CHAPTER 5

CORPORATE SOCIAL PERFORMANCE AND FINANCIAL PERFORMANCE

A RESEARCH SYNTHESIS

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Introduction

What is the relationship between corporate social performance (CSP) and corporate financial performance (CFP)? The community of Business and Society scholars has been investigating this question for over 30 years. The typical conclusion, based on narrative reviews of this literature, is that the empirical evidence is too mixed to allow for any firm conclusions (e.g. Ullmann, 1985). In these reviews, poor measures and weak theory construction are often mentioned as causes of this apparent variability in findings (see e.g. Griffin and Mahon, 1997; Wood and Jones, 1995). The assumption that this research stream is inconclusive has persisted until after the turn of the millennium (Godfrey, 2005; McWilliams and Siegel, 2001; Schuler and Cording, 2006).

So, what may be required at this point is a critical examination of the evidence that seems to have motivated these (inconclusive) conclusions. In this chapter I will argue that certain types of literature review should be treated with caution. I will propose an alternative and use this more rigorous methodology of literature reviews in order to assess the cumulative evidence on the two core constructs which are defined at the beginning of this chapter. Then I will present the general conclusions from this research program. The next three sections will describe possible mediators, moderators, and confounds in greater depth. The chapter will conclude with some suggestions of future research needs in the corporate social-financial performance domain.

Superficially, a literature review looks like an easy task. A researcher tabulates the empirical evidence pro and con a particular research hypothesis. In this type of research review, the real difficulty, it is assumed, lies in including all relevant studies, not so much in the actual technique of reviewing the literature. In the end, it is argued, all we need to do is count the vote tally that supports, or fails to support, the research question that motivated the review. This classic solution of vote counting of statistically significant and non-significant results sounds reasonable, but comes with a host of pitfalls and weaknesses (Chalmers and Lau, 1994; Hedges and Olkin, 1980; Hunt, 1997). In psychology and medicine, such simplistic literature reviews are now held in disdain (Hunt, 1997). In contrast, certain communities of researchers within Organizational Behavior and Organization Theory continue to rely on vote counting, or what is labeled the 'box-score method' (Schwab, 1999: 301), although statisticians, psychologists, and at least one prominent economist have long argued that a rigorous literature review requires a quantitatively more sophisticated underpinning than that afforded by the typical narrative literature review (e.g. Cohen, 1994; Hedges and Olkin, 1985; Hunter and Schmidt, 2004; McCloskey, 1998). Because the errors can be grave (Orlitzky, 2002), such reliance on classic types of literature review ought to become as much of a taboo in this research stream as it is in other disciplines and research programs. Meta-analysis avoids these methodological and logical mistakes and, thus, will be the type of research synthesis on which this literature review is based.

Meta-analysis is a type of literature review that goes beyond the outcomes of statistical significance tests (Schmidt, 1992). Instead, it focuses on effect sizes, such as the correlation coefficient r or effect size d (Rosenthal, 1984; Rosenthal and DiMatteo, 2001). One particular method of meta-analysis, called 'psychometric meta-analysis', not only takes into account sample size differences, but also corrects for measurement error (unreliability in measures), dichotomization of variables, and several other study artifacts that typically affect primary studies (Hunter *et al.*, 2004). Because of their ability to correct for these study artifacts, meta-analytic research syntheses have become very influential in the social sciences

(Cooper and Hedges, 1994; Hunt, 1997). For this reason it makes good sense in this review to rely primarily on two award-winning meta-analyses (Orlitzky and Benjamin, 2001; Orlitzky *et al.*, 2003),[1] which problematized and relativized the aforementioned typical conclusions about the seemingly 'equivocal' relationship between CSP and CFP.

The Two Core Constructs

Corporate Citizenship and Corporate Financial Performance

The first core concept at the heart of this literature review is *corporate social performance* (CSP). Wood (1991: 693) defined CSP as a 'business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm's societal relationships'. This comprehensive definition assumes that CSP is broader than corporate social responsibility (CSR), which consists of three norms at different levels of analysis: institutional, organizational, and individual (Wood, 1991). In addition, CSP includes organizational processes of environmental assessment, stakeholder management, and issues management, but also, and perhaps most important, various measures of its external manifestations and societal effects, such as social impacts. The apparent complexity of the definition of CSP can be untangled conceptually by visualizing Wood's model as a relatively straightforward systems model of inputs, throughputs, and outputs. In retrospect, because the construct conceptually and operationally includes considerations of company performance vis-à-vis the natural environment, a better term for it may be *corporate citizenship* (Davenport, 2000). At best it is awkward, at worst false, to include the caveat that corporate *social* performance also refers to corporate *environmental* performance (cf. also Holliday *et al.*, 2002). There are many other good reasons to prefer the term 'corporate citizenship' (CC), or regard CC as slightly different from CSP (Gunther, 2004; Matten and Crane, 2005), but for the purpose of this chapter I will

