TWO ESSAYS ON THE NATURE AND PRACTICE OF CORPORATE SOCIAL RESPONSIBILITY

by

KAREEM MAHMOUD SHABANA

(Under the Direction of Ann K. Buchholtz)

ABSTRACT

Corporate social reporting is the voluntary disclosure of corporate social performance information to the general public. Although the idea of corporate social reporting was first discussed in the late 1960s, the practice did not take root until the late 1980s. Since the early 1990s, the number of corporate social reports published annually has been steadily increasing, suggesting that corporate social reporting is slowly moving toward being an accepted business practice. In this proposal, which is composed of two essays, I explore the moral and behavioral underpinnings of corporate social reporting. In the first essay, I use a contractarian approach to propose a set of hypernorms for business ethics that consists of competitive and cooperative principles. The principles are developed using arguments from integrative social contracts theory, game theory, and the theory of institutions. Then, from the proposed hypernorms, I derive a contractarian statement of corporate social responsibility that specifies a hierarchy of moral obligations for the firm. In the second essay, I conduct an empirical examination of the determinants of corporate social reporting. I argue that firms initially publish corporate social reports to respond to legitimacy challenges arising from three firm-specific characteristics: business exposure, public awareness, and past performance. I then draw upon institutional
theory to hypothesize that firms will eventually issue social reports to enhance their legitimacy through isomorphism, thereby diluting the explanatory power of firm-specific characteristics over time.

INDEX WORDS: Corporate social responsibility, Business ethics, Integrative social contracts theory, Hypernorms, Corporate social reporting, Business exposure, Institutionalization of corporate social reporting
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by

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To my parents, Mahmoud and Naira.
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CHAPTER 1

INTRODUCTION AND LITERATURE REVIEW
INTRODUCTION

The late 1980s witnessed the beginning of global efforts to institutionalize corporate social responsibility (CSR) and its various practices. In 1989, the Coalition of Environmentally Responsible Economies (Ceres) was founded; in 1997, the Global Reporting Initiative (GRI) was launched; and in 2000, the United Nations Global Compact (UNGC) was established. These efforts indicate a global desire to promote CSR. Business and society scholars (e.g., Bowen, 1953; Carroll, 1979; Carroll, 1991; Davis, 1960; Davis & Blomstrom, 1975; Elles, 1956; Elles & Walton, 1974; Epstein, 1987; Frederick, 1994; McGuire, 1963; Sethi, 1975; Wartick, & Cochran, 1985; & Wood, 1991) have also been carrying out efforts to advocate the notion of CSR. These efforts span more than eight decades.

Firms’ acknowledgement of CSR may be evident in several practices that include the adoption of ethical codes of conduct, environmental awareness programs, diversity programs, philanthropy, and corporate social reporting. These practices indicate that CSR is, symbolically and substantively, being integrated with generally-accepted business routines. This integration is motivated by the notion that business has a moral obligation to society. Perhaps the most telling CSR practice of this obligation is corporate social reporting. Through corporate social reporting, firms issue “stand-alone” reports with the express purpose of disclosing information pertaining to their social and environmental performance to the public and their stakeholders (Owen & O’Dwyer, 2008, p. 384). This disclosure implies that the public and the firms’ stakeholders have the right to ensure that corporate social performance meets certain standards required by firms’ moral obligation to society.

Although not required by law, social and environmental reporting are gradually becoming accepted business practices. In addition, some of these companies develop their reports
according to guidelines recommended by “watchdog” organizations such as Global Reporting Initiative (GRI). The absence of regulation and the lack of universal standards cause significant variances in the reporting behavior among firms. Some firms issue social reports; others do not. Some reports are perceived to reflect a company’s commitment to social responsibility, while others are believed to be nothing more than a publicity stunt.

Antal, Dierkes, MacMillan, and Marz (2002) gave an overview of the development of corporate social reporting and its methodologies and models. The authors traced corporate social reporting back to the late 1950s. In the late 1960s, an increase of public interest in corporate social reporting occurred. In the 1970s, corporate social reporting was carried out under the rubric of the social audit. In the 1980s and 1990s, a decline in corporate social reporting took place. A revival of the interest in corporate social reporting occurred from the 1990s to the present.

Various studies examined corporate social reporting from a variety of angles. Some explored corporate social reporting practices in different countries such as Germany (Brockhoff, 1979; Dierkes, 1979; Dierkes & Antal, 1986), the United Kingdom (Hammond & Miles, 2004), Mexico (Paul et al., 2006), Thailand (Kuasirikun & Sherer, 2004), and Malaysia (Hai-Yap & Thong, 1984). Other studies compared corporate social reporting practices across countries (Chapple & Moon, 2005) and across industries (Campbell, Craven, & Shrives, 2003). Many scholars justify corporate social reporting as a mechanism by which firms manage their legitimacy and reputation (Clarke & Gibson-Sweet, 1999; Hooghiemstra, 2000; Woodward, Edwards, & Birkin, 1996). Others justify it as a tool for organizational learning (Gond & Herrbach, 2006). However, some scholars express their skepticism as to its purpose (Guthrie & Parker, 1989). Researchers have also explored determinants of corporate social reporting such as
organizational size (Patten, 1991) and industry classification (Cowen, Ferreri, & Parker, 1987; Gray, Kouhy, & Lavers, 1995; Patten, 1991).

THE NATURE AND PRACTICE OF CORPORATE SOCIAL RESPONSIBILITY

This dissertation examines the nature and practice of CSR. I conduct a normative inquiry in Chapter 2 that explores the source, nature, components, and scope of CSR. I build on previous research to investigate the moral underpinning of CSR and propose a contractarian statement for it. The statement provides a more precise depiction of the concept of CSR by explicitly stating its source, nature, components, and scope. This precision is sought through a derivation process that (1) uses a framework that adopts David Gauthier’s (1986) version of contractarianism, and (2) integrates the strengths of previous milestone definitions of CSR. The statement attempts to provide a moral justification for the socially responsible behavior of firms. In other words, the contractarian statement of CSR contends that social issues, in addition to stock prices, are worthy of orienting firm action.

The contribution of this endeavor is twofold. First, developing a statement for the definition of CSR by using David Gauthier’s (1986) version of contractarianism would strengthen its claim. The claim would be strengthened because Gauthier’s contractarianism grounds morality in rational choice theory. In addition, it accepts the contention that free-market produces optimal solutions. The same principles that are used to advocate the stockholder model of the firm are, therefore, used to support the CSR claim. Second, an explicit statement of the source, nature, components, and scope of CSR would (1) depict the principles from which CSR emanates, (2) suggest a hierarchical categorization to rank order CSR obligations, and (3) justify the scope of their discharge. The statement, consequently, will be more readily available to operationalization.
In Chapter 3, I take a behavioral approach in studying the determinants of corporate social reporting. I propose a more comprehensive model of corporate social reporting. The model depicts its determining factors at different points in time. Rational factors appear to explain corporate social reporting in the early 1990s. The effect of the rational factors progressively fades through the 1990s and the early 2000s indicating the institutionalization of corporate social reporting.

The behavioral study sheds light on the mechanics of the institutionalization process of CSR practices exemplified by corporate social reporting. A CSR practice is introduced as a reaction to social pressures. The practice is seen as a rational response to a social concern arising from the operations of a group of firms. One such practice takes root among the firms of the group, other groups become subject to social pressures demanding the adoption of and conformity to the newly introduced practice. The rational factors that were the reason for the development of a CSR practice at its earlier stages become irrelevant as the practice diffuses among different organizational groups under the pressure of institutionalization forces.
REFERENCES


CHAPTER 2

CORPORATE SOCIAL RESPONSIBILITY: A CONTRACTARIAN APPROACH

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INTRODUCTION

The late 1980s witnessed the beginning of global efforts to institutionalize corporate social responsibility (CSR) and its various practices. In 1989, the Coalition of Environmentally Responsible Economies (Ceres) was founded; in 1997, the Global Reporting Initiative (GRI) was launched; and in 2000, the United Nations Global Compact (UNGC) was established. These efforts indicate a global desire to promote CSR. Business and society scholars (e.g., Bowen, 1953; Carroll, 1979; Carroll, 1991; Davis, 1960; Davis & Blomstrom, 1975; Elles, 1956; Elles & Walton, 1974; Epstein, 1987; Frederick, 1994; McGuire, 1963; Sethi, 1975; Wartick, & Cochran, 1985; & Wood, 1991) have also been carrying out efforts to advocate the notion of CSR. These efforts span more than eight decades. However, the stockholder model of the firm, which contends that the only responsibility of the firm is toward its stockholders, prevails (Walsh, Weber, & Margolis, 2003).

The contributions made by businesses and society scholars to advocate the notion of CSR represent significant strides. These contributions shape the field and present a strong case for the claim. Carroll (1999) overviews “the evolution of [the] definitional construct” and its alternative themes, which “include corporate social performance, stakeholder theory, and business ethics theory” (p. 268). He concludes that CSR is a “core construct” (p. 268). However, the statement of the CSR definition still faces the challenge of “determining ‘operationally’ what [it] implies for management” (Carroll & Buchholtz, 2006, p. 34).

The evolution of the notion of CSR, therefore, faces two main challenges: the dominance of the normative thesis asserted by the stockholder model of the firm, and the difficulties of operationalizing the statement of the CSR definition. The first challenge presented by the dominance of the normative thesis of the stockholder model raises the question, “why, upon
considering options for action and their potential outcomes, [social issues] and stock price are worthy of orienting action in the first place and what the actor is to do if a course of action will damage one of those objectives?” (Walsh, et al., 2003). The second challenge, which underscores the necessity of the operationalization of the statement of the CSR definition, appeals for a clearer statement that spells out the moral principles from which CSR emanates, and from which their hierarchical order and their criteria of assessment are determined.

In this paper, I build on previous research to address these challenges. I investigate the moral underpinning of CSR and propose a contractarian statement for it. The statement provides a more precise depiction of the concept of CSR by explicitly stating its source, nature, components, and scope. This precision is sought through a derivation process that (1) uses a framework that adopts David Gauthier’s (1986) version of contractarianism and (2) integrates the strengths of previous milestone definitions of CSR. The statement attempts to provide a moral justification for the socially responsible behavior of firms. In other words, the contractarian statement of CSR contends that social issues, in addition to stock prices, are worthy of orienting firm action.

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the scope of their discharge. The statement, consequently, will be more readily available to operationalization.

This paper is organized in five sections. Section one presents an overview of CSR research. The overview highlights the strengths and limitations of the current statements of CSR definitions. The conclusion that a clearer statement of CSR is needed is then made. Section two searches for the principles of CSR in business ethics. An examination of the Integrative Social Contracts Theory reveals that the articulation of such principles would be impossible in the absence of explicit hypernorms. Section three develops the hypernorms necessary for articulating the principles of CSR. Section four provides a contractarian statement of CSR and proposes a normative hierarchy for corporate social responsibility categories. Finally, section five presents the conclusion and suggestions for future research.

CORPORATE SOCIAL RESPONSIBILITY

The Shaping of Corporate Social Responsibility: Social Forces and Academic Debate

The past three decades witnessed significant strides in the quest for the institutionalization of corporate social responsibility (CSR) and its various practices. Two major endeavors stand telling of the existence of social forces that aspire for a socially responsible business: the Coalition of Environmentally Responsible Economies and the United Nations Global Compact. The Coalition of Environmentally Responsible Economies (Ceres) was founded in 1989 to integrate “sustainability into capital markets for the health of the planet and its people” (Ceres). Ceres, in 1997, launched the Global Reporting Initiative (GRI), a sustainability reporting framework, to provide sustainability reporting guidelines for businesses. The initiative gained momentum to the extent that GRI became an independent entity in 2002.
In 2006, GRI released its third version of corporate social reporting guidelines known as G3 (GRI). The release of G3 suggested a growing acceptance of the practice of sustainability reporting. Today, 70 companies endorse the Ceres principles, among them giants such as the Bank of America, the Coca-Cola Company, Dell Inc., and General Motors (Ceres). Worldwide, 223 companies including Bayer AG of Germany, BP of the United Kingdom, and Ford Motor Company of the United States are helping shape the course of GRI by actively participating in the development of reporting guidelines. For their efforts, GRI recognizes them as organizational Stakeholders (GRI).

The United Nations led a parallel effort to that of Ceres and GRI by launching the Global Compact in 2000. The United Nations Global Compact (UNGC) is primarily “concerned with exhibiting and building the social legitimacy of business and markets … in the areas of human rights, labour, the environment and anti-corruption” (UNGC). In 2006, UNGC and GRI formed a strategic alliance “aimed at providing the global private sector with an opportunity to embrace a responsible business strategy that is at once comprehensive, organizing, integrated and enjoys near or total universal acceptance” (GRI). The alliance is symbolic as well as it is substantive. The UNGC and GRI alliance indicated that the endeavors to institutionalize CSR and its various practices are carried out under a unified effort. This unified effort signaled a convergence in the views and conceptualization of CSR. In addition to its symbolic value, its substantive value was evident in the connection of the UNGC principles to the GRI indicators (UNGC) aiming at the development of a unified standard for CSR. To date, the number of documents voluntary published by business participants in the UNGC has reached 2876 (UNGC).

The social forces aspiring to institutionalize CSR and its various practices represented in Ceres, GRI, and UNGC are landmarks that signal the presence of a global concern about CSR.
This concern gained attention in the business press as well as in academic literature (Campbell, 2007). Walsh et al. (2003) called for recognizing the importance and centrality of CSR to organization and management research. The authors argued that the purpose of organization and management research is to help achieve economic and social objectives. However, they contended, economic objectives earned much more attention from researchers and scholars than did social objectives. The authors, therefore, asked for “the attention granted to economic performance … be integrated with comparable attention to social outcomes” (Walsh et al., 2003, p. 877).

Walsh et al. (2003) are not the first to draw attention to the importance of examining the relationship between business and society. Calls for attention to the social impact of business and recognition of its social responsibility are traced to Edgar Heermance’s (1926) *The Ethics of Business: A Study of Current Standards* (Dahlin, 2007). Chester Barnard’s (1938) *The Functions of the Executive*, J. M. Clark’s (1939) *Social Control of Business*, and Theodore Kreps’ (1940) *Measurement of the Social Performance of Business* are also considered among the earliest works that echoed the same call (Carroll, 1999). Since the 1920s, and up to the present date, inquiry in the relationship between business and society has been conducted under the rubric of corporate social responsibility (Bowen, 1953; Carroll, 1991; Davis, 1960; Davis & Blomstrom, 1975; Elles, 1956; & Epstein, 1987), corporate social responsiveness (Frederick, 1994), and corporate social performance (Carroll, 1979; Wartick & Cochran, 1985; & Wood, 1991). The concern for CSR is not new; it is a tradition with a rich history that spans more than eight decades.

In spite of the rich history and long tradition of business and society research, acceptance of the concept remains challenged (Friedman, 1962). The stockholder model of the firm that
views it as a nexus of contracts (Fama, 1980; Fama & Jensen, 1983; & Jensen & Meckling, 1976) with a primary, if not sole, obligation to maximize shareholders wealth prevails as the dominant view (Margolis & Walsh, 2003). However, the stakeholder model that accepts a notion of a corporate responsibility that extends beyond the firm’s obligations to its shareholders to include other stakeholders (Donaldson & Preston, 1995; & Freeman, 1984) continues to gain appeal and momentum. Tension persists between the two competing models (Margolis et al., 2003).

Similarities and Differences between the Stockholder and Stakeholder Models of the Firm

The stockholder model of the firm. The most widely adopted version of the stockholder model of the firm in management literature is that proposed by Jensen and Meckling (1976). The authors defined firms as “legal fictions which serve as a nexus for a set of contracting relationships among individuals” (p. 310). Distinguishing between relationships inside and outside the firm makes no sense. The authors contended, “[t]here is in a very real sense only a multitude of complex relationships (i.e., contracts) between the legal fiction (the firm) and the owners of labor, material and capital inputs and the consumers of output” (p.311).

