Theoretical perspective of csr management essay

Business, Management

There are two perspectives on the role of business in society. There is the classical view which is also known as the shareholder theory which is purely economic profit making terms, focusing on the profit of the shareholders. On the other hand, the stakeholder theory implies that company has a social responsibility that requires them to consider the interests of all the parties affected by their actions.

2. 4. 1 Stakeholder Theory

The conventional definition of a stakeholder is " any group or individual who can affect or is affected by the achievement of the organization’s objectives" (Freeman, 1984). However with time, the definition of the theory of stakeholder changed and in one of his latest definitions Freeman (2004) defined stakeholders as " those groups who are vital to the survival and success of the corporation". Boatright (2003) suggested that the stakeholder model is valuable in identifying and organizing the multitude of obligations that corporations have to different groups. Stakeholder theory is based on the notion that beyond shareholders there are several agents with an interest in the actions and decisions of companies. Stakeholders are ‘ groups and individuals who benefit from or are harmed by, and whose rights are violated or respected by, corporate actions’ (Freeman, 1998). In addition stakeholders include creditors, employees, customers, suppliers, and the communities at large. Furthermore, Donaldson and Preston (1995) identified three aspects of this theory namely the normative, instrumental and descriptive theory which are mutually supportive. C: UsersOochitDesktopStakeholder_(en). png

Figure 2. 1 Coalitions of Stakeholders

Source: (http://stakeholdertheory2011. blogspot. com/2010/11/stakeholder-theory-explanation. html)Stakeholder theory claimed that companies have a social responsibility that required them to consider the interests of all parties affected by their actions. Management should not only consider its shareholders in the decision making process, but also anyone who is affected by business decisions. Many interesting typologies of stakeholders have been proposed. Clarkson's typology of stakeholders is the most widely cited and accepted. Clarkson (1995) distinguished primary and secondary stakeholders. Primary stakeholders are those ' without whose continuing participation the corporation cannot survive as a going concern' whereas secondary stakeholders are ' those who influence or affect, or are influenced or affected by the corporation but they are not engaged in transactions with the corporation and are not essential for its survival.'

2. 4. 2 Shareholder Theory

The essence of this theory is that the purpose of any business is to make profit for their shareholders. As indicated by Coelho et al. (2003) and Letza et al. (2008), the shareholder model is derived from an assumption that the social purpose of corporations is to maximize shareholders' wealth. Therefore, managers and owners have an implicit obligation to ensure that firms are run in the interests of shareholders. The idea which underlined the shareholder perspective is that the only responsibility of managers is to serve the interests of shareholders in the best possible way, using corporate resources to increase the wealth of the latter by seeking profits (Jensen, 2001). In other words, the theory proposed that corporation should legally maximize long-term shareholder wealth. In financial language, shareholder theory advocated that a firm should maximize the present value of all future cash flows (Danielson, Heck, and Shaffer, 2008). The theory saw the primary responsibility of firms as that of generating profits for shareholders and working hard to raise their stock values. The perception on the performance of social activities by firms for society is that such activities are not necessary except the laws specify otherwise since business firms are created primarily to enhance shareholder value. In the words of Smith (2003), the fundamental distinction between the shareholder and stakeholder model is that: ‘ the stakeholder theory demands that interests of all stakeholders be considered even if it reduces company profitability. In other words, under the shareholder theory, non-shareholders can be viewed as " means" to the " ends" of profitability; under the stakeholder theory, the interests of many non-shareholders are also viewed as " ends"’.

