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How do companies invest in corporate social responsibility? An ordonomic contribution for empirical CSR research

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Matthias Georg Will und Stefan Hielscher

How do Companies Invest in Corporate Social Responsibility? An Ordonomic Contribution for Empirical CSR Research

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Abstract

This paper takes both a *conceptual* and an *empirical* approach to answer the question of how CSR can be connected to the company's role as an agent of social value creation that operates within an imperfect institutional framework of market competition. To develop a functional design for an empirical study, we draw on the concept of ordonomics, which provides a heuristics of how companies can use morality as a factor of production. Drawing on ordonomics, we derive three central questions: In what CSR activities do companies engage in the course of their day-to-day business? How can win-win solutions be realized through strategic rule commitments? In what stakeholder dialogues do companies engage in order to discuss and find functional rules for organizing win-win solutions? Linked with a combined factor analysis and dynamic panel estimation, this empirical approach yields new insights into the relationship between CSP and CFP. As control variables we use company fundamentals and the evaluations of CSR and finance managers. In a reduced pre-study, we reveal some first insight into the CSP-CFP link and generate several new hypotheses to be the subject of a further major study.

Key Words: CSP-CFP relationship, CSR, ordonomics, win-win, factor analysis, dynamic panel estimation.

JEL Classification: M14, D22, C38

How Do Companies Invest in Corporate Social Responsibility? An Ordonomic Contribution for Empirical CSR Research

Matthias Georg Will and Stefan Hielscher

Introduction

For almost 35 years, the effect of social activity on company performance has been under empirical analysis. More specifically, empirical studies have inquired into the relationship between corporate social responsibility (CSR) and corporate financial performance (CFP). After about 170 studies, it is still unsettled whether companies do well because they do good or whether companies that do well can also do good. This ambiguity has led some of the most prominent scholars in the field to the discouraging conclusion that the “[t]he continuing quest to substantiate or repudiate a link between CSP and CFP may be of little value. While the quest is seductive, it may be time to let this particular question rest. ... Research must now show *how* CSP comes to bear upon CFP.”¹

This paper takes the above conclusion as its starting point and makes an ordonomic contribution to the empirical CSR research. Following the ordonomic perspective on business in society, the article develops the tripartite ordonomic idea that companies can assume social responsibility not only in the arena of ordinary day-to-day business activity, but also in the public arena of rule-finding and the political arena of rule-setting. Based on the ordonomic understanding that companies can use “*morality as a factor of production*,” this paper takes both a *conceptual* and an *empirical* approach to answering the question of how CSR can be connected to the company’s role as an agent of social value creation in its day-to-day business and governance activities.

This ordonomic contribution to the empirical literature on CSR is in three parts. Part 1 reviews the current state of empirical macro-level and micro-level research on CSR. Part 2 presents the ordonomic concept of “morality as a factor of production.” Based on this conceptualization, Part 3 contains an ordonomic contribution to the empirical research. Section 1 of Part 3 provides a concept for a dynamic panel estimation inspired by the ordonomic perspective. Section 2 presents the results of a reduced pilot study, with which we illustrate some multi-complex interdependencies of the CSP-CFP link and develop five hypotheses for a forthcoming dynamic panel estimation. Part 3 concludes with some suggestions for future empirical work.

1. The Current State of Empirical CSR Research

During the last 35 years, more than 170 empirical studies have been published that analyze the market return of firm investment in corporate social responsibility (CSR).² The good news is that many of these empirical CSR studies find a significant relationship between corporate social performance (CSP) and corporate financial performance (CFP). The bad news is that we still lack a clear understanding of *how* CSR positively

¹ Margolis et al. (2007, p. 6 et passim).

² Cf. Margolis et al. (2007, p. 6).

influences a firm's processes of value creation. In this section, we classify the extant empirical research into two categories: studies that focus (1) on the macro-level and (2) on the micro-level of the firm.

(1) There is a long tradition in empirical research of analyzing the direct impact of CSP on corporate financial performance. By now, many of these studies' results have been scrutinized using statistical meta-analysis. Three particularly prominent meta-studies estimate the overall impact of CSP on CFP.

- Orlitzky et al. (2003) analyze 52 empirical studies. The authors conclude (a) that although the studies mainly find positive and significant correlations, the causal link between CSP and CFP is likely to be reciprocal and simultaneous.³ (b) Orlitzky et al. (2003) emphasize that the reputation the company gains from CSR activity greatly influences the strength of the CSP-CSF-link. (c) The authors also highlight the methodological weaknesses of all CSP-CSF studies. According to Orlitzky et al. (2003), the variance of the error terms explains from 15 to 100% of the CSP-CFP link in the original studies.
- Allouche and Laroche (2005) analyze 82 empirical studies.⁴ Their meta-analysis has five main results. (a) CSP has a positive impact on CSF and this effect is stronger in the United Kingdom than in the United States.⁵ (b) The reputation gained from CSR activity has a stronger influence on the CSP-CFP link than other explaining parameters such as, for example, company audits. Philanthropic activity and environmental programs have a small effect on CFP. (c) The results of the empirical studies are partial statistical artifacts. For example, the authors show that the positive effects are stronger if the studies use OLS regression or mean comparison tests. (d) Parameters such as size of firm, the industry, the company-specific risk, or R&D expenditure have no effect on the CSP-CFP relationship. (e) Tests suggest that CSR has a bigger influence on subjective measures and market indicators like stock market returns than on accounting-based parameters. (f) According to the meta-analysis, there is a structural discontinuity in the observation period: Allouche and Laroche (2005) show that CSR had stronger effect in the 1960s than in the 1980s.
- Margolis et al. (2007) examine 167 empirical studies. Their meta-analysis yields the following results.⁶ (a) Capital markets do not punish companies that invest in CSR. (b) The returns of pro-active CSR activities are lower than investments in innovation, capital goods, or mergers. (c) Capital markets severely punish moral misconduct of firms in the present and also in the future. As a consequence, CSR is profitable if it helps minimize business scandals or if it is engaged in for preventing negative reputation effects caused by company scandals. (d) Companies with strong financial fundamentals in the past are more likely to in philanthropic activity. (e) Current CSR activity predicts neither present nor future CFP. Indeed, it is highly

³ Cf. Orlitzky et al. (2003, p. 427).