[1] Orlitzky and Benjamin (2001) won the 2001 Best Article Award given by the International Association for Business and Society (IABS) in association with *California Management Review*. Orlitzky, *et al.* (2003) won the 2004 Moskowitz award for outstanding quantitative research relevant to the social investment field. The sponsors of the Moskowitz Prize are Calvert Group, First Affirmative Financial Network, KLD Research & Analytics Inc., Nelson Capital Management, Rockefeller & Co., and Trillium Asset Management Corporation. The Moskowitz Prize is awarded each year to the research paper that best meets the following criteria: (1) practical significance to practitioners of socially responsible investing; (2) appropriateness and rigor of quantitative methods; and (3) novelty of results. Both award-winning papers were based on my doctoral dissertation, which was completed in July 1998.

consistently use CC as a (conceptually equivalent, yet rhetorically superior) synonym of CSP.

In contrast, *corporate financial performance* (CFP), the other core construct of this review, is usually considered less ambiguous and, thus, less contentious, than CC. The view of CFP as the 'financial viability of an organization' (Price and Mueller, 1986: 128) seems clear enough. So, CFP is the degree to which a firm is able to achieve its economic, or financial, goals (Venkatraman and Ramanujam, 1986). However, different measures of financial performance seem to diverge rather than converge (Meyer and Gupta, 1994). Therefore, although we can distinguish between two main CFP operationalizations, namely market and accounting measures, we cannot a priori assume that CC has questionable measurement properties, while CFP is clear-cut and uncontroversial. In fact, a closer measurement examination has generally shown that the construct validity of both core constructs is far from perfect, but still useful for research synthesis (Orlitzky, 1999). Construct validity refers to the degree of correspondence between a variable's operationalization and the conceptual definition, or mental image, of the construct that such a measure is designed to represent (Schwab, 1980). While measurement error is caused by random errors, lack of construct validity is produced by systematic errors (Hunter *et al.*, 2004; Nunnally and Bernstein, 1994). Both types of error can render a research literature uninterpretable. In this case, we deal with constructs which are imperfect (as is typical in all social science research domains; cf. Hunter and Schmidt, 2004), but their measurement properties can be judged good enough to allow for meta-analysis (Orlitzky, 1999).

The General Conclusions

Overall, the meta-analysis by Orlitzky, Schmidt, and Rynes (2003) supports a positive relationship between CC and CFP. Specifically, the meta-analytically determined true score correlation ρ was +0.36. Sampling and measurement errors alone accounted, on average, for 24% of the variance in observed correlations across studies. In general, reputation measures of CC were better predictors of CFP than social-audit disclosures, and the economic impact of CC was stronger on accounting measures than market measures of a firm's economic performance. Orlitzky and his colleagues also addressed concerns about availability bias—the possibility that studies which fail to show a relationship between CC and CFP were unlikely to get published. File drawer analysis is a technique useful for assessing this concern. The file drawer analysis indicated that over 1,000 such unpublished studies excluded from the meta-analysis would be needed to change the overall conclusions of the meta-analysis.

CC also seems to reduce business risk (Orlitzky and Benjamin, 2001). Again, these effects are most likely mediated by organizational reputation. By balancing a multitude of stakeholder interests, a firm may increase various stakeholder groups' confidence that the firm will be understanding and non-adversarial in resolving future stakeholder conflicts (Jones, 1995). In turn, this may reduce the variability of accounting rates of return and share prices because the investment community will not respond to temporary company set-backs by panic-selling of its shares, for example. Conversely, less business risk may lead to higher CC because discretionary spending on CC is facilitated by greater predictability of future cash-flows and slack resources. A corresponding causal model is depicted in Orlitzky and Benjamin's (2001) article.

In addition, the meta-analysis suggests that the organizational activities entailed by CC and CFP can be considered mutually reinforcing. Through the use of time lags, Orlitzky and his colleagues found that CFP is a positive predictor of future CC, and that CC also predicts CFP. In other words, the meta-analytic findings suggest that a business can develop mutually beneficial relations with stakeholder groups, which might pay off surprisingly fast for the socially responsible firm. In turn, these positive economic effects of CC might translate into more slack resources available for future investments in CC. Over time, these dynamics might constitute a virtuous cycle for the socially responsible firm (Waddock and Graves, 1997*a*).

