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Corporate Social Responsibility in a Competitive Business Environment

By

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Abstract

Using a representative sample of more than 5,000 Vietnamese enterprises, we explore the firm-level productivity effects of corporate social responsibility (CSR). The data enables us to create 12 quantitative CSR measures, which can be grouped into two broader categories related to management and community-based CSR initiatives. We find a positive relationship between adoption of CSR initiatives and firm efficiency, and reveal that the impact is stronger for firms in non-competitive industries. Moreover, we show that local community focused CSR initiatives drive the aggregate effect. This suggests that socially responsible actions by firms are likely to pay-off when stakeholder engagement has a localised focus. We provide evidence of reciprocity by showing that employees accept a lower share of additionally generated value-added (controlling for productivity differences) in exchange for working in a company that signals 'good' corporate values.

Introduction

While the concept of Corporate Social Responsibility (CSR) has been widely discussed (Kitz Mueller&Shim shack, 2012), there is neither general agreement about its definition nor a common way of quantifying CSR at the individual firm level. Moreover, there are varying interpretations in the literature about whether CSR improves firm performance and/or whether improvements in CSR levels are necessary for firm survival at given performance rates (Crifo & Forget, 2015). One key way of looking at improvements in CSR, which we pursue here, is that they form part of developing a modern enterprise in a competitive environment. If a firm wants to survive, it must 'follow the current' and improve its level of CSR. Not doing so reflects 'managerial slack', and will subsequently result in firm closure.

From a policy perspective understanding the relationship between firm performance and corporate governance in competitive and non-competitive industries, respectively, is important for designing appropriate industrial policy (Giroud & Mueller, 2010). If improving industry competition (such as deregulation and antitrust laws) automatically mitigates managerial agency problems then policies to improve corporate governance will be more efficient if focus is directed towards non-competitive industries.

A complex set of social preferences and market imperfections motivate CSR. At the same time, the evidence of the effects of CSR on firm performance and labour compensation is mixed at best. First, CSR is found to increase firm profits and improve general firm performance if it enables (i) lower production (environmental) costs; (ii) product differentiation through price discrimination mechanisms working in favour of the socially responsible firm; or (iii) innovation both in terms of managerial processes as well as technological upgrading (Crifo & Forget, 2015). However, managerial slack and decreasing profits are also observed in cases where the delegated responsibilities to firm executives lead to outcomes favouring the interests of stakeholders other than shareholders. Second, competition may have differential effects on CSR adoption and firm performance. If enterprises in competitive settings compete for socially responsible consumers, CSR activities may be boosted by market competition, improving in turn overall industry efficiency. On the other hand, realising that CSR provides a competitive edge, firms can use CSR strategically to raise entry barriers, increasing relative levels of industry concentration through, for example, influence on the regulatory system. This may in turn reduce firm-level dynamics and industry-level productivity. Third, employees can also be affected by CSR. Socially and environmentally responsible firms have an advantage in hiring motivated and skilled employees, which yields higher labour productivity (Delmas &Petkovic, 2013; Nyberg, 2014). While employees in CSR firms may show higher levels of dedication and success at work, they are also more likely to accept lower than market wages compared to other workers (Crifo & Forget, 2015).

We use four consecutive rounds of Vietnamese enterprise surveys from 2011 to 2014 (with rich information on CSR behaviour at the firm level) covering 5,185 enterprises (20,740 firm observations) to answer three empirical questions: (i) Does CSR lead to improvements in firm performance? (ii) Does CSR have a differential impact on firm-level (labour) productivity depending on the level of industry competition? (iii) Do firms use CSR strategically to offer lower labour compensation shares?

Literature Review

Vietnam is an illuminating case for exploring the potential impacts of CSR on firm-level performance. Initially, social initiatives implemented at the firm level were partly introduced through trade-related codes of conduct and partly through increasing engagement by multinationals in Vietnam (Nguyen, 2007). In 2007, the Global Compact Network Vietnam was launched to motivate Vietnamese companies to implement and establish corporate policies relating to labour and environmental standards, human rights, and anti-corruption (UN, 2014). This came at the same time Vietnam entered the World Trade Organisation (WTO), which increased exposure to and knowledge about international standards. This in turn increased the need for well-designed CSR strategies at the firm level to ensure sustainable integration of Vietnamese enterprises into global supply chains. Another reason for studying CSR in the context of Vietnam is its history of communist rule. To our knowledge, it remains unclear how the influence of communism affects CSR activity during a transition towards a more market-oriented economy. On the one hand, Ockenfels and Weimann (1999) find evidence that communism undermines people's propensity for voluntary pro-social activities. On the other hand, communist authorities may be better placed to put pressure on private firms to pursue CSR activities, and may even through State Owned Enterprises (SOEs) and other corporate structures with state ownership positively affect the provision of public goods (Trifkovic, Markussen, Newman, & Rand, 2018).

