Broad bond rating change and irresponsible corporate social responsibility activities

Wen-Chyuan Chiang\textsuperscript{a,}, Jennifer Shang\textsuperscript{b}, Li Sun\textsuperscript{c,x}

\textsuperscript{a} Collins College of Business, University of Tulsa, Tulsa, OK 74104, United States
\textsuperscript{b} Joseph Katz School of Business, University of Pittsburgh, Pittsburgh, PA 15260, United States
\textsuperscript{c} Collins College of Business, University of Tulsa, Tulsa, OK 74104, United States

\begin{abstract}
This study investigates the association between whether firms are near a broad bond rating change (a rating with a plus or minus specification) and their level of irresponsible corporate social responsibility (CSR) activities. Using a 24-year panel sample with 1182 U.S. firms and 11,335 firm-year observations, we find that firms near a broad bond rating change tend to reduce their irresponsible CSR activities more than firms that are not near a broad bond rating change. The results persist through a battery of robustness checks. Furthermore, we find that our results are stronger for high growth firms.
\end{abstract}

1. Introduction

Bond credit ratings are indicators of corporate credit quality or financial strength. Broad bond rating refers to credit ratings without a distinction of plus, middle, and minus specification (Kisgen, 2006). For example, a broad bond rating of CCC refers to firms with a rating of either CCC+, CCC, or CCC-. Kisgen (2006) argues that firms near a broad bond rating change (i.e., tier change) have stronger incentives to take actions to have their ratings upgraded (i.e., from CCC+ to B-) or prevent their ratings from being downgraded (i.e., from CCC- to CC), relative to firms that are not near a broad bond rating change. Due to regulatory and contractual factors, Kisgen (2006) claims that firms near a broad bond rating change tend to behave differently from those that are not near a broad bond rating change.

Corporate social responsibility (CSR) has received tremendous attention over the last decade. Whether firms near a broad bond rating change behave differently in their CSR engagement is an area that has not been examined previously. The lack of empirical evidence motivates us to conduct this study. Specifically, we study the relation between whether a firm is near a broad bond rating change and the level of irresponsible CSR activities. The stakeholder view of CSR argues that actively engaging in socially responsible activities (i.e., reducing irresponsible CSR activities) can improve the operating performance of a firm and benefit the firm. A firm’s operating performance is an important factor in determining its bond rating. If the stakeholder view of CSR is valid, we expect that firms near a broad bond rating change tend to reduce irresponsible CSR activities more than those who are not near a broad bond rating change. Hence, we posit a negative relation between whether a firm is near a broad bond rating change and the level of irresponsible CSR activities.

We focus on irresponsible CSR activities in our study for the following reasons. First, irresponsible CSR activities (i.e., CSR concerns) are often viewed by the public as detrimental to various stakeholders (Hoi, Wu, & Zhang, 2013). External stakeholders pay more attention to irresponsible CSR activities (i.e., CSR concerns) than to responsible CSR activities (i.e., CSR strengths). Second, prior research (e.g., Chatterji, Levine, & Toffel, 2009; Goss & Roberts, 2011) suggest that irresponsible CSR activities have higher explanatory power on CSR construct, relative to responsible CSR activities. Additionally, responsible CSR performance is too self-serving (Cho & Patten, 2007; Neu, Warsame, & Pedwell, 1998). Third, prior research argues that responsible CSR activities and irresponsible CSR activities are two different measures, representing two theoretically and empirically distinct constructs (Mattingly & Berman, 2006). Thus, Walls, Berrone, and Phan (2012) suggest that CSR studies should use the two measures (CSR concerns and CSR strengths) separately. Lastly, recent years have witnessed a rapidly growing interest in studying irresponsible CSR activities (e.g.,}
Chiu & Sharfman, 2016; Dunbar, Li, & Shi, 2017; Hoi et al., 2013). Thus, following the recent research trend, we exclusively focus on irresponsible CSR activities, measured by CSR concern scores, in our study.

Using a 24-year panel sample with 1182 distinctive U.S. firms and 11,335 firm-year observations, we find a significant negative association between whether firms are near a broad bond rating change and irresponsible CSR activities. Our results suggest that firms near a broad bond rating change tend to reduce their irresponsible CSR activities more than firms not near a broad bond rating change, supporting the stakeholder view of CSR. We perform various robustness tests, including alternative CSR measure, alternative samples, changes analysis, and two-stage ordinary least squares (OLS) regression analysis (2SLS), and consistently obtain same results. We also find that our results are stronger for high growth firms. CSR measure consists of seven categories: community, corporate governance, employee relations, environmental issues, diversity, human rights, and product. For completeness, we find that two components, namely environmental concerns and product concerns, are significantly and negatively associated with whether a firm is near a broad bond rating change.

