Effects of Corporate Social Responsibility on Corporate Financial Performance: A Competitive-Action Perspective

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We attempt to provide a more nuanced view of the relationship between corporate social responsibility (CSR) and firm financial performance using a competitive-action perspective. We argue that competitive action should be considered as an important contingency that determines the effects of CSR activities on firm financial performance. Using data for 113 publicly listed U.S. firms in the software industry between 2000 and 2005, we found that socially responsible activities (positive CSR) enhance firm financial performance when the firm’s competitive-action level is high, whereas socially irresponsible activities (negative CSR) actually improve firm financial performance when the competitive-action level is low. By introducing competitive action as an important contingency, this study contributes to the literature on CSR and strategic management.

Keywords: positive CSR; negative CSR; competitive action; financial performance

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A firm may engage in various types of actions, including corporate social responsibility (CSR), to enhance its competitive position—a competitively advantageous situation—enabling the firm to enjoy better financial performance (Li, Zhou, & Shao, 2009; Porter, 1980). CSR can help differentiate a firm from its competitors (Hull & Rothenberg, 2008; Jones, 1995) by building up reputation and obtaining support from diverse stakeholders, thus improving corporate financial performance (CFP). Empirical findings confirm a small but positive relationship between CSR and CFP in general (for details, see Aguinis & Glavas, 2012; Peloza, 2009). However, a few inconsistent findings in previous research have indicated that the mechanism through which CSR contributes to CFP is complex and beyond a direct causal relationship (Hull & Rothenberg, 2008; Wang & Qian, 2011).

We explicate this complex relationship by introducing competitive action (CA) as a contingency. CA refers to “externally directed, specific, and observable competitive moves to enhance a firm’s competitive position” (Smith, Ferrier, & Ndofor, 2001: 321). CA includes diverse competitive moves, such as new product introduction, marketing, and capacity expansion, reflecting a firm’s aggressive search for new ways to satisfy its customers. Thus, active and constant CA enhances a firm’s competitive position and increases CFP. Both CA and CSR are firm actions that do not only reinforce a firm’s competitive position but also fulfill its responsibilities as a business entity to society. The social responsibility of a firm encompasses “the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time” (Carroll, 1979: 500).¹ In particular, CA reflects a firm’s effort to fulfill its economic responsibility because economic responsibility emphasizes that a firm must bring value to customers by continuously striving to introduce new products, methods, and initiatives as a business entity (Aupperle, Carroll, & Hatfield, 1985). By contrast, CSR embodies the ethical responsibility of a firm (Carroll & Shabana, 2010; Mackey, Mackey, & Barney, 2007), which refers to “a corporate’s voluntary actions to promote and pursue social goals that extend beyond their legal responsibilities” (Carroll & Shabana, 2010: 95). Notably, economic and ethical responsibilities coexist and may even overlap (Carroll, 1979; Schwartz & Carroll, 2003) because actions that fulfill them, such as CA and CSR, can contribute to firm performance.² Given these characteristics of CA and CSR, integrating CA and CSR would be an appropriate approach to elucidate the complex CSR-CFP relationship.

Specifically, we first decompose CSR into socially responsible activities, or positive CSR (PCSR), and irresponsible activities, or negative CSR (NCSR).³ While PCSR refers to voluntary corporate actions designed to create benefits for diverse stakeholders (Mackey et al., 2007), NCSR refers to “the set of corporate actions that negatively affect identifiable social stakeholders’ legitimate claims (in the long run)” (Strike, Gao, & Bansal, 2006: 852).⁴ PCSR and NCSR are not directly opposite but conceptually distinct; not doing bad does not necessarily mean doing good, and a firm can simultaneously engage in PCSR and NCSR, which suggests that PCSR and NCSR are subject to different dynamics (Lange & Washburn, 2012; Mattingly & Berman, 2006). Therefore, studying PCSR and NCSR separately has been suggested as a way to explore the complex CSR-CFP link (Muller & Kräussl, 2011; Strike et al., 2006).⁵

We then investigate the boundary conditions of CA on the relationship between both PCSR and NCSR and CFP. Building on the resource-based view, we argue that the effects of PCSR and NCSR on CFP vary with CA. The effect of PCSR on CFP would be higher when
CA level is high; if economic responsibility has been established with a high level of CA, the positive response of stakeholders to CSR will be strengthened. By contrast, the potential negative NCSR effect on CFP is even stronger with a high level of CA; NCSR would fail stakeholders’ expectations of the firm for ethical behaviors, thus further destroying stakeholder relationships. We test our hypotheses using data from 113 publicly listed firms in the U.S. software industry between 2000 and 2005.

The current study has several contributions. First, this study introduces a new contingency of CSR by showing that the effects of CSR on CFP vary with CA. Second, this study further advances CSR literature by suggesting that PCSR and NCSR should be studied separately based on their different effects on CFP. Third, this study contributes to strategy literature by demonstrating how firms can enhance their competitive positions through CA, PCSR, and NCSR.

Theory and Hypotheses

Integration of CSR and CA

Based on previous literature, we develop the argument that both CSR and CA can help firms enhance their competitive position. CSR is a voluntary corporate action designed to create benefits for diverse stakeholders, including shareholders (Carroll & Shabana, 2010; Mackey et al., 2007). Hence, any firm activity related to resolving environment issues, human rights concerns, community development, and employee welfare can be considered CSR. Currently, firms increasingly engage in CSR for different groups of stakeholders. Approximately 90% of Fortune 500 companies have developed explicit CSR initiatives (Lichtenstein, Drumwright, & Bridgette, 2004). CSR is expected to reinforce a firm’s competitive position by differentiating it from rivals (Hull & Rothenberg, 2008; McWilliams & Siegel, 2001, 2010). From the resource-based view, a firm’s CSR builds good reputation or images of the firm, which are valuable, rare, and inimitable resources that can strengthen a firm’s competitive position (Russo & Fouts, 1997; McWilliams & Siegel, 2010). Such favorable images and reputation will create good relationships with diverse stakeholders and allow a firm to acquire their support, which is also a valuable resource that reinforces the competitive position of a firm (Jones, 1995).

