

Economic Perspectives on Corporate Social Responsibility

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This paper synthesizes the expanding corporate social responsibility (CSR) literature. We define CSR from an economic perspective and develop a CSR taxonomy that connects disparate approaches to the subject. We explore whether CSR should exist and investigate conditions when CSR may produce higher welfare than other public good provision channels. We also explore why CSR does exist. Here, we integrate theoretical predictions with empirical findings from economic and noneconomic sources. We find limited systematic empirical evidence in favor of CSR mechanisms related to induced innovation, moral hazard, shareholder preferences, or labor markets. In contrast, we uncover consistent empirical evidence in favor of CSR mechanisms related to consumer markets, private politics, and public politics. (JEL D21, L21, M14)

1. Introduction

Observers increasingly note that corporate social responsibility (CSR) has become a mainstream business activity (e.g., *The Economist* 2008). Firms are investing ever more resources in public goods provision, and many companies reduce negative externalities below levels required by law. More than half of Fortune Global 250

firms now provide regular public statements exclusively discussing CSR, and approximately 10 percent of S&P 100 companies report in detail on CSR activities (Kotler and Lee 2004a; Baskin and Gordon 2005). More than one-third of large firms have voluntary external certifications for social and environmental standards, and nearly 11 percent of professionally managed U.S. investment was certified as socially responsible. It is estimated that U.S. and European markets have over 2 trillion USD and 300 billion EURO in certified socially responsible assets (Social Investment Forum 2006). Firms such as IBM, General Motors, or Microsoft even inform potential employees about their CSR efforts (Turban and Greening 1996).

CSR has also become a high profile public issue. An extensive global survey found that two-thirds of people reported that they

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would like companies to contribute to social goals beyond shareholder wealth (Enviro-nics International 1999). Another survey found that 52 percent of respondents seek information about companies' CSR records (Fleishman-Hillard 2007). More than half of American consumers say that a company's social reputation influenced purchase decisions, and 70 percent of U.K. consumers state that they are willing to pay more for a product that they perceive as ethically superior (Ipsos MORI 2003). Scherer and Palazzo (2008) concisely summarize the evolving public view, "[p]aradoxically, today, business firms are not just considered the bad guys, causing environmental disasters, financial scandals, and social ills. They are at the same time considered the solution of global regulation and public goods problems."

Scholarly perceptions of CSR have evolved as well. Early work focused on whether CSR should exist. Economically-oriented work addressing CSR acknowledged the well-known incapacity of markets to ensure efficient pricing and provision of nonprivate goods and bads, but emphasized that firms could not and should not be expected to voluntarily act in a socially or environmentally responsible manner. Most famously, Friedman (1970) argued that the only responsibility of firms was profit maximization and that public preferences combined with democratic empowerment implied that governments, and not firms, should manage externalities and provide public goods. This division of corporate and government responsibility vis-à-vis society became generally known as the classical dichotomy. In contrast to Friedman (1970), early business and society scholars argued that firms ought to consider the implications of their actions for all constituencies even if such considerations reduced shareholder wealth. Influential business and society studies included the social issues

in management perspective of Wartick and Cochran (1985) and Wood (1991), as well as the stakeholder theory perspective of Freeman (1984). Since the 1970s and 1980s, related research in both broad disciplines has begun to converge to a nuanced middle ground. Most scholars now agree that social justifications for CSR may exist, but do not exist in all cases.

More recently, research has begun a shift from whether CSR should exist to why it does exist and how it affects the economy. This is a natural progression given recent increases in the scope and scale of CSR. Fundamental questions address firm-level incentives for CSR engagement, i.e., why is CSR growing so fast? A key insight within economics is that CSR is not necessarily incompatible with profit maximization, at least for a subset of firms within a separating equilibrium. While CSR to satisfy manager preferences may constitute moral hazard, CSR to satisfy nonclassical preferences of investors, employees, and consumers does not. Similarly, CSR to influence outcomes driven by public and private politics may be consistent with shareholder wealth maximization.

This paper clarifies how economists might think about CSR. Our primary emphasis is on insights from economic research, although we review several especially influential papers from other disciplines as well. Many insights relevant for an understanding of the subject were developed for the analysis of other economic and noneconomic phenomena. A key contribution of this paper is the synthesis of these diverse strands. We clearly define CSR from an economic perspective, and we develop a comprehensive taxonomy that connects formerly disparate approaches to the subject. An additional innovation is an integration of what we know about the theory of CSR with what we know about the empirics of CSR. We conclude the paper with a discussion of knowledge gaps

and implications for future research. A message of this paper is that a fundamental economic understanding of CSR is emerging.

We begin with the theory. Section 2.1.1 explores insights from public economics regarding the mechanisms underlying private (here, corporate) provision of public goods and its implications for social welfare. Following the evolution of the literature, sections 2.1.2 and 2.1.3 move from “whether CSR” to “why CSR.” The main endeavor is to motivate and integrate the role of preferences in the emergence and economic justification of CSR. Section 2.2 reviews strategic CSR in depth. Insights from behavioral economics and game theory enhance our understanding of strategic interactions between stakeholders and firms, and information economics, contract theory, and industrial organization shed light on CSR participation mechanisms and strategic interactions. The second half of the paper explores the empirical account. Section 3.1 reviews the empirical organizational behavior relationships between corporate social and financial performance. We examine the evidence for not-for-profit motivations for CSR in some detail. Section 3.2 investigates observational evidence on hypotheses related to market and political drivers of strategic CSR. If firms are accepting higher costs to engage in CSR, who is paying for these higher costs? Here, we combine observational insights from labor, environmental, and business economics with results from business and society, management, and marketing. Section 4 examines CSR in an international context, although this literature is in its infancy. Section 5 concludes with a summary and an outline of research gaps.

2. *Theoretical Inventory*

Before entering economic analysis, the stage has to be set by defining CSR. In

practice, several CSR definitions exist. The European Commission (2002) defines CSR as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.” The World Bank states: “CSR is the commitment of businesses to behave ethically and to contribute to sustainable economic development by working with all relevant stakeholders to improve their lives in ways that are good for business, the sustainable development agenda, and society at large.” A notion similar to “voluntary behavior” can be found in definitions of CSR that refer to either “beyond compliance” such as those used by Vogel (2005) or McWilliams and Siegel (2001), who characterize CSR as “the fulfillment of responsibilities beyond those dictated by markets or laws,” or to “self regulation” as suggested by Calveras, Ganuza, and Llobet (2007).

Attempts to define CSR reveal two basic conceptual features: First, CSR manifests itself in some observable and measurable behavior or output. The literature frequently refers to this outcome dimension as corporate social or environmental performance (CSP). Second, CSP exceeds levels set by obligatory regulation or standards enforced by law.¹ In essence, CSR is corporate social or environmental behavior that goes beyond the legal or regulatory requirements of the relevant market(s) and/or economy(s).

¹ Earlier attempts to develop a clear concept and establish the boundaries between definition and analysis of CSR include Locke (2002) and McWilliams, Siegel, and Wright (2006) among others. Locke (2002) structures models of CSR along two dimensions: Motivation (instrumental versus ethical) and Beneficiaries (shareholders versus stakeholders). He finds that there is significant divergence of opinion over key issues such as the role of management (contractual versus beyond contractual obligations), the relation to profits (is CSR profit enhancing?) or the scope of responsibility (direct versus indirect effects of conduct of business).

Two important notions of this definition merit attention: First, it is independent of any conjecture about the motivations underlying CSR. While Baron (2001) takes the view that “both motivation and performance are required for actions to receive *the* CSR label,” we propose that linking a particular motivation to the respective performance is required only for identifying the CSR mechanism. Second, in order to capture its complete economic relevance, this view emphasizes that CSR can be market driven or “strategic” as opposed to McWilliams and Siegel (2001), who equate CSR only with social or environmental performance “beyond market forces.” In other words, CSR may be strategic, but need not be.

2.1 *Economic Theory and the Evolutionary Understanding of CSR*

The quest to understand CSR as an economic phenomenon began by asking (1) whether it exists, (2) when and to which extent it can be efficient, and therefore, (3) whether and when it should exist. While the fundamental proof of existence, i.e., (1), must be established empirically, (2) and (3) fit the theory agenda well. In light of the neo-classical firm paradigm, economists immediately translated (2) and (3) into one question, namely whether firms do have any social responsibility other than employing people, producing goods or services and maximizing profits. The key to answering this normative question is to compare CSR with other channels of public good provision and to establish if and when CSR will improve total welfare. Another increasingly important research strand takes a less abstract and more positive perspective on CSR and investigates the mechanisms and incentives underlying CSR. The focus is on why CSR occurs and how the underlying incentives work and interact within today’s complex and global economy. Based on the role of shareholder and stakeholder preferences in the determination of

firm behavior, we can categorize CSR as strategic, not-for-profit, or the result of moral hazard. Once this distinction is established, strategic CSR mechanisms will be analyzed in depth within three conceptual boxes: Markets, Politics, and Social Norms.

2.1.1 *Whether CSR? A New Neoclassical Dichotomy*

The initial discussion will focus on comparative welfare implications of CSR. Due to the fact that social or environmental goods and externalities often are characterized by nonrivalry and/or nonexcludability, the classical public goods literature proves to be a natural point of departure. As CSR seems to invade the formerly undisputed government task of correcting market failure inherent in the provision of public goods or reduction of negative externalities, a reevaluation of the classical dichotomy between state and market is in order. The standard argument states that the provision of public goods should be based on public preferences or social objectives. Governments are endowed with the necessary democratic legitimacy and have the power to correct related market inefficiencies such as collective action problems or free riding. The standard argument goes on to state that private firms do not have sufficient incentives to efficiently internalize the costs they cause, but they will comply with regulation or taxation. At first sight CSR challenges this framework, but a growing literature attempts to integrate CSR into the classical public economics agenda and to characterize equilibrium attributes as well as relevant corollaries.

