The Roles of Sectoral Moderator – A Combination of Environmental Munificence and volatility – in the relationship between corporate social responsibility and financial performance

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Abstract

The Roles of Sectoral Moderator – A Combination of Environmental Munificence and volatility – in the relationship between corporate social responsibility and financial performance

Li Zhu, MSc

The relationship between corporate social responsibility and financial performance has been the topic of a long-standing debate among researchers. Controversial conclusions are drawn from different methodologies and ways of thinking. This study finds a persuasive jurisdiction to explain why the preceding results have been inconclusive by using a new moderator – the sectorial moderator. According to environmental munificence and volatility, I divide all industries into four sectors – Ideal, Crisis, Catastrophe, and Inertness. Industries sharing similar levels of munificence and volatility are grouped as a sector, and the magnitude of munificence and volatility moderates the significance of the relationship between corporate social responsibility and corporate financial performance link. Moreover, the CSR effect on financial performance in different sectors is distinctive. The empirical results reveal that the CSR effect on financial performance is highest in the sector with high munificence and low volatility, and vice versa. The present article provides a good explanation of the discrepancy in the CSR-CFP link and establishes a new avenue for future research.

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Introduction

The discussion on corporate social responsibility (CSR) has existed for many years. Researchers view the constitution and motivation of CSR through different angles. For example, Friedman (1962) clearly states that socially desirable goals, at the cost of profitability, should be separated from a company's fiduciary responsibilities and he justifies the social responsibility solely on the economic ground. More studies occurred in the field of CSR in academia when the stakeholder theory (Freeman, 1984) came into vogue. According to this theory, stakeholders play various roles in a corporate since their interests are distinctive, and their behaviors will, positively or negatively influence a firm's performance. Thus, the extent to which company behaves socially responsible mainly depends on whether it meets stakeholder's demands. Porter and Kramer (2011) have even advocated shifting societal issues from the periphery to the core of a business by 'creating shared value', which involves creating economic value in a way that also generates value for society.

Among many different topics related to CSR, the link between the corporate social responsibility and corporate financial performance (CFP) attracts lots of attention. The CSR-CFP link describes the additional value that the social responsibility could bring to a firm. The additional value contains different aspects. Hur et al., (2014) demonstrates that high level of social reputation, which is an essential part of CSR, makes the promotion of organization more effective and increases the tangible and intangible premium of the firm. In many cases, social philanthropy directly improves a firm's return on asset (ROA). Lopez et al., (2007) researched component firms of Dow Jones Index and proved that sustainable or environmental-friendly strategies will boost a firm's market capitalization and generate higher valuation in the public market. Although many studies have concluded that the social responsible behaviors generally enhance a firm's performance, but the CSR-CFP relationship is still arguable. Mill (2006) collected the financial performance data from a UK unit trust that had initially used the

'conventional' strategy and later adopted socially responsible investment (SRI) principles. As he purports, SRI only temporarily increases the profit of the fund and then it downgrades to the normal performance. In another study, Lee & Park (2009) indicates that being socially responsible is not a great choice if an airline company desires to improve its profit or to stimulate its market value. The inconclusive results render the researchers' curiosities. Some argue that the direction of causal connection is not well explored (Tsoutsoura, 2004). Nevertheless, after reversing the causality, the financial performance still does not show identical effects on CSR (Fauzi & Idris, 2009; Seifert, 2003; Sirega & Bachetiar, 2010). Others believe that social responsible behavior is not able to create economic profit; instead, it only generates social reputation to a firm. Respectively, most researchers employ a simple linear regression model to explicate the CSR-CFP link, which has been claimed inaccurate by Barnett & Salomon (2012). Through analyzing the inconclusive results from linear regression, they create a new curvilinear model to describe the relationship between the social responsibility and a firm's performance. Interestingly, the result reveals a "U Shape" which means companies with lower or higher than average scores of CSR will achieve better financial performance than those with average score. In addition, moderators can also influence the CSR-CFP link. Hur et al., (2014) amplifies that in retailing industry a firm's credibility and historical reputation directly indicates whether its charitable behaviors will increase its financial performance. The relationship between the corporate social performance and financial performance varies from one organizational environment to another (Goll & Rasheed, 2004). When researchers continue to investigate the CSR-CFP link, the various moderation effects attract their attentions. Studies have also emphasized on the moderating effect of industry-specific variables. As Lee & Park (2010) illustrate, the casino industry is proved an insignificant CSR-CFP link while the socially responsible actions will apparently improve the financial performance in the hotel industry. Judge & Miller (1991, P457) discourse that the high economic growth plays a positive role that affects the corporate financial performance. Following their study, Goll & Rasheed

(1997) complement that instability environment will jeopardize the possibility of transferring CSR to corporate profit. Although dozens of articles mention that the industrial or environmental munificence and volatility will be two most effective moderators (e.g. Goll & Rasheed, 2004; Lee & Park, 2009), no one integrates these two factors together to generate a more comprehensive moderation construct.

There are few reasons for combining these two moderators. Firstly, a combination of environmental munificence and volatility emphasizes the interactive nature of these two moderators. If we look at them separately, the interactions between two constructs are easier to be neglected, and thus we may lose the chance to understand the actual moderation effect when we explore the CSR-CFP link. Secondly, only using one moderator, either environmental munificence or volatility, may underestimate the moderation effect and obtain a misleading conclusion. Finally, it is easier to categorize industries based on environmental munificence and volatility and generalize them to different social contexts.

Research Purpose

I have four main purposes in the present study. First, I attempt to reconstruct the framework of corporate social responsibility. By reviewing current CSR conceptualizations from different perspectives, including resource-based view stakeholder theory and the traditional economic view, I redefine CSR and render it more suitable for the current social contexts. I propose a two-dimensional framework that can help researchers explain the different conclusions from previous studies on the CSR-CFP link. Second, to emphasize the interactions between corporate social responsibility and corporate financial performance, I elaborate why implementing socially responsible strategies can increase a firm's long-term profitability. Previous studies provide ambiguous explanations why CSR behaviors generate benefits for a firm. In the present study, we arrive at a better understanding of this relationship by adding the social-economic profit dimension to the framework of corporate social

responsibility. Third, I aim to examine the CSR-CFP link from a long-term perspective by using longitudinal data. Because CSR strategies do not concentrate on short-term benefits, the use of longitudinal data is more appropriate; however, the majority of previous studies employ cross-sectional data. Finally and most importantly, by combining environmental munificence and volatility as a single moderator, I endeavor to explain the inconclusive CSR-CFP results from previous studies. Given the different industrial growth rates and levels of instability, whether the CSR effects on financial performance are different among various contexts is our core research question.

This study does not aim to claim a victor in this long-standing debate; rather it, demonstrates that, despite the inconclusiveness of this link, a new analytical perspective may help us to better understand the variation in CSR-CFP relationships in various industries.

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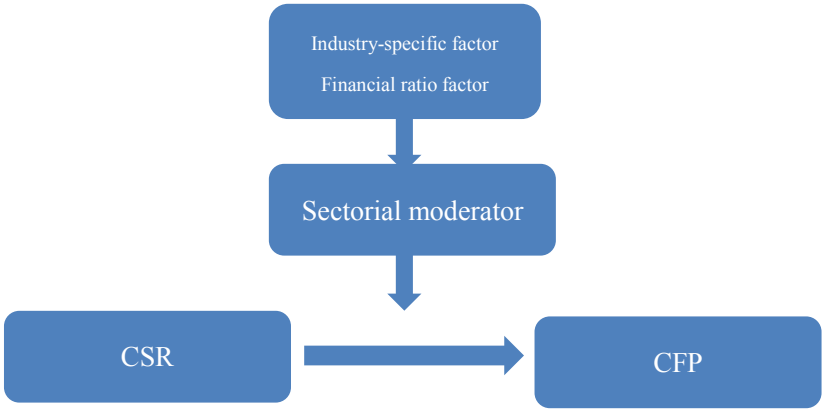
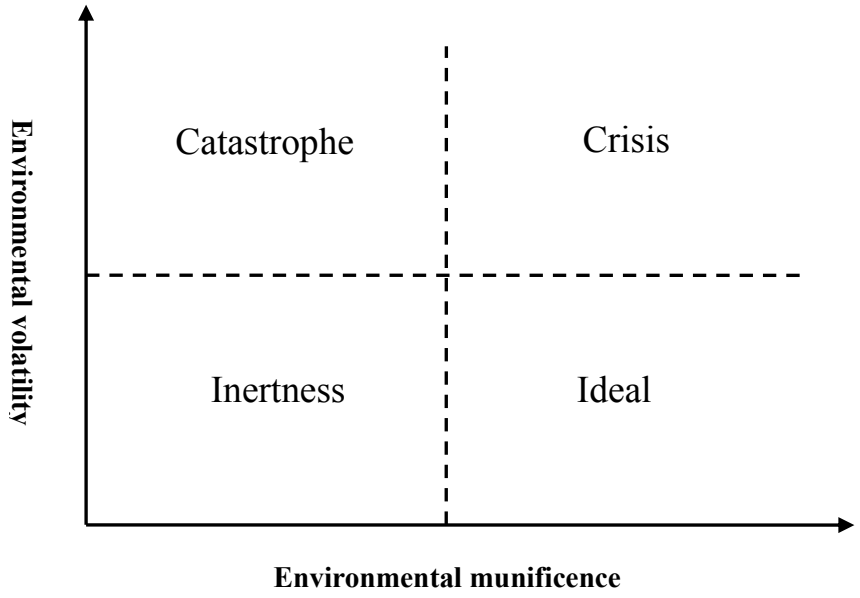


