

# Determinants of Corporate Social Responsibility, Dynamic Capability and Financial Performance (Cases Study: Accepted Firms in Tehran Stock Exchange Market)

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## Abstract

One of the main challenges for CEO is contradiction between the benefits of the shareholders and other stakeholders. On one hand, CEO should consider financial profits due to the shareholders; on the other hand, CEO should account for corporate social responsibility (CSR), concerning the needs and demands of society according to the interests of the stakeholders. The main question of this paper is whether corporate social responsibility is consistent with financial performance or not. A path analysis was conducted and the results indicated that CSR and dynamic capability have positive and significant influences on the financial performance. Furthermore, capital intensity, industry size, and firm size have positive and significant effects on CSR and concentration has a negative effect on corporate social responsibility. Moreover, the number of the shareholders has no effect on corporate social responsibility. One of the most complete procedures in MBA is the procedure of Thomas. He supposed that each customer in firms depends on CRM of the company.

**Keywords:** Corporate Social Responsibility, Determinants of Corporate Social Responsibility, Dynamic Capability, Financial Performance; Tehran Stock Exchange Market

## 1. Introduction

concept of corporate social responsibility has long been established in academic literature as both a business philosophy and practice (Anderson, 1989; Hay et al., 1976). The concept, however, is seemingly much more prevalent, timely and important in this new millennium, as firms attempt to be seen as being “sustainable” or

“socially responsible” in nature due to the demands of target stakeholders (Cornelius et al., 2007; Moir, 2001; Wilson, 2000). Internal and external stakeholders request that firms act responsibly and behave ethically. Moreover, firms are expected to respond to the changing beliefs and values of target audiences (Anderson, 1989; Steiner, 1972).

Whilst being socially responsible is often considered doing the “right thing” or being ethical. However in the past 20 years, CSR and an organisation’s goals share a broader connection and much research supports a positive correlation between CSR and an organisation’s financial performance (Lee, 2008).

The core idea of the CSR concept is that the business sector should play a deeper (non-economic) role in the society than only producing goods and making profits. This includes social and environmentally-driven actions, meaning that the business sector is supposed to go beyond its profit-oriented commercial activities and increase the well-being of the community, thereby making the world a better place (Robins, 2005).

The main theories included in the CSR classification are: 1. industrial organisation, environmental approaches; 2. resource-based view (RBV) and related theories of core competencies and dynamic capabilities; 3. business networking and relational perspectives; 4. knowledge view of the firm; and 5. stakeholder approaches. Besides, CSR practices can also be categorized on the basis of corporate interests. Rondinelli and Berry (2000) divide CSR into four levels:

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1. Commercial self-interest: Adhering to all laws and regulations and selecting those activities that benefit stakeholders and communities directly contributing to the profitability and competitiveness
2. Expanded self-interest with immediate benefits: Undertaking activities that go beyond normal business concerns to benefit stakeholders and communities in ways that also provide measurable short or medium-term benefits to the company
3. Expanded self-interest with long-term benefits: Supporting community activities, such as education and training that will have important impacts on continuing business success
4. Promoting the common goodness: Supporting or participating in activities that improve conditions in the community, or for the stakeholders with no expectation of direct tangible benefits to the company

This study specifies the main determinants of corporate social responsibility and their influence on financial performance, looking into institutional theory and resource-based view (RBV) and related theories of core competencies and dynamic capabilities. We imported dynamic capability as the mediator in the relationship between corporate social responsibility and financial performance in firms as follows.