First of all, firms are organizations owned by shareholders, run by workers and managers, and therefore conform to the broad group of private agents. Most importantly, firms often produce a public good or an externality jointly with their main task to provide private goods or services for consumption. This may occur

either in connection with the production process of private goods (e.g., less polluting technology or safe/healthy working conditions) or as a direct attribute of the private good or service itself (e.g., less polluting cars or energy saving light bulbs). Therefore, parallels with earlier works suddenly shed new light on old insights. Buchanan referred to the joint provision of a public and private good as an “impure public good,” and relevant results such as those derived by Bergstrom, Blume, and Varian (1986) can be readily translated into the CSR framework. Bergstrom, Blume, and Varian focused on the interaction between public and private, in their framework voluntary and individual, provision of the public good and the effect on overall levels of provision. They concluded that public provision crowds out its private counterpart almost perfectly. The crucial condition driving this result is that private and public provision are perfect substitutes in consumption.

Along these lines, Kotchen (2006) compares joint corporate provision of private and public goods in “green markets”² and separates provision of either. He derives the similar conclusion that the very same crowding out takes place between corporate provision and individual (what Bergstrom, Blume, and Varian called “private”) provision, and may even lead to an overall reduction in the level of the public good if it is a gross substitute for the private good characteristic. The effect of introducing a green market on demand for the public good is driven by a price effect that proves to be always positive if the private and public goods are complements in consumption, but may be negative if they are substitutes depending upon preferences, income

distribution and the green technology. In this context, the occurrence of corporate public good provision in equilibrium can be interpreted as a welfare enhancing, neutral, or reducing shift between competing supply channels.

Remembering the strict division of labor between government and firms envisioned by the classical dichotomy, Rose-Ackerman (1996) phrases the problem as the “[b]lurring of the analytically motivated division between for-profit, nonprofit and public sectors in reality.” Similarly, Besley and Ghatak (2001) notice that public goods provision has dramatically shifted from public to mixed or complete private ownership in recent years. Their analysis then leads to the conclusion that in a world of incomplete contracts (i.e., investments related to public goods provision are often noncontractible) a public good or project should be owned simply by the party that “[v]alues the benefits generated by the related investments relatively more,” a result that is based on Grossman and Hart (1986) and Hart and Moore (1990). Note that this holds true irrespective of the relative importance of the investments or other aspects of the production technology. Other works relating CSR exclusively with public good provision include Bagnoli and Watts (2003) and Besley and Ghatak (2007), who define CSR as the corporate provision of public goods or curtailment of public bads independent of legal benchmarks. Besley and Ghatak (2007) outline the above mentioned direct parallel with traditional models of private provision of public goods and show that CSR will exactly reproduce the second best equilibrium levels of public good provision envisioned by the standard literature. Only if governments fail to deliver optimal levels of public good will CSR be potentially efficient. In reality, however, this is an important issue. When we think of potential relative cost advantages of firms vis-à-vis

² The definition of a “green” market is based on technologies with joint production of a private good and an environmental public good, i.e., a kind of “green” impure public good.

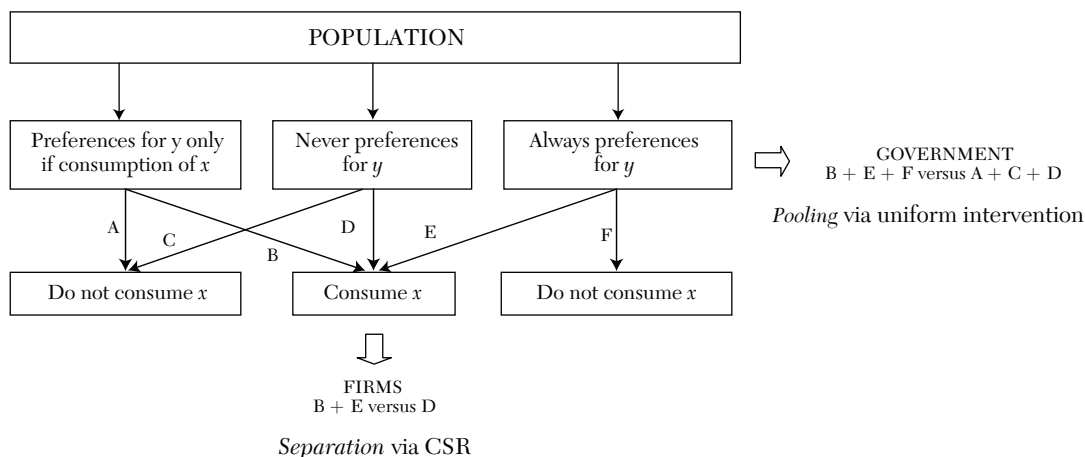


Figure 1. CSR and Welfare

governments, it appears straightforward to conclude that if economies of scope on the corporate side are absent, tasks should be segregated into specialized organizations, i.e., governments provide public goods and firms private ones, while otherwise CSR can be efficient. Of course governments can be opportunistic, corrupt, or have (re)distributional preferences, thereby creating obvious inefficiencies.

A simple thought experiment outlines the special trade-off between CSR and regulation that determines what Besley and Ghatak (2007) call the feasibility and desirability of CSR. Firms are producing a private good x jointly with a public good or externality y . Due to allocative efficiency, markets enjoy a comparative advantage in accommodating heterogeneous shareholder and stakeholder preferences at the cost of suboptimal public good levels. Uniform regulation can achieve first best public good levels at the cost of detrimental redistribution effects. By “uniformity of regulation” we refer to uniform application of the law within a jurisdiction, i.e., to homogeneously applied rules or

restrictions to identical agents or firms. We focus on profit maximizing firms interacting with consumers although the logic will equally apply to investors, employees or downstream firms in vertical relationships. Figure 1 sets the stage.

Society is divided into agents with general preferences for the public good (“caring” groups E and F), those without such preferences (“neutral” groups C and D) and finally those with conditional preferences related to their consumption pattern (“caring if consuming” groups A and B). Each person either consumes or does not consume good x , and caring (non)consumers feature a concave utility function $U(Y)$ with Y being the sum of per consumer provision y . Firms can produce y at constant marginal cost c . In the absence of regulation, competitive markets are able to reach a separating equilibrium as in Besley and Ghatak (2007). Two profit-equivalent sectors emerge with some firms engaging in CSR, charging higher prices and catering to “caring” consumers $B + E$, and others abstaining from CSR, charging lower prices and selling only to neutral consumers

D. Firms in the CSR sector will provide y^{CSR} per customer subject to

$$\frac{\partial U((B + E)y^{CSR})}{\partial y} = c.$$

Due to the standard public good problem, this CSR level is second best. Competition will force firms to pass on CSR costs to consumers such that a price premium of cy will be charged.

Perfect government can implement the first best level of the public good, $y^* > y^{CSR}$, which would satisfy

$$(B + E) \frac{\partial U((B + E)y^*)}{\partial y} = c$$

according to Samuelson (1954). However, a government usually represents a majority of the total population and either group $(B + E + F)$ or group $(A + C + D)$ could be in the majority and determine government policy. Two possible outcomes can then occur: either a regulatory standard will be imposed on all firms or markets are left alone (Pooling). If the government does not intervene, CSR constitutes a Pareto improvement benefiting contributors $B + E$ as well as free riders F without harming neutral (non) consumers. In case of regulation, neutral consumers will be forced to either pay a higher price for the private good or to forego consumption if prices exceed reservation values. Redistribution takes place from neutral D to caring consumers B and E , who now pay lower prices than under CSR,³ while caring nonconsumers (group F) simply free ride on total consumer contributions. Note that regulation in the first place only makes sense if the resulting public good level will exceed its CSR counterpart. It follows

that an increase in $\frac{F}{B + D + E}$ aggravates the free riding problem under either regime, while a larger $\frac{D}{B + E(+F)}$ implies a stron-

ger redistribution effect and eventual distortion in consumption under regulation. In absolute terms, the surplus maximizing level under regulation coincides with the first best level only if group D drops out of the consumer group. Otherwise, the result will be either underprovision or overprovision of the public good w.r.t. to the first best level. In sum, the relative welfare question of when total surplus is maximized under regulation as opposed to CSR can only be answered when weighting the relative benefits and losses of social groups $B + E + F$ against those of neutral D , both of which in aggregate depend on the number of members in each group as well as the strength of their preferences. Note that as opposed to direct government provision via a head tax, nonconsumers without preferences for y , i.e., groups A and C , are not affected by regulation and resulting higher prices of x . Additionally, government failure beyond free riding and externalities (e.g., bias, opportunism, or limited monitoring/enforcement) can lead to deviations from y even under regulation and further justify CSR as a welfare optimal channel to provide public goods.

2.1.2 Why CSR? Toward a Taxonomy

An alternative approach identifies CSR as a horizontal taste parameter with private character, a view naturally tailored toward different objectives than the public good approach. These objectives include to address the set of positive questions related to why CSR actually occurs, and to decrease the levels of abstraction by accepting a second best world as the relevant analytical framework. The focus here is on interactions between strategic actors such as firms, activists, regulators, consumers or investors

³ Note that the public good here must be aggregative in nature.

and how CSR may arise in a “political economy” or “stakeholder interaction” context. In other words, it is well suited to investigate corporate motivation to invest in voluntary social behavior and the exact mechanics of how preferences can translate into CSR. To get a more complete and ordered picture, this section develops a taxonomy of CSR along motivational lines and across theoretical frameworks. Furthermore, we discuss the role of extrinsic and intrinsic preferences.

Within this framework two opposing perspectives on CSR can be taken. First, CSR may constitute a special form of investment into innovation that may result in negative costs (net benefits) over time, *ceteris paribus*. Along these lines, Porter (1991) and Porter and van der Linde (1995) argue that environmental regulation increases costs and decreases competitiveness only in a static environment, where the firm problem reduces to one shot cost minimization under perfect information. Innovation and technological change, on the other hand, are dynamic concepts, i.e., economic and technological systems are repeatedly “shocked” out of their steady state. Therefore, a dynamic approach may “put a new free \$10 bill on the table,” ready to be picked up by the next firm coming along. In other words, if market economies are dynamic places with changing technologies, limited knowledge of the world or imperfect information, environmental innovation may constitute a “win win” scenario. Such innovation offsets are defined as investments and actions that address environmental or social impact—thereby producing public goods or reducing negative externalities—while at the same time improving the quality of the offered private products, the productivity of related processes and ultimately a firm’s or industry’s competitiveness. Theoretically, this argument relies on both the existence of dynamic inefficiencies that open up the opportunity for innovation to get more cost efficient

again, and the ability to identify opportunities and overcome inertia or detrimental short term incentives.