Mediators: The Causal Mechanisms that Link CC and CFP

In conjunction with primary studies, the meta-analytic evidence can also shed more light on the possible mediators or causal linkages between the two core constructs. The empirical evidence accumulated to date indicates that CC and CFP are most likely positively correlated because CC helps improve managerial knowledge and skills and enhance corporate reputation (Logsdon and Wood, 2002; Orlitzky *et al.*, 2003). When stakeholders are engaged constructively (rather than treated as adversarial forces or 'side constraints') they may look more favorably upon a socially responsible company. For example, firms high in CC may attract better and more committed employees (Backhaus *et al.*, 2002; Greening and Turban, 2000; Turban and Cable, 2003; Turban and Greening, 1996). Also, external stakeholders, such as customers, may become more willing to buy the company's products or pay a premium for the goods from socially responsible firms (Auger *et al.*, 2003). Although the meta-analysis suggested that internal competency-building was a less important factor than external reputation in the economic performance-enhancing effects of CC, socially responsible organizations can develop learning mechanisms and other internal resources which will facilitate adaptation to various environmental uncertainties (Russo and Fouts, 1997).

In short, there seem to be a variety of causal mechanisms responsible for the observed positive relationship between CC and CFP. In the following section I will only describe the most likely and important mediators. Orlitzky (2006) elaborates on many of these theoretical links and introduces several others. Frank (1996) provides another interesting overview of possible theoretical linkages.

Enhancing Organizational Reputation

From theoretical and practical perspectives, organizational reputation ranks as one of the most important mediating variables linking CC to CFP (e.g. Fombrun and Shanley, 1990; Read, 2004). Because of their own moral convictions and value systems, customers and suppliers may be, or become, more willing to deal with companies with a good CC track record. 'Ethical investors' may be willing to pay a premium for stocks of companies with high CC disclosures (Anderson and Frankle, 1980; Simon *et al.*, 1972). Thus, when studying external reputation effects, it may be important to consider information intensity and consumer decision processes (Schuler and Cording 2006).

Not all reputation effects are external, though. Employees may show more goodwill toward their high-CC employer and, because of increased organizational commitment and task motivation, produce better results and demonstrate more organizational citizenship behaviors (Davis, 1973; Hodson, 2001; McGuire *et al.*, 1988). The external and internal effects, in aggregate, could explain an increase in CFP as a consequence of increasing CC, mediated by organizational reputation.

The empirical research accumulated over 30 years lends strong support to reputation as a mediator (Orlitzky *et al.*, 2003). The true score correlation (ρ) between CC *reputation* measures and CFP (0.49) was 36% larger than the overall true score correlation (of 0.36; see previous discussion). However, the variance of this meta-analytic, corrected correlation was also much larger (0.32), which suggests that the way in which organizational reputation is manifested and managed by top management serves as an important moderator. For example, a further subdivision of the reputation CC data shows that company disclosures of CSR in annual reports or shareholder letters tend to contribute to organizational reputation only to a minor extent (Orlitzky *et al.*, 2003: 417–19).

From a slightly different angle, the fact that environmental performance is related to financial performance to a negligible (but still positive) extent might be seen as evidence corroborating the importance of organizational reputation as a mediator (Orlitzky *et al.*, 2003: 414–15). Anecdotal evidence suggests that *at present* many consumers, especially US consumers, are not particularly concerned about a company's environmental track record (Gunther, 2004; Read, 2004).[2] At the moment, environmental performance is typically either just a small blip on an organization's radar screen or treated as a cost only (not as an investment). That is, many organizations treat the natural environment as a legal (i.e. regulatory compliance) issue rather than an essential aspect of organizational reputation that needs to be managed proactively. Some observers claim that only when environmental activists institutionalize environmental concerns in the form of influential social movements do organizations respond (Gunther, 2004; cf. also McVeigh *et al.*, 2003).[3] But by that time, it may be too late to derive strategic benefits from reactionary adherence to already widely institutionalized norms of environmental responsibility.

Improving Internal Resources and Skills (Efficiency)

Another quite influential variant of the pro-CSR paradigm implicates organization-internal resources and skills as an important mediator between CC and CFP. Advocates of the internal-resources view of CC predict that CC enhances managerial competencies with respect to the efficient use and allocation of resources (e.g. accounting return measures such as return on assets or return on equity). Increased internal efficiencies may directly translate into savings from higher CC (Holliday *et al.*, 2002: 83–102). Also, CC may help top management develop better scanning skills, processes, and information systems which increase the organization's anticipation of, and preparedness for, external changes or turbulences. Know-how with respect to corporate environmental performance has been argued to be especially important in growing industries (Russo *et al.*, 1997). According to this view, whether CC measures are disclosed or not is largely irrelevant because organizational learning and the development of internal capabilities do not depend on the communication of the corporation's commitment to CSR to various stakeholders.

