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Corporate Social Responsibility as Reputation Insurance

ABSTRACT

This article examines previous attempts to determine the relationship between corporate social responsibility (CSR) and financial performance (CFP) and finds that studies have used an either/or approach. They have either examined the relationship between positive firm behavior and financial performance, or they have measured the relationship between some negative firm behavior and financial performance. Both of these firm behaviors must be integrated into the measurement model to provide a more accurate estimate of the overall value of CSR. Results from a study examining motives of decision-makers involved in CSR investments confirm that in addition to acting as a source of new competitive advantage these investments also serve to protect existing competitive advantage through the reputation mechanism.

Corporate Social Responsibility as Reputation Insurance

We know, for instance, that we have to measure results. We also know that with the exception of business, we do not know how to measure results in most organizations.

- Peter Drucker, *The Age of Discontinuity*

As businesses have increased their adoption of corporate social responsibility (CSR) practices and their involvement in issues traditionally under the domain of governments and NGOs, the measurement challenges associated with these non-traditional initiatives have also grown. Meanwhile, accurate measurement of results in corporate social responsibility has taken on additional importance over the past decade as managers face pressure to justify the allocation of scarce firm resources. Indeed, investments in socially responsible behaviors such as philanthropy have become much more strategic and focused on providing tangible returns to the firm.¹

The pressures to position CSR as enlightened self-interest have created a wealth of empirical research examining the relationship between CSR and corporate financial performance (CFP). This research examining CSR has largely considered the potential for such activities to provide an incremental gain to the firm. For example, researchers have cited heightened purchase intentions, increased sales, enhanced image, and improved employee morale as benefits of CSR.² However, the potential for CSR to act as an insurance policy and mitigate the effects of negative events has gone largely unexplored. Further, the examination of the relationship between CSR and CFP has not included both the incremental benefits of CSR and the potential for CSR to mitigate harm from negative events. Examinations of the CSR-CFP relationship have used either a comparison of CSR (e.g., investment in environmental controls) and some measure of CFP (e.g., ROE), or a comparison of some financial measure (e.g., stock price) both

before and after a negative event (e.g., a damaging environmental report). In the evaluation of the CSR-CFP relationship, these two forms of measurement have been used in an either/or fashion. CSR and its effects on reputation can have significant value as a form of insurance for the firm, and that both of these methods to link CSR and CFP must be integrated in order to fully assess the value of CSR as a form of insurance for the firm.

This article extends the literature examining the CSR-CFP relationship in a number of ways. First, the motivations of corporate managers involved in CSR decision-making processes are examined and confirm the importance of CSR as a form of insurance to the firm. Second, a framework for examining the CSR-CFP relationship by integrating two disparate methods used by previous researchers is presented. Finally, in accounting for an as-yet largely unrecognized value of CSR to the firm, this article provides an opportunity for researchers to gain a more accurate assessment of the actual value of CSR investments to the firm and offers guidance to managers seeking to justify the allocation of scarce firm resources.

In order to provide a more complete understanding of the CSR-CFP relationship a review of the movement towards greater accountability of the CSR activities of the firm, and the motivation for studying the relationship is presented. This is followed by the presentation of a study examining the motives of managers investing in socially responsible firm behavior, confirming their desire to capture incremental gains and protect their established reputations. Finally, the integration of these two ideas, largely disparate until now, and its implications for managers are discussed.

THE NEED FOR ACCOUNTABILITY

Smith outlined the dangers of “do-gooding executives” – those managers who justify CSR simply on the basis that it is morally defensible.³ Critics have long argued that firm investments in socially responsible but unprofitable ventures will ultimately lead to the demise of the firm at worst, and at best lead to unsustainable support for nonprofit organizations. Further, Murray and Montanari state: “the failure to supplement the moral justification for social responsibility with economic considerations may be why many corporate executives view social responsiveness as a strictly ‘nonproductive cost’.”⁴ Such criticisms have caused managers to develop more strategic forms of social responsibility that can be shown to deliver a financial return to the firm – initiatives positioned as enlightened self-interest. Indeed, managers report increasing professionalization of their support of social causes, particularly for large firms.⁵ This movement to justify CSR has also led to volumes of research over the past 30 years examining the relationship between CSR and CFP.

Against this backdrop, previous researchers have almost implicitly assumed that the value in CSR is in the form of incremental gains for the firm. For example, researchers often use the term *investment* when describing corporate support for social causes, and the forms of return on investment to the firm studied have included the ability to increase prices, enhanced image, and increased ability to recruit and retain employees, just to name a few. Further, Fombrun Gardberg and Barnett compare CSR investments to investments made in R&D or employee training in that they can unlock future growth potential for the firm.⁶ However, many firms report virtually no audit procedures to determine if their investments are actually paying dividends back to the firm, and

researchers have found that the opportunity to promote their business is not a major factor for managers deciding which charitable organization to support.⁷ Finally, Preston argued: “The bulk of the corporate philanthropic activity has no connection whatsoever with profit-seeking behavior or any other conventional business management goal.”⁸ These findings suggest benefits to the firm in addition to those concerning incremental gain.