The stockholder model of the firm set forth by Jensen and Meckling (1976) leads to the conclusion that “[t]he firm is not an individual” (p.311). Consequently, as the authors assert, questions about the objective function of the firm or its social responsibility are “seriously misleading” (p. 311).

The stakeholder model of the firm. The stakeholder model of the firm contends that “an organization’s success is dependent on how well it manages the relationships with key groups such as customers, employees, suppliers, communities, financiers, and others that can affect the realization of its purpose” (Freeman & Philips, 2002: 333). Goodpaster (1991) identified two
view of the stakeholder model of the firm: strategic and multifiduciary. The strategic view contends that managers act as agents to principals (stockholders). Managers, therefore, have a fiduciary responsibility toward the stockholders. This fiduciary relationship subordinates stakeholders’ concerns to those of stockholders. Goodpaster (1991) said that “stakeholders outside the stockholder group are viewed instrumentally, as factors affecting the overarching goal of optimizing stockholder interests” (p. 58). In contrast to the strategic view, the multifiduciary view posits that managers are agents to all stakeholders. Managers’ fiduciary relationship is, therefore, not between them and the stockholders; rather, it is between them and all stakeholders.

Goodpaster (1991) acknowledged an incompatibility between the multifiduciary view of the stakeholder model with widely-held normative conviction regarding the relationship between management and stockholders. He also said that at the center of this incompatibility “is the belief that the obligations of agents to principals are stronger or different in kind from those of agents to third parties” (p. 63). To resolve this incompatibility, Goodpaster (1991) set forth the synthesis view of the stakeholder model of the firm. The synthesis view reconciles the differences between the strategic view and the multifiduciary view. Managers are depicted as having two types of relationships and responsibilities. The first is a fiduciary relationship and responsibility toward stockholders. The second is a non-fiduciary relationship and responsibility toward other stakeholders.

**Similarities and differences.** The stockholder model of the firm and the strategic view of the stakeholder model of the firm are congruent. Both perspectives treat stakeholder concerns in an instrumental manner. Responses to stakeholder concerns are carried out in a manner that would serve the self-interest of stockholders. The multifiduciary view of the stakeholder model of the
firm is at odds with both the stockholder model of the firm and the strategic view of the stakeholder model of the firm. A fiduciary responsibility to all stakeholders is assigned to management. Management, therefore, is obligated to promote the self-interest of all stakeholders.

The synthesis view that was set forth by Goodpaster (1991) shares similarities and maintains differences with the perspective discussed above. The synthesis view agrees with both the stockholder model of the firm and the strategic view of the stakeholder model of the firm in that the only fiduciary responsibility that management has is toward stockholders. This responsibility entails that management serves the self-interest of stockholders. The synthesis view, however, differs with both the stockholder model of the firm and the strategic view of the stakeholder model of the firm in that it acknowledges that the fiduciary responsibility of management does not encompass the totality of management’s responsibility. The synthesis view contends that management, in addition to its fiduciary responsibility toward stockholder, has a non-fiduciary responsibility to other stakeholders.

**Sources of tension between the stockholder and stakeholder models of the firm.** The source of the tension between the two models may be attributed to two types of differences: normative and methodological. The normative differences exist due to three main reasons. First, the two models mandate two different sets of moral obligations. On one hand, the stockholder model posits that the only responsibility of business is to its stockholders (Friedman, 1971). The stockholder model also rejects the notion that the firm has an identity independent of its stockholders; therefore, may not be treated as a moral agent (Fama, 1980; Fama et al., 1983; & Jensen et al., 1976). On the other hand, the stakeholder model contends that the firm’s responsibility extends beyond that to its stockholders to encompass various stakeholders.
(Freeman, 1984). The firm is also regarded as a moral agent (Donaldson, 1982; Freeman & Philips, 2002; & Philips, Freeman, & Wicks, 2003). Second, different interpretation of property rights have contributed to the existing tension (Donaldson & Preston, 1995 & Jacobs & Getz, 1995). The stockholder model adopts a strict view of property rights that gives the owners of the firm uncontested control over it. In contrast, the stakeholder model holds a less stringent interpretation of property rights. Third, the stockholder model firmly endorses the notion that free-market provides optimal solutions. Conversely, the stakeholder model disputes that all should be left to the invisible hand of the market.

The methodological differences between the two models arise from the different methodologies adopted. The stockholder model is entrenched in rational choice theory and economic thought. In contrast, the stakeholder model is shaped by social contract theory and contractarian philosophy, which is shaped by philosophers such as Hobbes, Hume, Kant, Locke, Rawls, and Rousseau. Rational choice theory and economic thought advocate that the human being is a utility-maximizer. Human beings, therefore, will make rational decisions that maximize their utility. Social contract theory and contractarian philosophy, on the other hand, rely on a hypothetical thought process conducted under certain assumptions such a veil of ignorance, which has been used by Kant and Rawls.

In pursuit of a normative justification. This paper derives a contractarian statement for the definition of CSR. The derivation is conducted using a framework that adopts David Gauthier’s (1986) Morals by Agreement version of contractarianism, which grounds morality in rational choice theory. The derivation, therefore, integrates economic thought and contractarian philosophy. Consequently, methodological differences are minimized.
A thesis is developed from rational choice theory where the CSR doctrine is conceived to be complementary to the free-market doctrine. This complementary role is argued to be in the self-interest of economic actors when idealized market conditions are not realized. Tension between the stockholder and stakeholder models would be eliminated. In addition, the CSR claim would be strengthened due to the derivation process that utilizes the assumption and principles used by the stockholder model. The derivation process of the statement of the definition starts with an overview of the current statements of the CSR definition. The overview underscores its strengths and draws attention to its limitations.

Corporate Social Responsibility: the Clear, the Vague, and the Overlooked

Many scholars have contributed to the evolution and conceptualization of the notion of CSR (e.g., Bowen, 1953; Carroll, 1979; Carroll, 1991; Davis, 1960; Davis & Blomstrom, 1975; Elles, 1956; Elles & Walton, 1974; Epstein, 1987; Frederick, 1994; McGuire, 1963; Sethi, 1975; Wartick, & Cochran, 1985; & Wood, 1991). While each contribution has added significantly to our understanding of the concept of CSR, three milestone definitions may be considered its building blocks.

First, Davis and Blomstrom (1975) define corporate social responsibility as “the obligation of decision makers to take actions which protect and improve the welfare of society as a whole along with their own interest” (p. 39). The definition lays the foundation of our understating of CSR by clearly specifying its two main components: an obligation to protect and an obligation to improve. However, it has several limitations. First, it does not articulate what constitutes protection and what constitutes improvement. Second, it does not make clear the sources of these obligations. Third, it attributes responsibility to the decision maker, not to the firm. Fourth, the definition implies that the fulfillment of these obligations is conditioned upon
the improvement of the decision makers’ own interest. Fifth, it identifies the target of responsibility as society as a whole; responsibility toward specific stakeholders is not considered.

Second, Carroll (1979) introduced the now widely accepted definition of CSR: “[t]he social responsibility of business encompasses economic, legal, ethical, and discretionary (philanthropic) expectations that society has of organizations at a given point in time” (p. 500). The success of Carroll’s definition is partly due to the relative ease of its operationalization by both academics and managers (Wood, 1991). Carroll’s definition has several strengths. First, it clearly articulates the categories of a firm’s obligations toward society. His articulation of ethical and philanthropic categories, which extend beyond legal obligations, is consistent with McGuire (1963) definition of CSR. Second, it acknowledges the role that social expectations play in shaping CSR. Third, it points out that social expectations are dynamic and change over time.

Carroll’s definition, however, has invited some criticism regarding three main issues. First, the inclusion of a philanthropic category has been challenged since it is neither stimulated by economic nor by ethical motives (Schwartz & Carroll, 2003). Second, the definition, especially when presented as Carroll’s pyramid, is often perceived to imply a certain hierarchy for CSR categories: economic, legal, ethical, and philanthropic. This misconception is an error committed by the reader, not the author of the definition. Carroll (1979) explicitly states that the four categories of responsibility should be pursued simultaneously. However, this often-committed error highlights the intuitive need for a hierarchy of the CSR categories. Kang and Wood (1993) “turned Carroll’s pyramid on its head” and proposed a hierarchy that gives primacy to discretionary responsibility. Ethical responsibility, legal responsibility, and, finally, economic responsibility follow in this order. Third, Wood (1991) drew attention to Carroll’s four
categories of CSR which are not principles upon which CSR may be defended; rather, they are a classification device. While their value as managerial tools is unquestionable, principles are still needed to provide a justification for CSR.

Third, Epstein (1987) contended that “[c]orporate social responsibility relates primary to achieving outcomes from organizational decisions concerning specific issues or problems which (by some normative standard) have beneficial rather than adverse effects upon pertinent corporate stakeholders” (p. 104). Epstein’s definition advances the conception of corporate social responsibility in three important ways. First, it directs CSR toward certain identifiable stakeholders. Second, it casts CSR as a responsibility concerning specific issues. Third, it underscores the necessity of a normative standard to assess CSR.

Epstein’s definition, however, does not specify which normative standard should be used, nor does it indicate how such standard should be developed. In addition, while acknowledging a firm’s responsibility toward specific stakeholders, the definition is silent regarding the firm’s responsibility toward society as a whole.

**Strengths and limitations of the current statements of the definition of CSR.** The current statements of the definition of CSR succeed in accurately depicting many of its aspects (see Table 1.1). First, CSR consists of two main components: an obligation to prevent harm (to protect) and an obligation to generate benefit (to improve). Second, the obligations are categorized into four categories: economic, legal, ethical, and philanthropic. Third, the obligations are shaped, or at least influenced, by social expectations. Fourth, social expectations are not static; they are dynamic and change over time. Fifth, CSR is an obligation partly toward society as a whole and partly toward identifiable stakeholders. Sixth, CSR is a responsibility
with respect to specific issues. Finally, CSR is only meaningful in the context of a normative standard.

The current statements, however, remain somewhat vague and burdened by a number of limitations (see Table 1.1). First, a clear articulation of the origins of responsibility is not explicitly stated. The statements do not explain why the firm has obligations to society and to stakeholders. In other words, the source from which CSR emanates is not explicitly identified. Second, the components of responsibility are not adequately depicted. CSR refers to obligations to protect and improve society, but it does not specify the constituents of these obligations. Third, a well-articulated schema for rank ordering obligations is absent. The absence of such a schema creates moral dilemmas for practitioners and hinders the firm’s ability to respond to competing obligations. Fourth, evaluation criteria or benchmarks which can assess the extent to which a firm’s actions succeed to fulfill its obligations are lacking. Finally, there is no clear statement wherein obligations are directed toward society and wherein obligations are directed toward identifiable stakeholders.

**Origins of the Limitations of the Current Statements of the Definition of CSR**

A definition is an outcome of its derivation process. The logic and arguments utilized in a derivation process of a definition determine the set of assumptions upon which it is built. In addition, the assumptions and logic determine which outcomes would be accepted and which ones would be rejected. Therefore, a definition is path-dependent on its derivation process. Accordingly, to address the limitations of a definition, one may do so by examining its derivation process. Such examination would result in determining the causes of the limitations present in a definition. By offering alternative derivation routes, the limitations may, therefore, be removed and the definition enhanced.
The limitations burdening the current statements of the definition of CSR may be attributed to three factors: (1) the lack of integration between normative and instrumental arguments, (2) the absence of some instrumental aspects of the social processes of ascribing and using responsibility, and (3) the use of the term responsibility to refer to a myriad of obligations that often vary in the strength of their moral mandates. This section discusses these three factors in greater detail.

**Normative and instrumental arguments.** In CSR research and its alternative themes – corporate social performance, stakeholder theory, and business ethics theory, integration between the normative and instrumental arguments is not sufficient. Jones and Wicks (1999) underscored the need for integration between the normative and instrumental approaches in stakeholder theory while Donaldson and Dunfee (1994) appealed for the same kind of integration in business ethics.

CSR research under the rubric of responsibility, responsiveness, and performance, has gone through three stages of evolution. The first stage focused on the firms’ obligations toward society and stakeholders. Investigation was conducted under the rubric of responsibility and the argument was primarily normative (Carroll, 1999; Frederick, 1994). The second stage shifted attention away from the normative argument of responsibility toward an instrumental argument of responsiveness. The focus of the second stage was corporate actions (Frederick, 1994). Finally, the third stage introduced yet another shift of focus that moved attention away from actions to outcomes. Investigation in the third stage maintained the instrumental approach of the second stage, but was conducted under the rubric of performance where the impact of corporate actions on society and stakeholders was of primary concern (Carroll, 1979; Wartick & Cochran, 1985; & Wood, 1991).
Although the three stages of evolution have different foci (obligations, actions, outcomes), they are interdependent. Assumptions and contentions about obligations affect actions. Actions, in turn, determine outcomes. The shift from responsibility to responsiveness implied that “the normative question of corporate responsibility has been answered affirmatively” (Frederick, 1994). In other words, responsiveness is only meaningful and rational under the assertion that firms have moral obligations toward society. The interdependence of the normative and instrumental is also evident in corporate social performance models (Carroll, 1979; Wartick et al., 1985; & Wood, 1991). The models encompass three main components: principles, actions, and outcomes.

Clearly, the responsibility-responsiveness-performance theme illustrates the existence of interdependence between the normative and instrumental arguments of corporate social responsibility. Moreover, the inability to separate the normative and instrumental arguments attests to the need for integration.

Stakeholder theory (Freeman, 1984), which provides a “managerial conception of organizational strategy and ethics” (Freeman & Philips, 2002), is descriptive, instrumental, and normative (Donaldson & Preston, 1995). The theory proposes two main theses: an instrumental thesis and a normative thesis (Freeman & Philips, 2002). The instrumental thesis posits that firm performance will be enhanced if the firm manages its stakeholders better. The normative thesis contends that firms should manage their stakeholder better. The interdependence of the instrumental and normative is self-evident. Both normative and instrumental arguments are evident in the stakeholder theory theme.

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Business ethics, which articulates a moral framework for the institution of business as a whole, contributes normative and empirical streams of research. The normative stream introduced “purely normative nonempirical methods to the study of business ethics.... [The empirical stream, on the other hand, focuses on] predicting and understanding ethical behavior...” (Donaldson & Dunfee, 1994, p. 253). Underscoring the need for integration, Donaldson and Dunfee (1994) and Donaldson and Dunfee (1999) sought to advance the interconnection under the integrative social contracts theory.

The plea for integration between the normative and instrumental does not mean that answers to normative questions would be developed from a study of instrumental processes. An “ought” cannot be developed from an “is” (Donaldson & Dunfee, 2000). However, normative questions arise from an “is” and the “ought” is true to the extent that it is appropriate for implementation in the “is”. Moreover, because “ought” implies “can,” the answer to the normative question is bounded by instrumental constraints. The normative argument, thus, cannot be developed in isolation from the instrumental argument.

**Instrumental aspects of the ascription and use responsibility.** The instrumental aspects of corporate social responsibility provide the context in which moral relationships develop. A clear articulation of these aspects would enhance the compatibility between the normative and the instrumental arguments and ensure that the “ought” is developed based on a “can”. Three instrumental aspects in which corporate social responsibility arises need further development and articulation: the nature of the firm, the nature of the relationships that develop among the relevant parties, and the dynamics of their interaction.

A clearer articulation of the nature of the firm and the nature of the relationships that develop among the relevant parties would help determine the nature and scope of the firm’s
responsibilities. A more comprehensive depiction of the dynamics of interaction among the relevant parties would help provide the instrumental mechanisms through which outcomes develop. The acknowledgement of these instrumental aspects would provide a richer context for developing the moral arguments of CSR. Therefore, CSR and its moral foundations would be more attuned to the realities of the business practitioner, a condition deemed necessary for business ethics to reach “the business mind” (Frederick, 2000a, p. 467).