Second, CSR can be seen as a pure form of corporate expenditure, i.e., it simply is a static cost parameter. This view is the one taken by a majority of economists and allows us to establish the taxonomy of CSR outlined in the 2×2 matrix of figure 2.

The crucial question then asks why firms voluntarily incur the costs attached to CSR. Friedman (1970) proposed that “[t]he only responsibility of business is to maximize profits.” Within this narrow neoclassical firm paradigm, CSR expenditures could only be a manifestation of moral hazard towards shareholders. A business ethics literature does indeed postulate that the interests of managers or directors may drive CSR and may do so at the expense of wealth creation (Jensen 2002). However, Friedman’s conclusion turns out to be too simplistic in that there are other plausible explanations of CSR. Although being costly, CSR can form part of an optimal firm strategy. First, should shareholders themselves care about social or environmental performance, they may be willing to trade monetary profits for CSR or even incur net losses by using their firm ownership as a “do good” corporate channel and alternative to direct donations. Such a perspective is consistent with the ethical, discretionary, and institutional legitimacy principles developed in the social issues in management literature (e.g., Wartick and Cochran 1985 and Wood 1991). It is also consistent with an “owners as stakeholders” perspective from the management stakeholder theory literature (Freeman 1984 and Rowley 1997). If markets do not reward such behavior, i.e., costs cannot be rolled over to stakeholders, such “not for profit CSR” amounts to a reduction or sacrifice of profits in the social interest (Reinhardt, Stavins, and Vietor 2008). A similar motivation for not for profit CSR could stem from

STAKEHOLDERS	SHAREHOLDERS	
	Social (S) preferences	Classical (C) preferences
S	<i>Not for profit CSR</i> Mixed effects on profits	<i>Strategic CSR</i> Profit maximization
C	<i>Not for profit CSR</i> Reduction of profits	<i>No CSR</i> Profit maximization

Figure 2: Taxonomy (S denotes social preferences and C classic, monetary preferences)

“negative” preferences regarding profit distribution. This means that shareholders prefer spending money on CSR rather than increasing bonus payments for top management to stellar amounts. This may be especially true recently, as executive pay and banking failures are under public watch.

Second, shareholder value maximization in general, as well as profit maximization in particular, can motivate CSR. Stakeholders may be endowed with respective social, environmental or ethical preferences. Neoclassical firms cannot ignore such circumstances if they directly affect demand in product and financial markets, supply in labor markets, and/or shareholder value maximization. Such preferences might also affect firms indirectly through governments or regulators translating voter preferences into market intervention. In short, social and environmental preferences translate into some sort of action or behavior relevant to corporate profits and qualify CSR as part of corporate strategy.

CSR induced by demand side pressures or as a hedge against the risk of future regulation or activism has been termed “strategic CSR” by Baron (2001), while McWilliams and Siegel (2001) refer to the same underlying pure profit orientation of

CSR, i.e., CSR in absence of social shareholder preferences, as a “theory of the firm perspective.” This behavior is market driven, maximizes monetary profits, and features a reactive notion as it is induced by outside parties like consumers, employees, activists, and regulators. Purely profit oriented investors do not motivate strategic CSR, they only respond to profits determined by other (social) stakeholders.⁴

Gary S. Becker cautioned that firms that combine the profit motive with a true nonprofit consideration (including CSR) can only thrive in a competitive environment “[i]f they are able to attract employees and customers that also value these other corporate goals” (The Becker–Posner Blog February 10, 2008 “On Corporate Altruism—Becker”). While this is true for strategic CSR, not-for-profit CSR firms may very well compete with their purely profit oriented counterparts as long as shareholders have sufficient funds to sustain CSR expenditure. Here market power

⁴ If both share- and stakeholders have similar social or environmental concerns, the relative strength of their preferences will determine who bears the cost of CSR and ultimately the net effect on CFP.

and related profits ease the participation constraint of nonprofit shareholders.

We have seen that two “theory of the firm” relationships are of particular importance: (1) The internal one between owner and management, and (2) all relevant external relations between the firm and its stakeholders. The main critique of CSR has involved principal–agent relation (1). Friedman saw the “socially responsible firm” as a classic profit maximizer and its social contribution in goods production, employment and innovation all driven by undisturbed competition and the ultimate incentive—profits. Relationship (2) allows for the crucial updates proposed here. Social or environmental preferences may be extrinsic or intrinsic in nature, and in reality they most likely are a mix of both. Demand for CSR may reflect extrinsic motivation such as offsetting healthcare expenditures or saving on energy bills. Note that CSR can be strategic, while at the same time stakeholders might demand and pay for it based on purely monetary incentives, i.e., solar panels may be very expensive to produce, but immediately save energy costs and eventually outweigh the price premium paid by consumers. This means that there is scope but not need for going beyond the assumptions associated with *homo oeconomicus*.

2.1.3 *Preferences*

In order to separate different components of motivation driving CSR, we discuss the widening of traditional individual rational choice theory toward a broader set of attitudes, preferences and calculations. Stiglitz (1993, 2002), Becker (1993), and Camerer and Loewenstein (2003) review these issues. Benabou and Tirole (2003) as well as Besley and Ghatak (2005) assume that agents have preferences for money, social and public goods as well as reputation. A first important insight is that intrinsic motivation can act as a substitute for extrinsic, monetary incentives.

This has interesting and novel implications for pricing through the potential increase in consumers’ willingness to pay, and for determining incentives in employment contracts. Benabou and Tirole (2006) find that extrinsic incentives can crowd out prosocial behavior via a feedback loop to reputational signaling concerns. The reputational concern reflects the possibility that increased monetary incentives can lead observers to interpret prosocial action as greediness rather than social responsibility, thereby making prosocial behavior a less efficient signal of social type. Also firms often rely on reputation. Kitzmueller (2008) investigates the potential effects of a CSR subsidy. If firms vary in their capacity to benefit from CSR due to different mission and cost structures, and consumers have preferences for mission driven CSR independent of one shot government incentives and cannot observe firm types, then a subsidy can reduce the effectiveness of CSR as a signal and might crowd out CSR by some firms or lead to lower total CSR depending on the distribution of firm types. Reputation also counts for managers. If society rewards social behavior not only in the marketplace but also in “a more societal environment,” Baron (2008) concludes that this can aggravate the moral hazard problem and managers will have incentives to carry CSR beyond its strategic level.

Another perspective views CSR as an alternative, market based way to do social good. The key question asks why this “corporate channel” is preferred to donations or political engagement. The answer involves substitutability and comparative advantage of CSR. Andreoni (1989) compares different ways to contribute to a social good and asks whether they constitute (im)perfect substitutes. Although he compares public and direct private provision of public goods, the same analysis can be extended to compare various ways of private provision such as corporate and individual

social responsibility. The fuel of this analysis is the identification of “warm glow” preferences, i.e., utility derived from the mere fact of doing good yourself or being more directly involved rather than outsourcing it to governments or NGOs. If “warm glow” exists, public provision and direct donations are imperfect substitutes that imperfectly crowd out each other. An example of when CSR might be preferred builds on people’s needs to consume certain private goods while still deriving disutility from being connected to any socially stigmatized behavior related to their purchase, the use of the good, or the firm itself (e.g., firms using child labor or acting in an environmentally hazardous manner during the production process). Such motivation might appeal to both consumers endowed with social preferences independent of their consumption pattern and those consumers who only have social conscience considerations in relation with their consumption. The former might choose CSR in order to satisfy consistency with their general outlook, while the latter care about signaling.

Also, investors can be heterogeneous in the sense that there are “[t]hose for whom corporate giving is a close substitute for personal giving and those for whom it is a poor substitute” (Baron 2007). Graff Zivin and Small (2005) focus on the relationship between CSR, investment behavior, and firm valuation. They derive a “Modigliani Miller (MM) theory of CSR,” where the fraction of investors that prefers corporate philanthropy over private charitable giving drives CSR. A share constitutes a charity-investment bundle matching social and monetary preferences of investors with those of the firms’ management. The main conclusion follows the spirit of MM in the sense that if all investors consider CSR and private charity as perfect substitutes, it does not matter whether the public good is provided through philanthropy or CSR. If they are imperfect substitutes, a

positive level of CSR is necessary to maximize shareholder value.

A related issue is that CSR often has been connected with advertisement or public relations of firms, thereby suggesting that CSR eventually could change preferences and ultimately individual behavior. While the marketing literature has approached these issues via the concept of Corporate Social Marketing (Kotler and Lee 2004a), economists have been more cautious when it comes to endogenous preferences. Regarding preference formation, Becker (1993) concluded that “attitudes and values of adults are . . . influenced by their childhood experiences.” Samuel Bowles (1998) builds the bridge from Becker’s “family environment” to markets and other economic institutions influencing the evolution of values, preferences and motivations. Surveys such as Fleishman Hillard and the National Consumer League (2007) posit that the strength and active role of social or environmental preferences in a society strongly depend on demographic characteristics such as education or technological development.⁵ This points towards developed countries as the cradle of CSR preferences. Not only do living standards in the developed world endow people with purchasing power, but also provide them with information through education and connection to modern communication technologies. From another perspective, this argument reflects the Maslow pyramid in the sense that only when basic needs are fulfilled do people start worrying about more indirect ones such as environmental and ethical firm behavior. We note that these social or environmental goods do not always physically affect consumers, but rather are feeding through via intrinsic, reputational concerns.

⁵This suggests that preferences can and do change over time and while standard welfare implications certainly hold in the short and middle run, they may change in the long run.

Another concept lending support to such a view is the Environmental Kuznets Curve as outlined originally by Grossman and Krueger (1993) and revisited later by Dasgupta et al. (2002). The curve posits an inverted-*U* relationship between economic development, i.e., income per capita, and environmental pollution. In the initial process of industrialization, people only care about jobs and income and public environmental spending and regulations are weak and unpopular. As income rises, preferences as well as regulations begin to favor environmental protection. Arora and Gangopadhyay (1995) have built a theoretic model of overcompliance around this conjecture and showed that if the valuation of money and therefore the importance of prices decreases in income, heterogeneous preferences imply variation in the willingness to pay for CSR. Again, firms separate along the preference distribution, and in a two-firm model the introduction of a minimum regulatory standard always leads the firm serving the high income–high public preference segment to overcomply.