Positive reputations have often been linked to positive financial returns. However, their value is tied inherently to the inability for competitors to imitate the reputation. The value of a positive reputation is “precisely because the development of a good reputation takes considerable time, and depends on a firm making stable and consistent investments over time.”⁹ Reputation is therefore perhaps the most valuable asset of any firm. Moreover, the steps taken by managers to protect their reputations stretch far beyond the scope of traditional CSR activities to include such basic business processes as procurement. The notion of reputation adopted here is “a general organizational attribute that reflects the extent to which external stakeholders see the firm as ‘good’ and not ‘bad’.”¹⁰

Klein and Dawar¹¹ proposed that CSR has value to the firm as a form of insurance policy against negative events. Specifically, they found that consumer perceptions of a firms’ CSR moderated their attributions of blame on the part of the firm for a product failure, and argued that CSR may have value to the firm even if it does not immediately increase profitability because it can help mitigate the effects of a damaging event. Their study extended the work of previous researchers demonstrating that consumers are more willing to punish the bad behavior of firms more than they are willing to reward their

good behavior.¹² For example, they found that firms with positive CSR records had similar attributions of blame as those firms with neutral CSR reputations, while firms with poor reputations had attributions that were significantly negative. Similarly, previous research has shown that firms who are already considered scrupulous are not able to enhance their image through corporate philanthropy, and in fact do their reputation harm by engaging in philanthropy that required the consumer to purchase something before a donation is made.¹³

The potential for CSR to provide risk mitigation is a widely accepted benefit of such activities. For example, Knox and Maklan state: “being trusted by stakeholders and pursuing socially responsible policies reduces risks arising from safety issues, potential boycotts and loss of corporate reputation.”¹⁴ It has also been argued that executives have an obligation to take into account the effect of a potentially tarnished image that might result in lost sales or the reduction of benefits from other stakeholders such as governments. Dunfee, for example, argues that managers not only have a duty to maximize shareholder value but to also anticipate changing marketplace morality given their potentially devastating impact on shareholder value.¹⁵ Therefore, CSR has tremendous potential to serve managers seeking to mitigate negative impacts on financial performance. Indeed, previous research reporting on a series of corporate social responsibility audits revealed that in addition to the expected gains such as employee morale, the audited firms consistently lowered legal exposure and other risks to company reputation.¹⁶

Avoiding negative behavior has become even more important with greater media scrutiny and coverage, advances in communications technology and the use of rapid and

widespread communications vehicles such as the Internet by activist groups such as Greenpeace. Further, as markets have become more competitive, CSR has become an even more important source of differentiation for firms. Dawkins and Lewis found that over half the population in their sample ranked forms of corporate responsibility such as community commitment as the most important factor in forming an impression of a firm.¹⁷

Therefore, CSR has two forms of potential financial return for the firm – a positive incremental gain as a reward for positive behavior and a mitigation of consequences from negative firm behaviors. Fombrun Gardberg and Barnett¹⁸ categorized these as “opportunities” and “safety nets” and outlined the potential benefits to firms across a number of key stakeholder groups as shown in Table 1. These are not merely two sides of the same coin. For example, incremental benefit can be secured from customers in the form of increased loyalty or positive word of mouth. Customers can also take negative action and defect to a competitors’ product or engage in negative word of mouth. However, a customer who does not engage in one set of behaviors will not necessarily engage in the other set of behaviors.

Insert Table 1 about here

MOTIVES FOR CORPORATE SOCIAL RESPONSIBILITY

If the firm can benefit from CSR in two distinct ways, it can be expected that managers will consider both criteria when making decisions concerning the CSR activities of the firm. In order to uncover managerial motives for CSR, a series of

interviews with managers responsible for their firms' community and social investment portfolios was undertaken.

The sample included a total of fifteen senior and mid-level managers at nine firms across a range of industries. The firms were identified with the help of the local United Way chapter, who identified the firms as mature in their development of CSR. Firm size ranged from 500 employees to over 30,000 employees and all of the firms had generally positive reputations with stakeholders. Further, given the problem of examining a complex construct like CSR, the specific focus of the interviews was on the corporate philanthropic initiatives of the firm.¹⁹ Given that corporate philanthropy is often used to demonstrate the firms' position to a broad range of key stakeholders a focus on corporate philanthropy is expected to provide an accurate reflection of the firms CSR strategies.²⁰ However, given the unstructured nature of the interviews, informants also discussed the wider socially responsible activities on the part of the firm. Interviews lasted approximately one hour and were transcribed for analysis. Pseudonyms are used to protect the anonymity of informants; industry and position details are given in Table 2.

Data generated from the interviews highlighted two major themes concerning the strategy and motives behind reputation management and CSR: 1) The dual motive to both gain incrementally from CSR and to have CSR protect the financial performance of the firm through reputational effects, and; 2) The delicate promotion of the firms' CSR activities, with more emphasis placed on managing potential damage from promotional activities than on securing incremental benefits.