First, dynamic capabilities emphasize the variation in the firms' ability to adapt quickly to an ever-changing environment and its relative impact on organisational performance (Teece et al., 1997, Fang et al., 2010). The context of CSR strategy in question involves the dependence of corporate success on the relations and interactions between an organisation and its stakeholders. For instance, failure of the industry to satisfy consumers' demands or to provide acceptable pricing for safe products and the corresponding post-sale services will result in the collapse of consumers' confidence. Also as a part of the international supply chain, companies risk losing regular orders if they fail to meet environmental regulations required by downstream customers or are unable to respond more expeditiously than their competitors. Therefore, corporations must enhance their dynamic capabilities to meet the changing demands of their various stakeholders. Second, dynamic capabilities also stress the importance to enhance the productivity of other resources that a firm possesses in order to increase profitability (Makadok, 2001; Fang et al., 2010). As

mentioned above, the aim of this research is specifying the relationship between corporate social responsibility and financial performance of the firms with mediating role of dynamic capability. Furthermore, investigating the main determinants of corporate social responsibility is another aim of this research.

## 2. Literature Review

### 2.1 Corporate Social Responsibility

Corporate social responsibility can be classified as those policies, activities, or behaviours undertaken by an organisation that go beyond the traditional economic and legal obligations of the firm with its target internal and external stakeholders (Bowen, 1953; Carroll, 1979; Preston and Post, 1975). Studies looking at CSR have concluded that what "goes beyond" these traditional responsibilities is influenced and, therefore, ultimately demanded by the norms, values, and expectations of the organisational stakeholders, classified as ethical or moral obligations (Balmer et al., 2007; Carroll, 1979; Sethi, 1975). Responding to these ethical obligations must be voluntary in nature and if undertaken effectively, should eventually benefit and improve the overall welfare of the community in which the firm operates (Anderson, 1989; Manne and Wallich, 1972). Anderson (1989) argues that in order for these benefits to eventuate both the organisation and its stakeholders they should take the responsibility to work together. It is assumed that an organisation being proactive and meeting the needs of its stakeholders before it is required is deemed to be engaging in philanthropic or discretionary type behaviour (Carroll, 1979). Therefore, it is important that an organisation defines its role within the society and implements the necessary ethical, responsible, legal, and social standards to their firm (Lichtenstein et al., 2004; Lindgreen et al., 2008).

Corporate social responsibility is more than a business policy or a response to issues raised by society – it is a governing business philosophy (Holmes, 1976; Votaw and Sethi, 1973). There are a multitude of reasons behind the motivation of an organisation to engage in CSR (Moir, 2001; Wilson, 2000). These can range from purely selfish motives, such as the impact that CSR may have on the triple bottom line of the firm (Cornelius et al. 2007), to complete altruistic reasons that may include investment in a local community to benefit future generations (L'Etang, 1995; Moir, 2001; Zsolnai, 2006). Consequently,

it is argued that certain activities by a corporation can be deemed as socially responsible or socially “unacceptable”, depending on a combination of the period of time the issue occurs over, the external environment of the country the issue occurs in, and the nature of the parties that are involved in the issue (Sethi, 1975).

It is proposed that four distinct and heterogeneous dimensions of CSR exist. The first dimension is an environmental capability. The natural environment these days is a very important part of doing business (Moir, 2001; Panapanaan et al., 2003). The firm is required to manage their impacts on the natural environment through the means such as reduction of waste and emissions and their overall consumption (McWilliams and Siegel, 2000). Organisations are subsequently expected to disclose their level of involvement with the natural environment as part of an inclusion in their sustainability reports (Roberts, 1992; Yongvanich and Guthrie, 2006). The second dimension is a workplace capability. It is expected that employees will be provided with a safe and healthy workplace (Carroll, 1999; Esrock and Leichty, 1998; McWilliams and Siegel, 2000). This workplace may also involve the management of human resources through an ethical work climate (Barnett and Vaicys, 2000), employees’ empowerment and teamwork (McWilliams and Siegel, 2000), improving the balance between work and home life (Berg et al., 2008). Many organisations list both ‘People’ and ‘Health and Safety’ as important areas of CSR that they need to concentrate on within their sustainability reports.