Our study makes several important contributions. First, it links two research schools: bond credit rating in accounting and finance literature and corporate social responsibility in broad business literature. To the best of our knowledge, this is the first empirical study that examines the association between whether a firm is near a broad bond rating change and the level of irresponsible CSR activities. Second, despite the surge of research attention on bond rating, few studies have examined the behavior of firms near a broad bond rating change (i.e., firms with a plus or minus sign). Therefore, studying this unique sample of firms should lead to a more comprehensive understanding of the behavior of such firms. Third, recent research has focused on the impact of CSR on corporate financial performance, with little attention devoted to the identification of the determinants of CSR (e.g., Campbell, 2007; Ioannou & Serafeim, 2012). Indeed, Kitzmueller and Shimshack (2012) argue that there is much to learn on what characterizes CSR. Huang and Watson (2015) suggest that more research on the determinants of CSR could help better understand the relation between CSR and firm performance. We answer their call, by investigating the impact of whether firms are near a broad bond rating change on their irresponsible CSR activities. Fourth, Attig, Ghoul, Guedhami, and Suh (2013) find that socially responsible firms receive high bond credit ratings. Our study extends Attig et al. (2013) by showing that firms with a plus or minus sign in their bond ratings are even more socially responsible by reducing more irresponsible CSR activities, relative to firms that are not near a broad bond rating change. Hence, our study complements Attig et al. (2013). Fifth, Moser and Martin (2012) encourage researchers to adopt the stakeholder theory of CSR by stating that “accounting researchers would benefit from being more open to this alternative perspective (stakeholder theory) because it raises a variety of new and interesting research questions…” (pp. 799). Our study answers their call and documents evidence to support the importance of adopting the stakeholder theory of CSR. Lastly, from a practical perspective, our results should interest policy makers who design and implement guidelines for CSR policy and for firms that are near a broad bond rating change. Results should also provide practitioners with useful insights into what governs CSR decisions. Our results also have implications for stakeholders, as we find that firms near a broad bond rating change have stronger incentives to be more socially responsible.

The rest of this paper is organized as follows. Section 2 reviews the literature and develop the hypothesis. We present the research design in Section 3 and discuss the results of the empirical analyses in Section 4. Section 5 provides the results of additional tests. Finally, Section 6 concludes this study.

2. Literature review and hypotheses development

2.1. The stakeholder view of CSR

CSR has drawn significant research attention in the last decade. The definition of CSR by Carroll (1979) states that “the social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time” (pp. 499). The stakeholder view of CSR states that “the economic and social purpose of the corporation is to create and distribute increased wealth and value to all its primary stakeholder groups, without favoring one group at the expense of others” (Clarkson, 1995, pp. 112). Under this view, corporations have an obligation to constituents in society other than shareholders, including all constituents that are affected by business actions (Freeman & Liedtka, 1991). In addition, Porter and Kramer (2006) suggest that participating in CSR activities can bring long term financial benefits to firms through strategic positioning. Many CSR studies find that firms actively engaging in CSR activities also demonstrate superior financial performance (e.g., Beurden & Gossling, 2008; Graves & Waddock, 1994; Johnson & Greening, 1999; McGuire, Sundgren, & Schneeveis, 1988; Roman, Hayibor, & Agle, 1999; Waddock & Graves, 1997).

A significant body of CSR research appears to support the “stakeholder theory” in that CSR firms are more likely to do well in other dimensions. That is, firms that care about their overall corporate sustainability are assumed to be more responsible to their stakeholders. In addition, they are more likely to make efforts to satisfy their stakeholders, which include shareholders, employees, customers, suppliers, and the larger community in which they operate. CSR firms also aim to satisfy the natural environment, the government, and the general society (Freeman, 1984; Freeman, Harrison, & Wicks, 2007; Li & Chueh, 2015). For example, Freeman (1984) argues that it is significantly important to pay attention to all stakeholders’ needs or interests for the purpose of firm success. Specifically, Freeman (1984) suggests that managers not only need to pursue actions that maximize shareholder interests, but also optimal actions that benefit a broader class of stakeholders. Taken together, the proper goal of management under the stakeholder theory is to meet the objectives of all stakeholder groups simultaneously. If the firm strives to satisfy all stakeholders, the stakeholders should support the company. Hence, firms with higher CSR performance are likely to benefit both socially and financially, leading to a ‘win-win’ situation.

If being more socially responsible (i.e., reducing irresponsible CSR activities) can improve a firm’s operating performance and bring more benefits from different stakeholder groups, then firms near a broad bond rating change (i.e., with a plus or minus sign) have stronger incentives to reduce their irresponsible CSR activities than firms that are not near a broad bond rating change, due to the fact that a firm’s operating performance is an important factor in the bond rating process (S&P). Therefore, we expect a negative relation between whether a firm is near a broad bond rating change and the level of irresponsible CSR activities. We propose the following hypothesis:

H1. Irresponsible CSR activities are fewer for firms that are near a broad bond rating change as compared to firms that are not near a broad bond rating change.

2 Prior research (e.g., Chih, Shen, & Kang, 2006; Cho, Cheol, and Pfeiffer, 2013; Hong & Anderson, 2011; Kim et al., 2012 and Lars & Richardson, 2012) suggests that CSR reflects the level of ethics of a firm. Under this ethics view, socially responsible firms are more ethical than their non-socially responsible counterparts. Prior research documents that firms near a broad bond rating change are more likely to engage in questionable and unethical accounting practice. For example, Ab & Zhang (2008) find that firms near a broad bond rating change tend to inflate their earnings more than firms that are not near a broad bond rating. Similarly, Brown et al. (2015) find that manufacturing firms in the rating categories near the investment-speculative borderline (BBB to BB ratings) use the most aggressive income-increasing real earnings management. Hence, if the ethics view of CSR is valid, then we predict that firms near a broad bond rating change are more unethical, relative to firms that are not near a broad bond rating change. Therefore, it is possible that a positive relation may exist between whether a firm is near a broad bond rating change and the level of irresponsible CSR activities.
دریافت فوری
متن کامل مقاله

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات