How Corporate Social Responsibility Engagement Strategy Moderates the CSR–Financial Performance Relationship

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ABSTRACT   We propose that firm profits are shaped by *how* firms engage in corporate social responsibility. Recent research on the corporate social responsibility (CSR)–corporate financial performance (CFP) relationship proposes a variety of contextual and organizational factors to create a more robust link. However, few of these studies explore the role of the CSR engagement strategy. Drawing on absorptive capacity theory and related perspectives such as time compression diseconomies, asset mass efficiencies, and path dependence theory, we argue that when a firm engages in CSR slowly and consistently, focuses on related CSR dimensions, and starts with internal dimensions of CSR, CFP will be enhanced. With longitudinal data collected from 130 firms from 1995 to 2007, we find that firms benefit more when they adopt a CSR engagement strategy that is consistent, involves related dimensions of CSR, and begins with aspects of CSR that are more internal to the firm. The pace of the CSR engagement strategy, however, does not moderate the CSR–CFP relationship. This study helps fill the gap in CSR research by showing that, regardless of contextual factors, a firm can choose the proper strategy to enhance the financial benefits of the CSR engagement.

INTRODUCTION

The relationship between corporate social responsibility (CSR) and corporate financial performance (CFP) remains controversial after decades of research (Hull and Rothenberg, 2008; McWilliams and Siegel, 2000; Orlitzky et al., 2003; Russo and Fouts, 1997; Waddock and Graves, 1997). On the one hand, mainstream resource-based view (RBV) scholars argue for a positive CSR–CFP relationship, as CSR can improve firm–stakeholder relationships and enhance the firm's reputation among customers, employees, regulators, and suppliers (e.g. Berman et al., 1999; Brammer and Pavalin, 2006;

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Carmeli et al., 2007; Haley, 1991; Orlitzky et al., 2003; Waddock and Graves, 1997). On the other hand, some neoclassical economists argue that, constrained by complementary resources and capacity, CSR engagement can trigger disproportionally high cost, while stock market and product market returns are negligible (Brammer and Millington, 2008; Cornell and Shapiro, 1987; Friedman, 1970). So far, most research has focused on defining the exogenous factors that affect the CSR–CFP relationship, i.e. in what context will a positive CSR–CFP link be more robust. However, the question of what a firm can do, given its limited resources and capacity, to maximize the financial return of CSR engagement has been largely ignored.

To address this question, we have to move beyond contextual conditions and integrate the dynamic absorptive capacity perspective (Cohen and Levinthal, 1990; Zahra and George, 2002) into the mainstream RBV framework. The absorptive capacity perspective adds a dynamic insight to RBV: absorptive capacity is a firm's ability to recognize and understand new knowledge, assimilate the knowledge within the organization, and use the knowledge to create commercial outputs (Lane et al., 2006). A firm's absorptive capacity determines how much benefit the firm can realize from engaging in new activities. Vermeulen and Barkema (2002) further indicated that the manner in which a firm engages in new activities can significantly affect how much knowledge can be attained and absorbed from these activities, and eventually affect the benefit generated from the engagement. They found that the pace, rhythm, and scope in the products and regions of a firm's international expansion could significantly alter the financial benefits of such an expansion. This perspective thus provides us with an anchor to study how a firm can strategically engage in CSR in order to maximize its benefit. Thus, we define *CSR engagement strategy* as the manner in which managers identify CSR-related activities, organize resources to conduct these activities, and use the knowledge acquired from these activities for commercial outputs.

Knowledge acquired and absorbed from new activities and the resultant benefit from using the knowledge depends on how these activities are engaged. Building on neo-classical economics, scholars such as Dierickx and Cool (1989), Pacheco-de-Almeida and Zemsky (2007), and Vermeulen and Barkema (2002) argue that, in general, any engagement process aiming to accumulate knowledge is subject to two major forces: asset mass efficiencies and time compression diseconomies. *Asset mass efficiencies* explain how starting points of an engagement process matter: it is easier to add increments to an existing knowledge or asset stock when a firm has a successful starting point. *Time compression diseconomies* emphasize the importance of engagement pace and the consistency of such a pace, i.e. 'law of diminishing returns' (Dierickx and Cool, 1989), suggesting that organizations are not able to benefit from rapidly accumulated knowledge as much as from knowledge that is accumulated slowly and gradually. Furthermore, a long pause in an engagement process can interrupt the firm's ability to fully absorb and understand the acquired knowledge. These two forces address the starting point and the dynamic aspect of strategic engagement, but do not address the complexity aspect. Path dependence theory (Garud et al., 2010; Sydow et al., 2009; Vergne and Durand, 2010), a perspective rooted in absorptive capacity, highlights the concept that 'history matters' in how well a company can absorb and retain new knowledge; through accumulating similar knowledge, building complementary assets, and internal consistency, a firm can gain extra

efficiency from related behaviours. Based on what these three perspectives tell us about absorptive capacity, we aim to explain how a firm's CSR engagement strategy (pace, consistency, relatedness, and path) affects the performance implications of CSR activities.

We believe that this paper makes a timely contribution to CSR research. To date, research has extensively examined the 'what' question (i.e. what CSR is – e.g. Donaldson and Preston, 1995) and the 'why' question (i.e. reasons for engaging in CSR – e.g. Aguilera et al., 2007). The 'how' question (i.e. how to engage in CSR) has not been looked at to any great extent, despite well-reasoned calls for such studies in this area (Basu and Palazzo, 2008; Margolis and Walsh, 2003). We thus provide and evaluate a framework for assessing CSR engagement strategies, and offer the beginning of an answer to the question of which CSR engagement strategy will maximize the beneficial effects of CSR on financial performance. Our study thus adds to the current trend of examining the CSR activities through a more dynamic lens (Brammer et al., 2009; Delmas et al., 2011; Lockett et al., 2006; Margolis et al., 2009). Moreover, our findings clearly address the 'how' question raised by these scholars and provide a general guideline for practitioners in engaging CSR activities.

In the next section we provide a theoretical background of CSR engagement strategy and related research. We then propose four hypotheses. These hypotheses are tested with panel data collected from the Environmental, Social and Governance factors (ESG) and the Compustat datasets. After we present the results, we discuss the implications of our findings for CSR research and for firms considering engagement in CSR.

BACKGROUND

So far the dominant perspective in CSR–CFP research is the RBV, which has largely focused on exogenous factors to define this relationship (Russo and Fouts, 1997). It has been generally agreed that stakeholders, such as employees, customers, governments, and the media, tend to respond favourably to CSR activities on the part of firms (Agle et al., 1999). This favourable response leads to better reputation, improved human capital, and greater innovative capability for firms, which in turn lead to better financial performance (Surroca et al., 2010). Although the strength of such a CSR–stakeholder–CFP link can vary in different contexts (e.g. Tang and Tang, 2012), it has been largely confirmed that CSR activities can establish or fortify the firm–stakeholder relationship (e.g. philanthropic donation; Brammer and Millington, 2008), revive or strengthen the product's differentiation factor in the market (e.g. environmental friendliness; Klassen and Whybark, 1999), refine the cost-efficiency aspect of business processes (e.g. 'best practices'; Christmann, 2000), attract the best human capital (e.g. Johnson and Greening, 1999), or improve other intangible assets (e.g. reputation; Margolis et al., 2009) for the firm, which will benefit the firm financially. Thus, although this paper is not designed to explore the exogenous effect of a CSR engagement strategy, we build our model on the above well-tested premise that a firm's external and internal stakeholders will tend to respond favourably to its CSR activities.

However, exogenous factors alone are not sufficient to explain the variations in the CSR–CFP relationship (Muller and Kolk, 2010). How much and how fast a firm can

benefit from CSR engagement is constrained by its absorptive capacity and complementary resources (Zahra and George, 2002). Owing to the difference in these organizational constraints, the same CSR activities may benefit some firms but create negligible or even harmful effects for others. We believe that disregarding these constraints and how they are addressed by the company may have led to mixed empirical findings regarding the CSR–CFP link. McWilliams and Siegel (2000), for example, found that adding organizational R&D and marketing expenses into the model eliminated the positive relationship between CSR and CFP, indicating that the benefits of CSR were not enough to offset the cost. Hull and Rothenberg (2008), however, found that the CSR–CFP relationship is significant even if organizational innovation rate and the extent of product differentiation are considered. They found that CSR was more likely to contribute to performance in low-innovation firms and those with little differentiation. Studies using the static, exogenous view of CSR often yield mixed or conflicting results; endogenous factors should be taken into consideration.

