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The effect of small firms' competitive strategies on their community and environmental engagement

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ABSTRACT

Corporate social responsibility (CSR) literature holds that CSR can help firms gain a competitive advantage by enabling them to differentiate themselves from their competition and reduce costs. In the strategy literature, differentiation and cost reduction are recognized as two major competitive strategies that firms pursue to outcompete rival firms. Yet, how CSR is linked to a firm's choice of competitive strategy is not explicitly explored in the extant literature. The present paper fills this gap. Using data collected from 478 small firms representing multiple industries in the US, this paper finds that a firm's focus on competing through differentiation strategy is associated with its level of community engagement but not with its level of environmental engagement. Competing through a strategy of cost-leadership is associated with neither community nor environmental engagement. The paper concludes that, except for seeking differentiation through community engagement, the approach of small firms to CSR remains largely characterized by adhoc decisions with few ties to their competitive strategies. The paper advances the understanding of CSR in small firms and provides novel insights into how CSR is linked with competitive strategies.

1. Introduction

Corporate social responsibility (CSR) — business firms' voluntary engagement in broader societal issues — was originally propounded in relation to ethical or moral concerns (Bowen and Johnson, 1953). Over time, however, the notion of *moral CSR* has morphed into *strategic CSR* (McWilliams and Siegel, 2001). Firms do good, not only because it is the right thing to do but also because it helps them derive business benefits of sorts, which, in turn, help them gain a competitive advantage. This premise has been tested empirically, but the results have been inconsistent. Many studies found a positive association between CSR and a firm's performance (Epstein and Roy, 2003; Weber, 2008), some found a negative association (Brammer et al., 2006), and others found that the two are unrelated (McWilliams and Siegel, 2000). These inconsistencies prompted two meta-analytical studies (Margolis et al., 2007; Orlitzky et al., 2003) that concluded that CSR *seems* to help firms reap business benefits, further mainstreaming the strategic or the business-case argument for CSR. As the reasoning for CSR has evolved from a moral case to a business case (Panwar et al., in press), so too has the way in which CSR is conceptualized. Early scholars viewed CSR primarily in terms of social issues (Bowen and Johnson, 1953); contemporary scholars conceptualize it in terms of corporate sustainability (Lozano, 2008), which denotes an integration of social, environmental, and economic issues.

While these benefits can manifest in different ways, they ultimately aim at helping a firm to differentiate itself from its competition (McWilliams et al., 2006) and/or to reduce its costs of doing business (Christmann, 2000; Weber, 2008). Fortuitously, these two potential outcomes of CSR — differentiation and cost reduction — have parallels in the strategy literature that considers differentiation and cost leadership as two major paths that firms could take to gain a competitive advantage (Porter, 1980). In this sense, firms could leverage CSR to achieve a competitive advantage regardless of which strategy dimension they emphasize (Miller, 1988; Spanos and Lioukas, 2001). As such, previous literature has

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highlighted the need for integration of CSR with a firm's overall strategy (Baumgartner and Winter, 2014; Galbreath, 2009; Lamberti and Noci, 2012), but it has not yet explored whether a firm's choice of competitive strategy is associated with its level of CSR engagement. This paper seeks to fill this gap.

This research was conducted using small firms because they represent a wider array of CSR motivations – from CSR as a community obligation (Fitzgerald et al., 2010) to CSR under strategic pressures (Lee, 2008). Thus, a small firm context allows us to have maximum variation in our phenomenon of interest, i.e., the link between strategic choice and CSR. Additionally because small firms exhibit different behaviors in community and environmental realms (Panwar et al., 2015), the paper separately examines the effects of two strategy dimensions (cost-reduction and differentiation) on community and environmental engagement.

This paper makes two primary contributions to the CSR literature. On the one hand, it provides insights into how a firm's level of CSR engagement is associated with its strategic choice. On the other hand, it enhances understanding about small firms' social engagement. This is a topic that remains dwarfed by a continued focus on large firms, even though small firms are now widely accepted as indispensable partners in achieving sustainability (Jenkins, 2006). The paper is structured as follows. The theoretical background includes a brief literature review about differentiation and cost-leadership paths that result in a competitive advantage. It then outlines key features of small firms' social responsibility behavior. Hypotheses concerning relationships between competitive strategies and small firm social responsibility are developed in the subsequent section. Finally are sections on methods, results, and conclusions, which appear in that order.

2. Theoretical background

This section first explains the difference between differentiation and cost-leadership strategies and how both relate to CSR. It then addresses the specificities of social responsibility in a small-firm context.

