Stakeholder influence capacity and the variability of financial returns to corporate social responsibility

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Accepted for publication in
Academy of Management Review
Special Topic Forum on "Corporations as social change agents"
Forthcoming

October 2005 version

*My thanks to John Jermier, Rob Salomon, Sandra Waddock, Tim Fort, and the anonymous reviewers for advice on assorted aspects of this manuscript. I also thank the College of Business Administration at the University of South Florida for summer financial support.

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ABSTRACT

Should corporations serve as agents of social change? For more than 30 years, scholars have attempted to make a "business case" that demonstrates that corporations should because they can earn positive financial returns from social responsibility. However, the business case remains unproven. This paper argues that research on the business case must account for the path dependent nature of firm-stakeholder relations, and develops the construct of stakeholder influence capacity (SIC) to fill this void. SIC helps explain why the effects of corporate social responsibility (CSR) on corporate financial performance (CFP) vary across firms and across time, and so provides a missing link in the study of the business case. This paper distinguishes CSR from related and confounded corporate resource allocations and from corporate social performance (CSP), then incorporates SIC into a conceptual framework that illustrates how acts of CSR are transformed into CFP through stakeholder relationships. This paper also develops a set of propositions to aid future research on the contingencies that produce variable financial returns to investments in CSR.

"John Hyde, a retiree in Placerville, Calif., says it's hard to believe Philip Morris is 'a good guy just because it donates water to flood victims, or helps the hungry'" (Alsop, 2002: 1)

"There is a lot of skepticism out there when a company like McDonald's start to talk about salads, because people know McDonald's is not especially concerned about the health of America" (Rich Polt, consultant, quoted in Dressel, 2003: 1)

"I guess it depends if it's [the firm's participation in an act of corporate social responsibility] part of the total picture and [if] they really go out of their way. Like with Kroger, it isn't a one-time shot, they're always doing stuff for Egleston [Children's Hospital], or they've got the big barrels out there for the people to bring cans for the homeless or something at Thanksgiving and Christmas. It just seems more a way of business for them, continuously, so in that case, that's fine . . . But if somebody's doing it just for the publicity, then that would not make me think better of them" (survey respondent quoted in Webb & Mohr, 1998: 235).

Should public corporations serve as agents of progressive social change? For example, should Levi Strauss fund a campaign to end racism? Should Ford contribute to finding a cure for AIDS? If so, how much should these corporations contribute to these social causes? Because there are ethical considerations inherent in answering these questions, reasonable people can and do disagree. Some argue that because corporations draw resources from society, they have a moral obligation to give back to society, while others counter that corporations are inefficient and inappropriate agents of social change, and any voluntary contributions to social causes are misappropriations of shareholders' funds (Friedman, 1970).

In the face of this ongoing ethical debate, many researchers have turned to examination of the "business case" for corporate social responsibility (CSR). A large and ever-growing body of literature has investigated whether the financial benefits to the corporation can meet or exceed the costs of its contributions to social welfare (for recent reviews, see Margolis & Walsh, 2003; Orlitzky, Schmidt & Rynes, 2003). If so, CSR can be justified as a wise investment; if not, CSR can be condemned as an agency problem. The result: after more than 30 years of research, we cannot clearly conclude whether a one-dollar investment in social initiatives returns more or less than one dollar in benefit to the shareholder.

The lingering murkiness of the business case has been attributed to a variety of shortcomings present in the research of scholars approaching the topic from myriad (a)theoretical angles (Ullmann, 1985; Griffin & Mahon, 1997). Yet even as the rigor of CSR studies has increased to address these shortcomings, the link between CSR and financial performance has become only murkier. Margolis and Walsh (2003: 278) recently described this body of research as ". . . self-perpetuating: each successive study promises a definitive conclusion, while also revealing the inevitable inadequacies of empirically tackling the question." As a result, it ". . . reinforces, rather than relieves, the tension surrounding corporate responses to social misery" (Margolis and Walsh, 2003: 278). Thus, the seemingly tractable business case for CSR remains just as debatable as the associated ethical dilemma.

The continuing chaos surrounding the business case should not come as a surprise. The unique and dynamic characteristics of firms and their environments preclude stability in financial returns to CSR across firms and time, so we should not expect to empirically discern a consistent financial benefit—essentially, a universal rate of return—to a generic corporation for some given unit of social investment. Consider McDonald's and Subway restaurants. Though they are both in the same industry and so face similar competitive conditions, were each to contribute $1 million to efforts to curb obesity, it is unlikely that they would experience identical financial returns. In fact, their returns could differ radically, with one achieving a positive return, and the other experiencing losses. Even within the same firm, identical levels of CSR investment over different time periods are likely to lead to different financial returns, such as before and after lawsuits, intense media scrutiny, or other external shocks (cf. Alsop, 2002; Hoffman, 1997). Thus, efforts to universally legitimize or condemn the business case are "theoretically untenable" (Rowley and Berman, 2000: 406).

Researchers have often overlooked the many contingencies that cause variability in returns to CSR, perhaps in a zeal to legitimize or discredit the business case (Rowley & Berman, 2000; Ullmann, 1985). As a result, the business case has been neither made nor discredited, despite extensive research (Margolis & Walsh, 2003). The goal of this paper is to help reorient CSR research away from the long-fought battle for replicable empirical findings of the financial returns to CSR in general, and toward a quest for deeper understanding of the underlying drivers of whether and when particular firms may earn positive financial returns from CSR; in short, to make the business case firm-specific, not universal. In furtherance of this goal, this paper presents a conceptual framework that illustrates how firms generate financial returns from acts of CSR. Building on the stakeholder theory argument that firms can benefit financially from attending to the concerns of their stakeholders (Freeman, 1984), this paper discusses how these financial benefits vary as a result of *stakeholder influence capacity*, a construct that captures variation across and within firms in their ability to use CSR to profitably improve relationships.

The paper next presents an overview of the business case for CSR. Thereafter, CSR is distinguished from several related and sometimes confounded concepts. Then, the construct of stakeholder influence capacity is introduced, embedded within a conceptual framework, and elaborated through a set of propositions. The paper concludes with an extended discussion of the implications of stakeholder influence capacity for the future of CSR research and practice.

THE BUSINESS CASE FOR CORPORATE SOCIAL RESPONSIBILITY

CSR is often described as any discretionary corporate activity intended to further social welfare. For example, Target reported that it donates more than $2 million each week to the arts, education, and social services in the communities in which its stores operate. The presence of discretion is key. Many corporate activities that further social welfare are mandated by law, such

as equal employment opportunity and medical leave. But why, in the face of often-fierce competition, do for-profit firms voluntarily allocate additional limited resources to social welfare as an "almost universal practice" (Dressel, 2003: 1)? Certainly these resources could be put to better use in improving the efficiency of the firm, or returned to shareholders.

This is the core of the argument against CSR. Critics of CSR contend that expending limited resources on social issues necessarily decreases the competitive position of a firm by unnecessarily increasing its costs. Furthermore, even if a firm has slack resources but no favorable investment opportunities, and the costs of CSR are not ample to put the firm at a competitive disadvantage, the firm should still refrain from CSR. Devoting corporate resources to social welfare is tantamount to an involuntary redistribution of wealth, from shareholders, as rightful owners of the corporation, to others in society who have no rightful claim. Thus, CSR, though almost universally practiced, is considered by some to be an agency loss; managers pursue CSR for personal gain, not shareholder benefit (Friedman, 1970). McWilliams and Siegel's (2001: 117) definition of CSR, though they argue for a neutral relationship between CSR and financial performance, exemplifies the agency loss perspective: ". . . we define CSR as actions that appear to further some social good, *beyond the interests of the firm* and that which is required by law" (italics added). Simply put, critics contend that CSR is not in the firm's interests, and so should not be countenanced.

CSR proponents counter that when one takes a more enlightened view of how firms achieve competitive advantage, one can see that CSR is, in fact, in firms' best interests. Stakeholder theory (Freeman, 1984), the cornerstone of the business case for CSR, highlights the importance of a firm's relationships with a broad set of individuals and organizations, beyond just shareholders. Instrumental stakeholder theory (Jones, 1995) further clarifies how CSR

contributes to the bottom line via its favorable influence on the firm's relationships with important stakeholders. The importance of stakeholders can be determined by their relative power, legitimacy, and urgency (Mitchell, Agle, & Wood, 1997). The overall logic is that CSR (e.g., philanthropy) increases the trustworthiness of a firm and so strengthens relationships with important stakeholders (e.g., increases employee satisfaction), which decreases transaction costs and so leads to financial gain (e.g., decreased employee turnover, more eager talent pool, union avoidance). CSR can differentiate a firm's products (Porter, 1991), reduce its operating costs (King & Lenox, 2000), and serve as a platform for future opportunities as well as a buffer from disruptive events (Fombrun, Gardberg, and Barnett, 2000). Thus, from this angle, one can view CSR as an investment, perhaps with sizeable financial returns, in addition to or despite any benefits that might accrue to society. In short, CSR supporters argue that there is ample private incentive for improving social welfare.