2. 5 Reasons for companies to engage in CSR

Many corporate executives believe that CSR creates a competitive advantage for firms, thus leading to greater market share. CSR can differentiate a company from its competitors by engendering consumer and employee goodwill (McWilliams & Siegel, 2001). CSR may also be used to preempt competitors from gaining an advantage. Once a firm in an industry has implemented CSR policies successfully, rival firms may be forced to engage in CSR as well. If they do not exercise CSR, these rival firms are in danger of losing consumer loyalty. On the other hand, some firms are involved in CSR simply because they believe it is the right thing to do. Regardless of the underlying reasons, CSR has become a commonly used term in the business arena (Lindgreen, Swaen, and Maon, 2009). According to Smith (2003), " the impression created overall is that the debate about CSR has shifted: it is no longer about whether to make substantial commitments to CSR, but how". In the study of Miles and Munilla (2005), they explained the reasons why firms participate in CSR by using Van Marrewijk's (2003) CSR Framework and Carroll's (1991) Pyramid of Corporate Social Responsibility and the table is shown below.

Table 2. 2: The interrelationship of CSR framework and Pyramid of CSR

CSR Ambition LevelMotives(Van Marrewijk 2003)CSR Category(Carroll, 1991)Compliance DrivenDuty to society, CSR as a social obligation- perception of CSR expenditures as a simply a cost. Economic responsibility is paramount. LegalProfit DrivenCSR as a strategic initiative- using CSR to create competitive advantage and superior financial performance. CSR expenditure perceived as an investment in the creation and renewal of competitive advantage- resulting in an enhanced stream of future profit. EconomicCaringEconomic responsibility is paramount. Using CSR to balance the triple bottom line of profits, people, and planet. Explicitly stating that the corporation will manage for social welfare, not simply to create wealth for shareholders. Social and/ or environmental trumps economic responsibility. Ethical and philanthropicSynergeticUse of CSR to attempt to create a ' sustainable corporation'- that will be able to be an ongoing concern over the long run. Social and/or environmental responsibility. I strategically used to create competitive advantage and meet the corporation's economic responsibilities. Economic, legal, ethical and philanthropicHolisticCSR as a corporate culture- similar to when firm adopts a marketing, entrepreneurial, or quality orientation. Social and/or environmental responsibility is strategically used to create competitive advantage and meet the corporation's economic responsibilities. Economic, legal, ethical and philanthropic

Source: Miles and Munilla (2005)

Kotler and Lee (2005) argued that companies participated in CSR in order to look better, feel better, do better and live longer. They explained that by participating in CSR the company will look good in the view of potential customers, business colleagues, and investor and in the media etcetera. Furthermore, employees, customers, stockholders and board members will actually feel good. Many also argued that CSR improve the brand, and some claimed that companies with a strong reputation of CSR will last longer. Kotler et al. (2005) described that companies can gain great benefits from participating in CSR and that these benefits are the reasons for their engagement in CSR. Kramer and Porter (2006) described the reasons for participating in CSR by moral obligation, sustainability, license to operate and reputation.

2. 6 Impact of CSR

Companies engage in CSR for many reasons that include the ability to operate now and into the future by acknowledging areas of harm, risk or opportunity that affect their well-being. By effectively managing CSR in both internal and external activities, companies benefit through improved research and development, market position, employee development, government relations and risk management (Weiser and Zadek, 2000).

2. 6. 1 Advantages of CSR

Practically, consumer’s positive reaction and benefits from CSR (e. g. reduction of business risk and enhancement of stakeholder relations) have increased attractions of firm to engage themselves in CSR.

2. 6. 1. 1 Improved corporate reputation and brand image

Today corporate reputation and brand image has become more important as markets have become more competitive and corporate image/reputation more vulnerable. Corporations may simply be penalized by consumers and others for actions that are not seen in their eyes as being socially responsible (Smith, 2003). According to Smith and Taylor (2002), " Corporate image is a result of everything a company does or does not do". Reputation has become one of the most valuable intangible assets and CSR is an important key component of corporate reputation and brand recognition. Corporations with a strong CSR image/ or reputation last longer than a corporation without such an engagement (Kotler and Lee, 2005). Companies that last long are those that focus on their reputation (McIntosh et al., 1998). Being CSR is furthermore not only the right thing to do but it can also distinguish a corporation from its industry peers (Smith, 2003). In addition, Kraisornsuthasinee and Swierczek (2009) empirically supported that " CSR enhanced the brand image of these leaders and community support allows the companies to differentiate, gain a price premium and build the brand based on CSR values and sustainability actions." Having a good CSR image by acting ethical and responsible can create competitive benefits such as improve sales, strengthen financial relations, harmonize employee relations and managing crisis.