**Uses of the term “responsibility”**. The term “Corporate Social Responsibility” is used to refer to a variety of obligations that vary significantly in the strength of their moral mandate. Carroll (1979 & 1991) has set forth three levels of mandates: a required level that encompasses economic and legal responsibilities, an expected level that encompasses ethical responsibilities, and a desired level that encompasses philanthropic or discretionary responsibilities. Carroll’s articulation of the different levels of mandates is noticed by business and society scholars and keen business practitioners. However, such distinction is sometimes overlooked. It seems that the term “responsibility” tempts some to infer that it refers to obligations and that, if not fulfilled, should merit legal retaliation. Philips et al. (2003) described this inference made by some (e.g., Hendry, 2001a, 2001b; & Van Buren, 2001) as a “friendly misinterpretation” (Philips et al., 2003, p. 482) of the notion of “stakeholder responsibility” (Freeman et al., 2002, p. 342).

Another misinterpretation is sometimes committed when the notion of stakeholder responsibility is applied to the entire economy instead of being applied to its appropriate domain – the organization (Philips et al., 2003). Friedman (1962) described CSR as “unadulterated socialism” (p. 126). Friedman’s contention is shared by others (e.g., Barnett, 1997; Hutton, 1995; and Rustin, 1997) who claim that stakeholder theory is “thinly-veiled socialism” (Philips et al., 2003, p. 491).
Philips et al. (2003) noted yet another critical distortion to the stakeholder theory. The authors assert that stakeholder theory is not primarily concerned with the redistribution of financial outputs as Marcoux (2000) claims. Rather, stakeholder theory through the principle of stakeholder responsibility “claims that parties to an agreement must accept responsibility for the consequences of their action” (Freeman & Philips, 2002, p. 342). CSR, similarly, is concerned with a broad set of obligations. Redistribution of wealth is not the purpose of CSR. CSR refers to “the ethical principles that ought to govern the relationships between the corporation and society (Elles & Walton, 1961, pp. 457-458).

To help reduce such misinterpretations and criticisms, caution is advised when using the term “CSR”. It would also be useful to emphasize that it refers to a myriad of obligations that are justified at different levels of moral mandates. Using Carroll’s (1979; 1991) four categories of CSR is undoubtedly useful for manager as a tool to classify issues their firms face. However, such classification might be too broad for use in debates over the legitimacy of the CSR claim. An explicit statement of the ethical principles upon which obligations are justified would connect the issues facing firms more directly to their underlying ethical principles. This explicit statement of the principles and the direct connection between them and the issues would allow a pin-pointed debate. Therefore, the merit of each principle and the legitimacy of each obligation may stand trial independently of other principles and obligations. Opportunity will thus be available for reasonable critics to accept or reject certain principles and obligations. Chances of a blanket acceptance or rejection of CSR may then be reduced. In addition, this finer-grained depiction of CSR would permit local, rather than global, improvements and revisions. The possibility of local revisions would allow localized improvements and adjustments that would
permit addressing specific criticisms, even if they require some modifications, without doing-away with the whole concept.

IN PURSUIT OF THE ETHICAL PRINCIPLES OF CSR:
CAN INTEGRATIVE SOCIAL CONTRACTS THEORY (ISCT) PRODUCE THEM?

This paper derives a contractarian statement of the definition of CSR. This endeavor is not intended to add another definition, to the host of available definitions, which suggests alternative views of CSR. Rather, the intention is to build on current statements of the definition of CSR by integrating their strengths and addressing their limitations. The derivation is an exercise in business ethics. Developing the concept of CSR from the principles of businesses ethics may be justified based on two reasons. First, as noted by Carroll (1999), business ethics is an alternative theme to CSR. Essentially, both themes investigate the origin and nature of the moral obligations of the firm. Donaldson and Dunfee (1995) acknowledge a similar relationship between Integrative Social Contracts Theory (ISCT) and stakeholder theories. They emphasize that “the two concepts are complementary.” The authors add, “ISCT serves as a normative foundation to stakeholder theories…” (p. 235). The analytical tools available to business ethics are, therefore, appropriate for investigating CSR.

Second, the concept of responsibility is a subject matter of ethics and moral philosophy. Many ethicists and moral philosophers have investigated it. French’s (1991) *The Spectrum of Responsibility* presented a survey of selected works on responsibility. The anthology includes works that investigates the basic conditions of responsibility, the types and principles of responsibility, collective responsibility, and corporate responsibility. These investigations are carried out by philosophers that include Aristotle, K. Baier, F. H. Bradley, D. E. Cooper, P. French, V. Held, Hume, J. Ladd, J. L. Mackie, L. May, and M. J. Zimmerman. Clearly, ethics
and moral philosophy possess a wealth of resources relating to inquiries in the concept of responsibility. Using these resources would, thus, provide a variety of analytical tools that might authorize a deeper understanding of CSR.

The Promise of Integrative Social Contracts Theory (ISCT)

When one turns to ethics for answers regarding the ethical dilemmas of business, many business ethicists regard contractarian philosophy most applicable and applicable. Dunfee (1991) contends: “Extant social contracts, deriving from communities of individuals, constitute a significant source of ethical norms in business” (p. 23). Donaldson and Dunfee (1999) reaffirmed the appropriateness of applying contractarian ethics to business. The authors noted that while there is no single theory that has been capable of addressing the variety of business ethics problems, contractarian ethics is the most appropriate ethical theory for business because it has the ability to accommodate a variety of positions through contracting.

Donaldson and Dunfee (1994; 1999) extended the application of contractarian ethics to businesses by offering their landmark Integrative Social Contracts Theory (ISCT) for business ethics. The authors offer ISCT as a theory that “contains much of the substance of business ethics… [that not only] helps … in understanding the normative justification for business decisions, but … also helps … in reaching such decisions” (1994, p. 254). The theory succeeded in gaining wide acceptance in the field of business ethics. Wempe (2004) refers to ISCT as “one of the more authoritative recent contributions to this field” (p. 332). Bishop (2000) agreed and said that “ISCT seems the most promising normative theory available at the moment” (p. 564), while Philips et al. (2003) regarded ISCT as one of the “normative justifications of stakeholder theory” (p. 489) and Freeman (1994) endorsed the doctrine of fair contracts.
ISCT, however, received some criticism (Boatright, 2000; Frederick, 2000a; Fort, 2000; Salbu, 2000; Sanchez, 1999; Shaw, 2000; Wempe, 2004). Most of the criticism challenges the theory’s ability to deliver its promise; namely, to produce a specific enough reflection of the realities of business and provide a practical framework to help justify and formulate ethical decisions.

Can ISCT deliver its promise? Is it able to provide a framework that helps justify and formulate ethical decisions? If it is so able, then one would expect that ISCT, when applied to the problem of CSR, would produce a justification for and a formulation of CSR. If ISCT’s limitations prevent the stipulation of such justification and formulation, the challenges to the theory are, therefore, supported. Revisions of some aspects of ISCT would then be required to assist the theory in addressing its challenges and delivering its promise. Answers to these questions would be better articulated after an overview of ISCT.

**ISCT: an overview.** Contractarianism contends that practices are ethical to the extent that they conform to the terms of agreed upon contracts (Sayre-McCord, 2000). The contracts are moral when three main conditions are obtained. First, all contracting parties have the right to enter, participate, and exit. In other words, for contracts to be moral, negotiating parties are not to be coerced or forced to enter into any agreement. In addition, they are not to be forced out of any agreement in which they voluntarily chose to participate in. However, they are to be allowed to discontinue their participation in any negotiation process if they so choose. Second, negative rights of all contracting parties are honored. Negative rights refer to the individual’s right “not to be interfered with by others, where ‘interfered with’ is parsed in terms of physical harm (Philips et al., 2003, p. 334). Third, all contracting parties enjoy fair contracting conditions, especially equal bargaining power. Once these conditions are satisfied, contractarian logic concludes that
the negotiating parties are to be bound by the terms of the contract resulting from the bargaining process.

ISCT builds on contractarian thought and applies it to business (Donaldson & Dunfee, 1994, 1999, & 2000). It posits that contractors are characterized by bounded moral rationality, which refers to the limitations that confront them when they apply moral theory to actual situations (Donaldson & Dunfee, 1994). These limitations are set “by a finite human capacity to assess facts, by a limited capacity of ethical theory to capture moral truth, and by the plastic or artificial nature of economic systems and practices” (Donaldson & Dunfee, 1994, p. 258). Aware of their bounded rationality, contractors agree to the notion of a moral free space that allows diverse moral judgments regarding actual situations to coexist in different but interdependent economic communities. This moral free space permits a level of moral pluralism. To prevent themselves from slipping into moral relativism, the contractors agree to adopt a hypothetical, normative, and macrosocial contract. The macrosocial contract articulates the general principles of economic morality. These general principles of economic morality are hypernorms universal to all economic communities.

Authentic norms (norms endorsed by the majority of contractors in any given economic community) are legitimate and binding only if they are in accordance with the hypernorms. Authentic norms that conflict with hypernorms are deemed illegitimate and are therefore unethical. Within the confines set by the legitimate norms of their community, contractors may form existing, extant, and implicit microsocial contracts. The microsocial contracts specify the ethical norms of their particular community. In case of a conflict among legitimate norms of various economic communities, the contractors would resort to applying a set of priority rules to resolve the conflict.
**Hypertension over hypernorms.** Most of the criticism directed at ISCT’s are about the validity and utility of its hypernorms. Frederick (2000a; 2000b) contended that the thought processes used to develop the notion of hypernorms is superficial. Instead of using a thought process, Frederick (2000a) asserted that “[i]f ethicists are to reach the business mind and thereby influence business decisions and policies, their ideas and theories need to be framed in ways that are meaningful and compelling within the workplace where those decisions and policies are made” (p. 467). Frederick’s assertion underscores the need for integrating more instrumental arguments in contractarian ethics to enable it to reach “the core of business consciousness” (p. 467).

In contrast to Frederick (2000a, 2000b), Boatright (2000) and Shaw (2000) recognized that hypernorms play a fundamental role in ISCT. However, they asserted that an explicit articulation of these hypernorms is necessary for ISCT to deliver its promise. Shaw (2000) appealed to Donaldson and Dunfee to “sharpen their exposition of hypernorms” (p. 578), and Boatright (2000) called for a moral theory that justifies them.

Douglass (2000) argued that hypernorms are not essential to ISCT. The main function of the hypernorms may be achieved by the use of priority rules. Douglas (2000) insisted that “disputes between communities are resolved on an intercommunal rather than transcommunal levels and, thus, that the norms which resolve such disputes are the products of intercommunal, rather than universal, agreement” (p. 109). Priority rules may therefore be used to resolve these disputes without appealing to hypernorms.

Donaldson and Dunfee (1994, 1999, 2000a, & 2000b) insisted on remaining agnostic about the origin and nature of the hypernorms. While they partly agreed with the criticism regarding the need for an explicit articulation of hypernorms, they maintained that such a task
would be enormous and is not central to ISCT. Donaldson and Dunfee (2000b) agreed with Boatright’s (2000) call for a clearer articulation of hypernorms. They concurred: “Professor Boatright is surely correct to conclude that were such a feat possible, the elements of that more fundamental theory could illuminate the application of hypernorms in the context of microsocial contracts” (p. 481). However, the authors contended that such an endeavor is daunting and idealistic (Donaldson & Dunfee, 2000b). More importantly, Donaldson and Dunfee (2000b) posited that a full-fledged moral theory is not necessary for ISCT. They argued that:

[W]hile the theory would be crisper and its results surely more transparent were such a background theory found, ISCT nonetheless adds considerable value without such a specification. No matter which normative theory is relevant for the decision maker, and no matter which set of hypernorms—thin or thick, substantial or insubstantial—one prefers, ISCT counsels economic practitioners to attend especially to the reality of microsocial contracts (p.482).

The authors also contended: “Members of a microsocial community will be influenced by their understandings of hypernorms in the generation of microsocial norms” (p.482). In their view, hypernorms may be inferred from the convergence of ethical theories and world religions regarding certain principles. This convergence will eventually result in a universal consensus over what constitutes hypernorms.

**What, then, what are the CSR principles?** ISCT provides four core principles to recognize stakeholder obligations. Organizations, based on these principles, can establish two types of stakeholder obligations: mandatory and permissible. Donaldson and Dunfee (1995) referred to mandatory obligations as those already existing when “hypernorms and/or applicable legitimate norms establish nonoptional standards for organizations…. Permissive standards allow
organizations discretion to respond to particular nonshareholder stakeholder interests without fear of being considered to have violated an obligation to shareholders or even to other community constituencies with competing interests” (pp. 248-249). The four core principles are:

1. Relevant sociopolitical communities are a primary source of guidance concerning the stakeholder obligations of organizations formed or operating within their boundaries.

2. Where norms pertaining to stakeholder obligations are not firmly established in the relevant sociopolitical communities, organizations have substantial discretion in deciding how to respond to stakeholder claims and interests.

3. All decisions affecting stakeholders undertaken by organizations must be consistent with hypernorms.

4. Where there are conflicting legitimate norms concerning stakeholder obligations among relevant sociopolitical communities, the norms of the community having the most significant interests in the decision should be candidates for priority. Otherwise, where there are conflicting norms with no clear basis for prioritization, organizations have substantial discretion in choosing among competing legitimate norms” p.248).

The four core principles provide a valuable and precise approach to guide the justification and articulation of stakeholder obligations. However, the Achilles’ heel of these principles is their need for a reference point: hypernorms and/or legitimate norms. In the absence of an explicit statement of such norms, ISCT recommendations would not be as specific as desired. CSR or stakeholder obligations would be those obligations that are mandated or permitted by hypernorms and/or legitimate norms. But what are those obligations? What makes some of
them mandated and others permitted? These questions keep looking for more specific answers than the one ISCT provides.

ISCT’s ability to provide a clear articulation to what constitute CSR or stakeholder obligations, one must admit, remains limited. The pursuit of hypernorms is essential for ISCT to provide a specific and operationalizable account of CSR. Donaldson and Dunfee (2000b) said that “the bloody intellectual battlefield over normative theory during the last two millennia bears witness to the enormity of that task” (p. 481) and that attempts to reveal normative principles essential for the advancement of business ethics should not be abandoned.

**TRACKING DOWN ELUSIVE PRINCIPLES: REVEALING SPECIES OF HYPERNORMS**

And sometimes we are devils to ourselves
When we will tempt the frailty of our powers,
Presuming on their changeful potency.

*William Shakespeare*

*Troilus and Cressida (Act IV, Scene IV)*

Pain and foolishness lead to great bliss and complete knowledge,
for Eternal Wisdom created nothing under the sun in vain.

*Kahlil Gibran*

Wise business ethicists both admire and criticize Donaldson and Dunfee; prudent business ethics students heed their warning, but foolish enthusiasts contest the impossibility of the enormous task of pursuing an explicit articulation of hypernorms. This paper seeks to take a step toward the explicit articulation of hypernorms. To make the task more feasible, the scope of
application of the normative arguments presented in this paper is that of business ethics. The sought hypernorms are those moral principles necessary for an ethical institution of business. The hypernorms developed in this paper, while may be used to address ethical issues in other social institutions, are not developed nor intended to serve that purpose.

A Taxonomy of Hypernorms

Rawls (1971) contended that society may be thought of as a cooperative venture. Van Buren (2001) explained: “Rawls proposed that society be thought of as a cooperative venture that must be underpinned by principles of justice that free and rational persons would choose from a position of original equality” (p. 485). Rawls (1971) argued that rational persons, behind a veil of ignorance, would choose to enter in a cooperative venture over remaining in a Hobbesian state of nature. To develop fair and just rules for their cooperative venture, the rational persons do so from behind a veil of ignorance. The veil of ignorance ensures that they do not know their natural endowments (or the probability associated with their distribution) or the roles that they will play in society. The rational person would then agree to the principles of “justice as fairness” (Rawls, 1971).

