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How business strategy in non-financial firms moderates the curvilinear effects of corporate social responsibility and irresponsibility on corporate financial performance☆

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A B S T R A C T

Using the established distinction between corporate social responsibility (CSR) and corporate social irresponsibility (CSiR), this study proposes that there are U-shaped relationships between CSR and corporate financial performance (CFP) as well as between CSiR and CFP. Curvilinear relationships enlighten the coexistence of companies' positive and negative social engagements, both of which may have the potential to improve CFP. In addition, they help to explain the mixed results between social and financial performance previously discussed by researchers. Finally, cost leadership and differentiation strategies may positively moderate the relationship between CSR and CFP, and negatively moderate the relationship between CSiR and CFP. Our sample covers 1461 publicly traded non-financial service companies in the US with 6715 firm-year observations. The empirical results statistically support the U-shaped hypotheses and the moderating effects of cost leadership as well as differentiation strategies. The results also generate managerial and theoretical implications and highlight future research directions.

1. Introduction

The literature of CSR generally suggests that conducting more corporate social responsibility (CSR) activities may lead to better corporate financial performance (CFP) (Lev, Petrovits, & Radhakrishnan, 2009; Orlitzky, Schmidt, & Rynes, 2003; Waddock & Graves, 1997), whereas corporate social irresponsibility (CSiR) may jeopardize CFP (Jayachandran, Kalaignanam, & Eilert, 2013). However, if those statements are true, managers should make more CSR-oriented decisions in order to be more profitable, and should avoid grey activities to prevent receiving punishment made by stakeholders. However, in business practices, there are still so many companies either doing nothing for the society or even being considered socially irresponsible (Clark & Grantham, 2012; Mishina, Dykes, Block, & Pollock, 2010). This study aims to explain these phenomena by proposing that there are U-shaped relationships between CSR and CFP as well as between CSiR and CFP. As a result, these curvilinear relationships help explain the coexistence of CSR and CSiR in business practices because CSR and CSiR may both potentially benefit and imperil CFP under certain conditions. Additionally, the moderating effects of cost leadership and differentiation may offer new insights for managers' decisions on their companies' social engagements.

The academic foundation of CSR was laid in the late 1950s (Barnard, 1958; Carroll, 1999, 2008; Davis, 1960; Frederick, 1960). Although there is already a large body of literature, research has merely accelerated in recent years (Campbell, 2007; Carroll & Shabana, 2010). One stream of research explores whether better corporate social performance (CSP) leads to better CFP in order to maintain that CSR is good for business (Lev et al., 2009; Waddock & Graves, 1997). Several review papers have been published, but the results have been inconclusive (Ullmann, 1985; Van Beurden & Gössling, 2008). A recent study, however, indicates a curvilinear relationship between CSP and CFP. Barnett and Salomon (2012) use the theory of stakeholder influence capacity (Barnett, 2007) to explain a U-shaped relationship between CSP and CFP. They propose that companies conducting social engagements will enhance their reputation and credibility to sell at

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premium prices in the market, which alternatively offset the financial outlet caused by the companies' social initiatives. As a result, when companies have lower CSP, they may gain limit stakeholder influence capacity to improve firm performance. However, companies with greater CSP may have a better reputation and credibility to enhance their stakeholder influence capacity, and enjoy better firm performance. Barnett and Salomon (2012) maintain that those two forces are the two sides of the U-shaped relationship.

To further explore the mixed results in the literature, Porter and Kramer (2006) call for the alignment of a company's social and business strategies. Companies should consider their value chain activities in order to improve their firm performance when implementing social initiatives. The call for the new research direction has encouraged researchers to conduct more empirical experiments (Kang, 2013; Surroca, Tribó, & Zahra, 2013). Kang (2013) suggests companies' diversification strategies may influence their social performance. He finds that the CSP for companies implementing unrelated diversification strategy may outperform those companies with related diversification strategy ceteris paribus, because the management team in the unrelated diversification company is more capable of managing diversified stakeholders. Surroca et al. (2013), however, propose that stakeholder pressures in the home countries force companies to transfer their grey subsidies to foreign countries with weaker institutional structures. In this new research direction, more strategic oriented factors are considered in the literature.

Despite the enormous interest in the CSP-CFP relationship, another interesting research trend has emerged in the CSR literature to discuss the drawbacks of companies' social impacts, or CSiR (Mishina et al., 2010; Strike, Gao, & Bansal, 2006). Mishina et al. (2010) find that good companies may do bad things at the same time. Strike et al. (2006) indicate that higher levels of CSR and CSiR are positively correlated to higher levels of international diversification. They explain that a higher level of CSR improves the international reputation of US multinational companies; however, because of the weaker institutional structure in foreign countries, the US companies may take advantages of local conditions to expand businesses. Therefore, the issues of CSR and CSiR may open a new chapter for CSR research.

