Corporate Social Responsibility and Firm Reputation Risk: bettering firm reputational risk through socially responsible activities. http://ssrn.com/abstract=3015973

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Executive Summary

The academic literature examining the relationship between Corporate Social Responsibility (CSR) and firm performance, while extensive, has yielded mixed results (e.g. a positive, negative, or non-existent relationship). One burgeoning area in the literature envisions CSR as insurance like in relation to firm performance. Specifically, socially responsible activities may provide insurance against reputational crisis for firms. This 'moral capital' conceptualization (e.g. Godfrey, Merril, & Hansen, 200) is in contrast to the historical avenue of investigation treating CSR as only investment like where managers "invest" in socially responsible activities with some sort of expected future payoff (e.g. profit). If CSR is also insurance like then it would make sense for managers to engage in socially responsible activities to prevent future losses.

This study aims to extend the nascent literature on CSR as insurance like in relation to firm performance. Specifically, a positive relationship is hypothesized between CSR and reputational risk. The logic behind this hypothesis is that firm mangers should want to engage in socially responsible activities to protect their firm's reputation, if CSR provides insurance like benefits. Furthermore, if there is more risk vis-à-vis that reputation for a firm, there should be more engagement in CSR activities by that firm.

The two main focal variables for this study are CSR and reputational risk. CSR is defined as activities on the part of firms that are not required by law and promote social good (McWilliams & Siegel, 2001). Some examples of activities that go above and beyond the law could include progressive human resources policies, green initiatives like extra pollution abatement procedures, and programs supporting local businesses (McWilliams & Siegel, 2001). CSR is traditionally measured by data from KLD (now MSCI), and this study uses this data source. However, this study adds to the literature by incorporating an additional, potential data source for measurement of CSR: namely, Bloomberg ESG (environmental, social, and governmental) data. This study shows that Bloomberg ESG data and KLD data exhibit many of the same characteristics (e.g. a positive relationship with firm size). The use of Bloomberg ESG data not only provides an additional source of data to study traditional CSR, but also positions this study, and by extension the literature, to capture the operational trend of moving from the label CSR to ESG.

Reputation is defined using the Fombrun (1996) model where a firm's reputation is a strategic resource that is at risk with stakeholder interactions. Reputational risk then is defined as the risk of a firm's reputation, or brand, losing value. Specifically, in this scenario firm reputation could lose value due to some crisis like being caught engaging in socially irresponsible activities. In other words, the reputation is explicitly at risk with respect to CSR or ESG related issues. Reputational risk is measured using RepRisk's risk metric, the RRI (RepRisk Index). RepRisk uses a proprietary framework that combines human intelligence with technology to produce risk related data pertaining to 28 ESG issues. Its research is based on media, stakeholder, and other

public sources only and does not include information provided by a company. RepRisk argues that the RRI is not actually a measure of reputation, but rather an indicator of firm reputational risk related to ESG issues. This quantification, they argue, facilitates better assessment of firm ESG related reputational risk. It also allows for tracking of ESG related reputational risk exposure over time. These characteristics make RRI an ideal measure for studying reputational risk.

The statistical model used in this study is a multilevel mixed model examining CSR at both the industry and firm level. Using this model fills a gap in the literature, as CSR is a multilevel construct and most studies only engage in one level of analysis. Evidence is found for the hypothesized positive relationship between CSR and reputational risk, demonstrating an additional reason why pursuing socially responsible activities makes fundamental sense for managers. Using the KLD data, a 1 standard deviation increase in RRI is predicted to correspond to an increase in CSR by 3%. Using the ESG data, a 1 standard deviation increase in RRI is predicted to correspond to a 4.7% increase in CSR.

References

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