Consistent with these arguments, recent empirical findings generally support a positive relationship between CSR and CFP. A meta-analysis of 52 studies by Orlitzky, Schmidt, and Rynes (2003) found a positive impact of CSR on CFP. Moreover, after reviewing 127 empirical studies, Margolis and Walsh (2003) concluded a mainly positive association between CSR and CFP. Similarly, Peloza (2009) reported that 59% of 128 studies reviewed found positive, 27% mixed or neutral, and 14% negative relationships. A review by Aguinis and Glavas (2012) also found that a small but positive relationship exists between CSR and financial outcomes. Although numerous empirical studies support the positive relationship between CSR and CFP, some inconsistencies in the findings indicate that this relationship may be more complex than a direct causal relationship (Hull & Rothenberg, 2008; Margolis & Walsh, 2003). Scholars have explicated this relationship by exploring contingencies that underlie the mechanisms through which CSR leads to CFP (Bansal, 2003; Godfrey, Merrill, & Hansen, 2009; Wang & Qian, 2011).
CA includes diverse types of competitive moves (e.g., product introduction, capacity expansion, marketing campaigns, and sales) to enhance a firm’s competitive position, which in turn contributes to CFP (Derfus, Maggitti, Grimm, & Smith, 2008; Kim & Tsai, 2012). According to the Austrian economics view of markets, as disequilibrium systems (Schumpeter, 1976), active and incessant CA indicates that a firm is committed to aggressively appeal to the market and its customers. In addition, more CA reflects a firm’s dedication to improving product quality and competitive aggressiveness (Basdeo, Smith, Grimm, Rindova, & Derfus, 2006).

We argue that CA is an important contingency that deserves attention in exploring the CSR-CFP link because both CA and CSR are critical actions for a firm that not only reinforce its competitive positions but also help a firm fulfill its economic and ethical responsibilities. Economic responsibility of a firm is to produce goods and services to society at a profit, which the firm is required to fulfill (Carroll, 1979). Aupperle et al. (1985: 455) argued that a “business has an obligation to be productive and profitable and meet the consumer needs of a society.” Thus, CA is a main approach used to meet a firm’s economic responsibility by satisfying consumer needs through diverse and continuous competitive moves. Ethical responsibility of a firm is to promote social goals beyond the corporate’s immediate financial interests, which the firm is expected to fulfill (Carroll, 1979; Carroll & Shabana, 2010). Given that CSR is a voluntary firm action that improves community well-being, CSR embodies ethical responsibility. Ethical and economic responsibilities simultaneously exist as components of the broad definition of social responsibility; they are neither mutually exclusive nor opposing but overlapping (Carroll, 1979). For instance, CSR actions designed to meet ethical responsibility often help fulfill economic responsibility by differentiating a firm from its rivals (Jones, 1995). Aupperle et al. (1985) found that economic and ethical responsibilities are conceptually independent but empirically interrelated. Similarly, Schwartz and Carroll (2003) argued that ethical and economic responsibilities are encompassing to some extent. In sum, both CA and CSR reinforce a firm’s competitive position and represent economic and ethical responsibilities by fulfilling them. Therefore, independently focusing on CSR might yield insufficient understanding on CSR effects. Thus, exploring CSR effects in relation to CA is necessary to explicate the complex mechanism underlying CSR effects on CFP.

**PCSR, NCSR, and CFP**

As noted, NCSR and PCSR are conceptually distinct, and one way to disentangle the complex CSR-CFP relationship is to decompose CSR into PCSR and NCSR. Conceptually, PCSR actions are meant to ensure the welfare of diverse stakeholders, whereas NCSR actions may potentially harm the interests of stakeholders (Kotchen & Moon, 2011). However, NCSR is not the opposite of PCSR; a firm does not necessarily engage in NCSR if it is not initiating PCSR. For instance, “violence against employees is irresponsible, but the absence of violence is not necessarily responsible; it should be the status quo” (Strike et al., 2006: 851). Thus, firms engage in both PCSR and NCSR simultaneously. Kotchen and Moon (2011) found that firms with high NCSR tend to engage more actively in PCSR to cover up their NCSR. Moreover, PCSR and NCSR are not evaluated equally because cognitive responses to positive and negative events differ (Lange & Washburn, 2012). Thus, PCSR and NCSR are conceptually distinct phenomena with different performance implications for a firm (Muller & Kräussl, 2011).
PCSR has been viewed as a differentiation strategy to help firms achieve competitive positions in the market (Hull & Rothenberg, 2008; Klein & Dawar, 2004). PCSR increases firm reputation and stakeholder support, which directly add to firm value and shareholder wealth (Koh, Qian, & Wang, 2014). Previous studies have argued that PCSR helps promote the socially responsible public image of a firm, which is likely to build favorable relationships with diverse stakeholders. In turn, this facilitates more support from stakeholders in the form of considerable consumer support (Lev, Petrovits, & Radhakrishnan, 2010; Sen & Bhattacharya, 2001), high employee commitment (Greening & Turban, 2000), high level of legitimacy from the community (Fombrun, Gardberg, & Barnett, 2000), and even better governmental relations (Campbell, 2007; Wang & Qian, 2011). Moreover, PCSR can provide insurance value to a firm in the sense that positive moral capital gained from PCSR can mitigate the risk of shareholder value loss when a firm encounters negative events (Fombrun et al., 2000; Godfrey, 2005; Koh et al., 2014; Schnietz & Epstein, 2005). According to the resource-based view, good reputation and support from various stakeholders are valuable resources that PCSR can bring to a firm, which in turn improve a firm’s competitive position (McWilliams & Siegel, 2010; Russo & Fouts, 1997). Accordingly, PCSR is expected to contribute to CFP.

Hypothesis 1a: A positive relationship exists between PCSR and CFP.