However, a review of CSR research reveals that few empirical studies go into detail regarding how a firm can adopt different CSR engagement strategies to affect its financial performance. Most studies of the CSR process have focused on understanding key stakeholders' concerns, identifying the firm's-values, and assessing the firm and its competitors' status with regard to CSR (Maon et al., 2009). Some exceptions to this (Christmann, 2000; Darnall and Edwards, 2006; Darnall et al., 2008) explore the effect of complementary assets on the effectiveness of CSR implementation. Arya and Zhang (2009), another exception, examined the effects of the timing of regulatory changes on the CSR–CFP relationship. Hardly any previous studies explore how the actual CSR engagement pattern or strategy can affect the CSR's financial return.

Engaging in CSR consumes time and resources. Because the capacity of a firm to create and configure these resources and absorb new experiences is limited (Cohen and Levinthal, 1990; Penrose, 1959), time compression diseconomies may occur. Time compression diseconomies theory predicts that experiences that come too fast will not be able to generate the same benefits as they would have generated if they had come at a gradual, absorbable pace (Dierickx and Cool, 1989). For example, effective CSR activities that simultaneously enable a firm to protect the environment and reduce costs, such as programmes and policies to reduce waste, design for remanufacturing, or reduce material consumption, often involve multiple learning processes that are associated with the development of required new knowledge and capacities (Christmann, 2000). These learning processes are frequently sequential in nature, and devoting adequate time to go through the full range of each process allows the firm to take full advantage of the accumulated knowledge and capacities (Ghemawat, 1991). For example, it would be difficult to reduce manufacturing-level waste effectively without first getting an accurate account of material flows in a facility, implementing systems for continuous monitoring of these flows, and engaging employees as full partners in the waste reduction effort. Artificially cutting these processes short forces the firm to encounter the early – and often the most expensive – stage of a new learning curve before the firm has the chance to fully enjoy the benefit of the last learning curve. Thus, time compression diseconomies suggest that the faster a firm develops a resource, the greater the cost will be (Pacheco-de-Almeida and Zemsky, 2007; Scherer, 1967).

Path dependence theory also suggests that the actual pattern of a process matters (Garud et al., 2010). Path dependence scholars believe that as a company accumulates knowledge and investment, this accumulation constrains the available options that the company can choose in the future (Vergne and Durand, 2010). Consider a firm that has learned the necessary skills to adapt to one stakeholder's expectations, coordinated different aspects of engaging in this specific CSR dimension, and built complementary assets around this dimension. This firm may have an accumulated, exceptional efficiency in engaging in similar rather than unrelated CSR dimensions (Hull and Covin, 2010; Sydow et al., 2009). Building on our earlier example of waste reduction, once a firm has gained control over its material flows and use of toxic chemicals in developing an environment-friendly manufacturing process (i.e. the environment dimension), it should be easier for the firm to apply this knowledge to enhance the safe and natural features of its products (i.e. the product quality and safety dimension). However, it may be much harder to apply the same knowledge to advocate for universal human rights.

In both time compression diseconomies and path dependence theory, the initial point is already given. Neither clearly states how the choice of different initial starting points can affect the following pattern (Vergne and Durand, 2010). *Asset mass efficiencies* focus on the original starting point of a process. This theory emphasizes that possessing high levels of an existing asset makes it easier to add increments to that asset. The underlying notion is that 'success breeds success': historical success translates into favourable initial asset positions, which in turn facilitate further asset accumulation (Dierickx and Cool, 1989). Asset mass efficiencies suggest that the starting point matters because a smooth start will generate a much higher chance for ultimate success than a difficult start, and a smooth start also boosts the confidence of a firm to pursue higher achievements. For example, it has been found that when companies first initiate CSR activities, they tend to model the successful examples in the same industry as these examples are more likely to prove to be an easy start (Jenkins, 2006). Thus, organizational leaders need to plan and accomplish every step in their CSR engagement strategy carefully, because each step will become the starting point for the next step.

Together, these theoretical perspectives help us to understand the workings of CSR engagement strategy. In the following section, we will explain our arguments to the effect that, to maximize the CSR's potential benefits, a firm must adopt a sensible pace, pursue related dimensions of CSR, adopt a consistent approach, and choose an appropriate entry point.

THEORY

Pace

As time compression diseconomies theory suggests, the pace of CSR engagement will affect how much benefit a firm can absorb from this engagement. The *pace* of CSR engagement refers to the increase in CSR engagement within a given period of time. CSR engagement can be expensive. For example, pollution prevention or control technologies and related management systems often require major investments

to update relevant organizational infrastructure and operational systems (Klassen and Whybark, 1999). Thus, when a firm engages in CSR too fast, there may not be sufficient time for the firm to develop complementary capacities or technologies in order to achieve the 'best practice' in environmental management (Christmann, 2000). Similarly, improving employee work environments and increasing employment diversity often require extra updates to current facilities or special efforts to find qualified minority employees, both of which add extra financial costs to firm budgets (Johnson and Greening, 1999). Engaging in CSR at a rapid pace, therefore, will put heavy financial burdens on a firm over a short period of time, with a slow payback. As a result, the organizational financial performance, particularly short-term performance, will be compromised.

Rapid engagement in CSR may also push past the limits of a firm's ability to fully use and understand these changes, i.e. exceed the firm's absorptive capacity (Cohen and Levinthal, 1990) or learning capability (Hull and Covin, 2010). In a recent study, for example, absorptive capacity was shown to be positively related to proactive environmental strategies that result in competitive advantage (Delmas et al., 2011). When too much CSR knowledge is developed over a short period of time, much will be left under- or even non-absorbed and the full benefits of the CSR engagement strategy will not be realized. To paraphrase our discussion of time compression diseconomies, if it takes one person 24 months to fully understand, appreciate, and use newly acquired CSR knowledge, that understanding and appreciation cannot be matched by 24 people in one month (Graves, 1989). The learning effects of a CSR engagement strategy are felt over a period of time and cannot be replicated overnight. Thus, the pace at which companies can effectively engage in CSR is ultimately constrained by a firm's absorptive capability.

In summary, a CSR engagement strategy involving rapid engagement may cause prohibitive financial costs, suboptimal absorption of CSR knowledge, and extra investments in complementary resources, all of which jeopardize the likelihood of a firm benefiting from its CSR activities. Thus, we hypothesize:

> *Hypothesis 1 (pace hypothesis)*: The pace of a CSR engagement strategy negatively moderates the CSR–CFP relationship. Specifically, the faster a firm upgrades its CSR ratings, the weaker the positive relationship between CSR and short-term financial performance.

Relatedness

Another important aspect of the change pattern is the differences or similarities of events (Cohen and Levinthal, 1990). The theory of path dependence suggests that the differences or similarities of involved events determine how many complementary assets need to be established and how complex must be the coordination work done among these events (Sydow et al., 2009). A firm needs to engage in related CSR dimensions in order to achieve synergies that increase the yield of the organization's resources (Ng, 2007; Penrose, 1959). When the same number of CSR dimensions is engaged but these dimensions involve significantly unrelated competencies, the number of incompatible

resources needed grows at a geometric rate, which can damage the potential contribu-
tions of the CSR to financial performance (Teng and Cummings, 2002; Whittington
et al., 1999) and make the absorption of knowledge more difficult than it would be if the
competencies were related (Hull and Covin, 2010; Lenox and King, 2004).

Thus, the *relatedness* of a CSR engagement strategy refers to the similarities in the
resources, skills, and knowledge required by the different CSR dimensions in which a
firm engages. CSR has a number of dimensions that may relate to different aspects of a
firm's operations, such as human relations (Windsor, 2006), product safety and quality
(Johnson and Greening, 1999), environmental performance (Christmann, 2000; Klassen
and Whybark, 1999), community relations, and employee rights. Each dimension needs
complementary resources to exhibit its best effect. For example, prior research has shown
that firms with complementary capabilities are more successful at implementing envi-
ronmental management programmes (Darnall and Edwards, 2006; Darnall et al., 2008).
Christmann (2000) also found that, to achieve a desired result from environmental
management and technology, firms need complementary assets such as capabilities for
process innovation and implementation. Lenox and King (2004) found that managers
could increase a firm's absorptive capacity by providing information to those implement-
ing pollution prevention initiatives, and were most effective in doing so when the
recipient already had knowledge that was moderately related to the new information.
Without such complementary capabilities and resources, a firm's ability to diversify
among different CSR aspects will be limited.

Thus, if CSR activities can be grouped into different categories according to the
differences and similarities in their requirements for resources, we argue that a firm
should try to engage in CSR activities that fall into the same category. The more
categories of CSR in which a firm engages simultaneously, the more different capacities
and resources are required from the firm. As a result, the more difficult it is for a firm
engaging in less-related or even unrelated CSR activities to improve its financial perfor-
mance (Marcus and Anderson, 2006). The environmental dimension, for example, needs
complementary skills in innovating and implementing new processes (Christmann,
2000). However, for the global human rights dimension, the needed complementary
skills may be lobbying experience with international organizations (Windsor, 2006). The
employee relation dimension often requires a strong cash flow and effective human
resources development planning. Therefore, when the resources required by CSR
dimensions are diverse, firms face a heavier burden than when those resources are
complementary.