Motives for CSR

Informants consistently referred to their CSR investments as “strategy.” The degree of professionalization in the CSR process appears to be quite high, consistent with the findings of previous researchers who have studied organizations with long-standing CSR initiatives. Further, the desire for managers to position the allocation to CSR as enlightened self interest was perhaps the most dominant aspect of the interviews: *“We look at it as an investment. It either has to be something that we think is an important investment in our employees, an investment in other stakeholders, but it has to be an investment that would be good for us.”* (Ron)

Although many researchers have cited direct benefits to businesses such as increased sales or image enhancement, informants expected softer, less “direct” benefits from their CSR activities. Perhaps this is due to the difficulty in tracing back a specific business event with a specific CSR activity. Managers generally held the belief that their investments in CSR provided some incremental benefit to the firm, but they are under no illusion that CSR is some “magic pill” that can suddenly cause the firm to increase sales or win over an advocacy group. *“I’m sure it has benefited us along the way, but I can’t point to any one thing that we have gotten directly from what we do for charity. Apart from feeling good at the time, I can’t tell you exactly where it has paid back for us. But I know it has.”* (Tiffany)

However, informants were just as likely to discuss insurance benefits from CSR investments as they were to discuss incremental investment returns to the firm. For example, a manager at a large energy company feels that risk mitigation is one of the cornerstone benefits to the investment: *“I mean your reputation can be gone tomorrow –*

so for sure it's protecting your reputation. That's part of the textbook strategy for strategic community investment that you can help mitigate and manage your risks. You can screw up but you've got this reputation behind you that's solid and stakeholders are giving. The nature of our business is we transfer dangerous fluids through pipes. And pipe spills, pipe leaks, and they are just devastating to the firm. But they happen."

(Darcy)

Perhaps because the managers in the sample were associated with larger, more established firms, an aspect of the protective value of the CSR investment related to potential for stakeholders to view the firm as exploitative of the local community. Larger firms are perhaps more of a "lightning rod" for those concerned with resource depletion and other associated issues. Managers view their CSR investments as a strategy for mitigating the potential concerns over their exploitation. For example, a manager at one particularly profitable large public firm stated: *"We make a ton of money, right? So I think that we have to give back to the community – in a certain way, in a small way, to show our corporate responsibility."* (Charles)

Similarly, the majority of the firms had long standing histories, with many being in business for over 100 years. As such, these firms were able to build reputations over a significant period of time, and were in the position of having generally positive reputations. For these managers, the benefits of CSR surrounding corporate image were almost entirely associated with risk mitigation: *"It's trying to support an image that we have that we don't feel many organizations in this city have. We have a very big piece of the market here and we'd like to continue to project our presence."* (Roland)

In general, similar to the benefits of CSR in the form of incremental gain, the benefits of CSR as insurance were also more general than reflective of any specific anticipated threat. Indeed, previous researchers have argued that executives have difficulty in gauging the likelihood of bad press before the fact.²¹ Informants viewed the investments as a form of comprehensive insurance policy, covering a wide range of potential threats to reputation: *“So if the community can look and see that by having us being members doing business there, they’ve benefited, then that is going to be having them be more supportive to have us around.”* (Stephanie)

One interesting subtheme concerning the motive to have CSR mitigate reputational damage was that CSR strategies often resulted directly out of specific negative events such as plant closures or employee strikes:

“We had a merger five years ago and the place was a mess. We were laying off people, and the word on the street was that [this] was a terrible place to work. And although the two separate organizations each had good reputations the combined organization had no ‘buffer.’ We realized that we needed to create something to get over those bumps in the road – there will always be bumps in the road.” (Roxanne)

The firm described above set out with a CSR strategy specifically designed to build bridges with key stakeholders such as employees, but recognized the benefits of the reservoir of goodwill now extend to mitigating the effects of any future negative events. But it was the negative event that caused the firm to see the value in having the strong reputation that can withstand such pressures, an insight shared by a manager at another firm: *“We had a bad strike here which hit us hard. Since then we have gotten involved in*

many local charities, supporting local groups, you know. We recognized that we needed to have some kind of protection against the kinds of negative events. You can't protect against them, they're just business. But if you're not ready for them they can really hit you hard." (Yvette)

Other firms that have taken the time to build up strong reputations were able to withstand similar negative events. In fact, the CSR strategies of some firms caused some key stakeholders to not only resist attacking the firm for a negative event, but to actually *stand behind* the firm:

"We closed down a plant a couple years ago where we had an excellent relationship with the community. We went and talked to the community and the Mayor and that discussion went very well. I think because we had a good relationship with them because we donate to the community causes – the United Way, all sorts of things – it made that dialogue easier. And did they help us when the plant shutdown was in the media? Yeah. It's a very clear example where our investments in the community have clearly worked."

(Ron)

Many managers who participated in the study engage in CSR activities such as corporate philanthropy simply because they would be conspicuous in their absence. For managers in these firms, the value from such investments is received from merely belonging to their peer group. Indeed, previous researchers have found that peer pressure is an important factor for firms donating funds to social causes.²² Similarly, Galaskiewicz and Burt found a strong relationship between the level of business interactions between firms and their philanthropic activities.²³ Informants spoke of the

competitive pressures to be involved in CSR and for many firms the fact that competitors and other firms were involved in an initiative created a downside to their refusal to become engaged. For example, one informant spoke of the firms' decision to withdraw from the annual United Way campaign, which enjoys the support of the lions' share of firms in his industry.