So, does CSR build or destroy corporate wealth? Over the last three decades, many researchers have taken on the task of empirically testing the business case. According to Orlitzky et al. (2003), there recently were a total of 52 quantitative studies published on this topic. Margolis and Walsh (2003) put this figure at 127. For more than two decades, researchers have also taken on the task of reviewing these many studies, and bemoaning the mixed findings. Margolis and Walsh (2003) tallied 13 reviews since 1978. In one of the earlier instances, Ullmann (1985) described this body of research as "data in search of a theory." A dozen years later, Griffin and Mahon (1997) entitled their review as "twenty-five years of incomparable research." Roman, Hayibor, and Agle (1999) "repainted the portrait" they ascribed to Griffin and Mahon's (1997) critical study to recast it as more supportive of the business case, but Mahon and Griffin (1999) immediately repainted that repaint so as to return the portrait to its original

critical state. Most recently, Orlistky et al. (2003) performed a meta-analysis of the population of quantitative studies to date and found support for the business case. Margolis and Walsh (2003: 278), though, argued that any conclusion that the business case is now established because more empirical studies have been published in support of it than against it is "illusory."

The question remains without a definitive answer. The mixed findings have been attributed to a variety of shortcomings: "a lack in theory, inappropriate definition of key terms, and deficiencies in the empirical data bases currently available" (Ullmann, 1985: 540); stakeholder mismatching (Wood & Jones, 1995); ". . . conceptual, operationalization, and methodological differences in the definitions of social and financial performance" (Griffin & Mahon, 1997: 6); failure to control for risk, industry affiliation, and asset age (Cochran & Wood, 1984); and failure to control for investment in R&D (McWilliams & Siegel, 2000). Many of these shortcomings have been repeated in subsequent studies, but many have also been corrected as they were brought to light. CSR studies have improved over time, offering stronger theoretical rationale, more relevant operationalizations, and more and better controls for previously omitted variables. Yet the improved rigor has only produced rigor mortis. Mahon and Griffin (1999: 126) argued that 25 years of research has not produced a solution, but rather, isolated islands of partial insight about an unseen larger picture, akin to ". . . the fable of the five blind Indian men." As Rowley and Berman (2000: 405) put it, ". . . researchers have combined various mishmashes of uncorrelated variables, which render correlation and ordinary least squares regression results indiscernible." Margolis and Walsh (2003) concurred that, even after 30 years of research, with scholars increasing the depth and breadth of their databases, differences in perspective have only cumulated, not dissipated, thereby further obscuring the big picture.

Rowley and Berman (2000) further argue that efforts to universally prove the business case are doomed to failure, no matter how ingenious the theory, crystal clear the terminology, or rigorous the data and methodology. Rowley and Berman (2000: 401) contend that the 30-year quest ". . . represents an attempt to legitimize the researcher and the business and society field, rather than build understanding . . ." Theory and empirics that suggest a universally favorable rate of return to CSR validate the business case, and so help to legitimize the business and society field. Yet it is clear that CSR cannot universally produce favorable returns for all firms all the time, so favorable findings will never be replicable across all data sets. Returns to CSR are contingent, not universal (Ullmann, 1985). Though some studies have begun to empirically tease apart these contingencies (Barnett & Salomon, 2003; McWilliams & Siegel, 2000; Orlitzky et al., 2003), Rowley and Berman (2000) argue that the results of such studies are not interpretable because the theoretical underpinnings to explain which contingencies are relevant have not yet been established. Therefore, researchers should attempt to develop theory that explains heterogeneity in financial returns to CSR. The remainder of this paper heeds this call.

THE BOUNDARIES OF CORPORATE SOCIAL RESPONSIBILITY

CSR research has often been criticized for running fast and loose with its concepts (Griffin & Mahon, 1997; Ullmann, 1985). This section defines CSR and demarcates its boundaries by distinguishing it from related concepts.

Distinguishing CSR from CSP

This study explores the business case for CSR by examining how acts of CSR influence corporate financial performance (CFP). In contrast, most studies of the business case have examined the relationship between corporate social performance (CSP) and CFP. For example,

recent comprehensive reviews, both critical (Griffin & Mahon, 1997; Margolis & Walsh, 2003; Rowley & Berman, 2000) and supportive (Orlitzky et al., 2003) of the business case, all refer to CSP studies. Though the terms CSR and CSP are often used interchangeably, there is an important distinction. CSP may be described as a snapshot of a firm's overall social performance at a particular point in time; a summary of the firm's aggregate social posture. For example, Wood's (1991: 693) commonly cited definition of CSP is: ". . . 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 social relationships." Many researchers have attempted to gauge a firm's CSP at a point in time, and more rarely, over time, through such measures as reputation rankings and stakeholder surveys, and then correlate these proxies for CSP to CFP (Margolis & Walsh, 2003).

Though certainly of interest, this body of research does not directly aid management in making decisions about devoting limited resources to socially responsible actions in the face of competing demands. Rather, CSP – CFP studies address the financial benefits of having achieved a certain socially responsible posture at a particular point in time. Either a firm achieved this posture, and so might have expected these benefits (or harms), or a firm did not achieve this posture, and so should not. Often unexplained and untested are the costs and benefits of gaining this posture – the incremental steps toward attainment of a certain strategic CSP posture, or the value of discrete or less directed socially oriented activities undertaken as a firm "muddles" (Lindblom, 1959) its way through its strategy. Firms are not imbued with a certain CSP state. There is no "market for CSP" wherein such a state can be purchased. Rather, firms make investments that, over time, aggregate into certain CSP postures. These investments are CSR. For example, Ben & Jerry's created a favorable CSP posture through the CSR

activities of its Ben & Jerry's Foundation and its involvement in a variety of specific campaigns such as "One Sweet Whirled" and "Rock the Vote." Was each of these activities a wise corporate investment? That is the question of interest in this paper, so CSR is used[1].

Distinguishing CSR from Other Corporate Resource Allocations

Though recent scandals have channeled a great deal of attention toward CSR, it is only a subset of the many activities in which corporations engage. Arguably, all law-abiding and profit-maximizing corporate activities have a social component because they help to improve the economic conditions that support society. As Friedman (1970: 126) put it: ". . . there is one and only one social responsibility of business—to use its resources and engage in activities to increase its profits so long as it stays within the rules of the game. . ." Yet such a broad conception of CSR only confounds the study of the business case. In terms of social responsibility, is the construction of a new plant, with an attendant increase in employment, akin to the establishment of a company day care center or a donation to a local charity? Relatively few scholars have interpreted CSR as broadly as Friedman (1970), but CSR scholars have made generous use of the concept. Where do the appropriate boundaries lie?

Within the boundaries of CSR. There are two characteristics that distinguish acts of CSR from other corporate investments: *social welfare orientation* and *stakeholder relationship orientation*. The most obvious and distinctive characteristic of an act of CSR is its focus on increasing social welfare. Whereas other corporate investments, at least from a normative perspective, are focused on improving the wealth of the owners of the corporation, CSR activities involve efforts to improve social welfare. Research on the business case seeks a link to profitability, but any financial gains from CSR activities (e.g., corporate philanthropy) are

necessarily by-products of these direct contributions to social welfare. It is this aspect of CSR that makes it so controversial.

Stakeholder relationship orientation is an essential yet often implicit characteristic of the business case for CSR. The business case tries to move beyond the contentious ethical debate by claiming that CSR, though it is focused on improving social welfare, also increases CFP, and so can be considered an investment. In order to increase CFP, an act of CSR must ultimately increase a firm's revenues or decrease its costs. Unfortunately, the mechanisms by which CSR can do this are not always clear. Many early studies did not offer a theoretical framework to demonstrate this, and so were dismissed as atheoretical (Ullmann, 1985). The advent of a stakeholder perspective (Freeman, 1984) helped dampen these criticisms, but did not silence them because its vague boundaries frustrated the development of a viable stakeholder theory of the firm (Donaldson & Preston, 1995). Instrumental stakeholder theory (Jones, 1995) brought stronger theoretical underpinnings to the business case, primarily by linking it to transaction cost economics (Williamson, 1975):

> "Certain types of corporate social performance are manifestations of attempts to establish trusting, cooperative firm/stakeholder relationships and should be positively linked to a company's financial performance . . . firms that contract with their stakeholders on the basis of mutual trust and cooperation will have a competitive advantage over firms that do not. [This advantage stems from] reduced agency costs, transaction costs, and costs associated with team production. More specifically, monitoring costs, bonding costs, search costs, warranty costs, and residual losses will be reduced" (Jones, 1995: 422, 430).

Others have augmented stakeholder theory with aspects of resource dependence theory (Pfeffer & Salancik, 1978) so as to clarify "who and what really counts" (Mitchell et al., 1997) in regard

to stakeholder relationships, and resource-based theory (Penrose, 1959; Wernerfelt, 1984; Barney, 1991) to elicit how favorable stakeholder relationships produce not only cost savings, but also increased revenues (Russo & Fouts, 1997).