An organization can be viewed as a bundle of resources that yield multiple uses
(Penrose, 1959). CSR activities that are related to each other and use complementary sets
of resources should produce synergies that increase the use of the organization's relevant
resources in a cost-efficient manner (Basu and Palazzo, 2008; Ng, 2007). Moreover, it is
easier for a firm to use know-how when it is applicable to multiple tasks within the
organization (Dierickx and Cool, 1989). When a CSR engagement strategy builds upon
an organization's similar experiences, path dependencies are leveraged to exploit the
further use of related resources in a more cost-efficient manner than when engaging in
unrelated CSR activities (Kor and Mahoney, 2000; Teece et al., 1999). As such, we
hypothesize:

Hypothesis 2 (relatedness hypothesis): The relatedness of a CSR engagement strategy positively moderates the CSR–CFP relationship. Specifically, when the CSR dimensions in which a firm engages are related, the positive relationship between CSR and the short-term performance will be stronger than when the firm engages in less related CSR dimensions.

Consistency

The consistency with which a firm engages in CSR may also have an impact on the CSR–CFP relationship. *Consistency* in CSR engagement indicates that a firm involves itself with CSR activities in a systematic and regular manner (Vermeulen and Barkema, 2002). A consistent pace of engagement helps firms to better and more strategically plan their CSR activities. Thus, path dependence theory suggests that firms that adopt CSR strategies with consistent engagement are able to accumulate and absorb CSR knowledge in an incremental manner, build complementary resources in a more systematic way, and convey to their stakeholders the image of serious and persistent CSR rather than an irregular, ad hoc approach to CSR (Husted and Salazar, 2006; Vergne and Durand, 2010). A consistent approach can do more to help the firm benefit from CSR than can an inconsistent approach.

Consistent CSR implementation can help ensure that knowledge is fully absorbed and consumed. Harlow (1959) found that if a practice regarding a particular type of problem was discontinued before it was reliably learned, little transfer would occur to the next series or step. Consistent implementation can also produce reliable and continuous starting points from which firms can engage in next steps, and enable firms to absorb the knowledge generated by CSR engagement. Conversely, when firms engage in CSR in an inconsistent, ad hoc manner, they face unexpected bursts of information caused by their jumps in CSR engagement separated by long pauses. During these pauses in CSR engagement, firms face the need to battle the loss of knowledge and, as a result, the CSR knowledge they have generated cannot be absorbed efficiently (Vermeulen and Barkema, 2002). A constant pace of change creates momentum and, over time, the skills to maintain that momentum (Eisenhart and Brown, 1998).

A consistent CSR engagement strategy can help firms plan how to finance CSR activities and how to build the complementary assets necessary to maximize the benefits of CSR. A consistent CSR engagement strategy also makes it easier for firms to keep their CSR activities in line with their overall strategies (Basu and Palazzo, 2008), which will facilitate resource allocation by clarifying the priorities among an organization's operational activities.

Lastly, a consistent CSR engagement strategy builds stakeholder confidence in the firm's commitment to CSR. Consistency, for example, may improve employee commitment by supporting the belief that CSR engagement is a persistent goal of the organization (Carmeli et al., 2007). Inconsistency suggests that the firm is engaging in CSR in an unplanned, random, or even opportunistic manner. It may give the impression that its CSR engagement is mere window-dressing, or a response to external pressure after the occurrence of a negative event (Frooman, 1999). As such, the firm will not be able to capture the full benefits of its CSR activities. Thus, for all these reasons, we hypothesize:

Hypothesis 3 (consistency hypothesis): The consistency of a CSR engagement strategy positively moderates the CSR–CFP relationship. Specifically, the more regularly a firm engages in CSR, the stronger the positive relationship between CSR and short-term financial performance.

Path

The *path* of a CSR engagement strategy features the entry point of a firm's CSR engagement strategy (i.e. the first CSR dimension(s) in which the firm engages) and the development of other CSR dimensions over time. We believe that a firm can start its CSR engagement strategy either internally (e.g. focusing on employee policies, diversity, and corporate governance) or externally (e.g. focusing on environmental performance or product safety) to the firm. The argument over the entry point of CSR engagement, to a certain degree, reflects the argument between instrumental CSR and normative CSR. Those supporting instrumental CSR believe that firms should only engage in CSR activities that directly contribute to their financial performance (Wiener, 1982), while normative scholars do not view the instrumental approach as genuine CSR and believe that important stakeholders will discredit the pragmatism of instrumental CSR and reward firms that devote time and resources to CSR solely because they care more for social welfare than the pure financial return of their own firms (Weaver et al., 1999). The external CSR dimensions, similar to instrumental CSR, deal with such external stakeholders as customers and regulators, are more visible to the public and thus have a more direct impact on firms' reputations. The internal issues mainly deal with stakeholders internal to a firm, such as employees and governance; the social benefits of which are generally much less visible to the public, making pursuing these issues comparable to normative CSR. Although intuitively, engaging in external CSR should have a bigger impact on CFP than internal CSR, as external CSR is closer to the public's perception of the company's reputation, it is worth noting that so far, it is still inconclusive which approach can generate better CFP for firms (Basu and Palazzo, 2008).

From an absorptive capacity perspective, the entry point of CSR engagement is important because, as asset mass efficiencies suggest, an easy or smooth start can, in addition to increasing the organization's knowledge base regarding CSR, enhance its *confidence* in its capability to handle CSR activities, making future successes in CSR engagement more likely (Dierickx and Cool, 1989). We believe that when firms start with internal CSR, the financial returns will be different in three important ways than when firms start with external CSR. First, internal CSR is more in the company's span of control than external CSR. Second, internal CSR involves activities that can enhance performance related to external CSR, more so than vice versa (Basu and Palazzo, 2008; Carmeli et al., 2007; Cole et al., 2010; Roberts, 2003). Lastly, internal issues are indicative of a firm's true commitment to social issues, i.e. whether they are willing to 'practice what they preach'.

Time compression diseconomies and asset mass efficiencies suggest that firms find an easy, smooth start in order to benefit from CSR activities. Compared to dealing with stakeholders outside the firm (e.g. community, governmental or legal department), it is easier for firms to deal with the comparatively more familiar stakeholders within the

company (e.g. employees). Organizations in general have more knowledge and control of their internal management systems than they do of factors outside the organization. By starting with internal CSR, a firm has a chance to learn how to handle CSR issues when it has more control of these issues, and failures should incur relatively lower and more manageable costs than those relating to external issues that are customer- or regulator-related. In addition, because the stakeholders involved are all internal, knowledge absorption will be concentrated within the firm rather than dissipated across multiple organizations. Thus, starting with internal CSR should increase the likelihood of successfully handling external CSR activities and improving performance at the same time.

   A starting point focused on internal CSR issues also ensures that the company has the internal capabilities needed to make future successes more likely as it pursues external CSR activities. These internal activities allow CSR to be integrated into employees' day-to-day activities, something that is essential for a more normative commitment to CSR, rather than a more instrumental one (Basu and Palazzo, 2008). The normative commitment often helps to boost the employees' morale and productivity for a longer term than is the case with the instrumental commitment. Cole et al. (2010) and Carmeli et al. (2007) found that employee perceptions of internal CSR lead to increased organizational identification and thus harder work on behalf of the organization's goals. It seems reasonable that employees so motivated by a perceived normative commitment to internal CSR would be more receptive to absorbing CSR-related knowledge and skills than employees who perceive their organization to have an instrumental commitment to external innovation. A successful engagement strategy that first focuses on internal aspects of CSR can lead to a positive prospect of external CSR, more so than vice versa. Prior research has shown how proactive human resource practices contribute to improved overall social performance (Rothenberg and Hull, 2008). Also, consumers have been shown to differentiate among motives for CSR activity, responding negatively to efforts perceived as stakeholder driven rather than values driven (Ellen et al., 2006). On the contrary, firms that initially focus on external stakeholders, such as responding to an environmental crisis, may boost their market value temporarily (Klassen and McLaughlin, 1996); this benefit will evaporate quickly if the resulting knowledge and capacity are not internalized into the organization's operations and routines (Cohen and Levinthal, 1990). In other words, the firm still needs to engage its internal stakeholders to gain the full benefit of this initial external response. In fact, it is believed that a focus on internal issues is essential 'for the integration of responsible corporate process into organizations' everyday activities' (Weaver et al., 1999, p. 550). CSR activity driven by external pressures is likely to lead to less integrated CSR and can easily be decoupled from the firm's day-to-day practices (Basu and Palazzo, 2008). Thus, an initial focus on internal stakeholders allows a firm to build its internal capacities first, which in the long run can help the firm respond more effectively to external stakeholders' requirements.

