

# A literature review on corporate social responsibility



Corporate Social Responsibility has earned much salience over the last decades in academic literature. The literature offers various interpretations of the concept of corporate social responsiveness. The concept is understood as a process or set of processes on the way a firm approaches its environment. It is argued that business and society are interwoven: society has certain expectations regarding business and therefore the firm has responsibilities towards society. Hence, being a steward of the needs of society is deemed to be a socially responsible, appropriate, and natural act.

The first book acknowledged on CSR is the Social Responsibilities of the Businessman by Howard R. Bowen in the mid 1950s. But, the term CSR came in widespread use in the early 1970s. In fact, it owes its origin due to the globalisation which took place after many multinational corporations were formed. In brief, 'globalisation' means an increase in international transactions in markets for goods, services and factors of production and a growth in institutions that straddle international barriers. All these developments have brought in force the corporate governance mechanisms to ascertain fairness and transparency as well as social responsibility. Thus, this is how CSR was shaped and came into existence in the corporate world.

## 2. 1. 1 CSR across Countries

CSR, also known as corporate responsibility, corporate citizenship, responsible business, sustainable responsible business (SRB), or corporate social performance, is all but a form of corporate self-regulation integrated into a business model where companies manage the business processes to produce an overall positive impact on society. CSR has been defined in

various ways in different countries, of about being the capacity building for sustainable livelihoods from Ghana to about giving back to society from Philippines.

Conventionally, in the United States, CSR has been presented in a philanthropic model whereby companies make profits and then they donate a certain share of the profits to charitable causes. It is seen as tainting the act for the company to receive any benefit from the giving. As such, according to Carroll (2003), “ The social responsibility of business encompasses the economic, legal, ethical and discretionary (philanthropic) expectations that society has of organisations at a given point in time.”

The European model is much more focused on operating the core business in a socially responsible way, complemented by investment in communities for solid business case reasons and voluntary interaction with the stakeholders. Ideally and broadly, the concept of CSR is a built-in, self-regulating mechanism whereby business would monitor and ensure its support to law, ethical standards, and international norms.

### 2. 1. 1 Views on CSR

According to Hancock (2005), CSR can be viewed through 3 ways namely:

#### Sceptic view

According to this view, the notion of CSR is opposed to democracy and freedom, frustrating business focus on its purpose of wealth creation. Milton Friedman best defines this approach: “ Few trends would so thoroughly

undermine the very foundations of free society as the acceptance by  
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corporate officials of a social responsibility other than to make as much money for their stockholders as they possibly can”.

#### Utopian view

A utopian view of CSR reflects the idea that companies have a prior duty to anyone touched by their activity, their stakeholders rather than their shareholders, and especially the vulnerable that may be exploited by the company's operation. This is based on the work of Evan and Freeman who are for the stakeholder theory where a corporation must recognise and respect the vital interests of each of its surrounding stakeholders.

#### Realist view

This view gathers the greatest following of an alliance model advocated by Patricia Werhane. It states that CSR is not simply about whatever funds and expertise companies choose to invest in communities to help resolve social problems. But, it is also about the integrity with which a company governs itself, fulfils its mission, lives by its values, engages with its stakeholders, measures its impacts and reports on its activities.

### 2. 1. 2 The Key Drivers

CSR is seen by Porter and Van Der Linde (2000, p. 131) as a competitive driver that requires appropriate resources. CSR programmes, however, on their own, have certain main drivers which are as follow:

#### Bottom Line Effect

This is the most relevant driver of CSR programmes as it incorporates a socially responsible element into corporate practice. As John Elkington (1997) rightly underlined that many companies exhibit corporate citizenship through charity or philanthropy. Nevertheless, a new perspective evolved over time for some corporate stakeholders. Success of a corporation is now weighted and defined by evaluating businesses using a “ Triple Bottom Line” comprised of its social, environmental and financial performance.