There is now a substantive theoretical framework to explain how CSR produces increases in CFP. The basic premise is that CSR improves CFP by improving a firm's relationships with relevant stakeholder groups. As these relationships improve, and trust builds, transaction costs decline, and certain risks decline or are eliminated. For example, certain types of CSR may lead to more trusting labor relations, which can increase employee retention rates and so decrease labor costs (Greening & Turban, 2000). On the revenue side, improved stakeholder relationships can bring in new customers and new investment opportunities and enable a firm to charge premium prices (Fombrun et al., 2000; Porter, 1991; Porter & van der Linde, 1995). The key point is that CSR improves CFP by first improving relationships with key stakeholders. This indirect relationship between CSR and CFP inherent in the business case is distinct from corporate investments that have a direct impact on CFP, as well as those that indirectly impact CFP through channels other than stakeholder relationship building and the advancement of social welfare. The nature of CSR and the relevance of both characteristics — social welfare orientation and stakeholder relationship orientation — become more apparent when contrasted with those corporate activities that do not meet these criteria, as discussed next.

INSERT TABLE 1 ABOUT HERE

Outside the boundaries of CSR. Much that is often lumped in with CSR actually falls outside its bounds, as illustrated in Table 1. Let us first examine the upper left quadrant of Table 1, labeled "Agency Loss." Some types of social spending are not intended to directly or even

indirectly increase CFP. They may be acts of pure corporate altruism or pet projects of management. A substantial donation to a small charity headed by the spouse of the CEO or an anonymous donation to any charity would fall into this category. These allocations may improve management's welfare by increasing their self-image, social standing, or career prospects. However, if these allocations are not instrumental to improving the corporation's relations with important stakeholders, than any near- or even long-term increase in CFP is unlikely; it is neither countenanced nor accounted for. Resource allocations without concern for shareholder value maximization were what disturbed Friedman (1970). One cannot argue that the benefits to the corporation from such activities outweigh their costs because the benefits accrue to management or to society, not to shareholders. These are straightforward agency losses (Jensen & Meckling, 1976). Because there is no question about their effect on CFP, these types of resource allocations are not of interest to the business case. Therefore, corporate resource allocations that aid social welfare but are not instrumental in improving key stakeholder relationships (and thereby increasing CFP) should be at the center of the ethical debate over the role of the corporation in society, but they should not be confounded with the business case for CSR.

Direct influence tactics, as listed in the lower right corner of Table 1, are also distinct from CSR. This category includes political lobbying and campaign donations, the establishment of contractual relationships, and other means of directly influencing or "capturing" regulators, legislators, non-governmental organizations (NGOs) and other stakeholders who can affect the discretion and performance of a firm. Firms have long allocated significant resources to lobbying and political campaigns in order to curry favor with those who control legislative and regulatory agendas (de Figueiredo, 2002; Hillman, Keim & Schuler, 2004). "Green alliances" and other forms of cooperation between firms and NGOs have become increasingly common

(Stafford & Hartman, 1996). These cooperative relationships can include the payment of fees and royalties to NGOs in exchange for their endorsement of a firm's products and services (Hartman & Stafford, 1997). Such direct influence tactics are focused on improving relationships with important stakeholders, but they are not necessarily focused on improving social welfare. In fact, corporate efforts to capture regulators and legislators and co-opt activist NGOs can be instrumental in *reducing* a firm's contributions to social welfare (Stigler, 1971; Pfeffer & Salancik, 1978; Baysinger, 1984; Baron, 1995).

Direct influence tactics can best be distinguished from CSR activities by noting to whom the benefits accrue. The benefits of direct influence tactics – contributions, royalties, licensing fees – accrue directly to the stakeholders the firm seeks to influence; the benefits of CSR do not. The business case for CSR implies that as stakeholders observe a firm's socially responsible behaviors, they will deem the firm a more favorable party with which to conduct their own transactions. For example, Turban and Greening (1997) found that firms with favorable social performance records were more attractive to potential employees, and Brown and Dacin (1997) found that such firms were also more attractive to customers. Trust arises and relationships improve as stakeholders observe a firm's CSR activities, not as a consequence of a firm's use of direct influence tactics to "capture" their favor. Direct influence tactics, or perceptions of attempts at direct influence, can actually reduce trust with their targets (cf. O'Sullivan, 1997; Varadarajan & Menon, 1988), or simply make trust less relevant by substituting financial payouts and direct contractual ties (cf. Oliver, 1990). Direct influence tactics are of no less interest or importance to understanding CFP than is CSR (Shaffer, Quasney & Grimm, 2000), but in seeking to clarify the business case for CSR, it is essential to factor out those activities that affect CFP through other mechanisms.

Shown in the lower left corner of Table 1, more commonly confounded with CSR are process improvement efforts such as energy conservation, waste reduction, and pollution abatement (Hart, 1995; Klassen & Whybark, 1999). Social welfare gains can certainly arise from corporate efforts to improve processes and so lessen waste and harm to the natural environment. However, the link sought between the investment and the financial return is direct, and so again distinct from the indirect mechanism of the business case (cf. Windsor, 2001). That is, the gains to CFP are sought through cost savings achieved from improving the efficiency of operations (King & Lenox, 2002), not from improvements in stakeholder relations. Thus, such process improvement efforts merit categorization with other standard corporate investments in improving operational efficiency.

Complex investments and hidden motives. Though Table 1 and the above discussion provide a useful conceptual distinction to help sort out the myriad activities often confounded with CSR, many corporate investments do not fit neatly within one box. A single investment can focus on both social welfare and stakeholder relationships, yet can also entail aspects of direct influence, process improvement, and even agency loss. For example, one might classify a $1 million donation by a large financial institution to a preschool as a clear example of CSR, concluding that the financial institution wished to demonstrate a commitment to education to its customers and the community in which it operates. However, if one of the financial institution's co-CEOs spent the $1 million in order to directly influence one of its analysts, using the donation to get the analyst's child placed into this prestigious preschool so that the analyst would then upgrade a stock, so that the CEO of the firm whose stock rating improved, a member of the financial institution's board of directors, would then vote to oust the financial institution's other co-CEO (Gasparino, 2005), then one might also classify this $1 million investment as a direct

influence tactic (direct payment to improve relations with an important stakeholder, the analyst) and as an agency loss (a clear misappropriation of shareholder funds, for management gain). Less salacious but also complex could be a company's decision to invest $1 million in office and plant design technologies that reduce energy consumption. Though previously described as a process improvement effort, advertising and public relations arms of the firm may tout the environmental benefits of such actions in hopes of improving relationships with stakeholders (CSR). The $1 million project could also include funding for a partnership with an energy conservation NGO that had been pressuring the firm, and so could function as a means of co-opting that group (direct influence tactic), or it could be an inflated contract awarded to a relative of the CEO (agency loss).

Examples such as these illustrate that classification can be tricky, but the complex nature of some investments makes classification particularly important. Complex investments confound the relationship between CSR and CFP. If agency losses are confounded with CSR, findings may be biased toward a negative relationship, and so toward refutation of the business case. On the other hand, confounding CSR with direct influence tactics and especially process improvement gains may bias findings toward a positive relationship, and so toward support for the business case. It is therefore beneficial to parse out the CSR portion of complex investments. For example, the $1 million investment in energy conservation previously mentioned could be disaggregated into process improvement and CSR components. To measure the net financial benefits that accrued to CSR, the costs of the process improvement expenditures could be separated from any resources expended to internally and externally publicize this program, and the efficiency gains could be culled from the total financial gains from this investment, netting the financial gains attributable to improved stakeholder relations. Such parsing can be

subjective, but no more so than commonly accepted practices involved in accounting for intangibles (Lev, 2001). Another tool is real option analysis (Barnett, 2003, 2005; Bowman & Hurry, 1993; McGrath, 1997; Kogut & Kulatilaka, 2001). Fombrun et al. (2000) suggested that firms view investments in social responsibility as "opportunity platforms" that generate future opportunities, or real options (cf. Kogut & Kulatilaka, 1994). From this perspective, the $1 million energy conservation project would be treated as a platform investment, and the additional opportunities it produces to enhance stakeholder relations would be valued as real options. A variety of techniques exist to place a separate financial value on these real options (Trigeorgis, 1996; Copeland & Antikarov, 2003).

A further complication is determination of motives. Particularly in regard to social responsibility, firms may disguise the motives behind an action, or even misrepresent them (Greer & Bruno, 1996; Beder, 1997; Laufer, 2003). This is not problematic for managerial decision making, since managers are aware of their own motives, and can therefore make informed cost-benefit projections about even the most Machiavellian of acts. However, it does present a serious challenge to observers, such as researchers. In the "Discussion" section, this paper suggests research methods to cope with this issue.

As described above, then, CSR may be more narrowly defined as a discretionary allocation of corporate resources toward improving social welfare that serves as means of enhancing relationships with key stakeholders. Research on the business case for CSR extends the link to CFP, seeking to measure financial outcomes and so determine whether or not there is ample private incentive for firms to engage in these publicly beneficial activities. An effort to ultimately enhance CFP by demonstrating social responsibility to important stakeholders is much different than an effort to enhance CFP by squeezing more efficiency and effectiveness out of

processes and machinery or by directly capturing key stakeholders. Once these other types of resource allocations are cleared from our view of the business case, the mechanisms of true interest become more visible and subject to scrutiny.