   This internal-to-external approach also signals to consumers and employees that a firm is acting for the 'right' reasons, which can help a company to build a lasting, trusted relationship with external stakeholders and eventually lead to a better economic return than the other way around. It would be hard to imagine that a firm is genuine about its moral obligations to a society when it is generous in making donations to charity, but shies away from providing appropriate benefits to its own employees. In fact, research

has shown that labour practices in a company are one of the most salient aspects of CSR to consumers (Araña and León, 2009). Janney and Gove (2011) also found that the public especially considers a company's standards on such internal issues as corporate governance as a major indicator of whether the company is hypocritical in engaging CSR. Summarizing the above arguments, we hypothesize:

> *Hypothesis 4 (path hypothesis)*: The path of a CSR engagement strategy moderates the CSR–CFP relationship. Specifically, the CSR–CFP relationship will be stronger for firms engaging in CSR by following the path from internal dimensions to external dimensions than it will for firms engaging in CSR by following the external-to-internal path.

METHODOLOGY

Sample and Data Collection

We collected our sample from the Environmental, Social and Governance factors (ESG) database provided by Morgan Stanley Capital International (MSCI). MSCI ESG Indices are the continuation of indices developed over the past 20 years by Kinder, Lydenberg, and Domini (KLD), which became part of MSCI following MSCI's acquisition in June 2010 of RiskMetrics, which had acquired KLD in 2009. For each year beginning with 1991, this database provides data on a collection of approximately 650 companies that comprise the Domini 400 Social SM Index and S&P 500®. MSCI ESG, then KLD, expanded its coverage in 2001 to include all companies on the Russell 1000®. In 2003, they added full coverage of the Russell 3000®. This database includes seven major dimensions: Corporate Governance, Diversity, Employee Relations, Community, Environment, Human Rights, and Product, which are also the most commonly investigated dimensions in previous studies. As do most CSR studies, our paper focuses only on these seven major dimensions, which we hope can provide an easy basis for readers to compare our results with previous similar studies. Our results are based on measures consistent with those used in other studies that use the MSCI ESG dataset (e.g. Hull and Rothenberg, 2008; McWilliams and Siegel, 2000; Waddock and Graves, 1997).

For some of these dimensions, a few items have been changed since 1995: gay and lesbian policies for Corporate Governance; property, plant and equipment for the Environment dimension; and positive record in South Africa, Burma concern, and Mexico for Human Rights. We thus set our data collection period from 1995 to 2007 to avoid unbalanced variance caused by different numbers of items within a dimension across time periods in the panel data analysis.

Two hundred and thirty-nine firms with complete data were identified. We matched this dataset with the companies' financial data from the Compustat database. Because Compustat has limited research and development (R&D) data, the sample size was reduced to 130 firms with complete MSCI ESG and financial data. One of our key variables is the consistency of a CSR engagement strategy, and each consistency score requires at least four years of CSR values to compose. This reduced the analysis period from 1995–2007 to 1998–2007. We thus have 130 firms in the final sample with a

10-year analysis period for each firm, and the total number of cases is 1300. We conducted ANOVA to examine if including R&D creates any selection bias. The analysis found that the sample with R&D data has significantly higher Return on Assets (ROA), CSR, Pace, Relatedness and more slack resources than the sample excluded for missing R&D data. There is no significant difference of Consistency and Path between these two samples. In order to understand the implications of this selection bias, we later conducted the same analysis on the whole sample as well, as is described in the Robustness Checks section.

Measures

Corporate social responsibility (CSR). The CSR dimensions included in this study are the seven dimensions as mentioned. We adopted the same composite measure as that employed by Hull and Rothenberg (2008). They first measured each dimension score by the difference between the summed value of each dimension's strengths and the summed value of the dimension's concerns, and then formulated the CSR measure by calculating the average of the seven dimensions. Thus, in this method, the dimensions with many distinct items – meaning more aspects of this dimension need to be taken into consideration – receive proportionally greater weight than those that have fewer items. This continuous index of CSR provides more information than the dummy variable composed by McWilliams and Siegel (2000) and it can be more easily reproduced than the weighted index described by Waddock and Graves (1997), although the weights they describe correspond well with this index. This CSR measure has been verified to produce consistent results with such prior studies as Waddock and Graves (1997) and McWilliams and Siegel (2000), and can thus be considered robust and reliable.

Pace. Pace indicates how quickly a firm adopts CSR principles into its operations and how rapidly a firm develops CSR behaviours. The faster a firm engages in CSR, the more change in its CSR will appear in a short period of time. Please be aware that in this project, we measure the pace of a firm's CSR engagement strategy by its actual pace, i.e. the actual speed at which the firm achieves CSR. This pace should be related to but different from the pace at which a firm intends to engage in CSR. A firm may speed up its investment in CSR activities with the intention to increase the pace of CSR engagement, but such an investment may or may not increase the actual CSR pace. Whether such an investment can produce the intended effect depends on a variety of factors. For example, a firm may increase its investment in pollution control technologies, but whether such technologies can really produce the expected outcome also depends on whether the firm has such complementary assets as management know-how and capacities (Christmann, 2000). We thus measure the pace of the real improvement of a firm's CSR rating, which should comprehensively include all the necessary efforts made by the firm in order to make such an improvement happen.

We calculate the pace at which a firm pursues CSR by subtracting the average of its CSR scores for the prior three years from its current CSR score. This value reflects how quickly a firm has improved its CSR beyond the average level for the past three years. Thus, it captures a firm's CSR pace for each year. The higher the value, the faster the

pace at which the firm is engaging in CSR. We name this variable $Pace_1$. In order to cross-validate this measurement method, we also created $Pace_2$ by subtracting the average of a firm's CSR scores for the prior two years from its current CSR score. $Pace_2$ will be later entered into analysis to replace $Pace_1$ and the consistency of the results will indicate if our findings are robust to the three years or two years chosen as the measurement period.

Relatedness. This variable captures the degree to which the CSR dimensions in which a firm engages are related to one another. There are no prior studies that address the degree to which CSR dimensions are related. Most studies treat all CSR dimensions as independent parts of an aggregated CSR rating (e.g. Hull and Rothenberg, 2008; McWilliams and Siegel, 2000; Orlitzky et al., 2003; Russo and Fouts, 1997; Waddock and Graves, 1997) and the relationship of these dimensions has rarely been examined. In this paper, adopting Tang and Hull's (2011) method for measuring strategy relatedness, we compose the relatedness measure based on the correlations of these dimensions. We first calculated the Pearson correlations of the seven CSR dimensions in the 10-year period. These correlations reflect the overall correlation of each dimension with the other dimensions across the 10 years and were thus used to weigh each dimension's relatedness with the other dimensions. We then created seven variables to capture each dimension's relatedness with the other dimensions by summing the products of its correlations with all other dimensions' scores. We summed the seven variables to derive the relatedness variable, which indicates, for any given firm, how related to one another its CSR activities are. When a firm's activities fall into closely related categories of CSR, the value of this measure will be high. When they fall into categories less related, the firm's relatedness score will be low.

Consistency. This variable reflects whether a firm's changes in CSR over time are systematic, regular and consistent, or random and irregular. Following Vermeulen and Barkema's (2002) work, we measure CSR consistency by the kurtosis of a firm's CSR scores over time. As the CSR score records what a firm has achieved in a given year, a large kurtosis value indicates large peaks interspersed with significant inactive periods in CSR engagement, indicating that the firm engages in CSR activities irregularly, or inconsistently. A low kurtosis value, however, indicates that a constant, regular, consistent pattern is adopted by the firm in engaging CSR. We created two consistency variables to cross-validate each other. Both variables were calculated as described above but with different starting years. $Consistency_1$ starts in 1995 and $Consistency_2$ starts in 1996. When both variables generate similar results in the analysis, it indicates that no matter when a firm starts to engage CSR, the consistency of this engagement has important implications for its financial performance. In our final analysis, we use $Consistency_1$ for greater statistical power.

