



Signaling virtue: Does firm corporate social performance trajectory moderate the social performance–financial performance relationship? [☆]



Jacob Brower^{a,*}, Saim Kashmiri^b, Vijay Mahajan^c

^a *Smith School of Business, Queen's University, Canada*

^b *School of Business Administration, University of Mississippi, United States*

^c *Department of Marketing, McCombs School of Business, University of Texas at Austin, United States*

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ABSTRACT

Over the past 40 years, scholars have demonstrated the effects of corporate social performance (CSP) on corporate financial performance (CFP), finding mixed results on the main effect of CSP on CFP. This study moves beyond the search for a universal main effect of CSP on CFP to examine factors that drive some firms to experience greater returns from their CSP efforts. Building from the signaling and stakeholder theory definitions of reputation and the trajectory literature in psychology, this study examines the following question: what is the impact of a firm's CSP reputation on the relationship between CSP actions and CFP in the current period? Findings based on a sample of 351 US firms demonstrate that firms with either a history of growth in negative CSP, a propensity toward increasing negative CSP, or a more inconsistent history of positive or negative CSP, experience decreased returns from current period investments in CSP.

1. Introduction

Concerns about corporate social performance (CSP)¹ have grown to become issues of critical importance for businesses (Berns et al., 2009). One of the critical debates in this area centers on whether or not a firm's CSP can result in improved performance for the firm. More than 250 academic studies have examined the relationship between CSP and corporate financial performance (CFP²), demonstrating mixed results on the main effect of CSP on CFP; two meta-analyses have found that the overall impact appears to be positive, but small (Margolis, Elfenbein, & Walsh, 2009; Orlitzky, Schmidt, & Rynes, 2003). Recent work, however, has begun to move away from “the long fought battle for a universally positive or negative impact of CSP” (Luo & Bhattacharya, 2009, p. 198) toward a nuanced examination of how some firms gain higher returns from CSP than others, and how

different conditions impact the CSP–CFP link.

In addition to these macro-level findings on the CSP–CFP link, evidence at the micro-level of analysis suggests that consistent behavior over time improves stakeholders' attributions and evaluations of a firm's reputation, which allows the firm to capture the many stakeholder-based benefits attributed to CSP (Du, Bhattacharya, & Sen, 2007; Ellen, Webb, & Mohr, 2006; Sen & Bhattacharya, 2001; Sen, Bhattacharya, & Korschun, 2006). Despite the growing evidence that a firm's reputation and behavior over time are important for developing attributions and expectations at the individual level, few studies have examined the impact of a firm's CSP reputation on the CSP–CFP relationship. The present study seeks to address this gap explicitly by examining the key research question: What is the impact of a firm's CSP reputation on the relationship between CSP actions and CFP in the current period?

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* Corresponding author.

E-mail addresses: jbrower@queensu.ca (J. Brower), skashmiri@bus.olemiss.edu (S. Kashmiri), vijay.mahajan@mcombs.utexas.edu (V. Mahajan).

¹ Following Hopkins (2007), we define CSP as “voluntary initiatives taken by companies over and above their legal or social obligations that integrate societal and environmental concerns into their business operations and interactions with their stakeholders” (p. 27).

² Consistent with the previous literature, throughout this manuscript, we focus on the CSP–CFP relationship, by which we specifically refer to the relationship between positive CSP actions taken by the firm and its associated CFP. While the evidence suggests that negative CSP may also impact CFP, we are most interested in firms' strategic use of CSP. Most negative CSP actions are beyond the firm's control, or they may result from strains on firms' resources and capabilities (Kang, Germann, & Grewal, 2016; Strike, Gao, & Bansal, 2006), and they are thus beyond the scope of the relationship explored in this manuscript. Previous work suggests that negative CSP is a cue for interpreting and evaluating positive CSP (Lenz, Wetzel, & Hammerschmidt, 2017); therefore, we include measures of a firm's negative CSP trajectory as moderators of the CSP–CFP relationship. For the sake of simplicity, we will use CSP and positive CSP interchangeably, and we will explicitly call out any instances in which we are referring to negative CSP.

In building our model, we rely on signaling theory—a theory focused on the deliberate communication of information in an effort to convey positive, yet unobservable, organizational attributes to external stakeholders (Connelly, Certo, Ireland, & Reutzel, 2011). One important feature of the signaling literature is its focus on the firm's reputation. Signaling theory models of reputation are predicated on the “decision-theory vision of a world of imperfect information in which actors rely on proxies or signals to make rational assumptions about the intentions and future behaviors of other actors” (Rao, 1994). In this literature, reputation is defined as a function of the historical series of signals communicated by a sender over time (Heil & Robertson, 1991) and is described as “a collective representation of a company's past action and future prospects that describes how key resource providers interpret a company's initiatives and assess its ability to deliver valued outcomes” (Fombrun, 2001: p. 293). From this perspective, models of reputation rely on the idea that behavior is inter-temporally linked, presume a tight coupling between past actions and future expectations, and contend that reputation is accumulated and depleted through temporal signal flows (Weigelt & Camerer, 1988). This theoretical definition is echoed in stakeholder theory and the CSP literature, which have argued that as firms engage in CSP to improve stakeholder relations, a record of social performance accrues. In this regard, consistently engaging in acts of social responsibility over time shapes a firm's CSP reputation, with CSP reputation being an aggregate representation of how stakeholders perceive the character or “soul” of the firm (Barnett, 2007). This argument suggests that stakeholders draw from their prior knowledge of a firm when they assess the implications of new information generated by that firm's CSP activities, and that each stakeholder's reaction to an act of CSP by a firm is “...conditioned by his or her cognitive representation of the character of that firm” (Barnett, 2007: p. 807). Specifically, scholars have argued that a firm's historical trajectory of CSP acts as a sequence of signals to stakeholders about the firm's unobservable CSP motivations and its managerial commitment to the implementation of ethics within the organization (e.g., Zerbini, 2015). Based on the discussion above, CSP reputation is defined as a dynamic, path-dependent interpretation by stakeholders of the future prospects of the firm based on observations of the firm's historical trajectory of CSP actions over time.