By contrast, as a socially undesirable action, NCSR may be negatively associated with a firm’s financial performance because it undermines corporate reputation and destroys relationships with various stakeholders. Specifically, NCSR risks consumer disfavor, protests by activist groups, and negative media coverage (Barnett & Salomon, 2006). Thus, NCSR results in a general degradation of a firm’s reputation. For example, Amujo, Laninhun, Otubanj, and Ajala (2012) found that a multinational corporation’s irresponsible activities, such as environmental pollution, tax evasion, and contract scandals, substantially detract from a firm’s reputation and ultimately harm its performance. In addition to a decline in reputation, NCSR is likely to harm stakeholder relationships because it is a “bad” deed of a firm that reduces stakeholder value (Kotchen & Moon, 2011). The ruined relationship with diverse stakeholders prevents effective resource acquisition from them and, subsequently, could reduce firm performance (e.g., Barnett & Salomon, 2006; Dowell, Hart, & Yeung, 2000). Barnett and Salomon (2006) found that mutual funds that use a larger number of screens against irresponsible social behaviors show superior financial performance. Similarly, Muller and Kräusss (2011) reported that during the aftermath of Hurricane Katrina, firms with a reputation for social irresponsibility were associated with the greatest drop in stock prices. Accordingly, we predict that a firm performance would decrease as the firm engages in NCSR.

Hypothesis 1b: A negative relationship exists between NCSR and CFP.

Interaction Effects Between PCSR and CA on CFP

We predict that CA positively moderates the relationship between PCSR and CFP because a firm, as a business entity, should simultaneously fulfill its economic and social responsibilities (Aupperle et al., 1985; Carroll, 1979). Fulfilling its economic responsibility is an important criterion for the evaluation of a firm, because the general public pays particular attention
to a firm’s economic responsibility by focusing on whether a firm is able to provide goods or services that satisfy the needs of the public (Mohr, Webb, & Harris, 2001). Thus, CA, which reflects a firm’s economic responsibility, becomes an important condition that complements the effect of PCSR as an action mainly for its ethical responsibility (Tuzzolino & Armandi, 1981).

When the level of CA is low, PCSR may appear unexpected and a labored behavior that hinders effective resource acquisition from diverse stakeholders; without fulfilling its economic responsibility, stakeholders are less likely to appreciate the social behaviors of a firm and thus are less likely to offer their support to a firm (Wang & Qian, 2011). In such a situation, PCSR can be considered as a trade-off, making up for the lack of economic responsibility, and thus such PCSR would be less favorably accepted by stakeholders (e.g., Luo & Bhattacharya, 2009; Sen & Bhattacharya, 2001). Consumers may view PCSR activities by firms with low CA as opportunistic and discredited, possibly causing PCSR to backfire (Grandey, Fisk, Mattila, Jansen, & Sideman, 2005). For example, Sen and Bhattacharya (2001) found that CSR efforts could hurt a firm if such CSR is realized at the expense of developing corporate capabilities, such as product quality and innovation. Similarly, Luo and Bhattacharya (2006: 4) argued that “CSR initiatives fail to generate a favorable impact if the firm is perceived as less innovative and as offering poor quality products.”

Meanwhile, when a firm actively engages in CA, simultaneous engagement in PCSR will help such a firm to gain diverse supports from various stakeholders, such as employees, customers, and suppliers (Godfrey, 2005). In this case, PCSR is viewed as a natural step for the firm and also is considered a “sincere manner.” Thus, CA could complement PCSR effect by making stakeholders react more positively to such PCSR. A prior study also found that the general public responds favorably to PCSR, given parity in price and quality (Cone Communications, 1999). In summary, resource acquisition from diverse stakeholders through PCSR is more effective when CA is high, leading to better financial performance when a firm has simultaneously fulfilled its economic and ethical responsibilities through CA and PCSR. Consequently, we present the following hypothesis:

**Hypothesis 2:** The relationship between PCSR and CFP is moderated by a firm’s level of CA, such that the positive relationship between PCSR and CFP is stronger when the level of CA is higher.

**Interaction Effects Between NCSR and CA on CFP**

Similarly, the effect of a firm’s NCSR on CFP may also vary with the firm’s level of CA. In particular, we suggest that CA exacerbates the negative effect of NCSR on CFP for various reasons. First, NCSR brings several disadvantages to a firm, including undermined corporate image or reputation and damage to relationships with various stakeholders. Such disadvantages would be even greater when a firm has a high level of CA. A high level of CA indicates that a firm is actively trying to fulfill its economic responsibility. Thus, this firm is expected to simultaneously engage in actions to achieve its ethical responsibility (Aupperle et al., 1985; Carroll, 1979). In such a situation, NCSR is an action that deviates from stakeholders’ expectation, thereby critically degrading the firm’s reputation and image. Scholars have argued that when certain expectations exist, disconfirmation of these expectations leads to disappointment, which in turn leads to negative impacts on the actor who fails to meet the expectations (Zeelenberg, van Dijk, Manstead, & van der Pligt, 2000). For example,
Zeelenberg and Pieters (2004) showed that when a firm disappoints customers and fails to meet their expectations, customers tend to be dissatisfied, complain, and even stop purchasing the firm’s products. Thus, when a firm actively engages in CA, NCSR even more critically damages the firm’s reputation and hinders support from stakeholders by not meeting their expectations. For example, Nike, Inc., famous for its diverse and active CAs, such as marketing and new product introductions, was criticized for not meeting its ethical responsibility (e.g., using child labor in underdeveloped countries). As a result, the stock price of Nike, Inc., significantly dropped when the news was released (Cushman, 1998). Second, as a firm engages actively in CA, its public exposure also increases (Basdeo et al., 2006), which then puts the firm under higher scrutiny by stakeholders. Such a firm’s NCSR is more readily identified than that of other firms with less exposure to the public, as the public normally places higher scrutiny on more visible firms. Therefore, the reputation damage experienced by a firm because of NCSR would be more significant when the level of CA is high, which amplifies the negative effects of NCSR on CFP.