This study combines the strategic approach of CSR research and classic CSP-CFP issues with the current agenda of CSiR and its effects on firm performance to propose three research questions. First, what are the effects of CSR and CSiR on firm performance (Davidson & Worrel, 1988; Frooman, 1997)? Second, why do CSR and CSiR coexist in companies (Mishina et al., 2010; Strike et al., 2006)? Third, what are the effects of business strategies, such as cost leadership and differentiation, on the CSR-CFP and CSiR-CFP relationships? To answer the first question, this study suggests that there are positive and negative forces to govern the relationships between CSR and CFP as well as CSiR and CFP to form the U-shaped relationships. These findings may also help explain the coexistence of CSR and CSiR because both of them may potentially improve firm performance. Moreover, because of efficiency and innovation, cost leadership and differentiation are positively moderating the CSR-CFP relationships. However, cost leadership and differentiation negatively moderate the relationships of CSiR-CFP resulting from resource constraints and resource conflicts.

To test our hypotheses, this study drew its sample from the Kinder, Lydenberg, and Domini (KLD) ratings database and merged with the Compustat database for financial information. The final sample set contained 6715 firm-year observations, which consisted of 1461 non-financial service companies from 2003 to 2009.[1] The exclusion of financial firms is because they are generally missing their expenditure for R&D as well as plant and equipment in COMPUSTAT database, which are the essential components for our moderators.

This study measured CSR by the strengths, and CSiR denoted as concerns rated by KLD database (Strike et al., 2006). Additionally, this study combined multiple ratios into two aggregated variables measuring cost leadership and differentiation for clearer interpretation for the moderating effects of business strategies (Yamakawa, Yang, & Lin, 2011). Finally, net income was the measure of financial performance and several control variables were included. The results significantly support the hypothesized relationships, which provide several theoretical and practical implications.

We expect to make three academic contributions to the literature. The interactions among business and social strategies to enhance firm performance may constitute a new research direction. The U-shaped relationships between CSR-CFP and CSiR-CFP support the theoretical foundation of the separation of CSiR from CSR, which may explain the actual cases in the real world, and why they coexist. Finally, this study borrows prospect theory from behavior economics to explain the curvilinear relationship between CSiR and CFP, building a new bridge for the applications of behavior economics in the CSR research.

Managers should consider market and social strategies (Baron, 1995) to enhance their firm performance. Three scenarios may yield useful insights for business practitioners. Companies with more advanced business strategies are guaranteed better firm performance when they participate in social initiatives. However, if those companies are engaged in grey activities, they will be punished and their financial performance will be jeopardized. The implication for managers is that companies without clear business strategy, cost leadership or differentiation, and have mediocre social performance may experience the worst performance among other companies, ceteris paribus.

The remainder of the paper proceeds as follows. The next section presents the research background and hypotheses. The subsequent section describes the methodology. The results of the empirical study follow, and the last section discusses the managerial implications and offers suggestions for further research.

2. Research background and hypotheses

CSR is the set of corporate actions that positively affects an identifiable social stakeholder's interests and does not violate the legitimate claims of another identifiable social stakeholder in the long run (Strike et al., 2006: 852). However, Zyglidopoulos, Georgiadis, Carroll, and Siegel (2012) maintain that when companies operate in the marketplace, their actions may have both positive and negative effects on their stakeholders. Following this argument, Tang, Qian, Chen, and Shen (2015) maintain that CSR researchers have identified positive and negative components of CSR. As a result, Strike et al. (2006: 852) term negative social engagements as CSiR, and define it to be the set of corporate actions that negatively affects an identifiable social stakeholder's legitimate claims in the long run.

Friedman (1970) suggests that companies engaged in socially responsible activities may cause agency problems. He cautions that managers' responsibilities are to maximize shareholders' value, and the shareholders may rearrange their profit based on their preference and interests. However, Carroll (1979) extends Friedman's argument by suggesting that companies are not only to have the economic responsibility, which maximizes shareholders' value, but also to have legal, ethical and discretionary responsibilities. More importantly, his "Three dimensional model" is one of the first systematic interpretations of companies' social performance. Building on Carroll's model, Wood (1991) further provides a more practical model, which consists of principle, process and outcome associated social programs. This model is a more comprehensive and practical model to help managers think about their social programs. Both of them build cornerstones for the discussions of CSP-CFP relationships, and these topics have evolved into

[1] Due to merge and acquisition, KLD database had been significantly revised in 2010 and 2013. Therefore, we decided to only include data from 2003 to 2009 to ensure the consistence of rating criteria within our sample. More details will be discussed in the section of model and methodology.