2. 6. 1. 2 Improve sales

Today's customers are not only concerned about the quality or the price of products and services, but also about the way they have been produced and if the process has harmed the society, its resources or its people. " Consumers have become increasingly sensitive to the CSR performance of the companies from which they buy their goods and services. These trends have contributed to the pressure on companies to operate in an economically, socially and environmentally sustainable way" (Smith, 2002). It is not solely what companies say, but mainly what they do. " Actions are more important than words" (Kotler and Lee, 2005). A strong image originated from a corporation's actions improves a company's sales. It also increases its market share and market penetration (Moir, 2001).

2. 6. 1. 3 Strengthen financial relations

Being corporate social responsible helps to " raise the corporate profile and to make the organization's presence known to influential players within financial circles" (Smith & Taylor, 2002). In other words increasing investors appeal. Investors do not want to invest in an irresponsible and unethical business since those companies are less valued on the market. Therefore investors are more inclined to invest in businesses with outstanding reputation than one without (Smith, 2003). Having a good image/reputation could in addition strengthen the financial relation with governments and

NGO’s. And companies could through that gain and maintain legitimacy (Suchman, 1995). Legitimacy might be seen as a key reason for why corporations undertake social behaviour and using that activity as a form of publicity or influence (Lindblom, 1994).

2. 6. 1. 4 Harmonize employee relations and boost recruitment

Having a good image and reputation can attract and retain a motivated workforce. It is a way of keeping the best people within the company and improves their working performance. CSR brings more productive workers and greater employee loyalty. Good working condition and relations cannot only help companies to keep their human capital but also attract new people. Employees typically prefer to work for social responsible firms (Smith, 2003). A study with a national cross section of 1, 040 adults conducted by Cone Inc. showed that eighty percent of the respondents would likely refuse to work for a company if they were to find out about negative corporate practice (Kotler and Lee, 2005). Employees are simply choosing to work for a company that has strong values than for companies lacking those. " An image for being socially responsible adds to an image of being honest and trustworthy. Such a reputation is a major driver of customer and employee satisfaction. It is often correlated with sales growth" (Davies, 2004).

2. 6. 2 Disadvantages of CSR

While a majority of the current CSR literature is centered on the positive effects and implications on CSR strategies, some researchers disagree with the conventional thinking on CSR. Putting focus on CSR will only take the eye from the real goal; to increase their shareholders wealth, CSR is to confuse the essence of what corporations should do (Henderson, 2001).

2. 6. 2. 1 CSR reduce the focus on profit

The main purpose of any business is to maximize profit. CSR is something that governments and politicians have to work with, not businesses. " There is one and only one social responsibility of business-to use its resources and engage in activities designed to increase its profits" (Friedman, 1962). Corporation’s sole responsibility is to increase profits by legal means, donating to charities, is detrimental to firms since it may decrease profitability or increase product prices or both (Pinkston & Carroll 1996). CSR reduce the focus on profit and should therefore be cost outside the scope of legitimate corporate concern. Corporations and managers might not in addition be competent to engage in social issues (Friedman, 1970). Some go further with their arguments against CSR and states that being CSR and investing in CSR activities such as charitable contribution, promoting community development plans, establishing environmental protection procedures put those companies at an economic disadvantage compared to less corporate responsible companies (Aupperle, Carroll & Hatfield, 1985). CSR is a dilution of business primary purpose; it is seen as a social involvement that is costly and that is hindering from profit maximization. The content of CSR is what corporation says they are doing, but this may differ from what they are actually doing (Davies, 2001).

