

The effect of CSR on firm performance

Causality and employee motivation

Introduction and empirical background

In recent years, sustainable development has received significantly more attention from both politicians and the public. This has resulted in fundamental changes within the world of international business. Many do no longer regard profitability as the sole purpose of business and choose to also focus on other ways in which firms can contribute to society. Firms are now expected to take action against their negative externalities, and those who do not, risk facing a backlash. Because of these changes, the concept of corporate social responsibility has become much more prominent. This is important, considering a rise in consumer awareness of sustainability, which means that many consumers prefer buying products made using sustainable materials or methods.¹

The increased focus on CSR activities has been quite drastic, with the Fortune Global 500 spending approximately 20 billion USD a year on CSR activities.² Moreover, companies focusing on CSR are operating across many vastly different industries. This demonstrates that CSR has become a universal phenomenon within the business environment. A way to illustrate the development of CSR is to focus on the significant growth in the share of large firms publishing annual CSR reports:

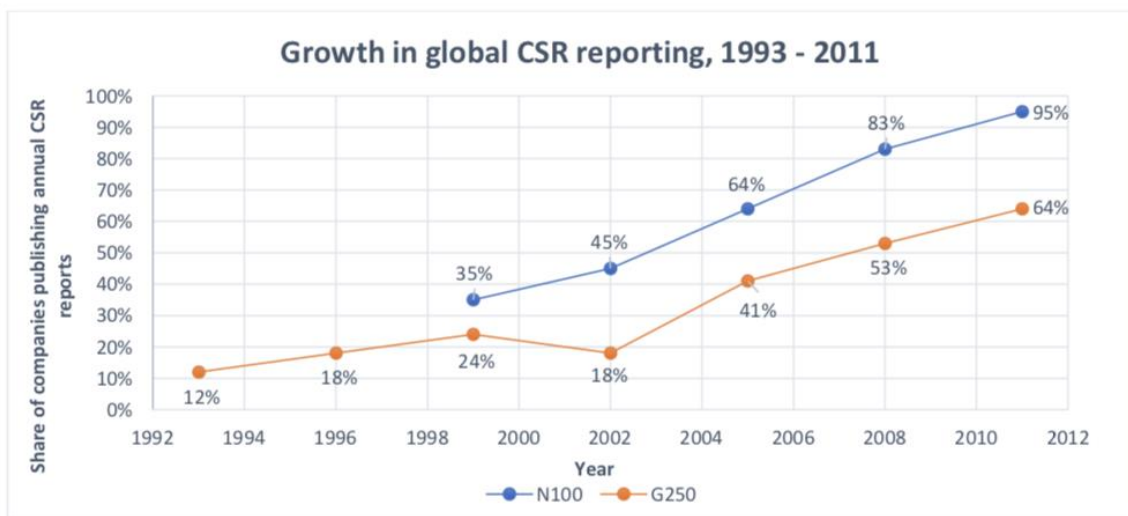


Figure 1. Growth in global CSR reporting between 1993 and 2011. N100 is based on a sample of the 100 largest companies from each of 49 countries measured on revenue. G250 refers to the global 250 largest companies measured on revenue. Source: Blasco & King: "KPMG Survey of Corporate Responsibility Reporting 2017"

Among the 250 largest companies globally measured on revenue, 64% published annual CSR reports in 2011 up from 18% in 2002 (Blasco, King 2017). Aside from the remarkable fast growth in the share of large companies publishing annual CSR reports, there is also an increasing tendency for these companies to include CSR information in their annual financial reports:



Figure 2. Growth in G250 companies including CSR information in their annual financial reports between 2011 and 2017. G250 refers to the global 250 largest companies measured on revenue.
Source: Blasco & King: "KPMG Survey of Corporate Responsibility Reporting 2017"

With 78% of the G250 companies including CSR information in their annual reports, up from 44% in 2011 (Blasco, King 2017), this demonstrates the increased importance of CSR. It also signifies that the CSR profile has become a much more defining characteristic of the company itself. The CSR profile is valuable to communicate not only to consumers but also to investors and other stakeholders.

