

Corporate Ethical Identity as a Determinant of Firm Performance: A Test of the Mediating Role of Stakeholder Satisfaction



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ABSTRACT. In this article, we empirically assess the impact of corporate ethical identity (CEI) on a firm's financial performance. Drawing on formulations of normative and instrumental stakeholder theory, we argue that firms with a strong ethical identity achieve a greater degree of stakeholder satisfaction (SS), which, in turn, positively influences a firm's financial performance. We analyze two dimensions of the CEI of firms: *corporate revealed ethics* and *corporate applied ethics*. Our results indicate that revealed ethics has informational worth and enhances shareholder value, whereas applied ethics has a positive impact through the improvement of SS. However, revealed ethics by itself (i.e. decoupled from ethical initiatives) is not sufficient to boost economic performance.

KEY WORDS: business ethics, corporate ethical identity, financial performance, stakeholder satisfaction, stakeholder theory

ABBREVIATIONS: CEI: corporate ethical identity; CRE: corporate revealed ethics; CAE: corporate applied ethics; SiRi: sustainable investment research international; KLD: Kinder, Lydenburg, Domini Research and Analytics Inc.; SS: stakeholder satisfaction; CFP: corporate financial performance; MVA: market value added; ROA: return on assets; R&D: research and development

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Introduction

During the last decades, the ethical behaviour of firms and the potential effects of malfeasance on society have attracted the interest of researchers and the business press alike. Recently, business ethics has generated renewed attention due to notorious corporate scandals like those of Enron, Worldcom, Arthur Andersen, Tyco International, and Adelphia. Additionally, the growing importance of governmental regulations, the amplified scrutiny of the media, and increased pressure from various stakeholders have placed the business ethics challenge on the strategic agenda of virtually all firms (Ponemon and Michaelson, 2000; Stevens et al., 2005; Weaver et al., 1999). In the academic arena, the proliferation of specialized journals like *Journal of Business Ethics* and *Business Ethics Quarterly* are testaments to growing interest in the subject.

There is still a number of unresolved academic issues in the area of business ethics and social responsibility of the firm, however (Donaldson, 2003; Harrison and Freeman, 1999; Walsh et al., 2003). Specifically, knowledge about existing linkages

between a firm's ethical stance and its performance remains limited at best. There are theoretical and empirical reasons for this situation. From a theoretical point of view, there is controversy over the effect of business ethics and good corporate behaviour on a firm's financial performance. Some authors (Hosmer, 1994; Jones, 1995) argue that good ethics is good business because it generates positive externalities like trust and commitment to stakeholders, which in turn assures long term performance. Others remain sceptical (Friedman, 1970; Jensen, 2001; Schwab, 1996). The skeptics argue that ethical initiatives are investments without pay offs and therefore against the shareholder's best interest. Unfortunately there is limited empirical work that has explicitly addressed these corporate ethical issues and the existing research has shown mixed results (e.g. Berman et al., 1999; Hillman and Keim, 2001). Thus the question remains: Is ethical behaviour a good predictor of business performance (Gibson, 2000)?

An interesting avenue for exploring the relationship between ethics and performance is through the perspective of corporate identity – the set of interdependent characteristics of the organization that give it distinctiveness: organizational philosophy, values, history, strategy, business scope, and communication, for instance (Balmer, 1998, 2001; van Riel and Balmer, 1997). Since corporate identity is recognized as a source of competitive advantage (Balmer and Gray, 2000), we suggest that a firm's ethical stance (i.e., its ethical values, behaviours, and communications on ethical commitments) can be seen as a component of the firm's corporate identity that may enhance corporate performance.

Despite the significance that corporate identity research has recently engendered (Balmer, 1998, 2001), previous research has largely ignored the ethical dimension of corporate identity and its relationship to a firm's performance. This study aims to fill this gap in several ways. First, we define the ethical component of the corporate identity construct with a concept that we call *corporate ethical identity* (CEI). Relying on the notion of corporate identity, we define CEI as “the set of behaviours, communications, and stances that are representative of an organization's ethical attitudes and beliefs”. This narrowly defined concept encompasses two aspects: *corporate revealed ethics* (CRE), which comprises the communication of a firm's ethical attitudes

and beliefs, and *corporate applied ethics* (CAE), which comprises the firm's behaviours – actions and policies that can be considered as ethical.

A second way in which we aim to contribute to this literature is by drawing on stakeholder theory to propose a theoretical scheme whereby the gap between performance and ethics – specifically CEI – is bridged by stakeholder satisfaction (SS). Stakeholders play a key role in the formation of society's ethical demands and CEI emerges as a standard by which stakeholders compare the firm's ethical behaviours to their expectations. Thus, a strong CEI implies congruence with the ethical demands of the firm's stakeholders, resulting in higher levels of satisfaction. In turn, satisfied stakeholders are expected to be more willing to provide their services and resources to the firm, thereby enhancing performance.

A third way in which we plan to fill the gap between corporate identity and a firm's performance is to empirically test our theoretical contention. Our results indicate that firms with a strong CEI achieve a greater degree of SS, and this, in turn, positively affects a firm's financial performance. Also, we have found that CAE and CRE have differential effects. Whereas applied ethics has a positive impact on performance through improved SS, revealed ethics has informational worth and enhances shareholder value directly. However, revealed ethics by itself (i.e. decoupled from ethical initiatives) is not sufficient to boost economic performance.

The remainder of this article is structured as follows. First, we define CEI and its dimensions. Next, we present relevant literature relating to the objectives of this work and our theoretical formulation. We propose a set of hypotheses grounded in the logic of stakeholder theory, through which we analyze the relationship between CEI and the financial performance of firms. Next, we test our hypotheses on a sample of 398 firms from 26 countries. The article concludes with a discussion of the theoretical and practical significance of the study.

Theoretical framework and hypotheses

Perhaps because of the rapid growth of identity studies, the concept of corporate identity has not been homogeneously defined. The lack of consensus on a precise definition of corporate identity has led to

confusion with the usage of the term, which is often wrongly used interchangeably with related concepts like corporate reputation, corporate personality, and corporate image (see Balmer and Gray, 2003; Hatch and Schultz, 1997; and especially Balmer, 2001, for a clarifying discussion on this issue). Traditionally, the notion of corporate identity has been associated with graphics design, visual identification, and marketing communication. More recently, however, the definition of corporate identity has gradually broadened (Markwick and Fill, 1997; van Riel and Balmer, 1997). Thus corporate identity can be defined as the “the reality and uniqueness of an organization which is integrally related to its external and internal image and reputation through corporate communication” (Balmer and Gray, 2000; Gray and Balmer, 1998). Corporate identity deals with the essence of the firm and its unique characteristics: its philosophy, values, history, strategy, business scope, and communication (Balmer, 1998, 2001; Balmer and Gray, 2003; van Riel and Balmer, 1997).