⁴ Cf. Allouche, Laroche (2005, p. 10).

⁵ Cf. Allouche, Laroche (2005, pp. 19–21).

⁶ Cf. Margolis et al. (2007, pp. 22–23).

probable that a good CFP promotes CSP, not vice versa. (f) In many cases, the reliability and validity of the CSP indicators are doubtful.⁷

In short, the available meta-studies reveal that the data of the original studies are often too strongly aggregated to be fully exploited by correlation or regression analysis. This is so for two reasons: first, firms are very diverse with respect to their organization and industry and, second, CSR activities vary among companies because firms have to, e.g., address diverse stakeholders in different industries. As a consequence, empirical studies that use aggregated macro data to evaluate the CSP-CFP link encounter difficulty in finding causal interdependencies. As a matter of fact, in many cases the link between CSR and profitability is neither linear nor monocausal. Thus, empirical research needs a theoretical framework to handle the complex CSP-CFP link before the link can be evaluated.

Margolis et al. (2007), therefore, criticize not only the empirical conception but also the theoretical foundation of CSP-CFP research. According to them, a lack of theoretical conception strongly reduces the quality of many empirical studies.⁸ The authors even go so far as to challenge the whole endeavor of analyzing the CSP-CFP link using macro data:

Ironically, 167 studies later, managers may be exactly where they were in 1972: seeking criteria to judge when CSP makes sense and guidance about how to advance both CSP and CFP, if they are both worthy of pursuit but not entirely consistent. The continuing quest to substantiate or repudiate a link between CSP and CFP may be of little value. While the quest is seductive, it may be time to let this particular question rest. There may be other aspects of the CSP-CFP relationship that are now more important to investigate.⁹

(2) A more systematic approach to empirical CSR research focuses on “other aspects of the CSP-CFP relationship” and pays attention to the organizational micro-level of the firm’s value creation activities. The idea behind such empirical work is to associate CSR with specific business functions such as reputation management, risk management, innovation management, and human resource management. These micro-level studies ask how different CSR functions can influence the present or future profit and even the market value of the firm. The underlying assumption is that CSR activities that affect the future value also raise present equity prices because of a higher cash value. As shareholders anticipate prospective gains from their current investment decisions, CSR can also bear on the current market value of the firm. Figure 1 illustrates the hypothesis that functional CSR explains the CSP-CFP relationship and also shows the research is associated with this hypothesis.

- *Management of reputation.* Several studies investigate the impact of reputation management on the CSP-CFP relationship. Neville et al. (2004, pp. 1193–1194) find a positive link between reputation and financial performance,¹⁰ but according to Sánchez and Sotorrío (2007, p. 343), the marginal returns of reputation are declining.¹¹ Reputation management does not seem to be a cash cow and the effects of a good reputation on profitability are small. These micro-level studies do not analyze to what extent reputation increases (future) profits or whether reputation directly increases the stock market yield. According to Fama and French (2007, p. 676), however, know-

⁷ Cf. Margolis et al. (2007, p. 27).

⁸ Cf. Margolis et al. (2007, p. 28).

⁹ Margolis et al. (2007, p. 26).

¹⁰ Cf. Neville et al. (2004, pp. 1193-1194).

¹¹ Cf. Sánchez and Sotorrío (2007, p. 343).

ing this is important in evaluating the efficiency of capital markets: if investors focus only on the reputation of companies and not on their fundamentals, capital will accumulate inefficiently because investors will waste scarce capital and create bubbles. Under these circumstances, acting morally would lead to socially undesirable results. Doing good would lead to market failure.

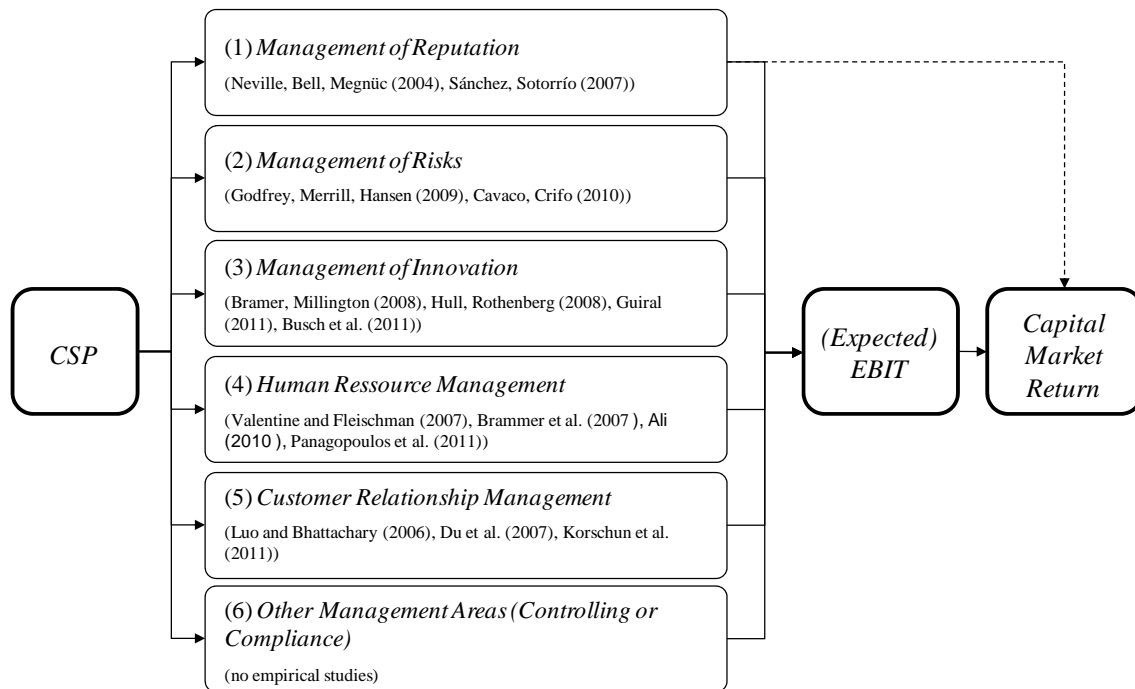


Figure 1: Micro-level empirical CSR research: CSR functions and the CSP-CFP relationship