The integration of prior CC-CFP research shows that, although the internal-skills perspective is substantiated empirically to some extent, the internal learning effects of CC tend to be 33% smaller than the reputation effects emanating from high CC. As tabulated in Orlitzky *et al.* (2003: 418), the effect sizes pertaining to the internal-efficiency versus external-reputation explanations were 0.33 and 0.49, respectively. However, 0.33 is still a quite sizeable mean true score correlation (ρ). In addition,

[2] In the future consumers may exhibit greater environmental awareness, for example, because of sharp increases in energy prices or catastrophic climate shifts. These possible attitudinal changes may, in the future, result in the emergence of a company's concern for the natural environment as the most important dimension of CC reputation.

[3] Of course, there are industry- and firm-specific exceptions to this rule (e.g. Interface and Patagonia). These exceptions illustrate the importance of executive values in managing company reputation for high CSR (cf. also Orlitzky and Swanson, 2002).

the empirical analyses (Orlitzky *et al.*, 2003: 418) point to the greater generalizability of the internal-skills effects relative to the CSR reputation effects (which may be industry- or firm-specific). In sum, this meta-analytic evidence reaffirms CC as an important, but not essential, *internal* resource.

Increasing Rivals' Costs

A company may become relatively more efficient not only by decreasing its own costs but also by raising competitors' costs. Thus, a related resource-based argument focuses on the effects of CC as a political strategy to increase rivals' costs (McWilliams *et al.*, 2002). High-CC firms can try to make their new technology an industry standard through which they effectively restrict access to substitute resources. It can be shown that companies, especially large ones, can use occupational safety and health as well as environmental regulations strategically to raise rivals' costs. Some organizations may concentrate on those social or environmental criteria that they already find relatively easy to meet or exceed, and then push their various stakeholder coalitions for broader adoption of those policies in their organizational fields. McWilliams and her colleagues (2002) presented various examples of CC as indirect rent-seeking strategy. Ultimately, strategic actors will adopt those CC practices that make the firm-specific resources valuable, rare, and costly to imitate in order to render the company's competitive advantage more sustainable. This explanation is not only consistent with the resource-based view of the firm, but also the view of CC as a signal to government about expected compliance costs with future costly and rigid government regulation (Heyes, 2005).

Attracting a More Productive Workforce

Firms with high CC may also attract better employees. There is some empirical support for this explanation (Backhaus *et al.*, 2002; Greening *et al.*, 2000; Turban and Greening, 1997). CC may serve as a signal to potential applicants that the organization is a socially responsible employer and upholds ethical values. Because, as a result of these signals, applicants may experience positive affects, such as an enhanced self-concept (Greening *et al.*, 2000), they will be more attracted to high- rather than low-CC firms. This association between CC and company attractiveness as an employer has been found at the organizational level (Turban and Greening, 1997) as well as the individual level of analysis (Backhaus *et al.*, 2002; Greening *et al.*, 2000). When competitive advantage increasingly depends on a quality workforce (Huselid, 1995; Pfeffer, 1994, 1998), a large labor pool from which to select employees is usually beneficial to companies. Companies with low CC inadvertently restrict the labor pool from which they can recruit by appearing unattractive to potential job applicants and, thus, are at a human resource and economic disadvantage relative to companies with high CC (cf. also Orlitzky, 2007*c*).

Boosting Sales Revenues

Probably the most direct explanation of a positive effect of CC on CFP is the view of CC as a revenue generator—especially in the long run. Firms that enjoy favorable reputations for their CC may be able to charge premiums for their products and services (Auger *et al.*, 2003). Consumers may value social responsibility so highly that they are willing to pay more for products and services from socially responsible companies. In addition, by conveying important information about how products have been manufactured in a socially or environmentally responsible manner, companies may increase market share relative to competitors that are poor corporate citizens (Miller, 1997). Whether the effect is through increased prices or a larger customer base, CC may help the business generate more sales revenues. Authors in the popular business press adhere to this revenue-generating view of CC to some extent (e.g. Read, 2004), although the academic experimental research evidence is more tenuous (Elliott and Freeman, 2001; Folkes and Kamins, 1999; Roberts, 1996). Certain customer segments (e.g. members of Amnesty International, older women, or Generation Y) have been found to be willing to pay premium prices for products from high-CC firms, but these purchasing decisions may not be generalizable to the whole population of consumers (Auger *et al.*, 2003; Read, 2004). However, the currently weak corroboration of this mediator does not strike a fatal blow to the positive view of CC-CFP linkages because, as I argue in this chapter and elsewhere (Orlitzky, 2006), there are so many other mediating variables that have received strong empirical support.

Reducing Business Risk

Firms may also financially benefit from CC because it tends to reduce business risk (Orlitzky and Benjamin, 2001). CC can decrease business risk by allowing firms to anticipate environmental upheavals more effectively (King, 1995). Good CC is typically characterized by effective environmental assessment (Wood, 1991), which helps companies address stakeholder concerns proactively or interactively (Waddock, 2002). By balancing a multitude of stakeholder concerns, firms can potentially lower their legal costs because it is precisely the unaddressed stakeholder concerns that usually turn into lawsuits against neglectful companies.