Corporate identity is receiving increasing attention from practitioners and academics alike, because it is believed to have a positive influence on corporate reputation (Fombrun, 1996), which, in turn, spawns superior financial performance (Deephouse, 2000; Fombrun and Shanley, 1990; Roberts and Dowling, 2002). Corporate identity is also recognized as a strategic resource and a valuable tool for addressing the needs of the firm’s stakeholders (van Riel, 1995). Indeed, corporate identity and such related concepts as corporate communication and organizational identity are the result of permanent interactions between the firm and its stakeholders (Balmer and Gray, 2000; Hatch and Schultz, 1997; Scott and Lane, 2000; Stuart, 2002; van Riel and Balmer, 1997). Stakeholders have interests and demands, and the way in which a firm manages these claims contributes to the shaping of its corporate identity, insofar as its values, actions, and stance differentiate it from other organizations.¹

CEI: definition and components

One neglected area of research is the ethical dimension of corporate identity. Yet, the firm’s ethical behaviours and stance are also part of its reality and uniqueness. In this paper, we offer a definition of

the ethical dimension of corporate identity that we call CEI. Bearing in mind the aforementioned definition of corporate identity, we approach the CEI concept as “the set of behaviours, communications, and stances that are representative of an organization’s ethical attitudes and beliefs”. It contributes to the organization’s reality and uniqueness and reflects the extent to which a firm can be considered ethical. Thus, CEI refers to a firm’s ethical goals, values, practices, communications, and actions, and provides a reference for stakeholders to compare their ethical claims with the ethical stance of the corporation.

In the same way that corporate identity is the result of continuous interaction between the firm and its stakeholders, CEI is influenced by the interaction between a firm and its stakeholders’ *ethical* claims (Fombrun and Foss, 2004; Fritz et al., 1999; Logsdon and Yuthas, 1997). The ethical stance of a firm is based on the expectations of society – the *legitimate* claims made by the constituencies with which the firm interacts (Logsdon and Yuthas, 1997; Mitchell et al., 1997; Wood, 1991). In the words of Ferrell et al. (2000), if “a specific required behaviour is right or wrong, ethical or unethical, is often determined by stakeholders, such as investors, customers, interest groups, employees, the legal system, and the community” (p. 6). Recent empirical studies support the previous argument. For instance, Weaver et al. (1999) showed that the orientation of corporate ethics programs reflected both external influences (e.g. institutional environment) and internal pressures (e.g. top management). Such ethical endeavours as ethics programs merge the organization’s decisions and the ethical claims of society (Weaver et al., 1999). In a similar vein, Stevens et al. (2005) found evidence that financial executives are more likely to integrate their firm’s ethical code into their strategic decisions if they perceive pressure from market stakeholders. Other factors such as the idiosyncratic position of a firm’s executives toward corporate ethics can influence the ethical stance of an organization (Weaver et al., 1999). Also, these studies indicate that ethical decisions and actions are at least partially the result of the interaction between the firm and its stakeholders. As we argue later in the paper, when there is congruence between the firm’s ethical actions and societal ethical claims, stakeholders are expected to be satisfied. Thus SS is defined as the extent to which the stakeholders’ claims are met by the firm’s actions.

Because corporate identity is a multidimensional concept (Melewar and Jenkins, 2002), various dimensions can be identified. Previous literature seems to show consensus on two main factors – communication and behaviour – that define corporate identity and the way it is demonstrated to internal and external audiences (van Rekom, 1997; van Riel, 1995; van Riel and Balmer, 1997). Communications refer to the explicit revelation of such aspects of identity as history and values. Corporate communication plays a pivotal role in the process through which stakeholders perceive that the company's identity and reputation is formed (Balmer and Gray, 2000; van Rekom, 1997). Behaviours are related to those activities and actions that characterize corporate identity. Likewise, we identify two dimensions that define the CEI: (1) what we call CRE, which deals with the communication of the firm's ethical identity to its constituencies and relevant audiences and (2) what we term CAE, which deals with all actions and policies that can be considered ethical, thereby exceeding the simple communication of ethical values. It is important to distinguish these ethical actions from other initiatives that are related to the good management of stakeholders (Fisher, 2004). Whereas the latter deals with everyday activities like employee training programs or profit sharing schemes, ethical actions refer to processes, activities, and events conducted on an ethical basis that go beyond a firm's daily functions. For instance, the adoption of ethical codes as a self-commitment device, initiatives like HIV/AIDS programs, or divesting from a country to avoid corruption problems are examples of the application of ethics (Margolis and Walsh, 2003).

The distinction between CRE and CAE provides us with a better understanding of the relationships among CEI, SS, and corporate financial performance (CFP). In the following sections, we focus on these relationships.

Stakeholder theory

Because stakeholders are engaged in constructing the ethical identity of firms, a stakeholder approach appears to be the appropriate framework to connect ethics with performance. Moreover, management scholars studying ethical and social issues have

generated an extensive body of research (Garriga and Melé, 2004; Margolis and Walsh, 2003) drawn primarily on stakeholder theory (Freeman, 1984).

Stakeholder theory has deep roots in the notion of corporate social responsibility (Carroll, 1979; Clarkson, 1995; Wartick and Cochran, 1985; Wood, 1991) and in Freeman's (1984) seminal book, *Strategic Management: A Stakeholder Approach*. Freeman's main thesis is that the firm is responsible for managing and coordinating the constellation of various competitive and cooperative interests of various constituencies or stakeholders. Thus, firms have multiple goals in addition to the singular end of maximizing shareholder's value, as proposed by traditional economic theory (Friedman, 1970).

In applying stakeholder theory, we can distinguish two almost entirely separate methodological approaches: (1) the theoretically-based *normative stakeholder approach*, which emphasizes the ethical and moral standards as the only acceptable mode for corporate behaviour, independent of the repercussions of these behaviours on the firm's performance and (2) the *instrumental stakeholder approach*, which focuses primarily on stakeholder orientation as a means of achieving corporate success. Research employing the latter perspective is more empirically based (Berman et al., 1999; Donaldson and Preston, 1995; Jones and Wicks, 1999).

Recently, however, some scholars have attempted to integrate the two approaches (Gibson, 2000; Jones, 1995; Jones and Wicks, 1999). The underlying rationale of their studies is that ethical behaviours (a normative orientation) can result in a significant competitive advantage (an instrumental orientation). Ethical principles and behaviours foster trusting and cooperative relationships with stakeholders, which, in turn, lead to a reduction in opportunism and contracting costs. In the end, there is an improvement in the firm's competitive advantage over those firms that do not rely on ethical principles. Although some scholars have expressed skepticism over this integrated perspective (Donaldson, 1999; Freeman, 1999; Schwab, 1996; Treviño and Weaver, 1999), we believe that it provides a key avenue for research into the ethical and social issues of firms.