Path. The path variable indicates whether a firm engages in internal or external CSR dimensions first. To evaluate the path of the CSR engagement strategy, we categorized the seven CSR dimensions into two groups. The group related to stakeholders within the organization includes Corporate Governance, Diversity, and Employee Relations. The

group related to stakeholders outside the organization is made up of Community, Environment, Human Rights, and Product. We then created a dummy variable for each CSR dimension to indicate whether a firm has a net positive contribution to that dimension: '1' if it scores above 0 and '0' if otherwise. The score for internal CSR is the average of the Corporate Governance, Diversity, and Employee Relations dummies, and the score for external CSR is the average of the Community, Environment, Human Rights, and Product dummies. If a firm's internal CSR score is higher than its external CSR score, it focused on internal dimensions in that year. If its external CSR score is higher than its internal CSR score, it focused on external dimensions in that year. A firm that spends its first continuous three years focused on internal CSR is considered to be on the internal-to-external path, and is coded as 1. A firm that spends its first continuous three years focused on external CSR is considered to be on the external-to-internal path and is coded as 0. The logic is that when a firm has engaged in internal or external CSR dimensions consistently for three years, it has been strongly committed to these dimensions. We name this variable $Path_1$. Again, we created two other path variables. $Path_2$ uses the first two years and $Path_4$ uses the first four years as the criteria to code the variable.

Performance. As do most studies in this field, and in order to be able to compare our findings with prior findings, we employed ROA to measure firm financial performance.

We also controlled for the following variables that have been verified to affect the CSR–CFP relationship. The first variable is *Slack*. Organizational slack is 'a cushion of actual or potential resources which allow an organization to adapt successfully to internal pressures for adjustment or to external pressures for change in policy, as well as to initiate changes in strategy with respect to the external environment' (Bourgeois, 1981, p. 30). Prior research has shown that slack has a positive impact on social performance (Bowen, 2002; Sharma, 2000). The more slack resources a firm has, the more it can spare for a fast adoption of CSR and the more easily it can engage in multiple CSR dimensions. We controlled for organizational slack by including the ratio of long-term debts to total capital in our model (Chatterjee, 1990; Reuer and Ragozzino, 2005; Singh, 1986). The smaller the ratio, the less need for a firm to go outside for funding, implying that it has more slack. Thus, this ratio is an inverse measure of organizational slack.

R&D investment. Recently, R&D has been verified as an important contingent factor that affects the CSR–CFP relationship (Hull and Rothenberg, 2008; McWilliams and Siegel, 2000). R&D activities can compete with CSR activities for limited resources. More importantly, R&D investment potentially enhances the organization's capability to differentiate itself from competitors and thus undermines the need to invest in CSR as a differentiation factor. R&D is highly correlated with CSR, making it difficult to measure the effects of CSR in highly innovative companies. Thus, CSR most strongly and visibly affects firm performance in low-innovation firms (Hull and Rothenberg, 2008). We included R&D investments weighted by firm total assets to control for such an effect in our model.

Firm size. Larger firms may have a stronger motive to engage in CSR activities. They may want to lead the industry or avoid becoming a target for government regulations or

NGO campaigns. Larger firms may also be better able to handle complicated, fast CSR engagement strategies, as they are more familiar with diversified operations. We thus included the logarithm of total assets in our model to control for the effects of firm size.

Industry effect. Our sample is composed of firms in various industries, and ROA can be affected by industry growth rate and the instability of such a growth rate. The munificence of a high growth industry can make up for low organizational slack, allowing firms to more easily adopt a fast pace of CSR or engage in multiple CSR dimensions. But firms in industries with unstable growth rates may need to preserve their resources against future scarcity, and spend fewer resources on CSR activities. Based on Palmer and Wiseman's (1999) work, we calculated the three-year moving average of industry sales and net income growth rate by using Compustat data, with industry identified by the first three SIC digits. We then calculated the three-year standard deviation of these two growth rates to gauge the instability of industry growth. The industry growth and industry stability variables included in the model are calculated, respectively, by averaging the two growth rates and the two instability items.

ANALYSIS AND RESULTS

We applied Hausman–Taylor modelling (HTM) to estimate the hypothesized relationships. We chose HTM over fixed-effect (FE) modelling because Path is a time invariant variable in our model as every firm has only one starting point. In FE modelling, time invariant variables, already a fixed effect variable across years, will be automatically excluded from the analysis. But HTM allows us to eliminate the bias in parameter estimates stemming from endogenous unobserved effects (Hausman and Taylor, 1981) and thus, it can provide an estimate for time invariant variables. Hence, HTM allows us to include Path in our analysis.

Means, standard deviations, and correlations of the relevant variables for this study are summarized in Table I. ROA has a positive relationship with CSR ($r = 0.12$). This observation echoes the finding in previous meta-research on the CSR–CFP link that *in general*, CSR has a mild positive contribution to firm performance (Margolis et al., 2009). We also found that some CSR engagement strategy variables are correlated with each other. Path and Relatedness are associated at 0.25, suggesting that firms engaging in internal CSR first are likely to engage in closely related CSR dimensions. Exploring the relationships among CSR engagement strategy constructs should be a promising area for future research.

Table II presents the panel data analysis results. Model 1 includes the organizational and industrial covariates. As expected, ROA is negatively related to the ratio of long-term debt to total capital ($B = -0.04$, $p < 0.000$), indicating a positive relationship between organizational slack and organizational performance. ROA is also negatively related to R&D investment adjusted by total assets, indicating that when a firm spends resources on R&D activities, its short-term performance suffers ($B = -232.47$, $p < 0.000$). Industry growth has an expected positive and significant relationship with ROA ($B = 0.11$, $p < 0.05$) and industry instability has a negligible effect on ROA ($B = 0.00$, $p > 0.1$). Model 2 adds CSR into the model. CSR is positively related to ROA ($B = 15$,

Table I. Means, standard deviations, and correlations

		1	2	3	4	5	6	7	8	9	10	11
Mean		7.36	0.01	14.91	31.03	0.78	0.07	1.10	0.17	0.17	0.06	0.58
SD		7.16	0.02	0.38	40.30	4.69	2.23	3.24	1.70	0.25	2.24	0.49
1.	ROA											
2.	R&D	-0.35***										
3.	lgAssets	0.03	0.00									
4.	Slack	-0.30***	-0.13***	-0.03								
5.	Industry instability	-0.03	-0.01	-0.00	0.00							
6.	Industry growth	0.03	-0.02	0.01	-0.02	0.24***						
7.	CSR	0.12***	0.11***	0.04	-0.02	0.01	0.05†					
8.	Pace$_1$	0.07**	0.06*	0.07**	0.01	0.00	0.08**	0.54***				
9.	Relatedness	0.09***	0.08**	0.05**	0.02	0.02	0.06*	0.65***	0.39***			
10.	Consistency$_1$	0.01	0.03	0.02	-0.04	0.03	0.05†	-0.02	0.03	-0.01		
11.	Path$_1$	0.02	-0.04	0.02	0.07**	-0.04	0.06	0.23***	0.08**	0.25***	0.06*	

Note: † $p < 0.10$; * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$, two-tailed test.

Table II. Hypothesis test results

	Dependent variable = ROA					
	Model 1		Model 2		Model 3	
	B	SE	B	SE	B	SE
R&D	−232.47***	11.99	−234.06***	12.01	−231.75***	11.93
lgAssets	0.17	0.34	0.15	0.34	0.11	0.33
Slack	−0.04***	0.00	−0.04***	0.00	−0.04***	0.00
Industry instability	0.00	0.03	0.00	0.03	−1.25**	0.46
Industry growth	0.11*	0.06	0.11*	0.06	1.05**	0.43
CSR			0.15*	0.08	−0.08	0.12
$Pace_1$					0.20*	0.13
Relatedness					−0.05	1.30
$Consistency_1$					0.08	0.07
$Path_1$					−0.02	0.86
CSR*$pace_1$					−0.00	0.02
CSR*relatedness					0.42*	0.25
CSR*$consistency_1$					−0.06**	0.02
CSR*$path_1$					0.34*	0.17
Specification test	95.95		80.78		532.30	
Prob.	0.000		0.000		0.000	
rho	0.48		0.49		0.49	
No. of observations	1300		1300		1300	
No. of groups	130		130		130	

Notes: * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$, one-tailed test.
Model 1 and Model 2 do not have time invariant variables and thus, Hausman–Taylor modelling does not apply. We apply fixed-effect modelling to these two regressions and present the results for readers' reference.
B is the marginal effect coefficient, which indicates how much variance in the dependent variable is caused by a change of one unit in the independent variable.

$p < 0.05$), which verifies that CSR positively affects financial performance. Model 3 tests the moderating effect of Pace, Consistency, Relatedness, and Path on this positive relationship. The interaction item CSR*$Pace_1$ has a negative relationship with ROA, as expected, but it is non-significant (B = −0.00, $p > 0.1$). Hypothesis 1 is thus not supported. The interaction term CSR*Relatedness has a significant, positive relationship with ROA (B = 0.42, $p < 0.05$), indicating that, as expected, when a firm engages in related rather than unrelated CSR dimensions, the positive contribution of CSR to ROA will be enhanced. Thus, Hypothesis 2 is supported. CSR*$Consistency_1$ has a significant, negative relationship with ROA, indicating that an inconsistent approach to CSR will hurt firm performance (B = −0.06, $p < 0.01$). Thus, Hypothesis 3 is supported. CSR*$Path_1$ has an expected positive relationship with ROA (B = 0.34, $p < 0.05$), meaning that if a firm pursues internal CSR first rather than external CSR, firm performance is improved. Thus, Hypothesis 4 is supported.