EXPLAINING HETEROGENEITY IN THE FINANCIAL RETURNS TO CSR

The theoretical framework underlying the business case proposes that CSR improves key stakeholder relationships, which decreases costs and increases income, and so increases CFP. However, an extensive body of empirical testing has failed to conclusively support the business case. Does this mean that the theory is flawed? As argued below, this paper asserts that the basic theoretical underpinnings of the business case are correct, but a key construct that moderates the transformation of CSR into improved stakeholder relationships is missing. This section outlines this key construct and embeds it within a conceptual framework that better explains the relationship between CSR and CFP.

Stakeholder Influence Capacity

CSR has a variable effect on CFP. Equal investments by different firms, or even the same firm at different points in time, do not return equal amounts of financial gain, as implied by 30 years of inconsistent findings. How can this variability be explained? Over the past several decades, scholars have added myriad control variables to their studies to capture variation, but they have done so in an ad hoc fashion, leaving critics to contend that the end result is nothing more than a “mishmash” (Rowley & Berman, 2000: 405) of variables. We now understand the effects of isolated pieces of the overall puzzle, ceteris paribus, but the dots remain unconnected through any theoretical framework that adequately explains the contingent nature of the business case (Mahon & Griffin, 1999; Margolis & Walsh, 2003).

One notable attempt at connecting the dots was that of McWilliams and Siegel (2001). They constructed a supply and demand model of CSR that explained how size, level of diversification, research and development, advertising, government sales, consumer income, labor market conditions, and stage in the industry life cycle influenced the level of CSR output by a given firm. Their "theory of the firm perspective" assumed, though, ". . . that each firm makes optimal choices, which means that each produces at a profit-maximizing level of output" (McWilliams & Siegel, 2001: 125). Under this logic, since CSR is an "almost universal practice" (Dressel, 2003: 1), it must also be an almost universally wise investment. Support for the business case is an assumption of the model, since each firm makes only optimal choices – if CSR did not maximize profit, then firms would not engage in it. Thus, while it offers an economic rationale for why firms supply CSR (because there is profitable demand for its supply), such a model fails to explain why or even acknowledge that some firms might earn negative financial returns from CSR activities.

In their call for theoretical development of a contingent approach to the business case, Rowley and Berman (2000: 410) outlined a model of heterogeneity in financial returns to CSR that proposed "some of the dimensions" that drive stakeholders to action. The conceptual framework developed in this section builds on the insights of Rowley and Berman (2000) regarding the importance of stakeholder action in making the business case. However, it was McWilliams and Siegel's (2000) call for the use of R&D measures in CSR studies that sparked the development of the key construct in this framework. McWilliams and Siegel (2000) argued that previous CSR studies were misspecified because they failed to control for R&D, a known predictor of CFP. The use of R&D as a predictor of CFP elicits an interesting comparison with research on the link between organizational learning and innovation. One of the fundamental

issues in the literature on innovation concerns why so many firms invest in basic R&D though the fruits of such efforts are public goods. The prevailing logic for several decades was that basic R&D was primarily the province of well-diversified firms, since such firms are able to capture a larger share of these otherwise public benefits (Nelson, 1959). However, Cohen and Levinthal's (1990: 128) introduction of the "absorptive capacity" construct, which they defined as "the ability of a firm to recognize the value of new, external information, assimilate it, and apply it to commercial ends," shifted innovation research away from a quest to elucidate the structural conditions that produce spending on basic research, and toward a quest to gain a deeper understanding of how basic research can serve as a form of organizational learning that mediates and moderates financial returns to R&D. Though costly R&D activities can increase social welfare by generating public knowledge, absorptive capacity helped explain how such activities can also benefit the sponsoring firm and, moreover, how these benefits vary across firms and time. In effect, the construct of absorptive capacity solidified what could be termed "the business case for basic R&D" by demonstrating the contingent link between R&D and CFP.

As Lane, Koka, and Pathak (2002: M1) declared, "Absorptive capacity is one of the most important constructs to emerge in organizational research over the past decades." It clarified the cumulative and path dependent nature of learning, arguing that the stronger the base in learning, the greater the payoff to future investments in learning: "prior knowledge permits the assimilation and exploitation of new knowledge . . . Accumulating absorptive capacity in one period will permit its more efficient accumulation in the next" (Cohen & Levinthal, 1990: 135-136). Without absorptive capacity, new knowledge has no context, no way to associate and embed. It is analogous to soil; its presence is required for a seed to grow, and the richer the soil, the greater the growth. An extensive body of theoretical and empirical research now attests that

some firms have more absorptive capacity than others, and so are able to transform a given unit of investment in learning into greater financial gains than others (Zahra & George, 2002). Therefore, the business case for basic R&D is contingent (on absorptive capacity), not universal.

The relationship between CSR and CFP is, in many ways, like that between learning and innovation as addressed in the absorptive capacity literature. One of the fundamental issues in the CSR literature is to explain why so many firms devote resources to CSR given that the benefits are public and the costs are private. The long-standing assumption of the business case (normative and agency issues aside) has been that those firms that can capture more of the private benefits of CSR will invest more in it. So, researchers have sought to clarify the structural conditions under which firms might receive private gains from CSR. We now have insight regarding why firms supply CSR (McWilliams & Siegel, 2001). However, we still have no theoretical framework to explain heterogeneous returns to CSR (Rowley & Berman, 2000).

To fill this void, this paper introduces the construct of *stakeholder influence capacity (SIC): the ability of a firm to identify, act upon, and profit from opportunities to improve stakeholder relationships through CSR*. Similar to the way that the ability of a firm to notice, assimilate, and exploit new knowledge depends upon its prior knowledge, the ability of a firm to notice and profitably exploit opportunities to improve stakeholder relations through CSR is dependent upon its prior stakeholder relationships. The basic premise is that stakeholders draw from their prior knowledge of a firm when they assess the implications of new information generated by that firm's CSR activities. In short, the actions of a firm and the responses by its stakeholders in regard to CSR are path dependent, such that different firms obtain different results from CSR, dependent upon their unique histories. SIC is an umbrella construct that

accounts for those factors that forge this history and so influence how stakeholders react to new CSR initiatives, as well as limit the range of CSR initiatives a firm will pursue.

If a firm's CSR activity is to alter its relationship with a stakeholder, that stakeholder must notice, interpret, and act upon the information conveyed by the CSR activity. The SIC construct augments interest-based (Frooman, 1999) and identity-based (Rowley & Moldoveanu, 2003) views of stakeholder action by pointing out that the likelihood that a stakeholder will notice a firm's CSR act, the way a stakeholder will interpret a noticed act of CSR, and a stakeholder's reaction to that interpretation are all influenced by the history of the focal firm. The path dependent nature of stakeholder relations means that a given investment in CSR may provoke different stakeholder reactions and yield different financial results for different firms at different points in time. Moreover, a firm's history affects the degree to which it will be presented with CSR investment opportunities, be cognizant of their presence, and be willing and able to exploit them. Therefore, similar to Cohen and Levinthal's (1990: 128) argument that "lack of investment in an area of expertise early on may foreclose the future development of a technical capability in that area," the SIC construct points out that lack of investment in stakeholder relationship building can limit the scope of future profitable CSR opportunities.

Figure 1 places SIC within a conceptual framework illustrating the business case for CSR[2]. The remainder of this section discusses the mechanisms of this framework.

INSERT FIGURE 1 ABOUT HERE

CSR flows build SIC stocks. The core of Figure 1 illustrates the mediated relationship that defines CSR. CSR does not directly contribute to CFP, but instead affects CFP through its influence on stakeholder relations. As previously discussed, corporate activities that directly

affect CFP or that indirectly affect CFP in ways other than through stakeholder relationship building are not CSR. In addition to its effects on stakeholder relations, an act of CSR produces a substantial byproduct – it contributes to a firm's SIC. Dierickx and Cool (1989) pointed out that many strategically valuable assets such as trust and reputation cannot be bought on "strategic factor markets" (Barney, 1986), but instead must be built over time through a series of investments. These discrete investments are the "flows" that contribute to the attainment of a certain asset "stock" at a particular point in time. Accordingly, CSR flows forge SIC stocks.