Following this integrated line of research, we borrow from the normative approach to examine the relevance of business ethics as the driving force for SS and from the instrumental approach to assess

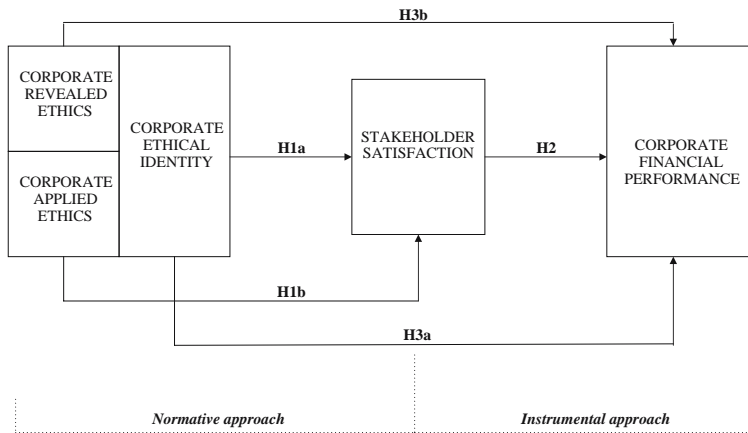


Figure 1. Corporate ethical identity and its effects on stakeholder satisfaction and financial performance.

the link between SS and better financial performance. Figure 1 illustrates our theoretical model and presents the central arguments, concepts, and relationships of this study.

SS through CEI: a normative approach

The normative approach is characterized by the incorporation of ethical and moral principles into the firm's decision making – in particular, into decisions relating to the way in which a firm manages its stakeholders (Donaldson and Dunfee, 1994; Evan and Freeman, 1983; Philips, 1997; Wicks et al., 1994). The normative approach is characterized by two main positions: (1) stakeholders have legitimate interests in corporate activities independent of the corporation's instrumental interests in them and (2) each stakeholder is of intrinsic worth (Donaldson and Preston, 1995). Thus, the normative core of the stakeholder approach prescribes that a firm should incorporate ethical standards in order to achieve SS. Under the normative approach, SS should be the final goal of the firm because of the intrinsic worth of stakeholder interests. These interests are based on ethical and moral principles and are not necessarily related to their instrumental worth to the corporation (Berman et al., 1999; Donaldson and Preston, 1995; Evan and Freeman, 1983).

Stakeholders have a set of expectations relating to an organization's ethical activities and various groups,

such as managers, employees (Das, 2005; Grojean et al., 2004), government (Rockness and Rockness, 2005), consumers (Rawwas et al., 2005), and other constituencies (Phillips and Reichart, 2000) reveal these expectations. As previously argued, CEI provides a reference or standard for stakeholders to use in evaluating a firm's actions (behaviours and communications). When there is congruence between stakeholder expectations and CEI, we predict a greater degree of SS. Since stakeholders expect a firm to fulfil its ethical responsibilities and its philanthropic duties (Ferrell et al., 2000), ethical manifestations stimulate the formation of trust and commitment between the stakeholders and the firm, resulting in stronger relationships and greater satisfaction (Fritz et al., 1999; Hosmer, 1994; Strong et al., 2001). Hence, our first hypothesis is:

Hypothesis 1a: The CEI of the firm has a positive influence on stakeholder satisfaction.

However, we expect that the two components of CEI will have differential effects on SS: that CAE will have a greater impact than CRE. Whereas CRE signals the ethical stance of the firm and acts as a declaration of purpose for the firm's future actions, CAE involves specific concrete activities to serve the needs of stakeholders who demand ethical behaviour from the firm. Stakeholders evaluate how well companies perform according to their ethical expectations and standards and exhibit a certain degree of fulfilment only when they experience tangible results from such

ethical corporate behaviour (Logsdon and Yuthas, 1997). This suggests that the manifestation of ethical values decoupled from ethical actions may be not valued by stakeholders. Therefore, we expect that the revelation of a firm's ethical beliefs is less effective in boosting satisfaction than are the tangible ethical initiatives that align with stakeholder demands. These arguments are captured in:

Hypothesis 1b: CAE has a stronger influence on stakeholder satisfaction than does CRE.

Financial performance through SS: an instrumental approach

The other main approach of stakeholder theory is the instrumental approach. It indicates that a stakeholder orientation gives the firm a source of competitive advantage which, in turn, will result in better financial performance. A key assumption of this approach is that the firm's ultimate goal is market success and that satisfying stakeholder claims helps to achieve this goal (Donaldson and Preston, 1995; Freeman, 1984). This ultimate objective may not be related to the wellbeing of stakeholders in general, but it may be in the interest of shareholders. Thus, stakeholder management has a strategic value with a "means to an end" perspective (Berman et al., 1999), which is opposed to the intrinsic value of the normative approach.

The instrumental approach advocates the formulation and implementation of processes that satisfy stakeholders because they control key resources (Pfeffer and Salancik, 1978) and suggests that SS, in turn, will ensure the long term survival and success of the firm (Freeman, 1984; Freeman and McVea, 2001; Hillman and Keim, 2001; Post et al., 2002). Accordingly, stakeholders that own resources relevant to the firm's success will be more willing to offer their resources to the extent that their different claims and needs are fulfilled (Strong et al., 2001). Therefore, we expect that SS leads to a higher commitment, to greater effort, and, ultimately, to superior performance (Hosmer, 1994; Stevens et al., 2005), as articulated in:

Hypothesis 2: Stakeholder satisfaction has a positive influence on the firm's financial performance.

Financial performance through CEI: the mediating role of SS

Whether or not business ethics has a positive influence on financial performance is an open research question. Some authors (Friedman, 1970; Jensen, 2001; Schwab, 1996) assert that the only social function of the firm is to maximize shareholder value while complying with the rules of the market. These scholars argue that ethical investments are in conflict with the primary profit oriented strategies of the company, and that if investors cared enough about ethical behaviour to punish it by divesting, firms would have a market based incentive to behave ethically. The necessity of regulations such as the US Sarbanes Oxley legislation (Rockness and Rockness, 2005), which levies severe penalties for unethical behaviour, suggests that such market incentives are highly uncertain.

In contrast, other authors have argued that proactive ethical initiatives have a positive impact on financial performance because ethical behaviours result in the creation of intangible assets, which are vital to long term business success (Jones, 1995; Jones and Wicks, 1999). Intangibles like good reputation, trust, and commitment are generated through a strong ethical stance (Fombrun et al., 2000; Hosmer, 1994). We agree with this latter perspective. By behaving ethically, a company generates intangible gains that improve its ability to attract resources, enhance performance, and build competitive advantages while satisfying its stakeholders' needs (Fombrun et al., 2000). As discussed with respect to Hypothesis 1a, we propose that CEI has a positive effect on SS because stakeholders expect the firm to fulfil their ethical demands. To the extent that the firm attends the stakeholders' ethical claims, their satisfaction levels increase and they are more willing to provide their resources and effort which, in turn, produces enhanced performance (Hypothesis 2). Therefore, we suggest that the relationship between business ethics and financial performance is not straightforward, but is mediated by the level of SS. That is, we expect an indirect effect between the CEI of the firm and its financial performance.