We present the moderation diagrams in Figures 1–4. Figure 1 shows that whether a firm adopts CSR slowly or quickly, the CSR–ROA relationship is not affected, though
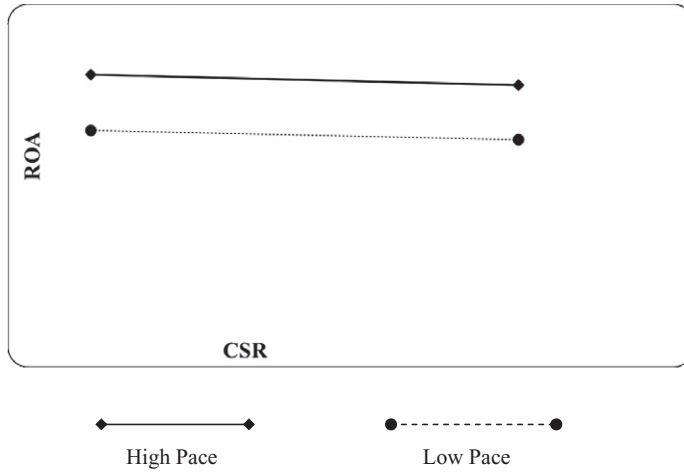
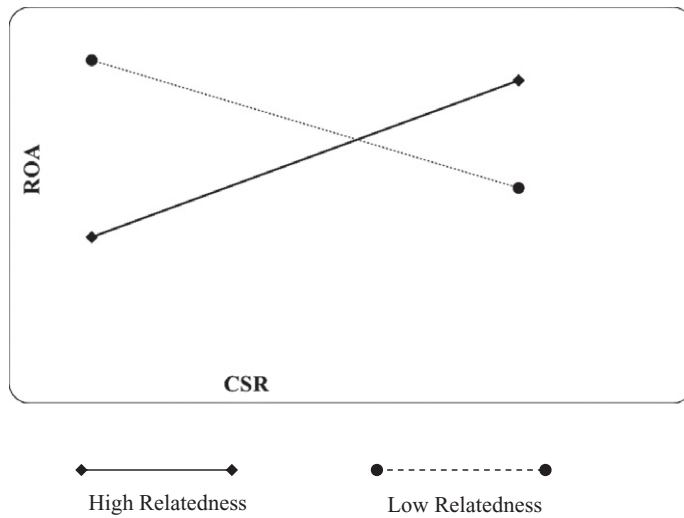Figure 1. The moderating effect of pace

Figure 2. The moderating effect of relatedness

the intercepts are at different levels. Figure 2 shows that when a firm engages in CSR in a related manner, ROA is higher than when it engages in CSR in an unrelated manner. The moderating effect of consistency on the CSR–ROA relationship is also clear, as shown in Figure 3. When the CSR engagement strategy is consistent, firm financial performance benefits greatly. When the firm's CSR engagement strategy is not consistent, performance suffers. Figure 4 shows that if a firm engages in internal CSR first, then moves to external CSR, firm performance will benefit, but ROA will suffer if the firm adopts the reverse path. These four figures illustrate the above findings that Hypothesis 2 (relatedness hypothesis), Hypothesis 3 (consistency hypothesis) and Hypothesis 4 (path
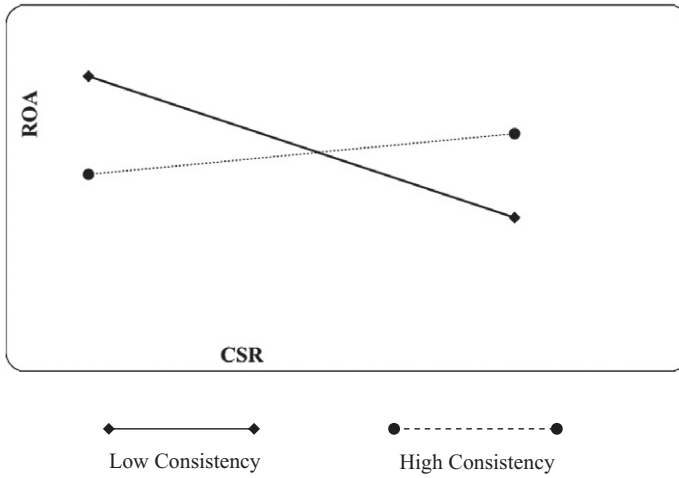
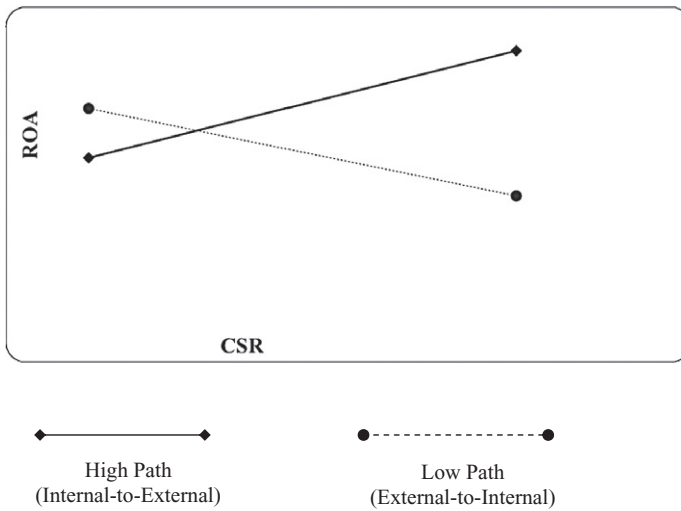Figure 3. The moderating effect of consistency

Figure 4. The moderating effect of path

hypothesis) are supported by the longitudinal data, while Hypothesis 1 (pace hypothesis) is not.

When interpreting the practical implications of our findings, it is worth noting that our measures are based on the subjective evaluation by MSCI ESG, which is based on the arithmetic sum of a series of dummy variables. When assessing the practical meaning of such subjective measures, it is often hard to say exactly how much a firm should do in reality in order to improve its CSR evaluation from 1 to 2 or how much damage a firm has to do to be downgraded from −1 to −2. When interpreting test results based on such measures, trying to put an exact meaning on 'one unit of change' can be futile and the

meaning often varies from firm to firm. Thus, in this type of study, the key finding is the trend of a change rather than the absolute unit of the change. Applying this logic to our study, the important implications for scholars and managers are that when a firm engages in CSR, it should pursue related CSR activities that share common resources, engage in these activities in a planned and consistent manner, and build up the internal dimensions first.

ROBUSTNESS CHECKS

We conducted various analyses to examine the robustness of our estimation. The first analysis is to examine if our choice of the three-year period will produce any bias versus measures that employ a two-year or four-year period and if our choice of 1995 as the starting year, due to the data limitation, creates a bias versus when a different year is chosen as the start point. As mentioned, compared with $Pace_1$, $Pace_2$ is calculated using a two-year period instead of the three-year period. Compared with $Path_1$, which employs a three-year period in the calculation, $Path_2$ uses a two-year period and $Path_3$ uses a four-year period. Compared with $Consistency_1$, which starts the calculation in 1995, $Consistency_2$ starts in 1996. We replaced the original measures in Table II with these alternative measures and the results did not change. This indicates that our measures are strong representatives of what we plan to measure and the findings are robust to the research period and measurement period that we have chosen.

We then examine if the high correlation between CSR and Relatedness ($r = -0.65$, $p < 0.001$) creates multicollinearity problems that potentially contaminate our findings. We dropped each of these two main effect variables and reran the analysis, and the findings were unchanged. Similarly, the correlation between CSR and $Pace_1$ ($r = 0.54$, $p < 0.001$) also raises multicollinearity concerns. However, deleting either of them does not change our findings, so multicollinearity is not an issue with these findings. The variance inflation factor (VIF) values in our final report are lower than 3.54, far less than the 10 threshold (Perrini et al., 2007).

Third, as mentioned, although the inclusion of the R&D variable has been strongly advocated by CSR scholars (e.g. Hull and Rothenberg, 2008), it reduces our sample from 239 firms to 130 firms and may also create selection bias because R&D may be more important in certain industries than in others (McWilliams and Siegel, 2000). We thus conducted the same analysis in the whole sample, excluding the R&D variable. The findings hold for the moderation effect of Pace, Consistency, and Path. The moderating effect of Relatedness is still positive as expected, but not statistically significant ($B = 0.15$, $p = 0.52$). This indicates that the inclusion of R&D can sufficiently change the dynamics between CSR strategy variables and ROA, and the inclusion of R&D should not be neglected by CSR scholars.