By contrast, when the level of CA is low, the effect of a firm’s NCSR would be less negative. Although NCSR is detrimental to firm reputation and firm-stakeholder relationship, it may potentially create value to a firm through cost saving at the expense of stakeholder interests (Mani & Wheeler, 1998; Strike et al., 2006; Tang, Qian, Chen, & Shen, 2015). For example, firms may save operating costs by engaging in NCSR, such as using nonrefined oil, even though this can lead to environmental pollution. Kotchen and Moon (2011: 2) stated that firms engage in NCSR “in order to take advantage of profitable opportunities or to avoid higher costs.” Saving cost is considered an additional way to increase CFP (Porter, 1980; Li et al., 2009) and satisfies a firm’s economic responsibility. Thus, when the level of CA is low, NCSR enables a firm to decrease the price of its product as well as production cost, which contributes to firm profit. Moreover, a firm with a low level of CA is less exposed to the public. Thus, its NCSR might be less noticed by various stakeholders. In other words, NCSR might be less detrimental to firm reputation when CA is low, because the bad deeds of such a firm are less recognized by stakeholders. Furthermore, in such a situation, a firm may be able to mislead or manipulate customers via NCSR. For example, from a thorough case study of Fair and Lovely’s whitening cream in India, Karnani (2007) argued that the lack of information about the firm is the main reason why Fair and Lovely enjoys profits from its manipulation of customers. If customers do not know much about the firm or the product, then the firm can easily exploit them by providing inaccurate information. Given that a firm with a low level of CA is less exposed to the public and information on the firm is limited, NCSR is less salient and may be used to manipulate customers. Thus, NCSR’s effect on CFP would be less negative under a low level of CA. Consequently, we propose the following hypothesis:

Hypothesis 3: The relationship between NCSR and CFP is moderated by a firm’s level of CA, such that the negative relationship between NCSR and CFP is stronger when the level of CA is higher.

Method

Sample

We obtained samples from the U.S. software industry to test our hypotheses. We selected the software industry for two main reasons. First, firms in this industry actively engage in CA to
outperform their rivals, given that this industry is characterized by fierce competition (Gardner, 2005; Young, Smith, Grimm, & Simon, 2000). Second, firms taking high-level risks may benefit from CSR because firm reputation, a valuable resource gained from CSR, can mitigate the potential damage from risks (Koh et al., 2014; Williams & Barrett, 2000). CSR activities are likely to play a major role in the software industry considering that it is characterized as having a high level of litigation risk (e.g., Francis, Philbrick, & Schipper, 1994; Matsumoto, 2002). Thus, both CA and CSR are equally important to business operations in the software industry.

We initially identified 185 software firms (Standard Industrial Classification code 7372) from the Compustat Xpressfeed database that were in operation from 2000 to 2005. We then focused only on firms with a minimum of 2 years’ worth of CSR information in the Kinder, Lydenberg, Domini, and Co., Inc. (KLD) data set. We excluded 72 firms that either lacked CSR information in the KLD data set or had only a year’s worth of CSR information. This procedure yielded 113 firms as our final sample. We obtained necessary financial statement data regarding these sample firms from the Compustat Xpressfeed database. We then obtained data regarding PCSR and NCSR from the KLD data set. We retrieved all news articles related to software firms’ CAs from the Factiva database to obtain CA data. This sample was composed of unbalanced panel data, including 565 unique firm-year observations.

**Measures**

**Dependent variable: Tobin’s Q.** Tobin’s Q is the ratio of the sum of the market value of the firm and the book value of its debt to its total assets (e.g., Chung & Pruitt, 1995). Thus, this measure captures the firm’s growth potential and profit sustainability (Luo & Bhattacharya, 2006). As a forward-looking measure that reflects the investors’ expectations on the firm’s future profitability (Rao, Agarwal, & Dahlhoff, 2004), certain scholars argue that Tobin’s Q is biased with investors’ investment behaviors (e.g., Shleifer, 2000). Despite this drawback, Tobin’s Q is frequently used to test the CSR-CFP relationship as an indicator of CFP (e.g., Luo & Bhattacharya, 2006; Wang & Qian, 2011) because CSR’s outcomes are not necessarily realized in short-term profits. Following prior studies, we also used Tobin’s Q as the measure of CFP to test our hypotheses.

**Independent variables: PCSR and NCSR.** PCSR and NCSR data were obtained from the KLD data set. The KLD data set contains binary-item measures of firm engagement along seven social dimensions, namely, community, corporate governance, diversity, employee relations, environment, human rights, and product. Following prior studies (e.g., Hillman & Keim, 2001; Kacperczyk, 2009), we excluded the corporate governance and human rights dimensions to focus on those that represent voluntary corporate activities for primary stakeholders (Wang & Choi, 2013; Tang et al., 2015). We also excluded the product quality dimension, which represents a firm’s efforts for extra quality control and product safety (Minor & Morgan, 2011) and potentially shares some similarities with CA. The exclusion of this dimension clarifies the distinction between CSR and CA at the level of empirical analysis.

Each of the four dimensions involves different categories of CSR strengths and concerns (weaknesses). Within each category, KLD assigns 1 or 0 based on whether a firm meets certain criteria (Mattingly & Berman, 2006). To create PCSR (or NCSR), we counted the number of strengths (or concerns) of all four dimensions and then divided this score by the total
number of categories in four dimensions (see the KLD manual for further details of the categories).

**Moderator: CA.** CA refers to any newsworthy move, such as marketing, new product introduction, and capacity increase, initiated by a firm to reinforce its competitive position within the industry (Smith et al., 2001; Young, Smith, & Grimm, 1996). CA is likely to be reported in the press, given that it is visible to customers, competitors, and other stakeholders. Thus, we identified and obtained information on CA from publicly available news sources using prior competitive dynamics research as a guide (Basdeo et al., 2006; Derfus et al., 2008; Kim & Tsai, 2012). We identified and coded CA by conducting a structured content analysis (Jauch, Osborn, & Martin, 1980) of news announcements found in the Factiva article index. This index allows electronic searching of full-text articles from thousands of newspapers and journals. To ensure the credibility of the source, we retrieved news from *The New York Times, The Wall Street Journal, Business Wire, and PR Newswire*.