While being a great influence to business ethics, Rawls’ theory is criticized on two counts. First, the use of a veil of ignorance, while a technique that is often used in contractarian ethics, is thought to inadequately represent the realities of business. Therefore, business practitioners would be unable to relate to the moral principles generated under the condition of the veil of ignorance (Frederick, 2000a, 2000b). Second, the difference principle (as cited in Rawls, 1971, p. 65-70) contends that justice will be achieved when social inequalities are arranged in a manner that would benefit the least well-off group in society. This argument is perceived as too strict and unlikely to be endorsed by the business world.
Gauthier’s (1986) *Morals by Agreement* sets forth a version of contractarianism that might be more suitable for economic issues and may hold some key answers to the classification and development of hypernorms.

**Competition and cooperation.** Gauthier (1986) used the traditional conceptualization of morality as “a rational constraint on the pursuit of individual interest” (p. 2). He agrees with Hobbes that in the natural condition of humankind, individual persons have no constraint on maximizing their self-interest. The invisible hand of the market (Adam Smith, 1776) would coordinate interaction between economic actors and ensures an optimal equilibrium. Gauthier contended that such optimal equilibrium will be attained, but only under three idealized market conditions: (1) cessation of force and fraud prevalent in the natural condition of human kind, (2) private ownership, and (3) private consumption.

The cessation of force and fraud is endorsed by Adam Smith as a condition for the emergence of the market. Adam Smith (1776) stated that “every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest, his own way, and to bring both his industry and capital into competition with those of any other man…” (p. 745). Private ownership applies to: (1) individual factor endowments and (2) individual market activity. Individual factor endowments determine the supply to the market. Gauthier (1986) said that individual market activity secures the free activity of each economic actor in the market. Ownership grants each economic actor the right to use a product or factor that he/she owns as he/she “pleases in the processes of production, exchange, and consumption” (p. 86). Private consumption applies to private goods and mutual unconcern. Private goods refer to the condition where multiple economic actors cannot mutually consume a good. The consumption of a good by an economic actor excludes all others from its consumption. Gauthier said that mutual...
unconcern refers to the conception of persons “as not taking an interest in the interest of those with whom they exchange” (p. 87).

Under these three conditions of the idealized market, economic actors are able to reach optimal equilibrium through their pursuit of self-interest. Gauthier (1986) characterized this situation as the “antithesis to the Prisoner’s Dilemma” (p. 83). Figure 2.1 illustrates this situation for a simple two-player game. In a simple two-player game, each player’s pursuit of self-interest (Strategy B for both players) yields optimal equilibrium at (10, 10). Both players realize maximum gains through the pursuit of their self-interest. No restriction on the pursuit of self-interest is required.

When either or both conditions of private ownership and private consumption are violated, market failure occurs. Economic actors pursuing their self-interest face a prisoner’s dilemma (Figure 2.2). The equilibrium reached through the pursuit of self-interest (Strategy A for both players) is suboptimal at (3, 3). Optimal solution for both players is reached at the Nash-equilibrium of (8, 8), which is only feasible through cooperation. Under idealized market conditions, the invisible hand of the market, through competition, coordinates interaction between economic actors to reach optimal equilibrium. In contrast, under conditions of market failure, the invisible hand produces a suboptimal equilibrium. Gauthier (1986) said that “cooperation arises from the failure of market interaction to bring about an optimal outcome because of the presence of externalities. We may think of co-operative interaction as a visible hand which supplants the invisible hand, in order to realize the same ideal as the market provides under conditions of perfect competition” (p. 128).

**Domains of morality and species of hypernorms.** The discussion presented above suggests that Gauthier’s depiction of the evolution of society as a cooperative venture from the natural
condition of humankind may be conceived as a two-stage evolutionary process. The first stage transformed the existence of individuals from the natural condition of humankind to a market condition. This transformation was allowed by a “pre-market morality.” This market condition, within the confines of the “laws of justice,” would permit economic actors to attain optimal equilibrium through the pursuit of self-interest. Due to market failure, the pursuit of self-interest results in suboptimal equilibrium. Since accepting suboptimal outcomes is irrational, economic actors, who are rational, cooperate to achieve optimality. They agree to a post-market morality that dictates the practices of their cooperation.

Under idealized market conditions, cooperation is not required among economic actors to reach optimality. No restriction on the pursuit of self-interest is needed. Gauthier (1986) explained that morality is conceived as “a rational constraint on the pursuit of individual interest” and is, therefore, not needed (p. 2). Gauthier (1986) also contended that “the perfect market, where it realized, would constitute a morally free zone, a zone within which the constraints of morality would have no place” (p. 84). Gauthier has not been the only one to contend that the perfect market constitutes a morally free zone. Grice (1958) held the same conviction. He argued that “the very raison d’être of morality is to yield reasons which overrule the reasons of self-interest in those cases when everyone’s following self-interest would be harmful to everyone” (p. 309).

The principles or Hypernorms of morality, therefore, would play two roles. The first is to bring about the conditions of the perfect market; the second is to restore such conditions when markets fail. Hypernorms may, therefore, be divided into two species: competitive and cooperative. Competitive hypernorms are those norms that allow the transfer of individuals from the natural condition of humankind to the market condition, therefore permitting the realization
of optimal equilibrium through competition. Cooperative hypernorms, in contrast, are those hypernorms that coordinate interaction under conditions of market failure, therefore allowing the realization of optimal equilibrium through cooperation. The purpose of competitive hypernorms is different than that of cooperative hypernorms. Competitive hypernorms produce the conditions for market operation. Cooperative hypernorms, on the other hand, rectify the conditions of market failure. The relationship between both species is that of complementaries. Figure 2.3 illustrates the purpose and domain of competitive (pre-market morality) and cooperative (post-market morality) hypernorms.

**Competitive Hypernorms: The Constructive Argument**

As discussed above, competitive hypernorms are those norms that aim at transferring individuals from the natural condition of humankind to an idealized market condition. The natural condition of mankind is characterized by the prevalence of force and fraud (Gauthier, 1986; Rawls, 1971). Adam Smith (1776) argued that market competition is feasible only under the protection of the “laws of justice”. Primary among the laws of justice would be those that lead to the cessation of force and fraud. To permit the emergence of the market, economic actors must be protected from harm and from fraudulent activities. A pre-market morality would, therefore, grant this protection. Economic actors would then agree to the following competitive hypernorms:

*The Principle of Negative Rights:* Violation of Negative rights constitutes a violation of free market interaction; therefore, is prohibited: Economic actors are not to be interfered with by others.
**The Principle of True Representation:** Fraud constitutes a violation of free market interaction; therefore, is prohibited. Economic actors are entitled to true representation of implicit and explicit terms of interaction.

Adam Smith’s (1776) endorsement of the “laws of justice” would make him in agreement with the two competitive hypernorms stated above. Friedman’s (1962) contention that purist of self-interest would be carried out “while conforming to the basic rule of society, both those embodied in the law and those embodied in ethical customs” is also in agreement with the proposed hypernorms (p. 32). These two hypernorms construct the conditions necessary for the emergence of the market.

**Cooperative Hypernorms: The Restorative Argument**

Gauthier argues that under perfect market conditions, no restriction on individual pursuit of self-interest is needed because such a pursuit results in an optimal equilibrium. The market is considered a morally free zone. In contrast, under conditions of market failure, the pursuit of self-interest results in a suboptimal equilibrium. Optimal equilibrium will only be reached by cooperation. Rational economic actors, therefore, would choose to cooperate. To cooperate, economic actors have to impose restrictions on their pursuit of self-interest. These restrictions are embodied in a post-market morality shaped by cooperative hypernorms.

Cooperative hypernorms are needed to reach optimality under conditions of market failure. If optimality were to be reached through competition, cooperative hypernorms would not be needed. Competition rather than cooperation would be the mode of interaction among economic actors. However, due to market failure, optimality can only be reached via cooperation. Cooperative hypernorms restrain economic actors’ pursuit of self-interest so that the equilibrium reached from interaction is optimal. In other words, cooperative hypernorms aim
to restore the conditions of the idealized market. Cooperative hypernorms shape cooperation in a manner that minimizes the effects of market failure and restores, to the best extent possible, the idealized market conditions.

**Externalities.** Idealized markets are realized when three conditions are satisfied: (1) cessation of force and fraud prevalent in the natural condition of human kind, (2) private ownership, and (3) private consumption. Under these conditions, externalities are absent. When conditions 2 and 3 are violated, externalities occur in one of two forms: negative or positive. Negative externalities occur when an economic actor shifts part or all of the cost of production onto others. Gauthier (1986) used the term “parasite” as those who enjoy the benefits of production without paying for part or all of its costs (p. 96). Positive externalities occur when an economic actor benefits from the consumption of a product without paying for part or all of its costs. Gauthier also used the term “free-rider” as those who enjoy the benefits of consumption at a reduced or no cost (p. 96).

To restore market conditions, economic actors need to eliminate negative and positive externalities. Therefore, they would agree to internalize the costs associated with production and consumption. Producers must pay for all the costs associated with their production activities, and consumers must pay for all the costs associated with their consumption activities. The economic actors would thus agree to the following hypernorm:

**The Principle of Cost Internalization:** Economic actors are to internalize the total costs associated with their production and consumption activities.

**Institutions.** To move away from the natural condition of humankind to a society, humans adopt certain normative, cultural, and regulative elements to coordinate their cooperative venture (Scott, 2001). North (1990) contended that “[i]nstitutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction” (p. 3).
Their major role, North added, “is to reduce uncertainty by establishing a stable (but not necessarily efficient) structure to human interaction” (p. 6). These constraints, formal and informal, reduce the costs of human interaction. They determine, among other things, standards of economic interaction. Their function is manifest in the conformity to them. Conformity to institutions allows economic actors to achieve optimality through cooperation. North also argued that there is a symbiotic relationship between institutions and organizations. Conformity to these institutions is necessary for their existence. A cooperative hypernorm may then be stated as:

**The Principle of Uncertainty Minimization:** Economic actors are to conform to social institutions that do not violate the competitive hypernorms and the principle of cost internalization.

Economic actors, owners of the factors of production, will pursue their self-interest within the boundaries set by the social institutions. Since institutions are the “rules of the game,” they will have the same effect on all economic actors of the same type. However, they may have different effects on economic actors of different types. For example, a given institutional structure may have a positive effect on owners of capital. This positive effect will influence all owners of capital in the same way. The same institutional structure, however, may have a negative effect on labor, which will influence all labor in the same way. Consequently, agreement needs to be reached as to which institutional structure to adopt. Which institutional structure will the factors of production agree to?

Rawls (1971) argued that, from behind a veil of ignorance, rational individuals will agree to the institutional structure that makes the worst group better off. Since Rawls’ argument regards the natural endowments of the economic actors as arbitrary. His conclusion, therefore,
partly aims to address such arbitrariness and achieve justice for all individuals. By using Minimax, Rawls addresses the arbitrary distribution of natural endowments and achieves justice. Rawls’ proposal was met by some criticism. First, some social scientists, (e.g., Frederick, 2000a, 2000b) contend that the use of the veil of ignorance is an approach that does not represent the realities of the business world. They appealed for an approach that relates more to these realities. Second, the Minimax principle was perceived as incompatible with the values of the business world.

In contrast to Rawls (1971), Gauthier’s contractarianism does not attempt to make any moral claims regarding the distribution of natural endowments. Natural endowments of the economic actors are taken as a given. Economic actors have a moral obligation not to worsen the conditions of other, but they do not have a moral obligation to improve it (Gauthier, 1986). These assumptions makes Gauthier’s version of contractarianism more suitable for application in the business world.

Gauthier minimized the artificiality of the hypothesized original condition by using more realistic assumptions to describe it. He refers to the original condition from which bargaining among the economic contractors start as the initial bargaining condition. He argues that this condition represents the gains each economic actor realizes in the absence of cooperation. Gauthier concedes that there is no equality among actors at the initial bargaining condition because their gains in the absence of cooperation are determined by the actors’ natural endowments. The initial bargaining position represents a reference point to which the gains from cooperation are to be compared.

Economic actors, through a bargaining process, will seek to maximize their gains. Any given economic actor will demand at least a share of the economic surplus equal to his/her own
surplus that would have been generated in the absence of cooperation. A smaller share will not be acceptable to any of the economic actors because it will not justify the cooperative venture. Through cooperation, each actor aims at gaining more than what he or she could have generated in the absence of cooperation. Bargaining among the actors will then be reduced from bargaining over the total economic surplus to bargaining over the cooperative surplus, which is the surplus resulting from cooperation in excess to the total surplus that would have been generated in the absence of cooperation.

How, then, may the cooperative surplus be divided among the cooperating economic actors? What is the just share for each actor? What is the just equilibrium of the bargaining process? Gauthier argued that since each of the economic actors needs the others to carry out the cooperative venture, such venture would not be possible in the absence of any one of the cooperating parties. Accordingly, each of the cooperating parties is entitled to an equal share of the cooperative surplus. Each one of the cooperating parties will then receive an amount equal to the economic surplus that he or she would have generated in the absence of cooperation in addition to an equal share of the cooperative surplus. This outcome is reached by maximizing equal relative benefits of the overall economic surplus (or by minimizing equal relative concessions of the overall economic surplus). A cooperative hypernorm may then be set forth as:
**The Principle of Institutional Justice:** Economic actors are to agree to an institutional structure that will distribute the economic surplus among the factors of production such that each factor receives what it would have received in the absence of cooperation in addition to an equal share of the cooperative surplus. In other words, the total economic surplus is to be dividing among the factors of production according to maximum equal relative benefits (or minimum equal relative concessions).

**Allocations of the factors of production.** Economic actors participate in economic activity in pursuit of gains. Such gains, as argued above, are maximized through the unrestricted pursuit of self-interest under idealized market conditions. Due to market failure, unrestricted pursuit of self-interest leads to suboptimal equilibrium. To eliminate the possibility of a suboptimal equilibrium, the economic actors cooperate. Since the purpose of cooperation is to eliminate the possibility of a suboptimal equilibrium and not to eliminate the pursuit of self-interest, economic actors would agree to exercise a constrained pursuit of self-interest. They would agree to restrict their pursuit of self-interest by the two cooperative hypernorms developed above: cost internalization and uncertainty minimization.

Within the confines of these constraints, economic actors would be free to pursue their self-interest. They would seek to maximize the returns of the factors of production they own. Therefore, they would allocate their factors of production in the manner that would maximize their gains. A hypernorm may then be developed as:
The Efficiency Principle: In pursuit of maximizing their gains, economic actors are permitted to allocate their factors of production in a manner that would maximize their efficiency within the boundaries set by the competitive hypernorms and the principles of cost internalization and uncertainty minimization.

The economic surplus of market interactions. Under idealized market conditions, the unrestricted pursuit of self-interest results in an optimal equilibrium. The economic surplus generated from the interaction is then accordingly distributed through free market mechanisms. The resulting distribution of the economic surplus is, of course, acceptable to the interacting economic actors. If it would have been unacceptable, the economic interaction would not have taken place. Cooperation is only necessary because of market failure. Through cooperating, the economic actors eliminated the possibilities of a suboptimal equilibrium. Consequently, equilibriums within the boundaries of cooperation would remain acceptable to the economic actors. Distributing the economic surplus, therefore, would be left to be determined by market mechanisms. A hypernorm may then be stated as:

The Distribution Principle: Economic actors are permitted to distribute the economic surplus resulting from their interactions through market mechanisms operating within the boundaries set by the competitive hypernorms and the principles of cost internalization and uncertainty minimization.

