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Corporate social performance, financial performance and institutional ownership in Canadian firms

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Abstract

This study examines the relationship of corporate social performance (CSP) to financial performance (FP) and institutional ownership. We perform our empirical analyses on a large-sample of publicly held Canadian firms and use a novel independent measure of CSP. Based on tests utilizing four years of panel data, we found no significant relationship between a composite measure of firms' CSP and FP. However, we found significant relationships between individual measures of firms' CSP regarding environmental and international activities and FP. Our findings indicate a significant relationship between firms' composite CSP measure and the number of institutions investing in firms' stock. In addition, we found significant relationships between firms' CSP ratings regarding their international activities and product quality and the number of institutions investing in firms' stock. These findings, while subject to the limitations inherent in the use of specific CSP measures, provide mixed support for the business case for CSP.

Keywords: Corporate social performance; Institutional ownership; Financial performance

1. Introduction

Various groups, such as the *Task Force on the Churches and Corporate Responsibility in Canada*, have pushed for increases in corporate social performance (CSP) since the 1970s (Brooks, 1997). During that period, this interest in defining and measuring the social responsibilities of business provided the impetus for studies by the National Association of Accountants (1974),

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the American Accounting Association (1976), and the American Institute of Certified Public Accountants (1977). In addition, the studies performed by these institutions helped to motivate early academic accounting research focused on CSP (Ingram, 1978; Shane & Spicer, 1983; Trotman & Bradley, 1981).

Since this early empirical work, CSP research has employed a variety of theories and methodologies to study the potential relationship between corporate social responsibility activities and other traditional measures of a firm's success. The purpose of this study is to extend prior large-scale empirical research by investigating potential relationships between CSP, traditional accounting measures of financial performance (FP), and measures of institutional ownership for a large-sample of publicly held Canadian firms. Our study provides novel evidence concerning these relationships by employing independent CSP ratings that were developed using a multi-attribute rating system. This rating system, developed by *Michael Jantzi Research Associates*, allowed us to test both a composite measure of CSP and individual components of the overall CSP rating.

The ability to test both composite and individual component ratings of CSP is important to help us learn more about how each component may impact the overall relationship between CSP and FP. Historically, CSP has been viewed as a multidimensional construct consisting of economic responsibility to investors and consumers, ethical responsibilities to society, legal responsibility to the government or the law, and discretionary responsibility to the community (Carroll, 1979). According to Wartick and Cochran (1985) this multidimensional construct incorporates the interaction between the principles of social responsibility, the process of social responsiveness, and the policies and programs designed by corporations to address social issues. CSP occurs across a wide range of industries with significantly different characteristics, histories, and performance in different CSP domains (Waddock & Graves, 1997a). Even though a precise definition has not been agreed upon in the literature, CSP is generally portrayed as a broad construct comprised of social issue and stakeholder management (Clarkson, 1995; Hillman & Keim, 2001; Swanson, 1995; Wood, 1991). As researchers attempted to learn more precisely how CSP may affect firm performance, testing of individual components of CSP began to show up in the empirical literature (Johnson & Greening, 1999; Mahoney & Thorne, 2005). As we show in the paper, our results partially support arguments that CSP is related to measures of firm financial performance. However, we also recognize the limitations within our research, the problems associated with quantitatively measuring and aggregating CSP, and, therefore, we are careful not to overreach in our conclusions.

Our research is important for several reasons. First, our paper extends large-sample CSP studies by utilizing data on publicly held Canadian firms. This extension allows researchers to compare findings from other countries with the results found in Canada. Second, our examination can provide insights into the field of social responsibility investing (Johnsen, 2003; Schueth, 2003). Institutional investors include mutual funds that focus their investments on corporations who exhibit a certain minimum level of social responsibility. Our research can help them evaluate the social performance/financial performance relationship and the relationship between social performance and the extent of interest these firms generate among institutional investors. Third, our paper, while using the research methods of large-sample studies, explicitly recognizes the limitation inherent in this stream of research. Using this methodology we are able to observe statistical associations among our empirical proxies for social and financial performance and institutional ownership. The reliability of our findings depends on how well these proxies map to actual corporate performance. Also, by definition, this large-scale study examines general tendencies across the firms that we studied. Each firm in our sample most likely has unique characteristics worthy of study in its own right.