CSR already plays a defining role today and will likely play an even larger role moving forward as consumer and stakeholder awareness for sustainability increases. This is particularly the case regarding environmental protection and the fight against climate change. However, during recent years, working conditions and other social issues have received more attention from the public as well. This indicates a trend with no signs of slowing down.

Because of the large and still increasing investments in CSR activities, it is important to understand what implications this has for firms. Specifically, the effect of CSR on firm performance. This is an important aspect of CSR, which is still not clearly understood. More research and knowledge within this field will help firms attune their CSR strategies and better understand not only the consequences of their CSR activities but also how these activities should be communicated to stakeholders to maximize potential benefits.

Research objectives

The aim of this research project is to better understand the relationship between CSR and firm performance. The main objective of the study is to explore whether a firm's CSR profile can increase its performance and to identify some of the ways in which performance may be affected. Multiple measures exist for performance such as profitability, market value or productivity. It is

possible that depending on what measure is used for performance, the results as to whether a firm's CSR profile affects performance will vary. Whereas many previous studies have used accounting measures for performance, this study will go more in-depth with the effect of CSR on employees.

Another defining aspect of the relationship between CSR and performance is how a firm's CSR activities are communicated to consumers, employees and other stakeholders. A firm's CSR profile is not defined only by its actual CSR activities, but also by how it manages to communicate these activities to its stakeholders. It is likely that the way of communication plays a major role and may even be the defining factor as to whether the firm can reap the benefits of its CSR activities. However, due to time and resource limitations, the communication of CSR will be out of the scope of this study despite its importance.

Theoretical background

The impact of CSR on firm performance has been the subject of extensive research. Many researchers have found a positive correlation between CSR investments and firm performance but under varying circumstances. Du, Bhattacharya and Sen (2010) conducted a meta-review to summarize and analyze prior research findings. The key implications of the study were, that firms can strengthen its relations with stakeholders and to build a positive brand image. However, there are many limitations to this relation. A major impediment is low awareness and skepticism toward a firm's CSR activities. Stakeholders can easily attain an extrinsic perception of a firm's CSR policies, meaning that they perceive the firm to only invest in CSR for its own financial benefit and not due to sincere, intrinsic intentions to benefit society.

Furthermore, they find the reputation of the firm prior to investing in CSR to be critical for the stakeholders' perception of the CSR activities. The main limitation of the study is that the role of communication is still largely unexplored. There is a need to explore the role of CSR communication and how to communicate CSR effectively to different stakeholders. Without knowing how to communicate effectively, it might be difficult for firms to strengthen relations with their stakeholders and to build a brand image. In the worst case, consumers might perceive a firm's motives as extrinsic, potentially decreasing performance. The findings of the study could be entirely dependent on the mode of communication, which will inevitably impact the performance of firms.

Yoon, Gürhan-Canli and Schwarz (2008) took a more quantitative exploratory approach. They investigated the link between CSR and performance. Specifically, they investigated how the correlation is affected by a firm's prior reputation, the source through which consumers are informed about the CSR actions of a firm and the ratio of money spent on CSR activities to money spent on advertising CSR. They did 3 smaller studies with undergraduate students (n=128, n=124,

n=139), where they presented the students with different companies, some of them being fictional. The students were then given information about the CSR activities of these firms through different sources and were asked to rate the credibility of the firms. A control group was only presented with firm information and were not told of their CSR activities. The main findings of the study were, that if consumers become suspicious of the firm's motives, it can potentially backfire. The CSR actions by the firms had no effect if the firm was perceived to be unethical in the first place. Also, even though a firm might have a positive reputation, if more money was spent on advertising CSR than CSR itself, there may still be a backfire effect.

However, the perceived sincerity of the firm's CSR motives was drastically improved if the students were informed of the CSR actions through a neutral source instead of the firm. The main limitation of the study is that there might be an interaction between the variables that was not accounted for. For example, if a firm spends a lot more money on the CSR activities than advertising them, the perception of the firm's sincerity might still improve even if consumers are informed through the firm instead of a neutral source.

