with greater free cash flow, and higher advertising outlays demonstrate higher levels of corporate social responsibility (CSR). We also find that companies with stronger institutional ownership are less likely to invest in CSR — which casts doubt on the argument that these investments are designed to promote shareholder value. Consistent with the literature that explores how CEO personal attributes influence corporate decision making, we find that female CEOs, younger CEOs, and managers who donate to both Republican and Democratic parties are significantly more likely to invest in CSR. This latter result suggests that CSR investments may not be driven solely for altruistic reasons, but instead may be part of a broader strategy to create goodwill and/or help maintain good political relations. Finally, we find a strong positive connection between the level of media scrutiny surrounding the firm and its CEO, and the level of CSR investment. This finding suggests that media attention helps induce firms to make socially responsible investments.

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1. Introduction

Apart from their financial obligation to create value for their investors, companies also often face pressure from various stakeholders to invest in activities that are deemed to be socially responsible. Anecdotally, most large companies routinely stress the importance of corporate social responsibility (CSR) and take steps to highlight their investment in these activities.[1] Whether or not these activities come at the expense of investors, and if so, whether managers should place stakeholder concerns above stockholders have been hotly debated issues for at least several decades.[2]

☆ Earlier versions of this paper were titled, "What motivates corporate managers to make socially responsible investments?".

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[1] From examining some company websites and annual reports, it is clear that many top corporations highlight their various attempts to operate in a socially responsible manner. As some examples, see the websites of Starbucks, Johnson and Johnson, and Duke Energy, where each of these companies prominently emphasizes their social outreach.

[2] See, for example, Drucker (1968), Friedman (1970) and Handy (2002). Lougee and Wallace (2008) also provide a nice summary of key philosophers' views regarding CSR.

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Clearly, the interests of stockholders and stakeholders are not always aligned.[3] Nevertheless, some studies provide some evidence of a positive link between investments in CSR and measures of financial performance — suggesting that in some cases "doing good" may also be good for business.[4] While these findings are illuminating, there remain questions regarding causality — do investments in social responsibility make companies more profitable, or is it the case that profitable companies are more willing or able to divert resources towards investments in CSR? Moreover, the evidence suggests that corporate investments in CSR vary widely (even among companies within the same industry) — which is something that we might not expect to see if investments in CSR were universally beneficial to investors and non-financial stakeholders.

Given this backdrop, in this paper we investigate the factors that spur firms to invest in CSR. Recent theoretical work by Baron (2008), and Bénabou and Tirole (2010) highlights the various reasons that corporate managers may invest in CSR, and they also consider the various channels in which CSR investments may lead to enhanced financial performance. Borrowing from their theoretical framework, we conduct an empirical analysis where we conjecture that there are at least three different reasons why corporate managers may invest in CSR. One reason is altruism. Corporate managers may personally believe that they (and their company) have a moral imperative to invest in CSR activities such as environmental protection, employee welfare, and other humanitarian and community-based investments. A second motivation is that managers undertake these investments because they are consistent with the firm's financial interests. For example, providing generous benefits to employees and establishing a reputation for being socially responsible may help companies attract and keep high-quality employees, attract and maintain loyal customers, and mitigate legal, political and tax risk (to the extent these CSR investments reduce the likelihood of being sued and/or regulated).[5]

As a possible final motivation, we argue that managers pursue CSR activities because they believe it enhances their professional and/or personal reputation. Barnea and Rubin (2010) similarly highlight the potential agency problem that arises when managers over-invest in CSR to enhance their own private reputations. This "halo effect" may help them avoid the negative attention that can arise from inside the firm (e.g., disgruntled employees) or outside the firm (e.g., protests from consumer groups and unwanted media attention).

Obviously, these three motivations are not necessarily mutually exclusive, and the combination of specific factors that precisely lead managers to invest in CSR is difficult to completely disentangle.[6] However, we develop an empirical strategy that enables us to provide further insights into the various factors that create cross-sectional differences in the level of CSR investment. Most notably, we control for a wide range of firm-level and CEO-level characteristics, including the age and gender of the CEO, the CEO's political contributions (which provide insights into the manager's political leanings and/or desire to be politically connected), and the level of media scrutiny jointly surrounding the firm and its CEO (which is often influenced by the CEO's desire to strike a public posture). To the extent that these factors influence CSR investment, it suggests that these investments are not always made for pure economic reasons, and that the CEO's background, personal attitudes, and incentives play an important role.

While different CEOs may have different thoughts regarding the optimality of socially responsible investments, their ability to undertake these investments also depends on the attitudes of the firm's investors and the level of corporate governance. Specifically, we argue that the manager's investments in CSR are determined in large part by important interactions between the manager's true beliefs and the level of corporate governance.[7] Thus, in our analysis we also incorporate traditional proxies for the strength of corporate governance (the percentage of insider and institutional ownership, as well as the Governance Index (G-Index) developed by Gompers et al. (2003)).

To measure CSR, we employ data from KLD Research & Analytics. KLD uses a proprietary research process to classify both the strengths and concerns within six primary categories related to different aspects of social responsibility (*Community*, *Diversity*, *Employee*, *Environment*, *Humanitarian*, and *Product*). KLD considers a variety of sub-category measures within each of these six primary measures, and they assign dummy variables to indicate if a particular area is either a strength or concern. From these measures, we calculate an overall CSR index for each company in our sample by summing up all of the various strengths and subtracting all of the concerns. Using a sample of 11,711 firm years from 1992 to 2006, we find that the calculated indices for the firms in our sample range from a minimum value of -9 to a maximum value of $+15$. To conduct our empirical tests, we merge the KLD-related data with corporate governance data, data on CEO characteristics, information about the political contributions of the firms' CEOs, the CEOs media coverage, and CRSP/Compustat data regarding firm characteristics.

As one might expect, the calculated CSR measures vary considerably across industries. For example, companies in the Consumer goods, Computer hardware, and Banking industries tend to have above-average CSR measures, whereas companies in

[3] In a survey of the literature, Margolis and Elfenbein (2008) note that while CSR behavior may not impose large financial costs, there are many other ways to spend the money that could deliver a greater return on investment. At the same time, they argue that framing a societal investment in terms of shareholder interests may be misguided and that leaders can and should explore their own motivations such that doing good may be its own reward.

[4] See for example, the recent work by Gillan et al. (2010).

[5] Huseynov and Klamm (2012) provide evidence on the influence of CSR activities on tax avoidance. Karpoff et al. (2005) explore in detail the effects that environmental violations have on stockholder value. They demonstrate that shareholders bear the cost of imposed penalties, but they do not typically face any additional costs resulting from damages to the firm's reputation. Their results indicate that shareholders suffer when firms are socially irresponsible, which as we suggest, provides managers with an incentive to make CSR investments. While we also look at reputation effects, our emphasis instead concentrates on the impact that CSR investments have on CEO reputation.

[6] For example, it is particularly difficult to distinguish between managerial investments in CSR that are truly altruistic and those that are designed to enhance their reputation and career concerns. More broadly, recent work by DellaVigna et al. (2012) develop an interesting experiment to tease out whether individual charitable donations are motivated by altruism or social pressure.

[7] Adams et al. (2005) make a similar point in their study of "powerful" CEOs, where they suggest that interactions between CEO and firm characteristics have an important influence on firm performance.

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