Hypothesis 3a: Stakeholders satisfaction mediates the relationship between CEI and the firm's financial performance.

However, when we break CEI into its two dimensions, we expect distinguishable effects on financial performance.

Traditional capital market studies have largely acknowledged the role of information disclosure on the performance of firms. Asymmetries of information and incentive problems obstruct the efficient allocation of resources in a capital market economy and disclosure plays a key role in mitigating these problems (Healy and Palepu, 2001). Prior research has extensively examined the level of disclosure of social activities and its effect, particularly when analyzing the relationship between corporate social performance and CFP (see Margolis and Walsh, 2003; Orlitzky et al., 2003; Walsh et al., 2003 for recent reviews). In addition, environmental accounting scholars have shed some light on the subject by analyzing the impact of voluntary environmental disclosure on firm performance (Cragg, 2002; Lorraine et al., 2004). As a whole, these two lines of research offer supporting evidence for a positive relationship between social disclosure and financial performance.

Similarly, we expect CRE to have a positive impact on the financial performance of a firm. CRE can have beneficial value to for several reasons. (1) It attends to the investors' need for ethical and social information which, in turn, helps to achieve better long term investment decisions (Hummels and Timme, 2004; Sethi, 2005). (2) It provides a clear signal about the stance and beliefs of the firm, reducing uncertainty about future actions and long term risks (Sethi, 2005), which can stimulate trust and commitment between shareholders and top management and reduce opportunistic behaviours and transactional costs (Hosmer, 1994; Jones, 1995). (3) It may be a valuable tool for creating such intangible assets as good corporate image and enhanced reputation, which can be sources of competitive advantage (Fombrun, 1996; Fombrun and Foss, 2004; Hillman and Keim, 2001). (4) Investors may interpret an ethical statement as a positive signal regarding the firm's resources, because only companies with sufficient resources can embark on ethical enterprises (cf. Orlitzky et al., 2003; Waddock

and Graves, 1997). In short, CRE has an important informational value, and we expect that investors incorporate ethical information into their assessment of a firm's value.

Even though CRE is expected to increase shareholder value because of these arguments, CAE is an initiative oriented to specific stakeholder needs and does not necessarily represent investments subject to return evaluation (Fombrun et al., 2000). Following the example presented earlier in this article, divesting from a country to avoid corruption problems can be considered an ethical initiative, but it does not necessarily represent an optimal decision from the perspective of maximizing value. Similarly, investing in HIV/AIDS programs can be of fundamental importance to people stricken with the disease, but is not expected to have a direct impact on the financial performance of the firm. Hillman and Keim (2001) have presented empirical evidence to suggest that participation in social initiatives that are not related to primary stakeholders hinders shareholder value. Although these initiatives may have potential reputational benefit and a positive impact on SS (Hypothesis 1b), they are costly in terms of organizational resources and create dubious financial pay offs (Hillman and Keim, 2001; Fombrun et al., 2000).

Therefore, we expect, on the one hand, that the informational value of CRE has a positive impact on the financial performance of a firm, even after controlling for its effects on SS. On the other hand, we expect no further positive impact of CAE beyond the positive effect on SS. This implies that the effect of CAE on performance is fully mediated by SS. These two ideas are captured in our final hypothesis.

Hypothesis 3b: Corporate revealed ethics has a positive influence on financial performance, even after controlling for stakeholder satisfaction; whereas CAE has no further influence.

Methods

Sample and data

We created our data sample from the 2002 SiRi ProTM database compiled by the company Sustainable Investment Research International (SiRi) – the

world's largest company specializing in the analysis of socially responsible investment. SiRi comprises eleven independent research institutions, such as the US firm of Kinder, Lydenburg, Domini Research and Analytics Inc. (KLD) or the UK firm of Pensions and Investment Research Consultants Ltd. The SiRi reports rely on each company's reporting procedures, policies and guidelines, management systems, and key data. This information is extracted primarily from ongoing contact with management representatives, but also from financial accounts, company documentation, international databases, media reports, and interviews with key stakeholders. Each firm's profile contains over 350 data points that cover all major stakeholder issues, including community involvement, environmental impact, customer policies, employment relations, human rights, activities in controversial areas (e.g. alcohol), supplier relations, and corporate governance. We supplemented the information on social and ethical issues with financial data extracted from the OSIRIS database for the years 2000–2003 – a comprehensive database of listed and large unlisted companies around the world, compiled by Bureau Van Dijk. It contains balance sheets, income statements, cash flow statement, and stock data. Given the differences in accounting practices among the different countries included in the database, it is important to note that OSIRIS's information is standardized.

We excluded from our sample financial firms and those that do not provide complete information on financial data. The final sample comprised 398 companies belonging to 26 countries.² Our data only allow a cross sectional analysis because our information is limited to one year from the SiRi ProTM. This limitation is not critical in our analysis, given the inertia associated with a firm's ethical policies (Agle et al., 1999).

Measures

Corporate ethical identity

We operationalized this variable through the sum of its two basic ethical components: CRE and CAE.

Corporate revealed ethics

A mission statement is seen as the starting point for revealing a corporate identity program, as it is an effective vehicle by which a firm's essential values are

communicated to its stakeholders (Leuthesser and Kohli, 1997). Issues of business ethics are likely to be explicit in mission statements, and mission statements are included in annual reports or in other corporate statements. To measure the CRE variable, we used the SiRi ProTM database, which contains business ethics report. In the first part of this report, SiRi analysts study the various corporate statements and determine if the company discloses relevant information related to its ethical business behaviour. As a result, SiRi builds a dummy variable in which the company scores "1" on this item if it discloses information on business ethics in the corporate statements and "0" if it does not. In our empirical application, we used this item provided by SiRi.

Corporate applied ethics

We measure CAE using another dummy variable. In this case, the SiRi analysts assess the organization's business ethics initiatives, policies, and procedures. Specifically, the company statements are inspected in order to identify any specific ethical procedures (and the scope of any such procedures) compliant with the standards of business ethics. The company is labeled "ethical" (a score of "1") if it conducts all of the following actions: withdraws from a market to avoid corruption problems; has an explicit, readily available employee ethics policy; has a contact person in case of irregularities; guarantees that the reporting agent remains anonymous; and uses sanctions for unethical behaviours. If the company does not employ these business ethics procedures, it receives a score of "0".