- *Management of risks.* Godfrey et al. (2010) conclude that CSR can insure against the risk that the company's core business activities will result in unintended but morally suspicious results, such as company scandals. According to their analysis, stakeholders (especially the general public) tend to forgive business misbehavior more easily if firms display good moral intentions and less easily if firms have a doubtful moral reputation.¹² Similar results are provided by Orlitzky and Benjamin (2001), who argue that an investment in CSR pays off for shareholders because a good CSP reduces business risks and therefore also decreases volatility on the capital market. According to their view, good CSR management creates strong ties with important stakeholders of the company, as well as with shareholders, that will endure even in periods of crisis.¹³
- *Management of innovation.* Several empirical studies show a strong relationship between CSP, CFP, and innovation management.¹⁴ The direction of the causality, however, is still an open question: Does CSR increase the probability of generating more and better innovations or does CSR send a positive signal to financiers so that companies can invest in more risky projects? In addition to the problem of reverse causality, the empirical studies do not reveal whether innovative companies invest more money in CSR activities. It is quite possible that the measured

¹² Cf. Godfrey et al. (2009, pp. 428, 441–442).

¹³ Cf. Orlitzky and Benjamin (2001, pp. 390–391).

¹⁴ Cf. Brammer and Millington (2008, p. 1335), Busch et al. (2011, p. 24), and Guiral (2011, p. 20).

relationship is just a spurious correlation in the case that highly profitable and innovative firms also implement CSR and in the case that CSR does not influence the investors' decisions and does not increase the probability of being innovative. Hull and Rothenberg even measure a negative and significant relationship between CSP and innovation.¹⁵

- *Management of human resources.* The theoretical CSR literature champions the idea that CSR has a positive impact on employee productivity.¹⁶ The empirical CSR research seems to support this idea.¹⁷ The commitment literature provides an idea for why CSR can positively influence a firm's human resources management. According to Mowday et al. (1979), a commitment "represents something beyond mere passive loyalty to an organization. It involves an active relationship with the organization such that individuals are willing to give something of themselves in order to contribute to the ... organization's well being."¹⁸ Along these lines, employees who are strongly committed to their companies seem to work more productively.¹⁹
- *Management of customer relationships.* CSR activities increase customer satisfaction.²⁰ The link, however, is not statistically significant. The relationship varies because "satisfaction plays a significant role in the relationship between CSR and firm market value and ... a proper combination of both CSR initiatives and product-related abilities is important."²¹ In a micro study of 3,500 customers of three yoghurt companies, Du et al. (2007, p. 231) reveal that CSR activities have a statistically significant impact on purchasing behavior. Customers are more likely to buy the products of companies that use CSR. In addition, buyers show more loyalty to and identification with goods that are produced by companies that engage in CSR. Also, if CSR fosters the social identity of the staff, employees tend to be more responsive to customer needs.²² However, consumer orientation is higher only if employees are convinced that the company has a credible customer focus. In addition, the staff has to be sure that consumers have a strong demand for CSR and share the same values.

(3) There is no doubt that the micro-level research has enriched the macro-level empirical research on CSR. In fact, the idea of focusing on how CSR impacts specific business functions is a big step forward in the attempt to better understand the functional CSP-CFP relationship *en detail*. To date, most of the empirical literature primarily attends to management functions such as reputation management, risk management, innovation

¹⁵ Hull and Rothenberg (2008, p. 786). In addition, the empirical literature has not yet asked the question of whether firms explicitly use stakeholder dialogues to develop new organizational innovations such as new business models.

¹⁶ Cf. Bhattacharya (2008, pp. 42-44).

¹⁷ Cf. Valentine and Fleischman (2007, pp. 164-166) for the empirical relationship between CSR and work satisfaction. Cf. Ali (2010, pp. 2798-2799) for the effect of employee commitment on company fundamentals such as market share, competitive position, and return on investment.

¹⁸ Mowday et al. (1979, p. 226) and for first empirical findings of the relationship between commitment, job satisfaction and turnover rates cf. Porter et al. (1974).

¹⁹ Cf. Panagopoulos et al. (2011, pp. 38-39, table 2) or Brammer et al. (2007, p. 1712, table 3) for the influence of employee commitment on a variety of output-orientated parameters, including job performance, intention to stay, loyalty, and positive word-of-mouth recommendations.

²⁰ Cf. Luo and Bhattachary (2006, p. 14, figure 3).

²¹ Luo and Bhattachary (2006, p. 14).

²² Cf. Korschun et al. (2011, pp. 24-25).

management, or human resources management²³ and, unfortunately, the evidence uncovered by this micro-level empirical CSR research is by no means clear-cut. In short, it is still an open question whether companies do well by doing good or whether firms that do well can also afford to do good—Does CSR influence the profitability of companies or has profitability an impact on CSR activities? After more than 35 years of intense research, the empirical CSR literature is a long way from providing a suitable management heuristics for business practice. Based on the current evidence, the only clear conclusion managers can come to is that investing in CSR will be an adventure of uncertain outcome. Despite many research efforts made at the micro-level of the firm, the empirical CSR research remains in the state so eloquently described by Margolis et al. (2007):

Too many studies speculate about mechanisms that explain results or end with a call to investigate them. It is time to study mechanisms systematically. ... No matter how well measured the constructs [of the 167 studies], research must move beyond simply assessing the magnitude of the CSP-CFP relationship. Research must now show *how* CSP comes to bear upon CFP.²⁴

From this short survey, we conclude that the empirical literature will greatly benefit from a conceptual contribution that helps to better understand “*how* CSP comes to bear upon CFP.” Using the ordonomic approach, we present in the following section a theoretical conception of business in society that also has a systematic place for CSR.

