ARTICLE IN PRESS

Journal of Economics and Business xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Journal of Economics and Business

journal homepage: www.elsevier.com/locate/jeb

Corporate social responsibility, product market competition, and firm value

Shahbaz Sheikh

Dan Department of Management and Organizational Studies, The University of Western Ontario, London, Ontario, Canada

ARTICLE INFO

JEL classification:
G30
G31
M14

Keywords:
CSR
Firm value
Endogeneity
Instrumental variables

ABSTRACT

This study empirically examines if and how product market competition influences the relation between corporate social responsibility (CSR) and firm value using a panel data set for the period 2003–2015. It explicitly recognizes the endogeneity of CSR and uses instrumental variable (IV-GMM) estimation regressions. Results indicate that CSR is positively associated with market value of a firm measured by industry adjusted Tobin's Q. However, this relation is influenced by product market competition and product fluidity. Specifically, CSR has no impact on firm value in firms that operate in low product competition environments or face low product fluidity. Furthermore, results show that the effect of CSR is driven by CSR strengths as CSR concerns have no effect on firm value. Additional tests show that community, diversity and environment dimensions are the main contributors to the total effect of CSR.

1. Introduction

Corporate social responsibility (CSR) has attracted the attention of many academics and practitioners in the last three decades. Most of the research attempts to find a link between CSR and firm value in order to establish why firms engage in CSR. However, there is no unified theory that can explain the relation between CSR and firm value. There are two dominant views on the relation between CSR and firm value. The agency theory (Jensen & Meckling, 1976) argues that CSR is an agency problem (Friedman, 1970) and a value decreasing investment as managers use corporate resources to draw benefits of personal reputation at the expense of shareholders (Barnea & Rubin, 2010). On the other hand, the conflict resolution theory also known as the stakeholder theory (Freeman, 1984) contends that CSR in fact is a value increasing investment as it balances the interests of both financing and non-financing stakeholders who have influence over firm resources. It also considers CSR as a strategic investment that increases firm value by enhancing firm competitiveness.

The empirical evidence on the relation between CSR and firm value is also mixed and even confusing (e.g. Margolis & Walsh, 2003; Orlitzky, Schmidt, & Rynes, 2003; Post, Preston, & Sachs, 2002; Margolis, Elfenbein, & Walsh, 2009). Margolis and Walsh (2003) mention sampling problems, concerns about the reliability and validity of the social and financial performance measures, omission of controls, opportunities to test mediating mechanisms and moderating conditions, and a need for a causal theory to link, as possible explanations of the conflicting empirical evidence.

In this study, I argue that competition in product markets influences the relation between CSR and firm value and can help in explaining the circumstances where CSR is more valuable. Economic theory postulates that competition in product markets plays an important role in disciplining the risk and effort averse managers (Alchian, 1950; Hart, 1983; Schmidt, 1997; Stigler, 1958). When market competition is high, profit margins are thin and managers have fewer resources to divert to their personal benefits. Product

E-mail address: ssheik2@uwo.ca.

https://doi.org/10.1016/j.jeconbus.2018.07.001
Received 7 February 2018; Received in revised form 18 May 2018; Accepted 9 July 2018
0148-6195/ © 2018 Elsevier Inc. All rights reserved.

Please cite this article as: Sheikh, S., Journal of Economics and Business (2018), https://doi.org/10.1016/j.jeconbus.2018.07.001

market competition thus can be viewed as an external control device that enforces discipline upon managers. CSR also enables firms to differentiate and achieve competitive advantage (Jones, 1995) especially in high competition and high growth industries (Russo & Fouts, 1997). Furthermore, competition in product markets is perceived as a substitute for corporate governance (Ammann, Oesch, & Schmid, 2013; Giroud & Mueller, 2011).

However, reduction in free cash flows due to thin profit margins in intense competition creates a trade-off between investment in NPV positive projects that have certain positive effect on shareholder wealth and CSR that is not always correctly priced by the stock market. High competition also reduces returns to any cost reduction and differentiating strategy and motivates the manager to reduce investment in CSR. Siegel and Vitaliano (2007) argue that in perfectly competitive markets all firms would have the same CSR level as every firm will invest in CSR to achieve higher market share. The effect of competition on the relation between CSR and firm value is therefore unclear and an empirical question. This study attempts to empirically investigate if and how product market competition influences the relation between CSR and firm value.