2.2 *A Framework for Strategic CSR*

Most analysis of CSR treats the existence of social or environmental preferences as exogenously given and focuses on the interactions between firms and stakeholders. We identify three broad theoretic channels—(1) markets, (2) politics, and (3) isomorphism—through which strategic CSR can arise. Our definition of strategic CSR implicitly assumes that the production of public alongside private goods is costly, since the theoretical contributions outlined in the remainder of this section uniquely assume a classical static environment.

2.2.1 *Markets*

There are two classical markets, the labor and product market, as well as the overarching market for information, that

are all relevant to the discussion of strategic CSR. First, it is hypothesized that CSR might affect the interaction between employers and employees and alter classical labor market outcomes. Indeed, the organizational signaling work of Fombrun and Shanley (1990) formalizes this notion. In economics, CSR–labor market interactions are usually analyzed in a contract theoretic framework, where the key issues arise from information asymmetry with respect to the employees' type (screening or signaling) or actions (moral hazard). Simon (1991) was among the first to argue that agency problems may be best overcome by attempting to change and ideally align preferences of workers and principals. Further, workers may identify with their organization via matching (selection), reducing cognitive dissonance (psychology) or induced convergence of preferences (endogenous preferences). Given these alternatives, CSR could either be interpreted as a signal leading to matching or alternatively as a tool to streamline preferences over time. While the latter suggestion lacks theoretic or empirical treatment, the potential matching (selection) role of CSR has been analyzed in more detail.

Preston (1989) was able to derive an equilibrium wage differential between non-profit and for-profit firms. The explanation is based on workers preferences for social good and their resulting willingness to trade off wages for these preferences in the form of "labor donations" (442). The higher the social benefits a nonprofit firm promises to provide, the higher the wage differential for any constant preference distribution. This supply side effect may be mitigated by nonprofit managers' discretion to pay above cost minimizing wage levels. Similarly, Bowles, Gintis, and Osborne (2001) address the role of preferences in an employer–employee relationship, where employees might have general preferences such as a sense of personal efficacy or a rate of time

preference that are able to compensate for monetary incentives. Therefore, employers may be able to induce effort at lower cost. The conclusions suggest an important role of preferences in determining the cost of labor services and affecting earnings of employees and employers alike.

Besley and Ghatak (2005) establish a theoretic framework to analyze the role and interaction of monetary and nonmonetary incentives in labor contracts within the nonprofit sector. They refer to nonprofit organizations as being mission oriented and conjecture that such organizations, e.g., hospitals or universities, frequently are staffed by intrinsically motivated agents. The main conclusion from their moral hazard model with heterogeneous principals and agents is that pecuniary, extrinsic incentives such as bonus payments and the agents' intrinsic motivation can act as substitutes. In other words, a match between a mission oriented principal and an intrinsically motivated agent allows for reduced contractual bonus payments and still induces the standard second best effort level. In the case of more than two types, a better match implies a higher substitution effect between money and motivation. Brekke and Nyborg (2004), based on Brekke, Kverndokk, and Nyborg (2003), explicitly show that CSR can actually reduce moral hazard in the labor market context. More precisely, CSR serves as a screening device for firms that want to attract morally motivated agents and the offset of the agency problem is again driven by substitutability of motivation and high powered incentives. In sum, the major result of this research is the notion of reduced agency cost due to matching motivated agents and principals as well as the related substitution between extrinsic and intrinsic incentives.

An alternative explanation of lower incentive pay in the nonprofit sector also relies on matching, but here the matching occurs between skill/productivity and pay.

It is simply assumed that workers only care about money but vary in their skills. Hence, employees sort along this dimension. Stigler (1962) aimed at disentangling the quality and price variation in labor markets with imperfect information. He illustrates the existence of dispersion in wage rates for homogenous labor and how more search by workers⁶ should decrease this "pure" form of dispersion. If employers search for high quality labor, "the problem of information on quality has been replacing that of information on price, and heterogeneity of quality has replaced homogeneity" (103). In this labor market, information is a two edged sword in the sense that more search equals better information and closer matches between workers' maximum productivity and incentives on one hand, while worsening employers' opportunity to pay less for superior labor quality. In sum, wage rates and the search for quality are substitutes, and it follows that higher pay attracts better applicants. Finally, Stigler points toward the potential role of nonmonetary conditions of employment that could enable firms to trade off wages and for example CSR without attracting lower quality workers. Also related to employee quality, a labor market context that connects CSR to corporate governance is explored by Cespa and Cestone (2007). They conjecture that inefficient managers can and will use CSR, i.e., the execution of stakeholder protection and relations, as an effective entrenchment strategy to protect their jobs. Their discussion of the effect of corporate governance institutions on firm value leads to the conclusion that institutionalized stakeholder relations close this "insurance" channel for

⁶ Employees search for employers until marginal costs of search equal expected marginal return. A positive correlation of wages over time provides a strong incentive for more search by increasing the expected utility of finding a good first wage offer.

inefficient managers and increase managerial turnover and firm value. This finding also provides a rationale for the existence of special institutions such as ethical indices or social auditors.

An additional signaling role for CSR is found and discussed by Greening and Turban (2000). The message is simple: CSR can act as a positive signal to attract a quality work force and thereby serve as a competitive advantage. They draw on social identity theory (e.g., Cable and Judge 1996) by suggesting that “[j]ob applicants have higher self-images when working for socially responsive firms over their less responsive counterparts” and find that “[a]pplicants will not only be attracted to firms with positive Corporate Social Performance reputations but also will pursue jobs with such firms, . . . attempt to interview with such firms, and . . . have a higher probability of accepting a job offer from these firms.” Maignan and Ferrell’s (2001) corporate citizenship as marketing theory comes to similar conclusions. A relevant theoretic explanation in the economics literature is provided by Akerlof and Kranton (2000, 2005), who build a model around the psychological concept of identity, where individual utility negatively depends upon the distance between behavioral norms within a social category and the actual, respective behavior of the individual member.

CSR has been suggested to serve as a way to forestall unionization attempts. Historical evidence is provided by Davis, Whitman, and Zald (2008), who state that so called “welfare capitalism” in the first half of the twentieth century used employee health insurance, community services, housing or pension programs “[w]ith an eye on keeping labor unions out . . . and the state at arm’s length” (6). Today, such conduct forms part of standard human resource management and the focus of attention clearly shifted to CSR activities tailored toward external stakeholders.

It is not only labor markets; social consumer preferences may also drive CSR. Marketing scholars drawing on theories of social and organizational identity postulate the emergence of socially responsible consumers. Such consumers, when matched with CSR firms, may be especially loyal, committed, and robust to negative information (e.g., Sen and Bhattacharya 2001 and Bhattacharya and Sen 2003).

Baron (2008) links managerial incentives with socially responsible consumers. He addresses the interaction of consumer preferences, the ability of managers, managerial incentive design, and social expenditures. The main focus is on joint determination of social expenditure and financial performance of firms. Causality can go either way and the decisive variable is whether consumers are ready to reward CSR or not. It is concluded that higher demand for social goods empowers the profit incentives of managers and their compensation will be positively correlated with social expenditure, i.e., managers are encouraged to spend socially as demand, profits, and their salary will then be maximized. If times are economically favorable and consumers value CSR, a positive correlation emerges between financial performance and CSR. Further, the level of both CSR and profits is increasing in managers’ ability. In absence of consumer preferences, CSR is determined by shareholder preferences and economic circumstances determining profits. If times get bad, e.g., due to a recession, both consumers and shareholders may not find that the marginal utility of social expenditure outweighs its marginal costs. The correlation eventually becomes negative in the presence of able managers, who redirect less funds out of the smaller pot to CSR. Another comparative static that may interact with optimal CSR levels is the degree of competition in the market. Bagnoli and Watts (2003) model competitive product markets with homogeneous, socially responsible

consumers. They conclude that competition for these consumers, who are willing to pay a premium for CSR, leads to private provision of public goods as a by-product and at levels that vary inversely with the degree of competitiveness in the private goods market. Furthermore, a more competitive environment in terms of prices, i.e., Bertrand as compared to Cournot competition, reduces profitability and a firm's ability to use the mark up to increase CSR. The result is less differentiation through CSR, less competitiveness, and ultimately less CSR. In sum, there exists a trade-off between efficient provision of the private good and efficient provision of the public good, i.e., the more competitive Bertrand environment leads to lower incentives for CSR.

If firms (Bertrand) compete in markets populated by heterogeneous consumers, i.e., consumers with and without preferences for CSR, Besley and Ghatak (2007) find that there exists a unique separating equilibrium where firms either serve social or neutral consumers but always make zero profits. Following up on our discussion in section 2.2.1, a few more standard results from the screening and public goods literature can be validated. The maximum sustainable level of CSR over time is achieved when the incentive compatibility constraint of caring consumers binds, while an exogenous increase of public good supply (e.g., by a government) perfectly crowds out competitive provision of CSR. Perfect governments are able to implement a Lindahl Samuelson equilibrium. However, if they fail, CSR and nonprofit provision may compete for Pareto improvement. It is also found that a small uniform regulation would leave the level of corporate public good production unchanged and redistribute contributions from social to neutral consumers, while large regulatory intervention can raise supply of the public good above second best, limited only by neutral

consumers' maximum willingness to pay for the private good.

Arora and Gangopadhyay (1995) model CSR as voluntary overcompliance with environmental regulation. Although consumers all value environmental quality, they vary in their willingness to pay a price premium for CSR depending on their income levels. Firms play a two-stage duopoly game and first decide about CSR (clean technology), and then compete à la Bertrand. Again, the subgame perfect equilibrium entails differentiation of firms through catering to different sets of consumers. Choosing technology acts as product positioning similar to the choice of product quality, and CSR is positively correlated with the income levels of either all consumer segments or of the lowest income segment. Similar to Besley and Ghatak (2007), comparative statics allow for the analysis of government policy. The main finding is that if a minimum standard is imposed, it will bind on the "worse" firm (lower CSR) while the better firm will overmeet the standard. CSR subsidies can have the same effect as standards, while taxes always reduce output (here the number of consumers served) and CSR efforts by all firms.