### Managing Risk

An endeavour to adopt CSR programme has been the gain in market share, key personnel and investment which pioneering companies enjoy when they seriously address labour and ‘ green’ issues. In fact, corporations implement such a programme to manage risks and ensure legal compliance as denoted by Levine Michael A. (2008). They try to avoid investigation, litigation, prosecution, regulation or legislation.

### Influence of the Corporate Disasters

There has been an increased perception of greed amidst senior business officials in the corporate world following corporate scandals affecting Enron, WorldCom and the like. CSR is important in counteracting allegations of corporate greed. As a result, as described by Hancock (2005) in his book, corporations are now shifting away from the philanthropic approach towards CSR and are moving towards the greater alignment of CSR with business strategy and corporate governance.

### Lower Equity Risk Premium & Reputation Management

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Corporations can face economic damage when their corporate reputations and brands are assailed or sales are affected by consumer boycotts. As argued by some rating agencies, a comprehensive CSR programme will lower a company's equity risk premium. A direct correlation between reputation and financial outcome measures – share price and credit rating (Hancock, 2005) has been illustrated through a model designed by the global public relations company Bell Pottinger. In fact, companies may face a variety of legal and reputational risks if they do not have adequate social compliance or corporate social responsibility/sustainability programs in place.

### Customer Loyalty

In today's markets, companies have to focus on building and maintaining customer loyalty. As proposed by Zhou Y. (2009), this can be done through a CSR programme which builds loyalty with customers by offering a competitive advantage in a marketplace where consumers find ethically delivered or produced goods and services.

### Stakeholder Activism & Investment Incentives

As perceived by Visser, W. (2008), CSR is encouraged through the activism of stakeholder or pressure groups which often address the alleged failure of the market and government policy. The trend of socially responsible investment gives CSR an incentive where funds are screened on ethical, social and environmental criteria. Thus, this proactively encourages businesses to inform shareholders of potential risks and issues and it helps them to better understand their stakeholders, including shareholders.

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According to Hill & Knowlton (2006), surveys have indicated that analysts place as much importance on corporate reputation as they do on financial performance.

## 2. 2 Theoretical Review

A theoretical framework can be constructed around the several theories that emerged to explain the reasons behind environmental reporting over the time. These are as follow:

### Operational Efficiency Theory

Operational Efficiency occurs when the right combination of people, process, and technology to boost the productivity and value of any business operation, while reducing cost of routine operations to a desired level. In the context of CSR, operational efficiencies can be achieved through managing impending risks and liabilities more effectively and efficiently through CSR tools and perspectives by reducing costs; streaming information to stakeholders concerning the investment community for better transparency and by using corporate responsibility and sustainability approaches within business decision-making to result in new market opportunities, newly developed manufacturing processes that can be expanded to other plants, regions or markets.

### Social Contract Theory

This theory dates from the classic period of history but it took its modern form between the sixteenth and eighteen centuries with the best known philosophers like Thomas Hobbes, John Locke and Jean Jacques Rousseau  
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who talk on social contract. Rousseau, in fact, conceptualised the individual-society relationship as a symbiotic situation whereby the two parties mutually confer some right to the state in order to maintain social order which makes human life and cohabitation better and to gain benefits of community and safety. In parallel to the social contract, the corporate social theory, pertaining to a firm's indirect social obligations, has been advanced as a theoretical basis to explain the practise of CSR by corporations. Accordingly, businesses are bound by the social contract whereby they consent to perform various socially desired actions in return for approval of their objectives and other rewards. This ultimately guarantees its continued existence.

### Legitimacy Theory

The theory is close to the social contract theory. Here, the corporations constantly seek to ensure that they operate within the limits and norms of their respective societies and the outside parties perceive their activities as being legitimate.

“ Society grants legitimacy and power to business. In the long run, those who do not use power in a manner which society considers responsible will tend to lose it.” This principle developed by Davis's (1973) is commonly known as the Iron Law of Responsibility. It expresses legitimacy as a societal-level concept and describes the responsibility of business as a social institution that must avoid abusing its power. Thus, this principle expresses a prohibition rather than an affirmative duty, and it applies equally to all companies, regardless of their particular circumstances.