While most of the previous studies on CSR and firm value mention endogeneity of CSR, few use empirical designs to treat it. This study explicitly recognizes the endogeneity issue and uses instrumental variable (IV-GMM) method as a research design. It uses the MSCI (formerly KLD) database to measure corporate social responsibility (CSR) and industry adjusted Tobin's Q to measure firm value for the period 2003–2015. It uses Hoberg and Phillips (2016) Herfindahl index of market concentration to measure competition and Hoberg, Phillips, and Prabhala, (2014) measure of product fluidity to measure product threats from competitors. Results indicate that CSR has a positive and significant effect on firm value. However, this positive effthreats from competitors. Results indicate that CSR has a positive and significant effect on firm value. However, this positive effect is statistically significant only in high competition markets and under high product fluidity. When markets are less competitive or product fluidity is low, CSR has no effect on firm value. Results also show that the effect of CSR is driven by CSR strengths and CSR concerns have no relation with firm value. Additional tests show that community, diversity and environment dimensions of CSR are positively related to firm value when competition (product fluidity) is high. Product and employee relations have no effect on firm value regardless of market competition or product fluidity. These results are robust to alternative measures of CSR, market competition, and firm value. The results also remain robust when the sample period is divided into pre and post financial crises periods.

This study adds to the current emerging literature on CSR, product competition, product fluidity and firm value (e.g. Fernández-Kranz & Santaló, 2010; Declerck & M'Zali, 2012; Jia and Shi, 2014). It is different from earlier studies in that it uses the recent time period (2003–2015) that has the most comprehensive coverage of MSCI social data.[1] It uses two different measures of market competition and uses product fluidity to measure threats coming from competitors. It treats CSR as endogenous and uses IV-GMM method to estimate the effect of competition on the relation between CSR and firm value. Furthermore, it controls for corporate governance and other variables that affect firm value.

The remainder of the study is organized as follows. Section 2 explains motivation and develops testable hypotheses. Section 3 presents data, measures of CSR, competition, product fluidity, and firm value. Section 4 describes empirical design. Section 5 discusses results, Section 6 checks the robustness of empirical results, and Section 7 concludes.

2. Motivation and hypotheses

2.1. CSR and firm value

Corporate social responsibility (CSR) has been a topic of discussion for the last three decades or so. Most of the discussions are centered on one question: does CSR increase firm value? Starting from the 1970s, hardcore economists considered CSR as waste of economic resources. The leading economic theory of agency cost (Jensen & Meckling, 1976) views CSR as a value decreasing investment and a misuse of corporate resources (Friedman, 1970). It argues that managers use corporate resources to enhance their personal reputations to extract rents from their firms (Barnea & Rubin, 2010). According to the agency theory, CSR is undertaken at the expense of shareholders and, therefore, results in lower firm value (Cronqvist, Heyman, Nilsson, Svaleryd, & Vlachos, 2009; Pagano & Volpin, 2005; Surroca, Tribo, & Waddock, 2010).

There are a number of empirical studies that find evidence in favour of the agency view of CSR. Galaskiewicz (1985) for example shows that CEOs spend corporate resources on philanthropy and gain respect and influential relations with local corporate elites. Atkinson and Galaskiewicz (1988) show that the percentage of equity ownership of CEOs is negatively related to company philanthropic contributions suggesting the CEOs stock ownership reduces agency costs of CSR. Similarly, Werbel and Carter (2002), using a sample of 160 corporate foundations, find that CEOs membership in charitable organizations is positively associated with corporate giving. Barnea and Rubin (2010) find that insiders tend to over-invest in CSR as they do not bear any cost but enjoy the benefits of enhanced personal reputations in the community.

On the other hand, the stakeholder theory (Freeman, 1984) contends that firm value is influenced by many stakeholders. It divides the stakeholders into investing (shareholders) and non-investing (employees, suppliers, customers, community etc.) stakeholders and argues that CSR enhances firm value by balancing the interests of all stakeholders and by reducing the risks of resource acquisitions (Backhaus, Stone, & Heiner, 2002; Haley, 1991). Ruf, Muralidhar, Brown, Janney, and Paul, (2001) find that changes in corporate social performance are positively related to firm financial performance. Brammer and Millington (2003) find that in a

[1] Fernández-Kranz and Santaló (2010) sample covers 1991–2005. Declerck and M'Zali (2012) sample is for the period 1995–2009 and Jia and Shi (2014) sample covers the 1991–2009 period.

Download English Version:

https://daneshyari.com/en/article/7360109

Download Persian Version:

https://daneshyari.com/article/7360109

Daneshyari.com