Fourth, as mentioned, the CSR–CFP relationship can be very industry-specific (Brammer and Pavalin, 2006). Prior scholars have argued that the difference in industry growth and volatility creates the variance in the CSR–CFP strength (Russo and Fouts, 1997). In a fast growing and less volatile industry, it is easier for firms to draw upon external resources to build necessary capabilities and fully absorb the financial benefits of a CSR engagement strategy. We thus controlled for these industry effects in our model.

In order to cross-validate the impact of the industry sectors, we coded two dummy variables, manufacturing industry and service industry, with '1' indicating that the firm belongs to either industry and '0' otherwise. The default industry is the agriculture industry. We then controlled for these two dummy variables instead. Our findings remained the same and hence, the findings are robust with respect to industry.

Fifth, we conduct a fixed-effects (FE) model to test the hypothesized relationships to provide a reference for our readers. Although FE excludes Path in its modelling, this exclusion, due to the nature of FE modelling, should not affect our estimation regarding other variables, including the interaction items composed by time invariant variables (Egger and Pfaffermayr, 2004). We chose the FE model over the random-effects (RE) model for our robustness test because we have no reason to assume that there may be omitted individual specific effects uncorrelated with the independent variables included in our model. Although the RE model can produce more efficient estimates, in this case, the FE model can give more conservative estimates. Statistically, FE modelling is always reasonable with panel data because it gives consistent results. We performed the Hausman test to compare the results of FE and RE modelling on our hypothesized relationships. The Hausman test checks a more efficient model, RE, against a less efficient but consistent model, FE, to see if the more efficient model also gives consistent results. The p-value indicated by the test, $\text{Prob} > \text{chi}^2$, was 0.008, much less than 0.05, indicating that the RE model does not give consistent estimates for our model. The FE model is thus a better modelling tool in this case. We reran the tests in Table II and the findings are the same. Thus, our findings are robust even when we adopt a rather conservative analysis method.

Lastly, we ran the finite distributed lag (FDL) model to examine if there are long-term effects of any of our CSR variables on ROA. FDL is a panel analysis model that predicts the current value of a dependent variable based on both the current value of an explanatory variable and the lagged (past period) values of this explanatory variable (Wooldridge, 2008). We estimated the prediction of the current value, one-year lagged value, and two-year lagged value of R&D, CSR, $Pace_1$, Relatedness, $Consistency_1$, and $Path_1$ and the moderation items on ROA. None of the CSR-related variables and moderation items has a statistically significant long-term effect on ROA, but the effects of their current values on ROA are significant and in the direction we have identified, which further shows the robustness of our findings with the presence of lagged effects of explanatory variables.

CONCLUSION AND IMPLICATIONS

For decades, scholars have hoped to show that there is a financial motive for for-profit organizations to engage in CSR (McWilliams and Siegel, 2000; Orlitzky et al., 2003; Russo and Fouts, 1997; Waddock and Graves, 1997). It is widely believed among RBV scholars that CSR engagement adds both tangible (e.g. 'best practices'; Christmann, 2000) and intangible (e.g. reputation; Margolis et al., 2009) assets to a firm; thus, it improves the firm's bottom line. However, the findings are notoriously mixed. Increasingly, scholars are broadening the scope of their attention from a focus on exogenous factors and are including endogenous ones, arguing that the strength or even the

direction of the CSR–CFP link is subject to the complementary resources and capabilities of the specific firm (Arya and Zhang, 2009; Christmann, 2000; Darnall and Edwards, 2006; Darnall et al., 2008). Building on this research stream, we explore how, given external and internal constraints, a firm can engage in CSR strategically in order to maximize the benefit of its CSR activities. Our paper is thus consistent with Basu and Palazzo's (2008) call for a focus on the details of CSR rather than on other variables which might interact with CSR to affect financial performance. Margolis and Walsh (2003) also made a similar call for studies to go beyond the 'what' to the 'how'.

In responding to these calls, we designed this study to discover whether the pace, consistency, relatedness, and path of a firm's CSR – its CSR engagement strategy – alter the CSR–CFP relationship. It is important to recognize that CSR engagement strategy matters, that stakeholders who care about CSR notice details (Basu and Palazzo, 2008), and that details of how a firm engages in CSR will affect its ability to absorb the knowledge and skills that accompany that engagement. Whether a firm engages in CSR in a predictable or erratic pattern, whether it concentrates its CSR efforts or disperses its CSR engagement in many directions, whether it tends to lower-profile internal matters before turning to flashier external matters – all these components of its CSR engagement strategy affect the firm's financial performance. Alternatively, it could be argued that some of these components affect the impact of the firm's CSR on the firm's cost efficiency (Christmann, 2000; Porter and Kramer, 2006) in addition to, or instead of, affecting the credibility or relevance of the CSR to external stakeholders. Determining which is outside the scope of the current project: the purpose of this study is to evaluate if a CSR engagement strategy affects the impact CSR has on financial performance, not to delve further into our understanding of how CSR has that impact on CFP. However, that we do not explore the precise nature of how different components of a CSR engagement strategy interact with exogenous variables is clearly a limitation of this study that needs to be addressed in a future study.

We note some further limitations. Because of missing data, the sample shrank to 130 firms. The benefit of this is that our sample contains only firms having complete data across the analysis period. Thus, our conclusions can be applied to the sample firms without concern for the effects of missing values. It is clear, however, that our conclusions may not apply as well to firms for which complete data for this period are not available. It is worth noting that in some industries (e.g. banking, retail), R&D is not as important as in others (e.g. consumer electronics). When the R&D-value is missing, it does not always necessarily mean that the firm missed reporting their R&D activities, but may mean simply that there is none. However, we are not able to differentiate this case from the true missing values. Thus, we are forced to stay with firms with complete data. Second, prior study indicates that current CSR has a stronger relationship with current CFP than with later CFP (Orlitzky et al., 2003), which is also what we have found in the robustness checks. This concurrent CSR–CFP link certainly raises concerns regarding ambiguity in the causal relationship between these two variables. Third, the measures of CSR engagement strategy have room to improve. Due to the lack of longitudinal data on organizational investment, we could only measure CSR engagement strategy features through actual CSR activities rather than attempts. For example, we measure relatedness by the correlations of CSR dimensions across 130 firms over 10 years. Lacking prior

studies' support, we have to assume that in the long term (i.e. 10 years), firms that engage in related CSR dimensions are more likely to succeed. Thus, a strong correlation between two CSR dimensions across multiple industries and over a long period should indicate that these two dimensions are more related than unrelated. Our empirical analysis seems to support this assumption. The highest correlation is between Community and Diversity ($r = 0.33$, $p < 0.001$), both emphasizing fairness issues, with one focusing on outside the firm (i.e. Community) and the other focusing on inside the firm (i.e. Diversity). Corporate Governance and Environment are barely correlated ($r = 0.01$, $p > 0.05$), reflecting the significantly diverse skills and knowledge required of a firm. Although we feel that the empirical findings seem to support this approach, directly measuring the relatedness in the skills and knowledge required by different dimensions would certainly be an improvement. Another example is that, due to the limitations of the data, we have to assess Path based on the criteria used by the MSCI ESG database. Although to a large extent this database allows us to identify the dimensions that are meant to please the internal or external stakeholders, this database is not *specifically* designed in such a way. A company survey should be able to provide a more accurate assessment of a company's CSR engagement strategy. Lastly, as mentioned, we build our argument that firm performance is affected by how firms engage in CSR – by their CSR engagement strategies – on the premise that stakeholders will respond favourably to CSR engagement. This premise can be challenged from case to case. For example, competitors may produce a 'race to the bottom' – a progressive spiral of deregulation and continuously eroding ethical standards (Williamson et al., 2006) and in low income countries, customers may favour affordability over CSR features (Tang and Tang, 2012). While prior studies have established that stakeholders generally favour CSR engagement from firms, more work can be done in this area. For example, we suggest that the consistency of the CSR engagement strategy affects stakeholder perceptions, and thus financial performance. This is something that could be tested more specifically in a study that focuses on exogenous variables.

Managerial Implications

We found that when a firm engages in CSR in an inconsistent manner, its financial performance suffers. This finding is a warning to firms that dress up their operations with occasional CSR activities. Stakeholders do not perceive such token gestures as genuine and thus, the expected benefits rarely materialize. To make matters worse, an inconsistent approach disrupts the learning process, and long inactive periods hurt the firm's ability to absorb CSR knowledge. Finally, because the company's financial performance suffers as a result of these sporadic, potentially half-hearted forays into CSR, its managers are conditioned to avoid full-scale commitment to CSR, as their experiences teach them – falsely – that CSR hurts financial performance. Thus, 'bad' firms have little hope of ever engaging properly in CSR and enjoying the benefits of well-managed CSR. Managers seeking to help their bottom line should grasp the nettle firmly and engage full-throttle and constantly in CSR. Anything less may worsen the performance.