According to A. K. H. Khor, the legitimacy theory is fundamentally a system-oriented theory where organisations are viewed as components of the larger social environment within which they exist.

### Stakeholder Theory

A key feature of CSR involves the way that a company engages, involves, and collaborates with its stakeholders including shareholders, employees, debt-holders, suppliers, customers, communities, non-governmental organisations, and governments. Companies can use stakeholder engagement to internalise society's needs, hopes, circumstances into their corporate views and decision-making. While there are many questions about how far a company's responsibilities extend into communities relative to the roles of governments and individual citizens, there is a strong argument that CSR can effectively improve a company's relations with communities and thereby produce some key features that will improve business prospects for its future.

### Agency Theory

This theory comes to explain the relationship that exists between the owners/shareholders and the management. As such the latter is the agent which appointed by the principal (owner/subsidiary) and problems such as the potential moral hazard and conflict of interest are likely to occur. CSR comes as a middle way so that both parties can maximise their gains. As such, when CFP is strong, managers may reduce social expenditures in order to maximise their own short term private gains whereas when CFP weakens, managers will try to offset their disappointing results by engaging in <https://assignbuster.com/a-literature-review-on-corporate-social-responsibility/>

conspicuous social programs, hence increasing their own wealth and that of shareholders as well, pursuant to the managerial opportunism hypothesis by Preston & O'Bannon (1997).

### 2. 2. 1 Corporate Social Performance (CSP)

In today's competitive market environment, business is confronted with a new set of challenges that are not only economics-related. To survive and prosper, firms must bridge economic and social systems. Maximising shareholder wealth is a necessary but by no means sufficient condition for financial prosperity anymore. A new performance measure called corporate social performance (abbreviated as CSP) is used to capture the performance of a business in the social realm allowing us to be more precise in thinking about corporate social responsibility.

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” (Wood, 1991), clearly shows that social performance is not limited to corporations only, but also applies to any firm and organisation.

### 2. 2. 2 Corporate Financial Performance (CFP)

Most of the businesses operate with a view of yielding profits. The financial performance of a company is reflected through its policies and operations in monetary terms. These results are reflected through its return on investment, return on assets, value added, return on sale and growth in sales. Managers work in the best interest of shareholders to maximise

profits. Financial performance is the most common, however, it cannot be considered as the only indicator used to measure a firm's wealth. A broader definition of financial performance is accompanied by additional indicators such as short-term profits, long-term profits, market value, and other forms of competitive advantage, as noted by Jensen (2001). In today's world, for a firm to achieve a good and high level of CSP, it has to go beyond the limits of its own corporate strategies and adopt views of other stakeholders who may be directly or indirectly related to the company.

### 2. 2. 3 Corporate Social Performance and Corporate Financial Performance

Since over the three decades, the study of the correlation between corporate social performance (CSP) and corporate financial performance (CSF) has gained much salience. Many studies conducted in this effect have yielded positive correlation, while others produced contradictory results with negative or non-significant different causal directions being found. In effect, there are several competing theoretical models which are proposed to explain three varying findings on the CSP-CFP link. Owing to these differing relationships, I. Y. Maroam (2006) proposes a unified theory of the CSP-CFP link that explain the different relationships that may be observed between CSR and CFP, thus basing itself on the parallels between the business and CSR domains.

The concept of CSR instils in corporations the moral responsibility towards society that go beyond the goal of simply making profits for their owners and shareholders (Berman et al., 1999). As Freeman (1984) rightly pointed out that corporations should be socially responsible for both moral and practical

(instrumental) reasons, by reflecting a socially responsible posture, a corporation can enhance its own performance. Thus, CSR activities can, inter-alia, be rewarded with more satisfied customers, better employee, improved reputation, and improved access to financial markets, all pertaining to improving financial performance and sustain the business. However, social accomplishments may equally involve certain financial costs which can effectively reduce profits and comparative performance. Hence, Vance (1975) came up with the trade-off hypothesis to show negative linkage between CSP and CFP whereby corporations displaying strong social credentials experience declining stock prices relative to the market average.

