

Pekovic, Sanja; Wagner, Marcus; Vogt, Sebastian

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## RESEARCH ARTICLE

# Differential effects of corporate social responsibility on downsizing: Evidence from the United States

Sanja Pekovic<sup>1</sup>  | Marcus Wagner<sup>2,3</sup> | Sebastian Vogt<sup>4</sup><sup>1</sup>University of Montenegro, Podgorica, Montenegro<sup>2</sup>Faculty of Business Administration and Economics, University of Augsburg, Augsburg, Germany<sup>3</sup>Bureau d'Economie Théorique et Appliquée, Strasbourg, France<sup>4</sup>Deloitte Touche AG, Zürich, Switzerland**Correspondence**Marcus Wagner, Faculty of Business Administration and Economics, University of Augsburg, Universitätsstr 16, 86159 Augsburg, Germany.  
Email: [marcus.wagner@wiwi.uni-augsburg.de](mailto:marcus.wagner@wiwi.uni-augsburg.de)**Abstract**

Based on an integrated theoretical framework, we argue that socially responsible firms aspire to higher ethical and moral standards than other firms and foster higher intrinsic motivation to avoid downsizing. In line with this, we develop hypotheses proposing a negative association of Corporate Social Responsibility (CSR) with downsizing incidence and downsizing severity. Using a panel data on U.S. firms over an eight-year period, we confirm these hypotheses and find that CSR has a negative association with downsizing, which increases with the severity of downsizing. We discuss the implications of the findings and how our work contributes to the body of academic work on downsizing with CSR as an important novel firm-level determinant that links to corporate sustainability and stakeholder engagement.

**KEYWORDS**

corporate social responsibility, corporate sustainability, downsizing, human resource management, resource-based view, severity, social contract theory, stakeholder theory

## 1 | INTRODUCTION

For the past few decades, employee downsizing has become an important part of the organizational repertoire, especially during times of economic crisis. Additionally, global competition, technological change, and changing demands force constantly companies to adjust their organizational structures and activity levels. Due to the massive global recession unfolding current COVID pandemic, downsizing is a major topic the current economic conditions, and it is therefore of high-practical interest and relevance, how it depends on levels of corporate social responsibility (CSR). Downsizing or employee reduction in our study refers to an intentional reduction of the number of employees in order to restrain costs, increase operating efficiencies, and become profitable in the short run (Chadwick et al., 2004;

Freeman & Cameron, 1993). Defined this way, downsizing is a useful tool to manage the financial bottom line in times of economic downturn. This is especially the case in liberal market economies such as the U.S. where, from 2007 to 2010, more than 6.5 million jobs were “downsized” (Datta et al., 2010).

However, prior research suggests that downsizing does not always result in organizational performance improvements (e.g., Cascio et al., 1997; Chadwick et al., 2004). Also, the decision to downsize, which often has negative effects on employees (e.g., McLoyd, 1998; Paul & Moser, 2009), contradicts business transformation attempts that stream to integrate more ethical approach in doing business avoiding “win-at-any-cost” mentality (Buckley et al., 2001). Accordingly, it seems that the decision to downsize also contradicts by its very nature the notion of CSR. As advocated by Lee and Chen (2018), CSR generates a win-win situations as firms can at the same time improve their performance but also create social benefits. Furthermore, given that CSR has become one of the leading frameworks to think about moral responsibility in business and thus relates the perspective of moral philosophy

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(Carroll, 1991; Wartick & Cochran, 1985), CSR-oriented firms should avoid downsizing since it is considered to be morally debatable (Long, 2012). This moral component of CSR provides employees with a sense of security and safety because it implies that firms will not take advantage of employees (Bauman & Skitka, 2012; Lee & Chen, 2018), since it is wrong to subject individuals to certain types of harm in order to benefit others (Orlando, 1999). Actually, CSR-oriented firms will always prioritize employee's social well-being (Sanusi & Johl, 2020). Furthermore, since CSR is considered as voluntary action that goes beyond legal requirements (Vogel, 2006), especially high levels of downsizing could even be perceived as an act of corporate social irresponsibility (Long, 2012).

Over the last few decades, researchers have paid considerable attention to the benefits of CSR. Since the early seminal work by Carroll (1979), some definitional convergence can be observed. More specifically, following Dahlsrud (2008), we understand CSR as a social construct that is fundamentally related to an environmental, a social, an economic, a stakeholder, and a voluntariness dimension, and while the environmental dimension is somewhat less central to CSR, all dimensions "are more likely than not to be included in a random definition" (Dahlsrud, 2008, p. 4).

However, Dahlsrud's study also reveals that effectively half of the CSR definitions he analyzed do not include the majority of the dimensions, which may explain why research is still equivocal as concerns the effects of CSR.<sup>1</sup> Yet, regardless of the definitional issues, a significant number of scholars argue that CSR may have a positive impact on firms by either reducing costs or increasing revenues (e.g., Cochran & Wood, 1984; Waddock & Graves, 1997; Wagner et al., 2002). However, several other scholars argue that any investment in CSR raises a firm's costs and in turn decreases its competitive position (e.g., Friedman, 1970; McWilliams & Siegel, 1997).

The previous literature has underlined that stakeholder theory is strongly associated with CSR (Clarkson, 1995; Ruf et al., 2001; Wood & Jones, 1995). Consistent with Dahlsrud (2008) identifying a stakeholder dimension as an important definitional element of it, researchers can understand CSR from the stakeholder perspective as firms co-creating value by engaging more comprehensively in meeting economic, social, or environmental needs and expectations of particular stakeholders (Bosse et al., 2009; Freeman, 1984; Harrison et al., 2010; Wood & Jones, 1995). Moreover, following Ruf et al. (2001), who consider CSR as a proxy for stakeholder orientation, it is expected that the more a firm engages in CSR, the stronger its level of stakeholder orientation will be. Alniacik et al. (2011) further argue that CSR-oriented firm needs to consider the effects of its activities on every actor related to the firm.