2. An Ordonomic Conceptualization of CSR: Morality as a Factor of Production

In this section we introduce the theoretical perspective of ordonomics put forward by Beckmann, Hielscher, and Pies (2011), Hielscher (2011), Pies, Beckmann, and Hielscher (2010), Pies, Hielscher, and Beckmann (2009), Hielscher, Pies, and Valentinov (forthcoming), and Pies, Beckmann, and Hielscher (forthcoming). Drawing on the ordonomic approach, we embed the idea of corporate social responsibility (CSR) in the wider classical notion that companies are agents of social value creation.²⁵ We develop this ordonomic concept in three steps. Step (1) argues that competitive markets are socially beneficial institutions. Step (2) argues that any societal role of business must be compatible with real-world markets. Step (3) develops the argument for how CSR can reinforce this role of business of business in society.

We draw on this ordonomic perspective for two reasons. *First*, we believe that a more fundamental approach to looking at the social responsibility of business firms achieves a better understanding how modern CSR can be used not to weaken, but to strengthen this role of business in society under the conditions of a modern, increasingly globalized market economy. In view of the current state of the empirical literature, we argue, *second*, that this ordonomic conceptualization can help develop an empirical research design that generates new ideas for studying *en detail* the CSP-CFP relationship.

(1) *Competitive markets*. The classical explanation of the working properties of a market economy rests in the idea of social cooperation in a modern society. According to liberal economists such as Ludwig von Mises (1927; 2002), the institution of the market is the prime instrument for maintaining peaceful cooperation among individuals in complex societies whose members do not know all the needs of all other members

²³ However, there is as yet no empirical work on several other management areas, such as controlling or investor relationships.

²⁴ Margolis et al. (2007, pp. 27–28).

²⁵ Cf. Pies, Beckmann and Hielscher (2011).

and cannot fully predict the entire consequences of their actions.²⁶ In a modern society, markets are functional loci of cooperation because markets use competition in a systematic and purposeful way. As a matter of fact, competition among suppliers on one side of the market and competition among consumers on the other side of the market prevents undesirable forms of cooperation such as producer cartels and monopolies or consumer cartels or monopsonies. From the perspective of society, this kind of cooperation is undesirable because it prevents consumers and producers from fully exploiting the win-win-potential of their cooperation. Therefore, the institutional framework of competition—e.g., property rights, contract law, the rule of law, and anti-trust regulation—is an instrument that helps all members of society to fully reap the benefits of their role as consumers *and* producers. In short, from an ordonomic perspective, competition is not an end in itself, but a means of societal cooperation.²⁷

The stepwise establishment of social cooperation on competitive markets has fundamentally changed many societies, beginning in Europe and its Western colonial satellites in the 18th and 19th centuries, followed by Asia and many other regions in the 20th century.²⁸ Simply put, in the absence of competitive markets, actors have to play static zero-sum games. In a competitive market, however, actors can cooperate in dynamic positive-sum games and can systematically create win-win-situations, i.e., in economic terms, they can create Pareto-superior outcomes. As a consequence, competitively organized market societies have accumulated a tremendous and unprecedented amount of wealth.²⁹ Along with material prosperity, markets support the emancipation of individuals because members of society who participate in markets can satisfy (to a large extent) their needs regardless of gender, religion, or origin.³⁰ But markets not only enrich the *vita consumenda* of the ordinary people; individuals also benefit in their role as active producers. Today, the number of people who make a living from physically strenuous, monotonous, or dangerous jobs is steadily declining. Increasingly, modern processes of value creation enable a *vita activa* that offers many interesting and challenging opportunities for self-fulfillment and self-perfection for a constantly increasing number of people.³¹ In short, competitive markets are a socially and morally beneficial institution because they actively support both a *vita consumenda* and a *vita activa*, especially for the poor members of society.³²

(2) *Companies as agents of social value creation.* The classical liberal argument against the “social responsibility” of companies is put forward by Milton Friedman. Friedman (1970, p. 122) argues that companies best fulfill their social responsibility if they maximize their profits. In contrast to Friedman’s idea, however, companies do not operate within a perfect framework of market institutions. In the “real” world, companies have to deal with systematic incompleteness—with an incomplete institutional order of competitive markets and with incomplete contracts for market transactions.³³

²⁶ Cf. Pies, Hielscher, and Beckmann (2009, p. 320).

²⁷ For an earlier version of this argument cf. Hazlitt (1964, 1994). For an ordonomic conceptualization cf. Pies (2000; p. 61).

²⁸ Cf. e.g. McCloskey (2007, pp. 1-53).

²⁹ Cf. North et al. (2006, pp. 36-44) and (2007, pp. 21-24) as well as Baumol (2010, p. 150).

³⁰ Cf. Becker (1993, pp. 386-389), Leijonhufvud (2007, pp. 4-7), and Pies, Hielscher, and Beckmann (2009, pp. 319-320).

³¹ Cf. Phelps (2009, p. 5) and Hielscher (2012).

³² Cf. McCloskey (2010, pp. 48-59).

³³ Cf. Pies et al. (2011; p. 177-178).

Under the ordonomic approach, incomplete institutions and contracts are the starting point of any moral role for business firms in society. Yet, embedding the corporation into the system of market competition and its indisputable moral quality, assuming a social responsibility cannot simply mean abandoning the profit principle in conflicts between profit and morality. According to the ordonomic approach, therefore, any role of business in society must be compatible with the real-world market system, and must be founded on the premise that companies are societal agents for mutually advantageous value creation.³⁴

Against this backdrop, the ordonomic approach focuses on how corporate actors can use moral commitments to create a functional framework for win-win cooperation with their stakeholders—that is, with their customers, employees, suppliers, and financiers—and also with civil society organizations, politicians, and the media. According to Schelling (1960, 2003: 4 et passim), however, social cooperation is nearly always antagonistic cooperation because it involves not only common interests but also conflicting interests. Take the stakeholder relationship between a company and its investors. Managers prefer to work for a successful market leader; investors want a high return on their investments. Hence, both parties have a common interest in a productive process of value creation. Yet, they also have conflicting interests. Managers are risk averse and tend to engage in mainly low-risk projects with a certain value added; investors would like to see managers invest in high-risk projects that yield higher—although more uncertain—expected returns. A successful cooperation between managers and shareholders thus requires a suitable institutional arrangement that reduces the impact of conflicting interests and brings to bear the common interests of cooperation. Indeed, the whole system of corporate governance is an attempt to institutionally establish and maintain the precarious relationship between management and shareholders.³⁵