Despite this established definition of CSP reputation, Wartick (2002) suggests that there is no theoretical basis for the way in which reputation has been parsed in the business and society literature, and that the definitions and data being used to conceptualize and measure corporate reputation in this literature are lacking. Previous work in the CSP domain is no exception. Scholars have argued that a firm's CSP reputation matters for its CFP, but have either employed: a) atheoretical and empirically problematic holistic reputation measures, such as Fortune's Most Admired Companies (Deephouse, 2000),³ or b) proxies for CSP reputation using a firm's CSP level at a single point in time, which fail to capture the incremental investments made in CSP and actions taken over time to attain a given CSP level—dynamic investments and actions that are the basis upon which stakeholders develop their perceptions of a firm's reputation (Barnett, 2007).

In the present study we address this significant gap in the literature by merging the definitions of reputation from signaling theory and stakeholder theory noted above with evidence from the trajectory literature in psychology to identify the elements of a firm's CSP trajectory that stakeholders are likely to attend to. Furthermore, we predict how stakeholder responses to each of these elements are likely to moderate the relationship between a firm's current period CSP and its CFP outcomes. In so doing, we bring a more nuanced, dynamic, and

³ For more detail on the lively academic discussion starting in the mid-1990's of the theoretical and empirical issues with the Fortune's Most Admired Companies reputation measure and other sources using similar methodology, please see Baucus (1995), Brown and Perry (1994), Fryxell and Wang, 1994, Mahon (2002), Sodeman (1995), and Wood (1995).

theoretically grounded perspective on CSP reputation in response to a call for “research on the business case for CSR...to account for the path-dependent nature of firm-stakeholder relations” (Barnett, 2007: p. 794). We also attempt to explain one path by which a given investment in CSP may induce a variety of stakeholder reactions and therefore yield different financial results for different firms at different points in time (Barnett, 2007). We demonstrate not only that reputation—as a function of expected stakeholder responses to a firm's CSP trajectory—is an important cue for interpreting and evaluating CSR (Lenz et al., 2017), but that there are particular features of a firm's CSP trajectory that significantly impact the payoffs a firm will experience as a result of increasing CSP.

2. Theory and hypotheses development

As noted previously, the stakeholder theory and signaling literature converge on a definition of reputation which suggests that a firm's CSP reputation is driven by the response of various stakeholders to the historical trajectory of its CSP actions over time. CSP reputation, in turn, influences: a) the likelihood that a stakeholder will notice a firm's CSP actions, b) the way a stakeholder will interpret a noticed act of CSP, and c) a stakeholder's reaction to that interpretation (Barnett, 2007). As a result, we argue that the actions of a firm and the responses by its stakeholders in regard to CSP are path-dependent such that different firms obtain different results from CSP, depending on their unique historical CSP trajectory (Barnett, 2007). The questions left unanswered in the signaling and stakeholder theory literature are: a) what features of a firm's CSP trajectory are most salient to stakeholders, b) how will stakeholders use information about these features in creating interpretations of the firm's CSP trajectory and assessments of its CSP reputation, and c) how will stakeholders respond to the firm's present CSP as a result of these interpretations?

Guidance in attempting to address these questions comes from a relatively well-developed stream of research in psychology that has investigated how individuals respond to patterns of observations over time for several different phenomena, including investment planning, salary preferences, advertising responses, gambling, and career satisfaction (e.g. Baumgartner, Sujan, & Padgett, 1997; Chen, Ployhart, Thomas, Anderson, & Bliese, 2011; Hsee & Abelson, 1991). This literature stream has demonstrated that individuals do not simply integrate the transient states that they experience as a sequence into their evaluations; instead, they rely on a model wherein certain key moments, or “gestalt characteristics” serve as proxies for the sequence as a whole and influence summary evaluations (Ariely & Carmon, 2000). Emerging from this body of research are three defining properties of a trajectory that have been demonstrated to have robust effects across many different contexts and research methods: 1) displacement, 2) propensity, and 3) reversals (Ariely & Carmon, 2000; DeKinder & Kohli, 2008; Hsee & Abelson, 1991).⁴ These three properties have been demonstrated to be independent, yet critical, in jointly determining individual responses to dynamic outcomes (Briggs, Landry, & Daugherty, 2010; Carver & Scheier, 1990).

We now define each of these characteristics, and delineate the logic behind why each of them matter in the present context. Next, as summarized in our conceptual model (Fig. 1), we develop hypotheses around how we expect stakeholder responses to each of these characteristics of a firm's CSP trajectory to impact the relationship between CSP and CFP.

⁴ These three properties have been referred to using different terminology in different academic fields of study. To maintain consistency in terminology throughout this manuscript, we follow the naming convention from the marketing and management strategy literature, introduced by DeKinder and Kohli (2008). We do, however, acknowledge the terminology used in other fields in the footnotes throughout the remainder of the theory and hypotheses development section.

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