But what constitutes an SIC stock? SIC is a multi-dimensional, firm-level construct that is composed of the dynamic relationships a firm has with its myriad stakeholders. Each stakeholder has his own fluid relationship with a firm. When these individual relationships are aggregated at some point in time, they form an intangible asset that a firm possesses – its SIC "stock." That is, though SIC is revealed in the dynamic relationships between a firm and its myriad stakeholders, it can be treated in the aggregate as a firm-level intangible resource; a firm possesses a certain stock of SIC. Other common constructs are conceptualized in a similar fashion. For example, absorptive capacity is considered a firm-level intangible resource (Cohen & Levinthal, 1990), yet its stock is a function of the knowledge present in the minds of individuals and the ability of these individuals to interrelate with other sources of knowledge (Lane & Lubatkin, 1998). Another example is corporate reputation: "a collective representation of a company's past actions and future prospects that describes how key resource providers interpret a company's initiatives and assess its ability to deliver valued outcomes" (Fombrun, 2001: 293). Each "key resource provider" has his own unique "image" of a firm, but these images can be aggregated into a collective representation. This collective representation, corporate reputation, is treated as a firm-level intangible asset (Fombrun, 1996). Creating an

aggregate firm-level intangible asset is perhaps the only pragmatic means of dealing with a construct of this nature (Wartick, 2002: 375). However, an aggregate measure can mask variation that may be relevant to the relationship of interest. Such criticism has been leveled against absorptive capacity (Lane & Lubatkin, 1998) and corporate reputation (Wartick, 2002). The merits and methods of disaggregating SIC are addressed in the "Discussion" section.

As addressed earlier, the construct of SIC was inspired by research on absorptive capacity, but it shares a close affiliation with corporate reputation, given that both concern how a firm's history affects current perceptions and thereby influences behavior toward that firm. However, SIC and corporate reputation differ in significant ways. The dominant component in measures of corporate reputation is financial, not social performance (Brown & Perry, 1994). Moreover, as Fombrun's (2001) definition states, corporate reputation entails an assessment of the firm's ability to deliver valued outcomes. These valued outcomes tend to depend upon the self-interests of each of the "key resource providers" who assess the firm. Brown and Dacin (1997: 68) made a parallel distinction in subdividing consumer opinions about a firm into two distinct dimensions: "Corporate ability associations are those associations related to the company's expertise in producing and delivering its outputs. Corporate social responsibility associations reflect the organization's status and activities with respect to its perceived societal obligations." Thus, corporate reputation is instrumental to answering the question, Given how this firm has performed (mostly financially) in the past (summed up by its corporate reputation), is it likely to deliver value to me in the future? In contrast, SIC is more an overall assessment of "the soul of a business" (Chappell, 1993) wherein observers ascribe character to the firm (Sen & Bhattacharya, 2001) that helps them to answer the question, Given how this firm has behaved (mostly socially) in the past (summed up by its SIC), can I trust it in the future?

Nevertheless, corporate reputation is an ill-defined construct that has been broadly conceptualized and whose definition continues to evolve (Barnett, Jermier & Lafferty, 2004; Wartick, 2002). Popular measures of corporate reputation have weighted financial performance heavily, leading researchers to conclude that corporate reputation ratings such as *Fortune's Most Admired Corporations* result from, rather than predict, CFP (Brown & Perry, 1994). However, more recent approaches have suggested more focus on stakeholder relationships beyond just shareholders (Mahon, 2002). Thus, the argument that corporate reputation focuses on financial performance to the detriment of concern for a firm's relationships with other stakeholders is increasingly a strawman. It is entirely possible that corporate reputation could be enlarged so as to effectively encompass the domain herein ascribed to SIC. However, such a possibility makes development of the SIC construct no less important. Whether SIC is treated as an independent construct or as part of an enlarged conceptualization of corporate reputation, its distinctive nature needs to be clearly specified.

To summarize, charitable donations, support of social causes, and other CSR acts are a means of improving stakeholder relations. As firms engage in CSR acts to improve stakeholder relations, a record of social performance incidentally accrues, forging a firm's SIC stock – much as R&D investments, though intended to further innovation, incidentally contribute to a firm's absorptive capacity (Cohen & Levinthal, 1990).

Proposition 1: A firm's current stock of SIC is positively related to its prior CSR activity.

Though flows to SIC from acts of CSR are generally incidental, a by-product of the firm's intentions to improve stakeholder favor, firms may make direct investments in SIC. Such investments do not return near-term increases in stakeholder favor, but a firm might directly

invest in SIC in order to build the necessary platform to create future CSR opportunities (Fombrun et al., 2000). Such SIC-building investments include hiring personnel and establishing organizational structures that facilitate timely recognition and execution of emergent CSR opportunities. Corporate owners must be vigilant, though, to maintain discipline in allowing management to cast activities into this vague role, lest agency losses arise (cf. Adner & Levinthal, 2004).

Effects of social change on SIC. If an act of CSR is characterized by its focus on social welfare, an obvious and relevant question is, Does CSR improve social welfare? Oddly enough, this question is seldom asked or answered[3]. Studies of the business case typically do not measure the actual social benefits created by CSR, and there is seldom any accountability (Margolis & Walsh, 2003). Given the role of SIC in the business case for CSR, though, it can be in a firm's interest to provide evidence of the gains to social welfare brought about by its CSR efforts. A firm's SIC is an aggregate representation of how stakeholders perceive the character or "soul" of that firm, and acts of CSR shape these perceptions over time. However, as the opening quotes to this paper anecdotally evidence, acts of CSR are often met with pessimism. Webb and Mohr (1998: 234) categorized more than 20 percent of consumers as "skeptics" whose views are typified by responses such as: "You show me something that shows exactly what people give and where it goes to and have someone to do this study that has nothing to do with that business and then I will listen to it. Otherwise, I just . . . I don't believe it at all." Currall and Epstein (2003: 195) claimed: "Because trust tends to be a very evidentiary decision, most of us behave as if we are from the 'Show Me' state of Missouri; we wish to *see* the evidence that someone is trustworthy" (emphasis in original). Thus, in the absence of evidence, many stakeholders discount or ignore a firm's CSR acts.

This, in effect, implicit discount rate for acts of CSR can be diminished or overcome if firms provide evidence that their CSR efforts produced social change. The stronger is the evidence, the smaller will be the discount rate, and so the stronger will be the effects of the CSR act on both stakeholder relations and SIC. This effect can be negative, though, for firms that make their CSR processes and outcomes more transparent, but fail to produce ample results; that is, transparency is double-edged. Firms that claim to engage in acts of CSR but fall short of their rhetoric can face lawsuits claiming deceptive advertising, as Nike recently faced in regard to its allegedly false claims of eliminating child labor in its subcontracted manufacturing facilities. The more transparent are a firm's CSR acts, the easier it is for activists to find evidence of their ineffectiveness and either file lawsuits or bring forth other public challenges to the trustworthiness of the firm.

Yet despite considerable evidence that many firms' CSR efforts are largely symbolic and sometimes even fraudulent (e.g., "greenwashing;" Greer & Bruno, 1996; Beder, 1997; Laufer, 2003), most stakeholders are willing to accept CSR acts at face value (Webb & Mohr, 1998). However, those firms that engage in symbolic-only acts of CSR are taking a risk. Trust is an asset that is built slowly, but destroyed quickly (Currall & Epstein, 2003). If it is revealed that a CSR activity was insincere or fraudulent, any trust gained from the CSR act will be lost, and the firm's stakeholder relations may be seriously degraded. Many recent examples of insincere and outright fraudulent corporate activity evidence the risk inherent in pursuing symbolism over substance. For example, The Body Shop, long hailed as "the Mother Theresa of Capitalism" (Entine, 2002), suffered a staggering loss of image, and profits thereafter, following a report that many of its products were not manufactured in the socially responsible manner advertised (Entine, 1994). Thus, firms that engage in symbolic CSR increase their risk and so effectively

decrease their risk-adjusted returns to CSR. Despite the frequent effectiveness of symbolic adoption (Westphal & Zajac, 1994), when risk is factored in, the following proposition holds:

Proposition 2: An act of CSR's effects on stakeholder relations and SIC are amplified in the presence of evidence of its effects on social welfare.

As dubious corporate behaviors come to light, public trust in business declines. Some dubious corporate behaviors are ample to produce a shock that destroys public trust and brings about government regulation. For example, recent accounting scandals quickly led to the implementation of the Sarbanes-Oxley Act of 2002, which placed additional burdens on firms. Others have more gradual effects. Expectations of corporate environmentalism shifted *From Heresy to Dogma* (Hoffman, 1997) over several decades as evidence of industrial harm to the natural environmental mounted. These shifts in formal and informal expectations of the social obligations of business can occur across entire economies, as with Sarbanes-Oxley, or be isolated to specific sectors or industries, as with the petrochemical sector in Hoffman's (1997) study.

These changes in societal expectations are not entirely exogenous – firms and industries influence the social standards by which they are judged. When a firm increases its CSR activities, its rivals feel pressure to increase theirs as well, since all else equal, most consumers prefer to buy from the most socially responsible firm (Mohr, Webb & Harris, 2001). Firms also influence societal expectations through direct influence tactics. McWilliams, Van Fleet, and Cory (2002) outlined the ways in which firms use "political strategy" to lobby for new laws that increase the social obligations facing certain industries in order place their less capable rivals at a competitive disadvantage. Accidental behaviors, such as Union Carbide's disaster in Bhopal, India, and the Alaskan oil spill of the *Exxon Valdez*, can also lead to change in the formal and informal societal expectations facing those firms responsible for the acts, and their rivals as well

(King, Lenox & Barnett, 2002). When expectations of CSR increase, the value of the status quo necessarily declines. In stock and flow terms, increasing societal expectations about CSR enlarge the “hole” in the “bathtub” that holds the stock of SIC, therein requiring additional flows of CSR to maintain a constant level (Dierickx and Cool, 1989: 1506). Overall, this points to a “Red Queen” effect (Barnett & Hansen, 1996) in CSR, whereby stationary firms lose ground due to increasingly stringent societal expectations. However, firms can also take part in collective efforts, through trade associations, to forestall and decrease the formal and informal social burdens placed upon their industries (Miles, 1982; Rees, 1994; 1997; King & Lenox, 2000). When effective, these collective efforts increase firms’ SIC.