From an ordonomic perspective, the simultaneous presence of common and conflicting interests can be understood as a social dilemma situation. The defining feature of a social dilemma is that it is a situation of collective self-damage, a situation in which a win-win solution cannot be realized due to an incentive structure that makes it difficult (if not impossible) for rational actors to behave in a mutually beneficial way even though it would be in their common interest to do so. Paradigmatically, the ordonomic approach distinguishes between two types of collective self-damage: one-sided dilemma structures and many-sided dilemma structures. Analogously, there are two ways of overcoming situations of collective self-damage: individual commitments in one-sided dilemma situations and collective commitments in many-sided dilemma situations.³⁶

As a consequence, companies can use moral commitments—i.e., institutional arrangements to overcome one-sided or many-sided social dilemmas—as a systematic “*factor of production*.”³⁷ The underlying idea is that prudent moral commitments can trigger a win-win outcome for the company by convincing its stakeholders of its reliability as an interaction partner and inducing them into a productive cooperation that would not be possible in the absence of such trust between management and the shareholders. Thus, moral commitments can be a factor of production in that they signal that

³⁴ Cf. Pies et al. (2011; p. 178).

³⁵ Cf. Hielscher (2011, p. 120-121).

³⁶ Cf. Hielscher (2011, p. 121).

³⁷ Pies (2009) and Hielscher (2011, p. 121).

the firm is interested in and considerate of others, a signal that can be immensely important to the firm's successful value creation.³⁸

(3) According to the ordonomic perspective, companies are agents of social value creation if they use morality as a factor of production. Taking value creation as a starting point, companies can assume social responsibility at three levels of social interaction. (a) In day-to-day business, companies create value by cooperating with their stakeholders in diverse markets, chiefly consumer markets, but also labor and other markets. (b) On the level of (political) rules and institutions, business firms can use moral commitments to create a functional framework for win-win cooperation with their stakeholders. (c) Finally, companies can also engage in (public) discourses and come to a common understanding with their stakeholders of the win-win properties of cooperation, which includes creating a common awareness of the underlying social dilemma and a common understanding of suitable moral commitments as a possible solution to it. In ordonomic terms, companies assume "ordo-responsibility"³⁹ if they take on a political role and participate in new governance processes of rule-setting and rule-finding.

3. Developing a Design for Empirical CSR Research Inspired by Ordonomics

Based on the ordonomic conceptualization of the (moral) role of business in society, we develop in this section a design for empirical CSR research. We do so in three steps. In Step (1) we present three sets of questions that can be derived from the ordonomic perspective. Step (2) introduces the overall idea for an extensive empirical study that relies on a combination of factor analysis and panel estimation. In Step (3), we present the results of a pilot study with a reduced design and formulate new hypotheses for a more extensive empirical study.

(1) Ordonomics identifies three arenas in which companies can assume corporate social responsibility (CSR). Therefore, an empirical research study based on the ordonomic approach can generate at least three categories of questions.

The first category refers to the arena of day-to-day business activity. In line with the first micro-level empirical CSR research, an empirical study inspired by ordonomics would focus on CSR as a possible instrument for strengthening the (core) business functions of the company and could ask the following questions: What are the specific functions of CSR policies? What is the specific goal of each project? What is the business case? What is the social case? Is the CSR activity pure philanthropy? Or does CSR relate to risk management, research and development, controlling, capital expenditure management, financial management, investor relations, compliance, human resource management, public relations, and marketing? In addition to these questions, which have at least to some extent been asked in many micro-level CSP-CFP studies, the ordonomic perspective would also evaluate the degree of professionalization of CSR so as to identify whether CSR is viewed as an important business activity or more as window-dressing. Appropriate control parameters would focus, therefore, on how CSR is implemented by the firm. Questions to be asked and answered in this context include: How is CSR integrated into the organization? Do companies professionalize CSR by

³⁸ Cf. Pies et al. (2011; p. 178).

³⁹ Beckmann and Pies (2008).

means of a specialized manager who has a budget and staff? To whom does the CSR division report—an executive department or straight to the CEO?

The second category refers to the arena of rule-setting. On this level, an empirical study inspired by the ordonomic perspective would turn its attention to commitments and commitment services that companies implement to establish cooperation with important stakeholders. In doing so, it could ask the following questions: Are CSR policies designed to enable reciprocal cooperation? What kinds of commitments do companies use? Do companies commit themselves or do they provide commitment services for their stakeholders? Do firms offer commitment technologies only to their closest stakeholders, such as customers, suppliers, employees, and shareholders, that participate in their core business activities? Do companies also offer commitments to other, more remote stakeholders, such as civil society organizations, environmentalist groups, politicians, or the media? Do firms provide commitment technologies on a regional, a national, or even an international level? Are the commitment technologies appropriate to achieve win-win cooperation?

Category three refers to the discourse arena of rule-finding. On the level of discourse, an ordonomic empirical study would concentrate on the role of stakeholder dialogues. Such dialogues can lead to resolving cooperation problems. To evaluate whether companies also professionalize stakeholder dialogues, an appropriate empirical analysis would focus on the following questions: Do companies cultivate contacts or even dialogues with their stakeholders? How do they organize them and which stakeholders are addressed? With which stakeholders do companies operate? Do firms promote only their existing way of doing business or are they also interested in finding new ways of mutually beneficial cooperation? Do companies engage in dialogues only because competitors do or do they so engage with a true purpose of discovering new ideas for their business models? How do companies rank the importance of stakeholder dialogues internally? Who is responsible for organizing stakeholder dialogues? Is the person in charge professionally trained to instruct other departments in the organization? How often do stakeholder dialogues take place? To what extent do companies institutionalize important dialogue functions such as mediation?

(2) To incorporate these three ordonomic categories into a well-grounded empirical research program, we designed an empirical study that primarily focuses on the degree of professionalization of CSR within the company. This focus serves two main purposes (cf. figure 2). (a) The study is designed as an expert interview study that compares CSR managers' evaluation of CSR projects with how the projects are viewed by finance department managers. (b) To estimate the CSP-CFP link, we control the assessments by using objective CSR figures, such as the integration into the organization, the budget of the CSR department, the number of employees engaged in CSR, and the number of stakeholder dialogues, as well as using company and macroeconomic fundamentals.