However, even though the stakeholder framework has proved useful in the analysis, it does not cover moral and ethical challenges that firms face in everyday business operations (Maak, 2008). Bendell and Kearins (2005) stress that the relation between firm and society should be based on assessing ethical/moral, financial, and legal dimensions of firms' activities. Therefore, our theoretical grounding will also include social contract theory, which assumes the existence of social contract that includes ethical and moral norms between business and society

(e.g., Gariga & Mele, 2004). Accordingly, the literature underlines the complementarity between these two theories (Dunfee, 2006).

Another angle employed to analyze CSR is the resource-based view (RBV) according to which a firm's internal resources, such as human resources, are the main tool for competitive success (Barney, 1986, 1991, 2001; Barney & Wright, 1998; Grant, 1991). What is more, Bowen and Ostroff (2004) consider human resource management (HRM) as a significant means for creating ethical working environments that subsequently influence employee attitude and behavior. In the same vein, Buckley et al. (2001) argue that establishing ethical contexts inside the firm creates proper working environment, which drives the development of ethical human resource practices that further foster firm's image, reputation, and legitimacy. Furthermore, Rothenberg et al. (2017) conclude that HRM practices help firms to work better while lowering its socially irresponsible behaviors.

In addition, previous work in accordance with the social dimension identified by Dahlsrud (2008) asserts that commitment to CSR encourages employees to align themselves to the goals of the firm and to exert more effort to achieve these goals (e.g., Lanfranchi & Pekovic, 2014; Turban & Greening, 1997). CSR is reported to enhance employee development and improve employee work quality (e.g., Afridi et al., 2022; Brammer et al., 2007; Dutton et al., 1994; Peterson, 2004; Sanusi & Johl, 2020; Turban & Greening, 1997), which leads to improved labor productivity and satisfaction (Delmas & Pekovic, 2013, 2018; Lee & Chen, 2018). Thus, investment in CSR creates an environment of exchange and reciprocity between a firm and its employees. In other words, previous scholars (Orlitzky et al., 2003) consider CSR to be tied to HRM, which implies that firms with more developed strategic HRM policies are more oriented toward social responsibility than those with less developed ones. Therefore, considerable HRM literature is devoted to the analysis of responsibility and ethics in the field of HRM (Jamali et al., 2009; Lombardi et al., 2020; Morgeson et al., 2013). For instance, Jamali et al. (2009) recognized the interaction between CSR and HRM and the role of HRM in CSR as an opportunity to contribute to the firm and its various stakeholders, especially employees.

Finally, the RBV, Barney (1991) also identified ethics as a valuable resource for creating competitive advantage. Accordingly, a RBV approach is implicitly linked to an ethical and human resource approach. Therefore, even though literature provides several theoretical models appropriate for examining CSR, in line with previous discussion, we focus on the importance of integrating stakeholder orientation, ethical reflection, and human resources in order to provide a comprehensive perspective for analyzing CSR (Litz, 1996).

This integration underlines that the stake that employees have in the firm is at least as large as that of shareholders (e.g., Parkinson, 2003). This is in line with CSR approach, which supports the notion that firms have obligations to parties other than shareholders. Based on our theoretical framework we derive hypotheses to empirically examine whether shareholder demands are superior to any competing duties, as exemplified by employee considerations (Orlando, 1999).

This not only allows us to test whether CSR is negatively associated with labor downsizing (i.e. whether socially responsible firms strike a balance between shareholders' and employees' interests or not), but also, the effect of CSR on the severity of the downsizing (i.e., beyond the effect of CSR on the pure occurrence of downsizing, we also test how the level of CSR relates to the magnitude of downsizing).

The remainder of the article is organized as follows: Section 2, reviews the core literatures on stakeholder and social contract theories and relates this to downsizing. Section 3 develops hypotheses, and Section 4 introduces the data and empirical modeling strategy to test these hypotheses. Section 5 presents the results, and finally, Section 6 provides a discussion and draws more general conclusions.

## 2 | LITERATURE REVIEW

### 2.1 | Stakeholders and social contracts

Regarding CSR, the literature is often framed in a debate on the shareholder versus stakeholder approach. However, more fundamentally, social contract theory provides a further basic premise for the CSR concept that resonates with this notion of stakeholder theory. In this, an organization is a socio-economical actor whose behavior and methods of operation must conform to the guidelines set by society (Wartick & Cochran, 1985). Thus, social contract theory describes the relationship between society and organizations similarly to stakeholder theory (Shocker & Sethi, 1973). As well as the government, an organization has a social contract—a set of obligations and social norms and values that functions as an implied but still binding contract between the society and the organization (Wartick & Cochran, 1985).

Furthermore, if there exists any potential or actual disparity between the values system of the society and the organization's values system resulting in a (long-term) disadvantage for the society, the organization's legitimacy would be questioned. This point of view indicates that organizations have at a very fundamental level no inherent right to exist. Bound by a social contract, the survival and growth of any social institution depends on the delivery of desirable outcomes to society in general, and the distribution of economic, social, or political benefits to the society from which it derives the legitimacy to exist (Shocker & Sethi, 1973). Beyond its anchoring in institutional theory, this notion of legitimacy can also be linked to the concept of a social contract (Mathews, 1993). As a theoretical construct, the notion of a social contract cannot be defined with any precision, mainly for two reasons. Gray et al. (1996) suggest that legal requirements offer the visible (explicit) part of the contract, whereas other non-legislated social expectations include the invisible (implicit) part of the contract. The implicit part of the contract, especially the moral understanding, can vary greatly within or among cultures, industries, business communities, and organizations (Donaldson & Dunfee, 1994). Due to the fact that the values and norms of the society can change over time, the expectations regarding the organization have no permanent character. Therefore, an organization must constantly meet the current

expectations to be a legitimate part of the society. This is fully consistent with stakeholder theory and the role of CSR in it. In line with Gray et al. (1996), we therefore argue that integrating social contract theory and stakeholder theory as two distinct theories would be beneficial for our research context. While both theories provide quite similar insights, their combination results in a more comprehensive understanding of particular organizational actions.