We found 57,940 articles with the sample firms in their headlines in the Factiva database. An author read all the randomly selected 3,000 articles and generated keywords that were likely to indicate competitive moves. Each competitive move was classified into one of five action types based on the keywords that reflect each type. These types are as follows: capacity expansion (keyword examples: extend, increase, distribute, and acquire), development announcement (develop, reinvent, adopt, and improve), marketing action (advertise, celebrate, marketing, sponsor, and promote), new product introduction (breakthrough, available, introduce, unleash, and unveil), and sales agreements, including licensing (choose, deliver, ship, retail, and sell). The keywords and action types developed in this study are highly consistent with previous studies (e.g., Basdeo et al., 2006). After developing keywords and action types, we conducted a keyword search of the Factiva database and identified a total of 15,440 actions from the 113 firms over the 6-year period. To verify the accuracy of the coding, two coders randomly reviewed 1,000 articles and obtained 95.4% of the coding agreement. Marketing activity constituted the largest portion of total CA (37%), followed by new product introduction (27%). Development announcements and sales accounted for 16% and 15%, respectively. The mean number of actions for each firm per year was 22.78.

We calculated the total CA of a firm in a year by summing the numbers of all types of actions except marketing in a year. Some marketing actions, such as cause-related marketing and sponsorships, are frequently regarded as CSR. Thus, to minimize the overlap between CA and CSR, we excluded marketing actions from our measure of CA. Competitive-dynamics research has shown that the total CA amount of a firm is an effective indicator of its capability to create value for the firm (Basdeo et al., 2006). Thus, this CA measure has been widely used in competitive-dynamics research (Basdeo et al., 2006; Derfus et al., 2008).

**Control variables.** We included several control variables in our model to control the factors that potentially predict Tobin’s Q. We controlled for advertising intensity, R&D intensity, firm size, firm age, return on assets, leverage, and liquidity, based on the extensive review of studies that used Tobin’s Q as a measure for firm performance (e.g., Hirschey & Weygandt, 1985; Surroca, Tribó, & Waddock, 2010). Eliminating firm-year observations with missing advertising and R&D expenditures significantly reduced our sample size. Thus, we replaced the missing advertising and R&D data with zero and then included two dummies (dum_Advertising and dum_R&D) to indicate whether advertising and R&D data were missing (cf. Luo &
Bhattacharya, 2009). We also included year dummies to control for the effect of year on firm value. We describe the construction of all variables in detail in the appendix.\textsuperscript{7}

We used theoretical and control variables that lagged by 1 year to strengthen our causality arguments following existing literature that tested the impact of CSR using cross-sectional time-series regression models (e.g., Wang & Qian, 2011). Using these lagged predictors allowed us to control a potential reverse causality problem regarding the relationship between our theoretical variables and Tobin’s Q (McAlister, Srinivasan, & Kim, 2007).

Model and Estimation Method

We developed a model to predict Tobin’s Q as a function of the variables described in the previous section. The model used to test the proposed hypotheses is given below.

\[
\text{Tobin’s Q}_{it+1} = \alpha + \beta_1 \text{PCSR}_{it} + \beta_2 \text{NCSR}_{it} + \beta_3 \text{PCSR}_{it} \times \text{CA}_{it} + \beta_4 \text{NCSR}_{it} \times \text{CA}_{it} + \\
\beta_5 \text{CA}_{it} + \beta_6 \text{Advertising intensity}_{it} + \beta_7 \text{R&D intensity}_{it} + \beta_8 \text{dum}_\text{Advertising}_{it} + \\
\beta_9 \text{dum}_\text{R&D}_{it} + \beta_{10} \text{Firm size}_{it} + \beta_{11} \text{Firm age}_{it} + \beta_{12} \text{Return on assets}_{it} + \beta_{13} \text{Leverage}_{it} + \\
\beta_{14} \text{Liquidity}_{it} + \delta_1 \text{Year dummies}_{i,t+1} + \epsilon_{it+1},
\]

where \(i\) indicates a firm, \(t\) indicates a year; Tobin’s Q is the financial performance metric, CA is the total number of CAs, PCSR is the total PCSR score, NCSR is the total NCSR score, and \(\epsilon_{it+1} \sim i.i.d.N(0, \sigma^2)\). We set coefficients \(\beta_2, \beta_3,\) and \(\beta_4\) as zero to test Hypothesis 1a and coefficients \(\beta_1, \beta_3,\) and \(\beta_4\) as zero to test Hypothesis 1b.

The data used to estimate the model were unbalanced panel data with multiple firm observations in multiple years. Residuals from ordinary least squares (OLS) estimations on panel data may be correlated across firms in a given year or across years in a given firm. The residuals correlated by OLS can result in biased standard errors because the assumption that errors are independently distributed identically may be invalid (Petersen, 2009). We tested the significance of the estimated coefficients using \(t\) statistics based on standard errors corrected for double (i.e., firm and year) clustering (Petersen, 2009).\textsuperscript{8}

Empirical Results

Table 1 summarizes the descriptive statistics of all the variables in our model. Although the pairwise correlations among the independent variables are not particularly high, firm size is correlated with other variables, which potentially raises a multicollinearity concern. A further check of the variance inflation factor (VIF) of the variables reveals no serious multicollinearity concern, with a maximum VIF of 4.38 and a mean VIF of 2.07.

Table 2 shows the results of the regression model used to test the proposed hypotheses. Model 1 reports the results from the baseline model estimation, which includes CA and control variables. Consistent with existing literature (e.g., Derfus et al., 2008; Miller & Chen, 1996), CA is positively related to Tobin’s Q (\(\beta = 0.02, p < .01\)). Moreover, R&D intensity and return on assets are positively associated with Tobin’s Q, whereas liquidity and firm size are negatively related to Tobin’s Q. Model 2 tests Hypotheses 1a and 1b by showing the effects of PCSR and NCSR on Tobin’s Q. As predicted in Hypothesis 1a, PCSR is positively associated with Tobin’s Q (\(\beta = 8.24, p < .01\)). Thus, Hypothesis 1a is supported. The coefficient for NCSR, however, is insignificant (\(\beta = .02, \text{ns}\)), suggesting
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<td>2. CA&lt;sub&gt;t&lt;/sub&gt;</td>
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<td>6. R&amp;D intensity&lt;sub&gt;t&lt;/sub&gt;</td>
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<td>5.82</td>
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<td>8. Firm age&lt;sub&gt;t&lt;/sub&gt;</td>
<td>6.83</td>
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<tr>
<td>9. Return on assets&lt;sub&gt;t&lt;/sub&gt;</td>
<td>−0.07</td>
<td>0.33</td>
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<td>11. Liquidity&lt;sub&gt;t&lt;/sub&gt;</td>
<td>2.90</td>
<td>1.87</td>
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<td></td>
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</table>

**Note:** CA = competitive action; PCSR = positive corporate social responsibility; NCSR = negative corporate social responsibility.