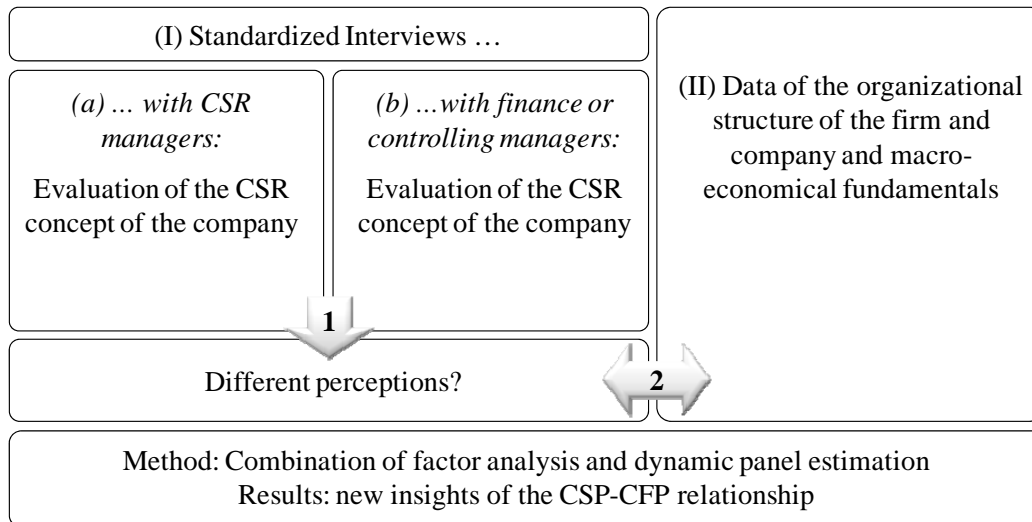


Figure 2: Design of the major study⁴⁰

(I) *Different perceptions of CSR managers and other managers.* The basic idea is that standardized interviews are conducted with CSR managers and financial managers. The interviews enable a quantitative and multidimensional approach compared to existing CSR ratings, performance criteria, or the CSR and sustainable indices. In contrast to many ratings and indices, the questions of our study are constructed in a descriptive way without assuming what activities are superior from a (specific) moral point of view.⁴¹ The descriptive design has positive effects on the reliability and validity of our data. Our data are made more reliable and valid in that we not only survey the tasks and evaluations of the CSR departments, but also those of finance or controlling managers. This overcomes the problem that an assessment of CSR by the CSR department can be strongly biased because CSR managers might tend to overstate the benefits of their own activities. In contrast, the very purpose of controlling and finance managers is to take the interests of the whole organization into account and to evaluate the value added by each department. As a consequence, the controlling and finance departments tend to estimate the costs and benefits of CSR more accurately and might be better able to assess the overall impact of CSR projects than CSR managers. Finance or controlling managers might also provide additional insight into the extent to which CSR complements the overall goal of the company. In short, if finance and controlling managers find a business justification for CSR, it should not only increase value added, it should also significantly affect the stock market.

(II) *Controlled estimation.* The empirical study also includes company and macroeconomic data. Controls include the number of employees, revenues, expenses, income, company ratios, incoming orders, and phase of the economic cycle. Additionally, we collect data on the integration of CSR departments into the companies to control the CSP-CFP link. Therefore, the questionnaire covers the following issues: Does the CSR department communicate directly with the board? Is the CSR department directly subordinated as a staff unit to one manager of the executive board? With which stakeholder group does the CSR department engage in dialogue and how often do the dialogues take place? Can the CSR department only collect and document stakeholder interests or does

⁴⁰ Own illustration.

⁴¹ According to our understanding, finding a consensus on the “correct” moral point of view is quite difficult in a pluralistic society. Cf. Rawls (1993, pp. 36, 63).

the board give CSR managers the authority to act operatively or strategically? The company and macroeconomic fundamentals in combination with the information about CSR integration control the measurement of the CSP-CFP link. The level of detail of the study not only enables microeconomic panel estimations of a great many companies, it facilitates estimations at the micro-level of a company.

(c) The data are analyzed in a two-stage process.⁴² Despite the complex data set, this two-stage approach enables a consistent estimation of all parameters with a combination of factor analysis and panel estimation.

- In Stage 1, the factor analysis reveals interdependencies between CSR concepts, the perception of CSR, the organizational structure, and specific company fundamentals. We extend the analysis by macroeconomic figures that account for exogenous shocks. The factor analysis helps reconstruct the value chains of the firms in light of their CSR concepts. Additionally, the factor analysis plays an important methodical role for the panel estimation because it reduces multicollinearity in the data set. The explanatory parameters can be consistently estimated. The precision of the panel estimation increases with the independence of the explanatory variables. Independent variables of the original data set are replaced by independent common factors of the panel analysis. This means that no important information will be lost.
- We analyze the multi-complexity of the data set and the temporal dependencies with a dynamic factor analysis. In a second stage, we will gather CSR data over several years and a variety of companies. Then, a panel estimation becomes a feasible method. A panel estimation has the advantage that it enables measuring individual-specific and time-specific effects. In contrast to a regression analysis, we can differentiate the variance between companies and the variance between moments. Such a panel estimation might help to answer the question of causality in a dynamic micro model: Do CSR projects have an impact on profitability or do high profits lead to delayed CSR campaigns? We can also analyze learning effects of how CSR is designed and implemented by business firms. Finally, the variety of control variables enables to inquire into macroeconomic effects and strategy changes within companies. This will reduce spurious correlations between CSP and CFP.

(3) As a pre-study to the two-stage factor analysis and panel estimation, we conducted empirical research involving 42 publicly listed companies active in the German capital goods industry. Let us be very clear: this is a pilot study with a severely reduced setup. Its main purpose is not to deliver final results, but to help to generate new hypotheses for the upcoming major study. This pilot study has a reduced setup with regard to the following aspects. (i) For the pre-study, we did not interview CSR managers or controlling or finance managers. Using the content of the larger questionnaire as developed for our two-stage major study, we evaluated only official corporate publications subject to a set of criteria focusing on the functions of CSR. (ii) With regard to the empirical method, our factor analysis revealed the relationship between CSR function characteristics and some company fundamentals. However, as time series data for CSR functions were not available, we were not able to conduct a longitudinal estimation in this pilot study. However, we included fundamentals of the current fiscal year, but also some previous

⁴² For a detailed application of the two-stage approach to an empirical explanation of the influence of fundamentals on stock market yields, cf. Will (2011, pp. 5-12).

values. Despite this limited design of the pilot study, our factor analysis shows differentiated results on the relationship between CSR functions and the CSP-CFP link that are stable even when we change the estimation method of our factor analysis.