Another study also focused on the correlation between CSR and performance (Tsoutsoura 2004). To measure CSR, the author used the KLD rating for the S&P 500 (n=422) and a dummy variable taking the value of 1, if the given firm is a part of the DSI 400 index. KLD is an investment research firm tracking the CSR activities of firms through company filings, government data, NGO data and media sources (Deng, Kang, Low 2013), while the DSI index is an index also published by KLD containing 400 socially responsible firms (Tsoutsoura 2004). To measure performance, the author used return on assets, return on equity and return on sales while controlling for size and industry.

The key finding of the study was that a high KLD rating and being in the DSI 400 was positively and significantly correlated with all the three measures used for financial performance. Thus, socially responsible firms experienced increased performance. However, the study did not provide a causality between CSR and firm performance. It is possible that the firms with a high KLD rating and those in the DSI 400 index were performing better financially than most companies, which enabled them to invest heavily in CSR. This is a potential selection bias. Thus, the causal link could be reversed with well-performing firms having the ability to invest more in CSR than less well-performing firms. Another limitation of the study is that the author only used accounting variables to measure performance. The effect of CSR on other performance measures such as market value or employee motivation is therefore not explored.

Deng and colleagues (2013) conducted a quite similar study also using the KLD database to measure CSR (n=1556). However, the dependent variable, in this case, is different from the accounting measures that Tsoutsoura (2004) used. Instead, Deng and Colleagues (2013) focus on merges and investigate the effect of CSR on merges. Specifically, they use post-merger operating performance and long-term stock returns as their dependent variables. The main implications of

the study were, that firms with prominent CSR profiles experienced increased long-term operating performance, stock returns and shorter deal completion time. Thus, these firms experienced a decreased probability of an unsuccessful merge.

Unfortunately, this study suffers from the same lack of causal identification as the previous (Tsoutsoura 2004). It is possible that these firms had a more prominent CSR profile due to being more financially successful than the average firm. Well-performing firms have more resources to establish a global presence and brand image through advertising. They are also able to make larger CSR investments leading to a more prominent CSR profile. This potential reverse causality has yet to be addressed. Moreover, there is a possible selection bias when concluding that firms with a prominent CSR profile are less likely to fail merges. It is likely that the KLD database contains more data on successful merges, considering that there is less available data from non-successful merges.

Another study chose a different area of focus and investigated whether different types of CSR activities influence firm performance equally (Du, Bhattacharya, Sen 2007). Du and colleagues conducted a survey in the North-East US (n=1062) about three different yogurt producers. These firms had different CSR activities with one firm fighting hunger, another fighting breast cancer and the third producer focusing on environmental sustainability. Consumers were asked about their recent purchases of yogurt, awareness of the firms' CSR activities and brand identification. They were then given information about the CSR activities of the three different firms and were asked about their perceived motives of each producer's CSR.

The main findings of the study were, that respondents showed a higher degree of brand loyalty if they were aware of the firms' CSR activities. Also, people already aware of the CSR activities were more likely to purchase yogurt from the company, whose CSR activities focused on environmental responsibility, than those who were not aware of the CSR activities. The study indicated that consumers have stronger intrinsic attributions and generally more positive CSR beliefs if the CSR activity is related to the core business of the firm.

However, this study faces multiple limitations. Aside from the fact that internet surveys usually are not representative of the population, the three yogurt brands might not have had an equal presence in the area. Even though all three brands had a strong presence according to the authors, one of the producers could still have a stronger brand image and may have had more success informing consumers of its CSR initiatives. Furthermore, different CSR issues might not be considered equally important, which could lead consumers to naturally favor CSR activities such as environmental protection regardless if it is closely tied to the business activity of the firm.

The final study investigated the effect of CSR on firm value, and how that correlation is affected by customer awareness (Servaes, Tamayo 2013). They also used data from the KLD database (n=400)

to measure CSR within 5 categories and used advertising expenditures as a proxy measure for customer awareness while controlling for the size of a firm. The key implications of the study were, that CSR and firm value are positively correlated for firms with high customer awareness. However, for firms with low customer awareness, the correlation was either negative or insignificant. They also found a backfire effect if the firm had a poor prior reputation, just like Yoon and colleagues (2008) discovered.