The commonly used notion of CSR as a means of product differentiation also emerged within the advertising and marketing literature. Firms use CSR to differentiate and advertise their product or to build brand loyalty. An interesting and relevant conjecture is that the advertising dimension of CSR may be especially strong when social efforts are unrelated to business conduct. In Navarro (1988), corporate donations to charity are identified as advertisement and CSR is meant to transmit a positive signal about firm quality and type. However, according to Becker-Olsen, Cudmore, and Hill (2006), the mere signal might not necessarily be positive as consumers may be able to identify low fit CSR as advertisement and tend to negatively perceive such CSR

efforts as greediness of firms or “greenwash” rather than genuine interest in social or environmental concerns.

2.2.2 *Politics*

Politics constitutes an alternative pass-through from social preferences to business outside the framework of classical market interaction with firms. There are two main subgroups, private and public politics. Private politics refers to social activism by NGOs or civil society, while public politics stands for actual or potential government engagement with firms via law and regulation. The crucial common feature of all politics is that the influence and power of the “politician,” i.e., the activist or the government, derives from some sort of support by the public (or a subgroup thereof). The corporate incentive to respond to politics and change behavior even before any activist or legal action is taken stems from the threat posed by increased costs, decreased demand, and competitive disadvantage. The logic is comparable to hedging against future risk in financial markets, just here the firm insures itself against a potential campaign by an activist or regulatory action taken by a government.

Let us focus on private politics first. The existence of social or environmental activists is intimately related with information asymmetries between companies and the outside world. At a basic level, social activism poses the threat of negative publicity or revelation of negative information through an unsatisfied activist. As soon as the activist is credible and has the ability to damage a firm’s reputation or cause substantial costs to the firm, the mere possibility of being targeted is sufficient to integrate CSR as part of corporate strategy. Baron (2001) refers to CSR as corporate redistribution to social causes motivated by profit maximization (1), altruism (2) or threats by an activist (3). However, it can be argued that the existence of activism qualifies CSR as an integral part of profit

maximization, i.e., motivation 3 fuses in 1. The game theoretic analysis reveals that CSR induced by private politics has two qualitatively different effects on firms and sheds light on both CSR and activist strategy. First, CSR entails a direct cost effect for those firms that are targeted by an activist. Second, CSR enhances or preserves firm competitiveness. Both effects determine the effectiveness of CSR and therefore the success of activism. Strategic activists choose firms that are more likely to respond to their demands. In equilibrium only realistic demands are posed, hence *ex ante* agreements regarding CSR are reached and boycotts are not enacted but just serve as sufficient threats. It is not surprising that the probability of compliance (here success) positively depends on the activist’s stake as well as the public saliency of the issue, and negatively on the stake of the firm and preexisting CSR levels.

An important comparative static is product differentiation acting as a measure of competition. There is a nonlinear trade-off between the direct cost effects of CSR and potential losses from an exercised boycott. Profits decrease in competition. For high levels of product differentiation (when competition is relatively low), the potential competitive disadvantage from a boycott increases with a marginal decrease in differentiation. Hence, the activist threat and the activist success rate increases. It follows that CSR will be high in these circumstances due to its relatively strong benefits. When approaching a competitive environment (i.e., Cournot competition), the positive correlation between competition and activist power may be reversed as firms have lower rents at stake and direct CSR costs weigh heavier on low profits. Finally, it is found that the existence of spillover effects from one firm to another or even the whole industry can act as an amplifier for activist power on the one hand, and motivation for (often observed) concerted nonmarket action by firms in the

same industry on the other (e.g., voluntary industry standards).

In a more comprehensive setting, Baron (2009) predicts market values of firms, prices, profits, support for activists and the level of CSP in a model of product and capital markets with strategic consumers, investors and activists. Social pressure refers to the outcome of the interaction between the activist and the firm, and is arising endogenously in what resembles a general equilibrium. The new feature is that there are two types of corporation, the morally managed⁷ and the self-interested one, and citizens can distinguish between strategic CSR induced by social pressure and independent, (in our taxonomy) not for profit CSR. CSR itself here acts as product differentiation. Equilibrium levels of CSR will vary across types and depend on the degree of substitutability between the various social contribution channels, i.e., invest, consume, donate or support an activist. Similar to Besley and Ghatak (2007), a separating equilibrium arises where the morally motivated firm charges high prices, produces high levels of CSR, and serves consumers with strong preferences for CSR.⁸ The self-interested firm will find it optimal to maximize differentiation and do the exact opposite.

The key insight is that activists' target selection depends on the extent to which people distinguish between strategic and not-for-profit CSR, as well as how strongly citizens would react to or protect a target (reputation). It is again the stakes (possible losses from an activist action) of the relevant

firm that determine its suitability as a target. In general, the activist selects a soft target, one with high stakes and therefore a higher response likelihood. Additionally, the activist will impose greater demands on softer targets (firms with higher stakes). With decreasing distinction between motivations for CSR, morally motivated firms appear to be a softer target and will be chosen by the activist unless the reputation of the self-interested firm is relatively weak. In other words, the morally motivated firm loses its advantage as consumers do not reward its ex ante commitment ex post and its stakes are higher. In contrast, with increasing distinction between motivations for CSR, social pressure will be directed toward self-interested firms who have more at stake as they are facing unfavorable ex post conditions in terms of consumers preferring morally managed to activist induced CSR. In general, less funded, low quality activists are more likely to target morally motivated firms and vice versa.

Baron and Diermeier (2007) define the "campaign" as the paradigmatic core of the analysis of competition between activists and targets. A campaign consists of the strategic activist's demand as well as the harm or reward in case of (non) compliance. The analysis reveals that demands increase in the importance of the issue and the responsiveness of the target. Demands decrease in the marginal cost of the campaign. Further, a proactive change in practice, i.e., CSR, may forestall a campaign if the activist can commit to not target the firm or shift to another target ex ante. If there are multiple targets, a race to the top in CSR may occur and an industry may find it optimal to coordinate. As a firm can always fight a campaign and reduce its success rate at a certain cost, in a repeated game they can gain a reputation for being either a soft or hard target. If types are private information, there exists an incentive to always signal to be a hard target, i.e.,

⁷ Defined as "a corporate pattern of conduct that goes beyond normal business management and compliance with law" (1).

⁸ Prices signal type and lead to consumer selection and the distribution of shareholders' social preferences determines the value of firms because it determines the ability to attract equity investment. The contributions to the activists are similarly dependent on people's social preferences and the quality of the activist.

fight and gain a hard reputation, in which case activism will be more costly and firms will oppose private and public politics more aggressively. Thus, the effectiveness of activism and other CSR drivers falls.

The impact of public interest advocacy and action either through activist groups or concerted consumer boycotts has also been analyzed from a marketing perspective (e.g., Klein, Smith, and John 2004). This literature is very similar to the economics one and its contributions are also rooted in the existence of information asymmetries. Here, CSR is often an experience or credence good for stakeholders. Marketing can be used to build reputation and avoid any form of activism that could harm business conduct. Recent innovations in marketing techniques take consumer preferences with respect to CSR into account and lead to a stepwise development from cause-related to social-cause marketing (Bloom et al. 2006), to corporate social marketing (Kotler and Lee 2004b).⁹ The latter goes beyond awareness creation and raising money by aiming at behavioral change. When people benefit from such a change in their actions, positive associations with the change agent will follow. Marketing benefits will be higher the better the cause fits a firm's core markets, goods, and services. In cases of a good fit, CSR can avoid halo effects and insure the firm against negative reputation and activism. In sum, economic and marketing research equally suggest that CSR can

differentiate a product, help build reputation, and avoid private politics.

Lyon and Maxwell (forthcoming) define greenwash as "[t]he selective disclosure of positive information about a company's environmental performance, without full disclosure of negative information on these dimensions" (31). They use a Bayesian game to explore the link between greenwash and strategic activism when the relationship between expected CSR and disclosure is non-monotonic. A firm with a low probability of a successful CSR project will find it optimal to disclose as there is a lot to win from a publicized CSR success and nothing to lose from a failed CSR attempt. A firm with a high probability of a successful CSR project will find it optimal not to disclose as they have a lot to lose from a failed CSR attempt and little to gain from a successful one. The intuition is that markets will expect those with high success probabilities to do well and those with low success probabilities to perform poorly *ex ante*. Furthermore, firms that are operating in an industry biased toward negative rather than positive social impact are more responsive to incentives such as NGO audits. Interestingly, if a clean firm with high probability of success has little information about its own impact, such incentives may backfire and lead to less disclosure. Dirty firms that know their impact, e.g., through the presence of an environmental management system (EMS), appear as responsive targets for a strategic NGO.

Now let the incentive to do CSR derive from the threat of public rather than private politics. Potential changes in regulation and related adjustment costs may lead firms to hedge against such an event and build a strategic "buffer zone" via overcompliance, i.e., CSR. Similarly, if firms expect stochastic shocks to their environmental or social performance, overcompliance may reduce the risk of future noncompliance. Furthermore, CSR can be used to invoke

⁹ Cause related marketing generally refers to any type of marketing effort for a social or charitable cause, including in-house cooperations with nonprofit organizations. Social (cause) marketing is the systematic application of marketing concepts to achieve specific behavioral goals for a social good. Behavioral changes not only increase the level of the social good, but they enhance marketing objectives such as brand positioning and sales as well. The reason given by Kotler and Lee (2004a) states that when behavior change is accompanied by personal benefit, people will have a strong positive association with the company that motivated the change.

procyclicality of regulation and enforcement, i.e., to improve regulatory relations today with the aim of getting preferential treatment, e.g., better permits or less enforcement, from the respective agency tomorrow. The common strategic effects include preservation of competitive position in the event of changes in regulation as well as discouragement of such intervention.