We present the result of our pilot study in two steps: Step (1) explains the results of the factor analysis. Step (2) derives, from the measured correlations, new hypotheses to be explored in the more detailed main study from the measured correlations.

(a) Table 1 summarizes the results of the factor analysis and shows the loadings of the eight factors with an Eigenvalue bigger than one. These eight factors explain about 80% of the variance in the data set. The individual factors can be interpreted as follows.

- *Factor 1.* Companies subject to public criticism tend to have a manager in charge of CSR, participate in dialogues with stakeholders, and apply CSR in many areas. Our pilot study considers companies with good public relations in CSR topics that connect CSR with their core business activities. The public relations activities and the integration of CSR into business models led to higher dividend payments in 2010. In 2011, these companies were expected to earn above average returns on the invested capital.
- *Factor 2.* Companies with a manager in charge of CSR that use CSR for management functions such as controlling, investment, finance, compliance, and investor relations more often participate in initiatives such as the Global Compact. The public criticizes both the sector and the individual firm even if firms engage in CSR activities. These companies had above-average price-to-book ratios in 2009 and paid higher dividends in 2010.
- *Factor 3.* Companies with more centralized CSR departments participate in CSR initiatives and use CSR for investor relations. The public rarely criticizes these firms. During the observation period, the price-to-book ratio is higher and the companies paid higher dividends in 2009 and in 2010.
- *Factor 4.* Companies without key performance indicators to control their CSR activities are viewed more critically by the public. These firms paid higher dividends to their owners in all observed years. In 2009, these companies achieved higher returns on invested capital.
- *Factor 5.* Factor 5 represents companies that also operate in a business-to-consumer market. Public opinion views these companies more critically compared to firms only operating in the B2B market. Key performance indicators show that these companies professionalize their CSR activities and that CSR has an impact on public relations and human resource management. These companies paid above-average dividends to their shareholders in 2010.
- *Factor 6.* Companies that organize CSR as a sub-division and not as an executive department do not use CSR to manage their capital expenditures. These companies engage in stakeholder dialogue, but that does not exempt them from public criticism. In 2011, these firms were to expect to achieve above-average returns on invested capital.
- *Factor 7.* Firms that professionalize CSR with key performance indicators (KPIs) engage in stakeholder dialogue. These firms have above-average returns on investment capital in 2009. The return on investment forecast is below industry average for 2011.

Number of Observations: n = 42	F1	F2	F3	F4	F5	F6	F7	F8	Uniqueness
Proportion	0.35	0.11	0.09	0.07	0.06	0.05	0.04	0.03	0.20
Eigenvalue	10.46	3.16	2.66	2.14	1.75	1.55	1.23	1.03	
B2C							0.80		0.31
Counterpart for CSR	0.45	0.38	-0.19					-0.47	0.37
CSR not as staff position		0.28			0.66				0.47
Decentralized CSR			-0.17		0.75			0.19	0.35
CSR in a subdivision		-0.18			0.64	-0.25			0.48
KPIs for CSR		0.29			-0.19	0.72			0.32
Philanthropy	0.88								0.15
Public Relation	0.69						-0.17		0.47
Risk Management	0.90						-0.17	0.17	0.11
Marketing	0.93								0.09
Research & Development	0.92							0.17	0.07
Controlling	0.86	0.19						-0.21	0.14
Capex Management	0.87								0.19
Financial Management	0.89	0.18							0.12
Investor Relation	0.79	0.18	0.21				0.17		0.26
Compliance	0.40	0.51			-0.27		-0.19		0.42
Human Resource Management	0.93								0.09
Public criticizes the sector	0.32	0.58			0.16		0.45		0.31
Public criticizes the company	0.24	0.55	-0.18		0.30		0.44		0.29
Dialogues with stakeholders	0.57	0.42		-0.21		0.16			0.40
Member of the UN Global Compact	0.30	0.86							0.15
Participation on UN GC with Reports	0.31	0.83		0.17					0.17
Participation on other CSR initiatives	0.23	0.57	0.26	0.17	-0.25	0.23	0.20		0.37
Price-to-Book-ratio 2008			0.96						0.06
Price-to-Book-ratio 2009		0.17	0.93						0.08
Price-to-Book-ratio 2010			0.85						0.24
Dividend Yield (%) 2008				0.88					0.19
Dividend Yield (%) 2009			0.27	0.67					0.44
Dividend Yield (%) 2010	0.20	0.22	0.19	0.76			0.28		0.22
Return on Assets (%) 2008	0.16		-0.21		-0.42	-0.18	0.33	0.32	0.50
Return on Assets (%) 2009		-0.17				0.77			0.33
Return on Assets (%) 2010	0.15				0.17	0.16		0.75	0.33
Return on Assets (%) 2011 (forecast)	0.32	0.16	-0.16		0.28	-0.39		0.25	0.54

Blanks represent absolute loading < 0.15:

Sources: Ariva.de, company publications, own calculations.

Table 1: Results of the Pilot Study: Factor Loadings⁴³

⁴³ For the pilot study, we analyzed 42 companies active in the German capital goods industry. The factors listed in the table were extracted by the non-iterative principal-factor approach. Only eight factors have Eigenvalues bigger than 1. The factor loadings are rotated by orthogonal varimax rotation. Blanks in the original data set were filled by mean imputation. Sources: Ariva.de, company publications, own calculations.

- *Factor 8.* Companies with decentralized CSR organized in sub-divisions rarely use key performance indicators to measure CSR. These companies engage in CSR initiatives; however, compliance is poor. In 2010, they paid lower dividends.