The study has two main limitations. Naturally, customer awareness is difficult to measure, and the authors opted for a proxy measure of advertising expenditures. Naturally, we would assume there to be a positive correlation between advertising expenditures and customer awareness, but customer awareness is also a result of many other factors. A firm does not necessarily enjoy high customer awareness, even if its advertising expenditures are high. Furthermore, the problem of a potential reverse causality still exists. We would expect a financially well-performing firm to have increased firm value, invest more in CSR and perhaps also have higher advertising expenditures.

Throughout much of the available literature, it is possible to identify central gaps of knowledge. Researchers have yet to clearly understand the role of communication in the relation between CSR and performance. Furthermore, when measuring the effect of CSR on performance, many researchers have adopted the use of accounting measures or firm value to determine firm performance. However, it is likely that a prominent CSR profile may benefit a firm in a multitude of other ways. For example, an increased ability to attract skilled employees or motivate existing employees.

Naturally, if we assume this leads to productivity increases, this effect would partially be captured using accounting measures, but using accounting measures would only paint part of the picture. This is an area of focus that requires further investigation. Furthermore, even though researchers have identified a correlation between CSR and performance, they have yet to identify causality. The intention is to investigate whether CSR affects performance, but the possibility that the findings are caused at least partially by a reverse causality has not yet been ruled out. The issues of causality and lack of different performance measures are to be investigated in this proposed research.

Proposed research design

Whereas many previous studies have taken a quantitative approach to study the effect of CSR on firm performance, this study opts for a qualitative methodology. The study takes an exploratory approach with the main objective of identifying causality between CSR and firm performance. Furthermore, the study will focus more specifically on the ability of CSR to attract skilled employees and motivate existing ones with the goal of boosting productivity. It is an area that has not been the subject of extensive research compared to other aspects of performance.

While a quantitative methodology has been suitable for establishing a correlation between CSR and firm performance, establishing a causal link may require more in-depth data. This is possible to achieve through a qualitative methodology based on interviews. The theory-building exploratory approach means that the objective of the study is not to make inferences about a larger population of firms. Making inferences would require more time and resources to allow for a proper sample size, which is not an option in this case.

Besides, the causality that we wish to investigate might depend entirely on the individual firm, industry and size among other factors, making it difficult to define a population. Rather, the study will explore the possibility of a causal link and identify crucial ways in which employees might respond to CSR. Because the aim of the study is not to make inferences, there would be no reason to do random sampling. Instead, the study opts for theoretical sampling, specifically choosing a critical case study: Choosing a firm based on certain desirable traits.

This study plans to work with Microsoft for a couple of reasons. Most importantly, Microsoft has consistently been ranked among the firms with the best CSR reputation (Strauss 2017). With both large, successful investments in CSR and a proactive CSR policy, it is evident that managers at Microsoft are aware of the consequences of their CSR policies. They would have the required knowledge and experience to identify different ways in which the CSR policies affect the firm and its stakeholders while also having a deep insight into the ability of Microsoft to invest in CSR. This can hopefully lead toward identifying causality and understanding the effect of CSR on employees.

Furthermore, Microsoft has also been ranked among the top firms regarding employee satisfaction and employee benefits (George 2019). They invest greatly in the well-being of their employees, which translates into a great understanding of employee motivation and productivity. This makes Microsoft a great option for a case study, also considering the practicality of the firm having an office in Denmark.

The desired subject for the interview is the director of politics and strategy at Microsoft Danmark. The manager is responsible for stakeholder relations, public affairs and CSR.³ The manager will be contacted by email and to increase the likelihood of a response, a proper first-hand impression is vital. A way to give such an impression is to show a clear interest in and knowledge about Microsoft specifically. The invitation must not look standardized in any way, as that coupled with the research being carried out by a bachelor student, will be sure to result in a rejection.

By highlighting the accomplishments of Microsoft within the area of CSR, insight and interest are being shown while at the same time giving a justification for the interview. It also needs to be clearly stated that causality between CSR and firm performance is still relatively unexplored, thus giving the interview a greater sense of importance. The interview will ideally be conducted at the manager's office outside his office hours to make it as convenient as possible for the manager.