There is strong evidence that the higher a firm's reputation for its CC, the lower the business risk (Orlitzky and Benjamin, 2001). That is, CC and business risk have been found to be inversely correlated. However, the negative CC-risk associations also exhibited relatively large variabilities around the meta-analytic means (Orlitzky and Benjamin, 2001: 385). This implies that such study artifacts as sampling error and measurement error explained only modest amounts of cross-study variability in findings. The only notable exception was the relationship between CC and total market risk, which was not only the largest correlation found (true score correlation coefficient ρ of −0.57), but also had the smallest true score variance around it (Orlitzky and Benjamin, 2001: 385). Of all CC measures, reputation tended to reduce risk to the greatest extent (ρ of −0.32), followed by social audits, processes, and outcomes (−0.13), CC disclosures (−0.10), and management social responsibility values (−0.07). The order of these corrected correlation coefficients was generally consistent with theoretical expectations (Orlitzky and Benjamin, 2001). Interestingly, and contrary to expectations, corporate environmental performance was related to risk to only a negligible degree (−0.02). However, a major caveat applies to this last finding because the number of quantitative studies that were integrated in the meta-analysis was small (only eight).

Reverse Causation?

So far, the discussion has implied that CC was the causal determinant, and thus temporal antecedent, of CFP. However, there are also strong theoretical arguments for reverse causation, with CFP as the precursor of CC. The arguments about reverse causation may generally be subdivided into two broad categories: the slack resources view and the (normative) '*noblesse oblige*' view.

First, previously high levels of CFP may provide the slack resources necessary for a company to engage in corporate social responsibility and responsiveness (Cyert and March, 1963; Ullmann, 1985). CC often represents an area of relatively high managerial discretion (Carroll, 1979), so that the initiation and maintenance of voluntary social and environmental policies may depend on the availability of excess funds (McGuire *et al.*, 1988). While executive leadership (cf. also Orlitzky and Swanson, 2002, 2006; Orlitzky *et al.*, 2006) and organizational culture (cf. also Swanson, 1999) must be supportive of CC, profits and thus slack resources represent the necessary conditions for high CC. In other words, a firm's prior profit level, if it is low, may act as a factor inhibiting CC activities and investments.

Second, a consistent track record of organizational success may create a sense of obligation among executives to give back to the community (*Economist*, 2006). This normative obligation may not only be felt by top managers on an individual level, but these communitarian values may also be expressed in the organizational activities initiated by those leaders. In his seminal institutional theorizing, Selznick (1949) demonstrated how normative commitments affected organizational behavior at the Tennessee Valley Authority. Internalized and legitimized shared norms can explain the persistence of organizational activities at the macro level as well (e.g. Kilduff, 1993). Above and beyond regulative pressures, network embeddedness and consequent network dependencies may stabilize and maintain organizational practices (Powell, 1991), such as industry-wide voluntary product standards (Hemenway, 1975; Scott, 1995: 79). In short, the slack resources argument, an instrumental explanation, may be insufficient by itself to explain the diffusion and maintenance of CC in organizational fields. Institutional theory (Powell and DiMaggio, 1991; Scott, 1995) can provide important additional insights focusing on normative pressures, which are likely to increase with increasing CFP.

The meta-analytic evidence accumulated by Orlitzky, Schmidt, and Rynes (2003) supports this view of reverse causality (CFP → CC) to about the same degree as a CC → CFP link. Regardless of the temporal order of the two core constructs, the true score correlation ρ was 0.29. Interestingly, the strongest meta-analytic correlation was found when both constructs were measured concurrently (ρ of 0.44)—i.e., in the same quarter or year. This meta-analytic evidence supports Waddock and Graves's (1997*a*, 1997*b*) good management argument. CC and CFP may reinforce each other in a virtuous cycle because good managers are capable of taking positive strategic action in both economic and social domains. Astute managers are able to identify and implement specific CSR activities through which their organization's reputation can be enhanced in social or environmental domains—and they also ensure that slack resources are invested wisely to promote and exploit these opportunities. Furthermore, skillful executives can sidestep the perception that the socially responsible activities by their companies are merely marketing ploys. They are able to convey to internal and external stakeholders that their company's CC is in fact rooted in top managers' deeply felt commitments to social and environmental causes.