Institutional change. North (1990) argued that economic actors, in pursuit of their self-interest, may direct their resources to change an existing intuitional structure when the payoff from that effort is higher than the payoff from investing under the existing constraints. North explained that “a change in relative prices [of factors] leads one or both parties to an exchange … to
perceive that either or both can do better with an altered agreement or contract. An attempt will be made to renegotiate the contract” (p. 86). Consequently, a bargaining process between the two parties will result. In this process, each party will attempt to achieve its goal of changing, or maintaining, the current institutional structure. Any one of the negotiating parties, in an effort to persuade the other one to agree to a given institutional structure, may choose to reallocate part of its economic gains in favor of its negotiating partner. This reallocation would occur from the party who is, or would be, more advantaged, under a given institutional structure, to the one that is, or would be, less advantaged. The purpose of this reallocation is to change the payoff function of the less advantaged party such that agreement is reached.

This reallocation of economic gains is at the discretion of the more advantaged party. It is not a necessary condition for fair bargaining because the disadvantaged party maintains its freedom to disagree and continue the bargaining process. This reallocation of the economic gains is, therefore, a philanthropic act by the more advantaged party to achieve its goal of changing or maintaining the current institutional structure. A cooperative hypernorm may then be stated as:

**The Principle of Philanthropy:** In an effort to persuade their negotiating partners to accept a given institutional structure, economic actors are permitted to reallocate a portion of their economic gains in favor of the less advantaged ones to alter their payoff function such that agreement is reached regarding changing or maintaining a given institutional structure.

**A CONTRACTARIAN STATEMENT OF CSR**

This paper promised a contractarian statement for the definition of CSR that articulates its source, nature, components, and scope. The argument above showed that such an endeavor
would be achieved through a derivation that integrates normative and instrumental arguments. The normative arguments utilized contractarian ethics (Gauthier, 1986; Hobbes 1881/1997; Hume, 1748/1969; Locke, 1690/1969, Rousseau; 1762/1993; & Rawls, 1970). In its center ISCT framework was adopted and incorporated with Gauthier’s’ version of contractarianism, which is regarded as the most significant contribution to contractarian ethics since John Rawls’ A Theory of Justice (Kavka, 1987). In addition, Gauthier’s version of contractarianism also used assumptions and logic that are more compatible with business realities.

The instrumental arguments constructed used rational choice theory (Harsanyi, 1955, 1977; Sen, 1970, 1988; Sen & Williams 1982), transaction cost economics (Coase, 1937; Williamson, 1979), game theory (Harsanyi, 1974; Nash, 1950; von Neumann & Morgenstern, 1994), and the theory of institutions (North, 1981, 1990). Rational choice theory provides fundamental assumptions about, and definitions of, rationality and rational choice. Transaction cost economics provides an understanding of the nature of the firm, which supplies the context within which contracting relationships develop (Fama, 1980; Jensen & Meckling, 1976). Game theory explains the behaviors and actions of the firm and other interacting parties. This explanation provides a rationale for the development and construction of agreements and contracts. The theory of institutions provides a depiction of the nature and dynamics of social institutions. This depiction permits making vital distinctions between different CSR obligations.

From Hypernorms to CSR

The two species of hypernorms developed above, competitive and cooperative, provide the foundation and justification for CSR. As an economic actor, the firm implicitly agreed to conditions of cooperation with other economic actors on rational basis to maximize its self-interest. The conditions consist of two species of hypernorms: competitive and cooperative. The
competitive hypernorms allowed the creation of a market out of the original condition of human kind. Through perfect competition and under idealized market conditions, economic actors are able to reach optimal equilibrium through pursuit of self interest. However, due to market failure, the pursuit of self-interest results in suboptimal equilibrium. The rational economic actors, therefore, agree to cooperate to restore optimality. The conditions of their cooperation are reached though a bargaining process that restores, as much as possible, market conditions (Gauthier, 1986). This restoration is achieved through cooperative norms. CSR is thus determined by the hypernorms of competition and cooperation. A contractarian statement of CSR may then be set forth as:

*Corporate social responsibility (CSR) refers to a firm’s commitment to implicit and explicit agreements by virtue of which it is a legitimate party of society. The firm’s commitment is embodied in its obligation to protect and improve society. The firm protects society through (1) refraining from harming other social actors, (2) abstaining from fraudulent activities, (3) internalizing the total costs associated with its production and consumption activities, and (4) conforming to institutions. The firm improves society through (1) agreeing to institutions that distributes the economic surplus among the factors of production according to maximum equal relative benefits, (2) allocating its resources efficiently, (3) maximizing its gains through constrained competition, and (4) using philanthropic activity to maintain or achieve favorable institutional structures.*
DESRIPTIVE AND NORMATIVE DEPICTIONS OF CSR CATEGORIES

Carroll’s Pyramid: A Descriptive Perspective

Carroll (1991) set forth the Pyramid of CSR (Figure 2.4). Carroll’s pyramid depicts four categories of CSR: economic, legal, ethical, and philanthropic. The economic and legal categories are considered required, the ethical expected, and the philanthropic desired. All four categories are meant to be pursued simultaneously. Interpretation errors, however, led some to believe that the four categories of CSR are to be pursued in a lexical manner mirroring their depiction in the pyramid. These misinterpretations resulted from using Carroll’s Pyramid as a normative model, while it is essentially descriptive. Carroll’s pyramid describe what is, i.e., how managers perceive the categories of CSR.

The contractarian statement of the definition of CSR and the articulation of the hypernorms from which it is derived provide useful tools to respond to the intuitive need for providing a lexical order for the categories of CSR. The value of providing a lexical order of the categories of CSR helps managers deal with competing stakeholder claims through prioritization. In addition, the lexical order may provide a justification for the different levels of moral mandates of the four categories of CSR depicted in Carroll’s pyramid.

A Normative Perspective

Since the cooperative venture is achieved through a constrained pursuit of self-interest to eliminate the possibility of a suboptimal equilibrium, constraining conditions are necessary for its success. Pursuit of self-interest is, then, permitted within the confines of the cooperative agreement. The principle of uncertainty minimization, introduced above, dictates that economic
actors conform to institutions. Conformity to institutions, therefore, is primary to the pursuit of self-interest.

North (1990) identifies two types of institutions: formal and informal. Formal institutions include formal laws and property rights. Informal institutions include codes of conduct, norms of behavior, and conventions. Both types are essential. Moreover, North (1990) underscores the significant role that informal institutions play in a society by noting that “formal rules, even in the most developed economy, make up a small (although very important) part of the sum of constraints that shape choices; a moment’s reflection should suggest to us the pervasiveness of informal constraints” (p. 36).

Formal institutions are self-enforcing. They maintain social order and reduce uncertainty through coercive mechanisms (Scott, 2003). Scott also said that they institutionalize norms that are “legally sanctioned” (p. 135). In other words, they are the “codified ethics” of society (Carroll, 1991, p. 41). Informal institutions are not self-enforcing. They maintain order and reduce uncertainty through mimetic and normative mechanisms (Scott, 2003). Mimetic mechanisms defuse “shared understandings” and normative mechanisms shape “binding expectations” (Scott, 2003, p. 135).

The coercive mechanism utilized by formal institutions indicates that violating legally sanctioned norms is critical. Society is taking severe measures to ensure that such norms are followed and violations are minimized. Such enforcement measures are not as strict for informal institutions. This disparity in enforcement indicates that formal institutions carry a higher moral mandate than that of informal institutions. Therefore, formal institutions are supreme over informal ones. In case of competing obligations, priority must be given to formal institutions over informal ones. The legal category of CSR precedes the ethical category.
As argued above, maximizing behavior is permitted within the constraints of cooperation. Conformity to institutions is, then, primary to the pursuit of self-interest. Therefore, the legal and ethical categories of CSR precede the economic category. The legal category precedes the ethical category because the first represents formal institutions and the latter represents informal institutions. Priority is thus given firstly to legal responsibility, secondly to ethical responsibility, and thirdly to economic responsibility.

The economic responsibility of the firm is toward its stockholders. This responsibility is a fiduciary responsibility. In contrast, the firm’s responsibility toward other stakeholders and society, as a whole, is non-fiduciary. However, the firm may fulfill its fiduciary responsibility within the constraints of its non-fiduciary responsibilities.

**Philanthropy: responsibility and supererogation.** The principle of philanthropy which was developed above permits economic actors to further their self-interest through philanthropic activity. Philanthropic activity is permitted, not mandated. It is justified in the derivation as a tool for the pursuit of self-interest. Philanthropic activity of this type is strategic. Epstein (1989) said that strategic philanthropy “constitutes a classic instance of business organizations seeking to ‘do well by doing good’…” (p. 592). Social expectations that organizations, especially profitable ones, give to communities in which they operate is an appeal to philanthropy of a different kind that is, philanthropy motivated by altruism. Rachels (2000) defines altruism “involves acting for the good of others even at some cost to oneself” (p. 81). Such action, while may be desired by society, is morally mandated by the hypernorms developed above. Such activity goes beyond the “call of duty”.

Legal and ethical norms are based on moral mandates. Even though they are varying levels, they are moral obligation. In a sense, they are morally required. Actions that extend
beyond moral obligation are supererogatory. The Stanford Encyclopedia of Philosophy defines supererogation as “the technical term for the class of actions that go ‘beyond the call of duty.’ Roughly speaking, supererogatory acts are morally good although not (strictly) required”. Such actions are permitted and even encouraged, but not morally mandated. Accordingly, supererogatory actions come after moral obligations.

Philanthropic activity motivated by strategic reasons is a permitted action in pursuit of self-interest. Philanthropic activity motivated by altruism falls in the category of supererogatory actions. Neither is morally required; both are permissible. Strategic philanthropy is then a part of advancing self-interest. Philanthropic activity that society desires from organizations is one that appeals to altruism. Therefore, Philanthropy motivated by altruism would follow both the fiduciary and non-fiduciary responsibilities of the firm.

**A lexical order for the categories of CSR.** According to the discussion presented above, the legal responsibility of the firm is primary. Ethical responsibility follows. Both legal and ethical responsibilities represent the non-fiduciary responsibilities of the firm and set the constraints for permissible behavior. Economic responsibility follow the legal and the ethical responsibilities. Economic responsibility represents the fiduciary responsibility of the firm. Finally, following the legal, ethical, and economic responsibilities of the firm, philanthropic activity may take place as a supererogatory activity. The four categories of CSR may then be stated in the following lexical order: legal, ethical, economic, and philanthropic (Figure 2.5).

**CONCLUSION**

This paper proposes a contractarian statement of CSR. The statement aims at providing a richer understanding of CSR and a clearer depiction of its origins, nature, components, and scope. The definition articulates four obligations to protect society. Such obligations originate
from the mandatory hypernorms of competition and cooperation. In addition, the definition articulates four obligations to improve society. These obligations originate from the permissive hypernorms of cooperation. The paper then proposed a normative perspective of CSR categories. The normative perspective casts the four categories in a lexical order that would allow for prioritizing the firm’s competing obligations.

The proposed statement of the CSR definition was derived using a business ethics approach that utilized ISCT framework and Gauthier’s version of contractarianism. In the derivation process hypernorms for ISCT were developed. The developed hypernorms are classified into two species. First, competitive hypernorms, representing those norms aimed at creating idealized market conditions, transferred humans from the natural condition of human kind where force and fraud prevails to the cooperative state of a society. Second, cooperative hypernorms, representing those norms that accounted for market failure, allowed humans, through a cooperative venture, to restore, to the extent possible, the conditions of the idealized market. The pursuit of self-interest within the boundaries of the cooperative venture, through constrained competition, was then permitted for economic actors to maximize their gains.

The contribution of this paper is twofold. First, the contractarian statement of the CSR definition lends it more to operationalization. Specifying the obligations and proposing a lexical order permits managers to determine, operationally, each of the CSR obligations. In addition, managers would be able to prioritize the firm’s competing obligations. Second, the proposed articulation of ISCT hypernorms represents a step toward realizing the broader normative principles of business ethics.
REFERENCES


Table 2.1
Strengths and Limitations of the Current Statements of the Definition of CSR

<table>
<thead>
<tr>
<th>Origins of the Limitations of the Current Statements of the Definition of CSR</th>
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<tbody>
<tr>
<td>Normative and instrumental arguments are not integrated.</td>
</tr>
<tr>
<td>Instrumental aspects of the ascription and use responsibility are fully depicted.</td>
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<tr>
<td>The term “responsibility” is used in different ways.</td>
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<table>
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<tr>
<th>Strengths</th>
<th>Limitations</th>
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<tbody>
<tr>
<td>CSR is only meaningful in the context of a normative standard.</td>
<td>A clear articulation of the origins of responsibility is not explicitly stated. The definitions do not explain from where CSR emanates.</td>
</tr>
<tr>
<td>CSR is constituted of two main components: an obligation to prevent harm (to protect) and an obligation to generate benefit (to improve).</td>
<td>The components of responsibility are not adequately depicted. CSR refers to obligations to protect and improve society, but it does not specify the constituents of these obligations.</td>
</tr>
<tr>
<td>The obligations are categorized into four categories: economic, legal, ethical, and philanthropic</td>
<td>A well-articulated schema for rank ordering obligations is absent. The absence of such a schema creates moral dilemmas for practitioners and hinders the firm’s ability to respond to competing obligations.</td>
</tr>
<tr>
<td>CSR is a responsibility with respect to specific issues.</td>
<td></td>
</tr>
<tr>
<td>The obligations are shaped, or at least influenced, by social expectations</td>
<td></td>
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<tr>
<td>Social expectations are not static; they are dynamic and change over time.</td>
<td></td>
</tr>
<tr>
<td>CSR is an obligation partly towards society as a whole and partly towards identifiable stakeholders.</td>
<td>No clear statement of what obligations are directed towards society and what obligations are directed towards identifiable stakeholders.</td>
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Figure 2.1
Idealized Market Conditions: Pareto-optimal Equilibrium

<table>
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<tr>
<th>Player 1</th>
<th>Player 2</th>
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<td><strong>Strategy</strong></td>
<td><strong>Strategy</strong></td>
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Figure 2.2
Market Failure: Suboptimal Equilibrium

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<td>A</td>
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<td>B</td>
<td>B</td>
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<tr>
<td>5,15</td>
<td>8,8</td>
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</table>

Figure 2.3
Restoring the Idealized Market Conditions

Natural Condition of Humankind

Pre-market Morality

Market Conditions

Imperfect Conditions

Competition

Sub-optimal Equilibrium

Cooperation

Post-market Morality

Idealized Conditions

Competition

Optimal Equilibrium

Restrained Competition
Figure 2.4
Carroll’s Pyramid of Corporate Social Responsibility: A Descriptive Model

Figure 2.5
A Normative Model of Corporate Social Responsibility
CHAPTER 3

CORPORATE SOCIAL REPORTING: RATIONAL AND INSTITUTIONAL APPROACHES TO ACHIEVING LEGITIMACY

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INTRODUCTION

Many corporations are issuing “stand-alone” reports with the express purpose of disclosing information pertaining to their social and environmental performance (Owen & O’Dwyer, 2008, P. 384). Although not required by law, social and environmental reporting are gradually becoming accepted business practices. In addition, some of these companies develop their reports according to guidelines recommended by “watchdog” organizations such as Global Reporting Initiative (GRI). The absence of regulation and the lack of universal standards cause significant variances in the reporting behavior among firms. Some firms issue social reports; others do not. Some reports are perceived to reflect a company’s commitment to social responsibility, while others are believed to be nothing more than a publicity stunt.