A social contract represents a local, integrated, dynamic moral boundary beyond, which organizations cannot operate and still be viewed as socially legitimate. If society is dissatisfied because the behavior of a firm is not in accordance with the prevailing values and norms, then society will effectively invalidate the social contract and withdraw the organization's license to operate, or in other words its legitimacy to exist (Porter & Kramer, 2006). According to the ethical principles of CSR, employee downsizing can be seen as a questionable business undertaking (Vuontisjärvi, 2013). Because downsizing most adversely affects employees (Tsai et al., 2005), it follows that an ethical perspective of downsizing will focus on the balance of the rights and responsibilities of the organization, its employees, and society at large (Van Buren, 2001). We will return to these more fundamental aspects when developing hypotheses in the next chapter.

### 2.2 | Downsizing

Researchers define corporate downsizing as a set of planned organizational activities aimed at workforce reduction with the goal of improving organizational efficiency and productivity and/or enhancing the competitive situation of a firm (e.g., Chadwick et al., 2004; Datta et al., 2010; Freeman & Cameron, 1993). Two main directions have been identified regarding the motives for downsizing. On the one hand, there are external factors referring to the business environment. Macro environmental (external) factors are the economic and institutional environment in which a business operates (Datta et al., 2010). Economic downturns induce a decline in consumer demand for goods and services and therefore create financial pressure on firms. Following this idea, downsizing rates should increase during economic downturns and decrease during economic peaks (Budros, 1997).

On the other hand, there are several determinants related to the organizational context (internal factors) as drivers of employee downsizing. As noted by Datta et al. (2010), the underlying assumption of this literature is that employee downsizing is efficiency-driven. Paradoxically, however, we note several studies find that firm business performance suffers after downsizing announcements as unpredicted costs are related to downsizing decision (e.g., Chadwick et al., 2004).

What becomes clear from our review is that although there is significant interest in both stakeholder-driven and social-contract based CSR and downsizing, their relationship thus far receives little attention from the academic literature. This paper contributes to filling this gap specifically by addressing the relationship between CSR and downsizing and how this changes with the level of firms' downsizing.

### 3 | DEVELOPMENT OF HYPOTHESES

According to some of the dimensions of CSR introduced earlier, employee downsizing can be seen as a questionable business undertaking (Vuontisjärvi, 2013). Because downsizing most adversely affects employees (Tsai et al., 2005), a social contract perspective on downsizing will focus on the balance of the rights and responsibilities of the organization, its employees, and society at large (Van Buren, 2001). An example of this could include downsizing severity. Consistent with this, several scholars suggest that employees are one of the most important stakeholder groups (Freeman, 1984; Henriques & Sadosky, 1999), and that their demands are an important motivating factor for socially responsible activities of firms (Freeman et al., 2010). Moreover, firms that develop fair, just relationships with crucial stakeholders, such as employees, are therefore better able to contribute to joint value creation (Afridi et al., 2022; Bosse et al., 2009; Freeman et al., 2007). Actually, if employees perceive that their firm is not acting in morally responsible manner, they may display negative attitude and behavior toward their work (Afridi et al., 2022).

Based on the social contract and stakeholder integrative perspective, reducing their workforce would mean that firms lose their competitive advantage because of a violation of the social contract with their employees as an important stakeholder group. Conversely, for firms not refraining from downsizing, given the fact that the aforementioned social contract is fundamental to employees' beliefs and experiences, immoral behavior such as downsizing has negative consequences on the motivation and behavior of the remaining employees (Robinson, 1996). Thus, relations and joint value creation with this crucial stakeholder group will more difficult.

Related to this, corporate reputation has also been suggested as a significant normative aspect (Roberts & Dowling, 2002), since, by being socially responsible, a firm will enhance its legitimacy (Peterson, 2004). Several researchers highlight the crucial role of CSR in reputation building (Brammer & Pavelin, 2006; Javed et al., 2020; Kowalczyk & Kucharska, 2020; Turban & Greening, 1997; Wagner, 2015). Equally, corporate downsizing likely has a negative impact on corporate reputation because downsizing often goes hand in hand with negative media and political attention. Moreover, external groups will condemn employers for downsizing, which increases negative public attention (Tsai et al., 2005). Consistent with these arguments, empirical studies confirm a negative effect of downsizing on corporate reputation (e.g., Flanagan & O'Shaughnessy, 2005; Love & Kraatz, 2009; Zyglidopoulos, 2005).

Beyond this normative argument, it is also argued that firms that pursue instrumental stakeholder management by allocating more resources to meet expectations and requirements of stakeholders are better able to concentrate on stakeholder interests and relationships rather than having to rely on market transactions (Freeman et al., 2010). Linked to this, the RBV argues that the human resources of a firm are potentially their ultimate source of sustained competitive advantage since traditional sources, such as financial capital or access to natural resources, have been commoditized by globalization (Pfeffer, 1994; Wright & Snell, 1998).

Accordingly, Lowry (2006) suggests that one of the fundamental principles of HRM is related to the reconciliation of organizational and individual interests. Firms with higher levels of CSR pay more attention to employment security and long-term relationships with their employees, since CSR activities are intended to benefit employees in several ways, that is, through training, strengthening employee involvement, or creating programs to address work-life balance. This is in line with Lee and Chen (2018) who demonstrated that CSR-oriented firms tend to fulfillment of employees' psychological needs such as the need for security and safety.

Several empirical studies show that CSR has a positive effect on employees and their work performance (Afridi et al., 2022; Brammer et al., 2007; Delmas & Pekovic, 2013, 2018; Dutton et al., 1994; Lanfranchi & Pekovic, 2014; Peterson, 2004; Turban & Greening, 1997). On the contrary, Buckley et al. (2001) state that the absence of business ethics may explain employees' disenchantment, lack of commitment, dissatisfaction, or growing cynicism in the workforce. These considerations suggest that socially responsible firms have a more motivated and skilled human resource pool, which gives them an advantage over their competitors. In other words, the literature has recognized that HR plays an important role when considering investment in and development of CSR (Rothenberg et al., 2017).