“It became a bit uncomfortable. Now instead of being projected as a concerned citizen, a grateful participant in the city’s economy, we were being criticized for not doing our share, which is obviously contrary to the image we were trying to project. And that criticism was coming from the business community. So, we thought that we can’t afford to do that, so we decided to ratchet up our effort and do the best we could in supporting United Way. If we’re not going to be the front-runner at least put ourselves in a position where we’re not going to be subjected to kind of negative criticism that we faced.” (Roland)

This statement echoes the views of other researchers who point to the “peer pressure” that exists for firms to become and remain involved in CSR activities. For many firms, the upside of these activities isn’t as great as the potential downside of being absent from the playing field.²⁴ Further, the downside is potentially moderated by factors such as firm size/dominance in the local community and the profile of the specific CSR initiative. For example, a manager asked to participate in a high profile annual charity event justified their participation is based on the profile of the event alone: *“We have to be involved because it’s such a major organization around the city and nationally that if we weren’t involved we would be noticed by our absence to be quite honest.” (Charles)*

Finally, informants were asked about the possibility that the firm would cease to participate in CSR activities, and focus strictly on delivering profits to shareholders who could then choose to support social causes. *“I think if we didn’t do it our reputation would suffer. And it’s hard to say how much it would suffer. Reputations take a huge amount of time to build – they can disappear in a moment. I think we get some goodwill from all of our stakeholders because of the things that they know us for in the community.”* (Ron) The damage to the reputation of the firm as a result of withdrawing support for CSR was expected to have immediate devastating impacts on the firm: *“I’d start looking for another job.”* (Heather) In fact, most informants couldn’t even envision the possibility that their firms would take such an action: *“Oh, that would never happen.”* (Marion) Such responses suggest that informants view their investments in CSR not as a discretionary expense, but rather as a necessary cost to running the business.²⁵

Promotion of CSR

Sometimes the firms’ good intentions can backfire and a CSR activity that is intended to avoid potential harm can actually result in a negative event for the firm; in other words, no good deed goes unpunished. For example, the selection of the target for the CSR can offend some stakeholders. Examples abound of firms that have provided support to a specific social cause or organization and then faced intense criticisms for their action. AT&T and several other firms, for example, faced an intense campaign in early 1990 from both sides of the abortion debate after their support and then withdrawal of support for Planned Parenthood. The firm angered pro-life activists with their support

of the organization, and subsequently faced scrutiny from pro-choice groups who accused the firm of caving into pressure. The result was an organized boycott of AT&T and a group of other major firms.²⁶

A positive action can also turn negative as a result of the firms' promotion of its CSR. Although many consumers find it acceptable for a firm to derive some benefit from their CSR activities,²⁷ and the inclusion of cause-marketing messages in advertising is generally seen as beneficial to the firm, researchers caution that this type of promotion requires great care.²⁸ Attempting to capitalize on good deeds by promoting them has backfired on some firms who have spent more on promoting their actions than they spent on the action itself.²⁹ The lessons of firms who have done more damage than good through the CSR activities were not lost on informants in the study. Similar to their motives for engaging in CSR, the primary concern for many informants responsible for promoting their firms' activities was to protect against potential harm. Because informants viewed the value in CSR as partially being able to draw back on a reservoir of goodwill at a future time, they were careful to promote their efforts with a quiet modesty to key stakeholders. Many managers worry that by overtly promoting their participation stakeholders might view the activity as self-serving. In fact, many respondents reported minimal or no attempts of self-promotion: *"We're pretty sensitive. We don't want to go out thumping our chests saying 'oh, aren't we wonderful and here's all the great things we do!' We want people to see for themselves and they can draw their own conclusions."* (Ron)

Instead of seeking to take credit at the time the investment is made, many informants felt that simply having stakeholders aware of the activity was valuable. *"We*

walk a line – you depend on the goodwill of the third party endorsements, we don't actively solicit them [to speak out on our behalf] because then you're in it for the wrong reasons, right? If you get the recognition, that's great – if you don't, you just keep going.” (Darcy) By keeping a lower profile, managers felt that stakeholders would be more likely to stand up for the firm because they viewed their CSR as being motivated by the benefit to the community. *“We're more interested in helping the community than having our name on a building. Our preference would be for people to be talking about us [instead of] having our name on a building.”* (Stephanie)

Likewise, firms recognized the value of making the investment in CSR prior to some potential negative event where they would need to rely on their reputation. Specifically, many felt that promoting CSR after a negative event in an attempt to overcome the situation would backfire and that such investments were needed in advance similar to insurance: *“I think it has a lot to do with corporate image and reputation. But it's not about trying to overcome some negative image or situation because you ideally do it before you have the negative situation. You don't want to call in the favor until you need it.”* (Elizabeth)

Similar to the motive for risk mitigation, the promotion of the firm may be moderated by the degree to which the firm already has a strong reputation for CSR. For example, an informant at a firm with a strong reputation among stakeholders in the community, and a long history: *“It's sort of a corporate modesty. We have a pretty good place in the community for a long time and I guess there's maybe some thinking around that we don't have to splash our name everywhere. Most people know us and respect us.”* (Wally)

The results from this study clearly support the theory that firms use CSR for both incremental gain and for mitigation of potential risks. In fact, the general consensus was that most of the value firms received from CSR was in maintaining their reputations and proactively building a reservoir to protect against an unforeseen event. Given that firms receive financial value from each of these two sources, the validity of traditional measures and methods used to establish a relationship between CSR and CFP is questionable. Specifically, the value received in the form of reputational insurance has been ignored in previous examinations of the CSR-CFP link, potentially grossly understating the value of CSR.