This analysis shows interdependencies between factors that do not reveal mono-causal relationships, but this result is not surprising: the 42 companies active in the German capital goods industry not only produce a wide range of goods, they also deal with CSR very differently and enjoy (or not) widely diverse public reputation. This pilot study, however, does highlight the broad spectrum of possible CSR concepts: CSR is used as pure public relations, as pure philanthropy, and also as a cooperation-oriented win-win approach.

(2) Despite the reduced design, this ordonomically-inspired factor analysis enables deriving new and interesting hypotheses about the CSP-CFP link. In the upcoming major study, these ordonomic hypotheses will be tested in order with the goal of appropriately interpreting the interdependencies shown in the factor analysis.

- *Hypothesis to factor 1.* Companies subject to public criticism attempt to use CSR as a public relations tool, e.g., to professionalize their public appearance and web sites. Presumably, they also engage in stakeholder dialogue in an effort to enhance their reputation. The dialogues, however, may also have a purpose in addition to reputation-building; these companies might use stakeholder dialogues to discover new needs and then to develop business models to meet them. This may be a profitable strategy as the pilot study showed that these companies pay high dividends to shareholders.
- *Hypothesis to factor 2.* If companies professionalize their CSR activities by means of more centralized CSR management, the public tends to be less critical of them. Such professionalization of CSR might enable more productive investor relationships: investors might expect more sustainable business models and also higher future growth values, both of which facilitate refinancing sustainable investment funds.
- *Hypothesis to factor 3.* Companies with a professional CSR manager engaging in public relations use public criticism as an impetus to question their existing business models. Stakeholder dialogues, the Global Compact, and other CSR initiatives are instruments they use to generate ideas for improving their processes of value creation.
- *Hypothesis to factor 4.* Some companies do not invest in CSR because other investments yield higher returns. These might be companies that are under strong pressure from investors to pay out high dividends. The price of this strategy is a bad public reputation. *Alternative hypothesis to factor 4.* Certain companies are so successful that they can afford not to respond to public criticism and thus do not engage in CSR activity. These firms buy legitimacy to operate due to high capital costs.
- (6) *Hypothesis to factor 6.* Companies operating in the business-to-consumer industry use key performance indicators to control their CSR activities and to respond to criticism more effectively. The key performance indicators help institutionalize CSR: the company's decisions can be oriented toward the interests of the stakeholders and CSR helps in strengthening management

areas such as public relations and human resource management. Additionally, companies incur higher capital costs if they have a bad public reputation.

(4) The results of our pilot study are mixed. In part, this is due to the complexity and diversity of CSR strategies within companies. At this point, the question of whether companies use CSR to solve real business problems remains unanswered. However, the pilot study does indicate that

- some companies use CSR to establish win-win-cooperation with a few stakeholders,
- only few core business functions are supported by CSR projects, and
- costs of financing are higher if companies inadequately implement CSR.

Our pilot study also gives rise to a new and more precise hypothesis that can enrich any further analysis in empirical CSR research: How do companies professionalize CSR and how can firms organize mutually beneficial cooperation through stakeholder dialogue?

Conclusion and Implications for Future Research

Based on the ordonomic notion that companies can use morality as a factor of production, this paper inquired into the question of how CSR can be connected to the company's role as an agent of social value creation. Figure 3 is a graphic summary of the ordonomic contribution to empirical CSR literature.

		<i>Empirical CSR Literature</i>	
		<i>Existing Literature</i>	<i>Ordonomic Contribution</i>
<i>CSR Concept</i>	<i>CSR Functions</i>	<ul style="list-style-type: none"> • <u>Focus</u>: Some CSR functions (reputation, risk or innovation, and HR) • <u>Result</u>: CSP-CFP research lacks theoretic. foundation (Margolis et al. 2007) 	<ul style="list-style-type: none"> • <u>Focus</u>: CSR as win-win; companies as agents of social value creation • <u>Result</u>: Pre-study reveals some relations of the multi-complex CSP-CFP-link
	<i>Commitments</i>	<ul style="list-style-type: none"> • <u>Focus</u>: No systematic treatment! • <u>Exception</u>: Commitment of Employees toward the company (Mowday et al. 1979) 	<ul style="list-style-type: none"> • <u>Focus</u>: Systematic focus on all stakeholders • <u>Result</u>: Major study to focus on the link between commitments and value creation

*Figure 3: Overview of the current empirical research and our approach*⁴⁴

We believe that our approach allows new conceptual insights into how companies can use CSR to create value. We are confident that we make an interesting contribution to the extensive empirical CSR literature, as our approach generates new insights and also poses several new questions for the field.

- An important insight is that not all CSR must be functional. From an ordonomic perspective, it is not at all surprising that CSR shows a negative

⁴⁴ Own illustration.

return in empirical studies if CSR activities are completely unconnected to the corporate processes of value creation, i.e., when CSR is exclusively designed as an instrument of “giving back to society.”

- Another important insight is that CSR can be functional if companies use moral commitments as a factor of production. This type of CSR must be strongly connected to corporate processes of value creation and, hence, also to important management functions such as, for example, risk management and innovation management. Such an effect should also show up in the data.
- If CSR is implemented with the help of moral commitments, companies are not only playing the game of day-to-day business but are in fact creating new rules of the game. We argue, therefore, that empirical CSR research should bear in mind Buchanan’s distinction between “choices within rules” and “choices among rules.”⁴⁵ It is not sufficient to just describe the CSP-CFP link by listing what companies actually do in the “real” world. A sound empirical analysis should be able to reconstruct social cooperation from the viewpoint of institutional (economic) theory.
- From an ordonomic perspective, the CSP-CFP literature would be well advised to distinguish not just two levels of social interaction, but three. In addition to the arena of business and the arena of rule-setting, the ordonomic perspective emphasizes that social cooperation also needs a common understanding of the win-win potential of social cooperation. Discourse, sometimes also public discourse, can create such a common awareness and is thus an important prerequisite for mutually beneficial value creation with stakeholders.
- Finally, the diversity of problems that companies face with regard to CSR cannot be analyzed by correlation or regression analysis alone. In future work, we intend to combine factor analysis and dynamic panel estimation in order to evaluate the interdependent parameters and time-series effects in the data.

⁴⁵ Cf. Buchanan et al. (1980).

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