2.1. Competitive advantage through differentiation and cost-leadership strategies

Porter (1980) maintains that a firm's long-term, above-average performance is based on its ability to achieve one of two basic types of competitive advantage — differentiation or low cost. Particularly, because a firm wants to sell its products (or services) at a price higher than the unit cost of production, it can either differentiate its product and command a premium price or produce the product at a lower cost than its competitors (Ortega, 2010). Strategy scholars have approached firm strategic posture in two ways. Some take an anatomical view (Dess and Davis, 1984; Hambrick, 1983) and consider differentiation and cost-leadership as two separate types of strategies. This position is consistent with Porter's original conceptualization in which a firm should focus on pursuing either of these two strategies in a pure form. In a sharp contrast, others (Beal and Yasai-Ardekani, 2000; Gopalakrishna and Subramanian, 2001) view cost-leadership and differentiation as two dimensions of a firm's strategy and argue that in light of the dynamism and turbulence of the contemporary business environment, firms should integrate elements of cost-leadership and differentiation and thus pursue hybrid or combinative—as opposed to pure—strategies. The case for combinative strategies has gained acceptance in the practitioners' world through the concept of a strategy clock (Bowman and Faulkner, 1997).

However, what is meant by differentiation and cost leadership? Differentiation refers the creation of a product or service that is somehow unique from its competitors. It can be achieved through design or brand image (e.g., Ikea), technology (e.g., BMW), customer service, or other features that are valuable to customers. Additionally, a firm may choose a multi-differentiation path. An iPhone, for example, would fall into this category because Apple seeks to differentiate itself via technology, brand image, and customer service. Ultimately, differentiation aims to create brand loyalty, which in turn gives rise to price inelasticity, and enables the firm to command a premium price for its products. Successful differentiation can create competitive barriers to entry for a firm's potential competitors, while providing a firm with higher sale margins. Notably, in pursuit of differentiation, a firm must commit to costly activities, such as extensive research, product design, and marketing expenditures, which Porter (1980) argues will often make a differentiation-focused firm a high-cost producer.

How CSR helps a firm in its pursuit of differentiation has been discussed in the literature. Reinhardt (1998), for example, stressed the need to integrate environmental actions with a firm's overall strategy to harness the potential for product differentiation. Recently, Dangelico and Pujari (2010) concluded that CSR activities can help a firm develop a unique reputation and image. In a similar vein, others have attributed to CSR the potential to contribute to product differentiation for which customers will pay a premium (Lin et al., 2013; McWilliams and Siegel, 2001).

In contrast to differentiation, a cost-leadership focus, by definition, means that a firm aspires to become the lowest cost producer in its industry. This typically entails, "construction of efficient-scale facilities, rigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts, and cost minimization in areas such as research and development (R & D), service, sales force, advertising, and so on" (Porter, 1980: 35). Cost control is at the heart of a cost-leadership strategy, which allows a firm to fetch above-average returns (Miller and Friesen, 1986). A cost-leadership focused firm strives to create internal efficiencies and, therefore, has a narrow scope of search emphasis (Hrebiniak and Joyce, 1985). That is, it is often confined to finding ways to lower cost curves and increase internal efficiencies (Pelham, 1999). Such a firm builds market share via aggressive pricing and aims to maximize economies of scale. Its products are designed for easy, mass manufacturing, and it relies on state-of-the-art technologies and equipment that maximize manufacturing efficiency. In the end, cost leaders focus on price and price-conscious customers.

The existing CSR literature has presented a multi-faceted view of the interplay between CSR and a firm's cost-leadership pursuits. Several studies have attributed a potential to reduce a firm's overall business costs to CSR (Epstein and Roy, 2001). While some have viewed CSR as a mechanism through which a firm could gain operational efficiency (e.g., waste management), others have considered how it could help a firm to reduce several transaction costs (Orlitzky et al., 2011). However, previous literature has not considered whether firms' strategic choices affect their CSR engagement, which, in turn, could indicate their proclivity to leverage CSR in their strategic pursuits. In the hypothesis section, we will explore this matter in the context of small firms. Before doing this, though, it is important to outline the salient features of small firms' social responsibility behavior.

2.2. Small firms' social responsibility

Despite the enormity of both their impact on, and contribution to, social and environmental wellbeing, small firms have traditionally received much less attention than large firms in the CSR literature (Lepoutre and Heene, 2006; Russo and Perrini, 2010). It was long held that because of the lack of required resources, small

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