IMPLICATIONS FOR THE RELATIONSHIP BETWEEN CSR AND CFP

Despite conflicting reports, criticisms of omission of controls, lack of causality and other methodological problems, the majority of researchers now agree that the CSR-CFP relationship is generally positive.³⁰ However, there remain serious questions pertaining to the proper operationalization of the CSR-CFP relationship. For example, in their meta-analysis Orlitzky Schmidt and Rynes highlight a large amount of unexplained variance across the studies in their meta-analysis, suggesting the presence of moderators, and McWilliams and Siegel find that when R&D expenditures are factored into the relationship, the link between CSR and CFP becomes neutral.³¹ Here, a further refinement to the CSR-CFP relationship is offered.

Previous studies have primarily used one of two methods for establishing the CSR-CFP relationship. First, researchers have examined the correlation between the level of investment in CSR and some measure of CFP. For example, many studies have

operationalized CSR using the KLD database that measures firms' social investment across a number of criteria such as community investment, treatment of the environment and quality of products and services. In these studies, the CSR is typically assumed to be a level of positive firm behavior. These measures of CSR are then matched with some accounting measure of CFP, such as share price. However, the measures of financial performance are often limiting. For example, each of the categories of financial performance measures outlined by Griffin and Mahon³² – profitability, asset utilization, growth, liquidity, risk/market measures – corresponds to incremental financial gain. Similarly, Orlitzky et al.³³ classified the three major types of measures as market-based (investor returns), accounting-based (accounting returns), and perceptual measures (e.g., surveys capturing subjective estimates of a firms' financial position), and none of these measures capture the financial benefit received from the mitigation of some negative event. Indeed, previous researchers have noted that the field has been obsessed with measures of CSR while largely ignoring measures of profitability.³⁴

The second method that has been used to quantify the relationship between CSR and CFP is to examine some financial index of performance, such as stock price, both before and after some negative event. These studies operationalize CSR as the negative event itself – CSR is assumed to be a lack of socially responsible behavior. However, the value of CSR as a form of insurance can only be captured by using both forms of CSR – some level of positive firm behavior, followed by some form of negative behavior by the same firm. Without taking into account the negative behavior, researchers discount the good things firms do and only focus on the lapse in social responsibility. Conversely, by

only taking into account the positive behavior researchers are unable to gauge the value of the investment as an insurance policy.

These two different views of CSR – one that focuses on the positive aspects of firm behavior and the other that focus on the negative – have lived almost exclusively in two separate camps throughout the decades-long debate over the CSR-CFP relationship. This distinction is evident in Frooman’s³⁵ meta-analysis of socially irresponsible and illegal firm behavior and its relationship to share price. The meta-analysis *specifically excluded* two studies that involved firms choosing to withdraw from South Africa during the Apartheid era, generally considered a form of positive CSR. Although his analysis underscored the importance of event studies in the examination of the CSR-CFP relationship, he neglected to evaluate the effects of positive behavior (i.e., a reservoir of goodwill) prior to the negative event. Similarly, studies that have examined the effects of positive firm behavior have neglected to include the effects of specific negative events. Although previous researchers have called for a level of investment that optimizes the value to the firm using cost-benefit analyses, previous studies have not taken into account the total benefit of CSR, including both incremental gain and the moderating effect of CSR on negative firm behavior.

Insert Figure 1 about here

As shown in Figure 1, the value of the firms’ reputation acts as both a mediator and a moderator in the relationship between CSR and CFP. First, the value gained by a *net positive* CSR enhances a firms reputation, which then provides benefits in the form of competitive differentiation, the ability to charge higher prices, etc. This positive

reputation also serves to moderate the specific effects of a negative event, such as a product recall. Thus, by protecting their reputation, firms can both enhance and buttress financial performance.

Since the potential cost to the market capitalization of the firm from the damage to their reputation is typically much greater than the hard costs incurred from the actual event itself, such as a product recall³⁶, mitigating the reputational effects from such events can provide tremendous benefit to the firm. Indeed, Frooman found a significant effect of negative firm behavior on return to shareholder equity – almost one full standard deviation below the normal return.³⁷ Based on the study presented here and the work of previous researchers like Klein and Dawar³⁸, it appears that the insurance benefits received by firms in the form of reputational capital could actually be *greater* than the incremental gains expected from CSR. Since a negative event is more likely than a lack of positive behavior to impact the financial performance of the firm³⁹, including a measure of the insurance value should have a disproportionate effect of CSR on CFP. Therefore, any measure of the CSR-CFP relationship that doesn't take into account some measure of the insurance value of CSR received by firms may grossly understate the value of the CSR investment.

If the firm has no negative event where the CSR can act to mitigate harm, the firm receives no insurance benefit from their investments in CSR. Similar to any insurance policy, if no claim is made the cost of the policy is simply expensed and the firm appears less profitable than they would had no such policy been purchased. Therefore, by not accounting for the potential value of the insurance gained from CSR, those firms that invest in such activities may appear less profitable than those that do not. Even

arguments that investments in CSR create a favorable business environment and therefore lift the performance of all firms fail to capture the insurance value, since firms that do not incur such expenses (i.e., free riders) will appear more profitable than those that do not.