Confronted with a downsizing choice, more socially oriented firms rather avoid to downsize because they would lose the specific value of their employees. In these cases, employers have invested more capital in the training and well-being of their employees, which makes them ultimately more valuable (in both a monetary and a knowledge-based perspective). Overall, linking corporate responsibility to employees implies that firms to go beyond complying with current legislation, meaning that employees are not considered only as a cost to be reduced but as an asset to be valued (de la Cruz Déniz-Déniz & De Saá-Pérez, 2003). Based on these considerations, we propose the following hypothesis:

**Hypothesis 1.** *CSR will have a negative effect on downsizing.*

Drawing on the assumption that downsizing in general violates the social contract, the severity of downsizing can be seen as a proxy of the degree of violation.<sup>2</sup> More unemployed workers result in a larger financial and social burden to society. Therefore, a larger downsizing is a stronger violation of the social contract between the firm and society. This corresponds to the notion that the negative impact of CSR on the probability of downsizing increases with the scope of downsizing since organizations that act socially responsibly would try to comply with the social contract and avoid causing significant harm to their employees or the society.

This is also the case because larger downsizing implies additional cost, including severance pay entitlements, high-unemployment taxes, and extended health benefits (Lee, 1997). Based on these considerations, CSR-oriented firms will also try to avoid downsizing from an instrumental perspective, and are more likely to choose more modest forms of downsizing. This means that CSR-oriented firms will avoid

large-scale downsizing since the larger the downsizing, the more likely that the consequences for firms' human capital will be disruptive (Coff & Kryscynski, 2011; Nixon et al., 2004; Norman et al., 2012). Based on the above arguments, the authors propose the following hypothesis:

**Hypothesis 2.** The negative effect of CSR on downsizing increases with downsizing severity.

## 4 | EMPIRICAL ANALYSIS

### 4.1 | Data

The empirical analysis of the hypotheses from the previous section is based on panel data from a set of U.S. firms covering the period 2003–2010. Compared to other countries, U.S. firms are less bound by unitary industrial relations (Muller, 1997). We consider this as the best context for unrestricted testing of our hypotheses. The data we employ comes from two sources. The initial sample consists of publicly traded firms covered by Kinder Lydenberg Domini Inc (KLD). We could only use data until up to 2010 because KLD was acquired that year and the format of its database changed, so it was not possible to integrate later years into our dataset. The KLD database is an accepted source for CSR measurement and has been broadly used in the empirical literature (e.g., Hull & Rothenberg, 2008; Ruf et al., 1998; Waddock & Graves, 1997). What is more, Waddock (2003) consider KLD data as a “*de facto* research standard” for measuring CSR. In addition, several scholars (e.g., Mattingly & Berman, 2006) also pointed out the reliability and validity of the KLD data established in empirical studies.

The period we employed for the analysis is very suitable because it reflects a time of economic downturn and financial crisis, during which it might be more likely that firms downsize their workforce for economic reasons. Since corporate downsizing is generally a rather rare event, such a time of recession is particularly suitable due to the fact that it increases frequency and the variation of downsizing (i.e., larger-than-average downsizing magnitudes), which is conducive for testing our hypotheses reliably. We merged the KLD data with firm-specific financial data from COMPUSTAT for the period 2003–2010. This merging procedure leaves us with a usable balanced panel of 1530 firms and 10,025 firm-year observations for the period 2003–2010, because we focused only on those firms for which data was available for the whole observation period to avoid distortions from missing observations.<sup>3</sup> Notwithstanding, we lag our explanatory variables by 1 year (plus one additional year in case of year-on-year changes), which reduces the number of observations in the regression models accordingly.

#### 4.1.1 | Dependent variables

Corporate downsizing refers to significant reductions in workforce as a result of layoffs (Cascio et al., 1997). Following Cascio et al. (1997),

in the classification of firms as downsizers through percentage thresholds, we initially define downsizing as a binary variable that has a value of 1 if the reduction in the number of employees between the year  $t-1$  and year  $t$  is equal to or larger than 5%. The resulting dichotomous measure of corporate downsizing allows for an easier interpretation than a continuous measure, which captures both increases and decreases in employment (Ahmadjian & Robinson, 2001; Cascio et al., 1997). Furthermore, given that we focus on percentages as thresholds ratios, we only capture downsizing events, which significantly change organizational structures, processes, or routines in a short timeframe. Several scholars use a similar indicator for downsizing (Alakent & Lee, 2010; Zylidopoulos, 2004), which furthermore circumvents the problem that downsizing announcements typically do not contain any, or only unreliable data on downsizing severity.

Relating to the effect intensity of CSR and severity of downsizing, we use four thresholds of corporate downsizing: (1) equal to or higher than 5%; (2) equal to or higher than 10%; (3) equal to or higher than 15%; and (4) equal to or higher than 20%. Some researchers have derived measurements of downsizing from press reports (e.g., Budros, 1997, 2004; Flanagan & O'Shaughnessy, 2005; Love & Kraatz, 2009; Love & Nohria, 2005), such as the leading U.S. financial newspapers, the *New York Times* and the *Wall Street Journal*. These measurements reveal the announcements of corporate downsizing rather than actual decreases in workforce that have occurred. However, press reports still leave the possibility that firms change their opinion and downsize less or even more employees than previously announced (Ahmadjian & Robinson, 2001). Hence, we think that actual downsizing figures derived from changes in the number of employees are a more reliable measure of real workforce reductions in comparison with downsizing announcements. Thus, actual downsizing figures are opting for this approach.

#### 4.1.2 | Independent variables

Consistent with the formal definition we adopted in the introduction, an aggregated measure of CSR based on the KLD database is used. This aggregated net KLD score is a widely used in assessments of firms' overall level of CSR (e.g., Ullmann, 1985; Waddock & Graves, 1997). Firms have to engage significantly in a broad scope of social and environmental activities to achieve high-net scores. A clear benefit of this measure is that it reflects the multidimensional character of the CSR construct (Sharfman, 1996).

Our net CSR score includes the following dimensions: employee relations, diversity, community relations, corporate governance, product, environment, and human rights. The scores for each attribute are based on numerical assessments, where  $-1$  represents an area of weakness,  $+1$  represents an area of strength, and  $0$  represents a neutral score. All strengths are added and subtracted from all weaknesses to create a CSR score for each firm in a given year.<sup>4</sup> The CSR score ranges from 1 to 24, with the value 1 representing the lowest CSR level and the value 24 representing the highest CSR level.