Various studies examined corporate social reporting from a variety of angles. Some explored corporate social reporting practices in different countries such as Germany (Brockhoff, 1979; Dierkes, 1979; Dierkes & Antal, 1986), the United Kingdom (Hammond & Miles, 2004), Mexico (Paul et al., 2006), Thailand (Kuasirikun & Sherer, 2004), and Malaysia (Hai-Yap & Thong, 1984). Other studies compared corporate social reporting practices across countries (Chapple & Moon, 2005) and across industries (Campbell, Craven, & Shrives, 2003). Many scholars justify corporate social reporting as a mechanism by which firms manage their legitimacy and reputation (Clarke & Gibson-Sweet, 1999; Hooghiemstra, 2000; Woodward, Edwards, & Birkin, 1996). Others justify it as tool for organizational learning (Gond & Herrbach, 2006). However, some scholars expressed their skepticism as to its purpose (Guthrie & Parker, 1989). Researchers have also explored determinants of corporate social reporting such as organizational size (Patten, 1991) and industry classification (Cowen, Ferreri, & Parker, 1987; Gray, Kouhy, & Lavers, 1995; Patten, 1991).
Antal, Dierkes, MacMillan, and Marz (2002) gave an overview of the development of corporate social reporting and its methodologies and models. The authors traced corporate social reporting back to the late 1950s. In the late 1960s, an increase of public interest in corporate social reporting occurred. In the 1970s, corporate social reporting was carried out under the rubric of the social audit. In the 1980s and 1990s, a decline in corporate social reporting took place. A revival of the interest in corporate social reporting occurred from the 1990s to the present.

In this study, I propose a more comprehensive model of corporate social reporting. The model depicts its determining factors at different points in time. Rational factors appear to explain corporate social reporting in the early 1990s. The effect of the rational factors progressively fades through the 1990s and the early 2000s indicating the institutionalization of corporate social reporting.

This essay is organized into four sections. First, a brief overview of corporate social reporting behavior is presented. Second, a theoretical model for corporate social reporting is proposed and hypotheses are stated. Third, an empirical analysis is conducted and results are presented. Fourth, a discussion and conclusion is provided.

CORPORATE SOCIAL REPORTING

Many social groups, non-governmental organizations, and international organizations have been advocating the practice of corporate social reporting, perhaps the most salient of which are the Coalition for Environmentally Responsible Economies (Ceres) and the United Nations Global compact (UNGC). Ceres was formed in 1989 as a partnership between some environmentalist groups and institutional investors. Ceres’ mission is to advance sustainable prosperity. Its core beliefs include environmental stewardship, sound corporate governance, and
stakeholder transparency. In 1997 Ceres launched the Global Reporting Initiative (GRI) to serve as standard for economic, social, and environmental reporting. GRI become an independent entity since 2002. In the year 2006 GRI published its third generation of reporting standards, the G3, which demonstrate a high level of integration between GRI and UNGC. These events highlight the increasing public interest in corporate social reporting.

Corporate social reporting is indeed a timely issue. An increased public interest is evident in the fact that the incidences of social reporting is nearly ten times as great now as it was a decade ago. Many corporations acknowledge the importance of social reporting and are effectively and proactively engaging their stakeholders. Some corporations, however, remain dormant and raised the question: “why do some firms issue corporate social reports whiles others do not?”

THEORY DEVELOPMENT

Suchman (1995) defines legitimacy as “a generalized perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs and definitions” (p. 574). A firm’s actions are legitimate as long as they are congruent with the standards expected by society. When actions are suspected to deviate from the standards, the firm faces an increased need for legitimacy. While the firm claims that its performance adheres to expected standards, stakeholders suspect that it is below standards. To resolve this challenge, the firm is pressured to provide evidence that its operations are indeed congruent with the expected standards. Such evidence is often in the form of information regarding the firm’s performance. If the evidence provided supports the firm’s claim that its performance is congruent with expected standards, the legitimacy concern is
resolved. If firm performance is below the expected standards, the firm is pressured to change its operating standards to meet expectations.

In the absence of an agreed upon disclosure framework, a firm seeking to enhance its legitimacy would collaborate with its stakeholders to produce a disclosure framework that is acceptable to all parties and has the capacity to resolve the issue. The outcome is a social innovation that successfully addresses specific legitimacy needs of the firm (Johnson, Dowd, & Ridgeway, 2006). The developed framework, in turn, becomes a target of a legitimacy challenge: what makes the newly developed disclosure framework the proper manner through which a firm seeks to achieve legitimacy?

Johnson et al. (2006) argue that social objects gain legitimacy through a four-stage process: innovation, local validation, diffusion, and general validation. A social innovation is created to address a specific need of an individual or a collective. The innovation is locally validated when it is integrated with accepted local culture (Walker, 2004; Zelditch 2001; Zelditch & Walker, 2003). Diffusion then occurs when the innovation starts to gain support in other contexts than the one for which it was originally developed. Finally, as Johnson et al. (2006) explained, “the social innovation gains general validity when it is used to frame the future behavior of actors in many contexts” (p. 61).

In turn, the developed disclosure framework faces its own legitimacy challenge by going through the four-stage process of legitimation depicted by Johnson et al. (2006). First, the disclosure framework starts as a social innovation, the method of choice for specific firms to address their specific legitimacy challenge. Second, the disclosure framework is adopted by other firms operating in the same context (e.g., firms operating in the same industry or market), gaining local validation. Third, the disclosure framework diffuses to other contexts. The
framework is sporadically adopted by firms who perceive it to be an effective method for achieving legitimacy. Fourth, over time, the disclosure framework gains widespread acceptance among a growing number of firms where it achieves general validation.

A firm will face legitimacy problems when its operations are suspected not to be congruent with expected operating standards. Clarke et al. (1999) argued that “legitimacy … problems arise because of the perceived damaging impact of [a firms’] operations” (p. 7). Accordingly, a firm that is perceived to have the capacity to cause a damaging effect would face legitimacy problems. Miles (1987) assessed the firm’s capacity to cause a damaging effect along four dimensions: product mix, customer mix, geographic mix, and size. These four dimensions determine the extent to which a firm is subject to public scrutiny. A higher capacity to cause a damaging effect leads to a higher level of public scrutiny, which is referred to as business exposure. Saiia, Carroll, and Buchholtz (2003) defined business exposure as “the extent to which the firm is open and vulnerable to its social environment”. In addition to a firm’s capacity to cause a damaging effect, the level of public awareness of the firm and the nature of its operations would contribute to the formation of a legitimacy problem. Finally, a legitimacy problem would indeed occur if actual past performance of a firm was below expected operating standards.

Three factors emerge as leading causes of legitimacy problems: business exposure, public awareness, and past performance. Business exposure and public awareness are hypothesized to put more pressure on firms to resolve their legitimacy problems. Negative past performance would discourage firms from disclosing performance information. In contrast, positive past performance would encourage firms to disclose performance information.
The model proposed in this paper hypothesizes that business exposure, public awareness, and positive past performance would increase the likelihood of the publication of a corporate social report (a stand-alone report that discloses information about the firm’s environmental and social performance). In contrast, negative past performance will decrease the likelihood of the publication of a corporate social report. These factors provide rational reasons upon which the decision to publish a corporate social report may be made. However, over time, the explanatory power of the model is expected to decline, indicating that the influence of the depicted factors on the likelihood of corporate social report publication is fading. This decline in explanatory power provides evidence for the institutionalization process of corporate social report publication.

**Business Exposure**

Brammer and Pavelin (2004) following others (Hackston & Milne, 1996; Cormier & Magnan, 2003) contended that business exposure drives voluntary disclosure. They argued that higher levels of business exposure intensify the social pressures on the firm. These higher levels of business exposure exacerbate the firm’s legitimacy problems. Business exposure consists of four dimensions: product mix, customer mix, and geographic mix, and size (Miles 1987). Product mix refers to the extent to which risk is inherent in the product or production process of a product or service; customer mix refers to the breadth of the customer base; geographic mix refers to the degree to which the firm has geographically dispersed operations, and size refers to the scope of the economic presence of the firm.

Miles’ articulation of the dimensions of business exposure was conducted in the context of the U.S. insurance industry by using a grounded theory approach. By conducting the analysis in the context of one industry, Miles was able to separate industry exposure from business exposure. In addition, the four dimensions of business exposure were developed to reflect the
nature of the U.S. insurance industry. First, product mix was conceptualized to encompass two dimensions. Miles identified these as follows: “The first dimension is the extent to which the firm’s products or services are viewed by the general public as necessities or luxuries…. The second dimension is the extent to which the product or service offered by the firm, or the processes by which it is produced or distributed, create potential negative contingencies for the general public” (p. 21). Second, the customer mix was determined by the type of product offered. A customer mix was considered personal when the insurance firm offered products in the personal-line. When the insurance firm offered products in the commercial line, the customer mix was considered commercial. Geographical mix reflected the differences in political and legislative environments in which firms operate. Miles identified two types of geographical mix: urban and non-urban. These two types, he argued, are significant in shaping the social environments of firms operating in the U.S. insurance industry. Firm size was omitted from the study because its focus was on large U.S. firms. However, Miles asserted “it is appropriate to offer organizational size as a fourth element of business exposure when considering firms that vary substantially on this dimension” (p. 16).

Miles’ conceptualization of business exposure is driven by the context and methodology he used. While developed according to the specifics of the U.S. insurance industry, the concepts of business exposure are intended to be generalizable to other business contexts. To achieve such generalizability, the operationalization of the four dimensions of business exposure need to be adapted. This adaptation should allow the examination of the concept not only within other industries, but across industries as well.

The essence of the product mix dimension is to capture the impact of the product and its production processes on the environment of the firm, natural and social. Within the context of
the U.S. insurance industry, reducing the two-dimensional product mix to a one-dimensional construct measured along the necessity-luxury dimension is suitable. However, it limits its applicability to other contexts and across industry. Moreover, such operationalization would be problematic to apply at the firm level for firms that offer multiple product lines. I propose to adhere to the essence of product mix, but operationalize it along its second dimension, i.e., at the level of hazard associated with the production or consumption of the product. This operationalization captures the environmental and social hazard potential of the product. In addition, it is congruent with the triple bottom line concept, which is of high relevance to this study.

The customer mix captures the breadth of the firm’s customer base. Miles (1987) conceptualized the customer mix in terms of personal-lines and commercial-lines. This dichotomous conceptualization was able to capture different impacts of the products on the consumer. However, it is specific to the insurance industry. Conceptualizing customer mix as the level of consumer proximity would capture the essence of customer mix. High levels of consumer proximity indicate that the firm is primarily offering products to end consumers. In contrast, low levels of customer proximity indicate that the firm is offering products to business customers (Brammer et al., 2004).

The geographical mix intends to capture different features of business environments brought by the virtue of its location. For example, the legal environment is different from one state to another. It is also different from one country to another. Culture is different from one country to another. Accordingly, companies face different social issues in different countries and regions. The geographical mix captures the significance of the differences. Mainly, geographical mix aims at capturing differences in business environments resulting from the
extent of geographical dispersion. Since the type and nature of social and environmental vary from one country to another, the level of internationalization would be most suitable to capture such variance and provide a meaningful operationalization of geographical mix.

Product mix. Product mix influences the attention the firm receives from the public due to the inherent risk associated with its products and its producing processes. In this case, the public’s primary concern is the potential harm. As explained above, I will conceptualize the product mix as the level of environmental or social hazard associated with the production or consumption of the product.

Environmental hazard refers to the firm’s ability to cause a negative impact on the natural environment due to its operations. For example, oil companies are notorious for the potential hazards that they pose to the natural environment that may result from oil extraction or transportation, such as oil spills. Environmental impact is one form of the inherent risk of the product mix (Brammer et al., 2004). Industrial membership influences the environmental impact of different firms. Brammer et al., (2004) contended that empirical research (e.g., Bowen, 2000; Clemens, 2001; Hoffman, 1999; Morris, 1997; Sharma, 1997; Sharma, 1999) indicated that certain sectors, “e.g. the metals, resources, paper and pulp, power generation, water, and chemicals” have high environmental impacts (p. 88). Membership in these industries would increase the environmental hazard of firms. The general public’s attention to and scrutiny of firms in these industries is expected to be significantly different than that of firms in other industries.

Member firms in industries with higher environmental impact would be more scrutinized by the general public. To manage such challenges, they would be more likely to utilize corporate
social reporting as a tool to manage their legitimacy challenges (Cowen et al., 1987; Gray et al., 1995; Patten, 1991). A hypothesis may be formally developed as:

**Hypothesis 1:** Firms in hazardous industries are more likely to publish a corporate social report than firms in non-hazardous industries.

Social hazard refers to the firm’s ability to cause a negative impact on its social environment. Such impact results from the firm’s social issues participation (Hillman & Keim, 2001). Social issues participation refers to the firm’s involvement in one of six controversial business issues identified by KLD: alcohol, gambling, firearms, nuclear power, military, and tobacco. Brammer et al. (2004) argued that a firm’s association with controversial business issues constitutes an inherent risk of the firm’s product mix. Due to this inherent risk, a firm’s business exposure is heightened. For example, the tobacco and alcoholic drinks industries produce large social externalities (Brammer et al., 2004). The public is thus more critical of firms associated with such social issues. Clarkson et al. (2007) argued that socio-political theories contend that firms would increase their level of disclosure when their legitimacy is threatened. They explained that increasing the level of disclosure aims at “(1) educate and inform relevant publics about (actual) changes in their performance, (2) change perceptions about their performance, (3) deflect attention from the issue of concern by highlighting other accomplishments, and (4) seek to change public expectations of their performance” (p. 308). Accordingly, firms involved in controversial business issues would be motivated to publish a corporate social report more than firms that are not involved in controversial business issues. A hypothesis may then be formally stated as:
Hypothesis 2: Firms involved in controversial business issues are more likely to publish a social report than firms who are not involved in controversial business issues.

Customer mix. As mentioned above, customer mix refers to the proximity of the firm to the end consumer. Stanwick and Stanwick (2006) argued that disclosing social performance information may be used by firms to differentiate their products from rivals. Firms selling products to end users, such as consumer product firms, would find the publication of social reports a useful tool for differentiating their products more than firms selling products to business customers. In addition, firms dealing directly with end consumers are more open and vulnerable to social pressure and criticism than firms that deal with business customers. Consumer proximity, therefore, would motivate the publication of corporate social reports.

Indicative of consumer proximity is the firm’s advertisement intensity. Firms dealing directly with end consumers rely more on advertisement than do firms that deal with business customers (Andras & Srinivasan, 2003). Accordingly, higher levels of advertisement intensity would be positively correlated with the motivation of publishing corporate social reports. Firms with higher levels of advertisement intensity would, therefore, be more likely to publish corporate social reports than firms with lower levels of advertisement intensity. A hypothesis may be formally stated as:

Hypothesis 3: Firms with higher levels of advertisement intensity are more likely to publish a corporate social report than firms with lower levels of advertisement intensity.

Geographical mix. Geographical mix refers to the extent to which the firm has geographically dispersed operations. The level of internationalization (Westphal & Fredrickson,
captures the geographic dispersion of a firm’s operations. Higher levels of internationalization would present the firm with a larger variety and number and of environmental and social issues. In turn, the firm would experience more legitimacy challenges and social pressures. Responding to such pressures would be more vital. Accordingly, higher levels of internationalization would increase the likelihood of the publication of a corporate social report. A hypothesis may be formally stated as:

**Hypothesis 4:** Firms with higher levels of internationalization are more likely to publish a corporate social report than firms with lower levels of internationalization.

**Firm size.** Larger firms capable of affecting their economic environment earn more attention from the general public than smaller firms. Public attention often results in more scrutiny. Kimberly (1976) investigated the role of size in organizational studies. He argued that while size is operationally understood, its theoretical foundation is not well-developed. He proposed four aspects of size that he contended are “conceptually independent”. The first is the physical capacity of an organization. It refers to the constraints imposed on the organization due to its physical size. The second is the personnel available to an organization, which refer to the limited number of people available to carry out the organization’s work at any given point in time. The third is organizational inputs and outputs, which reflect the amount of activity carried out by the organization. The fourth is the discretionary resources available to an organization at any given point in time.