Proposition 3: As societal expectations of a firm’s social obligations increase (decrease), all else equal, that firm’s SIC decreases (increases).

SIC as moderator. Individuals are limited in their ability to process the unlimited stimuli that surrounds them (Simon, 1955). To cope, we reduce complex situations to simplified cognitive representations, take action based on heuristics, and develop routines (Cyert & March, 1963; Nelson & Winter, 1982; Tversky & Kahneman, 1986). These simplifications allow us to lessen cognitive loads, but they also restrict the search for new information. New information is interpreted and assessed according to existing cognitive representations and disconfirming evidence is often overlooked (Dutton & Dukerich, 1991; Weick, 1995). As a result, cognitive representations are hard to change once established.

Such is the case with SIC. Stakeholders are boundedly rational, and so rely on a simplified cognitive representation to proxy for a complex reality. Each stakeholder’s reaction to an act of CSR by a firm is conditioned on his cognitive representation of the character of that firm. These cognitive representations affect which CSR actions stakeholders notice and how

they make sense of those CSR actions they notice. Each stakeholder has her own unique and subjective representation. One stakeholder may view, say, Wal-Mart favorably because of its "Made in America" policy, another may have an enduring unfavorable view of Wal-Mart because of its questionable labor practices, and yet another stakeholder may have a consistently mixed view because of the conflicting facets of Wal-Mart's social efforts.

SIC acts as an aggregate gauge of these cognitive representations, or "perceptual filters" (Starbuck & Milliken, 1988), through which new information about the firm's CSR practices flows to stakeholders. Firms with poor SIC may have their CSR efforts overlooked, or if noticed, met with skepticism, or may even experience degradation in stakeholder relations in response to CSR. People are loath to update their prior convictions even in the face of disconfirming evidence (Staw, 1981). They are unlikely to notice activities that they consider out of character with the actor. If they do notice out-of-character activities, they may react with cynicism, discounting them as self-serving. Therefore, their trust in the firm is unlikely to increase, and could even decrease, as they come to believe that the firm will do anything to appear socially responsible (Varadarajan & Menon, 1988; Webb & Mohr, 1998).

A variety of studies have suggested that stakeholder beliefs about the character of a firm affect how they notice, interpret, and react to new information about that firm. Brown and Dacin (1997) determined that consumer evaluations of new product offerings were contingent upon their beliefs about the social responsibility of the firm – if the consumer believed the firm was socially responsible, her assessment of its new product was more favorable; if the consumer believed the firm was not socially responsible, the assessment was unfavorable. Sen and Bhattacharya (2001) connected stakeholder perceptions of the social posture of a firm to purchase intentions, finding that CSR can actually reduce purchase intentions for consumers with

unfavorable opinions of a firm's social posture. Linxwiler, Shover, and Clelland (1983: 434) found that ". . . when regulatory personnel perceive clients to be responsive to regulatory demands, their enforcement responses are more likely to demonstrate forbearance. The net result is leniency." Thus, a firm's perceived character can even affect formal relationships.

Proposition 4: SIC moderates the effect of an act of CSR on stakeholder relations.

The paradox of performance. The business case for CSR has been characterized as searching for an answer to the question, Can you "do well while doing good?" (Hamilton, Jo & Statman, 1993). Though the answer remains in dispute, many studies have shown the reverse to hold—that strong CFP (i.e., doing well) is associated with increased CSR (i.e., doing good) (see Margolis & Walsh, 2003 for a summary). But how are acts of CSR received when they come from a firm with strong CFP? Anecdotal evidence suggests that if a firm does particularly well (CFP), its efforts at doing good (CSR) may be perceived negatively. For example, Microsoft has a strong record of philanthropy, but because of its yet stronger record of profitability, some expect even more philanthropy, making it a "no-win situation," as Alsop (2002: 2) exemplified with a quote from a stakeholder: "I also think they donate far less than they could given Bill Gates's billions." Whereas a donation of $1 million from a small firm might trigger a favorable stakeholder response, the same donation from a large and highly profitable firm such as Microsoft might engender little attention or even pessimism.

SIC provides an explanation for why doing well may decrease the financial benefits of doing good. Doing too well can lead stakeholders to perceive that a firm is not doing enough good. Excessive CFP indicates that a firm is extracting more from society than it is returning, and can suggest that profits have arisen because the firm has exploited some of its stakeholders in order to favor shareholders and upper management. This can indicate untrustworthiness to

stakeholders looking to establish or maintain relations with the firm. As a result, increases in CFP can lead to decreases in SIC[4]. This lower stock of SIC dampens the value of future acts of CSR. Overall, more profitable firms are expected to do more "good," but get less financial reward in return.

Proposition 5: Excessive CFP decreases SIC.

This suggests a self-regulating cycle that places upper bounds on CSR contributions. Many studies have suggested a virtuous cycle without limits: " . . . financially successful companies spend more [on corporate social responsibility] because they can afford it, but CSP[5] also helps them become a bit more successful" (Orlitzky et al., 2003: 424). But if CSR has a universally favorable rate of return, why would a firm ever stop investing in CSR? While not completely explaining the upper bounds of CSR investments, the negative effect of CFP on SIC highlights one way in which gains to CSR eventually extinguish themselves. This mechanism also helps to explain the findings of Seifert, Morris, and Bartkus (2003: 208) that there is " . . . a positive relationship between available resources and giving to charity, but neither a significant positive nor a significant negative relationship between giving to charity and financial returns."

DISCUSSION

Consider your reaction were Union Carbide to announce a $10 million donation to community hospitals in Bhopal, India, or were Exxon to announce a $10 million donation to improve wildlife habitats along the Alaskan coast. Now consider your reaction were Ben & Jerry's to do either of the above. The simple premise of this paper is that your reactions would differ, due to your prior beliefs about the characteristics of each of the donating firms. The path dependent nature of firm-stakeholder relations helps to explain why the financial returns to CSR

differ across firms and time, and serves as the cornerstone of a contingent framework for the business case, offered to supplant a long-standing quest for a universal business case for CSR.

The precise payoff to a particular CSR act for a particular firm at a particular point in time is not particularly predictable, though. There are many factors to consider. This paper focused on the role that a firm's unique history plays in eventually transforming an act of CSR into CFP. It did not distinguish between types of CSR, instead working from the standpoint that a firm's history influences this relationship regardless of the type of CSR. However, the nature of the CSR investment itself is also bound to have an influence. Most tests of the business case have made only a binary distinction regarding a firm's overall social posture — a firm is considered to be socially responsible or not. The few studies that have disaggregated social responsibility have found variance in financial returns. For example, Berman, Wicks, Kotha and Jones (1999) found that the state of a firm's employee relationships and product safety/quality were positively related to CFP, but a firm's community relations and support of diversity and the natural environment were unrelated to CFP. Barnett and Salomon (2003) found a positive relationship between the financial performance of mutual funds and their decision to exclude firms with poor community relations, but a negative relationship when these funds excluded firms with poor labor relations or poor environmental performance. But as with most prior studies, these scholars measured CSP stocks, not CSR acts. Berman et al. (1999: 501) parsed the commonly used KLD database into subcategories, each representing a different "stakeholder posture." Barnett and Salomon (2003) divided the universe of socially responsible mutual funds by twelve measures of social responsibility, each of which assessed whether firms within a mutual fund's portfolio possessed a particular stock of social responsibility.

Not surprisingly in light of extant emphasis on forging a CSP – CFP link, there is no well-established means of categorizing acts of CSR. It is beyond the scope of this paper to fully develop a CSR classification system, and so this substantial task is left to future research. However, the framework developed herein does suggest several viable directions. As previously discussed, the implicit logic behind CSR is to engage in explicitly selfless acts in order to exude general trustworthiness and so enhance relationships with important stakeholders. Such an approach is distinct from direct influence tactics, whereby corporate resource allocations are intended to directly influence specific stakeholders (see Table 1). Nevertheless, it is possible that a corporate resource allocation could be intended to curry favor with particular stakeholders—perhaps those with the highest levels of power, legitimacy, and urgency (Mitchell et al., 1997)—yet fall short of classification as a direct influence tactic. For example, a firm might make a highly visible and substantial donation to a national charity with the intent of improving relations with government officials in the specific community in which it seeks favorable zoning permits. This would not be a direct influence tactic, as previously defined, since the beneficiaries of the resource allocation are not the parties the firm intends to influence. Yet the intent to direct the act toward a specific set of stakeholders makes this something more than pure CSR[6].