\*p < .10.

\*\*p < .05.

\*\*\*p < .01.
that NCSR does not meaningfully influence a firm’s financial performance. Thus, Hypothesis 1b is not supported.

In Table 2, Models 3 and 4 show the interactions between PCSR and CA and between NCSR and CA, respectively, whereas Model 5 includes all interactions between PCSR and CA and between NCSR and CA simultaneously. We rely on Model 5 to test Hypotheses 2 and 3 because Model 5 is a fully specified model and provides an accurate picture of the impact of each
variable. Hypothesis 2 predicts that CA positively moderates the relationship between PCSR and Tobin’s Q. The positive relationship between PCSR and Tobin’s Q becomes stronger with more CA. As seen in Model 5, the coefficient for the interaction between PCSR and CA is positive and significant ($\beta = 0.14, p < .05$). This result indicates that when a firm engages in more CA, the effect of PCSR on Tobin’s Q strengthens, which is consistent with Hypothesis 2. Hypothesis 3 predicts a stronger negative relationship between NCSR and firm financial performance when more CA exists. In Model 5, the coefficient for the interaction between NCSR and CA is negative and significant ($\beta = -0.20, p < .05$). This negative interaction suggests that when a firm’s CA level is high, NCSR’s effect on Tobin’s Q is negative, as predicted in Hypothesis 3.

Based on the results from Model 5, we plotted the interaction effect using one standard deviation above and below the mean of CA. As shown in Figure 1, PCSR is more positively associated with Tobin’s Q when CA is high than when CA is low. This interaction pattern is consistent with our prediction and supports Hypothesis 2. Figure 2 presents an interaction plot between NCSR and CA. As shown in this figure, NCSR is negatively associated with Tobin’s Q when CA is high. However, the association becomes positive when CA is low. Thus, Figure 2 confirms Hypothesis 3.

The results of Hypothesis 3 and Figure 2 may explain the insignificant main effect of NCSR as predicted in Hypothesis 1b. The insignificant effect of NCSR on CFP implies that the nature of NCSR is more complex than expected. On the one hand, NCSR as a “bad” deed can be harmful to a firm’s financial performance by undermining firm image or reputation. On the other hand, NCSR can also be beneficial by helping a firm save cost. Results of
Hypothesis 3 and Figure 2 support this view on NCSR by demonstrating that the effect of NCSR is negative when CA is high but positive when CA is low.

In summary, based on the meaning of Tobin’s Q, our findings indicate that firms with high PCSR are expected to enjoy higher profit and are expected to enjoy even higher profit when CA is high. By contrast, firms with high NCSR are expected to achieve high profit when CA is low.

**Robustness Check**

We conducted a robustness check with size-adjusted CA as an alternative CA measure. In fact, some companies are likely to be discussed more in the media than others. Thus, although we followed the conventional data collection procedure in competitive-dynamics literature, our measure of CA (i.e., publicly available visible actions) may mainly capture a firm’s visibility in the press rather than its real CA. Especially, given that “the larger a firm becomes, the more likely it is to catch the public’s eye” (Meznar & Nigh, 1995: 980), our CA measure may reflect firm size. To address this concern, we used size-adjusted CA as an alternative CA measure. Size-adjusted CA (denoted as aCA) is generated by dividing CA by firm size. The results from this measure are reported in Table 3.

Most results are consistent with those reported in Table 2. In detail, as shown in Model 2 in Table 3, PCSR is positively related to Tobin’s Q, but NCSR is insignificant. Notably, Model 5, which is a full model that includes all interactions simultaneously, shows that the interaction effects between PCSR and aCA and those between NCSR and aCA are also
consistent with the results in Table 2. In summary, these results suggest that our findings are robust to the alternative measure of CA and indicate that our measure of CA is distinct from visibility.

Furthermore, to directly investigate any potential visibility effect, we tested Hypotheses 2 and 3 by replacing CA with firm size and assuming that firm size is an effective proxy for

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
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<td>—</td>
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<td>2.18</td>
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<td></td>
<td>(5.39)</td>
<td>(1.11)</td>
<td>(5.52)</td>
<td>(1.14)</td>
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<td></td>
<td>(0.05)</td>
<td>(0.23)</td>
<td>(1.28)</td>
<td>(1.36)</td>
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<tr>
<td>PCSR_t × aCA_t</td>
<td>—</td>
<td>—</td>
<td>2.14**</td>
<td>—</td>
<td>2.08**</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>(3.70)</td>
<td></td>
<td>(3.40)</td>
</tr>
<tr>
<td>NCSR_t × aCA_t</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>−1.82†</td>
<td>−1.50*</td>
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<td>aCA_t</td>
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<td>0.13**</td>
<td>0.02</td>
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<td>R&amp;D intensity_t</td>
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</tr>
<tr>
<td></td>
<td>(2.02)</td>
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<td>(0.27)</td>
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<td>(5.56)</td>
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<td>0.24</td>
<td>0.26</td>
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</table>

Note: CSR = corporate social responsibility; CA = competitive action; PCSR = positive CSR; NCSR = negative CSR. aCA is an adjusted CA scaled by firm size. The t statistics calculated with standard errors adjusted by firm- and year-level clustering are presented in parentheses. Year dummy variables are included in all models.