Research Design

To achieve the research objectives, several things must be accomplished. First, I review the development of the CSR conceptualization in academic studies. By integrating perspectives from various theories, I construct a new two-dimensional framework, which provides the construct validity necessary for our empirical examination. Second, I examine the overall relationship between corporate social responsibility and financial performance to ascertain whether I can solidify the

positive link. Furthermore, environmental munificence and volatility start to be taken into consideration as an integrated moderator. To synthesize these two factors, I establish a 'four-industry classification' model to explain the moderation effects of the industry sectors. In Figure 1, because the extents to which environmental volatility and munificence are different, I divide all industries into four quadrants – 'Ideal', 'Crisis', 'Catastrophe', and 'Inertness'. Therefore, I create a new moderator – the sectorial factor. Finally, because many studies find insignificant or slightly positive results concerning the CSR-CFP link (Prado-Lorenzo et al., 2008; Seifert et al., 2003), I attempt to examine whether the significance and the CSR effect on CFP are distinctive among different sectors.

Figure 1. Industry classification model



Literature review

The business environment and the millennium

It is fascinating how quickly the global business environment develops and changes. The latest insight article by Aghina et al. (2014) illustrates the point very well, highlighting the fifty-year gap between the past and the present. For example,

numerals years ago, in 1964, IBM made a breakthrough in computer technologies with their System/360 mainframe, a desk- size machine used primarily by corporate and governmental organizations. At that time, the United States was the only targeted market. Some 15 years ago, we became familiar with mobile phones, desktop computers and limited Internet connection; hence, technology has become more available to individual consumers but remains a rarity for many. Sony and Nokia, as widely acknowledged brands in the electronics industry, entered the American market and rapidly captured nearly 60% of the market share. Today, computers and mobile phones are everywhere worldwide. Children are becoming tech savvy before they even start attending school, we have the internet in our homes, in our mobile devices and in many different public places, and one rarely sees a person without some technological gadget in his or her hands. Clearly, globalization is one of the hot terms when you glance at the financial news. A great example comes from China, where one city recently launched a special walking lane for people using cellphones.

The question arises: What drives the development and transformations in the business environment? The answer may vary based on different generations, cultures, and ideologies. Another question is: Is there something in common that explains this phenomenon? I suppose that the common answer is the modification of the logic and philosophy governing business. More specifically, business models are far from what they were in the past. E-business is an appropriate example that demonstrates my point. As a nascent business model, online businesses, such as Amazon and eBay, drastically impact the configuration of the retail industry, forcing traditional companies to change. Most importantly, the shift in the rationale that configures the business strategy has a tremendous effect on the development of the business environment. When the Standard Oil Company was founded in 1870, John D. Rockefeller certainly only cared about how much he could earn. With the proposal of the ‘Clayton Act’, the concept of the shareholder was emphasized, changing citizens’ perception of business. In the 1990s, Wal-Mart began to implement its globalization strategy to maximum supply chain advantage, taking business thinking into a new era.

The case implies that, instead of simply considering the benefit to a company itself, it is better to regard the upstream and downstream as an entire business system to create a win-win situation. Notably, factors that have long been treated as external or irrelevant variables capture the businessman's attention. Now, forming a business strategy requires managers to consider benefits from a number of aspects, such as the environment, suppliers and consumers, and the public community.

Taken together, the transformation of business models and the rationales governing business thinking significantly changes our present and our future.

Corporate social responsibility

Generally, corporate social responsibility (CSR) is the idea that a corporation should act in socially responsible ways. The discussion of CSR among executives and practitioners can be traced back to the late 1930s (e.g., Donham, 1927; Barnard, 1938). The terminology of CSR has gained momentum in academia as various theories, including stakeholder theory, institutional theory, and the resource-based view, have attempted to explain the conceptualization from their perspectives.

Before I begin to explicate corporate social responsibility, it is critical to clarify another similar framework – corporate social performance (CSP). As Wood (1991,P695) asserts, 'CSP is defined as a business organization's principles of social responsibility, process of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm's societal relationships'. Notably, some researchers indicate that CFP emphasizes results and consequences; CSR, however, is more likely to describe accountability and obligation. Some believe that CSP is a more appropriate concept for measuring the actual performance of social responsibility. From my perspective, CSR is an extended framework of CSP for two reasons. First, according to Wood's (1991) definition, corporate social performance only concentrates on the outcomes of social responsibility, whereas CSR actually entails a more comprehensive nature, including both ratings (output) and

accountability (input). Second, CSP has the lag effect. To employees, communities, and customers, corporate social responsibility is a leading and direct reflection of actual social responsibility. In practice, CSR and CSP are typically interchangeable. Thus, to reduce the ambiguity, I align CSR and CSP as one term: CSR.

Despite a vast and growing body of literature on CSR (e.g., Crane et al, 2008; Lockett et al, 2006) and its related concepts, the definition of CSR is never easy. Internal complexity – the dimensions of ambiguity in CSR – is responsible for the unclear definition.

The moral issue is widely acknowledged as one essential part of corporate social responsibility (e.g., Aupperle et al., 1985, Carroll, 1979). Bowen & Johnson (1953) first described corporate social responsibility as the social consciousness of managers. As they believed, the entrepreneurs should not only be concerned with profit-and-loss issue but also pay attention to the firm's socially responsible behaviors. Because the few hundred largest corporations at that time impacted the lives of citizens in many ways, the ethical level of managers in these companies – for instance, whether they were greedy or generous – heavily influenced their employees' lives. Compliance with the law or legal obligation is also significant when we consider CSR (McGuire, 1960). In McGuire's definition, beyond fulfilling people's moral expectations, CSR refers to the obligations of businessmen to pursue beneficial policies, make responsible strategies and follow the lines of actions. Davis (1968) later claimed that it was better to regard all aspects of social issues as an entire social system. From his perspective, corporate social responsibility indicates that a firm has obligations to consider all the consequences produced by their decisions with respect to the social system. With more theories applied in the field of CSR, new definitions and dimensions appear. The major contributor to raise a new CSR dimension is Johnson (1971). He elaborates that social responsibility is the firm's socially responsible programs that simultaneously increase its profits. In his view, CSR is perceived in terms of long-term profit maximizing behaviors. More practically, Backman (1975) lists a series of socially responsible actions that involve employing minority groups,

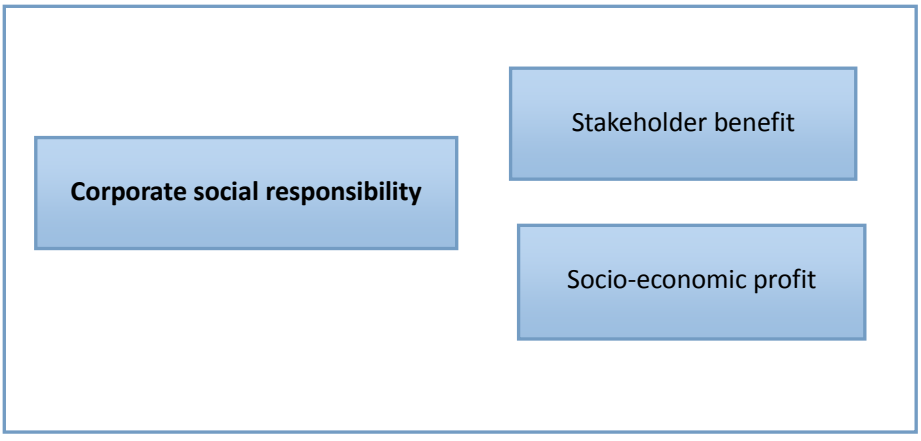
reducing pollution, improving medical care, and enhancing industrial health and safety. A company that performs these philanthropic tactics is viewed as a socially responsible organization. Although various definitions enter into our view, the majority of them only glimpse a tiny part of CSR. A more comprehensive framework has been presented since the 1980s. Socially responsible behavior means that, in addition to considering the benefits to shareholders and complying with laws and union contracts, a company has obligations to involve related groups, including consumers, suppliers and employees (Jones, 1991). It is notable that this framework emphasizes two basic ideas. One idea is that socially responsible behavior is voluntary, not mandatory. The other idea is that 'societal groups' have been introduced to CSR studies and that this construct is the foundation of the stakeholder perspective of corporate social responsibility. Integrating previous studies, Carroll (1983) proposes a four-dimensional CSR framework: economic, legal, voluntary, and ethical. As quoted above, he believes that 'CSR involves the conduct of business so that it is economically profitable, voluntarily active, law abiding, and ethical supportive'. The four-dimensional framework of CSR provides us with a general vision of social responsibility. However, controversial results have been obtained as studies have applied this framework to distinctive contexts (e.g., McGuire et al., 1988, Cochran & Wood, 1984). Thus, I still need to find a better operationalized conceptualization of CSR.

