Peer Effects and Strategic Corporate Social Responsibility

Research Objectives

This research considers the role of information in creating incentives for firms to engage in strategic social or environmental performance. When a firm faces uncertainty over strategic outcomes it may obtain information on the performance of relevant peer firms and use this to inform its own profit strategies. This study addresses the following research questions. Do firms use observations of the corporate social responsibility (CSR) performance of relevant peers as a low cost source of information on the effectiveness of CSR strategies? Do firms form strategic performance goals based on those peers' performance, and do firms exhibit satisficing behavior after meeting those goals? Are firms more likely to emulate strategies of those peers that are more profitable?

Theoretical Perspective

Firms can be forced by law or regulation to provide costly public goods (or limit its provision of public bads). The concept of CSR - that a firm will voluntarily engage in the private provision of public goods to a greater degree than its legal and regulatory obligations demand - suggests that firms do act in ways that promote the social good. Many views exist on the nature of firm motivations to engage in this provision; a compelling explanation that has intrigued scholars for decades is the concept of strategic CSR (McWilliams and Siegel, 2001): firms increasingly engage in CSR for its perceived benefits to the firm, whether directly measurable or intangible, and whether motivated by profit opportunities or risk management, such as prevention of potential losses (Baron, 2001) or threats to legitimacy (Wood, 1991).

Whereas evidence suggests that firms tend to engage in CSR because they perceive it to be good for business, we do not observe universal maximization of CSR, perhaps because of uncertainty in strategic outcomes and opportunity costs of investment. The connection between a firm's own CSP and the returns to firm profits and social welfare are often highly intangible and nearly impossible to quantify directly with a high degree of confidence (Peloza, 2009). In this context, managers seeking to add value to a firm through CSP often have little specific guidance in determining the optimum level or direction of CSR activities to undertake. In the presence of incomplete information, corporate managers engage in search to acquire information regarding the potential success or failure of certain modes of strategic conduct (Levinthal and March, 1981). Key criteria for information search are that it be of high strategic value and relatively low cost. Public information is a notable source of low cost information, and is thus easily obtained and exploited by firms in search contexts. One important source of public information for setting of strategic goals is the performance of relevant peer firms.

Strategic goal setting is ubiquitous in corporate management; firms need goals to inform strategy (Cyert and March, 1963), particularly when expected profitability behind a given

strategy is ambiguous. CSP ratings provide firms a convenient, publicly available measure by which to compare feedback of own performance relative to that of relevant peers. If firms use such strategic goals as a benchmark for own performance, they are likely to exhibit tendency to adjust strategy based on performance relative to that benchmark (Greve, 2003). As a firm increases CSP above and beyond that of relevant peers, there is less strategic impetus to increase CSP further.

Methodology

This study seeks to identify and characterize peer effects in strategic CSR through observing patterns of historical corporate performance using econometric techniques. Data employed includes generally available data sets on corporate social performance (CSP) ratings, combined with corporate financial data and information linking various firms into relevant peer groups. The empirical model is structured as a dynamic panel data model with linear-in-means style peer effects components. This type of model is subject to relatively well documented identification issues stemming from a number of endogeneity concerns. Two primary tools are employed to overcome these issues: (1) firm and year fixed effects to control for time-invariant unobserved firm-specific characteristics as well as temporal market shocks affecting all firms, and (2) instrumental variables to control for the endogenous simultaneity problem of circular peer interactions (Manski, 1993). I make use of recent innovations from other literatures to achieve this identification strategy: the presence of partially overlapping peer groups (De Giorgi et al., 2010) afforded by my peer group classification (Hoberg and Phillips, 2015).

Key findings

Initial results find evidence for the presence of peer effects in CSR as a means for reducing strategic uncertainty. The results further demonstrate that firms may set strategic performance goals, or aspiration levels, based partly on performance of relevant peers, and that firms may select on key characteristics or attributes of those relevant peer firms (such as financial performance) to increase probability of success in strategic CSR.

These findings offer a new theoretical rationale to the concept of profitability of CSR: if firms adopt practices by learning from the experience of their more profitable peers, we may infer that firms generally expect CSR to be profitable, and by selecting on observable peer firm characteristics they expect to reduce strategic uncertainty that accompanies decision making in new non-market strategic contexts.

References

Please refer to full manuscript for a complete bibliography.