As discussed in section 2.2, CSR might Pareto improve welfare only if governments fail in some way. Maxwell, Lyon, and Hackett (2000) introduce such inefficiencies on the public side by assuming that consumers can influence policy via lobbying at a positive cost. As a result, firms can use CSR to preempt entry of consumers into lobbying activities as their marginal utility from CSR rises beyond the benefits from “investing” into regulation (through lobbying). For this relationship to hold, lower costs of lobbying imply more stringent levels of self regulation. Self regulation in an oligopolistic industry is facilitated through coordination. However, consumers and firms are both better off without regulation only as long as strategic coordination on CSR does not undermine consumers’ lobbying effect on regulation too much. The most comprehensive outline and general analysis of such interaction between CSR and public policy as well as the political life cycle is provided by Lyon and Maxwell (2004). Calveras, Ganuza, and Llobet (2007) study the interplay between activism, regulation, and CSR and find that private and public politics are imperfect substitutes. It follows that increased self regulation (i.e., CSR) can crowd out formal government regulation. It is emphasized that when society free rides on a small group of activist consumers, loose formal regulation (voted for by the majority of nonactivists) might lead to an inefficiently high externality level where activist consumers bear the related cost via high prices for socially responsible goods.

Ultimately a word of caution in this context. If different pollutants are complementary through technology, e.g., SO₂ and mercury, then what amounts to compliance with more stringent regulation of pollutant A might appear as CSR for pollutant B. This leverage effect of jointly determined pollutants has been addressed by Shimshack and Ward (2008), who conclude that under these circumstances observed overcompliance is driven by traditional regulatory incentives. This is not CSR, but mere compliance. Public policy should take this complementarity into account, otherwise regulatory effects appear as understated and optimal fines and policy end up being biased.

2.2.3 *Social Norms*

While the relevant pressure groups in the previous cases were employees, consumers, activists, and governments, the incentive to do CSR here roots in social pressures and norms within geographic communities or functional entities such as industries. It is the institutional environment and commonly (locally) accepted norms, views and values that might discipline firms into certain social behavior. Institutional factors that are potentially shaping the nature and level of CSR in a community include cultural-cognitive forces, social-normative factors as well as regulative factors. The inclusion of regulative community factors complements the analysis of public politics by testing whether differences in regulation on a community level imply different levels and nature of CSR by firms located in these communities. In other words, subsidiarity in regulation implies variation across regions (local entities), and therefore, comparing similar firms located in different regulatory environments can give hints about its correlation with CSR.

Marquis, Glynn, and Davis (2007) identify, in an institutional theoretic setting, the degree of conformity of corporate social

performance in focus, form and level within a community, as a potential explanatory variable for empirical observations concerning CSR. Such normative pressures may also arise within industries, and may lead to industry-wide self-regulatory activities. Industries that are well organized and represented by a centralized lobby might be especially able to exert pressure on firm behavior. DiMaggio and Powell (1983) similarly describe processes that lead to organizational assimilation and homogeneity of organizational forms and practices. They argue that structural change is less and less driven by competition and efficiency while the relevant modern causes of rationalization and bureaucratization go well beyond markets into institutional fitness and pressure. Related to firms, change will be stronger the more firms depend on each other (especially in terms of resource supply), the greater is the uncertainty in the industry and the more ambiguous is the mission of the firm. Isomorphic change will also be stronger the more firms within a field or industry depend on common external factors such as participation in trade unions, academic credentials as prerequisite for hiring, transactions with the state, technological uncertainty or the number of organizational or legal forms to choose from.

3. *The Empirical Account*

As discussed above, the theoretical study of CSR has naturally progressed from a public goods perspective on when CSR may be optimal to a stakeholder perspective on why individual firms engage in CSR. Early empirical CSR research explored the broad links between corporate social and financial performance while more recent research emphasizes mechanisms for CSR. Understanding why firms engage in CSR and which stakeholders bear the costs of CSR are the fundamental concepts.

Before reviewing the empirical account, two issues bear noting. First, much of the empirical economic literature relevant to CSR does not present itself as corporate social or corporate environmental research. The empirical economic studies most relevant to CSR often explore overcompliance, voluntary compliance, philanthropy, eco-labeling, productivity, transparency, nonprofit labor markets, and other subjects. Second, while the theoretical outcomes reviewed in the previous sections are clearly defined, empirical explorations are more ambiguous. Tests may support or refute several hypotheses simultaneously.

3.1 *Empirical Relationships between Corporate Social and Financial Performance*

Early empirical research related to CSR explores the overall relationships between corporate social performance and competitiveness. In essence, this literature tests Porter and van der Linde's (1995) conjecture that environmental regulations may increase competitiveness via induced innovation offsets. Studies in this area naturally focused on regulation rather than CSR because legal mandates are the literal driver in the original model. However, since the Porter theory's win-win logic applies equally to voluntary and mandatory environmental performance, empirical papers related to the Porter hypothesis shed light on whether CSR may reduce costs, *ceteris paribus*. There is sparse evidence that environmental performance enhances financial performance via induced innovation, and therefore CSR activities are unlikely to be costless to firms. Extensive review articles consistently report no systematic evidence that environmental performance motivates innovation, and the preponderance of empirical economic studies favor a mild negative relationship between environmental performance and overall competitiveness.

(Jaffe et al. 1995, Ambec and Barla 2006, and Pasurka 2008). As Jaffe et al. (1995) put it, economists' natural skepticism regarding this free lunch is appropriate, though further research would help convince others that our conclusions are well grounded in fact.

An organizational behavior literature explores the broader relationship between corporate social and financial performance. The papers at the core of this literature test whether companies do well by doing good. Several studies survey this large literature, so we typically reference the results of Margolis, Elfenbein, and Walsh (2007) rather than individual papers. Margolis, Elfenbein, and Walsh perform an especially comprehensive meta-analysis of 192 relationships from 167 studies spanning 1972 to 2007. One way to interpret this literature in an economic context is as a coarse test of not-for-profit CSR. Not-for-profit CSR to satisfy manager preferences is consistent with the moral hazard hypothesis most often attributed to Friedman (1970). Not-for-profit CSR to satisfy investor preferences (independent of profit motives) is consistent with the sacrificing profits in the social interest perspective of Reinhardt, Stavins, and Vietor (2008). On average, the observational evidence does not support either not-for-profit CSR hypothesis. Margolis, Elfenbein, and Walsh's meta-analysis detects a modest positive average correlation between corporate social and financial performance.

A quantitative business and society literature also finds limited evidence in favor of not-for-profit CSR. For example, environmental performance at foreign-managed and absentee-managed facilities is no worse, on average, than performance at otherwise similar plants (Grant and Jones 2004; Grant, Jones, and Trautner 2004). Plants operated by individuals with plausibly lower preferences for local environmental quality

produce the same amount of environmental CSR as plants operated with plausibly higher preferences for local environmental quality. Further, Davidson, Worrell, and El-Jelly (1995) finds no significant financial market impact when small groups of investors publicly announce stock divestitures for social purposes. Other investors appear immediately willing to buy divested stocks.¹⁰ In sum, quantitative empirical data are not consistent with hypotheses suggesting that not-for-profit motivations systematically drive observed CSR.

An alternative interpretation of the social and financial performance literature is a broad test of various hypotheses predicting that CSR will enhance average profitability. While the evidence is not consistent with moral hazard, the data are also not strongly supportive of CSR having a systematic positive profitability effect. Margolis, Elfenbein, and Walsh's meta-analysis found a median correlation between social performance and financial performance of 0.08, and the authors assert that this relationship is small in practical terms. Further, the average correlation shrinks significantly when only studies that include basic controls like industry, firm size, and risk were reviewed. Margolis, Elfenbein, and Walsh also note that the detected positive average correlation between corporate social responsibility and corporate financial performance (CFP) is at least as attributable to causation from CFP to CSR as the reverse.

¹⁰ A large literature explores investor reactions to both positive and negative events related to corporate social performance. Seminal quantitative papers include Hamilton (1995), Wright et al. (1995), and Klassen and McLaughlin (1996). This literature typically finds that stock prices decline in response to negative social news and increase in response to positive social news. Unfortunately, it is not possible to attribute financial market impacts to manifestations of investor preferences (and thus not-for-profit CSR) or to beliefs about the influence of these events on profitability through other channels like consumption or politics (and thus strategic CSR).

3.2 *Empirical Support for Strategic CSR*

As opposed to evidence for not-for-profit CSR and the induced innovation hypothesis, the observational evidence for strategic CSR is somewhat more favorable. Nevertheless, data on systematic large gains from CSR are limited. As Margolis, Elfenbein, and Walsh (2007) note, natural questions arise. What then explains the coexistence of corporate social and financial performance? If CSR has limited financial benefits on average, why do we observe it in the real world? Who is paying for the higher costs underlying corporate environmental and social behavior? We argue that while more research is needed, insights into these questions can already be obtained from diverse empirical literatures. In this section, we review the existing evidence.

3.2.1 *Markets*

Theory suggests that CSR might influence the interaction between employers and employees and that labor markets may bear some of the costs of CSR. A survey-based business and society literature finds that job seekers express preferences for organizations with better public images and values similar to their own. Ethics and management researchers consistently find positive associations between companies' CSR ratings and business students' self-reported opinions of employment attractiveness (Turban and Greening 1996; Backhaus, Stone, and Heiner 2002; Albinger and Freeman 2000). Similar studies find that experimentally manipulated CSR ratings are positively correlated with undergraduate management students' stated intent to pursue and accept positions (Greening and Turban 2000). Results not only support links between CSR and job seekers' behavior, but a growing survey literature indicates that current employees self-report better work attitudes and higher organizational commitment at companies

associated with greater corporate citizenship (Peterson 2004).

Despite consistent qualitative survey results that suggest that CSR may influence labor markets, the quantitative empirical literature generally fails to reject a null hypothesis of small or no labor market effects. Frye, Nelling, and Webb (2006) compare executive compensation at socially responsible firms to a matched sample of other firms. Matches were based on industry and size. The authors find that CEOs at companies with ethically screened stocks earn similar total cash compensation as CEOs at matched counterparts. They also detect no significant differences in executives' long-term incentive plans and stock options.¹¹

Other direct quantitative tests of the labor market impacts of CSR are limited, but existing studies on nonprofit and public interest sectors shed light on the donated labor hypothesis that is necessary for employees to significantly bear the costs of observed CSR. Many studies demonstrate that commonly observed negative wage differentials between nonprofit and for-profit organizations become small and typically statistically insignificant once controls for worker, job, and workplace characteristics are included in empirical models. Goddeeris's (1988) seminal study finds that lawyers in public-interest law are not accepting large wage sacrifices to work in the public sector. Individual characteristics appear to drive wage differentials. Recent economy-wide studies of comprehensive datasets demonstrate, on average, no systematic difference between wages in the nonprofit and for-profit sectors after controlling for individual, job, and workplace attributes (Leete 2001; Ruhm and Borkoski 2003). Some studies even discover premiums

¹¹ Frye, Nelling, and Webb (2006), as well as many other reviewed studies, make contributions beyond those discussed. We focus only on findings most relevant for our purposes.

in the nonprofit sector (Holtmann and Idson 1993 and Mocan and Tekin 2003).¹² In sum, while more evidence is needed, workers at socially responsible firms do not appear to be sacrificing wages or other forms of compensation. It therefore appears unlikely that labor market effects systematically drive observed CSR.