Insight into the intent behind specific acts of CSR could elicit contingencies of relevance to the business case. Of course, intent can be difficult to determine – it can be hidden from observers, and even be disguised within the hierarchy of the firm itself, given agency issues. Fortunately, a variety of primary methods such as observation, interviews, and surveys of top management, and secondary methods such as content analyses of reports by the firm and about the firm, court documents, and top management speeches, are available to aid in discerning intent. Many of these methods are laborious, and none will perfectly reveal intent when firms

and their managers wish to hide it. Arguably, though, most widely accepted methods of assessing firm behavior and performance suffer this same problem (e.g., formal certified accounting figures, as revealed by numerous scandals). Nonetheless, to the degree that intent can be discerned, important contingencies may be revealed.

One possibility, suggested by the above discussion, is that firms may intend some acts of CSR to be more "applied" than others. Analogous to the distinction made between forms of R&D, some types of CSR may be "basic"—intended as a broad indicator of the trustworthiness of a firm—while others may be "applied"—intended to curry favor with a particular set of stakeholders. In terms of the framework presented in this paper, basic SIC would contribute more to building SIC stock than to immediately improving stakeholder favor, while applied SIC would achieve more immediate gains to stakeholder favor, with a relatively small addition to SIC stocks. Such insight could help with the "stakeholder mismatch" problem (Wood & Jones, 1995) by clarifying which types of CSR are most likely to be discerned in which CFP measures. Applied CSR acts would be more likely to result in near-term gains and so lend themselves to empirical tests with stock price as the CFP measure, such as event studies. Basic CSR acts would be less likely to have a short-term impact and so would be more amenable to tests with accounting measures of CFP as the dependent variable, such as lagged multivariate regression.

Given the challenges of discerning intent, as well as the potential disparity between intent and outcome, researchers seeking to identify relevant categories of CSR may be more likely to succeed by focusing on the outcomes of CSR. The KLD database provides a good opportunity for such research. The KLD database includes an annual rating, on a five-point Likert-type scale, of the state of a firm's relationship with several groups of stakeholders. Researchers could relate firms' varying KLD profiles to the flows of CSR activity that produced them, both cross-

sectionally and longitudinally. For example, how do the prior CSR flows of a firm that scored a "-2" on employee relations, a "-1" on local community relations, and a "+2" on product safety/quality, compare with the CSR flows of a firm that scored +2, +1, -2, respectively? Data on acts of CSR, or CSR flows, are publicly available by definition, since private acts are herein categorized as agency losses, not CSR. Factor or cluster analysis could help determine the types of CSR associated with changes in particular stakeholder relationships. For example, if a firm were more interested in improving employee relations than community relations, in which types of CSR should it engage? The revealed categories could help firms to better target intended audiences without resorting to direct influence tactics, which have some negative properties as previously discussed. Thus, clear insight into the differing types of "applied CSR" and their effectiveness could significantly benefit management practice.

Studies of this nature could also illuminate the severity of the tradeoff problem inherent in CSR. A firm's myriad stakeholders have myriad interests. In seeking to improve relationships with one set of stakeholders through a visible act of "applied" CSR, a firm may worsen its relationships with other stakeholders. For example, in the past, Microsoft established a policy of providing benefits to the same-sex partners of its employees and openly advocating legislative action to more broadly increase gay and lesbian rights. Arguably, this policy improved Microsoft's relationships with its employees and gay and lesbian organizations, and possibly provided a more "basic" CSR benefit by softening Microsoft's often-harsh image with other stakeholder groups. Recently, because of its support for a Washington State anti-discrimination bill, Microsoft was threatened with a boycott led by a conservative pastor. In response, Microsoft ended its support of this bill. As a result, Microsoft avoided the threatened boycott,

but harmed its relations with employees and gay and lesbian organizations. A few weeks later, Microsoft reversed its reversed position and again supported this and other such bills.

Examples such as this demonstrate the tradeoff problem and suggest that an act of CSR could even produce a net loss in aggregate SIC and stakeholder relations. Thus, further study of the severity of these tradeoff problems is clearly warranted. Given the many stakeholder interests that a firm must balance, study of these tradeoffs will necessarily be complex. Even within themselves, stakeholders have differing interests. For example, a single stakeholder may have multiple roles relative to a given firm, such as employee (works for the firm), investor (owns stock of the firm), community member (lives in the city in which the firm is located), and social activist (member of a civic group, church, or NGO). Researchers may rely on qualitative methods such as interviews and surveys to gauge changes in a firm's relationships with various stakeholder groups. Admittedly, it is often not feasible to obtain such data on all of a firm's stakeholders. As a standard proxy for an aggregate market reaction to a particular CSR event, researchers may employ event study methods (McWilliams & Siegel, 1997).

Timing may also be a relevant contingency. Researchers have noted a variety of ways that firms can financially benefit from instituting processes that reduce pollution and other harms to the natural environment (Hart, 1995; King & Lenox, 2002; Klassen & Whybark, 1999; Russo & Fouts, 1997). Many such process improvement efforts have minimal or no time component – even late movers can improve financial performance by cutting waste. However, early movers can gain greater benefit in some instances; in particular, there are: ". . . avenues for 'early mover' advantages whereby the firm can capitalize on an enviropreneurial opportunity before it is shared with or adopted by competitors (Porter & Van der Linde, 1995). Enviropreneurial initiatives that lead to complex eco-efficiencies, patented technologies and products that are difficult for

competitors to imitate could provide firms more sustainable competitive advantages . . ." (Stafford, Polonsky and Hartman, 2000: 133). The framework presented herein provides perspective, beyond the ability of first movers to forge enduring barriers around new technologies, on why early mover advantages may exist for some types of socially responsible behavior. Proposition 3 suggests that as a particular type of CSR becomes common, societal expectations increase[7]. Firms that do not meet the increased expectations suffer a decline in SIC. Given that SIC moderates the gains to an act of CSR, the later a firm waits to engage in that particular CSR act, the less it will benefit. Therefore, CSR acts may have life cycles that produce early mover incentives. A CSR life cycle could help explain prior discrepant findings, owing to variation in sample windows, and so CSR studies should control for timing effects. To better specify CSR life cycles, future research should examine variation in the outcomes of specific types of CSR over time. As we further untangle CSR from process improvement[8], timing may take on additional importance in the study of the business case.

This paper is based on the notion that accounting for a firm's SIC, herein treated as a firm-level intangible asset, will increase the precision of studies of the business case. We currently have many proxies for SIC. In particular, measures of CSP, as snapshots of the state of a firm's stakeholder relations at a point in time, are proxies for the overall state of a firm's relationships with those stakeholders it wishes to influence. CSP alone has not resolved the business case, but because it represents a firm's stock of SIC, CSP can play an important role in future studies of the contingent nature of the business case. In a contingent framework, CSP becomes a measure of the given state as we advance beyond CSP to a new, more fruitful question for both research and practice: *Given a firm's SIC*, *which CSR acts are profitable?*

CSP has many well-established measures, such as the KLD database (see Margolis & Walsh, 2003 for a summary). Many of these are firm-level measures. Such summary measures are convenient for reporting, but they can mask important variation in a firm's relations with its myriad stakeholders. To cope with this issue, some CSP measures have been disaggregated into component relationships. However, CSP generally has been disaggregated into component parts without the guidance of a commonly accepted or even explicit theoretical rationale. Sharfman (1996: 288) found that combinations of the subcategories of the KLD measure correlate with other common CSP measures, but noted that, " . . . there is no discernible theory underlying the choice of variables" that populate these subcategories.

Given the focus of the business case, relevant theory must provide guidance in discerning which of the relationships inherent in the aggregate concept have independent influence on CFP. Measures of corporate reputation, considering their emphasis on financial performance, might offer insight here. Indeed, some scholars have performed empirical tests with corporate reputation serving as a measure of CSP; commonly, *Fortune*'s ranking of "Most Admired Corporations" (McGuire, Sundgren & Schneeweis, 1988; Sharfman, 1996). More recently, a special issue of *Business & Society* debated " . . . whether reputation is a relevant and useful construct to integrate more explicitly into theories of business and society relationships" (Logsdon & Wood, 2002: 365). The conclusion was that, as with other measures of CSP, there is no theoretical basis for the ways in which corporate reputation has been parsed (Wartick, 2002).

An adequate theoretical framework must distinguish not only the component relationships inherent in a firm's overall social posture, but also the relative importance of each distinct component. Again, this presents a problem, ". . . since theoretical work in stakeholder

management and social issues participation has yet to identify a ranking of importance for the various stakeholder groups and issues" (Hillman & Keim, 2001: 131). As with the business case in general, the factors determining "who and what really counts" (Mitchell et al., 1997) and how much they count may be too firm specific to enable the development of useful universal categories. Regardless, it is beyond the scope of this paper to offer a well-developed categorization and weighting scheme of SIC's component parts and so this, too, is left as fertile domain for future research.