To explore the nature of CSR, different theories provide various perspectives. The stakeholder theory has been expanded by Donaldson and Preston (1995), who stress the moral and ethical dimensions of CSR, arguing that a firm's moral behaviors to its shareholders, employees, and external suppliers and customers will boost its reputation and subsequently offer a higher possibility of success. The institutional approach has also been used to analyze social responsibility. More specifically, Jennings and Zandbergen (1995, P1020) analyze the role of institutions in shaping the consensus within a firm regarding the establishment of an 'ecologically sustainable' organization. Jones (1995) indicates that, because maintaining trust and committed

relationships with stakeholders can decrease transaction costs and improve returns, managers are highly motivated to follow ethical and honest norms. Finally, Waldman et al. (2004) apply strategic leadership theory to CSR. They conclude that some aspects of transformational leadership are positively correlated with a firm's favorability to engage in socially responsible activities. As the most prevalent theory in the strategic management field, the resource-based view also attempts to explore the definition of CSR. First, Hart (1995) links the RBV to corporate social responsibility. To avoid over-abstracting, he exclusively focuses on environmental social responsibility. Hart (1995) asserts that, for certain types of firms, environmental social responsibility can create a resource or capability that leads to sustained competitive advantages.

Integrating major perspectives from the previous studies, I categorize CSR into two dimensions: stakeholder benefit and socio-economic profit. We explicate both dimensions below.

Figure 2. Two-dimensional framework of corporate social responsibility



Stakeholder theory

With the notable development in the field of strategy management, stakeholder theory enters into our view and becomes an increasingly critical perspective on both managerial and academic domains (Peng et al., 2009; Clemens & Douglas, 2005).

Instead of being an omitted variable, stakeholders determine what bullets a firm has in its clip in its struggle to formulate and implement its strategy. Before the development of stakeholder theory, industrial organization theory and the resource-based view predominantly steered academic research. Porter (1979) proposes the 'Big-Five Forces': the bargaining power of suppliers and buyers, the threat of new entrants, the threats of substitutes, and the intensity of industry rivalry, which directly determines a firm's competitive advantages. From his perspective, the external factors rather than a company's internal factors exert greater influence on shaping business strategies and configuring relative advantages relative to competitors. If shareholders and managers want to attain extraordinary profits, then it is better to fully understand the characteristics of the industry and then enact the appropriate strategies.

Studies based on industrial organization theory are more likely to neglect the attributes of the corporation itself, that is, its internal drives. In other words, whether a company can succeed in a business may depend on the resources that it currently had and how it utilize them instead of industrial factors. Wernerfelt (1984) implies that a firm's product market position in an industry is based on the portfolio of resources that it controls. He asserts that the increase in competitive advantage derives from more disposable resources, which make huge contributions to the development of RBV. Rumelt (1984) defines a firm as a bundle of productive resources and suggests that the economic value of different resources varies among different contexts. RBV explains how significantly internal factors will influence corporate strategies, filling the gap left by industrial organization theory.

However, some pieces are still missing. Systematically, four determinants – internal factors, external factors, profits (revenue), and costs – need to be considered when we plan a strategy (Green & Armstrong, 2005). The preceding theories only explain three of the four, and no one emphasizes the importance of costs in forming a scheme. The appearance of stakeholder theory fills the long-lasting gap in academic studies. Stakeholder theory emerged in the mid-1980s. One focal point in this movement was the 1984 publication of Freeman's (1984,P40) Strategic Management:

A Stakeholder Approach. As he elaborated, a stakeholder is defined as 'any group or individual who is affected by or can affect the achievement of an organizations objective'. For example, normally, we believe that only suppliers, targeted consumers, and rivalries affect a firm's financial situation. However, stakeholder theory asks researchers to extend the vision to explore more groups that may influence a firm's decisions and performance. For example, the government is typically a 'non-apparent' related group. Whether a firm's business fits the development profile of the local economy, which is planned by a local government, genuinely impacts a firm's profit. For instance, if the business violates environmentally oriented development strategies, then the government is able to shut down the firm's plants, which will decrease its revenues. Thus, the government is indeed a stakeholder that impacts the firm's strategies and profits. The impetus behind the proposal of stakeholder theory is the construction of a framework that is responsive to the concerns of managers who are buffeted by the conflicts of interests among the different groups. Because the colliding relationships maximize expenditures associated with the planning and implementation of strategies, the purpose of stakeholder management is to devise means to enhance consensus among various parties. The strategy-making process requires the agreement of all stakeholders; therefore, managers have to actively balance the interests of all parties to develop business strategies.

Stakeholder theory has four major mechanisms. First, the stakeholder strategy is a strategic management process rather than a strategic planning process. The strategic planning process has two steps: predicting the future environment and independently developing plans for a firm to exploit its position (Cheung, 1987). Nevertheless, strategic management actively plots a new direction for companies and considers how a firm can interface with the environment. The theory offers an approach to forming strategies that can constantly be modified and improved. Hence, it is flexible to fulfill different interests in a changing environment. Furthermore, the stakeholder strategy provides an instrument that can integrate all relevant parties' interests. Notably, successful strategies consider the perspectives of all stakeholders rather than pitting

one stakeholder against another. This does not mean that the strategy should satisfy all stakeholders simultaneously; however, each stakeholder will benefit from the strategy in the long run. These characteristics distinguish stakeholder theory from other perspectives because it does not purely concentrate on certain beneficial groups. Stakeholder theory regards a firm as an open system, which means that each internal or external link has the possibility to determine the extent to which it is successful in implementing the strategy. Third, the salutary effect of stakeholder management on a firm derives from the reduction of transaction costs among various groups. In economics, a transaction cost is defined as a cost incurred in making an economic change (Cheung, 1987). In the field of stakeholder theory, researchers view the construct as an expenditure for attaining support from all stakeholders when a firm plans and implements strategies (Kluver & Wicks, 2014). The transaction cost is typically grouped into three parts: the cost of finding parties, the cost of negotiating agreements, and the cost of monitoring and enforcing compliance with said agreements (Macher & Boerner, 2005). The stakeholder management strategy is capable of reconciling interests among groups, effectively lowering the negotiating and monitoring costs. Finally, by driving down transaction costs, a firm is more likely to satisfy all relevant groups and achieve higher financial performance.

Because of the accommodated framework, the stakeholder perspective of CSR provides an opportunity to develop an overarching CSR definition that considers all internal and external parties. In the traditional strategy management domain, there are few concerns with external links as the determinants of planning business strategies. Although ‘Porter Five Forces’ offer a good perspective on how external stakeholders may influence the formation and implementation of a scheme, they are not regarded as an interactive system. Synthesizing the possible advantages together, stakeholder benefits are definitively the essential part of corporate social responsibility.

Socio-economic profit

In practice, corporate social responsibility is often regarded in terms of 'doing good but going bad' (Stead & Stead, 2013; Schaltegger et al., 2012). 'Doing good' indicates that 'businesses make donations to civil society and environmental organizations, sponsor projects in developing countries, build solar power units, spend money on counseling for employees, etc.' (Porter, 2008, P75). These projects are commonly perceived as 'good' and are thus easy to communicate to the general public. The community is supposed to be aware that a firm with these good behaviors is socially responsible (Porter, 2011). Standing out in the intense competition, enterprises that behave in a socially responsible manner are supposed to gain public prestige and a high reputation.

However, things may not go as expected. Because being socially responsible creates extra costs, it jeopardizes revenue, which is almost the only thing that managers genuinely care about. 'Going bad' means that a corporation faces severe operational and financial problems when it is supposed to compensate tremendous profits to its employees, be accountable for environmental pollution, or recruit minorities to its staff. In such cases, profits are more likely to be threatened. As a manager, the question of whether it is worth spending the money on socially responsible actions comes to mind. Due to the possibility of reducing existing revenues, a number of decision-makers choose the conservative strategy, and they refuse to implement a CSR strategy. Thus, CSR can be seen as a facilitation of 'going bad'.

In the academic field, arguments over whether CSR can enhance or weaken corporate financial performance (CFP) began in the 1980s, and to date, no conclusion has yet been reached. The link between CSR and CFP varies in different industries and cultures. In Spain, corporations that enact socially responsible practices show a positive and significant impact on return on sales but an insignificant impact on productivity or market value (Prado-Lorenzo et al., 2008). Contrary to this study,

Seifert et al. (2003) indicate that corporate philanthropy does not have a significant relationship with financial performance, regardless of whether corporate philanthropy is measured in terms of cash payouts or aggregate contributions and regardless of whether financial performance is gauged based on market-based or accounting-based performance. More interestingly, Siregar and Bachitar (2010) find that perceived financial performance is positively related to corporate social responsibility; however, when they use real financial data from the market, scarce evidence shows that profitability significantly correlates with CSR. The results imply that the community believes that socially responsible firms attain higher revenues because of their reputation, public awareness, and brand premium. However, the actuality is that these philanthropic practices do not boost firms' short-term returns.