2. 6. 2. 2 CSR used as a window dressing tactic

CSR is simply a way for corporations to hide behind the mask of their obligations and responsibility (Christian Aid, Behind the Mask- The Real Face of CSR, 2004): a window dressing tactic. CSR sounds and looks good: corporations just appear to be socially responsible for the purpose to not damage their image and brand as well as for the reason to keep the critics quit. CSR is only seen as a " branch of PR" and a mask that companies hide behind. It has become a " vital tool in promoting and improving the public image of some of the world's largest corporation" (Christian Aid, Behind the Mask- The Real Face of CSR, 2004). And since CSR is a promotional tool it can mean a variety of things to different people (Frankental, 2001).

2. 7 The correlation between CSR usage and financial performance

The relationship between a firm's corporate social responsibility and its financial performance has been the subject of lively debate since the 1960s (Cochran and Wood, 1984). A key question concerning CSR is whether it improves or detracts a company's financial performance. Both accounting and market definitions have been used to study the relationship between corporate social responsibility and firm performance (Orlitzky et al., 2003). Babalola (2012) predicts three possible relations between CSR and company financial profitability. Positive correlation between CSR and financial performanceNo correlation between CSR and financial performance andNegative correlation between CSR and financial performance

2. 7. 1 Positive correlation between CSR and financial performance

Waddock and Graves (1997) pointed that satisfying interest of stakeholders may lead to a positive impact on financial performance of the firm. In the same vein, Roberts and Dowling (2002) highlighted that when a company engaged in CSR, this can lead to reputation advantage which consist of new market opportunities, positive reaction of capital markets which ultimately improve the company’s financial performance. From the studies of Ioannou and Serafeim (2010), the stakeholder theory state that effective management of stakeholder relationships and fundamental blocks of CSR may outcome in better financial performance. Accordingly, Shen and Chang (2009) assumed that firms engaged in CSR had stronger financial performance by adopting CSR. Saleh et al., (2007) found positive relationship between CSR actions disclosure and company performance in the short run. Uadiale and Fagbemi (2011) examine the impact of CSR activities on financial performance measured with Return on Equity (ROE) and Return on Assets (ROA) in Nigerian companies. The results show that CSR has a positive and significant relationship with the financial performance measures.

2. 7. 2 No correlation between CSR and financial performance

As stated by McWilliams and Siegel (2000), there is no relationship between corporate social responsibility and corporate financial performance. Waddock et al. (1997) argued that there is no relationship between CSR and financial performance since there are so many intervening variables that are hard to control. Moreover, in a study conducted by Brine et al., (2007) to examine the relationship between the adoption of CSR and the financial performance across the top 300 Australian listed companies for the 2005 financial year. The study used return on assets, return on equity and return on sales to evaluate the financial performance of each company. The preliminary results revealed no statistically significant relationship between CSR and financial performance.

2. 7. 3 Negative correlation between CSR and financial performance

Lastly, the idea of that negative relationship between CSR and financial performance is focused on empirical studies and contributions that refer to managerial opportunism hypotheses. Preston et al., (1997) pointed out that manager can reduce investments in corporate social responsibility in order to increase short term profitability. Analysis based on measuring abnormal returns, market measures and long term studies showed that there is negative relationship between CSR and financial performance (Wright and Ferris 1997). In the same line, McGuire et al., (1988) highlighted that the added cost that CSR investment bring might place a company in an economic disadvantage compared to companies that have not make these CSR investments. These added costs mainly result from firm extensive charitable contributions, promotion of community development plans and establishing protection procedures.

2. 8 Summary

Corporate Social Responsibility (CSR) may be described as an approach to decision making which encompasses both social and environmental factors

(Uadiale and Fagbemi, 2011). CSR means that companies do not only have one objective, profitability, but that they also have objectives of adding environmental and social value to society (Mirfazli, 2008). CSR remains a beaming light of success for improving the role of business in society but is also an ongoing challenge to which companies must remain vigilant, especially in emerging markets.