Path dependence has implications not only for how stakeholders notice and react to CSR, but also for how firms notice and react to CSR opportunities. Employees in firms with a history of CSR may come to have CSR enmeshed in their identities (Dutton & Dukerich, 1991), and are more likely to be cognizant of new CSR opportunities. Due to adjusting aspiration levels (March & Simon, 1958), CSR-oriented firms are more likely to engage in CSR acts once opportunities are noticed. Cohen & Levinthal's (1990: 137-138) discussion of absorptive capacity explains this self-reinforcing behavior:

> "If the firm engages in little innovative activity, and is therefore relatively insensitive to the opportunities in the external environment, it will have a low aspiration level with regard to exploitation of new technology, which in turn implies that it will continue to devote little effort to innovation. This creates a self-reinforcing cycle. Likewise, if an organization has a high aspiration level, influenced by externally generated technical opportunities, it will conduct more innovate activity and thereby increase its awareness of outside opportunities. Consequently, its aspiration level will remain high."

Similarly, firms with weak (strong) histories of CSR are less (more) likely to notice and seek new CSR opportunities. This notion that cognition is a key determinant of CSR activity adds

realism to McWilliams and Siegel's (2001) economic model of CSR supply and demand to help explain enduring non-optimal supplies of CSR by some firms. McWilliams and Siegel (2001) assumed that supply and demand for CSR always matched (or equilibrium was quickly reestablished). However, the SIC construct explains why firms vary in the degree to which they notice and act upon demand for CSR. A firm must first notice and desire to act upon any demand for CSR before it is supplied, and its history affects the degree to which it will do this. If a firm has weak SIC, it may consistently undersupply CSR.

The normative implications of this paper are limited only to the business case – whether or not certain firms[9], in certain situations, ought to invest in certain kinds of CSR in order to improve CFP. If we assume that stockholders are the sole owners of a firm, this paper argues that a firm should not engage in an act of CSR that is unlikely to offer a compensating increase in stakeholder favor or stakeholder influence capacity. Given their histories, some firms should engage in little or no CSR at certain points in time because poor SIC prevents CSR from transforming into stakeholder favor. In fact, it can create stakeholder discontent, and so is money poorly spent. Future research must continue to uncover the contingencies that determine the benefits of CSR so as to allow managers to determine whether particular acts of CSR are wise investments for their firms.

CONCLUSION

Whether corporations are "owned" by their shareholders or by society, and whether or not corporations have any obligations beyond becoming increasingly efficient at shareholder wealth production are topics that have long been fiercely debated. This debate has recently intensified on the heels of many well-publicized instances of dubious corporate behavior. It shows no signs of resolution and will surely remain a contentious topic for the foreseeable future.

This paper offers no resolution to this debate. So long as we desire capitalism with a safety net, this is a dialectic tension that our society must continuously manage, not resolve.

However, this paper has shed light on the business case for CSR. As others have surmised, ". . . managers should treat decisions regarding CSR precisely as they treat all investment decisions" (McWilliams & Siegel, 2001: 125). The difficulty, though, is that the payoffs have been unclear because researchers have struggled for several decades to demonstrate a universal rate of return in a situation that clearly calls for a contingent perspective (Rowley & Berman, 2000; Ullmann, 1985). A contingent perspective argues that though all CSR activities are not profit maximizing, some may be, and so the careful use of CSR can fulfill management's fiduciary responsibilities. The SIC construct and the conceptual framework developed in this paper bring us closer to specifying a contingent model of the business case for CSR.

In many ways, the struggle to make the business case for CSR resembles the struggle to show the financial merit of investments in a variety of intangible assets. Accounting and financial methods have developed over the years to justify many of the "gut feelings" of managers as they invest in projects that have no immediate financial return, such as R&D and advertising. Given that CSR is an almost universal practice, either we have a long-standing agency problem that boards of directors and the mechanisms of the free market have almost universally been unable to correct, or we have yet to amply demonstrate the financial merits of CSR. This paper advocates the latter, and calls for increased attention to a contingency perspective that affirms the payoffs to some forms of CSR for some firms at some points in time. CSR cannot financially please all of the corporations all of the time, but it can please some of the corporations some of the time. Researchers should try to figure out which ones and when.

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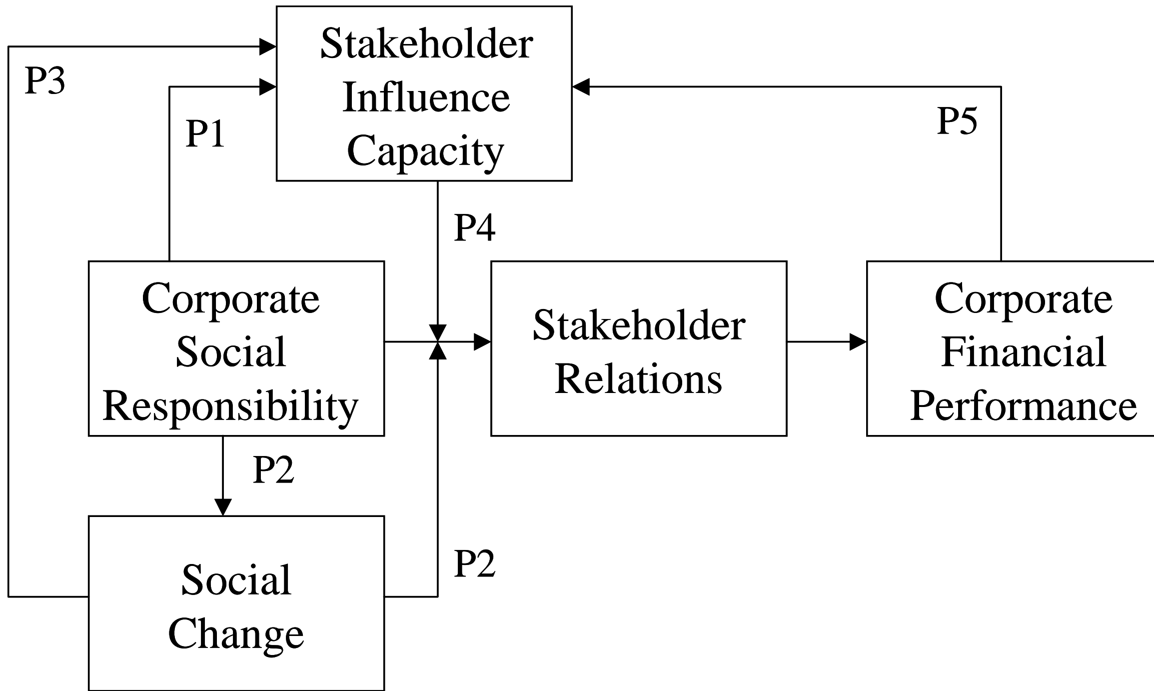
TABLE 1
Types of Corporate Resource Allocations

Social welfare orientation	Low *Stakeholder relationship orientation*	High *Stakeholder relationship orientation*
High	Agency Loss	CSR
Low	Process Improvement & All Other	Direct Influence Tactics

FIGURE 1
A Conceptual Framework Underlying the Business Case for CSR



ENDNOTES

[1] Nonetheless, CSP and CSR are both important factors in predicting the marginal returns to social investment opportunities. The core premise of this paper is that the financial returns to CSR are dependent upon a firm's history. Measures of CSP can proxy for a firm's history. See the "Discussion" section for more detail.

[2] Figure 1 is not a complete model of the business case for CSR. Rather, it is a framework that illustrates the effects of a discrete act of CSR, as discussed in Propositions 1 through 5. Stated differently, the box containing the term "Corporate Social Responsibility" refers to a discrete act of CSR, and the remainder of the figure illustrates the effects that this discrete act has on the status of the other variables.

[3] The literature on the natural environment is the primary exception to this rule, often seeking to distinguish discretionary corporate acts that improve the natural environment from mere "greenwashing" (e.g., Greer & Bruno, 1996; Laufer, 2003).

[4] This again distinguishes SIC from corporate reputation. Increases in CFP have consistently been linked to increases in common measures of corporate reputation, demonstrating corporate reputation's emphasis on CFP (Brown & Perry, 1994).

[5] Generally this virtuous cycle is said to exist between CSP and CFP, not CSR and CFP. Bearing in mind confusion and lack of distinction between CSR and CSP in prior literature (as previously discussed), the same logic holds for CSR.

[6] Table 1 actually represents a continuum, wherein acts vary from low to high on the dimensions of interest. The polar ends of each dimension are pure forms that may never be fully realized in practice.

[7] Empirical testing of Proposition 3 necessitates a measure of change in societal expectations. Possible measures include changes in the number and magnitude of lawsuits, proxy fights, protests, media coverage, and Congressional discussion concerning specific topics (cf. Hoffman, 1997). One might also take a reverse perspective and measure changes in the amount of a firm or industry's attention to certain matters, as disclosed by coverage in their trade journals, under the assumption that firms increase attention to matters that are of increasing importance (Hoffman & Ocasio, 2001).

[8] As previously discussed, process improvement efforts are distinct from CSR (see Table 1), but they may involve a CSR component. This component may be separately analyzed from the costs and benefits of process improvement.

[9] The framework applies only to public corporations, not private firms. Private firms do not face the same agency issues that are integral to the definition of CSR and the framework presented herein.