The mixed effects lead to the consequence that practitioners are afraid of implementing CSR strategies even though they create a better organizational image. Based on the previous literature, we can see that numerous studies explore the CSR-CFP relationship, but almost no one attempts to explain why the mixed effects occur. To fill this gap, Porter and Kramer (2011) propose a new construct: creating shared value (CSV). In their definition, creating shared value indicates a corporation's behaviors that can bring financial benefits to a firm while simultaneously promoting the social conditions in which it operates. The premise of CSV is that it measures value considering both social benefits and a firm's financial profits. Friedman (2007) presents a similar idea, also asserting that socially responsible behaviors will increase a firm's profits and simultaneously give back to society. In more practical terms, Carroll and Shabana (2010) study several cases and they conclude that only some socially responsible actions will generate real profits for a firm. Furthermore, the perceived socially responsible activities that cannot lead to more profits will eventually be irresponsible for society in the long term.

To make CSR strategies more practical and genuinely beneficial for a firm, I add a new dimension to the original CSR framework: socio-economic profit. Socio-economic profit indicates that a firm should benefit all stakeholders in the long

term and eventually enhance its financial performance. The key idea of socio-economic profit lies in ‘creating long-term benefits’; it implies that, regardless of whether the behavior is perceived as salutary to stakeholders, a firm must select the best strategy for long-term development. For example, given that the environmentally friendly perspective is widespread, a petroleum producer is willing to reduce its carbon emissions to enhance its social reputation. According to the original CSR theory, it is better to invest in other forms of renewable energy or simply reduce production. However, these strategies are not sustainable because they directly jeopardize the firm’s revenues and may cause downsizing, which is not beneficial to stakeholders in the long term. From the socio-economic profit prospective, we generate a recommendation that the firm can introduce advanced machines to optimize productivity and drive down carbon emissions. The firm is even able to develop a related business to reuse polluting materials, such as carbon and sulfide, which most likely improves the firm’s profits. Although closing plants or reducing production seems socially responsible in this case, the possible consequences, such as redundancy, will adversely affect society.

Socio-economic profit contains four dimensions: a) firm premium; b) organizational legitimacy; c) strategic external economy; and d) utility maximization.

As a financial term, the premium means that investors are willing to pay more than the actual value of certain financial objects, such as securities and futures (Mehra & Prescott, 1985, P150). There is a similar construct used by marketers: the brand premium. The brand premium implies the extra value that a company realizes from a product with a recognizable name compared to its generic equivalent (Ailawadi et al., 2003). Companies can create brand equity for their products by making them easily recognizable and superior in quality and reliability. Following the idea of these constructs, we are able to define the firm premium as the additional value that stakeholders will recognize beyond an organization’s financial value. This framework emphasizes the interaction between the social benefits and the firm’s profits. For instance, socially responsible strategies improve a firm’s social reputation.

Furthermore, as demonstrated, companies with a high social reputation make high profits (McWilliams & Siegel, 2001).

Organizational legitimacy derives from institutional theory. DiMaggio and Powell (1983) categorize the process of institutional isomorphism into three types: coercive, mimetic, and normative. To better understand the role of institutions in social life, Scott (1995) specifies constraints and incentive behaviors by identifying three pillars: regulative, normative, and cognitive behaviors. The normative perspective involves value and norms. Value means the conceptions of that which is preferred or desirable; and norms indicate the expectations of how things should be conducted, including the informal expectations of fair and acceptable business practices (Doh et al., 2010). Hence, the normative perspective creates the conditions for legitimacy: 'Organizational legitimacy refers to the degree of cultural support for an organization – the extent to which the array of established cultural accounts provides explanations for its existence, functioning, and jurisdiction' (Meyer & Scott, 1983, P45). Suchman (1995, P574) contends that 'legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed systems of norms, values, beliefs, and definitions'. Legitimate organizations meet and conform to societal expectations, and as a result, they are accepted, valued, and taken for granted as right, fitting, and good (Aldrich & Fiol, 1994, P653). Organizational legitimacy also indicates that a corporation makes rational decisions, considering shareholders, employees, customers and suppliers. Due to the advantages of being a legitimate organization, a firm is able to attain consensus from the community, which decreases its agency cost. In other words, organizational legitimacy can assist a firm in achieving its social objectives while not crippling profits.

The external economy is a construct that comes from the classical microeconomic perspective. Externalities are the costs or benefits that affect a party that is not intended to incur costs or benefits (Buchanan & Stubbienben, 1962). The external economy is the positive side of externality, implying that an organization's

action is voluntarily beneficial to an irrelevant group. We must emphasize that the nature of 'irrelevant groups' has shifted from economic research to management studies. Some scholars may ask why the 'irrelevant party' will increase our socio-economic profit. To answer this question, we first need to explain the definition of relevant groups in the management field. Economists consider that only parties that have direct business relationships with the corporation are regarded as relevant groups. However, stakeholder theory defines relevant groups as parties that can affect or be affected by a firm's strategies (Donaldson & Preston, 1995). For instance, economists argue that, if a firm operates its business and unintentionally benefits surrounding groups, such as the government and environmentalists, then it is regarded as an external economy effect because the firm does not purposely produce these benefits. However, from stakeholder theory, if a firm implements these tactics, then it will empower its social reputation, which is ultimately salutary to itself. Thus, in strategic management, the local community is a relevant group. Using the idea of externality, we can create a new construct: the strategic external economy. If organizations' behaviors eventually reward them when they make socially responsible actions in relation to their stakeholders, then we can claim that these activities are a strategic external economy.

The last dimension of socio-economic profit is utility maximization. Distinguishing from the original CSR framework, effectively utilizing the advantages produced by socially responsible behaviors can generate excessive revenues and profits. Most studies are flawed because they only explore the relationship between CSR and financial performance (e.g., Cavaco and Crifo, 2014) and because they often ignore the profound implications of their results. It is certain that socially responsible actions cannot generate revenues when a firm is unable to appropriately use the unique competitiveness brought by these practices. Conversely, when a firm knows how to maximally leverage its social reputation to create firm premium, it will benefit its brand, product, and supply chain association and increase its profits in the long term. The focal point in this dimension is that firms should learn how to effectively

utilize their competitive advantages, that is, the reputation of being socially responsible, to achieve their financial goals.

Corporate Financial Performance

The relationship between CSR and corporate financial performance (CFP) is an issue of interest. In elaborating the relevant CSR dimensions, it is necessary to select the suitable financial performance measure. The CFP definitions and their corresponding measures in the previous studies can be decomposed into the three groups indicated by Orlitzky et al. (2003): a) market-based CFP, b) accounting-based CFP, and c) perceptual-based CFP.

Market-based measures of CFP, such as price per share or share price appreciation, reflect the notion that shareholders are a primary stakeholder group (Cochran and Wood, 1984). Beurden and Gossling (2008) add further market-based measures in their review, including stock performance, market return, market value to book value, etc. In exploring the correlation between CSR and CFP, scholars normally use market value of entity (SVE) to measure a firm's financial performance. They often assume that all other things being equal, the company with the higher CSR ratings will achieve better stock returns and SVE. From my perspective, I believe that SVE does not seem to be an appropriate measure for detecting market sensitivity to CSR for two reasons. First, the assumed firm's social philanthropy can be reflected in its market value, which means that future cash-flows or discount rates depend on the firm's CSR level. As a result, these two effects are likely to influence the firm's market value, and it is very difficult to disentangle the effects. More importantly, if the market is at equilibrium and shareholders and managers rationally have the same goal of maximizing the firm value, the market-to-book ratio must be identical to all companies in a given sector. Thus, we prefer not to apply SVE as the measure of financial performance.

Alternatively, the accounting-based measures consist of profitability measures, asset utilization such as return on assets (ROA), asset turnover, and growth measures (Wu, 2006). This assertion is in line with Cochran and Wood (1984), who argue that accounting-based indicators, such as the firm's return on assets (ROA), return on equity (ROE), or earnings per share (EPS), capture a firm's internal efficiency in some manner. Most previous studies use the accounting data to measure financial performance. For example, Waddock and Graves (1997) use three accounting variables: return on assets (ROA), return on equity (ROE), and return on sales (ROS). Prado‐Lorenzo et al. (2008) employ return on assets (ROA) and loan losses, whereas Siregar and Bachtiar (2010) only apply return on assets (ROA). Earnings per share (EPS) have also been utilized in exploring the CSR-CFP link (Oeyono et al, 2011). Furthermore, previous studies utilize the q-ratio as a measure of a firm's performance, especially when there is a mediator between CSR and corporate financial performance. Tobin's q is a widely acknowledged financial term. It refers to the ratio between a physical asset's market value and its replacement value. The latest study by Jayachandran et al. (2013) also uses Tobin's q to examine the environmental disclosure on the firm's financial performance. However, Tobin's q is more likely to be used in mergers and acquisitions because the intrinsic value is needed in this context (Parrino et al., 2009).

Lastly, the perceptual measures of CFP require survey respondents to provide the subjective estimates of a firm's financial performance, including the soundness of the financial position, the wise use of corporate assets, or financial goal achievement relative to competitors (Wartick, 1988). New perceptual CFP measures are adopted by the reviewed studies, for instance, the 'scaling of financial performance' as rated by surveyed respondents. Because the perceptual measures of CFP are unstable, which may vary from different angles and understandings of a firm, we have decided not to apply them in this research.