Stakeholder satisfaction

SS is viewed as a multidimensional construct (Carroll, 1979) that captures a wide range of items – at least one for each relevant stakeholder (Waddock and Graves, 1997). In the past few years, the KLD Social Index has been used extensively in empirical research on stakeholder theory and has been found to be one of the best measures of SS available to date (Hillman and Keim, 2001). This index provides a measure of the overall wellbeing of a firm's multiple stakeholders.³

In this study, we use the score provided by the SiRi ProTM. This score aggregates the degree to which the company satisfies stakeholders' interests and rates SS from 0 (worst) to 10 (best). Taking into

account the score received by each stakeholder group or area – community, corporate governance, customers, employees, environment, and vendors and contractors – SiRi builds an aggregate score, which we use as our final measure of *stakeholder satisfaction*.⁴

Corporate financial performance

A great deal of debate surrounds the use of financial measures to assess performance. We use a market based measure: *market value added* (MVA). In addition, for the sake of robustness, we provide results using an accounting based measure, *return on assets* (ROA). MVA is calculated as the equity market valuation of the company minus the capital invested in the company, and can be interpreted as the stock market's estimation of net present value (Hillman and Keim, 2001). ROA is defined as the ratio of profits before interest and taxes to total assets. Accounting measures of financial performance are inadequate for conducting large cross sectional comparisons across industries, because the results may mask differences in financial performance based on the specific context of an industry (Griffin and Mahon, 1997). Thus, we use a frequently applied method for controlling industry effects (e.g. Agle et al., 1999), a measure arrived at by subtracting the average ROA of the industry from each firm's ROA.

Although many different measures of financial performance could have been used, we emphasize market based measures because they better capture the expected future impact of ethics on performance. Specifically, the informational value of CRE can only be measured through variables that discount the expected future intangible investment derived from a firm's revealed ethical behaviour. Such variables are forward looking measures (market performance variables) rather than backward looking measures (accounting performance variables). On this point, several authors have acknowledged the deficiencies of accounting measures in capturing intangible relationships and the benefits provided by market based measures (Hillman and Keim, 2001; Orlitzky et al., 2003).

Control variables

We control for R&D investment, marketing controversies, firm size, industry, risk, and country fol

lowing the lead of previous researchers (McWilliams and Siegel, 2000; Waddock and Graves, 1997). We operationalized these variables as follows:

R&D investment is defined as the ratio of R&D expenses to total assets in a log scale. McWilliams and Siegel (2000) showed that R&D is positively correlated with stakeholder performance and financial performance. As they point out, a major determinant of the financial performance of firms is their spending on R&D, because it leads to product and process innovation and enhances firm productivity. At the same time, the correlation between R&D and SS is explained by the fact that many aspects that create utility for a firm's stakeholders are generated through product or process innovations. Thus, in order to isolate the real impact of a firm's SS on financial performance, we need to control for investment in R&D. Otherwise, we would provide upward biased estimators of the SS variable.

Marketing controversies is intended to capture the marketing practices of firms – a variable that has been shown to be an important determinant of financial performance and SS. Consequently, an appropriate econometric model must include a proxy variable for marketing practices, and we use SiRi's dummy variable "existence of controversies over marketing practices". This variable takes a value of "1" if the firm has controversies over product quality and safety or if the firm benefits from market power over its clients and a value of "0" otherwise. Irresponsible marketing practices – i.e. controversies on product quality and safety or the abuse of market power – is expected to decrease SS (Moskowitz, 1975). Therefore, we expect marketing controversies to be negatively related to SS. Consistent with our theoretical model, we also expect that marketing controversies will have a negative effect on financial performance. However, there may be an opposite effect, given that a high level of controversy could also indicate the market power of the firm. A firm with strong market power (e.g., a monopolist firm) can take advantage of its power financially and pass the costs of advertising to customers (Tannous, 1997). This practice will result in bigger advertising budgets, which are expected to have a positive impact on performance (McWilliams and Siegel, 2000) but result in high levels of controversy (e.g. unhappy customers because of excessive pricing). As

a consequence, the influence of marketing controversies on CFP is unclear because we do not know which of these two effects will prevail.

Size is defined in terms of a firm's total sales on a log scale. The size of a firm is a standard factor in explaining the ethical basis of CFP and SS. A firm's commitment to a particular ethical behaviour and the instruments it has available to implement this commitment is expected to be related to the size of a firm.

Risk is measured by a firm's beta (Hillman and Keim, 2001) as reported by OSIRIS. This variable is recognized as a pivotal determinant in any estimation of financial performance. Moreover, we allow this variable to affect SS. Stakeholder well-being is expected to be related to the possibility of financial distress (Roberts, 1992). A firm with a strong orientation towards its stakeholders may be viewed as being better managed and therefore as being less risky and *vice versa* (a firm with lower risk is more likely to be committed to satisfying its stakeholders).

We control for industry and country, as there are 13 sectors and 26 countries in our sample. *Industry* effects are captured by 4 digit SIC dummy variables (DummyS). To control for *country* influences, we use a set of 25 dummy variables (DummyC).

Finally, in order to prevent potential endogeneity problems between measures and consistent with previous studies like that of McWilliams and Siegel (2000), we used the mean of all our variables. The underlying idea is that by averaging variables, it is possible to find more robust coefficients in the estimations because the error terms are less highly correlated with the average independent variables.

Data analysis and model specification

A test for identifying outliers in multivariate data was performed. The method developed by Hadi (1992, 1993) indicated that we have significant outliers in our data. It is well known that ordinary least squares are sensitive to outliers (Berk, 1990). In this case, robust regression may be the only reasonable statistical recourse (Hamilton, 1992) because it limits the influence of outlying observations and allows for more robust inferences.⁵

In our empirical application, we rely on two basic specifications, one explaining SS and one explaining

CFP. The main independent variable in both cases is CEI, which is also separated into its component parts, CRE and CAE. Following previous research (Waddock and Graves, 1997), we consider the same set of control variables in explaining CFP and SS. In order to explain a firm's SS and test Hypothesis 1a, we consider the following specification:

$$\begin{aligned} SS_i = & \alpha_0 + \alpha_1 CEI_i + \alpha_2 R\& D_i \\ & + \alpha_3 MARKETING_CONTROVERSIES_i \\ & + \alpha_4 SIZE_i + \alpha_5 RISK_i + \sum_{K=1}^{12} \alpha_{5+K} DummyS \\ & + \sum_{K=1}^{25} \alpha_{17+K} DummyC \end{aligned} \quad (1)$$

In analyzing the possible differential effect of CRE and CAE on SS, as stated in Hypothesis 1b, we conducted two further estimations of specification (1) by breaking the variable CEI into its two basic components: CRE and CAE.