The interview will be semi-structured since it ensures flexibility, unlike a fully structured interview. However, a fully non-structured interview is not an option, considering a student's lack of experience conducting interviews. A topic guide will be crafted to ensure that the central topics of causality and effect on employees are being examined while still allowing room for other subjects. This topic guide will be sent to the manager in advance to not only show a high level of preparation and seriousness but also full transparency.

Furthermore, during the interview, the audio will be recorded with the consent of the manager. An inexperienced interviewer will have difficulties writing notes at a proper pace, paying attention and formulating questions at the same time. Therefore, audio recordings will relieve the pressure of taking notes, making notes only necessary for central answers that need to be probed for a more thorough explanation. The topic guide will look as follows:

Topic 1: The CSR of Microsoft

- What is the general philosophy behind the CSR at Microsoft?
- How does the CSR policy at Microsoft affect the firm?
- What is special about the CSR at Microsoft and how do you fight skepticism?
- What benefits are you experiencing as a result of CSR?

Topic 2: The causality between CSR and performance

- To what extent does your ability to invest in CSR depend on good financial performance?
- Do you find yourself investing significantly more into CSR during times of good financial performance?
- Do you find CSR to have a positive impact on the performance of Microsoft?

Topic 3: The effect of CSR on employees

- How do you think employees at Microsoft are influenced by its CSR activities?
- Does the CSR and reputation of Microsoft help attract skilled employees?
- Do you experience an increase in motivation and productivity from employees as they come to learn about the CSR of Microsoft?

Limitations

A clear limitation of the study is that it does not factor in the communication of CSR. We know that communication plays a major role in fighting stakeholder skepticism. Thus, the ability to reap the benefits would rely heavily on communication. If Microsoft is not able to make its CSR appear out of intrinsic motives, it could affect causality between CSR and performance while also affecting the influence of CSR on its employees. Because of this, the response to both causality and employee influence could be considerably different if another firm had been chosen for the case, or if the study was reproduced using another case.

This limitation could be partially accommodated for using a larger sample size. Even though the impact of CSR might be very different between firms, the reliability of the results would improve as the sample size increases. Although the intent of the study was not to make inferences about a

large population of firms, the study would benefit from increased reliability through a larger sample size.

Furthermore, we are interviewing a single manager from the Danish department of Microsoft. Although we would expect an MNE like Microsoft to have a large degree of uniformity in their CSR policy across the globe, results might have varied if interviews were conducted with a different manager in another country or at a different level. It is important to note that it is not only the CSR policy that might change but also the manager's perception of that CSR policy. This also affects the reliability of our measurements negatively. Although the study opted for a qualitative methodology, there is still the issue of measuring performance, which is heavily based on the perception of the individual manager. This manager might attribute certain measures of performance more value than others, which affects the perception of how CSR impacts performance.

Furthermore, it can be difficult to directly trace performance increases to very specific actions such as CSR. In such a complex and multidimensional area as an MNE, it can be difficult to identify clear causes as they may often not be singular but a combination instead, thus reducing the validity of our measurements. Furthermore, the manager might also have an incentive to downplay any financial gains from the CSR policy as to avoid giving the impression that the motives behind are extrinsic with the goal of boosting profits.

Finally, there is the issue of accessibility for the interviews. Due to the research being carried out by a bachelor student, it is likely that a given manager would not find it worthwhile to conduct an interview. Naturally, there are ways to accommodate this problem, which this study tries to do. This includes showing a high degree of knowledge about the firm, making the invitation not appear standardized and indicating a high degree of importance for the research area. Regardless, there is still a high probability of facing rejection. A way to combat this would be to send out many invitations. However, with the time and resource constraints of being a student, that would mean standardizing invitations and less time available for researching the chosen firms.

Time schedule

The time schedule would naturally depend on availability of the manager but would look like this:

Month 1	Research on Microsoft, its CSR initiatives and spending. Invitation will be sent out.
Month 2	Preparation of interview questions and angles. Practice of interview techniques.
Month 3	Interview will be conducted, and results will be interpreted.

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