### 2. 2. 3. 1 CSP as Business Strategic

From the above, it is clear that CSP can be used as a business strategy which can contribute to the competitive advantage of firms. A study by N. A. Dentchey (2004) on the effects of CSP on the competitiveness of organisations reveals that CSP should not be thought of an innocent adventure for executives. It is rather a strategy for achieving corporate strategies, which if not carefully implemented, may harm the competitive advantage of the firm.

Competitive advantage, as seen by Porter (1996), denotes the ability of a company to outperform others from successful differentiation from rivals' actions. This strategic fit between the outside environment and companies' internal resources and capabilities (Hoskisson et al., 1999) results in superior financial results, as indicated by various measures of profitability. Hence, as per Burke and Logsdon (1996), a strategic implementation of

social responsibility brings benefits for all since it results in strategic outcomes such as customer loyalty, future purchases, new products, new markets and productivity gains. Arguably, CSP can be a source of competitive disadvantage for firms which regard CSP as an additional cost. Business contributions to social prosperity (CSP) are seen by Keim (1978, p. 33) as an investment in public good which is consumed or enjoyed by a number of individuals disregarding the cost sharing. Thus, investing in CSP is likely to bear negative effects for the firms which are incurring costs that might otherwise be avoided or that should be borne by others, for example, individuals or government (Aupperle et al., 1985).

#### 2. 2. 4 CSP, CFP and the Stakeholder Theory

Following the above arguments, a new perspective of CSP, based on the stakeholder analysis, emerges to argue furthermore that there exists a positive relationship between CSP and financial performance. As such, S. A. Waddock and S. B. Graves (1997) propose that a tension exists between the firm's explicit costs (for instance, payments to bondholders) and its implicit costs to other stakeholders (for example, product quality costs, and environmental costs). Therefore, a firm which tries to outweigh its explicit costs by increasing its socially responsible actions incurs higher implicit costs, resulting in competitive advantage. Thus, high levels of CSP are seen as indicators of superior management by Alexander and Buchholz (1982) which lead to lower explicit costs and enhanced financial performance.

The stakeholder theory accompanies the concept of CSR by shedding more light on the issue of social responsibility. This theory is spread over three

aspects (Donaldson and Preston, 1995) namely, descriptive, instrumental and normative. While the descriptive aspect describes and explains the theory, the instrumental aspect discloses the cause-effect relationships between stakeholder management practices and improving corporate performance. The normative aspect, on the other hand, as perceived by I. Y. Maroam (2006) emphasizes on the moral imperatives for practising stakeholder management, rather than the business benefits it may provide. A parallelism between the core business domain and the CSR domain will maximise a firm's profitability.

The stakeholder theory provides a framework for investigating the relationship between CSP and CFP by examining how a change in CSP is related to a change in financial accounting measures. In fact, the two concepts of CSR and stakeholder share the proposition that social responsibility affects financial performance in some way or other. This subject area has been so vastly explored that this trend is now seen as a natural progression which goes associatively with developments in the industrial and business world. There is an increasing concern and emphasize on humanity, environmental preservation and enlightened social consciousness. Thus, a new area of research began to pave its way within the field of business and society where the relationship between corporate social conduct, both toward the corporation's stakeholders and the wider society, and the corporation's financial performance was and is still being investigated across several countries. Over environmental issues, research has revealed that businesses which are eco-friendly and demonstrate good

CSR practices enjoy increased consumer purchase preference (Gildea, 1994; Zaman, 1996) and good economic performance (Al-Tuwaijiri, et al., 2004).

A stakeholder group, as identified and defined by Freeman (1984), is one that that “ can affect or is affected by achievement of the organisation’s objectives”, that is, which can be harmed as well as can help it to achieve its goals. Therefore, there is a growing need for firms to address the needs and expectations of the stakeholders to avoid negative outcomes and produce positive outcomes for themselves (Donaldson and Preston, 1995; Freeman, 1984; Frooman, 1997). Pursuant to the stakeholder theory perspective, CSP can be assessed in terms of a company meeting the demands of multiple stakeholders, ranging from cost minimisation to societal maximisation.