Larger organizations impact their economic environment through inputs and outputs, which reflect the amount of activity carried out by the organization. In this context, Blau (1972) defined size as the “the scope of an organization and its responsibilities” (p. 3). The general
public, therefore, would be more concerned with larger organizations than with smaller ones. Accordingly, larger organizations will earn more attention and scrutiny. These organizations will face more intense legitimacy challenges than smaller ones. The publication of a corporate social report would then be more vital to larger organizations than it is to smaller ones (Patten, 1991; Cormier et al., 2003). Larger organizations would be motivated to publish a corporate social report more than smaller ones. A hypothesis may then be formally stated as:

**Hypothesis 5:** Larger firms are more likely to publish a corporate social report than smaller ones.

**Public Awareness**

As mentioned above, a firm would face a legitimacy problem when its operations are perceived to have a negative impact on its environment. Such perception is based on the general public’s awareness of the firm and its operations. Public awareness would then heighten the level of scrutiny to which the firm is exposed. In today’s age, public awareness is significantly influenced by media coverage. Accordingly, media coverage heightens these social pressures (Brammer et al., 2004; Erfle & McMillan, 1990). A firm enjoying higher levels of media coverage is in the spotlight and its legitimacy would be frequently challenged. Brown and Deegan (1998) argued that the media may increase public concern regarding certain organizations. These organizations respond to such concerns by increasing their performance disclosure. Firms enjoying higher levels of media coverage would have the incentive to publish a corporate social report. A hypothesis may then be formally stated as:

**Hypothesis 6:** Firms with higher levels of media coverage are more likely to publish a corporate social report than firms with lower levels of media coverage.
Past Performance

Greenley and Foxall (1997) defined stakeholder orientation as “[t]he relative attention that companies give to each of their stakeholder groups…” They argued that the priority and makeup of the attention given to stakeholder groups varies. This variance may be explained using Logsdon and Yuthas’ (1997) model of moral development for organizations. Paralleling Kohlberg’s (1969; 1976 & 1981) study, they depicted three levels of moral development for organizations: preconventional, conventional, and postconventional. At the preconventional level, the firm views its relationship with other stakeholders as a means to advance its self-interest; at the conventional level, the firm forms “narrow market-based stakeholder relationships” where only those obligations mandated by law are recognized; and at the postconventional level, the firm forms relationships with a “broad range of stakeholders” where positive obligations and stakeholder welfare promotion are emphasized (p. 1217). Consequently, the variance in the attention given to different stakeholders would be influenced by the organization’s level of moral development: higher levels of moral development promote higher levels of stakeholder orientation and lower levels of moral development promote lower levels of stakeholder orientation.

Shropshire and Hillman (2007) argued that “[s]takeholder management by definition seeks to provide more relevant and mutually beneficial programs and policies to its most powerful, legitimate and urgent constituents”. A firm’s stakeholder orientation manifested by its stakeholder management would be reflected in its relationships with its stakeholders. While in theory, a stakeholder is “any group or individual who can affect or is affected by the achievement of the organization’s objectives” (Freeman, 1984), a firm’s stakeholder orientation is usually depicted by its performance in five categories: community relations, employee
relations, environmental performance, product safety or quality, and diversity (Berman, Wicks, Kotha, & Jones 1999; Hillman et al., 2001; Shropshire, 2007). Higher levels of performance on these categories reflect higher levels of stakeholder orientation, while lower levels of performance reflect lower levels of stakeholder orientation.

Often times an aggregate measure is used to measure stakeholder orientation (e.g., Hillman et al., 2001). However, Griffin and Mahon (1997) have raised concerns about using an aggregate measure. The authors argued that stakeholder orientation is a multidimensional construct. Using one aggregate measure may cause some of the dimensions to mask others. Taking into account Griffin and Mahon’s concerns, I disaggregated stakeholder orientation into stakeholder strengths and stakeholder concerns. Stakeholder strengths represent the aspects of positive stakeholder performance and stakeholder concerns represent the negative aspects of stakeholder performance.

**Stakeholder strengths.** Stakeholder strengths results from a higher level of organizational moral development. Attention is given to various stakeholders and obligations toward them are fulfilled. Higher levels of stakeholder strengths constitutes a performance record that would strengthen an organization’s legitimacy status and dismisses, or at least mitigates, any legitimacy problems. Motivated by their sense of accountability, these firms would be more responsive to their stakeholders’ needs. They would be more inclined to disclose information regarding their social performance to enhance their legitimacy (Hooghiemstra, 2000; Clarke et al., 1999). Higher levels of stakeholder orientation would enable firms to publish a corporate social report. Therefore, firms with higher levels of stakeholder strengths would have an incentive to disclose such performance information through the publication of a corporate social report. Clarkson et al. (2007) said that, in addition to the motivation caused by the level of
moral development of the organization, “companies have incentives to disclose ‘good news’ to
differentiate themselves from companies with ‘bad news’ in order to avoid the adverse selection
problem” (p. 307). The publication of corporate social reports reveals to investors and other
stakeholders information about the firm’s performance that would enhance its legitimacy. A
hypothesis may then be formally stated as:

**Hypothesis 7: Firms with higher levels of stakeholder strengths are more likely to publish a corporate social report than firms with lower levels of stakeholder strengths.**

Stakeholder strengths may also result from public awareness pressure. Firms attuned to
their environment would appreciate the role that public awareness plays in heightening
legitimacy problems. A firm’s long-term orientation would enhance its ability to plan for the
future and prepare for how it can resolve the legitimacy problems of the future. Nevins,
Bearden, and Money (2006) and Thorne and Saunders (2002) argued that managers with short-
term orientations fail to recognize a link between their present actions and future outcomes.
They also said that myopic (short-term oriented) managers are “obsessed with the concerns in the
near-term at the expense of longer-term goals” and that managers with a long-term orientation
recognize the “value of planning for the future” (p. 262). To best respond to the pressures of
public awareness in the future, managers with long-term orientation would build their firm’s
stakeholder strengths so that they may be able to supply the kind of information that would
enhance their legitimacy upon disclosure. Building a firm’s stakeholder strengths may then be
recognized as the kink between public awareness and publication of a corporate social report. A
hypothesis may then be stated as:
**Hypothesis 8:** Stakeholder strengths mediate the relationship between public awareness and corporate social report publication.

**Stakeholder concerns.** In contrast to stakeholder strengths, stakeholder concerns represent the negative aspects of the firm’s past performance. Disclosure of such information would indeed exacerbate a firm’s legitimacy problems. The presence of stakeholder concerns is a disincentive for firms to publish a corporate social report. Hoping to conceal such information, firms with stakeholder concerns will be reluctant to publish a corporate social report. A hypothesis may then be formally declared as:

**Hypothesis 9:** Firms with higher levels of stakeholder concerns are less likely to publish a corporate social report than firms with lower levels of stakeholder concerns.

**The Institutionalization of Corporate Social Reporting**

Institutional theory (DiMaggio & Powell, 1983; Tolbert & Zucker, 1983; Zucker, 1987) argues that individual members of a population will adopt certain practices to resemble others. These practices will become institutionalized and cause the population to be more homogenous. DiMaggio and Powell (1983) proposed that the institutionalization occurs through three different types of isomorphisms: normative, mimetic, and coercive. Reasons for adopting a given practice are different between early adopters and imitators. Early adopters subscribe to a given practice due to a set of determining factors that is specific to them. In other words, they have rational reasons such as economic motivation (Budros, 2004) or organizational characteristics (Burns & Wholey, 1993). Over time, however, isomorphic forces will cause imitators to follow suit through a four-stage legitimating process (Johnson et al., 2006) discussed above. As the
in institutionalization of the practice builds, the predictive strength of the determining factors decreases (Tolbert & Zucker, 1983).

Abrahamson (1991) offered an explanation for the diffusion of innovation. He argued that an innovation will diffuse among organizations within the same group to the extent that the innovation provides an efficient solution for closing performance gaps. In contrast, the innovation may diffuse among organizational groups, even if it is inefficient, when the innovation is backed by powerful organizations. Organizations in hazardous industries, because their potential of hazard is high, find it efficient to address legitimacy challenges through the publication of corporate social reports. Organizations in other industries will follow suit because corporate social reporting is backed by powerful organizations such as GRI and UNGC. The effect of the rational determining factors (business exposure, public awareness, and past performance) will decline over time. Therefore, the explanatory power of the model proposed in this paper will eventually decrease. A hypothesis may then be formally stated as:

_Hypothesis 10: The explanatory power of the model depicting the determinants of corporate social report publication will decline over time._

**METHODS**

**Sample, Variables, and Measures**

**Sample.** The population of interest in this study is large publicly-traded firms in the United States. The sample consists of firms that appeared on the Fortune 500 list in 1992, 1997, 2002, and 2006. The chosen years reflect significant dates pertaining to corporate social reporting. GRI was launched in 1992 and became independent in 1997. The second generation of GRI reporting standards was released in 2002 and the third generation was released in 2006.
The firms included in the study are only those that remained active throughout the time period from 1992 to 2006. Firms that entered or dropped out during this period were eliminated. Eliminating these firms allowed the analysis of a cohort of firms that lived in the same “world”.

Initially, 233 firms appeared on the Fortune 500 list in 1992, 1997, 2002, and 2006. Nine firms were subsequently eliminated because no information about their corporate social reporting activities was available in the data source used. The sample size was, therefore, reduced to 224. Further eliminations were made to get rid of cases with missing data. The number of firms in the final sample was 140 in 1992, 189 in 1997, 194 in 2002, and 184 in 2006.

**Dependent variable.** The dependent variable is the publication of a corporate social report. A corporate social report is defined as a stand-alone document that a firm publishes with the express purpose of communicating its social responsibility activities to the general public and its stakeholders. Publication of a corporate social report is measured as a dichotomous variable. Firms publishing at least one social report in a given year are coded 1; others, 0. The dependent variable lags the independent variables by one year. The dependent variable is collected for 1993, 1998 (Table 3.1), 2003 (Table 3.4), and 2007 (Table 3.6). The data for corporate social reports are collected from corporateregister.com.

Corporateregister.com provides a database of corporate social reports since 1992. It lists corporations that issue reports and those that do not. Information regarding the dates of the issued reports is also listed. While posting a report on corporateregister.com is voluntary, the website solicits companies to disclose their reports. Multiple attempts are made to acquire published social reports. Firms’ responses to corporateregister.com solicitation are indicated on the database of corporateregister.com. Firms that do not have a corporate social report posted on corporateregister.com for a given year are coded as not having published a corporate social
report for that year. I justify relying on corporateregister.com as the sole source of corporate social reports based on two reasons: (1) making the report public is part of its purpose, and (2) the status of corporateregister.com as a worldwide source of social reports makes it an essential element of corporate social reporting.

**Independent variables.** In addition to one control variable and relative cash flow, eight independent variables are included in this study: hazardous industry membership, participation in controversial business issues, advertisement intensity, internationalization, size, media coverage, stakeholder strengths, and stakeholder concerns.

Hazardous industry membership refers to membership in oil and gas, chemical, or petroleum industries. These industries are chosen because of their potential for and history of spills and other hazards. A code of 1 indicates a firm’s membership in a hazardous industry; a code of 0 indicates the firm’s membership in any other industry. Industry membership is identified by the SIC code.

Participation in controversial business issues refers to involvement in one of six issues identified by KLD: alcohol, gambling, tobacco, firearms, military, and nuclear power. Participation in controversial business issues is measured as a dichotomous variable. A code of 1 is given to firms that participate in at least one of these six issues; a code of 0 is given to all other firms. Advertising intensity is calculated as the ratio of advertising expense to sales (Andras & Srinivasan, 2003). Data for advertising expenses are collected from COMPUSTAT.

Internationalization is measured as foreign sales divided by total sales. This measure is a variation of the composite measure developed by Sullivan (1994). The variation is similar to Westphal and Frederickson (2001) adopted variation of the same measure. Data for foreign sales and total sales are collected from Worldscope.
Firm size is measured as the natural logarithm of sales. The natural logarithm is applied to normalize the variable’s distribution (e.g., Coombs & Gilly, 2005; Ginsberg & Buchholtz, 1990). Following Brammer and Millington (2002), media coverage is measured as the natural logarithm of the number of news hits a firm receives. The data are obtained from Factiva database. The number of news hits is calculated for the time period corresponding to each calendar year. Stakeholder strengths are measured as a simple summation of the firm’s strengths in six stakeholder areas identified by KLD: community, diversity, employees, environment, human rights, and product safety. Gestalt measures of stakeholder management have been developed and used. Hillman and Keim (2001) developed a gestalt measure for stakeholder management “by summing the dimensions of the KLD measure…” (p. 131). Agreeing with Mitchell and Wood (1997), Hillman et al. argued that such a measure is appropriate because no ranking of importance for various stakeholder groups or issues has been identified. Stakeholder concerns are measured in the same manner as a simple summation of the firm’s concerns in the six stakeholder areas identified by KLD. Stakeholder strengths and stakeholder concerns are measured separately to avoid the possibility of a masking effect. Johnson and Greening (1999) “echoed” the concerns raised by Griffin and Mahon (1997) with respect to collapsing KLD’s multiple dimensions. Griffin and Mahon (1997) argued that “collapsing the KLD’s multiple dimensions into a unidimensional index may mask the individual dimensions that are equally important and relevant” (p. 15). Data for stakeholder strengths and stakeholder concerns are collected from KLD STATS.

Organizational slack is the control variable in this study. Cyert and March (1962) defined organizational slack as the “difference between total resources and total necessary payments…”. Organizational slack enables the firm to engage in certain strategic behaviors
Amato and Amato (2006) agreed with others (McGuire, Sundgren, & Schneeweis, 1988; Ullmann, 1985; and Roberts, 1992) that slack resources permit firms to engage in social responsible behaviors. In other words, “doing well enables doing good” (Seifert, 2004). Buchholtz, Amason, and Rutherford (1999) found that perceived organizational slack is associated corporate philanthropy and Brammer and Millington (2002) related availability of employees and inventory to non-monetary contributions to the community. Organizational slack, therefore, may be considered as an indicator of the organization’s capacity of voluntary action.

Brammer and Millington (2002) argued that the publication of a corporate social report requires monetary resources, expertise, and labor hours. These resources are directed at measuring and verifying social impacts as well as related administrative expenses (Brammer & Millington, 2004; Verrecchia, 1983; Li, 1997; Cormier & Magnan, 1999). Therefore, slack availability is expected to influence the firm’s capacity to publish a social report and its influence is controlled in the analysis.

Slack is operationalized as relative cash flow (operating cash flow divided by sales). Operating cash flow was chosen over cash and cash equivalents, which may be used instead of operating cash flow in calculating relative cash flow because it accounted for more variance when each was used as a sole predictor of corporate social reporting. Using operating cash is thus a more conservative decision. Data for operating cash flow are collected from COMPUSTAT. Descriptive statistics of the independent variables are presented in Table 3.1, Table 3.4, and Table 3.6.
Statistical Analysis

In 1993, only 2% of firms issued social reports (3 firms). This low number made it impossible to conduct a meaningful analysis for 1992 and so analyses were conducted for 1997, 2002 and 2006. To test the model, I used logistic regression analysis. Unlike linear regression which demonstrates the degree of association between the dependent variable and the independent variables, logistic regression demonstrates odds ratios (Pedhazur, 1997, pp. 759-761). A regression coefficient of a dichotomous independent variable represents the odds ratio between its two categories. The coefficient of a dichotomous variable X, which represents membership in group A or group B, is the natural logarithm of the ratio between the odds of a given outcome for members of group A and the odds of the given outcome for the members of group B. This ratio is known as the odds ratio (OR). The odds of a given outcome are the probability of the outcome occurring (p) divided by the probability of it not occurring (1-p): OR=p/(1-p). The regression coefficient of X is expressed as: \( \beta = \ln(OR) \). In contrast, if the variable X is continuous, then the odds ratio refers to the change in the odds for the outcome due to a unit change in X. Interpretation and discussion of the results, therefore, are going to be in terms of odds ratios, not in terms of degree of association.