Observing the full range of firm activities is difficult and so is measuring CSR, which tends to address a range of stakeholder concerns and to be manifested in a variety of activities, from certification of environmental standards to donations to the non-profit sector. This leads to analytical problems in studies that link CSR behaviour and firm performance. For example, the effect of CSR on firm performance may be underestimated if the CSR metrics are noisy indicators of true CSR activities (Chatterjee, Levine, & Toffel, 2009). Even though crucial for

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establishing the mechanisms through which CSR affects outcomes, simultaneous treatment of different forms of CSR within one study is, to the best of our knowledge, generally missing in the literature.

In this paper we focus on two dimensions of CSR including the extent to which the firm (i) has a well-developed CSR strategy at the management level that goes beyond compliance with existing regulations (management-related CSR – four indicators); and (ii) engages in beyond-compliance activities not directly linked to firm operations (community/society-related CSR – eight indicators).[1] Based on these two indicators, we generate a CSR index measuring the degree of beyond-compliance CSR-related activities undertaken by the individual firm. We use these distinct categories of CSR activities to uncover the likely mechanisms underlying the CSR-productivity relationship.

Our results show a positive relationship between CSR adoption and firm efficiency. Controlling for unobserved heterogeneity, adding one additional activity to a firm's strategic CSR portfolio gives on average a well-determined 0.3 per cent increase in labour productivity. In addition, the positive relationship between CSR adoption and firm efficiency is stronger for firms in non-competitive industries. Disaggregating this effect by type of CSR engagement reveals that the aggregate effect is largely driven by community-level CSR initiatives. The impact of beyond-compliance CSR, and of community-based CSR activities in particular, on firm performance also emerges applying different generalised method of moments (GMM) estimators. On average, each additional community-related CSR initiative results in a 0.5 to 0.6 per cent increase in labour productivity, and again there is an indication of the effect being stronger in non-competitive industries. Moreover, the stronger community-related CSR effect is found among firms that are more deeply rooted in the local community (sourcing most inputs locally and having most of their customers within the province/district). This confirms that socially responsible actions by Vietnamese private domestic firms are to some extent likely to be reciprocated. Finally, results reveal that employees are willing to accept a lower share of the additionally generated value-added (controlling for productivity) in exchange for working in a company signalling 'good' corporate values especially benefitting the local community.

Our paper adds to the literature on the impact of corporate social behaviour on firm-level performance with insights on how the effect of CSR differs by the level of industry concentration and by the type of CSR engaged in. Focusing on different manifestations of CSR, we also contribute to understanding how these potential added benefits from CSR are distributed among stakeholders and workers. Most CSR studies focus on Europe and USA and a recent review of studies on CSR emphasises the need for more empirical tests of the mechanisms driving CSR and its impact on firm performance in emerging countries (Crifo & Forget, 2015). To our knowledge, the present study is one of the first attempts to systematically map such cross-firm CSR differences for a fast-growing transition economy.The paper is structured as follows. Section 2 presents key concepts that underpin our analysis, while Section 3 defines our quantitative measures of CSR and competitiveness. Section 4 presents the data and the empirical framework, and Section 5 the results. Section 6 concludes.

Although several papers have tried to pin down indicators of CSR, no common measurement or definition exists (Crifo & Forget, 2015). In some definitions, CSR refers to firm activities that go beyond the law in incorporating social, environmental, ethical, and consumer concerns into their business operations to create shareholder and stakeholder value (Bénabou &Tirol, 2010; Crifo & Forget, 2015; McWilliams & Siegel, 2001). Common societal expectations are that firms achieve their economic objectives within the legal framework (Carroll, 1979). While this could be taken as given in advanced economies, it may not hold in developing countries, where the rule of law may not be enforced to the extent expected (see, for example, Barrett, Browne, Harris, & Cadoret, 2002). In other definitions, CSR is identified as a mix of economic, legal, and ethical responsibilities of businesses (Schwartz & Carroll, 2003). The UN Global Compact for example considers compliance with laws and regulations including labour conditions and anti-corrupt behaviour an integral part of CSR (UN, 2013). In this paper, we follow the literature referring to CSR as what firms do to further the social good beyond the law, but at the same time we acknowledge the context within which the analysis is done, and take into account in our estimation approach whether firms in fact do live up to the legal requirements expected of them.

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Methodology

The literature highlights several reasons for a positive association between CSR and firm performance. First, a positive effect may come through improvements in the company's image and reputation, which in turn has been shown to influence firm competitiveness and performance, at least in the long run. Second, an improved CSR strategy may increase employee motivation, retention, and recruitment. This effect may come through the above-mentioned reputation improvement, or directly through an employees' motivation effect due to (perceived) improvements in the working environment. Third, CSR strategies may lead to efficiency gains as firms become more open to alternative production strategies and to investors with a higher sensitivity to sustainability issues. Fourth, improvements in CSR may lead to revenue increases; either indirectly through improved brand image or directly by CSR-driven product or market development (niche markets). Finally, CSR is a means to reduce or manage CSR-related risks such as the avoidance of negative press coverage. CSR, however, does not necessarily result in improved firm performance as documented in a recent meta-study by Margolis, Elfenbein, and Walsh (2009). This finding is related to the fact that some shareholders care about social or environmental performance to the degree that they willingly trade profits and firm-level performance for social goods (Kitz Mueller&Shim shack, 2012). Although shareholder preferences for CSR may influence firm-level efficiency negatively, the five above described mechanisms lead to our first hypothesis (H1).