Building on the previous mentioned definition of CSP, Wood and Jones (1995) propose that stakeholder theory is the key to understanding the structure and dimensions of the firm’s societal relationships. This theory thereby assumes that firms are responsible for honouring all the implicit and explicit contracts they hold with their various constituents.

Therefore, the stakeholder theory provides a system-based perspective of the organisation and its stakeholders where it acknowledges the dynamic and complex nature of the interplay between them. The various stakeholders of the firms, such as the employees, shareholders/ financiers, environmentalists, government, communities, customers and even competitors should be convinced by the management that it is working harder to satisfy them. The more important the stakeholders to the firm, the more effort the firm needs to put to uphold its relationship with the former.

According to Clarkson, Donaldson and Preston et al. (1995), the stakeholder  
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theory must place shareholders as one of the multiple stakeholder groups which managers should consider in their decision-making process. However, like the shareholders, the other stakeholders may have a say upon the firm, bestowing societal legitimacy. Notably, Bernadette M. Ruf et al. (2001) asserted that firms must address these non-shareholder groups demands otherwise they might face negative confrontations which can ultimately result in diminished shareholder value, through boycotts, lawsuits, protests and so on. Hence, firms have a fiduciary duty relationship not only to the shareholders, but to all stakeholders (Hasnas, 1998, p. 32).

So far, recognising a company's contractual relationship with the various stakeholders has been instrumental in better comprehending the relationship that CSP and CFP share. Stakeholders have expectations from the organisation. Nevertheless, these expectations may conflict with the firm's limited resources leading the firm to evaluate its costs and benefits tradeoffs. Firms must thus come with measures representative of the various factors of CSP and stakeholders' interests. Unlike neo-classical stockholders who were only interested in financial performance (Grouf, 1994; Shapiro, 1992), the major stakeholders of today, that is, the stockholders are more interested in the firm's current and future financial benefits and social performance.

## 2. 3 Empirical Review

This section reviews the works done and methods used by researchers on the relationship of CFP and CSP. Empirical results on the correlation between these are mixed whereby some yielded in positive, some in negative or some



in non-significant relationships. Basing on the stakeholder theory approach, several models on the CFP-CSP relationship have been proposed, where the largest number of investigations found a positive CSP-CFP relationship. Notably, different methods to compute indexes for CFP and CSP have been used since data on both cannot be possibly obtained in absolute figures.

As such, using aggregated weights assigned to K dimensions of social performance obtained through questionnaire for CSP and using change in Return of Equity, change in Return on Sales and growth in sales as financial measures on a sample of 496 firms, Bernadette M. Ruf et al. (2001) came up with a positive relationship between CSP and CFP. They, in fact, regressed change in CSP on change in CFP. The results revealed a significant positive relationship between change in CSP and change in Return on Equity and change in Return on Sales in the long term but that with the Growth of Sales to be significantly positive only in year 0 and 1. The study suggests that improvements in CSP have both immediate and continuing financial impacts.

A paper by S. A. Waddock and S. B. Graves (1997) also came up with positive linkage between CFP and CSP. An index for CSP was computed using eight attributes, rated consistently across the entire Standards & Poors 500 by a rating service, which were related to stakeholder concerns. The firm financial performance (profitability) was measured using three accounting variables, namely, return on assets (ROA), return on equity (ROE) and return on sales (ROS) used to assess CFP by the investment community. Factors such as size, risk and industry which affect both CFP and CSP were taken as control variables. Used on a sample of 469 companies and using CSP as both dependent and independent variable, the results revealed that CFP does <https://assignbuster.com/a-literature-review-on-corporate-social-responsibility/>

depend on CSP and vice-versa and also indicated the importance of controlling for industry in assessing such a relationship.