†p < .10.
* p < .05.
** p < .01.
the firm’s visibility. We find that the interaction between firm size and PCSR is positive and significant but that the interaction between firm size and NCSR is insignificant, which is different from the result for the interaction between CA and NCSR. These results demonstrate that our CA differs from visibility. The results are available from authors upon request.

**Discussion**

In this study, we attempted to explore the complex relationship between CSR and CFP by using CA as a contingency. Specifically, we first distinguished CSR into PCSR and NCSR and then examined how the effects of PCSR and NCSR vary with CA. Using data on U.S. software firms between 2000 and 2005, we find that PCSR is positively associated with CFP, and this positive relationship is strengthened when the firm actively engages in CA. Results indicate that a firm’s CA complements PCSR by augmenting the effect of PCSR on CFP. We also find that NCSR harms a firm’s CFP when the level of its CA is high, but the negative impact of NCSR is mitigated when the level of CA is lower. This result regarding the NCSR-CFP link may indicate that although NCSR may be socially harmful, it might contribute to a firm in a particular situation.

Our findings advance CSR literature in several ways. First, the theoretical argument and the empirical findings in this paper emphasize that exploring CSR effects in relation with CA is important in elucidating the mechanism through which CSR affects CFP. As a business entity operating in a society, a firm is expected to fulfill both economic and ethical responsibilities (Carroll, 1979; Carroll & Shabana, 2010). Given that both CA and CSR are firm actions that primarily represent economic and ethical responsibilities, respectively, the current study claims that a firm’s CA should be an important consideration in exploring the performance implications of CSR. Our findings suggest that CA can be an important boundary condition of the CSR-CFP link in addition to several contingencies examined by previous studies (Bansal, 2003; Godfrey et al., 2009; Wang & Qian, 2011). In this sense, this study adds to CSR literature by identifying a new contingency that explains the complex relationship between CSR and CFP.

Second, our research is one of the few studies that decomposed CSR into PCSR and NCSR and empirically examined the effects of both PCSR and NCSR on CFP simultaneously. Several studies on CSR have emphasized that PCSR and NCSR are different concepts and should be distinguished from the other to gain a better understanding of the CSR-CFP link (e.g., Kotchen & Moon, 2011; Muller & Kräussl, 2011; Strike et al., 2006). Moreover, simultaneous investigation of PCSR and NCSR has been requested to delve deeply into their differing dynamics (Muller & Kräussl, 2011). To the best of our knowledge, this study is the first attempt to empirically demonstrate the distinctive effects of PCSR and NCSR on firm performance: The effect of PCSR on firm performance is positively moderated by CA, whereas that of NCSR is negatively moderated by CA. These results also suggest that both types of CSR actions should be separated when examining CSR’s effects on CFP.

Third, this study sheds new light on the implications of NCSR for CFP. Although NCSR is not the direct opposite of PCSR, its impact on CFP has been neglected in literature (e.g., Karnani, 2007; Muller & Kräussl, 2011). We find that NCSR does not necessarily decrease performance; in a particular situation (e.g., when the level of CA is low in our study), NCSR can actually help a firm increase its financial performance even though it may potentially
undermine social welfare. Thus, this result suggests that NCSR is not always an action that a firm should avoid. With our finding, we do not claim that NCSR is either a desirable or an undesirable action. Our result simply suggests a situation in which NCSR can be good for financial performance.

Moreover, this study suggests potentially interesting dynamics in PCSR and NCSR. Considering that we found a marginally significant positive correlation between PCSR and NCSR, firms may use PCSR to cover up their NCSR (Kotchen & Moon, 2011). Thus, the positive effect of NCSR when CA is low may be because PCSR is initiated to hide NCSR; a firm engaging in NCSR also actively initiates PCSR to cover it. Therefore, the positive relationship between NCSR and firm performance when CA is low can be attributed to PCSR. However, we found a negative relationship between PCSR and firm performance when CA is low. This result indicates that the effects of PCSR and NCSR have different mechanisms and suggests that engaging in more PCSR to cover up NCSR may not be an effective strategic action for a firm.

Finally, our findings provide interesting and important practical implications. Prior studies on CSR have debated on whether firms should engage in CSR activities (e.g., Griffin & Mahon, 1997; Orlitzky et al., 2003). Our study suggests that managers should consider whether their firm actively engages in CA when it engages in PCSR or NCSR. Although PCSR can contribute to CFP in general, its effect could be even greater if the firm is actively conducting CA because CA would complement PCSR by fulfilling the firm’s economic responsibility. Hence, to best capitalize on PCSR, managers need to check their firm’s level of CA and consider PCSR an appropriate action when sufficient CA is already being implemented. Otherwise, when CA is insufficiently implemented, saving cost with NCSR may actually be a better strategic option.