The third dimension is a marketplace capability. This dimension is comprised of the development of long-term ethical relationships with suppliers, customers, and business partners (Carter, 2000; Whysall, 2008). Further it involves manufacturing a product that is safe and desired by the community (the traditional ‘economic’ obligation of business) (Carroll, 1979; Panapanaan et al., 2003). The final dimension is societal capability. The societal obligation involves short-term investments into the local community for the current generation (Panapanaan et al., 2003; Rossi, 2001) as well as long-term investments into the local community for future generations (Méral, 1998). Philanthropic behaviour of a monetary or non-monetary nature (Carroll, 1999; Seifert et al., 2004; Wulfson, 2001) and the promotion of basic human rights of all local and global citizens (Moir, 2001; Welford, 2002) also fall within this dimension. In this research, corporate social

responsibility is measured according to four above-mentioned dimensions.

## 2.2 Determinants of Corporate Social Responsibility

Campbell (2007) offers an institutional theory of CSR that consists of a series of propositions, specifying the conditions under which corporations are more or less likely to behave in socially responsible ways, including general financial conditions of the firm, the health of the economy, the level of competition corporations face, and some institutional factors: public and private regulation, the presence of nongovernmental and other independent organisations, institutionalized norms (e.g., norms of firm size), associative behaviour among corporations (e.g., norms of capital intensity), and organized dialogues among corporations and their stakeholders. Based on Campbell (2007), this section focuses on explaining the determinants of CSR in our study.

Campbell (2007) proposes that: “Corporations will be less likely to act in socially responsible ways where they are currently experiencing relatively weak financial performance,” since firms that are less profitable have fewer resources to spare for socially responsible activities than firms that are more profitable (Waddock and Graves, 1997).

Campbell (2007) proposes that: “Corporations will be less likely to act in socially responsible ways if there is either too much, or too little competition. That is, the relationship between competition and socially responsible corporate behaviour will be curvilinear.” In situations where competition is extremely intense, corporations will act in socially irresponsible ways to save money since their profit margins are narrow enough to put shareholders’ value at risk (Shleifer, 2004; Campbell, 2007). At the other extreme, in situations where competition is nil, a corporation may have little interest in using philanthropy to enhance its “competitive advantage (Porter and Kramer, 2002)” to improve its long-term financial performance, since its stakeholders, e.g., customers or suppliers, have few alternatives (Campbell, 2007).

Campbell (2007) proposes that: “Corporations will be more likely to act in socially responsible ways if there are strong and well enforced state regulations in place to ensure such behaviour, particularly if the process by

which these regulations and enforcement capacities were developed was based on negotiation and consensus building among corporations, government, and the other relevant stakeholders.” According to Leuz, Nanda, and Wysoki (2003), legal systems can protect outside investors by conferring on them the rights to discipline insiders (e.g., to replace managers), as well as by enforcing contracts designed to limit insiders’ private control benefits. As a result, legal systems that effectively protect outside investors reduce insiders’ incentives to act in irresponsible ways, e.g., to manipulate or obfuscate firms’ earnings to conceal their rent-seeking behaviour.

Campbell (2007) proposes that: “Corporations will be more likely to act in socially responsible ways if there is a system of well-organized and effective industrial self-regulation in place to ensure such behaviour, particularly if it is based on the perceived threat of state intervention or broader industrial crisis, and if the state provides support for this form of industrial governance.” Campbell (2007) also proposes that: “Corporations will be more likely to act in socially responsible ways if there are private, independent organisations, including NGOs, social movement organisations, institutional investors, and the press, in their environment who monitor their behaviour and, when necessary, mobilize to change it.”

Campbell (2007) proposes that: “Corporations will be more likely to act in socially responsible ways if they operate in an environment where normative calls for such behaviour are institutionalized in, for example, important business publications, business school curricula, and other educational venues in which corporate managers participate.”

