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The corporate social responsibility–financial performance link in the U.S. restaurant industry: Do economic conditions matter?

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ABSTRACT

This study examines the role played by economic conditions (recessionary periods) on the link between corporate social responsibility (CSR) and corporate financial performance (CFP) in the U.S. restaurant industry. The choice of industry setting is based on the fact that the restaurant industry is subject to consumer discretionary expenditures and is thus highly sensitive to the state of the economy. This study further examines the relationship between CSR and CFP by dichotomizing CSR activities based on whether they are related to the firm's core operations or not, thus parsing out the effect of operations-related (OR) and non-operations-related (Non-OR) CSR activities, providing a more nuanced explanation of how some CSR activities may be more beneficial than others, to firm value in hard economic times.

1. Introduction

The link between corporate social responsibility (CSR) and corporate financial performance (CFP) has been extensively examined in the management and financial economics literature with no conclusive results. Scholars have found a positive, a negative, a curvilinear, and even a zero effect of CSR on CFP (Aupperle et al., 1985; Barnett and Salomon, 2006; Bhattacharya and Sen, 2004; Hillman and Keim, 2001; McWilliams and Siegel, 2000; Preston and O'Bannon, 1997; Wu, 2006). It has therefore been suggested that the link should be examined within a particular industry context (Chand, 2006), and that moderating and mediating variables should be considered for a nuanced examination of this relationship (Rowley and Berman, 2000).

A meta-analysis by Orlitzky et al. (2003), and a later overview article by Allouche and Laroche (2006), found that there may be a positive effect of CSR on CFP across industries and the results confirmed two theories: the instrumental stakeholder theory, which states that the social responsibility towards stakeholders is instrumental to firm performance (Donaldson and Preston, 1995; Jones, 1995) and the slack resources hypothesis, which states that previous financial performance in turn affects social performance using the slack resources available. While the slack resources explanation is intuitive to some extent, it is not known how broad based declining economic conditions, like a recession, affect the link between corporate social and financial performance. This question is especially pertinent not only because of the recent slowing growth in the world economy, but also because economic cyclical behavior impacts different industries differently. Further, different components of CSR (i.e. components related to the firm's operations versus components unrelated to the firm's operations) may affect financial performance in varying degrees.

Therefore in this study, we seek to address this important gap in the extant literature by examining the role played by economic conditions on the link between CSR and CFP in the U.S. restaurant industry. The choice of industry setting is based on the fact that the restaurant industry is subject to consumer discretionary expenditures (Singal, 2011), and is thus highly sensitive to the state of the economy (Kim and Gu, 2006; Thompson and Kwortnik, 2008), thus allowing us to examine the moderating influence of economic conditions on CSR and CFP. We further examine the relationship between CSR and CFP by dichotomizing CSR activities based on whether they are related to the firm's core operations or not, thus parsing out the effect of operations related and unrelated activities, providing a more nuanced explanation of how some CSR activities may be more beneficial than others, to firm value in hard economic times.

We posit that operations-related (OR) CSR activities, like product quality and employee relations, in general, may help restaurant firms improve their financial performance regardless

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of economic conditions, because these CSR activities have direct cost-saving or performance-enhancing implications. These positive effects of OR-CSR activities may become more pronounced and influential during recessionary periods than non-recessionary periods, considering that immediate cost savings from OR-CSR, and attention to salient stakeholders may be instrumental to restaurant firms' performance. This argument suggests that economic conditions moderate the effect of OR-CSR activities on CFP.

On the other hand, non-operation-related (Non-OR) CSR activities, like those directed towards the community or environment, help restaurant firms improve CFP during normal economic or non-recessionary periods by enhancing reputation and brand image of the firm, but may not have direct, immediate cost-savings or performance-enhancing effect for restaurant operations. However, such positive effects from Non-OR CSR on CFP may be diminished during recessionary periods because restaurant operations tend to severely suffer from economic downturns. For example, financial markets assume a more cautious stance about restaurant firms' investments in discretionary Non-OR CSR activities towards distal stakeholders during lean periods when restaurant firms struggle to survive, and immediate returns of such investments may not be expected. Accordingly, firm performance based on a market-value measure may not be enhanced by Non-OR CSR activities. This argument again suggests that economic conditions moderate the effect of Non-OR CSR on CFP.

To empirically test our argument we use panel data from KLD STATS, a widely used measure of CSR (Margolis and Walsh, 2003). The KLD dataset includes a number of qualitative dimensions of CSR, among which seven areas are directly relevant to the restaurant industry: employee relations, product quality, community relations, environmental issues, diversity issues, humanity issues, and corporate governance. Our preliminary analysis confirms the finding of Park and Lee (2009) regarding the non-significant effect of CSR on CFP in the restaurant industry. However, further analyses reveal that, as hypothesized, economic conditions positively (negatively) moderate the effect of Non-OR (OR) CSR activities on firm performance.

