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Competitive and responsible? The relationship between corporate social and financial performance in the energy sector

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ABSTRACT

Our key research objective in this study is to examine whether investments in corporate social responsibility (CSR) have an effect on corporate financial performance (CFP), or vice versa. The context is the energy industry, in which sustainability issues are of vital importance. Our data set is compiled from the KLD database and Thomson ONE. We use panel data on energy-sector companies covering the years 1991 and 2009 in order to assess Granger causality between CSR strengths/concerns and CFP. We consider strengths and concerns separately, and use both accounting and market-based measures of CFP. Our findings indicate differing impacts on financial performance: CSR concerns Granger-cause both profitability and market value whereas CSR strengths seem only to Granger-cause market value. These effects appear after different delays. Furthermore, as CFP does not seem to Granger-cause CSP in most of the model specifications, our results do not support bidirectional causality between CSP and CFP.

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1. Introduction

The increasing global awareness of sustainability issues and corporate social responsibility (CSR) is requiring organizations to include CSR practices and principles in their business strategies. It has been argued that failure to do so could result in a loss of business opportunities and competitive advantage [1,3]. The

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relationship between firms' financial performance and CSR efforts has attracted increasing interest in recent years. Most studies on CSR compare the financial performance of socially responsible companies with the performance of firms that do not meet the same CSR criteria (e.g., [3–6]). Although there is very little evidence of a negative linkage, the relationship remains rather unsettled (e.g., [7,9]). Furthermore, many of the existing studies do not take time and context dependence into account. On the basis of previous research, therefore, it is difficult to ascertain whether CSR investments have a positive influence on performance, or if financially successful companies have just been investing more proactively in CSR [10].

Our key research objective was to find out whether investments in CSR have an effect on financial performance, or vice versa, within the energy industry. By its very nature the energy sector plays a crucial role in sustainable development (see e.g., Omer [11]) and is also a forerunner in CSR-related issues (see e.g., Hughey and Sulkowski [12]). Despite this, however, previous studies on the relationship between CSR investments and financial performance in the sector are scarce.

We constructed our data set from the KLD database (CSR-related variables) and Thomson ONE (financial information). Our panel data covers the years 1991 and 2009. We collected information on 14 companies in the energy sector in order to examine Granger causality between CSR and corporate financial performance (CFP). Granger causality has been used previously to investigate this relationship (e.g., [13–16]). However, our results make a valuable contribution to this literature given the longer time dimension than in most of the earlier studies. Moreover, we treat CSR strengths and concerns from the KLD database as distinct constructs.

The paper is organized as follows. We begin by reviewing the previous literature on CSR and CFP, and consider CSR in the context of the energy sector. The next section describes the data and methodology we used, and Section 3 presents the empirical results. In the final section we summarize and discuss the findings, and draw conclusions.

2. Theoretical background

2.1. CSR and profitability

By definition, CSR is "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis" [17] (p. 6). The level or practice of CSR in a given firm is reflected in its corporate social performance (CSP), defined as "a business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm's societal relationships" [18] (p. 693). Hence, in this study we conceptualize CSP as the manifestation of CSR.

The purpose of a profit-making organization is to maintain or increase the wealth of its owners in the long run. Therefore, it is legitimate to ask why business organizations would invest in voluntary actions that have other purposes (in this case, CSR) if it were not the case that what is good for society is not necessarily bad for business. It may be that, as Davis [19] (p. 313) writes: *"The firm which is most sensitive to its community needs will as a result have a better community in which to conduct its business"*. Given that (according to the definition) CSR is so comprehensively related to the firm's actions, achieving good CSP is likely to require critical assessment of its principles and practices, as well as communication with various stakeholder groups. Such an activity may reveal opportunities for cost savings, in the form of waste reduction for example, or by enhancing the understanding of the business environment and decreasing the risk of conflict. Therefore, although investing in CSR does not necessarily mean investing in the firm's core business, and in some cases it is just a cost, it may be a source of financial benefit.

The literature describes various ways in which CSR investments can influence a firm's financial performance. It has been suggested, for example, that they may have a positive effect on its resources and capabilities, or its managerial competence. They may also have positive reputational impacts, which could decrease operational costs in terms of reducing the amount of waste, decreasing the risks, or positively influencing employee commitment and productivity (for various possible links, see e.g., Orlitzky and Schmidt [9], Aguinis and Glavas [20], Russo and Fouts [21], and Weber [22]). There is recent empirical evidence of a positive impact on operational costs. El Ghoul et al. [23], for example, found that better CSP lowers the cost of equity capital, and Greening and Turban [24] that it attracts prospective job applicants. CSR investments may also create goodwill towards the firm, attenuating reactions in case of a negative event [25], and enhanced CSP could be connected with customer satisfaction [14]. However, according to a recent review, consumers' appreciation of higher CSP may be reflected in a firm's corporate reputation or brand image and not so much in the *"manner that is directly reflected in the company's "bottom line"."* [26] (p. 32) Thus, it may be difficult for a firm to set a price premium on responsibly produced products. Furthermore, markets may differ greatly in how well consumers are informed about the qualities of the product and issues related to its production, as well as in customers' willingness to pay for responsible production. For instance, despite its higher price, the demand for organic food has increased, and the demand for fair trade products has also been growing in recent years. These aspects may indicate an increasing awareness of or need to reflect on values in people's buying behavior, and the future will show how extensively this phenomenon will spread to different industries and businesses.

It may also be that the competitive advantage gained through CSR investments is temporary at best. At some point, when the so-called "low hanging fruit" has been picked, a certain level of CSP may become standard in an industry, and firms would need to take a more proactive stance towards CSR in order to be better than average (see e.g., Russo and Fouts [21] and Sharma and Vredenburg [27] for a discussion). At the point when it is no longer a question of relatively quickly reachable benefits, such as cost savings, but one of the long-term commitments with due risk, it may be more difficult to justify CSR investments to shareholders.

However, according to the accumulated empirical evidence, good CSR practices seem to improve CFP (for reviews see e.g., Margolis and Walsh [7], Orlitzky et al. [9], and van Beurden and Gossling [28]). On the other hand, Surroca et al. [29] report an indirect relationship that depends on the firm's intangible resources, whereas Barnett and Salomon [30] found evidence of a curvilinear relationship. There is also some empirical evidence [31,32] that good CSP is connected with better CFP, implying that CFP precedes CSP. These findings lend support to the so-called slack resources theory, according to which a financially well performing firm is in a better position to invest in CSR. Given that, according to the results of Waddock and Graves [32], the causation between CSP and CFP may run in both directions, the authors speculate further on the possibility of a "virtuous circle" formed by a simultaneous and interactive impact.

A number of methodological issues burden the accumulated research. For instance, the validity of the measures has been questioned, as has the omission of adequate control variables (e.g., [7]). It has also been suggested that the context specificity of CSR should be taken better into account, such as by using single