Campbell (2007) proposes that: “Corporations will be more likely to act in socially responsible ways if they belong to trade or employers’ associations, but only if these associations are organized in ways that promote socially responsible behaviour.” Campbell (2007) also proposes that: “Corporations will be more likely to act in socially responsible ways if they are engaged in institutionalized dialogue with unions, employees, community groups, investors, and other stakeholders.”

In this research, the determinants of CSR, measured by Campbell (2007) include capital intensity, firm size, industry size, concentration rate, and shareholders’ number. These variables in Campbell’s approach are financial performance, economic environment,

competition, institutionalized dialogues with unions, employees, community groups, investors or other stakeholders, and shareholders’ number.

### 2.3 Dynamic Capabilities Focus

This focus permits to resolve some deficiencies brought to light in the resources vision, above all, in considering the effects of time pass and capabilities’ evolution. This theory illustrates the enterprises’ need to alter their resource bases and capabilities to be competitive and generate new strategies, creating value. Dynamic capabilities are defined by Teece et al. (1997) as the ability to build, integrate, and reconfigure internal and external competencies to react to quickly-changing surroundings. According to Prahalad and Hamel (1990), dynamic capabilities arise from collective learning of an organisation, especially in relation with the coordination of production techniques and integration of technologies, based on intangible assets, particularly organisational and technological knowledge of the enterprise. According to this perspective, the competitive advantages of an enterprise lie in their organisational and managerial processes, called ‘routines’, determined by their tangible assets, technology, industrial property, relations with suppliers and customers, and strategic alternatives within their reach (Grant, 1991). It has also been stated that the development of dynamic capabilities is determined by learning mechanisms such as repetition, trial and error, and experience, as well as the same market dynamism (Eisenhardt and Martín, 2000). Although this focus is different from that of resource-based view because of the inclusion of dynamism in the model, both of them show the importance of internal business resources, especially those that are intangible among which an enterprise’s environmental capital is found (Claver et al., 2004). Furthermore, some studies based on these two focuses state the existence of a positive relation between environmental practice and the generation or reinforcement of organisational capabilities that eventually enable the improvement of results (Hart, 1995; Russo and Fouts, 1997; Judge and Douglas, 1998; Sharma and Vredenburg, 1998; Christmann, 2000). Thus, Sharma and Vredenburg (1998) and Christmann (2000) suggest the existence of three organisational capabilities intertwined with the environment: 1. the capability to join together with the organisms and institutions that surround the enterprise and affect their development (e.g. regulator organisms or

environmental organisations), fostering better relations and less opposition to development; 2. the capability to promote learning processes and increase knowledge as the company explores new alternatives and creates new interpretations of existing information, and 3. the capacity for continuous innovation, understanding that a greater wealth of perspectives and analysis in the learning process contribute to the continuous generation of technological, organisational and operational innovations (Carmona et al., 2003). On the other hand, Aragón et al. (2005) have selected three of the organisational capabilities: suitable management capability of pressure groups (Hart, 1995; Henriques and Sadorsky, 1999; Sharma and Vrederburg, 1998), strategic pro-activity (Aragón, 1997; Sharma and Vrederburg, 1998) and participative leadership (Hart, 1995; Russo and Fouts, 1997). Dynamic capabilities are antecedent organisational and strategic routines that managers use to transform their resource base and develop new value-creating strategies (Grant, 1996; Pisano, 1994). Eisenhardt and Martin (2000) propose that dynamic capabilities can enhance existing resource configurations when pursuing long-term competitive advantages. In non-linear and unpredictable competitive landscapes, managers' capabilities to "integrate, build, and reconfigure internal and external competencies to address rapidly-changing environments" (Teece et al., 1997) are sources for sustaining competitive advantages. Dynamic capability is essential in identifying competitive advantage under environmental volatility (Eisenhardt and Martin, 2000; Newbert, 2005; Rindova and Kotha, 2001; Teece et al., 1997; Wu, 2007; Zollo and Winter, 2002). This proposition is antecedent to the suggestion that regardless of environmental volatility's degree, dynamic capabilities represent an emerging and potentially integrative approach for understanding new sources of competitive advantage. Therefore, environmental volatility does not moderate the relationship between dynamic capabilities and firm performance.