Moderators: The Contingency Factors on which the CC-CFP Relationship Depends

The main moderators that Orlitzky, Schmidt, and Rynes (2003) and Orlitzky and Benjamin (2001) proposed were the measurement strategies associated with CC and CFP, respectively. Unlike a narrative literature review, a meta-analysis can empirically examine the strength of moderator (or interaction) effects by disaggregating the overall meta-analytic data set into relatively homogeneous subgroups (which are categorized by the postulated moderator). When (*a*) the mean correlations differ in those subgroups and (*b*) the study artifacts explain more cross-study variability in these subgroups compared to the overall meta-analytic data set, a meta-analysis can demonstrate the existence of contingencies. Both meta-analyses by Orlitzky and his colleagues showed that the way CC and CFP were operationalized exerted a great impact on the study effects found. Thus, any new primary study that attempts to measure only one specific dimension of CC may not capture the full economic impact of CC.

Because Orlitzky *et al.*, found only a few instances in which study artifacts explained between 75% and 100% of cross-study variability in the CC-CFP effect sizes, several other contingency factors are likely to affect this relationship as well. One of them, already confirmed in a primary study of one dimension of CC, is industry growth. Russo and Fouts (1997) found that industry growth, as a moderator, strengthened the relationship between corporate environmental performance and profitability. That is, CC was a more important internal resource when an industry was growing relative to when it was stable. Most likely, this moderator effect exists because a firm operating in a growing industry requires the kind of environmental assessment and management for which CSR provides the normative (rather than instrumental) foundation and benefits more from the resource-based, internal benefits of CC under those growth conditions. Generally, though, a lot more research is required to examine the moderator effects that have been proposed in the literature. The theoretically most compelling argument for moderator effects is presented by McWilliams and Siegel (2001) in their supply and demand model of CSR. Their proposed moderators included an organization's size, level of diversification, research and development, advertising, government sales, consumer income, labor market conditions, and stage in the industry life cycle. All of them require empirical follow-up research.

Confounding Variables

The empirical impact of confounding variables must be distinguished from these postulated moderator effects. Moderators interact with exogenous variables to affect the dependent variable under consideration. That is, moderators are modeled mathematically as multiplicative effects. Confounding variables act differently. Confounding variables may create spurious relationships if the study design or data analysis does not control for their impact. Their impact is (usually) additive. The importance of these potential confounds explains the fact that potential confounds are typically entered first in multiple regression models. Variance explained (R^2) is often considered a pretty good indicator of the impact of potential unmeasured confounds, but not of the magnitude of contingency effects. The higher R^2, the lower the probability that important confounds have been ignored. However, R^2 may also be deceptive because any effect size between CC and CFP may be artificially inflated because the conceptual model is incomplete or misspecified. Such

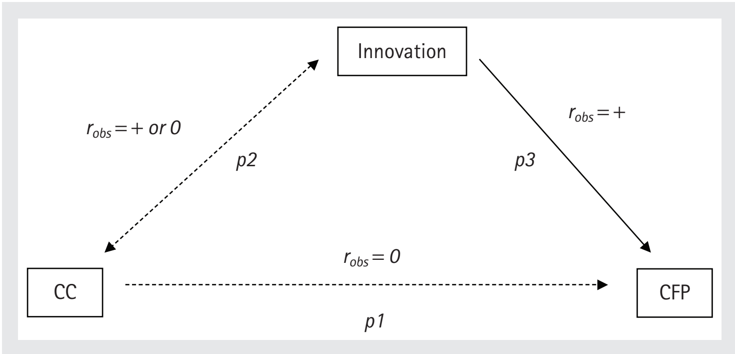

Fig. 5.1 Innovation as confounding variable

misspecifications are sometimes labeled 'errors of the third type' (cf. also Leamer, 1983).

Innovation

Innovation, often operationalized as a firm's level of investments in research and development, can be considered a potential confound of the CC–CFP relationship. McWilliams and Siegel (2000, 2001) emphasize that the association between CC and CFP cannot properly be understood without consideration of organizational innovation. McWilliams and Siegel (2000) argued that if studies statistically controlled for firms' investments in research and development (R&D), the positive association between CC and CFP would vanish. Such a postulated confounding effect is shown in Figure 5.1. However, the direct association between CC and CFP might also be zero or statistically non-significant if innovative activities were *mediating* the relationship between CC and CFP, as shown in Figure 5.2. In my view, Figure 5.2 is as plausible as Figure 5.1 (cf. Geroski, 1994 on the