Socially responsible consumption offers an alternative explanation for observed CSR. A well known coffee retailer offers fair trade and organic coffee for 15 and 30 percent premiums over otherwise similar products (Loureiro and Lotade 2005). Approximately one million U.S. electricity consumers chose to pay an average price premium of 1.8 cents/kWh (a roughly 16 percent premium) for green power products. Total voluntary purchases of renewable energy exceed 24 billion kWh, or about 0.6 percent of total electricity sales (Bird, Kreyckik, and Friedman 2009). Additionally, a survey-based marketing literature finds that CSR influences self-reported consumer product responses and product attitudes. Brown and Dacin (1997) find that experimentally manipulated CSR information significantly influences stated perceptions of products and the corporations that offer those products. Such marketing survey results, however, appear to be driven by a subgroup of vocal individuals with strong feelings about socially responsible consumption (Mohr, Webb, and Harris 2001; Mohr and Webb 2005). Blend and van Ravenswaay (1999) find that purchase intent for eco-labeled apples is strongly influenced by consumers' overall environmental concerns. Even at a \$0 premium, approximately 30 percent of consumers report no intention of buying environmentally friendly produce.

¹² A possible explanation for a nonprofit wage premium is a property rights hypothesis, where nonprofit workers have poorer incentives for cost minimization. Product quality offers an alternative explanation, since nonprofit organizations in the studied health and child care sectors may offer higher quality than for-profit organizations.

A growing stated preference economics literature is largely consistent with the marketing literature. Contingent valuation, contingent ranking, and conjoint analysis papers almost universally find that consumers, on average, express an incremental willingness to pay for environmentally friendly and socially responsible products. Consumers reveal additional values for local, organic, free trade, and eco-labeled foods including wine, potatoes, and seafood (Loureiro and Hine 2002; Loureiro 2003; Johnston and Roheim 2006). Electricity consumers state that they are willing to pay 0.6 to 2 cents/kWh, or about a 5 to 20 percent premium, for renewable energy (Goett, Hudson, and Train 2000; Roe et al. 2001). Valuations for CSR-related activities in this literature, however, are also sensitive to individual preferences. The mean or median willingness to pay discussed in most of the relevant papers may be misleading, as a detailed examination of reported results typically reveals a non-uniform distribution where some consumers report a very high willingness to pay and some report 0 willingness to pay. Further, stated preference results often vary significantly by subgroup. For example, European consumers express a willingness to pay for GMO-free organisms that is nearly 30 percent higher than U.S. consumers (Lusk et al. 2005).

A limited econometrics literature is also generally consistent with marketing survey results. In the most directly relevant study, Eichholtz, Kok, and Quigley (forthcoming) use a large sample of buildings to econometrically evaluate price premiums for green buildings. They find that those with green ratings earn rental rates that are 3 percent higher per square foot than rental rates for control buildings matched on attributes like quality and location. Sales prices are 16 percent higher. Other econometric studies find that companies in industries where final consumer goods are the primary output are

substantially more likely to participate in voluntary environmental programs or adopt voluntary environmental management systems, *ceteris paribus* (Innes and Sam 2008; Anton, Deltas, and Khanna 2004).

In sum, marketing surveys, stated preference valuation studies, and revealed behavior econometrics papers all concur that consumers' assessment of firms, evaluation of products, final consumption decisions, and willingness to pay depend on CSR records. Consumers appear to bear at least some of the costs of CSR. A further area of agreement between the diverse literatures is that the demand for CSR is not universal. While intensity of demand varies across studies and contexts, subgroups with strong feelings about socially responsible consumption drive consumption outcomes. This suggests that the ten to thirty percent of large companies externally certified as engaging in CSR may serve socially responsible customers in a kind of Tiebout sorting equilibrium.

The precise mechanisms underlying socially responsible consumption, however, remain the subject of debate. Marketing survey results suggest that CSR influences consumers' overall assessment of firms' reputation, rather than their beliefs about product attributes (Brown and Dacin 1997). Indeed, it is difficult to explain market sorting and price premia for goods produced by firms associated with free trade, divestitures from apartheid-era South Africa, and charitable contributions without reference to direct consumer preferences for corporate pro-social behavior. Much of the economics literature, however, suggests that CSR primarily influences consumers' beliefs about product attributes. Siegel and Vitaliano (2007) find that firms producing durable experience goods or credence services are considerably more likely to engage in CSR than firms selling search goods. Consumers imperfectly observe quality and reliability in markets like those for automobiles,

appliances, health care, and investment services, so CSR may be especially useful as a signal of product and service attributes in these industries. Other researchers note that consumers have difficulty understanding and differentiating CSR messages, and that personal health rather than environmental preferences are the dominant reason consumers purchase eco-labeled products (Leire and Thidell 2005). Eichholtz, Kok, and Quigley (forthcoming) find that tenants and buyers are willing to pay more for energy-efficient buildings but not for buildings that are sustainable in a broader sense.

3.2.2 *Politics*

Theory suggests that private politics may drive strategic CSR provision, and that the preferences of social advocates, environmental activists, or other stakeholders may influence CSR levels via channels outside of classical market interactions. Eesley and Lenox (2006) identify more than 300 large firms that were subject to at least one protest, boycott, letter writing campaign, proxy vote, or citizen suit between 1971 and 2003. Other researchers' samples suggest that approximately 5–10 percent of large firms were subject to boycotts and approximately 5–10 percent of large firms were subject to proxy items (Gupta and Innes 2009). A survey-based law and society literature finds that firms' environmental managers express concerns about private politics or their threat as a source of pressure. Representatives from 400 of Canada's largest firms report that their plans for dealing with environmental issues are influenced by neighborhood and community pressures, even after controlling for pressure from consumers, employees, regulators, and shareholders (Henriques and Sadosky 1996). Kagan, Gunningham, and Thornton (2003) find that managers at pulp and paper mills report that social license stresses have a significant impact on environmental performance.

The authors further argue that such pressures are unlikely to explain large changes in environmental performance over time, but they may help explain differences in social performance across firms at a given point in time.

Quantitative economic studies that explore the role of community characteristics in environmental behavior shed an indirect light on the conjecture that private politics impacts CSR levels. Broadly, studies find that community characteristics affect firms' toxic releases, air pollution abatement expenditures, and water pollution discharges, even after controlling for public regulation and demographic factors correlated with consumer preferences (Arora and Cason 1999; Becker 2004; Earnhart 2004). Results for specific mechanisms related to private politics, however, remain controversial. For example, Arora and Cason (1999) find that a proxy for the propensity for collective action and political engagement, voter turnover, meaningfully affects environmental outcomes. In contrast, Becker (2004) and Earnhart (2004) both fail to detect such a relationship. Liston-Heyes and Ceton (2007) contend that the commonly observed negative correlation between conservative politics and CSR provision supports the hypothesis that CSR is a form of political contribution. However, unexamined channels like public regulation may be equally plausible explanations.

An alternative empirical literature more directly explores relationships between private politics and CSR. The evidence here is more consistent. Financial event studies find that consumer and union boycotts result in economically important and statistically significant stock price declines among targeted firms (Pruitt and Friedman 1986; Pruitt, Wei, and White 1988; Davidson, Worrell, and El-Jelly 1995). Given these observed market effects, it is perhaps not surprising that companies themselves often respond

to private politics and its threat. One third to one-half of firms targeted by stakeholder actions publicly announce subsequent behavioral changes that are broadly consistent with activist aims (Davidson, Worrell, and El-Jelly 1995; Eesley and Lenox 2006). Other companies voluntarily implement environmental management systems in response to proxy actions and other activist pressures (Gupta and Innes 2009). Effects are not necessarily limited to targeted firms alone. Innes and Sam (2008) find that the average firm in an industry that has been subjected to boycotts is substantially more likely to later participate in voluntary pollution reduction programs, so private political actions may spillover to influence behavior at nontargeted firms as well. In sum, extant evidence supports a role for private politics in the emergence and growth of CSR. The magnitude of the relationship relative to other potential CSR mechanisms, however, remains an important direction for future research.

Public politics offers an additional explanation for CSR as a response to pressures outside of classical market interactions. Economists and policymakers consistently view public monitoring and enforcement as necessary tools to secure compliance with environment, health, and safety regulations.¹³ However, public regulator pressures can also spur the beyond compliance behavior necessary to satisfy the economic definition of CSR. A growing survey literature is broadly supportive. Respondents at S&P 500 firms report that second-order environmental practices like total quality management are largely attributable to market factors, but first-order practices

¹³ Indeed, an empirical economics literature shows that these activities significantly deter subsequent violations at the sanctioned facility and at other facilities in the same jurisdiction (Magat and Viscusi 1990; Gray and Jones 1991; Gray and Deily 1996; Shimshack and Ward 2005).

like environmental staffing, audits, and internal policies are attributable to legal and regulatory factors (Khanna and Anton 2002). Respondents at U.S. and Canadian industrial sources rank the influence of public authorities on environmental performance higher than that of community organizations, activist groups, and the media (Doonan, Lanoie, and Laplant 2005; Delmas and Toffel 2008).

Several empirical economics papers more directly test the conjecture that public regulatory pressures drive CSR provision. Innes and Sam (2008) uncover evidence that plants voluntarily reduce pollution emissions in an effort to improve future interactions with regulators. The authors find that facilities with higher rates of government oversight are more likely to voluntarily participate in a toxics reduction program.¹⁴ Observed behavior seems rational; in the Innes and Sam (2008) study, plants going beyond compliance in one period were rewarded with reduced regulatory oversight in future periods. Similarly, Decker (2003) finds that voluntary pollutant reductions shorten the time it takes firms to subsequently receive permits for major new projects and discharges. Other authors find that when environmental behavior has a stochastic component, plants intentionally overcomply to build a strategic buffer zone against accidental violation and subsequent punishment (Bandyopadhyay and Horowitz 2006; Shimshack and Ward 2008). For example, Shimshack and Ward find that plants with pollution discharges well below permitted levels reduce discharges further beyond compliance when the perceived regulatory threat increases. They also found that likely noncompliant plants respond

to increased perceived regulatory threats by reducing discharges well beyond those required to meet statutory requirements alone. To summarize, the evidence supports a role for public politics as an important CSR mechanism.