The second equation is aimed at explaining CFP and, as mentioned, we contemplate the same basic control variables as in specification (1). Hence, the basic specification is:

$$\begin{aligned} CFP_i = & \beta_0 + \beta_1 SS_i + \beta_2 CEI_i + \beta_3 R\& D_i \\ & + \beta_4 MARKETING_CONTROVERSIES_i \\ & + \beta_5 Size_i + \beta_6 Risk_i + \sum_{K=1}^{12} \beta_{6+K} DummyS \\ & + \sum_{K=1}^{25} \beta_{18+K} DummyC \end{aligned} \quad (2)$$

From this specification, it is possible to test Hypotheses 2, 3a, and 3b. More specifically, to test Hypothesis 2, we exclude the CEI variable from specification (2) in order to study the existence of a direct effect of SS on CFP. This hypothesis is confirmed when β_1 is positive. To test the mediating role of SS (Hypotheses 3a and 3b), we follow the methodology described in Baron and Kenny (1986). In the case of Hypothesis 3a, the methodology consists of comparing two specifications: one that excludes the SS variable and one that incorporates all the variables. This hypothesis is confirmed when two conditions are met: (1) β_2 is positive and significant in the

specification that does not include the SS variable and (2) in the specification that includes the SS variable, β_1 is positive and significant whereas β_2 is neither positive nor significant. Finally, by separating the CEI variable into its two basic components of CRE and CAE, we can test if there is a differential mediating effect of SS in the connection between a firm's ethical dimension and its performance dimension. In that case, Hypothesis 3b will be confirmed when, jointly with the significant coefficient of SS, the coefficient of CRE is positive, independent of whether or not the SS variable is present in the specification; however, the coefficient of CAE will only be positive when the SS variable is not included in the analysis.

Results

Table 1 reports means, standard deviations, and correlations among the main variables used in the study. Descriptive statistics show the existence of large differences between the means and medians, especially for the MVA and firm size variables. These data suggest the existence of outliers, an extreme confirmed by using the method of Hadi (1992, 1993). Thus, the implementation of robust regression techniques to test specifications (1) and (2) turns out to be particularly desirable.

Concerning the correlation matrix, we find that CEI and SS are positively correlated offering preliminary support to Hypothesis 1a. Comparing the correlation coefficient between CAE and SS with the one between CRE and SS, we find that the former is larger and significant at 1% (compared to the 5% in the case of CRE). This provides initial support for the differential effect stated in Hypothesis 1b. Furthermore, as predicted in Hypothesis 2, SS and CFP are positively correlated. However, this is not true when we use ROA as a measure of financial performance. Finally, CEI and its two basic components, CRE and CAE, are positively related with the market based measure of CFP.

Table 2 summarizes the regression analysis of specification (1), whereby we test the effect of a firm's CEI on SS (Model 1A). Also, we break CEI into the two basic components: CRE and CAE (Model 2A). Finally, we study the existence of a possible complementarity between CRE and CAE.

To do so, in Model 3A we force CRE dummy variable to be "1" when CRE = 1 and CAE = 0 and "0" otherwise.

Model 1A shows that the coefficient for CEI is positive and highly significant ($\alpha = 2.182, p < 0.01$) for explaining SS. These results provide strong support for Hypothesis 1a. Furthermore, when we break CEI into its two basic components (Model 2A), we find that both are positive and highly significant ($p < 0.01$). However, CAE ($\alpha = 1.107, p < 0.01$) contributes more than CRE ($\alpha = 0.852, p < 0.01$) to the SS, and the difference between both is significant ($F = 2.79, p > F = 0.095$). Thus, there is support for Hypothesis 1b. The last row of Table 2 presents the result of testing the complementarity between CRE and CAE. We observe that CRE does not affect SS whenever CAE is "0". Hence, SS requires the firm to implement some tangible measures (e.g., defining a CAE policy) – not merely to make ethical statements (CRE).

Finally, Table 2 illustrates that the control variable for measuring R&D investment is positive, although not significant. As expected, marketing controversies and risk are negatively and significantly related to SS and size has a positive and significant effect on SS.

Table 3 displays the regression analysis results for specification (2).

Model 1B tests the direct effect of SS on CFP. Results indicate that the effect of SS on financial performance is positive and significant ($\alpha = 0.053, p < 0.01$), providing support for Hypothesis 2.

In order to test the mediating role of SS in the relationship between CEI and CFP, as mentioned, we compare Model 2B with Model 3B (Baron and Kenny, 1986). We find that CEI, initially significant in Model 2B ($\alpha = 0.296, p < 0.05$), turns out to be nonsignificant once the SS variable is introduced ($\alpha = 0.186, p > 0.1$). Moreover, this latter variable is also significant ($\alpha = 0.050, p < 0.05$), suggesting that it fully mediates the connection between CEI and CFP and confirming Hypothesis 3a.

Next, Models 4B and 5B test the differential mediating effect of SS in the connection among the various components of ethical identity and CFP. We find that a differential effect exists. The significant coefficient of SS in Model 5B is accompanied by (1) a change in the coefficient of CAE from significant ($\alpha = 0.145, p < 0.05$; Model 4B) to nonsignificant ($\alpha = 0.087, p > 0.1$; Model 5B) and (2) a maintaining

TABLE I
Estimative statistics and Spearman rank correlation matrix^a

	Mean	s.d.	Median	Min.	Max.	1	2	3	4	5	6	7	8	9
1. Returns on assets (E + 01)	0.35	2.79	0.60	-51.62	4.93									
2. Market value added (E + 09)	1.18	8.51	0.01	-0.03	191.00	0.21***								
3. Stakeholder satisfaction	4.64	1.53	4.73	0.21	8.73	0.03	0.15***							
4. Corporate ethic identity	1.06	0.67	1.00	0.00	2.00	-0.04	0.08**	0.55***						
5. Corporate revealed ethics	0.81	0.40	1.00	0.00	1.00	-0.10***	0.05**	0.41***	0.84***					
6. Corporate applied ethics	0.26	0.44	0.00	0.00	1.00	0.01	0.09***	0.54***	0.89***	0.52***				
7. R&D	0.09	0.27	0.05	0.00	6.22	0.08**	0.80***	0.09**	0.09**	0.04	0.09***			
8. Marketing controversies	0.13	0.34	0.00	0.00	1.00	0.09***	0.16***	-0.05**	0.04	0.02	0.01	0.08**		
9. Size (E + 09)	1.27	9.10	0.01	0.00	131.00	-0.01	0.78***	0.21***	0.16***	0.12***	0.17***	0.74***	0.08	
10. Risk	0.62	0.41	0.53	-0.36	2.37	-0.28***	0.20***	0.09***	0.10***	0.09***	0.10***	0.37***	-0.22***	0.30***

^an = 398. Size and R&D are shown in their original scale.

*p < 0.10; **p < 0.05; ***p < 0.01.

of the significance of the CRE coefficient, albeit lower in Model 5B ($\alpha = 0.156$, $p < 0.1$) than in Model 4B ($\alpha = 0.201$, $p < 0.05$). Hence, we can state that SS fully mediates the connection between CAE and CFP but this is not found in the relationship between CRE and CFP, thereby confirming Hypothesis 3b.

Finally, in the same manner used in Table 2 for SS, we test if a complementary relationship exists between CRE and CAE in their connection with CFP. To test this notion of complementarity, we use the aforementioned dummy variable for CRE that is equal to “1” when CRE = 1 and CAE = 0; and “0” otherwise. It is remarkable that all firms in our sample using ethical programs (CAE = 1) revealed their ethical posture in their corporate statements (CRE = 1). However, some firms disclose their ethical posture (CRE = 1) but do not conduct ethical programs (CAE = 0). Model 6B shows that the effect of CRE on financial performance is negligible when firms do not institute ethical initiatives (i.e. CAE = 0). Thus, revealing ethical information does not improve financial performance *per se*. Applied ethical actions are needed in order to take full advantage of ethical disclosure.