Due to the fact that Hull and Rothenberg (2008) validate the robustness of an equally-weighted CSR net score, we do not use weighted scores, as suggested by Waddock and Graves (1997) or McWilliams and Siegel (2001). Hull and Rothenberg (2008) compare the different calculation variants of Waddock and Graves (1997) and McWilliams and Siegel (2001) with their equally weighted index. Yet, Hull and Rothenberg (2008) arrive at the same empirical relationships, thus confirming equivalence for the purpose of this study.

### 4.1.3 | Controls

Following previous scholars (Ahmadjian & Robinson, 2001; Budros, 1997, 2000; Cascio et al., 1997; De Meuse et al., 1994; Lee, 1997; Ofek, 1993; Perry & Shivdasani, 2005), we control for both firm-specific characteristics and business environment-specific factors that may influence the dependent variable. These are included as control variables: leverage, return on assets, new technology, firm size, mimicry, gross domestic product, market-to-book ratio, and sales growth.

No problems with multicollinearity, as is testified by the VIF values reported in the last column of Table 1.

## 4.2 | Method

We use panel data for our empirical analysis. Unlike cross-sectional analysis, panel data analysis allows us to control for some types of omitted variable bias by observing changes in the dependent variable over time. We estimate conditional logit models using the four alternative binary variables for downsizing as dependent variables.<sup>5</sup> Furthermore, we reduce endogeneity as well as reverse causality issues by using lagged explanatory variables.

Firms have a variety of characteristics that are not captured in the data (e.g., operational structures or corporate culture) and many of those could have been determined prior to the data period. Based on the Hausman test, we compare the difference between the random-effect estimator and the fixed-effect estimator under the null hypothesis that the individual effects are uncorrelated with the other regressors in the model (Hausman, 1978). This shows for our models that the individual effects are correlated. A random effect model produces biased estimators and therefore the fixed-effect model is preferred.<sup>6</sup>

Given that reverse causality between our dependent and explanatory variables is possible, we lag all explanatory variables by 1 year. Based on this and taking into account the controls outlined earlier, fixed effects panel models are estimated according to the following equation:

$$y_{it} = \alpha + \beta_1 CSR\_Score_{it-1} + \beta_2 Leverage_{it-1} + \beta_3 ROA_{it-1} + \beta_4 New\_technology_{it-1} + \beta_5 Size_{it-1} + \beta_6 Mimicry_{it-1} + \beta_7 GDP_{(it-1)} + \beta_8 Market\ to\ book\ value_{it-1} + \beta_9 Sales\ growth_{it-1} + \alpha_i + \epsilon_i.$$

TABLE 1 Descriptive statistics, correlation matrix and variance inflation factors

Variable	Mean	SD	Min.	Max.	1	2	3	4	5	6	7	8	9	10	VIF
1 Downsizing (5%)	0.28	0.45	0.00	1.00	1.00										1.26
2 CSR	11.4	2.28	2.00	24.00	-0.04	**	1.00								1.03
3 Leverage	0.20	0.21	0.00	2.62	0.05	**	-0.14	**	1.00						1.07
4 ROA	0.02	0.15	-3.68	2.17	-0.16	**	0.04	**	-0.15	**	1.00				1.16
5 New technology	0.08	0.41	-1.00	11.10	-0.20	**	-0.02	**	0.06	**	1.00				1.05
6 Firm size	1.46	1.67	-5.12	6.63	-0.03	**	-0.04	**	0.20	**	-0.05	**	1.00		1.11
7 Mimicry	0.27	0.17	0.00	1.00	0.39	**	-0.02	**	-0.14	**	0.04	**	1.00		2.06
8 GDP	1.78	2.12	-2.50	3.80	-0.31	**	0.04	**	0.12	**	0.0026	**	-0.66	**	1.95
9 Market-to-book value	1.42	1.1	0.01	15.63	-0.13	**	0.08	**	0.12	**	-0.17	**	0.17	**	1.12
10 Sales growth	0.63	44.5	-0.97	3701.47	-0.01	0.0031	0.02	-0.0032	0.0093	0.0046	-0.0077	0.01	0.0069	1.00	1.00

Note: (\*\*) indicates significance at the 5 percent level.

In this equation,  $i$ , equaling from 1 to  $N$ , refers to the number of firms in the data, and  $t$ , equaling 1 to 8, refers to the years that are observed in the data set.  $\alpha_i$  and  $\delta_t$  are the intercept and the error term, respectively. In the following section, the results of the analysis are presented and discussed.

## 5 | RESULTS

Table 2 provides the results of the regressions as described in the previous section.

As concerns the first hypothesis H1, Table 2 shows that the results for all four models support H1. This occurs because in each of the models the CSR coefficients are negative and significant, which implies that the probability of downsizing decreases if a firm acts in a more socially responsible way. For instance, a one-standard deviation increased CSR investment is on average associated with around a 21% decrease in downsizing (when referring to the 5% downsizing threshold), which is economically significant. Compared to lower thresholds, the effect is increased at other, higher thresholds. Therefore, findings lend support to the argument that firms perceive obligations to parties other than shareholders.

In H2, we propose that the negative effect of socially responsible behavior will be stronger the higher the level of downsizing. This

hypothesis is also supported by the findings since the magnitude of the impact increases with downsizing severity. More specifically, the coefficient for 5% downsizing is  $-0.06$ , while it reaches  $-0.18$  when looking at the results for 20% downsizing.

Each two successive coefficients are highly significantly different when compared individually, based on the Welch test. More specifically, for coefficients 5% and 10% downsizing, the difference is highly significant ( $t = 18.04$ ,  $p < 0.01$ ), as is the one for the coefficients 10% and 15% downsizing ( $t = 12.41$ ,  $p < 0.01$ ). Also, the difference between the coefficients of 15% and 20% downsizing is highly significant ( $t = 8.31$ ,  $p < 0.01$ ). Based on these findings, we may conclude that the effect of CSR increases with downsizing severity.