An insurance policy is only valuable if it is purchased before a claim is made. Similarly, the ability of CSR to mitigate the harmful effects of a negative firm behavior is expected to protect the financial performance of the firm if it is exhibited prior to a negative firm event. Indeed, researchers have found that prosocial corporate communications (e.g., cause-related marketing advertising), while successful at generating a positive response before a negative event, loses its ability to influence public opinion if it follows a negative news report about a firm.⁴⁰ Also, similar to other forms of insurance, if no claim is made then in an accounting sense the premium payments do not have residual capital value. However, there is expected to be residual value in the form of reputation capital and thus protection against potential negative forms of CSR.⁴¹ Therefore, relying solely on accounting measures of financial performance ignore the value of reputational capital, built up in a reservoir of goodwill over many years. The framework presented in Figure 1 takes into account the potential for incremental gain from CSR as well as the potential differential in effect between incremental gains and mitigation of harm and the value of reputational capital built up over time.

Further, the value of CSR to the firm may be in an event that *doesn't* occur. For example, researchers have argued that by acting in a positive manner, the firm (and indeed the whole industry) may benefit by avoiding government legislation that would impose restrictions or otherwise change the business environment in which the firm operates.⁴² Thus, in addition to acting to bolster attempts to influence existing

government legislation, CSR can act to suppress potential legislation. In the latter scenario, despite the potential for some “free riders,” CSR is clearly financially beneficial to the firm but such value would not be evident in traditional measures of the CSR-CFP relationship.

The inclusion of reputation into the CSR-CFP framework has implications for how researchers develop their measures when studying this relationship. Specifically, the use of reputation indices such as the aforementioned KLD database as a measure of CSR is questionable since they are expected to be highly correlated with and obscure the relationship between actual CSR investments (e.g., corporate philanthropy, investment in environmentally friendly production practices, etc.) and financial performance. This supports the concerns of previous researchers over the use of such indices and their correlation to financial measures.⁴³ Further, if the firm is hesitant to formally promote its CSR, external indices may not capture the full spectrum of the CSR investment and therefore overestimate the relationship between CSR and CFP.

The proposed framework for examining the CSR-CFP relationship in Figure 1 advances the study of this relationship by providing a mechanism for quantifying both the incremental and insurance value of investments in CSR. Examination of the moderating effect of CSR/reputation on negative events has been initially quantified in the consumer-based study of Klein and Dawar.⁴⁴ Future studies can use firm-level data (i.e., profitability, stock price, etc.) to measure profitability where a negative event has affected a cross-section of firms across an industry. An example could be the recent negative publicity received by the apparel and footwear industries for their use of sweatshops overseas.⁴⁵ In this case, CSR may provide incremental gain during good

times and subsequent mitigation of negative publicity. Perhaps most importantly, examinations of the CSR-CFP relationship that include measures of the insurance value will move toward an understanding of the optimal levels of insurance investment for firms seeking to protect their financial performance through their reputations.

TOWARDS A VALUATION OF CSR AS INSURANCE

The findings reported here and elsewhere about “peer pressure” for firms to engage in CSR have significant implications for the study of the relationship between CSR and CFP. Specifically, the findings reported here suggest that not all forms of CSR are equal, not only for incremental gain but also for insurance purposes. For example, when a manager specifically chooses a high profile charity event to support because he will be conspicuously absent *from that specific event*, s/he is prioritizing the value of the many CSR options available to him. Measures of CSR that are broad in nature, and capture only the overall investment by firms do not take into account the nuances of individual CSR activities and their specific value as forms of insurance (nor, in fact, do the measures that have assumed CSR is tied to incremental gain). These specific events become like the “ante” in a poker game, and by being absent from such events firms can place themselves in greater jeopardy than by being absent from other forms of CSR. For managers, CSR appears to not be considered a general activity between homogeneous options, but rather a series of carefully evaluated and chosen activities designed to deliver both incremental and insurance value to the firm. Therefore, measures of CSR that do not take into account the differential value among a group of heterogeneous CSR options will miscalculate the “real” value to the firm.

The insurance value of CSR is expected to vary across industries and firms. For example, Miles⁴⁶ highlighted the concept of business exposure, the degree to which a firm is vulnerable to its environment. Firms that are under greater scrutiny from a broader range of stakeholders face greater business exposure. Indeed, previous research has shown that a firms' philanthropic activity was highly correlated to the level of business exposure it faced.⁴⁷ Similarly, Smith⁴⁸ argued that reputational risk is more of a concern for consumer goods firms which have a larger exposure to a consumer boycotts or negative media exposure. However, he also highlights reputational risk for business-to-business firms who face pressures from other stakeholders such as distribution channel members or government legislation. The results presented in the study here suggest that firms outside of consumer products categories still face a high degree of reputational risk. Also, those firms that are in inherently higher risk categories, such as firms that work in environmentally sensitive areas, are perhaps more likely to require this form of insurance than firms that operate in more stable industries, or industries where the potential costs of harmful events are less severe. Examples of severe negative events for firms in sensitive industries include the Exxon Valdez disaster, or the recent recall of Vioxx by drug-maker Merck.

Firm-specific variables may also exacerbate the need for insurance through reputations. For example, firms that operate in certain geographic locations may face greater potential for significant negative events to occur. Examples could be transportation firms that operate in densely populated areas of the world versus those that operate in more rural areas where catastrophic events are likely to have fewer

consequences for the population. Individual managers must assess the risk of their firm/industry and make investments in insurance accordingly.