Our study makes several contributions to the existing literature. First, we provide a more nuanced approach to studying CSR's effect on CFP. By parsing out the effect of operations related and immediate stakeholder related activities of CSR from the non-operations related and distal stakeholder related activities, we introduce a dichotomization of the CSR measure that will be useful for future studies. This finer-grained approach also provides managers guidance as to which CSR activities are likely to impact firm performance during lean economic times and hence a direction to focus on such activities during weakening financial conditions. Second, by analyzing how recessionary periods impact the relationship between CSR and CFP we contribute to the theory on social issues in management and add to the instrumental and slack resources explanations of corporate social responsibility. Lastly, by focusing on the restaurant industry we provide an industry context that can be useful for other industries that are also highly sensitive to discretionary consumption expenditures like services related to hospitality, tourism, leisure, and entertainment.

The rest of the paper is organized as follows: the next section reviews the relevant CSR literature in general and in the hospitality setting with reference to its effect on firm performance providing the background for the proposed hypotheses. Then, we describe the data, sample, variables and methods employed for the analysis in the methodology section, which is followed by a report and discussion of the results with implications. Finally, we conclude the paper with limitations and suggestions for future research.

2. Literature review and theory development

2.1. Corporate social responsibility and corporate financial performance

Since the concept of CSR was introduced in the 1950s, definitions, and debates regarding its effect on firm value have been the subject of considerable scholarly inquiry. A common theme in the definitions and description of what is considered corporate social responsibility entails activities beneficial to some segment of society that are beyond the self-interested profit motive of the firm and beyond the strict requirements of the law (Kang et al., 2010; McWilliams and Siegel, 2001). While most companies today undertake some form of CSR encouraged by government and non-governmental organizations like UN Global Compact and World Business Council for Sustainable Development, theories as to why firms should initiate such activities range from the instrumental or "enlightened self-interest" (i.e., CSR is an instrument to other desirable firm outcomes like employee retention, reputation, or enhanced customer satisfaction) to the normative (i.e., CSR is rooted in ethical or moral responsibility and the firm *ought* to act in the interest of the society, human rights, and the environment) (McWilliams and Siegel, 2001).

Regarding the relationship between CSR and CFP, a major question of CSR studies, empirical results have been inconsistent. Several studies have found that CSR impacts CFP positively (Bird et al., 2007; Bragdon and Martin, 1972; Hart and Ahuja, 1996; Judge and Douglas, 1998; Nicolau, 2008; Orlitzky et al., 2003; Waddock and Graves, 1997). A meta-analysis of 121 studies conducted by Wu (2006) revealed an average effect size of 0.166 between corporate social and financial performance. Based on the argument of instrumental stakeholder theory (Donaldson and Preston, 1995; Freeman, 1984), the results from these studies imply that an increase in CSR activities, which considers all legitimate stakeholders in decision making, enhances firm performance by improving a firm's reputation or brand equity, saving costs in operations by precluding government regulations (Bird et al., 2007; Kang et al., 2010; Lee and Park, 2009).

On the other hand, other studies report a negative effect of CSR on CFP (Cordeiro and Sarkis, 1997; Frankle and Anderson, 1978; Vance, 1975; Wright and Ferris, 1997), which supports Friedman (1970)'s perspective that the sole responsibility of a firm is contributing to the maximization of shareholders' wealth. Based on the argument of Friedman (1970), CSR, which is considered the responsibility of society, not the firm, may harm a firm's financial performance by hindering optimal resource allocation (Kang et al., 2010).

In addition, some scholars find no particular, unilateral relationship between CSR and CFP (Abbott and Monsen, 1979; Alexander and Buchholz, 1978; Aupperle et al., 1985; Margolis et al., 2007; Teoh et al., 1999) or even a reverse directional relationship between CFP and CSR. For example, Margolis et al. (2007), by conducting a meta-analysis that comprehensively incorporates 167 previous CSR studies, found that 58% of the sampled studies show a nonsignificant relationship between CSR and CFP. Preston and O'Bannon (1997) studied correlations between social and financial performance indicators both contemporaneously and with lead-lag effects for 67 large U.S. corporations from 1982 to 1992, and reported that out of 270 correlations, they did not find any significant negative correlation in this link, but interestingly, the strongest positive correlations were found in the lead financial performance–social performance relationship, indicating that financial performance may precede social performance providing support to the slack resources theory.

In another recent empirical study, Barnett and Salomon (2006) examined 61 mutual funds that apply social responsibility screens