H1: There is a positive relationship between CSR provision and firm-level productivity.

Campbell (2007) argues that firm-level CSR activities are likely to be lower in competitive settings, and that the relationship between industry competitiveness and firm-level socially responsible activities is nonlinear. Bagnoli and Watts (2003) agree that the provision of CSR and industry-level competition will be inversely related, so a trade-off exists between the optimal level of CSR activities and firm-level efficiency. This is in accordance with Porter and Kramer (2002), who argue that concentrated sectors have lower rates of CSR adoption because firms lack incentives to engage in a socially responsible manner due to lower potential impacts of increasing competitive advantages. In addition, when competition is perfect, firms search for immediate cost-reducing strategies, which likely involve reducing

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beyond-compliance related socially responsible initiatives, to ensure firm survival (Shleifer, 2004). According to Porter and van der Linde (1995), certain environmental standards and regulations can push forward innovative ideas and subsequently reduce production costs, resulting in dynamic competitive advantages. The speed at which this process evolves will depend on industry-level competition, thereby leading to a hypothesis of differential impacts of socially responsible behaviour on firm-level productivity along the competition dimension. Bénabou and Tirole (2010) show that assuming a limit on firm managers' temporal horizon of corporate governance, a negative relationship between firm-level provision of CSR activities and industry-level competitiveness can be observed. Stakeholder monitoring of firm executives is needed to correct for the management's 'short sightedness', but such monitoring tools will be less effective in competitive settings, that is, leading to a differential efficiency impact of CSR along the industry competitiveness dimension. This result is also shown to apply in settings where shareholders are willing to sacrifice firm profits (philanthropy) to promote CSR behaviour. Applying a transaction cost argument, philanthropy through corporations (delegated monitoring) is optimal if transaction costs are lower for corporations than for investors. In such cases, greater prevalence of CSR practices is more likely to be found among larger, more profitable firms, leading in turn to predict an inverse relationship between CSR provision and industry competition. 2 The theoretical prediction that the impact of CSR on firm-level productivity varies with the degree of competition leads to our next hypothesis.

H2: There is positive relationship between CSR provision and firm-level productivity, but the effect diminishes with industry-level competition.

Finally, the idea that employees value the social responsibility of their employers has been proposed both in theory and tested empirically (Besley & Ghatak, 2005; Brekke & Nyborg, 2008, 2010; Heal, 2005; Nyborg & Zhang, 2013). In a model allowing for moral hazard and heterogeneous principals and agents, it can be shown that pecuniary extrinsic incentives (bonus payments) and the workers intrinsic motivation can act as substitutes (Besley & Ghatak, 2005). Crifo and Forget (2015) also show that motivated employees may accept a wage below the equilibrium market value because they enjoy non-monetary compensation through working in a firm aligned with their personal values. If CSR helps incentivise and motivate workers and makes it easier to attract highly qualified employees, we expect to find a positive association between CSR and firm-level productivity, through an employee 'inspiration' effect (Akerlof & Kranton, 2005). All else given, a worker with a stronger inclination for social responsibility would value working in a firm with higher CSR provision and this preference implies that there exists a strictly positive wage differential such that even if the socially responsible firm offers a lower wage by this amount, the employee would still prefer working in a firm with higher levels of CSR provision (Nyborg & Zhang, 2013). For a given productivity level, we therefore expect that the net effect of CSR on the labour compensation package negotiated between workers and employers of the additional value added gained due to the positive productivity effect of CSR will be negative, which leads to our third and final hypothesis.

Conclusion

This study used firm-level panel data covering more than 5,000 firms from Vietnam during the period 2011–2014 to examine the relationship between distinct types of CSR and firm-level performance. We asked three questions:

a. Are CSR adopting firms more productive?

b. Does CSR matter in competitive industries?

c. Do firms use CSR strategically to offer lower labour compensation shares?

We found a positive relationship between CSR engagement and firm efficiency, and conclude that this positive effect is largely driven by CSR initiatives labelled as community-level CSR, that is, corporate socially responsible acts focused on servicing the local community (environmental protection activities, participation in local poverty alleviation programmes, community-based education, and/or health programmes). Firms that are more reliant on the local economy (for example, firms sourcing inputs at the district level and having most customers within the local community) are more likely to engage in socially responsible actions at the local community-level. Our results also indicate that corporate social initiatives are likely to be reciprocated through a workforce mechanism whereby employees are willing to accept a lower share of generated value added. Moreover, CSR impacts are found to be stronger for firms in non-competitive industries. Therefore, the hypothesis that competition mitigates managerial agency problems cannot be rejected, at least in the case of Vietnamese manufacturing firms.

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