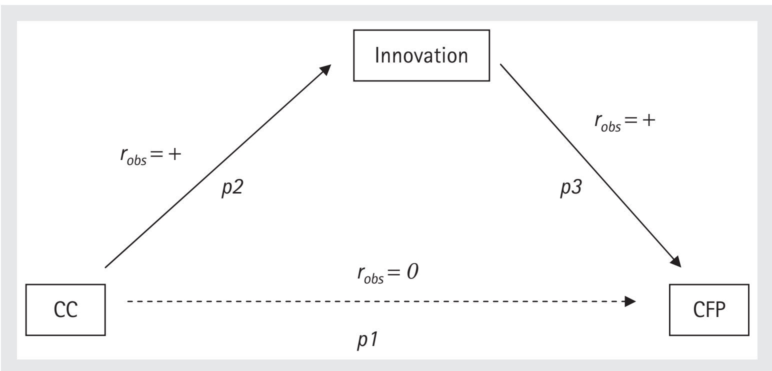

Fig. 5.2 Innovation as mediating variable

innovation–financial performance relationship; Waddock *et al.*, 2002 on the CSP–innovation relationship). Moreover, from the methodological literature (Schwab, 1999), we can infer that innovation tends to inflate the zero-order correlation between CC and CFP if the association between CC and innovation ($p2$) is positive rather than zero, or statistically nonsignificant. Hence, because the main difference between Figures 5.1 and 5.2 tends to boil down to the causal arrow of $p2$ (i.e. Is CC a causal predictor of innovation or is innovation a causal predictor of CC?), this particular facet of the CC–CFP research program certainly represents an area in need of future empirical study. From a theoretical viewpoint, it will be important to go beyond the consideration of R&D expenditures as a control variable—and study designs will have to reflect that.[4]

Organization Size

Another variable which may confound the CC–CFP relationship is organizational size. Large firms may both exhibit greater financial performance and engage in more socially responsible activities as they tend to have more slack resources (which are needed not only for CSR investments but also for other investments that may allow a given firm to stay ahead of its competitors). If this argument, which Orlitzky (2001) presented in greater depth, were true, the CC–CFP relationship may, in fact, be spurious.

The meta-analytic data do not support this view. When size is added as a variable influencing both CC and CFP (in a similar way as 'Innovation' in Fig. 5.1), the path-analytic model shows that the 'true score' correlation ρ between CC and CFP remains high ($\rho = 0.37$) despite this statistical control (Orlitzky, 2001). Importantly, this meta-analytic finding suggests that large *and* small firms can financially benefit from being or becoming good corporate citizens, albeit (most likely) due to different causal mechanisms. Why this is the case awaits future research.

Conclusions: Research Politics and Future Directions

In conjunction with a meta-analysis of event studies (Frooman, 1997), this research program has generated some generalizable knowledge:

[4] Though interesting in theory, the direction of the causal arrow of $p2$ (CSP $\rightarrow$ innovation or innovation $\rightarrow$ CSP?) may not be so important in practice.

- Overall, there is a positive, but also highly variable, relationship between CC and CFP.
- CC and CFP tend to be mutually reinforcing organizational activities.
- CC and CFP are positively correlated, most likely because social performance helps enhance corporate reputations, and, to a lesser extent, improve managerial learning and internal efficiencies.
- The large variability of findings in studies is partly due to primary-study artifacts.
- CC may also reduce business risk.
- Organization size does not confound the relationship between CC and CFP.
- The large variability of the CC–CFP relationships suggests several moderators (e.g. measurement strategies, industry growth, etc.) which should be examined in future research.

Because of this variability, scholars in this area should probably reformulate the question that introduced and motivated this research synthesis as follows: How can we characterize the relationship between corporate citizenship (CC) and corporate financial performance (CFP)? Rephrasing the question this way is sensible for two main reasons. First, it acknowledges that a company can become a responsible corporate citizen through more routes than only high *social* performance (see also Holliday *et al.*, 2002). Second, and more important, the reformulation puts the researcher and the community of researchers at center stage (Orlitzky, 2007*a*). This is vital in any research domain in which construct validity is a key problem. For example, what some people regard as the epitome of CSR (e.g. affirmative action) is denounced by others as morally questionable organizational conduct. Value relativism demands a balanced attention to the normative foundation of every single dimension of CC. We cannot assume that the manifestations of CC in a particular domain are self-evident. At the same time, though, an 'anything-goes' definition of CSR (e.g. 'CSR is whatever market participants consider CSR') may, in fact, be as damaging to future refinement as an absolutist insistence on certain ideologies. Conceptually, we need to come to a consensus about the types of activities that have a net positive impact on business environments. To 'better society' is hardly a sufficient guide for a scientifically useful definition of CSR. I agree with Rowley and Berman (2000) that, at present, CSP as a construct probably raises more questions than it answers. At the same time, I think the correct research strategy is not a moratorium on the CC–CFP research stream, but instead an intensified, politically aware examination of the philosophical underpinnings of CC, so that it becomes useful for social scientists of all political persuasions.