Taken together, to develop the relationship between CSR and corporate financial performance, we identify that ROA is the most appropriate measurement of financial

performance in the present research because it is less likely to be manipulated and is the most widely used measurement of a firm's performance (Yoshikawa and Phan, 2003).

Environmental Munificence

The organizational environment represents one of the major contingencies faced by firms (Tosi and Slocum, 1984). Over the last forty years, an extensive body of research has accumulated that explores the environmental influences on organizational strategies, structures, processes, and performance. Environmental munificence is defined as the scarcity or abundance of critical resources needed by a firm operating within an environment (Dess and Beard, 1984; Randolph and Dess, 1984). It influences the survival and growth of the firms that share the environment and affects the abilities of new firms to enter the environment (Randolph and Dess, 1984).

To operationalize the construct, Castrogiovanni (1991) classifies three types of munificence: capacity, growth/decline, and opportunity/threat. Capacity refers to the excess space for firms to grow, which, in other words, indicates the potential magnitude in certain domains. For example, people's lives increasingly rely on smart phones, laptops and the internet. Recently, we have observed a number of companies, including Google, Facebook, and Alibaba, which have achieving outstanding accomplishments in growing from small-to-medium enterprise to top 500 global corporations in less than 20 years. Thus, capacity is determined by people's demands, and it influences a firm's development. The second dimension, growth/decline, presents the actual condition of a field. Clearly, we are able to understand an industry trend based on various sources, such as the average stock return (ASR) and consumers' perceptual optimism/pessimism toward the industry. Notably, if the ASR slope for recent years is positive or if consumers' perceptions of future development are positive, then we believe that the environment is munificent. The last dimension is

opportunity/threat. The more opportunities there are in the environment in which firms operate, the more environmental munificence they have.

Together, these findings suggest that a high level of munificence in the environment has maximum strategy options and minimum competitive pressures.

Environmental Volatility

Environmental volatility is an essential variable that has been researched dozens of times since the 1980s. Although the literature applies a variety of terms, such as uncertainty, volatility, and high-velocity (Goll & Rasheed, 2004; Li & Simerly, 1998), to some extent, they all capture the underlying nature of unpredictable change. To avoid the complexity and misunderstanding of these constructs, we only use environmental volatility in this article. The moderating role of environmental volatility is empirically well-documented in the case of a variety of relationships between organizational variables and firm performance (Gilley & Rasheed, 2000; Hough & White 2003). According to Dess and Beard (1984), environmental volatility is defined as the extent of unpredictable changes in an organization's environment (Dess and Beard, 1984). Similarly, Dean and Sharfman (1996) define environmental instability as 'the extent to which market demand and technology are rapidly changing in a given industry'. Based on their definition, a characteristic needs to be emphasized. Volatility refers to the extent of fluctuation that is a relative rather than an absolute concept. For instance, given that the growth rate of a utility industry was 10% last year whereas it was only 5% for the automobile industry, if the growth rate for both industries this year is 10%, then it is notable that the utility industry is stable but that the automobile industry is highly uncertain because the reference point is different.

In summary, environmental volatility often adversely affects a firm's performance, its decision-making rationale and its competitive advantages.

Integration of environmental munificence and volatility

Because many studies find insignificant or slightly positive relationships between corporate social responsibility and financial performance (Prado-Lorenzo et al., 2008; Seifert et al., 2003), we attempt to investigate the implications behind these findings – what factors lead to the inconclusive results. Lee and Park (2010), using the identical methodology, demonstrate that the casino industry finds an insignificant CSR-CFP link whereas socially responsible actions would apparently improve financial performance in the hotel industry. Other studies (Henriques and Sadorsky, 1996; Lankoski, 2000; Salzmann et al., 2005) also reveal similar results finding that the CSR-CFP link in different industries is distinctive. We have already known that the industry plays a crucial role in investigating the CSR-CFP link; however, the causes of this phenomenon remain unclear. In the present study, we assume that environmental volatility and munificence, which are based on the industrial level, affect the extent to which corporate social responsibility improves financial performance. Thus, we divide all industries into four zones – Ideal, Crisis, Catastrophe, and Inertness.

Table 1. Sector Classification

Industry classification		**Industry munificence**	
		Low	High
Industry volatility	High	Catastrophe	Crisis
	Low	Inertness	Ideal

Hypothesis

A high number of studies explore the CSR-CFP link. He et al. (2007) investigate how non-market strategies can positively influence a firm's performance. Ruf et al. (2001) find that size, industry, and the prior year's sales had significant effects on CFP. Dowell et al. (2000) research the relationship between global environmental

standards and market value. They ask, 'Is adhering to higher global environmental standards associated with higher market value or does it represent a non-productive use of assets and a drag on market value?' Consequently, they find a positive relationship. Similar to the findings by other studies (e.g.,; Judge & Douglas, 1998), the external environment appears to have limited direct effects on financial performance (McWilliams and Siegel 2001; Peloza, 2006), and its influence is primarily moderating, influencing the relationship between CSR and other dependent variables. Therefore, we utilize environmental volatility and munificence to classify four context typologies: crisis, catastrophe, inertness, and ideal. We assume that, although the overall relationship between corporate social responsibility and financial performance is positive, the effects in the four contexts are different. This assumption suggests that socially responsible behaviors have a stronger influence on a firm's profitability if said firm operates within a more munificent and stable industry; furthermore, if a firm is in a volatile or restricted industry, then the CSR effect is, of course, weaker or even insignificant.

Hypothesis 1a: *The overall relationship between corporate social responsibility and corporate financial performance is positive.*

Hypothesis 1b: *The positive effect of corporate social responsibility on corporate financial performance is moderated by various types of industry contexts.*

The 'Ideal' context refers to an organization that is located in an environmental situation with high munificence and low volatility. The high munificence environment implies that the external environment sufficiently support the growth of organizations. The environmental munificence influences the survival and growth of firms sharing the environment and affects the ability of new firms to enter the environment (Randolph and Dess, 1984). When resources are abundant, it is relatively easy for firms to develop, and thus, they become more able to pursue goals other than survival. In such situations, organizations often have less market competition, which leads to

higher profits. In addition, a stable environment reduces their transformation costs and decreases the possibility of violating stakeholders' expectations. Goll and Rasheed (2004) propose that environmental instability will impede the manager's ability to satisfy stakeholders' demands. This finding is also supported in the longitudinal study by Lamberti and Luci (2012). Drawing on their research, I can assume that CSR offers a more comprehensive approach to reaching better financial performance if the environment is stable.

Hypothesis 2: *The positive effect of CSR on corporate financial performance in the 'ideal' context is higher than in any other contexts.*

The 'Catastrophe' context refers to an industry with high environmental instability and low munificence. When resources become scarce in an industry, competition intensifies, which adversely affects a firm's profitability and leads to organizational slack and changes in the intra-organizational characteristics (Li et al., 2013). For example, Jones et al. (1992) reveal that the high level of expectations of volatility in an industry will decrease a firm's profits. Gilley and Rasheed (2000) argue that environmental dynamism moderates the relationship between outsourcing and firm performance. According to their proposal, a high-velocity environment reduces the reliability of outsourcing, which seriously threatens the survival conditions of firms that heavily rely on it. Hough and White (2003) realize that companies operating within a highly dynamic environment have lower profits compared to their peers. Many studies reach similar conclusions that industries with high dynamism and volatility may directly or indirectly jeopardize a firm's financial performance. In exploring the CSR-CFP link, I find that researchers provide a number of explanations concerning the controversial conclusions on the relationship between corporate social responsibility and financial performance. From my perspective, I assume that the external environmental factor, which is a combination of environmental munificence and volatility, generates the inconclusive results. In the

‘survival or die’ condition, firms that insist on the implementation of CSR strategies cannot be helped to pass through the crisis because corporate social responsibility only focuses on long-term benefits. The mismatch between stakeholders’ needs and the goals of CSR strategies impairs a firm’s performance. In the ‘Catastrophe’ context, firms suffer restrictive constraints due to the external environment, and the context is less favorable for the development of an organization that is associated with an ambiguous and unpredictable expectation of support in the future. Because an organization is less likely to attain economic profits through its normal operations, it may implement extreme tactics, such as tax fraud and an environmentally unfriendly policy, to survive; eventually, it will create a vicious circle, impairing its public image and attaining worse financial conditions. Due to the high uncertainty and difficulty to survive, firms that implement CSR strategies are not empowered with more benefits. In other words, corporate social responsibility does not significantly improve a firm’s financial performance in this context.