Another important managerial implication has to do with the relatedness issue: it is better to specialize in one or more closely related areas of CSR at a time than to try to

pursue all of them at once. When a firm pursues two drastically different dimensions, the firm may have trouble allocating enough resources to both of them and absorbing the different sets of skills and knowledge associated with them. These difficulties hurt both their effectiveness and their likelihood of turning a profit, but pursuing two related dimensions helps profits (see Figure 2). Finally, our study indicates that the more effective approach to pursuing CSR is to start with internal dimensions and to work outward from those once they have been mastered. Thus, managers are advised to take care of 'internal' dimensions such as Governance, Diversity, and Employee Relations before 'external' dimensions such as Community, Environment, Human Rights, and Product. Pursuing CSR internally first gives the firm more control. Uncertainty is limited, and potential damage can be more easily controlled; thus, it is easier to succeed. Initial success breeds future successes, making the transition from internal to external dimensions easier than the other way around. Internal CSR activities involving Governance, Diversity, and Employee Relations help the firm build the internal loyalty and morale necessary for sustainable success in CSR exploration. Given these reasons and our findings, we believe practitioners are well-advised to focus on internal CSR first.

Thus, in summary, managers are advised to pursue a CSR engagement strategy that starts with an internal focus, specializes in related aspects of CSR, and is consistent and reliable over time. It is hoped that further research in this area will provide further guidance.

Contributions to the Literature

Within the limitations discussed above, this study has contributed to CSR research by showing how a firm's CSR engagement strategy affects the benefits its CSR offers. In short, this study addresses the need to examine what firms really do regarding CSR activities, not just whether they engage in CSR. Our study has significantly moved the CSR–CFP research forward by giving the autonomy back to the firm: even with limited capacities and resources, a firm can still optimize the CSR activities' benefit by choosing to engage in related CSR dimensions, engage in a consistent manner, and take an internal-to-external path. Thus, this study rests on previous findings regarding the benefits of CSR discovered by RBV scholars (Brammer and Millington, 2008; Russo and Fouts, 1997) but draws heavily on the nascent movement of dynamic CSR (Margolis et al., 2009). We reveal that even with limited capacities and resources, a firm can still optimize the CSR activities' benefit by choosing to engage in related CSR dimensions, engage in a consistent manner, and take an internal-to-external path.

While consistency and an internal-to-external path are straightforward enough, the relationships among the dimensions of CSR and our findings concerning them merit further discussion. Though the differences among the dimensions have often been noted in CSR studies, an empirical evaluation of their relatedness and how their relatedness affects performance outcomes has been missing from CSR studies. CSR dimensions are vastly different in nature and thus require different types of resources and skills to operate. When a firm pursues two drastically different dimensions, for instance environment and diversity ($r = 0.06$), the firm may have trouble allocating enough resources to

both of them, hurting both effectiveness and the likelihood of turning a profit. The environment dimension requires investment in environmental equipment and management systems. However, the diversity dimension requires resources for finding, recruiting, and training qualified minority employees. The skills related to these dimensions are rarely complementary, making the absorption process more difficult, and few resources can be used by both dimensions. Financial performance for a firm in such a situation will suffer, as shown in Figure 2. But if a firm bundles the product dimension with the environment dimension (r = 0.25), the environmental investment will establish or enhance the green reputation of the product. Both dimensions benefit from the same investment and skill sets and thus performance improves. Thus, we offer empirical evidence, and reproducible methodology, concerning the diversity and relationships among CSR.

No prior study, to our knowledge, has examined what difference entry point makes to the relationship between CSR engagement strategy and financial performance. A good entry point facilitates the learning process and knowledge accumulation and thus improves the effectiveness of a CSR engagement strategy. Our findings confirm the applicability of path dependence to the study of CSR.

To our surprise, the pace of a CSR engagement strategy does not significantly moderate the CSR–CFP relationship (p = 0.78). This finding may indicate that whether a firm adopts CSR slowly or quickly, the consistency, path, and relatedness of this adoption more strongly affect whether the CSR knowledge accumulates well and whether stakeholders see the CSR engagement as genuine. The correlation matrix shows that when a firm engages in related CSR dimensions or adopts the internal-to-external path, it is more likely to employ a relatively faster pace: the correlation between pace and path is 0.28 and the correlation between pace and relatedness is 0.59. This may show that what matters is not how fast a firm engages in CSR, but which dimensions it chooses and where it starts. Alternatively, it is possible that more extreme variations of pace than were obtained in our sample would yield more significant results. This interesting puzzle is worth further pursuit, as we discuss below.

Given the current state of knowledge about CSR, conducting this project was the logical next step. The contribution of adding the 'how' to the study of the CSR–CFP relationship offers a new perspective on why prior studies have yielded mixed results. For example, while some (e.g. McWilliams and Siegel, 2000) argue that innovation competes with CSR for resources within a firm, others (e.g. Hull and Rothenberg, 2008) found that innovation does not take away the positive contribution of CSR. Our study indicates that either argument may be right, as CSR's effect is subject to how the firm engages in CSR activities. Different CSR engagement strategies may yield different results even though the context is the same. We also hope our project helps turn scholars from a static view of CSR to a dynamic one. CSR is a process of accumulating knowledge and experience, during which a firm can *strategically* choose and manipulate the manner in which it accumulates this knowledge and experience (Porter and Kramer, 2006). This strategy can damage the firm's competitive position and profits, or improve them if we know enough about this process (Dierickx and Cool, 1989). Our study offers a foundation on which scholars can build further knowledge of CSR engagement strategies.

Future Research

As mentioned above, pace, consistency, relatedness, and path are correlated with each other. There is a possibility that one will affect the moderating relationship of another on the CSR–CFP relationship. For example, when a firm consistently engages in internal CSR, the benefit to financial performance may be stronger than if it engages in internal CSR dimensions inconsistently. An investigation of the relationship among different aspects of CSR engagement will be able to provide a comprehensive picture of its pattern. Although we did not find evidence that pace affects the CSR–CFP relationship, further exploration of its relationship with the CSR–CFP relationship is certainly warranted. In addition to considering the alternatives mentioned above, it is worth exploring if, for example, a fast adoption of related CSR dimensions may actually yield a more efficient result than a slow adoption of related CSR. Further, we only investigated how CSR engagement strategy affects accounting-based performance, namely ROA. CSR activities have a different, often weaker effect on market-based performance than accounting-based measures (Orlitzky et al., 2003). Will a CSR engagement strategy affect market-based performance in the same way as it does ROA? The answer is likely to be no, as market reaction to organizational behaviours is not always rational. More interestingly, if the effect is different, to what extent and why? We believe that examining this issue can provide more directions for managers in making sound decisions regarding engaging in CSR depending on whether their goal is to improve accounting-based performance or boost market value of the company. Moreover, we have only investigated four aspects of CSR engagement strategy in this study; it is likely that there are other aspects that should be examined. For example, we examined the relatedness of different CSR dimensions in the study. An interesting question can be asked about how coherent the engaged CSR activities are with other operations and routines within the organization, and how consistent the firm's CSR strategy, if it has one, is with its overall corporate strategy. An examination of this issue can further help us to understand how to integrate CSR engagement into organizational operations and overall strategic planning. Finally, in this study, we controlled for industry effects. We did not examine how contextual factors affect the impact of CSR engagement strategy on the CSR–CFP relationship. We expect the impact can be significant, as scholars have argued that CSR issues are always context-specific (McWilliams and Siegel, 2000; Scherer and Palazzo, 2011). Intuitively, in a fast-growing industry, a firm may be able to pursue CSR more quickly than firms in a declining industry. Without a thorough examination, however, this proposition is just a notion. More work can and should be done to bring the interactive effect of contextual factors and CSR engagement strategy into the picture.

Discussion

It is not enough to do a thing; one must do it well. Hackneyed though this truth may seem, researchers have not applied it to the question of how CSR might affect CFP. More important than any specific finding of this paper may be the general conclusion that *how* a firm engages in CSR is at least as important a question as *whether*. It has previously been noted that some of the ambiguity surrounding the financial results of

CSR may be related to variations in how CSR is measured, an issue which the use of the MSCI ESG database has done much to resolve (Waddock and Graves, 1997). By measuring how CSR is pursued, we have further reduced the ambiguity, and established that CSR, done consistently, with a focus on related dimensions of CSR, and with a starting focus on internal dimensions, has a strong positive effect on firm performance. To do well by doing good, firms must do good well.

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