## 2.4 Financial Performance

As previously discussed, target stakeholders of the organisation place numerous demands on retail firms in terms of ethical and socially responsible conduct. However, the most important question for many retailers that engage in corporate social responsibility is whether CSR results in superior performance. Literature exists that highlights

the link between a sustained positional advantage by a firm and superior organisational performance (Barney, 1991; Campbell et al., 1999; Day and Wensley, 1988; Fahy and Smithee, 1999; Ljungquist, 2007). Superior performance may be indicated by increased profits, sales, market share or achievement of strategic goals. As the first responsibility an organisation has is an economic one to its shareholders, managers and organisations may be hesitant to invest in CSR policies and practices if a proven link to financial performance is not established (McWilliams and Siegel, 2000). McWilliams and Siegel (2000) in their analysis of extant literature argue that there have been mixed results of the financial impact of such well-doing strategies on short-term and long-term profitability of the organisation. Numerous other studies, however, suggest that, as a result of a firm engaging in socially responsible practices, overall profitability of the firm is enhanced (Berrone et al., 2007; McWilliams and Siegel, 2000).

## 3. Sample and Data Collection

To examine the effect of corporate social responsibility on organisational performance, we conducted a survey from November to December 2010 among the accepted firms in Tehran Stock Exchange Market. We chose a written survey in the form of a questionnaire. It was based on 5-likert scale with an agree/disagree continuum (1 = strongly disagree, 2 = disagree, 3 = neither agree nor disagree, 4 = agree, 5 = strongly agree). It contained 19 questions about dynamic capability. In the questions of corporate social responsibility, we proposed that four distinct and heterogeneous dimensions of CSR exist: environmental capability, workplace capability, marketplace capability, and societal capability. All of our respondents were in charge of the firms in Tehran Stock Exchange. Questionnaires were distributed and we followed their results by telephone. 105 questionnaires were received that were filled completely and accurately. In order to gather secondary information that were related to concentration variable (Herfindahl-Hirschman index), capital intensity (amount of applied capital), firm size (number of employees), shareholders' number, industry size (number of employees that worked in special industry) were applied; for measuring financial performance, (ROA) was extracted from financial statements.

### 4. Results

Construct measurement in this study was evaluated by examining the reliability and validity of the measurement scale. To examine reliability, we considered Cronbach' Alpha, using SPSS software whose results are presented in Table 1. Since Cronbach'Alpha value (0.88) is larger than 0.6, the reliability is acceptable.

**Table 1: Reliability Statistics**

Cronbach's Alpha	Number of Items
0.887	19

In order to examine the corporate social responsibility related to financial performance, path analysis was utilized. Path analysis enables the use of regression methods in order to examine causal relationships between constructs of interest; its use in this context is consistent with prior works on corporate social responsibility. Alternative structural equations' modeling approaches such as LISREL could not be utilized, due to the stringent sample size requirements of maximum likelihood estimation procedures.

The structure of under-examination model is outlined in Figure 1. In this model, corporate social responsibility and dynamic capability are considered as main indicators of financial performance. Furthermore, variables like capital intensity, industry size, firm size, concentration and number of shareholders are main determinants of corporate social responsibility.