To bring more integrity, M. Orlitzky et al. (2003) conducted a quantitative meta-analysis on the CFP-CSP relationship building on the hypothesis that CSP and CFP are generally positively related leading to competencies, learning, efficiency and reputation-building with its external stakeholders. Taking CFP as a company's financial viability through three broad subdivisions consisting of market-based (investor returns), accounting-based (accounting returns), and perceptual (survey) measures and constructing CSP through four broad measurement strategies, namely: (a) CSP disclosures (annual reports, letters to shareholders); (b) CSP reputation ratings; (c) social audits, CSP processes, and observable outcomes; and (d) managerial CSP principles and values (Post, 1991), the study suggests that corporate virtue in the form of social responsibility and, to a lesser extent, environmental responsibility can pay off, despite the CSP-CFP operationalisations can also moderate the positive association. CSP appeared to be more highly correlated with accounting-based measures of CFP than with market-based indicators, and CSP reputation indices were more highly correlated with CFP than are other indicators of CSP. This meta-analysis establishes a greater degree of certainty with respect to the CSP-CFP relationship than is currently assumed to exist by many business scholars.

According to Mahoney L. and Roberts R. W. (2007), there is no significant relationship between a composite measure of firms' CSP and CFP. Using four years panel data of Canadian firms, they calculated a composite measure of CSP score by summing all dimension strength ratings, such as, community  
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relations, diversity, employee relations, environment, international, product safety, and amongst others and subtracting all dimension weaknesses ratings. As concerned the CFP, following Waddock and Graves (1997a), return on assets (ROA) and return on equity (ROE) were used separately to measure a firm's CFP. As CFP was expected to be positively related to CSP, a one-year lag between CFP and all independent variables (CSP, firm size, debt level, and industry) was used. Inconsistent with their expectation, they found no significant relationship between the composite CSP measure and either ROA or ROE. However, the use of individual measures of firms' CSP regarding environmental and international activities and CFP resulted in a significant relationship providing mixed support for the business case for CSP. A study, using the "Granger causality" approach, by Rim Makni et al. (2008) reaffirms Mahoney and Roberts (2007)' works on the non-significant relationship.

However, there may also be a simultaneous and interactive negative relation between CSP and CFP, forming a vicious circle.

Building on P. L. Cochran and R. A. Wood (1984) CSR-financial performance model where average age of corporate assets was found to be highly correlated with social responsibility rankings, D. J. Wood (1991) reformulated the CSP model to build a coherent, integrative framework for business and society research. The principles of social responsibility were framed at the institutional, organisational, and individual levels; processes of social responsiveness were shown to be environmental assessment, stakeholder management, and issues management; and outcomes of CSP were posed as social impacts, programs, and policies. The third part of the CSP model concerning the social outcomes was the only portion that was actually

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observable and open to assessment and any real performance, determined by stakeholders, existed. It was noted that stakeholders were likely to evaluate CSP differently, depending not only on their own interests, but also on their understanding and acceptance of social responsibility principles and their relationship to CSP. Building on this model, many researchers worked on finding the linkage between CFP and CSP. Using Wood (1991)'s model, the results of a study conducted by P. A. and S. D. Stanwick (1998) showed that a firm's CFP is indeed affected by the size of the firm, and the amount of pollution emissions released.

Where many numerous quantitative studies have been carried out to establish, largely in samples of multiple industries, the CSP-CFP relationship, M. Soana (2009) investigated this very linkage in the banking sector using a sample of national and international banks where social performance was proxied using content analysis, surveys, reputational measures, unidimensional indicators, ethical ratings and financial economic performance was proxied using market and accounting ratios. The eventual examination resulted in a no statistically significant link that could indicate any positive or negative correlation between CSP and CFP. The reason was that the majority of studies revised till now are also almost exclusively focused on the USA and UK markets. Corporate governance was also used as control variable, but it showed a non-significant and negative link with ROA and ROA. The study also confirmed the hypothesis that those banks that have the most transparent and efficient ownership structure are also the least profitable for shareholders.