Concerning control variables, we find that R&D investment and marketing controversies have a positive and significant impact on CFP ($p < 0.01$ in all models). The positive effect on CFP of marketing controversies suggests that the aforementioned effect of market power more than compensates for the negative influence of controversies through a reduction in SS. Overall, these results are consistent with those of McWilliams and Siegel (2000). Finally, in accordance with Hillman and Keim (2001), we find that size has a significant effect on CFP, while the effect of risk can be neglected.

For robustness, we replicate the previous analysis, but making use of ROA rather than MVA as a proxy of CFP. The results are consistent with Hypothesis 2 ($\alpha = 0.036$, $p < 0.1$) and SS leads to improvements in accounting measures of CFP. However, there is no connection between the ethical stances of a firm and its accounting measure of financial performance. We relate this result to the difficulties of using accounting variables to capture the future effects on performance of the intangible resources linked to the ethical dimension of a firm. With respect to the rest of the predictor variables, we find that the marketing

TABLE II
Results of robust regression analyses for stakeholder satisfaction^a

Variable	MODEL 1A	MODEL 2A	MODEL 3A ^c
Corporate ethic identity	2.182***		
Corporate revealed ethics		0.852***	-0.497
Corporate applied ethics		1.107*** ^b	
Controls			
R&D	0.462	0.445	0.676
Marketing controversies	-0.750***	-0.722***	-0.624***
Size	0.194***	0.193***	0.354***
Risk	-0.499***	-0.491***	-0.626***
Sector dummies	Yes	Yes	Yes
Country dummies	Yes	Yes	Yes
Constant	-0.217	0.594	-1.196
R ²	0.442	0.441	0.350
F Test	9.36***	8.99***	6.35***
N	398	398	398

^aUnstandardized regression coefficients are shown in the table.

^bThe test of equality of coefficients showed that the marginal effect of applied ethics is significantly higher than that of revealed ethics ($F = 2.79$; $p > F = 0.095$).

^cIn this specification, we force corporate revealed ethics (CRE) dummy variable to be equal to 1 when CRE = 1 and corporate applied ethics (CAE) = 0; otherwise this dummy is 0.

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

controversies variable has no significantly positive effect on ROA and that R&D investment is significantly related to ROA in two of the five regression analyses and only at 10% level. The negative and significant effects of size and risk on ROA are in accordance with the evidence reported by Waddock and Graves (1997) (Table 4).

Discussion and conclusion

In this paper we have introduced, as a way to approach the ethical dimensions of a firm's corporate identity, the concept of a firm's CEI as well as its two basic components of CRE and CAE. We further investigated the connections among these ethical stances and a firm's CFP, and the role of SS in mediating this relationship. As predicted, this study showed that a strong CEI was positively related to high levels of SS, which, in turn, had a positive influence on the financial performance of a firm. Hence, we conclude that the relationship between CEI and CFP is mediated by SS. Moreover, we

found that each dimension of CEI (CRE and CAE) has a distinctive effect on both SS and CFP. On the one hand, CAE has a greater influence on SS than does CRE. This finding suggests that stakeholders obtain greater value from tangible ethical actions than they do from simple ethical revelation. On the other hand, we found that CRE has a positive informational effect on shareholders' value after controlling for SS, whereas CAE has no further impact on stock market value. This means that SS mediates the relationship between CAE and CFP but does not mediate the connection between CRE and CFP. Nevertheless, both ethical concepts are closely related, as we have found that ethical disclosures (CRE) only affect CFP when the disclosure is accompanied by a positive CAE. This suggests a complementary role between the two dimensions of CEI.

In addition, by using alternative measures of financial performance, we have been able to capture the intangible nature of the CEI dimension. Accounting measures of performance are recognized as having difficulties in capturing the long term

TABLE III
Results of robust regression analyses for financial performance: market value added^a

Variable	MODEL 1B	MODEL 2B	MODEL 3B	MODEL 4B	MODEL 5B	MODEL 6B ^b
Stakeholder satisfaction	0.053***		0.050**		0.048**	0.051***
Corporate ethic identity		0.296**	0.186			
Corporate revealed ethics				0.201**	0.156*	0.207
Corporate applied ethics				0.145**	0.087	
Controls						
R&D	1.524***	2.284***	2.015***	2.240***	1.820***	1.443***
Marketing controversies	0.347***	0.429***	0.428***	0.450***	0.430***	0.344***
Size	0.191***	0.214***	0.200***	0.204***	0.187***	0.179***
Risk	-0.001	-0.017	0.017	-0.005	0.023	0.003
Sector dummies	Yes	Yes	Yes	Yes	Yes	Yes
Country dummies	Yes	Yes	Yes	Yes	Yes	Yes
Constant	-2.495***	-2.729***	-2.822***	-2.560***	-2.492	-2.319***
R ²	0.720	0.719	0.731	0.720	0.718	0.682
F Test	30.61***	30.08***	30.73***	29.05***	27.91***	26.44***
N	398	398	398	398	398	398

^aUnstandardized regression coefficients are shown in the table.

^bIn this specification, we force corporate revealed ethics (CRE) dummy variable to be equal to 1 when CRE = 1 and corporate applied ethics (CAE) = 0; otherwise this dummy is 0.

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

value of intangible resources, such as reputation, corporate culture, or knowledge assets. This difficulty explains the null effect of the ethical dimensions on performance in the case in which we measure performance with an accounting measure like the ROA, thereby confirming the relevance of intangible resources on a firm's CEI. Furthermore, when we focus on traditional measures of intangible investments, like R&D investments, the relationship between intangibles and firm's ROA is weak. However, when we operationalize financial performance by means of market based measures such as the MVA, a clear positive connection is found between financial performance and ethics and between financial performance and R&D. Note that market based measures of performance are more suitable in capturing the long term value created by these intangibles: they approximate the stock market's estimation of the net present value of the future stream of income generated by intangible resources.

These results have clear implications for management researchers and practitioners, as they combine theoretical aspects with other aspects that have a clear practical content.

Implications for research

This paper contributes to the business ethics literature by introducing constructs aimed at capturing a firm's business ethical identity and assessing the pattern among these constructs, SS, and financial performance. Theoretically, we link the relationship among these concepts and test them empirically, enhancing the limited evidence for a link between business ethics and performance. Our results indicate that a strong ethical identity can have both intrinsic and strategic value. In this regard, there have been controversies about the application of ethics as a strategic tool. For instance, Queen and Jones (1999) argued that ethical initiatives justified on a strategic basis are, in fact, unethical. Furthermore, they suggest that because an ethical stance is difficult to fake when its underlying motivation is profit maximization, such a strategy is unlikely to provide economic benefits. Hillman and Keim (2001) have also argued that participation in social and ethical issues may adversely affect the firm's ability to create shareholder wealth. However, our results show that a well built CEI has direct and indirect positive influences on financial performance.