Hypothesis 3: *Corporate social responsibility has an insignificant effect on financial performance in a ‘Catastrophe’ context.*

The ‘Inertness’ context refers to an organization that operates within a stable environment with low munificence. The environmental capacity to achieve a high growth rate is relatively weak, whereas the environment is not highly uncertain. Compared to the ‘Catastrophe’ sector, firms that operate within the ‘Inertness’ context infrequently face the issue of survival because the industry is not drastically changing. This phenomenon always occurs in the process of transitioning from a developing country to a developed country. Some low-end industries that historically have made tremendous contributions to the nation come to have an increasingly narrow space to develop. Dahlsrud (2008) concludes that the economic dimension of CSR is concerned with how to convert social reputation into financial benefits. Considering the low growth rate of the ‘Inertness’ zone, the accumulation of social premium,

which is a prime component of CSR, can hardly generate real financial profits. As discussed above, the 'Ideal' context is the perfect condition for a firm to develop. The difference between the 'Ideal' context and the other contexts is interesting. Given the similar stable environments, the possibility of converting the same CSR strategies into financial profits depends on the condition of industrial profitability. In a hostile or non-munificent environment, firms require the devotion of greater effort to achieve the same performance compared to firms operating within munificent industries (Seregar & Bachtiar, 2010). Scarcity of resources leads firms to avoid excessive expenditures to engage in CSR activities and to pay greater attention to conservative strategies. Therefore, we posit that socially responsible actions are valuable to a firm in the 'Inertness' context even though the CSR effect may be weak.

Hypothesis 4: *The positive effect of CSR on corporate financial performance in an 'Inertness' zone is lower than that in an 'Ideal' zone.*

The definition of the 'Crisis' context comes from the Chinese interpretation (in Chinese, 'Weiji' means Crisis). 'Weiji' indicates a combination of threat and opportunity. In Figure 1, we see that 'Crisis' refers to an unstable environment with high munificence. Based on the arguments of Fredrickson and Mitchell (1984), because information is difficult to obtain in an unstable or uncertain context, the rationality of decision making, that is, the comprehensiveness in collecting and analyzing data, is more likely to decrease, leading to unpredictable performance. Fredrickson and Iaquinto (1989) repeat the experiment using a longitudinal approach and reach similar results. Contrary to this perspective, Husted and Allen (2007) indicate that high velocity plays a positive role in influencing corporate financial performance. There are abundant studies that provide empirical support for this view (e.g., Judge & Miller, 1991; Goll & Rasheed, 1997; Castrogiovanni, 1991). Wilson (2003) offers an appropriate explanation of this phenomenon. He claims that, due to the stimulus of the 'growth or die' condition, decision makers will utilize their full

capability to analyze the relevant information and optimize their plan to seek the maximum level of support from all stakeholders. Thus, the strategy is more likely to meet all parties' requirements and achieve success.

Previous studies have shown that environmental munificence is a measurement of the possibility of growth in the future. Environmental munificence has been explored in a number of studies, mainly as a moderator. For example, Rosenbusch et al., (2013), find that declines in munificence are associated with changes in budgets, planning and control systems, equipment and facilities, and departmentation among primary and secondary schools.

Yasai-Ardekani (1989) demonstrates that the contexts and organizational structures shift in situations with different levels of environmental scarcity/munificence. These results suggest that, in a highly munificent condition, perceived environmental pressure leads to great structural complexity, measured by the functional specification and decentralization of operational decisions. Because the external business environmental is more flexible and tolerant, managers are less likely to use risk-averse strategies and more willing to delegate authority to their peers.

Furthermore, studies have also shown that environmental munificence interacts with decision-making rationality and organizational performance. In their study, Goll and Rasheed (1997) show not only that rationality benefits organizational performance in dynamic and munificent environments but also that the positive effects of rationality on performance are strongest in environments that are high in both dynamism and munificence. They also demonstrate that rationality leads to high levels of organizational performance in dynamic environments. However, Elbanna and Child (2007) reach a different conclusion, showing that rationality is most likely to have a positive effect on a firm's performance when the environment is munificent and stable.

The 'Crisis' context often appears in emerging markets. Multinational companies (MNCs) confront this situation when they enter a new market. MNCs from developed or industrialized countries realize major differences in the level of stability between

the social context and even the institutional context of their home countries compared with those in emerging economies. To operate in these countries and to generate profits, socially responsible behaviors that may significantly improve a firm's financial performance are more likely to be enacted.

Hypothesis 5: *The positive effect of CSR on corporate financial performance in the 'Crisis' zone is lower than in the 'Ideal' zone.*

Methodology

Level of analysis

Many empirical studies exploring social impacts on financial performance have been conducted either at the firm level or at the industry level. Industry-level analyses have typically focused on the CSR-CFP link in a certain industry, and they also analyze its impacts on economic growth, productivity, trade flows, and investment flows (e.g., Barnett & Kramer, 2008; Goll & Rasheed, 2004; Cavaco & Carifo, 2014).

In the present study, I investigate the CSR-CFP link on the firm-level; however, we also take industry factors into consideration as a moderator. This approach fills the gap that remains because researchers always consider firm and industry influences separately, losing sight of a more comprehensive vision when exploring the relationship between corporate social responsibility and financial performance.

Data Collection

The sample is composed of 227 companies in North America from Standard & Poor's 1500 Index (S&P 1500 Index). In my study, two databases are used. I employ the KLD database to collect the social ratings (CSR). The COMPUSTAT database serves as a supplement to measure firm-level and industry-level financial performance. COMPUSTAT is a well-known database for fundamental and market data on over

30,000 publicly traded companies. It provides firm-specific profit and loss, income and cash flow data and critical information on firms, such as location and ownership. In addition, it reveals the index-specific fundamentals and related industrial economic data.

Sample Selection Procedures:

(1) Principle 1: The data overlap in both the KLD and COMPUSTAT databases.

(2) Principle 2: The selected firms have complete datasets from 2003 to 2013, with no missing data in any year or column.

(3) Principle 3: The selected industry groups (SIC) must have more than 15 firms.

I selected the sample based on three steps. Initially, I employed the Industrial Standard & Poor's 1500 index (S&P 1500) from 2003 to 2013 to measure industry growth and instability instead of the more commonly used Industrial S&P 500 because the larger constitution of the index minimizes large-firm-bias. The S&P 1500 index combines three leading indices – the S&P 500, the S&P MidCap 400, and the S&P SmallCap 600 – which cover approximately 90% of U.S. market capitalization. It is designed for investors seeking to replicate the performance of the U.S. equity market or to benchmark against a representative universe of tradable stocks. The industrial S&P 1500 index gauges the weighted average ratio of each industry, including ROA, debt ratio, etc. It offers a more comprehensive view of the development of certain sectors over the past ten years. We then matched the KLD and COMPUSTAT databases and obtained a preliminary sample with 1107 firms.

In the second step, based on the objectives of the present study, corporations without complete financial and KLD data for the 10-year period 2003-2013 were deleted. Following Principle 2, only 318 firms remained in the sample.

Finally, in terms of the Standard & Poor's industry classification (GIC) codes, the 318 firms were distributed across 27 industry groups. Following Principle 3, only 11 industry groups had more than 15 companies in the data warehouse. Therefore, the sample used in the present study included 227 firms.

Table 2. The distributions of the sample

Industries	GIC	Numbers
Energy	1010	24
Material	1510	19
Capital goods	2010	26
Retailing	2550	21
Health Care	3510	15
Biotechnology	3520	22
Real Estate	4040	18
Software	4510	19
Hardware	4520	21
Semiconductor	4530	20
Utility	5050	22
Total		227

Measure of corporate financial performance

Having identified the CSR dimensions, we must choose the suitable measurement of financial performance to explore this relationship. Thus, we have decided to examine the CSR-CFP link by using the Waddock and Graves (1997) method. We use return on assets (ROA) as our dependent variable. ROA is simply net income divided by total assets, and it is most likely the most popular measure for gauging financial performance (Goll and Rasheed, 2004; Seifert et al., 2003; Prado-Lorenzo et al., 2008). It measures the ability of firms to conduct their business at a reasonable cost, invest funds in profitable sectors or programs, and profitably perform their day-to-day operations (Seifert et al., 2003; Fauzi et al., 2009). We collect all financial data from the COMPUTSAT database. Then, we calculate the sum of return on assets from 2003 to 2013 and calculate the 11-year average ROA for each company, designated average ROA, as our dependent variable.

Measure of corporate social responsibility

To measure CSR, we rely on the continuous scores and ratings provided by the KLD database. The CSR scores are based on 13 individual social performance criteria. In the analysis, I only use five key stakeholder characteristics: corporate governance, community, diversity, employee relationships, and the environment (Hur et al., 2014; Lai et al., 2010). For the purpose of comparison, based on prior research, I construct a general CSR measure by aggregating the different CSR ratings from KLD to create a net social performance score for each firm (e.g., Barnett & Salomon, 2012). The CSR ratings are represented as a dummy variable that takes the value of 0 or 1, where 1 represents an area of strength and 0 represents a neutral score.

The value of such ratings is that they are applicable to different firms across industries and comparable across different dimensions. Although various industries have their unique attributes of social responsibility, there are some characteristics that are common among all sectors, and the main dimensions of the KLD database accurately capture them. The general KLD score is an assessment of a firm's overall level of social responsibility; thus, it serves as a proxy for the stakeholders' influence capacity (Barnett & Kramer, 2008). A high general CSR score implies that a corporation engages in more socially responsible activities; of course, a low score means that a firm is not willing to participate in socially philanthropic actions.