As a case in point, some writers (e.g. Entine, 2003) argue that CSR represents advocacy of an inherently Liberal or even irrational conception of business activity. To some extent, these criticisms are a call to arms for CC researchers to demonstrate that their actual operationalizations of CC do not give priority to a particular political view of societal governance. Instead, our objective measures must reflect societal values which every reasonable person would deem 'positive'. This research may lead to a more limited view of CC because it would imply that we shift our focus from the motivations of CC to the actual social and environmental impact of CC. In this effort, our measurement of CC must become more sophisticated and ask the actual stakeholders about their satisfaction with an organization's CC activities (Orlitzky, 2007*b*). Consistent with the advocacy of more verifiable measures of the 'triple bottom line' (Elkington, 1998), we must demonstrate the validity (see e.g. Sharfman, 1996) and reliability of our chosen measures—without succumbing to the illusion that our measures will ever be perfect.

Better measures will enable us to answer the moderator and mediator questions with greater confidence, but we also need to make sure that our study designs and data analyses are in line with the theoretical complexity of these questions. For example, the postulation of CC as a causal determinant of CFP requires much more than the concurrent measurement of both constructs in the same time period. In turn, for the investigation of lagged effects, it will be important to use theory as a guide for possible lead-lag times and mediating variables (Orlitzky, 2006; Orlitzky *et al.*, 2003; Schuler and Cording, 2006).

This being said, the meta-analytic evidence does *not* point to the overall equivocality and inconclusiveness of this research stream. Researchers of corporate social and financial performance must not repeat the same mistakes that have been made in so many other social science research literatures which, until the introduction of meta-analysis, were littered with the false appearance of conflicting results (Hunt, 1997; Schmidt, 1992). When, based on narrative reviews, many different moderators effects were postulated, social scientists would conduct contingency studies, which only resulted in a more complex variability of findings. Ultimately, researchers would conclude that the variable under consideration actually had no 'generalizable' effects, and the research community ultimately turns to more 'tractable' problems. Over time, history shows that the same social science research pattern seems to repeat itself in many different areas of research (Schmidt, 1992). Taking the method of meta-analysis more seriously prevents this pattern because, based on meta-analytic findings, social science studies are, in fact, about as generalizable as studies in the natural sciences (Hedges, 1987). But overcoming this pattern will not be easy because, at first at least, the proposition of contingencies generally leads to the funding of more primary studies because the previous 'flawed' literature has only produced 'ambiguous' evidence and, therefore, additional new research should be supported (according to the typical argument). In this context it is no surprise that other academics emphasize the variability of findings reported by Orlitzky, Schmidt, and Rynes (2003) much more than practitioners and journalists, who focus on the means (e.g. Kelly, 2004).

We must confront the research politics not only of 'inconclusive' findings, but also of positive relationships. Researchers that believe in a positive relationship between CC and CFP are really caught between a rock and a hard place. On the one hand, they will be attacked by conservatives who believe that the 'business of business is business' (e.g. Friedman, 1970; Levitt, 1958). On the other hand, they will have to defend their findings against attacks from the Left. Social democrats and believers in big government may dislike the implications of positive CC–CFP correlations. Based on non-negative CC–CFP correlations, researchers can in fact argue that business will not always be reluctant to embrace CSR. Market forces may signal where the business opportunities for discretionary spending on CSR lie and in turn these market signals may turn out to be more reliable indicators of genuine social responsibility than government regulations emerging from interest-group politics. Those on the political Left know the case for governmental regulation would be much stronger if CC–CFP relationships were negative.[5] Occupying a middle ground between these views on the political right and left, the advocates of a generally positive CC–CFP association will be in a much better position to justify their views if they develop more defensible measures and study designs in illuminating these empirical relationships.

In the corporate social-financial performance research domain there is no shortage of rich theory (e.g. McWilliams and Siegel, 2001; Orlitzky *et al.*, 2003; Schuler and Cording, 2006). Before turning to the development of even more complex theory, though, we must be clear about two questions. First, are the findings really as equivocal as they appear? I hope this chapter has contributed to answering this question. The second question, though, is of a different, more philosophical nature: What is CSR? One important element of better conceptualization will have to heed Friedman's (1970) caveat about the socialist overtones of the doctrine of 'social responsibility'. But is CSR necessarily a collectivist doctrine? When we recognize (and can convincingly demonstrate) that 'socially responsible' behavior can *also* serve a firm's enlightened self-interest, we may be able to abandon the common-sense notion of 'social responsibility' as synonymous with 'altruism' or 'self-sacrifice' (see also Dalai Lama and Cutler, 1998; Rand, 1964). The second question requires an in-depth normative analysis by business ethicists. In fact, a comprehensive conceptual clarification of corporate responsibility is a necessary precondition for more valid and reliable measurement of CSP, CSR, and/or CC—and for better theory.

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[5] A negative relationship implies an economic disincentive emerging from CC. In turn, those businesses that show the greatest profits and steepest share price increases would be least likely to engage in CC. This means that, according to this view, market forces work at cross-purposes with non-market issues and interests—and only government intervention, it is argued, can correct this market–non-market discrepancy.

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