



# Local corporate social responsibility, media coverage, and shareholder value<sup>☆</sup>



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## ARTICLE INFO

### Article history:

Received 4 August 2015

Accepted 13 September 2017

Available online 19 September 2017

### JEL classification:

G14

G32

M14

L82

### Keywords:

Corporate social responsibility

Media coverage

Stakeholder theory

Intangibles

## ABSTRACT

Using news articles covering firm's corporate social responsibility (CSR) activities, we find that publicized CSR activities are positively associated with shareholder value and improved future operating performance. Furthermore, we find that media coverage on CSR engagements with local impact on companies' communities and employees, rather than those with broader social impact on the general public, is the main driver in explaining higher shareholder value and operating performance. We also implement a two-stage least-squares regression (2SLS) and propensity score matching to establish a causal link between publicized local CSR activities and shareholder value. Our evidence is consistent with the notion that shareholders put positive value on locally-oriented CSR when it is also complemented with high level of stakeholder awareness.

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## 1. Introduction

Corporate social responsibility (CSR) has become an important issue for corporations, with over 80% of publicly-traded companies reporting CSR activities online (PriceWaterhouseCoopers, 2010). Despite its growing importance, there is little consensus among scholars concerning the motivation for CSR and its effect on shareholder value (e.g., Margolis et al., 2007). A traditional view has been that CSR reflects managerial preferences and thus an agency cost (e.g., Hong et al., 2012; Di Guili and Kostovetsky, 2014; Masulis and Reza, 2015; Cheng et al., 2016) and that the responsibility of a business should only be to maximize business profits

(Friedman, 1970). In contrast, others have argued that CSR adds value for shareholders by creating reputational capital among customers, employees, and other stakeholders (e.g., Bénabou and Tirole, 2010; Deng et al., 2013; Ferrell et al., 2016).

Many existing papers have focused on the value of CSR investments, with an emphasis on the empirical challenges in addressing the causal impact of CSR. However, relatively little has been done empirically to examine the specific conditions in which CSR engagements create real impact on firm performance. In this paper, we depart from the existing studies by examining one specific channel in which CSR can generate real value for the firm: CSR activities that are publicized in the media. Furthermore, we also explore and try to answer whether the value of publicized CSR differs depending on whether CSR engagements have a direct benefit for firms' local stakeholders or have a broader social impact.

Publicized CSR activities directly address one important channel in the value-maximizing theory of CSR: CSR awareness. As pointed out by McWilliams and Siegel (2001), if CSR adds value by generating reputational capital, then the value of CSR should be increasing in stakeholders' awareness about CSR. We illustrate the importance of CSR awareness by considering the following news article from *The Wall Street Journal* following the September 11th terrorist attacks:

"After Sept. 11, Johnson & Johnson (J&J) sponsored a special issue of Newsweek magazine about the spirit of America, and do-

<sup>☆</sup> We thank Carol Alexander (the editor), two anonymous referees, Alex Edmans, Robert Kieschnick, Jun Li, and Michael Rebello for their valuable comments. We are also grateful for comments from Jong-Wan (John) Bae, Nina Baranchuk, Fred Bereskin, Ted Day, Bernhard Ganglmair, Maretno Harjoto, Hoje Jo, Arzu Ozoguz, Alessio Saretto, Michelle Sisto, Malcolm Wardlaw, Kelsey Wei, Han Xia, Yexiao Xu, Harold Zhang, and seminar participants at the University of Texas at Dallas, University of Mississippi, the 2013 SWFA Meeting, the 2013 MFA Meeting, 2013 SFA Annual Meeting, and 2014 DePaul Socially Responsible Investments Conference. We also thank Amanda Besch and Cindy Gross for their editorial assistance. The earlier version of this paper was part of Seong Byun's Ph.D. dissertation completed at The University of Texas at Dallas.

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nated the advertising space to various nonprofit organizations. “We don’t take much to touting what we feel is a special obligation to the community since we’re in the business of health care,” says Willard Nielsen, corporate vice president of public affairs. *But Mr. Nielsen says J&J did send an advisory to the news media listing its donations of cash and products to the relief effort after investors and employees complained that they hadn’t heard about anything J&J was doing to help survivors.*<sup>1</sup>

This anecdotal evidence demonstrates that a firm’s CSR investments may not necessarily enhance the firm’s reputational capital if the relevant stakeholders are not well aware of the firm’s CSR activities.

Examining publicized CSR can capture stakeholder awareness of CSR that other existing measures overlook. The role of the media in affecting reputational capital has been well documented in Dyck et al. (2008), among others:<sup>2</sup> to “collect, select, certify, and repackage information,” thereby reducing the cost of obtaining information and reducing “rational ignorance” (Dyck et al., 2008). Thus, the media can effectively provide information that caters to the interest of the relevant stakeholders (i.e., potential customers or employees) who can influence a firm’s future cash flow.<sup>3</sup> Therefore, if the value of CSR comes from the stronger reputational capital, investors would more likely have higher expectations on a given firm’s future cash flow when the stakeholders have more awareness of CSR.

Using CSR media coverage, we find strong evidence that publicized CSR activities have a significant and positive impact on shareholder value as measured by Tobin’s *q*. Specifically, we show that a one-standard-deviation increase in CSR-related news articles published in a major U.S. newspaper is associated with a 2.44% increase in shareholder value. The documented effect of publicized CSR activities is obtained after controlling for the extensive factors including a firm’s overall level and the tone of general news coverage, and firms’ own advertising efforts to promote their CSR activities.