4. *International CSR*

Both the theory and empirics of CSR in an international context are underdeveloped. Transitional economies typically have limited formal regulation, so CSR may be especially important. Further, the institutional challenges inherent in globalization have implications for CSR and its optimality. Firms are becoming increasingly global; for example, the United Nations reports that the number of multinationals grew from 37,000 to 60,000 between 1990 and 2001. Foreign affiliates increased from 170,000 to 800,000 over the same period.

CSR in an international context is related to several significant theoretical questions. Coordination problems across countries weaken the role of government provision of global public goods, suggesting that CSR may gain a comparative advantage. Disparate locations between production, consumption, and ownership establish an elevated role for preference-based CSR mechanisms. Consumers in developed countries may influence environmental and social performance of firms operating in the developing world. A necessary condition for CSR mechanisms to operate across borders is information, and the costs of information acquisition and processing may be increasing in geographic and cultural distance. There may be trade-offs between cost-motivated outsourcing and firm reputation. The quintessential example is backlash from labor-related allegations toward Nike operations in Southeast Asia. Related directions for future theoretical research include the role of NGOs in a globalizing economy with

¹⁴ Other authors have found that participation in voluntary environmental programs is driven by perceived regulatory pressures. See Koehler (2007) for a review of the related literature.

CSR, the development policy implications of CSR, and the relationships between CSR and institutions, supply chains, and firm locations.

The empirical literature related to international CSR is more extensive than its theoretic counterpart. Advantages of international, and especially transitional country, empirical explorations are: (1) results are unlikely to be confounded by unobserved public regulation, and (2) nonpublic CSR mechanisms are likely to play larger roles. As Pargal and Wheeler (1996) note, without recourse to legal enforcement of existing regulations (if any), social preferences must translate into behavior via leverage provided by social pressure on workers and managers, adverse publicity, the threat [or use] of violence, recourse to civil law and pressure through politicians, local administrators, or religious leaders. The disadvantage of observational work in developing country contexts is data quality, and results are therefore often subject to concerns about measurement error, omitted variable bias, and reverse causality (Blackman 2010).

Many relevant empirical studies indirectly explore mechanisms for not-for-profit CSR and market mechanisms for strategic CSR. While more research is needed, the evidence to date is not strongly in favor of these mechanisms systematically operating in the international setting. Several studies investigated the relationship between foreign ownership and environmental performance in developing countries, and find inconclusive results. Seroa da Motta (2006) reports a positive relationship in Brazil, Aden, Kyu-Hong, and Rock (1999) finds a negative relationship in Korea, yet others find no significant relationship for several countries in Southeast Asia (Pargal and Wheeler 1996; Hettige et al. 1996). Collectively, the lack of a consistent correlation may suggest no evidence in favor of not-for-profit CSR, either through extrinsic

preferences (preferences for public goods in one's own geographic area) or intrinsic preferences (altruistic preferences for public goods in another geographic area). A handful of studies explore the relationship between the environmental performance of firms producing in developing countries and the presence of exports to OECD countries. Again, research generally finds a nonresult (Hettige et al. 1996; Dasgupta, Hettige, and Wheeler 2000; Seroa da Motta 2006). This suggests no evidence that consumer preferences in developed countries influence social performance by producers in developing countries.¹⁵

The vast majority of the international empirical literature focuses on political mechanisms for strategic CSR, and results generally support a role for politics in developing country contexts. The literature most often studies informal regulation, which satisfies our economic definition of CSR. Quantitative studies that explore the role of community characteristics shed an indirect light on CSR and private politics. The assumption here is that community characteristics such as education, income, and voter turnout proxy for the legal institutions, political organizational ability, freedom, information accessibility, and NGO presence that are necessary to influence firm behavior (Hettige et al. 1996). The literature consistently finds a positive correlation between local income and education and firm environmental performance (Pargal and Wheeler 1996; Hettige et al. 1996; Seroa da Motta 2006). Similarly, Pargal and Wheeler (1996) and Hettige et al. (1996) discover that public firm ownership influences environmental performance,

¹⁵ Note that these results are not necessarily relevant to the hypothesis that firms owned by OECD countries impose one internal standard for all of their worldwide operations, since the reviewed empirical literature explores developing country producers owned by both locals and foreigners.

suggesting that public ownership shields firms from community activism. Goldar and Banerjee (2004) also note that voting rates and literacy are positively correlated with water quality in India.

Studies more directly investigating relationships between private politics and CSR include Aden, Ahn, and Rock (1999), which finds that the number of community complaints or firm-community agreements affects abatement expenditures in Korea. Dasgupta, Laplante, and Mamingi (2001) show that capital markets in Argentina, Chile, Mexico, and the Philippines react to citizen complaints and high profile environmental spills. Other authors report that negative environmental news then influences ambient environment quality as well, even when controlling for changes in formal regulation. Surveys administered by Liu (2009) find that managers of Chinese firms report that community and NGO forces are the most important driver of changes related to enthusiastic social behavior like innovation or greening of the supply chain.

Evidence pertaining to public politics is rare. However, existing studies support public regulation as an international CSR mechanism. A growing literature demonstrates that expanding formal regulations with extensive monitoring and enforcement drive environmental performance in transitional economies (Dasgupta et al. 2001; Liu 2009). Yet, it is unclear whether these results reflect increasing compliance or increasing CSR. Aden, Ahn, and Rock (1999) provide some suggestive evidence. They show that Korean regulators appear to engage in a tit for tat strategy with firms, where facilities that perform well are subsequently rewarded with more lenient regulatory oversight and treatment. While more research is needed, the evidence to date supports politics as an important driver of CSR, while other mechanisms receive less backing.

5. *Discussion and Conclusions*

This paper provides a coherent framework for the economic analysis of CSR. The literature demonstrates that CSR can only achieve a second-best level of public goods provision. However, it outlines conditions under which CSR may produce higher welfare than public or other private provision channels. Beyond issues of welfare, the literature explores why CSR emerges. Our taxonomy of mechanisms connects and synthesizes formerly disparate approaches under the labels of moral hazard CSR, not-for-profit CSR, and strategic CSR. In short, the match of preferences between shareholders and stakeholders motivates different models with different implications. A broad theoretical result within the strategic CSR framework with heterogeneous preferences is a sorting equilibrium. Others assume exogenous sorting and explore the influence of market and political stakeholders within the CSR sector.

We also connect theoretical propositions with diverse empirical findings from both economic and noneconomic sources. The literature finds no systematic support for the hypothesis that CSR reduces costs, *ceteris paribus*. Similarly, the literature finds limited systematic evidence for not-for-profit CSR, as a manifestation of either moral hazard or shareholder preferences. For hypotheses related to strategic CSR, the evidence in favor of labor markets as drivers of CSR is mixed. In contrast, studies reveal consistent evidence that consumers bear at least some of the costs. The empirical market demand, however, is not universal, suggesting that theoretical predictions of equilibria with sorting along the CSR dimension are supported by the data. Finally, empirical evidence supports relationships between private and public politics and CSR provision. The empirical magnitudes of these latter effects, however, are poorly understood.

Despite the emergence of a coherent framework for analysis, and despite a number of clear findings, many questions related to the whether? and why? of corporate social responsibility remain incompletely answered. Most notably, as discussed in Section 4, the entire field of international CSR warrants greater attention. This research may be especially important because the international environment is characterized by limited and incoherent government oversight. The preferences and politics that motivate much of strategic CSR may differ substantively across countries as well. Cross-border externalities and cross-border preferences may interact in nonstandard ways, and therefore the international and especially developing country context is an interesting natural laboratory to explore CSR and its mechanisms. Additionally, empirical results are unlikely to be confounded by unobserved aspects of public regulation.

We have much to learn about the welfare properties of CSR, both absolutely and relative to alternative forms of public goods provision. Key theory questions include: what do different welfare definitions imply about the optimality of CSR? And, what is a good definition of welfare for the analysis of CSR? A limitation of current theoretical welfare measures is that they are confined to a static world with imperfect and incomplete information, ignorance, and/or myopia. A promising direction for future research acknowledges wedges between preferences that determine classic welfare measures and actual welfare outcomes in the real world. In the empirical account, virtually no research even attempts to assess comparative surplus or comparative outcomes between CSR and other channels for the provision of public goods. Consequently, the development of empirical strategies for evaluating welfare is promising.

Several explanations for the emergence of CSR are underdeveloped in the literature. Regarding theory, marketing and advertising studies highlight the possibility that CSR

influences preference formation, while economists have traditionally assumed that exogenously formed preferences influence CSR. More complete models might acknowledge two-way causality. Traditional political economy issues such as regulatory capture, overlapping consumers and voters, and CSR as a form of political contribution are largely unexplored. Additionally, future research investigating the implications of CSR for industrial organization broadly and market structure, conduct, and performance more specifically may be promising. Regarding empirics, there is a need for more complete models that simultaneously examine CSR mechanisms and acknowledge their correlations. Most current studies explore one stakeholder or one political mechanism at a time, and so results may be subject to omitted variable bias.

While theoretical analysis lags empirical investigation in an international context, tests of more general CSR hypotheses lag behind theoretical insights. Directions for future research include tests of specific economic CSR hypotheses rather than first-order explorations of relationships between stakeholders, stakeholder characteristics, and CSR. In addition, more attention needs to be paid to the measurement of CSR. Chatterji, Levine, and Toffel (2009) examined the validity of a widely used proxy for corporate environmental responsibility, and they found that ratings may not accurately predict corporate environmental performance. Empirical research in the area should focus on detailed historical performance in addition to convenient summary statistics. A related issue is that very little research explores the actual costs of CSR to firms. Yet, these costs are essential to understanding what CSR represents in the real world.

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