Given that no universally agreed CSR definition exists, but that converging dimensions of it emerge, as detailed above, in a sensitivity analysis, we address the possibility that different dimensions affect downsizing differently. For example, it has been argued that conceptually CSR predominantly relates to the governance of supply chains (Scherer & Palazzo, 2007). Empirically, some studies have broken down the aggregated net CSR score into sub-scores relating to different dimensions (e.g., Block & Wagner, 2014). In this way, CSR is more strongly reflected as a multidimensional concept.

In our sensitivity analyses we follow this approach and utilize CSR sub-scores that can be related well to dimensions identified by

**TABLE 2** Results of fixed-effects regression analyses: The impact of CSR on downsizing

	5% downsizing	10% downsizing	15% downsizing	20% downsizing
CSR	$-0.06^{**}$ ( $-2.12$ )	$-0.11^{***}$ ( $-2.95$ )	$-0.14^{***}$ ( $-2.91$ )	$-0.18^{***}$ ( $-3.03$ )
Leverage	$1.04^{***}$ ( $2.85$ )	$0.70$ ( $1.61$ )	$0.53$ ( $1.01$ )	$0.72$ ( $1.13$ )
ROA	$-1.55^{***}$ ( $-4.97$ )	$-1.32^{***}$ ( $-4.22$ )	$-1.75^{***}$ ( $-4.22$ )	$-2.33^{***}$ ( $-4.31$ )
New technology	$-0.31^{***}$ ( $-2.74$ )	$-0.46^{***}$ ( $-3.07$ )	$-0.77^{***}$ ( $-3.69$ )	$-0.53^{**}$ ( $-2.21$ )
Size	$3.78^{***}$ ( $18.74$ )	$3.95^{***}$ ( $16.21$ )	$3.81^{***}$ ( $13.53$ )	$3.38^{***}$ ( $10.76$ )
Mimicry	$-0.37$ ( $-1.32$ )	$-0.01$ ( $-0.02$ )	$0.15$ ( $0.37$ )	$0.63$ ( $1.31$ )
GDP	$-0.08^{***}$ ( $-3.73$ )	$-0.10^{***}$ ( $-3.64$ )	$-0.12^{***}$ ( $-3.34$ )	$-0.09^{**}$ ( $-2.11$ )
Market-to-book value	$-0.94^{***}$ ( $-11.26$ )	$-1.01^{***}$ ( $-9.72$ )	$-0.84^{***}$ ( $-6.95$ )	$-0.75^{***}$ ( $-5.12$ )
Sales growth	$-0.25^{**}$ ( $-2.03$ )	$-0.19$ ( $-1.29$ )	$-0.23$ ( $-1.34$ )	$-0.15$ ( $-0.90$ )
Log likelihood	$-2171.18^{***}$	$-1378.43^{***}$	$-820.47^{***}$	$-514.61^{***}$
Likelihood ratio test	940.25	665.11	427.35	268.06
Observations	6929	4912	3124	2049
Number of firms	1027	727	467	307

Note: (\*), (\*\*), (\*\*\*) indicate parameter significance at the 10, 5, and 1 percent level, respectively.



Dahlsrud (2008), namely the environment-related sub-score (corresponding to the environmental dimension of CSR), the community-related sub-score (corresponding to the stakeholder dimension of CSR), and the employee relations-related sub-score (corresponding to the social dimension of CSR). While we cannot create links to all dimensions, we cover more than half of them based on these three sub-scores. Furthermore, we also consider the other available CSR sub-scores in this sensitivity analysis, namely the product-related sub-score, the human rights-related sub-score, the diversity-related sub-score, and the corporate governance-related sub-score

and in this way can achieve a sufficiently comprehensive assessment. Table 3 reports the estimation results of our analyses.

The findings indicate that generally two dimensions of CSR negatively influence a firm's probability to downsize, as downsizing severity increases, the human rights dimension also becomes significant.

Finally, a different version of the model has been investigated to confirm the robustness of our results. Specifically, as reproduced in the Appendix 1, we estimated a model variant with a continuous dependent downsizing variable, which reproduces our above findings. In other words, the findings with continuous dependent variable are

**TABLE 3** Sensitivity of fixed-effects regression analyses: Models with single CSR dimensions

	5% downsizing	10% downsizing	15% downsizing	20% downsizing
Environment	−0.04 (−0.40)	−0.06 (−0.44)	0.01 (0.04)	−0.25 (−1.23)
Product	−0.11 (−0.96)	−0.18 (−1.24)	−0.44** (−2.05)	−0.28 (−0.98)
Employee relations	−0.13** (−2.32)	−0.24*** (−3.25)	−0.19** (−2.05)	−0.26** (−2.09)
Diversity	0.12* (1.93)	0.14* (1.80)	0.15 (1.42)	0.19 (1.37)
Corporate governance	−0.32*** (−4.17)	−0.38*** (−3.90)	−0.41*** (−3.27)	−0.46*** (−2.92)
Community	0.12 (0.98)	0.25 (1.62)	0.05 (0.22)	0.02 (0.08)
Human rights	0.13 (0.66)	−0.24 (−1.01)	−0.65** (−2.24)	−1.12*** (−3.10)
Leverage	1.06*** (2.89)	0.74* (1.71)	0.60 (1.16)	0.74 (1.16)
ROA	−1.52*** (−4.85)	−1.28*** (−4.06)	−1.72*** (−4.14)	−2.32*** (−4.30)
New technology	−0.32*** (−2.74)	−0.45*** (−3.01)	−0.79*** (−3.71)	−0.53** (−2.17)
Size	3.80*** (18.77)	4.01*** (16.34)	3.90*** (13.62)	3.49*** (10.87)
Mimicry	−0.42 (−1.49)	−0.08 (−0.24)	0.04 (0.10)	0.51 (1.03)
GDP	−0.07*** (−3.45)	−0.10*** (−3.59)	−0.12*** (−3.33)	−0.11** (−2.34)
Market-to-book value	−0.93*** (−11.08)	−1.01*** (−9.62)	−0.84*** (−6.89)	−0.77*** (−5.15)
Sales growth	−0.25** (−2.00)	−0.18 (−1.23)	−0.22 (−1.30)	−0.14 (−0.87)
Log likelihood	−2159.34***	−1365.47***	−811.77***	−506.05***
Likelihood ratio test	963.94	691.04	444.76	285.19
Observations	6929	4912	3124	2049
Number of firms	1027	727	467	307

Note: (\*), (\*\*), (\*\*\*) indicate parameter significance at the 10, 5, and 1 percent level, respectively.

in the same direction as the previous ones that confirm the negative relationship between CSR and downsizing incidents.