In order to fully capitalize on the value of CSR as insurance, the firm must engage its stakeholders and ensure they are aware of the actions of the firm. External stakeholders such as activist groups can actually be engaged as partners in prosocial behavior thereby reducing the need for any form of promotion to that stakeholder group.⁴⁹ Since promotion of CSR activities can be a dangerous proposition, and can actually backfire on the firm, understated promotion or none at all may be the best option. Many of the informants in the study presented here relied heavily on their stakeholders to speak on their behalf in the event of a negative consequence of firm operations. Further, the value of a strong reputation may provide value to the firm even if the negative event is outside the normal operations of the firm. During the 1992 riots in Los Angeles, McDonald's restaurants were largely spared by vandals and looters, a result that the firm credits to its proactive efforts to develop rich relationships with the community through its development of employment opportunities and other efforts such as Ronald McDonald House.⁵⁰

Finally, the recognition and valuation of CSR as a form of insurance may offer insight into the cause and effect relationship between CSR and CFP. Although some recent research has established a "virtuous circle" between CFP and CSR⁵¹, questions remain about whether a firm "does well by doing good" or that it "does good by doing well." When CSR is viewed partially as insurance, it adds another dimension to the virtuous circle by suggesting that the direction is dependent upon the life cycle of the firm. For example, in the developmental stages firms may use CSR primarily for

incremental gain. Because they have virtually no reputational capital to protect (although CSR activity will play a role in developing such capital), the primary benefit to the firm is in the form of incremental gain such as differentiation among its competitors. Such benefit is expected to lead to financial performance. However, after doing well financially, the firm invests in protecting its assets including its reputation. Engaging in this protection ensures that the firm can continue to thrive in the future, which creates additional CSR activity. Thus, reputation may initially play a mediating role between CSR and CFP, and later justify investments in CSR in order to maintain CFP. When investments in CSR are considered as a form of insurance, there is no doubt as to the causal ordering of the CSR-CFP relationship – insurance premiums must be paid prior to any claim. This virtuous circle is depicted in Figure 2.

Insert Figure 2 about here

The relationship depicted by the dashed lines in Figure 2 illustrates the complex nature of this virtuous circle. Previous research suggests that the relationship between financial performance and reputation is reciprocal.⁵² Similarly, the relationship between CSR and reputation is also reciprocal. For example, Osterhus⁵³ demonstrated that prosocial positioning strategies are more effective when consumers exhibit a level of trust toward the firm. Thus, firms can engage in CSR to gain reputation (and subsequent financial performance), but then engage in CSR in order to protect that reputation (financial performance). This creates exciting possibilities for future research that include the relationship between CSR and firm life cycle in addition to profitability, and

addresses the concerns of previous researchers who argue that specific conditions may change the nature of the relationship between CSR and CFP.⁵⁴

CONCLUSIONS

Contrary to Drucker's confidence that at least in business organizations we can measure results, the multi-dimensional nature of the CSR-CFP relationship had created tremendous measurement difficulties. Interestingly, the first serious attempts to capture the CSR-CFP relationship came only a few years after Drucker made that claim, and the debate has been kept alive ever since.⁵⁵

Attempts to accurately reflect the financial return from CSR are more than an academic exercise. Many nonprofit organizations are now reliant on corporate sources of support, and without sustained support many may not have the ability to pursue their missions. The increased pressure faced by managers to justify the allocation of scarce resources means that dollars spent on CSR activities are becoming more closely scrutinized, and are at risk of being withdrawn.

The proposed refinement to the measurement of the CSR-CFP relationship should encourage managers to consider the value of CSR beyond the ability of such practices to provide incremental gain. Often, even if the firm only maintains the status quo the investment in CSR can be considered a wise investment. By presenting this novel conception of the value of CSR, this article has extended the work of previous researchers who have called for a more complete accounting of the value of CSR investments, including the value of the insurance function of those investments.

The results presented here suggest that investments in CSR are not, and perhaps should not, be considered by managers to be a discretionary expense. Just as the purchase of other forms of insurance are considered sound management practice, so too is the purchase of insurance through reputation. Through this widening of the perceived value of the CSR investment, firms can better justify their role in solving societal woes from a position of enlightened self-interest.

TABLE 1
VALUE SPECTRUM OF CSR

Firm Behavior	<i>Positive</i>	<i>Negative</i>
Financial Impact	<i>Incremental Gain</i>	<i>Mitigate Harm</i>
Stakeholder/Effects	<ul style="list-style-type: none"> • Employees - increased morale, commitment • Customers – repeat purchase, enhanced image • Investors – lower cost of capital • Partners (suppliers) – increased collaboration, trust • Regulators – favorable legislation • Activists – product recommendations • Community – favorable business climate • Media – favorable coverage 	<ul style="list-style-type: none"> • Employees – reduced rogue/self-interested behavior • Customers – reduced defections • Investors – reduce potential for abandonment • Partners (suppliers) – reduce defection • Regulators – reduce imposing legislation • Activists – reduced threat of boycott • Community – reduced threat of uprising • Media – reduced threat of negative coverage

Adapted from Fombrun et al. (2000).