Measure of environmental munificence and volatility

The moderator, which is designated 'sectorial moderator', integrates the industry-specific and financial ratio-specific factors. We start with the financial ratio-specific factor. Based on Castrogiovanni (1991), I find that over-abstraction and conceptual ambiguity limit researchers' ability to gauge industry factors. To avoid this problem, I employ environmental munificence and volatility to specifically represent the industry factor (Yasai-Ardekani, 1989; Goll and Rasheed, 2004). I collect the data from the S&P 1500 industry fundamental index. The rationale behind selecting the

S&P 1500 instead of the more commonly used S&P 500 index is that the S&P 1500 involves firms of various sizes ranging from small to large; thus, it reflects the reality and the dynamism in the industry. Munificence is operationalized as the average return on assets (ROA) from 2003 to 2013 of each industry, and volatility is operationalized as the variability in the value of shipments (Goll & Rasheed, 2004), which is the standard error of the ROA in the 11-year period. Therefore, I collect 11 years' worth of (2003-2013) industrial ROA data from the S&P 1500 and calculate the average ROA for the selected industry. In addition, I regress the industrial average ROA on year (from 2003-2013) and obtain the standard deviation of the ROA.

Table 3 shows that each industry has a distinctive average return on assets and standard deviation of the ROA (Std of ROA). The differences are huge,

Table 3. ROA & Std of ROA of industries

Industries	Average ROA	Standard	Sectors
Energy	17.000%	5.666%	Crisis
Material	11.980%	4.595%	Catastrophe
Capital goods	15.930%	2.308%	Ideal
Retailing	15.650%	3.648%	Crisis
Health Care	13.350%	2.030%	Inertness
Biotechnology	16.625%	1.766%	Ideal
Real Estate	7.810%	3.128%	Catastrophe
Software	18.240%	3.800%	Crisis
Hardware	15.150%	3.850%	Crisis
Semiconductor	11.866%	5.785%	Catastrophe
Utility	9.873%	2.155%	Inertness

ranging from 7.81% to 18.24% in ROA and 1.76% to 5.785% in Std of ROA.

Then, I continue to construct the moderator by synthesizing with the industry-specific factor. Table 4 shows that, according to the magnitude of ROA and Std of ROA, I divide all industries into four zones, representing high or low growth

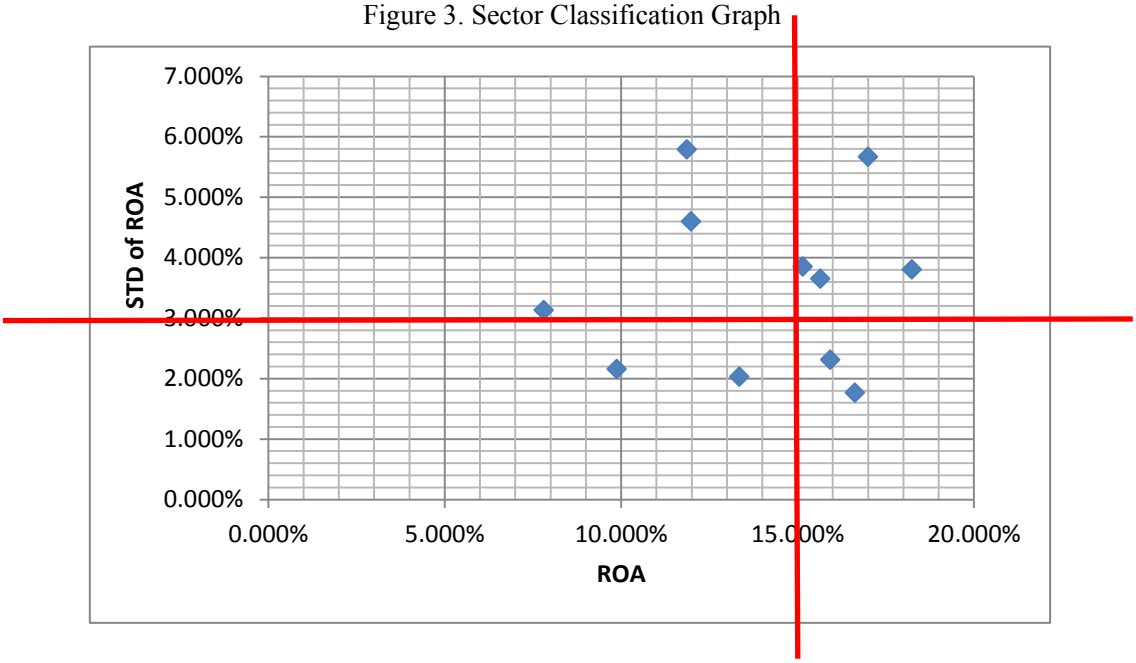
rates and volatility.

As depicted in Figure 5, contingent on the characteristics of each sector, I designate the sectors Ideal, Crisis, Catastrophe, or Inertness. There are two to four industries in each quadrant. Although the nature of the industries is different, they share the same attributes, in this case, a similar ROA and Std of ROA.

A firm operating within an industry with a higher growth rate and stable environment will deserve better financial performance (Goll and Rasheed, 2004).

The biotechnology industry, which falls into the 'Ideal' zone, exemplifies the stable and munificent industry. For the 11-year period, firms in this industry achieve a 16.625% ROA and only a 1.766% Std of ROA, which indicates steady and generous room for development. Meanwhile, the 7.81% ROA and 3.128% instability implies the terrible environment that real estate industry suffers. When I divide all industries into 4 sectors, I assume that the CSR effect on financial

Figure 3. Sector Classification Graph



performance will vary due to the effect of the sectorial moderator, which I explain in detail below.

Table 4. Industries classification model

	Average ROA (<15%)	Average ROA (>15%)
Standard deviation of ROA (>3%)	Catastrophe	Crisis
Standard deviation of ROA (<3%)	Inertness	Ideal

Control variables

Because I am exploring the CSR-CFP link, identifying the control variables that might influence the results is important. I code for the most common control variables when investigating the CSR-CFP link, including the firm size, debt ratio, and net income (Mill, 2006; Barnett & Salomon, 2012; Barth et al., 1998; Parrino et al., 2009).

Firm size is a control variable because larger firms will have more resources to achieve better financial performance. Normally, larger companies have competitive advantages through hiring advanced employees, creating innovative products, and developing economies of scale (Wu, 2006). To gauge firm size, I use the measure of the firm's total assets (Becht et al., 2003). We designate this variable *firm size*.

In addition to size, I control for the debt ratio of the firm. I define debt ratio as the firm's total liabilities divided by its total assets. A ratio of less than one means that a company has more assets than liabilities, and a ratio of more than one means vice versa. Debt ratio is a measure of how risky it is for a company to develop its business by continually using loans. Barnett and Salomon (2012) argue that debt imposes discipline upon managers and encourages them to make decisions that are best for the firm. Thus, I designate the variable *debt ratio* in our analysis.

Net income is also a necessary control variable. Net income is defined as a company's total earnings (or profits). Net income is calculated by taking and adjusting for the cost of doing business, depreciation, interest, taxes and other expenses (Parrino et al, 2009). It is worth discussing because firms with higher post-tax net income have more flexible room to develop. Additionally they can plan and implement optimized

strategies in the long term (Davidson & Worrell, 1990; Lai et al, 2010). Thus, I designate this variable *Net income* in the present study.

I find that research and development (R&D) expenses and advertising expenses are also widely used control variables in studies (e.g., Barnett & Kramer, 2008, Brammer et al., 2006); however, in the present analysis, the sample includes many small-to-medium-size enterprises that do not have much expenditure on R&D and advertising. Therefore, I do not utilize these variables. Finally, because all firms in the sample are derived from North America, there is no need to control for contextual factors.

Results

Table 1 presents the descriptive statistics and correlations of the variables that we use to examine the hypotheses. The average ROA for the 228 companies in the sample is approximately 4.6% per annum. The average CSR score is approximately 1.873. The mean values for ROA and net income are generally consistent with the expectations, even though the minimum value for the ROA (−63.2%) value seems exorbitant. Although at first glance the minimum/maximum performance values may appear out of line with the rest of the data, the other values are very comparable. Moreover, the data checks reveal that the COMPUSTAT database is reported faithfully. For example, the $392 million net income (and 7% ROA) of Advance Auto Parts Inc. was reported in its financial statement. We conduct multiple data check, and the results show that the data collected in the COMPUSTAT database are accurate.

Not surprisingly, the descriptive statistics indicate a relatively higher correlation between net income and firm size ($\rho = 0.533$), which indicates that firms with a larger firm size generally have higher revenues; however, the results remain acceptable. The correlations both between the independent variables and the dependent variable and among the independent variables are generally moderate in magnitude. Firm size is only weakly related to ROA ($\rho = 0.138$) because ROA eliminates much of the scale

effect by using total assets as the denominator.

Table 5. Descriptive statistics and correlations

	1.	2.	3.	4.	5.
Average ROA	1				
Average CSR	0.175***	1			
Debt ratio	-0.232***	0.088**	1		
Net income	0.198***	0.075***	0.006	1	
Firm Size	0.138***	0.467***	0.020	0.533***	1
Mean	0.046	1.873	0.522	512.1	3594.1
SD	0.068	2.275	0.186	1669.9	8645.4
Minimum	-0.632	0	0.085	-889.5	-329.4
Maximum	0.300	5	1.174	18038	89746

*$p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

Although the correlation matrix supports the contention that the independent variables are not highly correlated, we still need to examine their multicolinearity. We find that firm size has the maximum variance inflation factor (VIF= 8.53<10), which is the generally accepted range for individual variables (Kennedy, 1998). Furthermore, the VIF values of the other variables are less than 5. Thus, we can conclude that multicolinearity does not negatively impact the results.