## 6 | DISCUSSION AND CONCLUSIONS

This study extends the current literature and contributes a more comprehensive theoretical perspective of the link between CSR and downsizing. Whereas most empirical studies so far have addressed questions like “Does it pay to be social responsible?” (e.g., King & Lenox, 2000), “When or under what circumstances does it pay to be social responsible?” (e.g., Wagner, 2005) or in a more general context “Does CSR enhance firm performance?” (e.g., McWilliams & Siegel, 2001), our point of departure is the ethical theory underlying CSR, especially the concepts of social contract and stakeholder theory that depend on a system oriented view including the organization, society and employees. Furthermore, the issue of immoral activities has been largely neglected in the firm-level empirical literature on CSR.

Our theoretical contribution is an integrative model underlying the link between CSR and downsizing, especially by joining the concepts of stakeholder and social contract theories. The complementarity of the two theories is reflected in the fact that social contract theory considers the link between society and organizations equivalently to stakeholder theory (Shocker & Sethi, 1973) but from an opposite perspective since social contract theory focuses on a set of obligations and social norms and values that tie up society and the organization to certain responsibilities (Wartick & Cochran, 1985). In addition, by drawing on both theories, as suggested by Zakhem and Palmer (2017), social contract theory helps to both explain why stakeholders matter and how managers can deal with competing stakeholder claims. As indicated by Gray et al. (1996), CSR is a very complex phenomenon that cannot be explained easily by a single theory.

Furthermore, we propose an integrated framework of social contract and stakeholder theories that is complemented also with RBV and HRM perspectives. Therefore, by embedding different theories and perspectives and linking them to each other, we arrive at a more nuanced understanding of the link between CSR and downsizing that extends prior literature. In doing so, we identify important interactions between these theories and perspectives in order to build a theoretical understanding of why CSR-oriented firms avoid downsizing.

For instance, the link between stakeholders and social contract theories is well acknowledged through integrative social contract theory (ISCT) developed by Donaldson and Dunfee (1994), which postulates that stakeholder theory misses out on important ethical implications. Following the RBV approach, Rothenberg et al. (2017) indicate that competitive advantages arise from corporate reputation and human resources. Furthermore, as indicated by Litz (1996), drawing only on the RBV when analyzing firms' decision process is insufficient since it does not address the social and ethical dimensions of firm resources. By joining these theoretical perspectives, we are able

to clarify more effects of CSR on levels of downsizing that researchers have not yet tested empirically.

We derive and empirically provide support to the two hypotheses that CSR significantly reduces the probability of downsizing and that the effect of CSR on downsizing is intensified with increasing downsizing severity. Further discussion provides several rationales that support our empirical findings. Based on the social contract theory, a firm is a part of the society and has to do its business in conformity with the norms and values of the society. Socially responsible firms adopt societal norms and values that consequently will have high relevance in the organizational decision process. Therefore, it is plausible that firms with a high-CSR effort try to avoid downsizing. The avoidance of downsizing is potentially associated with additional costs or a lower profitability for the firm. Socially responsible firms would not externalize these costs to the society due to fact that they want to take responsibility for their employees and society. In a sense, this position is at odds with Friedman's view that CSR should above all contribute to profits. However, if downsizing is seen as a violation of the social contract, an organization might lose its legitimacy to operate within the society in several ways (e.g., sales boycott, reduced pool of job applicants). Therefore, in a broader context, the violation of the social contract may become a question of existence for an organization. Socially responsible organizations may have not the thorough focus on profit maximization (due to their socially oriented behavior) but they have social legitimacy, which gives them the possibility to generate steady profits in the long run. In this vein, Van Buren (2001) and Long (2012) argue that firms have more obligations than simply increasing shareholder wealth or making profits. Actually, a firm also has moral and social obligations (Donaldson & Preston, 1995). Based on the fact that downsizing only protects the interests of the shareholders but not of employees, Orlando (1999) argues that downsizing cannot be morally justified.

The negative relationship between downsizing and firm corporate reputation is confirmed by previous scholars (e.g., Flanagan & O'Shaughnessy, 2005; Love & Kraatz, 2009; Zyglidopoulos, 2005). Drawing on these findings, it could be concluded that CSR firms will avoid downsizing in order to maintain their image among their employees and investors.

Additional explanations for a negative relationship between CSR and corporate downsizing is associated to RBV and HRM perspectives. The relevance of employees for firm competitiveness is well recognized in the literature (Freeman, 1984; Henriques & Sadosky, 1999). Moreover, as a result of social responsible investment, firms are able to improve various segments of employee behavior (Brammer et al., 2007; Dutton et al., 1994; Grolleau et al., 2012; Lanfranchi & Pekovic, 2014; Peterson, 2004; Turban & Greening, 1997), which positively affects their business performance (Delmas & Pekovic, 2013). In this vein, CSR firms will avoid downsizing in order to preserve their valuable human resources. Additionally, firms are aware that they cannot rely on survivors since their commitment to the firm will be diminished after downsizing (Appelbaum et al., 1997).



Furthermore, our sensitivity analysis reveals differentiated effects of single CSR dimensions (as operationalized by KLD sub-scores) on the probability of downsizing. More specifically, more outward-oriented CSR dimensions, as reflected by the product- or environment-related sub-scores, have a weaker effect on the probability of downsizing than more inward-oriented dimensions, as reflected by the employee relations-related sub-score. The strongest effects are in fact found for the latter sub-score and the corporate governance-related sub-score, and for both of these, H1 and H2 are again confirmed. As well, for the human rights-related sub-score, we find support, but only for the two highest downsizing levels.