Although we provide intriguing findings on CSR and its effects on firm performance, some limitations exist and they raise the possibility of further studies. First, a future study can generalize our findings with a sample of firms in multiple industries. Although the software industry is an appropriate context in which to test our hypotheses, results from a test with a multi-industry sample can be more generalizable. Similarly, a test with a sample of firms in other industries may provide industry-specific implications on the CSR-CFP link and CA’s moderating effect on this link. Second, CSR and CA have similar aspects, and thus, clearly distinguishing between the two is sometimes difficult. In particular, cause-related marketing or sponsorship simultaneously has both CSR and CA aspects. Moreover, some firms use CSR as a key competitive weapon. We attempted to empirically distinguish these overlapping aspects by excluding marketing actions from CA, because marketing actions are more likely to overlap with CSR than other types of CA, such as new product introductions or technology developments. We also excluded the product dimension score from the KLD database in measuring CSR because this dimension shares similar characteristics with CA’s new-product introduction. Moreover, we tried different combinations of CSR and CA measures (e.g., CA with or without marketing actions and CSR with or without product dimension) and found that the results from the diverse combinations are consistent. Although these additional analyses showed that our results are robust, an alternative CSR measure, like the actual dollar amount invested in CSR, may provide extra insights on performance implications of CSR (cf. Godfrey et al., 2009). Thus, future research might be conducted to construct more direct measures of CSR (including both PCSR and NCSR), which can generate a finer-grained analysis of the combined effects of CA and CSR.
The findings of this study contribute to future research in several ways. First, future research may delve more deeply into the meaning of NCSR to a firm and society (e.g., Muller & Kräussl, 2011; Tang et al., 2015). We find that NCSR is not always harmful to a firm because it can be beneficial in a particular situation. However, if the firm keeps using NCSR, the costs of NCSR may outweigh the benefits by damaging the firm’s reputation and relationships with different stakeholders. Therefore, more studies on NCSR and the situations in which firms can benefit from NCSR should be conducted. Relatedly, dynamics between PCSR and NCSR can be more deeply investigated by future research. Although our findings suggest that PCSR and NCSR may have different mechanisms, a firm can engage in PCSR to cover up NCSR (Kotchen & Moon, 2011). However, a firm with high PCSR could possibly engage in more NCSR if it is satisfied with its PCSR. Thus, examining how PCSR and NCSR influence each other, how PCSR is initiated to cover up NCSR, and how NCSR that is engaged in after high PCSR affects a firm would be an interesting study that advances CSR literature. Finally, further studies can examine the cooperative action of a firm as another contingency that explicates the CSR-CFP link. Competition and cooperation are two vital strategic options for firms (Chen, 2008). Moreover, cooperative action, like strategic alliance, enables a firm to acquire valuable resources as CSR does. Thus, similar to CA, cooperative action may also influence CSR’s effects on financial performance. Compared with the current study that focuses on CA, exploring whether the relationship between CSR and CFP varies with cooperative action might be another fruitful future research direction.

Conclusions

In this study, we explored CA as a key contingency that determines the effects of CSR on CFP. Arguing that CA is a firm’s action that fulfills its economic responsibility, we find that the relationship between PCSR and CFP is moderated positively by CA and that NCSR is moderated negatively by CA. With these results, this study emphasizes the importance of examining CA in understanding the performance implications of CSR and paves the way for a better understanding of contingencies when CSR is financially beneficial.

Appendix

Variable Operationalizations

<table>
<thead>
<tr>
<th>Variable</th>
<th>Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobin’s Q</td>
<td>(\frac{(\text{Total assets} - \text{common equity}) + (\text{common shares outstanding} \times \text{share price})}{\text{total assets}})</td>
</tr>
<tr>
<td>Advertising intensity</td>
<td>Advertising expense / total assets</td>
</tr>
<tr>
<td>R&amp;D intensity</td>
<td>R&amp;D expense / total assets</td>
</tr>
<tr>
<td>dum_Advertising</td>
<td>1 if advertising expense is missing, 0 otherwise</td>
</tr>
<tr>
<td>dum_R&amp;D</td>
<td>1 if R&amp;D expense is missing, 0 otherwise</td>
</tr>
<tr>
<td>Firm size</td>
<td>log(total assets)</td>
</tr>
<tr>
<td>Firm age</td>
<td>Year (t) minus year recorded in the Center for Research in Security Prices for the first time</td>
</tr>
<tr>
<td>Return on assets</td>
<td>Income before extraordinary items / total assets</td>
</tr>
<tr>
<td>Leverage</td>
<td>(Long-term debt + debt in current liabilities) / total assets</td>
</tr>
<tr>
<td>Liquidity</td>
<td>Current assets / current liabilities</td>
</tr>
</tbody>
</table>
Notes

1. Legal responsibility indicates that a firm is required to follow the obligations placed on the business by the laws and regulations of society where this firm operates (Carroll & Shabana, 2010). Given that a firm should obey the law to operate in society, legal responsibility is a need that firms should meet. In this sense, legal responsibility is not a domain of firm’s strategic decision. On the contrary, ethical responsibility is an obligation rather than need because firms can still survive although this responsibility is not met. Thus, ethical responsibility is a domain of firm’s strategic decision.

Discretionary responsibilities are purely voluntary activities of a firm as a member of society, such as philanthropic contributions and providing day care for working mothers (Carroll, 1979: 500). However, discretionary and ethical responsibilities are hardly distinguished (Aupperle, Carroll, & Hatfield, 1985), and even the former is a part of the latter (Schwartz & Carroll, 2003). Given these characteristics, we did not consider legal and discretionary responsibilities.

2. Corporate social responsibility (CSR) can also be an action for economic responsibility (Jones, 1995). However, CSR pursues social goals as well as an immediate financial interest. For example, cause-related marketing activity is defined as a subset of CSR because of a concern for society (Varadarajan & Menon, 1988). In this sense, CSR is considered an action for ethical responsibility rather than economic responsibility, although CSR does not exclude an economic aspect. We thank one of the anonymous reviewers for specifying this issue.

3. Scholars have used the terms corporate social irresponsibility and negative CSR (NCSR) interchangeably to refer to the negative aspect of CSR (Godfrey, Merrill, & Hansen, 2009; Kotchen & Moon, 2011; Muller & Kräussl, 2011; Strike, Gao, & Bansal, 2006).

4. Parentheses are present in the original.

5. The majority existing CSR studies using Kinder, Lydenberg, Domini, and Co., Inc. (KLD) data have combined these two concepts into a single measure as an overall CSR of a firm. For example, the firm-level CSR score in several existing CSR studies (e.g., Servaes & Tamayo, 2013; Waddock & Graves, 1997) is typically measured by subtracting the total number of NCSR actions (concerns in KLD) from that of positive CSR (PCSR) actions (strengths in KLD). Contrary to these studies, the present study considers strengths in KLD as PCSR and concerns in KLD as NCSR and tests the differential effects of PCSR and NCSR on financial performance.

6. The name of these data was changed to MSCI ESG STAT in 2011. For ease of presentation, we use the previous name.

7. We winsorized the continuous variables used in our regression models at the top and bottom 1% to eliminate the influence of potential outliers.

8. See Petersen (2009) for a detailed discussion of why double-clustered standard errors must be used to correct serial and cross-sectional residual correlations in panel data. We also tested the models using robust regression. The results with respect to the proposed hypotheses were substantially identical to the presented results.

9. We appreciate this insight from the anonymous reviewers.

References


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