Corroborating the positive relation between the publicized CSR and shareholder value, we show that publicized CSR activities are positively associated with a firm’s future operating performance, such as ROA, profit margin (PM), employee productivity (as measured by profit per employee), and sales growth. The positive relation between the publicized CSR and operating performance suggests that increased stakeholder awareness has real impact on a firm’s future cash flows. Taken together, our results are consistent with the notion that the publicized CSR activities enhance relevant stakeholders’ awareness about firms’ CSR engagements and thus increase the firm’s shareholder value via higher expectations of firms’ future cash flows.<sup>4</sup>

<sup>1</sup> Ronald, Alsop, “Perils of Corporate Philanthropy – Touting Good Works Offends The Public, but Reticence Is Misperceived as Inaction,” *The Wall Street Journal*, January 16, 2002.

<sup>2</sup> For example, Dyck, Moss, and Zingales (2013) and Liu and McConnell (2013) also rely on the argument that the role of media is to increase the reputational capital.

<sup>3</sup> At the same time, the information may not necessarily have the same focuses as CSR ratings. For example, a large amount of donations to the September 11th relief efforts from many corporations received record amount of attention from the media. However, the traditional CSR rating remains relatively flat during such event periods. Likewise, CVS in 2007 made a donation to the project of building a new playground at Harambee Park (Boston), which will be one of 112 Boundless Playgrounds around the country designed to allow disabled children full access. Another example is its \$6 million workers-driven charity program for ALS (commonly called Lou Gehrig’s Disease) Therapy Alliance in 2005 which has received a lot of good feedback from employees and customers. However, the traditional CSR rating does not incorporate these events as CVS’s CSR activities.

<sup>4</sup> Focusing on different channel than ours, Dimson et al. (2015) use data on CSR engagement records of a large institutional investor to examine the rate of success and the impact of CSR engagements on accounting performance for U.S. public companies. They find that successful CSR engagements are associated with positive

We next examine whether the value of stakeholder awareness depends on the types of CSR activities. Specifically, we explore which types of CSR engagements, if publicized, are actually creating real value. Recent studies have made a distinction between more stakeholder-oriented CSR (i.e., community engagements, employee relations, etc.) and more socially-oriented CSR (i.e., engaging in issues related to environmental and human rights outside U.S.) and find some evidence that more stakeholder-oriented CSR has stronger effect on shareholder value (e.g., Harrison et al., 2010; Servaes and Tamayo, 2013). The different value implications based on different types of CSR in previous studies imply that the distinction comes from whether the benefits of firm’s CSR investments are internalized by the firm’s local stakeholders such as current and potential customers and employee (“locally-oriented CSR” hereafter), or are externalized in benefitting the general public (“socially-oriented CSR” hereafter). For example, a firm’s efforts in solving human rights issues in developing countries, or efforts to implement high quality environmental standards in all of its operations, regardless of the (potentially lax) local environmental standards and regulations may not generate direct benefit for firm’s key stakeholders who can directly influence the firm’s cash flows. On the other hand, a firm’s investments in employee-friendly practices, in promoting diversity in the workplace, and in philanthropic activities in local communities may help firms to retain talented employees and valuable customers, as well as attracting new potential employees and customers.

To test this, we differentiate CSR media coverage into locally-oriented CSR coverage that contains CSR-related news covering issues related to communities, diversity, and employee relations, and socially-oriented CSR coverage that contains news related to firm’s environmental and human rights practices. When we examine the impact of these locally-oriented CSR coverage versus socially-oriented CSR coverage on shareholder value and operating performance, we find that the locally-oriented CSR coverage rather than the socially-oriented CSR coverage is positively and significantly associated with shareholder value and future operating performance.

We further implement various tests to rule out alternative hypotheses that can explain our results. For example, firms that are doing well may simply receive more favorable CSR media coverage, which can lead to reverse causality. To combat this potential endogeneity issue, we employ alternative identification strategies using the instrumental variables analysis and propensity score matching method. First, we utilize firm’s headquarter proximity to the major U.S. newspapers, as well as industry propensity for CSR coverage, as instruments for publicized CSR activities. Second, we use media-coverage-related factors to match firms based on their propensity to receive CSR media coverage to control for other omitted factors that can drive CSR publicity, and use the matched groups between high and low CSR media coverage as exogenous variation in the CSR media coverage. Using these exogenous variations in CSR media coverage, we show that publicized CSR activities have a positive causal impact on the shareholder value. Furthermore, consistent with our baseline results, we find that the causal impact of publicized CSR on shareholder value is mainly driven by the media coverage on locally-oriented CSR engagements.

stock price reaction, and subsequent improvements in operating performance measured by ROA, profit margin, asset turnover, and sales over employees. In contrast, using a broader international data, Barko et al. (2017) find that CSR engagements have little impact on subsequent operating performance, with the exception of sales growth rate, which suggests that CSR engagements with broader consumer appeal may generate value. While these studies do not focus on CSR awareness or media coverage, our results that publicized CSR activities, especially those that are likely to affect firms’ direct stakeholders (e.g., consumers and employees), have positive impact on firm performance are consistent with their findings.

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