Overall, we contribute to the literature by showing that socially responsible firms have higher inhibitions against immoral activities, such as downsizing than their less socially responsible counterparts and that this trend increases with the severity of such activity.

Accordingly, CSR firms should avoid immoral decisions such as downsizing. Actually, managers should be aware that downsizing as an irresponsible business practice (Long, 2012) would produce consequences for firm business performance (e.g., Muller, 1997), but also will have negative effects on employees (e.g., Paul & Moser, 2009). This is an important fact since decisions based on short-term financial results imply the societal well-being costs that could be reflected in competitive advantage and long-term successes or failures (Porter & Kramer, 2006). In addition, CSR also satisfies the need for security and safety of employees since firms with a strong reputation for CSR generally exhibit cooperative rather than opportunistic behavior (i.e., downsizing) across a number of stakeholder relationships (Bauman & Skitka, 2012) what could also generate long-term benefits for firm. Noteworthy, as suggested recently by McLachlan (2021), firms should adopt responsible forms of downsizing due to its heightened relevance in the context of the COVID crisis. Therefore, downsizing features should be defined in firms' CSR strategies. Importantly, managers need to be aware also that less strategic downsizing benefits pro-environmental employee behavior (Afsar et al., 2018; Faraz et al., 2021).

This study has some limitations that should not be neglected. First, the panel consists only of large U.S. industrial firms that were partly observed in a period with spells of relatively stronger economic decline. Therefore, the conclusions cannot be generalized readily to smaller firms, even though other research suggests that regional differences with regard to CSR may be limited (Ehnert et al., 2016). On the other hand, focusing on a time period with a stronger spell of decline allows us to better analyze downsizing since such economic conditions provide heightened variation.

Second, there could be substantial differences between downsizing behavior, for instance, in the United States and Europe, which may limit the geographical transferability of the findings. Whereas in the U.S., the so-called "hire and fire" mentality is a more integral part of the managerial mindset, in Europe, managers are more restricted by regulations and strong trade unions.

We are confident that our results hold even now since the world economy moved back to similar state as it was during Global Financial Crisis. Actually, though the Global Financial Crisis (2008–2009) and COVID are different in basic respects, as stressed by Marc-Olivier

Strauss-Kahn, Non-Resident Senior Fellow at the Atlantic Council, three main similarities could be identified: "(1) the role of uncertainty, defined as a non-quantifiable risk, given the new nonvisible coronavirus in 2020 and the hidden subprime virus in 2008; (2) the extent of initial financial and economic collapses; and (3) the massive reactions by authorities."<sup>7</sup> Therefore, we suppose that the assumptions underlying our findings did not change much until the end of 2020. Obviously, with the outbreak of COVID this can change significantly. Yet do date, the extensive support programs of governments worldwide have often helped to avoid major downsizing. Thus, even now the fundamental mechanisms on the interaction of CSR and downsizing are likely similar to those in the past (e.g., shortage of skilled labor or pressures by external stakeholders) and seem not having been affected too strongly by COVID yet. In fact, the period from 2010 onwards may turn out to resemble structurally to a certain extent to our period of analysis. Still, it should be clarified if COVID ultimately yields to different effects in future, but since these are extremely difficult to predict as of now, this would be a task for future research.

As well, in terms of future research, the above limitations would suggest important areas of further analysis that include studies in countries other than the U.S. and studies of small and medium-sized firms that are not stock-listed. This type of analysis was unfortunately beyond the scope of our study. Additionally, such future studies should extend to an analysis of post-COVID effects in these specific contexts.

Finally, as suggested in the business ethics and strategic management literatures (Love & Nohria, 2005; Wartick & Cochran, 1985), one can make a differentiation between corporate downsizing as a result of economic necessity (in other words, a survival cut) and downsizing as a profit maximization opportunity. Therefore, downsizing for profit maximization might be contradictory to the ethical stance of a socially responsible organization, while the level of social responsibility of a firm may have no influence on downsizing if downsizing is necessary to survive, since it could be deemed morally acceptable. Therefore, future research could analyze whether CSR firms engage in alternatives to downsizing, such as employees transferring to other departments or subsidiaries. Specifically, in this respect, it could be particularly interesting if post-COVID reductions in office spaces by firms due to teleworking are potentially even decreasing downsizing due to reduced rental cost.

## ORCID

Sanja Pekovic  <https://orcid.org/0000-0003-4783-8401>

## ENDNOTES

<sup>1</sup> For the purpose of this article, the authors follow previous scholars (e.g., Luo et al., 2015; Stuebs & Sun, 2015) due to their CSR measure being a multidimensional indicator covering employee relations, diversity, community relations, corporate governance, product, environment, and human rights.

<sup>2</sup> Lee (1997) argues that the magnitude of a layoff conveys a signal about the severity of the firm's problems.

<sup>3</sup> The authors excluded all firms that operate in the sector of public administration (SIC code 10) because this sector includes government-owned

and government-operated businesses. It is likely that these firms have other requirements according to downsizing than their non-government counterparts.

- <sup>4</sup> During our observation period, the number of strengths and weaknesses changed. KLD added some attributes and dropped other attributes. To have a comparable net score, only those attributes which were in the database during the whole period of analysis are taken into account for the calculations. For simplicity we transformed the KLD net score into a positive scale, which is a positive-linear transformation to which estimates are invariant.
- <sup>5</sup> As indicated previously, we use as thresholds for downsizing 5%, 10%, 15%, and 20%. We calculated descriptive statistics for all thresholds, and these are available upon request. There are no significant differences between the different thresholds.
- <sup>6</sup> Since we use fixed-effects models to study the causes of changes within an organization, a time-invariant characteristic cannot cause such a change because it is constant for each firm over the observed period. Therefore, the number of firms decreases from the total number of observations to the number of firms that have a minimum of one downsizing event at the level considered during the period. Additionally, we do not need to control for industry differences by means of industry dummies as the fixed-effects model captures these effects.
- <sup>7</sup> <https://www.suerf.org/policynotes/13389/can-we-compare-the-covid-19-and-2008-crises>

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