Table 2 presents the regression results for the drivers of corporate social responsibility. In order to facilitate

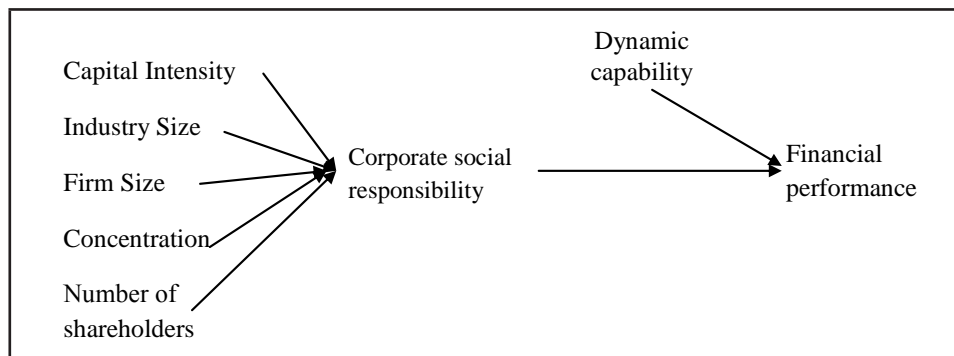
interpretation, all variables have been standardized, resulting in parameter estimates that can be interpreted as the path coefficients (Duncan, 1975; Hair et al., 1998). As seen from Table 2, the regression model achieves a high degree of fitness, reflected by a value of 0.89 (;  $p > 0.001$ ). In addition, the effects of universally accepted drivers of corporate social responsibility are in their expected directions. Positive effects can be found for the capital intensity ( $p > 0.001$ ), industry size ( $p > 0.01$ ), firm size ( $p > 0.001$ ) and concentration has negative effect ( $p > 0.001$ ). But, shareholders' number has no effect on corporate social responsibility ( $p < 0.05$ ).

**Table2: Determinants of Corporate Social Responsibility**

	Coefficient estimate	Standard error	Significance
Intercept	2.97	0.035	P=0.56
Intensity of capital	0.35	0.004	P>0.001
Size of industry	0.17	0.004	P>0.01
Size of firm	0.43	0.000	P>0.001
Concentration	-0.54	0.000	P>0.001
Number of shareholders	0.01	0.254	P>0.87
Notes: = 0.89, = 59.33			

Table 3 presents the regression results for the drivers of financial performance. As seen from Table 3, the regression model achieves a high degree of fitness, reflected by a value of 0.78 (;  $p > 0.001$ ). In addition, the effects of universally accepted drivers of financial performance are in their expected directions. Positive effects can be found for the dynamic capability ( $p > 0.001$ ) and corporate social responsibility ( $p > 0.001$ ).

**Figure 1: Model of Research**



**Table 3: Determinants of Organisational Performance**

	Coefficient estimate	Standard error	Significance
Intercept	0.97	0.005	P=0.03
dynamic capability	0.50	0.017	P>0.001
corporate social responsibility	0.37	0.058	P>0.001
Notes: = 0.78, = 31.42			

## 5. Conclusion

First, firms will be less likely to act in socially responsible ways if there is either too much, or too little competition. Second, firms and industries with larger size will be more CSR-minded. Third, corporations will be more likely to act in socially responsible ways if they have higher applied capital. Finally, firms with high dynamic capability and CSR have higher financial performance. The result of concentration effect, confirms the correlation between competition extent (which is the contrary of concentration) and social responsibility. This result agrees with the findings of Campbell (2007), implying that in the environment with high competition the firms participate in the activities related to social responsibilities more enthusiastically.

The results of testing capital intensity and industry size confirm the mentioned points in industrial organisation approach. The results of company size in this study agree with the findings of Song and Zu (2008) and Hsiang et al. (2005).

Examining the determinants of social responsibility showed that the number of stockholders doesn't impact social responsibility. This finding disagrees with the approach of stakeholders' management. The reason for such disagreement can be for the lack of stockholders' engagement or their inadequate involvement in directing the organisations.

Financial performance of every company results from purposeful activities for reaching economic profits. The companies with high financial performance can recognize the channels for profit earning and invest in them. The results show that social responsibility can significantly impact financial performance of the firms. This finding agrees with the findings of Schaltegger and Figge (2000),

Heal (2005), Kong et al. (2002), Hansen (2004), Epstein and Roy (2001), and Weber Manuela (2008).

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