With respect to the independent variable of interest (CSR score), the correlation with ROA as a dependent variable is positive (ρ = 0.175). To better understand the CSR-CFP link, we proceed to conducting a multivariate regression analysis.

In Table 2, we test for the hypothesized generally positive effects between corporate social responsibility and financial performance. Table 2 shows the results

from regressing ROA on average CSR. Firm size, debt ratio and net income are included as control variables. The model is significant ($p = 0.000 < 0.01$), and the R^2 for the model is 0.132. All control variables are significant. A firm with a larger size and a relatively lower level of debt compared to assets is able to enhance its profitability. Most importantly, as we expected, the t-test for the average CSR score is 2.514 ($p = .013 < .05$), which is significant. This value indicates that a firm's socially responsible actions will improve its financial outcomes. The coefficient is equal to 0.006, which means that ROA is likely to increase 0.6% if a company increases its CSR score by one point. Hypothesis 1 is supported.

Table 6. Results of regressing ROA on Average CSR, debt ratio, firm size and net income

Independent variables	**Beta coefficient**
Average CSR	0.006**
Debt ratio	-0.088***
Net income	0.0003**
Firm Size	0.002***
R^2	0.132
Adjusted R^2	0.117
F test	8.507***
df	227

*$p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

After reviewing the overall CSR-CFP link, we are proceed to examining the CSR-CFP link in each zone and investigating whether the magnitude of effect between the average CSR score and ROA varies in different contexts. Table 3 shows that the positive effect of CSR on financial performance is dramatically distinctive among the different sectors.

In the 'Ideal' context, we regress ROA on an independent variable and three control variables, including debt ratio, net income, and firm size. Consistent with the

results derived from the overall database (227 companies), we find a positive relationship between the ROA and average CSR scores.

Table 7. Results of regressing ROA on CSR, debt ratio, firm size and net income in different sectors

	Overall(Model 1)	Ideal(Model 2)	Catastrophe(Model 3)	Inertness(Model 4)	Crisis(Model 5)
Average CSR	0.006**	0.017***	0.001	0.007***	0.008**
Debt ratio	-0.088***	0.081	-0.028	-0.007	-0.054*
Net income	0.0003**	0.000	0.000***	0.064	0.0187
Firm Size	0.002***	0.001*	-0.009***	0.0153***	-0.004
R^2	0.132	0.561	0.525	0.408	0.183
Adjusted R^2	0.117	0.521	0.489	0.334	0.142
F test	8.507***	13.755***	1.383	5.504***	4.525***
df	226	47	56	39	84

*$p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

Notably, the effect of CSR (β_{ideal} =0.017, p=0.000<0.01) on financial performance is significantly higher than in Model 1 ($\beta_{overall}$=0.006, p=0.013<0.05). Hypothesis 2 is supported, which means that firms that operate within a more munificent and stable industry will have more advantages if they behave in a socially responsible manner. Not surprisingly, because corporations are more profitable in a flexible environment, they are able to pay attention to social philanthropy, building their firm premium and legitimizing their organizations. Less pressure from the capital budget leads a long-term orientation in organizational thinking that considers the interests of all stakeholders, which will eventually improve the firm's core competitive advantages. Consequently, a company's financial performance will be better, and the CSR effect will be more influential in this context.

As hypothesized, although the regression model is generally significant, the

effect of CSR on ROA in the 'Catastrophe' sector is very low ($\beta_{catastrophe}$=0.001) and, more importantly, insignificant (p=0.673>0.1). Hypothesis 3 is supported. Due to the many external distractions, a firm that operates within a restricted and highly volatile industry is not capable of converting socially responsible behavior into real profit. Excessive competition and a low threshold for entry, for example, represent characteristics of 'catastrophe' zones. Stakeholders are less likely to benefit from socially responsible actions due to the poor financial situation, and they require managers to spend every dollar in the short-term space for profitability instead of implementing CSR strategies that cannot immediately boost revenues. Investment in CSR most likely deteriorates their survival conditions and worsens financial performance. Therefore, the positive effect of CSR on financial performance is insignificant.

Hypothesis 4 assumed that CSR is positively related to a firm's performance in the 'Inertness' context and that the positive effect of CSR on corporate financial performance in the 'Inertness' zone is lower than that in the 'Ideal' zone. Model 4 shows that the positive effect of CSR on financial performance in the 'Inertness' sector is significant ($\beta_{inertness}$ =0.007，p=0.001<0.01). Thus, Hypothesis 4 is supported. Although the industry is not in the trajectory of rapid growth, the stable environment ensures relatively stable revenues and profits. In this circumstance, corporate social responsibility will continuously generate firm premium for the corporation and lead to stronger profitability. In addition, due to the restrictions imposed by lower environmental munificence, the CSR effect on financial performance is less than that in the 'Ideal' context ($\beta_{inertness}$ =0.007< β_{ideal}=0.017).

In the 'Crisis' context, corporate social responsibility also significantly improves financial performance (β_{crisis} =0.008, p=0.000<0.01). In the present research, a total of four industries and 86 companies fall under the 'Crisis' sector, including the software, hardware, retailing and energy industries. The definition of the 'Crisis' zone is an industry with high levels of both munificence and volatility. Over the past ten years, these industries have maintained stronger profitability (a higher average ROA) while

suffering major crises as well. Although these industries are not stable, compared to those in the 'Catastrophe' sector, the more profitable environment allows firms to concentrate more on the interests of their stakeholders rather than on survival. Additionally socially responsible activities can help firms stand out from the crowd and provide them with prestige. However, the CSR effect on financial performance (β_{crisis} =0.008) is nearly half of the CSR effect in the 'Ideal' context, which means that the unstable environment, to some extent, jeopardizes the firm's ability to convert social responsibility into real profit.

Discussion

The belief that environmental munificence and volatility will moderate the relationship between corporate social responsibility and financial performance has been discussed over the last few decades. The present study finds considerable empirical support that explains why researchers reach divergent results and conclusions. All the hypotheses in the present study are confirmed, thus lending support to the basic premise of the paper that the environment is a moderator of the relationship between corporate social responsibility and firm performance and, more importantly, that the CSR effects on financial performance vary by sector with different levels of munificence and volatility.

The present study makes two major contributions. First, I integrate the conceptualization of the stakeholder perspective on CSR and shared value (Freeman, 1984; Porter & Kramer, 2011; Barnett & Salomon, 2012) and redefine the dimensions of CSR. I add socio-economic profit as a new dimension to emphasize the interactive nature of CSR. Corporate social responsibility is not simply 'doing well' by stakeholders or achieving social benefits. It is the interaction between the society, the community, shareholders, employees, and the environment. Only when social responsibility and economic profit are mutually beneficial and consequently form a virtuous circle can a firm's CSR strategies benefit society and itself in the long term.

Second, I combine the industry-specific factor and financial ratio-specific factor to build a new construct: the sectorial moderator. In the previous literature, scholars have become habituated to analyzing these two components separately. A number of studies have explored the CSR-CFP link in different industries and reached controversial conclusions (e.g., Lee & Park, 2009; Benergee et al., 2003; Salzmann et al., 2005). However, none of them objectively investigates why these discrepancies occur. Meanwhile, environmental munificence and volatility have also been repeatedly discussed. However, in the present study, I find that different levels of sectorial munificence and volatility can affect the significance of the relationship between CSR and CFP. Moreover, the empirical results also show that the CSR effect on financial performance will be most significant when a firm operates within an industry with high munificence and low volatility. Furthermore, the CSR effects on financial performance are dramatically distinct from one sector to another (β_{ideal}=0.017 > β_{crisis}=0.008 > $\beta_{inertness}$=0.007> β_{crisis}=0.001).

Similar to other empirical studies, the present study has several important limitations that must be borne in mind when interpreting the results. First, as noted by Waddock and Graves (1997), measurement issues are problematic in the study of corporate social responsibility. The present study measures CSR by relying solely on the KLD database. Bias may occur, leading to the over- or under-evaluation of the CSR scores. Similarly, environmental munificence and volatility are simply gauged by average industrial ROA and its standard deviation. The natures of these two moderators are possibly not completely captured. Second, the method of screening the sample might be inappropriate. Following 'Principle 2', I reject 91 firms because I believe that small number (less than 15) of companies cannot fully represent an entire industry. Actually, there were 10 firms in the agricultural chemical industry in my sample, which may, at least, represent part of the industry. Finally, I only use net income, debt ratio, and firm size as control variables because of the limited data on R&D and marketing expenditures, which may jeopardize the effectiveness of the results.

In conclusion, the present study clearly suggests that the corporate social responsibility-firm performance relationship is contextually specific. Therefore, it is better to identify contextual factors before developing theoretical understandings and managerial implications. I hope that researchers can continue to study in this area and find fruitful results.

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