TABLE IV
Results of robust regression analyses for financial performance: return on assets^a

Variable	MODEL 1C	MODEL 2C	MODEL 3C	MODEL 4C	MODEL 5C
Stakeholder satisfaction	0.036*		0.036*		0.036*
Corporate ethic identity		0.067	-0.010		
Corporate revealed ethic				0.052	0.024
Corporate applied ethic				0.036	-0.003
Controls					
R&D	0.533	0.883*	0.542	0.817*	0.495
Marketing controversies	0.135	0.126	0.136	0.128	0.139
Size	-0.038**	-0.032*	-0.038*	-0.032*	-0.038**
Risk	-0.432***	-0.451***	-0.434***	-0.451***	-0.432***
Sector' dummies	Yes	Yes	Yes	Yes	Yes
Country's dummies	Yes	Yes	Yes	Yes	Yes
Constant	2.674***	1.737***	1.721***	1.775***	1.738***
R ²	0.368	0.353	0.367	0.355	0.369
F Test	6.88***	6.45***	6.61***	6.29***	6.44***
N	398	398	398	398	398

^aUnstandardized regression coefficients are shown in the table.

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

We take advantage in this paper of the integrative line of research of stakeholder theory by combining the normative and the instrumental approaches to develop our theoretical framework. Overall, we have found support for our theoretical contentions, reinforcing the validity of the integrative approach to stakeholder theory (Gibson, 2000; Jones, 1995; Jones and Wicks, 1999). This approach appears to be a promising theoretical framework for combining ethics and business, and it is our hope that future research can refine this concept and extend the search for connecting elements.

Implications for practice

Consistent with the findings of previous studies (Berman et al., 1999; Hillman and Keim, 2001), we found that firms satisfying stakeholder demands have higher economic benefits and achieve differentiation from their competitors. Developing close relationships with key stakeholders creates intangible resources that are the basis for a sustainable competitive advantage. Hence, managers should recognize the importance of these relationships and place them on their strategic agenda.

From a perspective of maximizing shareholder value, previous research has depicted the importance of social disclosure on the firm's value. At the same time, some studies have shown that investing in ethical and social initiatives can, in some cases, be against the shareholders' best interests (Hillman and Keim, 2001). Our study validates the relevance of ethical disclosure practices, as investors may be able to internalize the expected future benefits through their investment decisions in financial markets. Therefore, revealing ethical values and beliefs in accordance to those of the stakeholders appears to be an adequate strategy for managers to follow.

Our study also demonstrates that although ethical initiatives do not necessarily represent profitable investments (i.e. there is not a direct influence), they do form a key determinant of SS, and that SS, in turn, boosts financial performance. Thus, ethical actions have an indirect effect on financial performance through SS.

Finally, given the complementarity between CRE and CAE, we have demonstrated that firms that adopt an ethical disclosure policy disconnected from their actions may hinder their value. A company that merely adopts ethical behaviour in a symbolic manner (Stevens et al., 2005) decoupled from its

actions runs the risk of jeopardizing its own future. And ethical disclosure, it appears, is not enough: the positive influence of ethical behaviour existed in our study only when ethical revelation was substantively coupled with ethical activities. Our research suggests, in fact, that the effective management of ethical identity implies a balance between ethical communications and ethical behaviours.

Limitations and future research

Although we used a unique database with a number of strengths, including its international content, we must recognize some weakness in our empirical application. One such limitation is the cross sectional regression analyses on which our findings are based. Future work should attempt to expand the sample to include more years, allowing the employment of temporal lags in estimations – particularly in those estimations that include that are based on accounting measures of financial performance. Furthermore, richer panel data would allow the examination of more dynamic aspects on the connection between ethics, SS, and performance.

A second limitation is related to the way we have measured some of the variables. Consistent with previous studies, for example, we have adopted the SiRi score, which has been validated as one of the best available (Sharfman, 1996), as a measure of SS. However, the use of an index of aggregated satisfaction precludes the analysis for particular stakeholders. It is reasonable to expect that CEI will affect SS differently and that some stakeholders will have a more decisive effect on CFP than others will. Moreover, the scope of our research did not take into account the possibility that firms and managers may perceive the saliency of stakeholders differently (Mitchell et al. 1997) and their importance may have differential implications for corporate identity (Stuart, 2002). Nonetheless, we believe that our work have initial efforts to understand the multifaceted relations between corporate identity, ethics and firm performance. A more fine grained theoretical and empirical analysis will be the subject of future research.

Final remark

Ethics and business are not unrelated worlds. Our work provides strong support for the position that

ethical behaviour is ultimately in the company's best financial interest. It also demonstrates the strength of ethical behaviour in creating positive social consequences by providing greater satisfaction to stakeholders. It seems clear, then, that the effective management of CEI can play a significant role in the overall performance of the firm.

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Notes

¹ There are other features that influence the corporate identity of firms: for example, the competitive environment in which the company interacts, the personality of the original owners, the behaviours of employees, and the products and services it offers. The focus of our paper, however, is exclusively on the relationship between the firm and its stakeholders. We thank an anonymous reviewer for this clarifying suggestion.

² The distribution of firms by country is as follows: 30.49% US, 17.28% UK, 12.23% Swiss, 6.6% French, 6.02% Japanese, 5.63% German, 4.08% Dutch, 3.3% Italian, 2.72% Swedish, 1.94% of Spanish, 1.36% Belgian, 1.36% Finnish, 1.17% Hong Kong, 0.97% Canadian, 0.97% Danish, 0.78% Irish, 0.58% Australian, 0.58% Korean, 0.39% Norwegian, 0.39% Portuguese, and one firm each from Austria, China, Luxemburg, Taiwan, Thailand, and Singapore.

³ Although the debate of who is the stakeholder and to whom the firm should turn its attention is still an open one (Mitchell et al., 1997, Jensen, 2001, Hill and Jones, 1992), it seems that there is more agreement on the topic of which stakeholders are primary to the firm.

These primary stakeholders are those whose participation is essential for the firm's survival (Clarkson, 1995): typically, shareholders, employees, suppliers, customers, the community, and the environment. Our aggregated measure captures all major stakeholder groups and is consistent with measures used in previous research (e.g., Hillman and Keim, 2001).

⁴ Corporate governance is a proxy of shareholder satisfaction, as it assumes higher values when: (a) The positions of Chairman and CEO are not combined; (b) There is a maximum of 20% of executive directors on the board; (c) There is no limitation of shareholders rights; (d) the company has one class of stock or the company's classes of stock have equal voting rights; and (e) There is an independent audit, remuneration, and nomination committee.

⁵ We thank one of the referees for this suggestion.

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