TABLE 2
SUMMARY OF KEY INFORMANTS

Pseudonym	Industry	Title
Elizabeth	Public Utility	Vice President
Heather	Public Utility	Manager, Sponsorship & Community Investment
Charles	Financial Services	Regional Vice President
Graham	Financial Services	Community Services Manager
Roxanne	Power Generation	Executive Vice President
Wally	Power Generation	Senior Community Investment Officer
Tiffany	Telecommunications	Vice President
Cliff	Telecommunications	Community Projects Advisor
Stephanie	Oil and Gas Exploration	National Community Investment Manager
Lucy	Oil and Gas Exploration	Manager, Community Relations
Roland	Law	Managing Director
Ron	Integrated Energy	Senior Vice President
Marion	Integrated Energy	Senior Manager, Sustainability
Darcy	Pipeline	Manager, Community Investment
Yvette	Retail	Vice President

FIGURE 1
CSR-CFP RELATIONSHIP FRAMEWORK

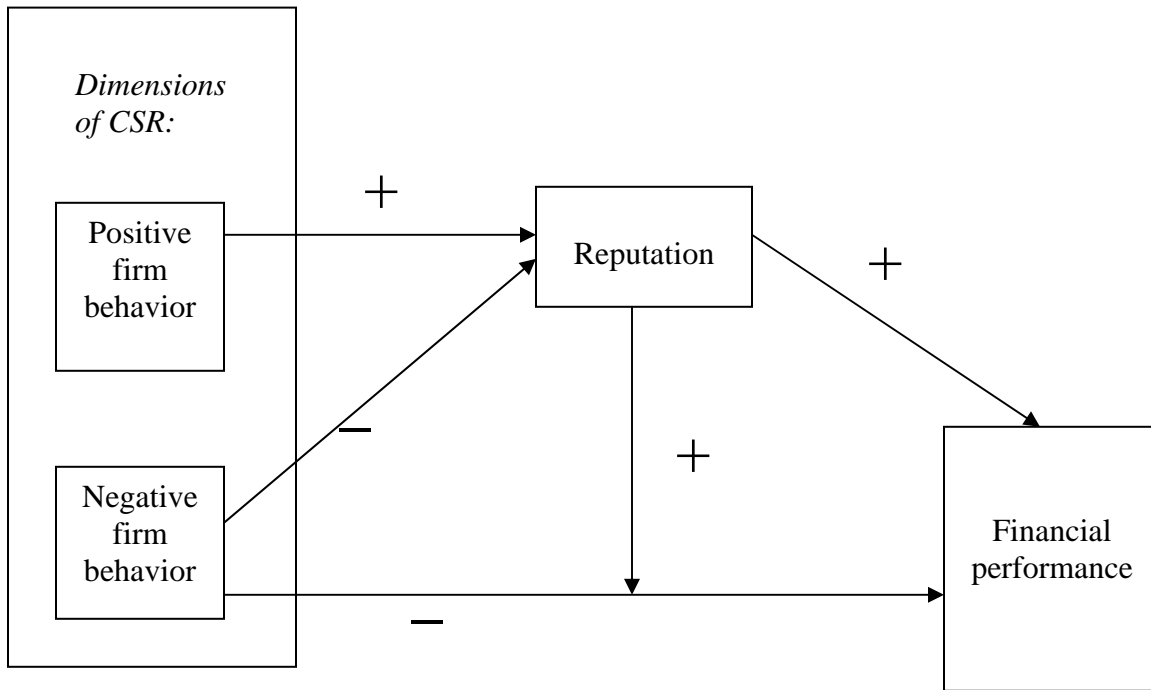
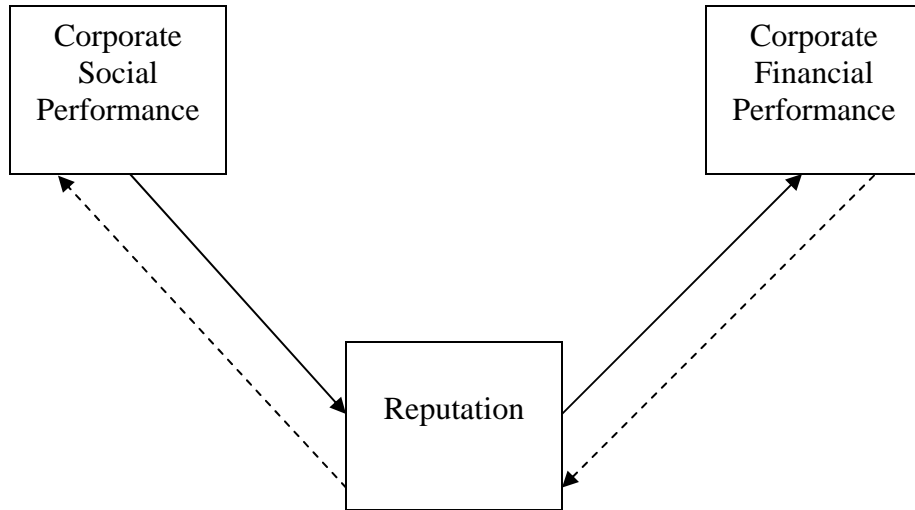


FIGURE 2
UPDATED VIRTUOUS CIRCLE OF CORPORATE SOCIAL RESPONSIBILITY



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