Three logistical regression models were tested, as shown in Table 3.1, Table 3.4, and Table 3.6; one for each of the three years of the study: 1998, 2003, and 2007. The analyses were executed using STATA8. To test the mediation effect of media coverage on the stakeholder strengths-corporate social report publications relationship, I followed the procedure proposed by Judd and Kenny (1981) and Baron and Kenny (1986). This procedure is a classical approach for testing mediation effects (Muller, Judd, & Yzerbyt, 2005), which has been widely used when such a test is desired (e.g., Brown, Jones, & Leigh, 2005). For each of the three years, in
addition to the main regression model, two additional models were developed (Table 3.1, Table 3.4, & Table 3.6). The four steps of the procedure necessary to establishing mediation were then followed (Table 3.10). To test the institutionalization hypothesis of corporate social report publication, following Tolbert and Zucker (1983), I compared the explanatory power (Pseudo $R^2$) of the models across the three years (Table 3.11). In addition, I compared the significance level and size of the regression coefficients of the predictors across the three years. The change in the size of the regression coefficients is graphed in Figure 5A through 5E. These graphs are offered as a pictorial representation of the change but should be interpreted with caution because the coefficients drop out of significance in later years.

Results

Descriptive statistics are presented in Table 3.1, Table 3.4, and Table 3.7; correlation coefficients are presented in Table 3.2, Table 3.5, and Table 3.8; and regression results are presented in Table 3.3, Table 3.6, and Table 3.9. Hypothesis 1, which predicts the odds of corporate social report publication will be higher for firms operating in hazardous industries than they are for other firms, was supported in 1997 ($p < 0.05$) (Table 3.3) and 2002 ($p < 0.001$) (Table 3.6); but not in 2006 (Table 3.9). In 1997, the regression coefficient was equal to 1.437. This coefficient means that the odds of publishing a corporate report by firms operating in hazardous industries is 4.2 ($1.437 = \ln (OR)$; $OR = e^{1.437}$) times as large as the odds of publishing a corporate report by firms operating in other industries. In 2002, the odds ratio was 1.754, which means that the odds of publishing a corporate report by firms operating in hazardous industries is 5.8 times as large as the odds of publishing a corporate report by firms operating in other industries. In 2006, the regression coefficient was not significant. The inverted U-shaped pattern of both the significance and the regression coefficients’ size (Figure
Hypothesis 2, which predicts the odds of corporate social report publication will be positively correlated with the level of participation in controversial business issues, was supported in 1997 (p < 0.05) (Table 3.3), but not in 2002 (Table 3.6) or 2006 (Table 3.9). The steady decline in the size of the regression coefficients suggests that, over time, the effect of participation in controversial business issues on the likelihood of corporate social report publication is waning. Thus, the likelihood of the publication of a corporate social report in later years tends to be the same whether the firm is engaged in controversial business issues or not.

Hypothesis 3, which predicts the odds of corporate social report publication will be positively correlated to the level of advertisement intensity, and hypothesis 4, which predicts the odds of corporate social report publication will be positively correlated to the level of internationalization, were not supported in any of the three years (Table 3.3, Table 3.6, & Table 3.9). Hypothesis 5, which predicts the odds of corporate social report publication will be positively correlated to size was not supported in 1997 (Table 3.3) or in 2002 (Table 3.6). However, the hypothesis was supported in 2006 (Table 3.9).

Hypothesis 8, which predicts that stakeholder strengths will mediate the relationship between media coverage and corporate social report publication, was supported in 1997 (Table 3.10). Media coverage exerted pressure on firms to enhance their stakeholder performance so that they may publish a corporate social report. This effect went away in 2002 and 2006 (Table
3.10). The presence of the mediation effect in 1997 and its disappearance in 2002 and 2006 suggest that attention to stakeholders becomes less dependent on media pressure over time.

Hypothesis 9, which predicts the odds that corporate social report publication will be negatively correlated with the level of stakeholder concerns, was partially supported (marginally significant) in 1997 (Table 3.3.), but not in 2002 (Table 3.6) or 2006 (Table 3.9). In 1997, since reporting standards were not developed and contents were not specified, firms facing legitimacy challenges due to their unattractive past performance would still have been able to take advantage of the publication of a social report as a legitimizing tool. Their report, probably, would have been more symbolic than substantive. In 2002, after the release of the GRI 2002 guidelines, reporting standards started to materialize. These standards would have put some restrictions on liberties associated with what and how to report. Accordingly, firms with stakeholder concerns might have chosen not to issue a report. Firms’ unattractive performance did not provide positive material for disclosure and the new standards would have made it more difficult to disguise their poor performance. In addition, corporate social report publication was neither widely practiced nor was it legally required.

Hypothesis 10, which predicts that the explanatory power of the overall model will decline over time, was supported. As shown in Figure 5A, the explanatory power (Pseudo R^2) of the overall model declined from 0.1996 in 1992 to 0.1848 in 1997, and then 0.1344 in 2006. To better understand the decline, I explored the change in each predictor. Both hazardous industry membership and participation in controversial business issues showed a decline in explanatory power. Advertisement intensity and internationalization were never significant and so a decline was not possible. Sales not only continued to be significant in the later years but even increased
in importance. In sum, two of the predictors declined in importance, two never were significant factors and one moved significantly in the opposite direction of that hypothesized.

**DISCUSSION**

The central thesis of this paper is that firms will face legitimacy concerns due to the nature of their business or their past performance. Legitimacy concerns will then develop into legitimacy challenges as a result of public awareness. The challenge will translate into pressure on the firm to show that its potential or past performance is congruent with accepted performance standards. In turn, the firm would respond by demonstrating that its performance is indeed congruent with accepted performance standards and, therefore, legitimate. Through successive legitimacy challenges, the firm learns and develops its most effective response. The effective response, in turn, becomes a standard procedure, which is expected and accepted by the public.

Over time, other firms witness the development of the legitimacy challenge response and they begin to adopt the response for reasons that are different from the rationales of the early adopters. Under the powerful forces of uncertainty, firms model themselves on the early adopters through a process of mimetic isomorphism (DiMaggio et al., 1983). The action that was once a rational response to a specific legitimacy challenge evolves into a generally accepted business practice that is adopted by firms whether or not they are facing legitimacy challenges. This study found support for the general thesis by showing that, in the early years, firms engaged in social reporting due to rational reasons related to the nature of their activities and their business. In later years, the rational reasons generally ceased to be a significant predictor. The only exception was size, which operated in the opposite direction of what was hypothesized.
The elements of business exposure were expected to have similar effects on intensifying the legitimacy problems that the firms experience. This expectation was shaped by research findings that use of the concept of business exposure as unidimensional or by findings that use only one of its elements as a proxy for the whole construct. In both cases, no appreciation was developed for the different effects that the elements of business exposure may have on the firm. In this study, the different effects of the individual elements of business exposure on the firm were noticed. Product mix was the most influential element of business exposure. Customer mix and geographical mix didn’t seem to play any role with respect to social reporting. Finally, size didn’t play its expected role.

Customer mix and geographical mix were hypothesized to increase the likelihood of corporate social report publication. Organizations with higher levels of customer proximity or internationalization are scrutinized more closely than organizations with lower levels of customer proximity and internationalization. However, the hypotheses were not supported. This finding suggests that the organization’s capacity to harm, rather than its opportunity to harm, may be the source of legitimacy challenges. For example, membership in hazardous industry means that the organization’s production technology has the capacity to cause environmental hazards. This capacity to harm causes a legitimacy challenge. In contrast, operating in a country where questionable business practices are common does not mean that the organization is going to get involved in such practices. Therefore, it is not a cause for a legitimacy challenge.

Abrahamson (1991) argued that among the factors that allowed organizations to reject a certain innovation is the ability of such organizations to resist the pressure for imitation. Abrahamson’s proposition helps explain the unpredicted trend of size as a determining factor of corporate social report publication. Larger organizations were able to resist the pressure to
publish corporate social reports in the early 1990s when the pressure was relatively low. As more organizations published corporate social reports, the pressure to publish increased. Larger organizations were then unable to resist the higher pressure. They started publishing corporate social reports in later years. This explanation implies that the effect of size on the likelihood of corporate social report publication in the early 1990s would have been significant, but with a negative coefficient. The results in Table 3.3 show that the coefficient of size was actually negative for 1997. However, the coefficient was insignificant. This insignificance is due to the fact that a number of the larger organizations are also members in hazardous industries. Their membership caused them to publish corporate social reports. Further statistical analysis is needed to verify this interpretation. The effect of size on the likelihood of corporate social report publication needs to be tested while controlling for industry membership. This test will allow the assessment of the effect of size without the influence of industry membership.

**Limitations.** Variations in the content and quality of the published reports are not reflected in the dependent variable; therefore it is impossible to differentiate between reports that convey the actual performance and others that are intended for impression management. The possibility of greenwashing remains and that could have affected the findings in unobserved ways. Because the differences in the effects of substantive reporting and greenwashing are not captured in the results of this study, no discrimination is made between the factors leading to substantive reporting and those leading to symbolic greenwashing.

The role that the GRI standards play in the corporate social reporting process has not been included as a variable in this study. While the existence and level of development of such standards may have affected firms differently, GRI standards were not incorporated in the model.
Attention to GRI standards may provide further explanation of the process of corporate social reporting and its institutionalization.

**Implications.** The findings of this study draw attention to the role of institutional forces in shaping the business environment. Due to the powerful influence, institutional forces unify the business environment and prevent its segregation. Managers need not only to look at the social issues that they face in their immediate environment. Rather, they need to pay attention to all social issues facing the institution of business. Some of these social issues might require a response even if such response may not be justified by rational causes. Scholars and practitioners are advised to conceptualize and deal with the business environment as an interdependent system, where rational causes in some parts of which may impact other parts through institutional forces.

The interdependence of the business environment may result in homogenizing firm responses to different stakeholder groups. A certain action may evolve from a response to a specific issue pertaining to a given stakeholder group to a standardized practice for stakeholder management that applies to multiple issues and stakeholders.

**Suggestions for future research.** This study aims to contribute to the understanding of legitimacy challenges, institutionalization processes, and corporate social reporting. In doing so, the investigation draws attention to other important questions that may be useful to explore in the future. First, the findings suggest that lack of reporting standards early in the process may have allowed firms that have social responsibility concerns to mask those concerns through social reporting. As standards toughened, the ability of firms to use social reporting as an effort to disguise those concerns diminished. A closer examination of the quality and content of social reports would refine and extend our understanding of corporate social reporting. Investigating
the effect of standards on the corporate social reporting process would shed important new light on the corporate social reporting phenomenon.

Clarkson (1995) argued that “corporations manage their relationship with stakeholder groups rather than with society as a whole…” (p. 92). Accordingly, corporate social reports must have a target audience, at least a primary target audience – specific stakeholder groups. Identifying the target stakeholder groups of corporate social reporting would have substantial utility. It would help advance stakeholder theory, issues management, institutional theory, and the understanding of corporate social reporting.

Another aspect of corporate social reporting that merits investigation is the responsiveness aspect: how quickly do companies respond to legitimacy challenges? How quickly do they adopt new standards? What are the factors that influence the speed of such responses? Answering these questions would contribute to the development of the understanding of corporate social responsiveness in addition to a better understanding of corporate social reporting.

CONCLUSION

The contributions of this study are twofold. First, the paper proposes and tests a theoretical model that explains the rational process through which firms seek to gain legitimacy through social reporting. Second, the study illustrates how, over time, the rational reasons for gaining legitimacy give way to isomorphism and firms begin to issue social reports in an effort to gain the legitimacy that the first adopters of corporate social reporting receive.

Corporate social reporting is an important area of inquiry that touches on issues of social responsibility, transparency, and stakeholder management. This study is intended to serve as a foundation for future inquiry into the interface of corporations and their stakeholders.
REFERENCES


Table 3.1

Descriptive Statistics for 1997 Variables

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<th>Max.</th>
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<td>0.65***</td>
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* p < .05  
** p < .01  
*** p < .001
### Table 3.3

Regression Models for 1997

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<tr>
<td>8</td>
<td>Stakeholder Concerns</td>
<td>0.17*</td>
<td>0.17*</td>
<td>0.15*</td>
<td>- 0.10</td>
<td>- 0.09</td>
<td>0.43***</td>
<td>0.39***</td>
<td>0.40***</td>
<td>1.00</td>
</tr>
<tr>
<td>9</td>
<td>Relative Cash Flow</td>
<td>0.00</td>
<td>0.06</td>
<td>0.09</td>
<td>0.08</td>
<td>0.02</td>
<td>0.26***</td>
<td>0.24***</td>
<td>0.09</td>
<td>0.05</td>
</tr>
</tbody>
</table>

N = 194  
* p < .05  
** p< .01  
*** p< .001
Table 3.6
Regression Models for 2002

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Model 1 Corporate Social Reporting</th>
<th>Model 2 Corporate Social Reporting</th>
<th>Model 3 Stakeholder Strengths</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hazardous Industry Membership</td>
<td>1.754***</td>
<td>1.681***</td>
<td>0.452</td>
</tr>
<tr>
<td>Participation in Controversial Business Issues</td>
<td>0.546</td>
<td>0.390</td>
<td>-0.178</td>
</tr>
<tr>
<td>Advertisement Intensity</td>
<td>5.972</td>
<td>10.495†</td>
<td>10.816*</td>
</tr>
<tr>
<td>Internationalization</td>
<td>0.188</td>
<td>0.389</td>
<td>0.120</td>
</tr>
<tr>
<td>Sales</td>
<td>0.429†</td>
<td>0.600*</td>
<td>0.719***</td>
</tr>
<tr>
<td>Media Coverage</td>
<td>0.064</td>
<td>0.108</td>
<td>0.299*</td>
</tr>
<tr>
<td>Stakeholder Strengths</td>
<td>0.320***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stakeholder Concerns</td>
<td>-0.069</td>
<td>0.018</td>
<td></td>
</tr>
<tr>
<td>Relative Cash Flow</td>
<td>-1.441†</td>
<td>-1.359†</td>
<td>-0.462</td>
</tr>
<tr>
<td>Constant</td>
<td>-6.529**</td>
<td>-7.808***</td>
<td>-6.003***</td>
</tr>
<tr>
<td>Pseudo R² / Adjusted R²</td>
<td>0.1848***</td>
<td>0.1343***</td>
<td>0.1714***</td>
</tr>
<tr>
<td>N = 194</td>
<td>p &lt; .10</td>
<td>* p &lt; .05</td>
<td>** p &lt; .01</td>
</tr>
</tbody>
</table>

† p < .10  * p < .05  ** p < .01  *** p < .001
Table 3.7

Descriptive Statistics for 2006 Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Min.</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Corporate Social Report Publication</td>
<td>0.4293</td>
<td>0.4963</td>
<td>0.0000</td>
<td>1.0000</td>
</tr>
<tr>
<td>2 Hazardous Industry Membership</td>
<td>0.1250</td>
<td>0.3316</td>
<td>0.0000</td>
<td>1.0000</td>
</tr>
<tr>
<td>3 Participation in Controversial Business Issues</td>
<td>0.2337</td>
<td>0.4243</td>
<td>0.0000</td>
<td>1.0000</td>
</tr>
<tr>
<td>4 Advertisement Intensity</td>
<td>0.0112</td>
<td>0.0221</td>
<td>0.0000</td>
<td>0.1152</td>
</tr>
<tr>
<td>5 Internationalization</td>
<td>0.3044</td>
<td>0.2387</td>
<td>0.0000</td>
<td>0.8807</td>
</tr>
<tr>
<td>6 Sales</td>
<td>9.7780</td>
<td>0.9202</td>
<td>8.4521</td>
<td>12.7221</td>
</tr>
<tr>
<td>7 Media Coverage</td>
<td>7.6094</td>
<td>1.2723</td>
<td>0.0000</td>
<td>10.5604</td>
</tr>
<tr>
<td>8 Stakeholder Strengths</td>
<td>1.6413</td>
<td>2.0032</td>
<td>0.0000</td>
<td>12.0000</td>
</tr>
<tr>
<td>9 Stakeholder Concerns</td>
<td>1.6576</td>
<td>1.6880</td>
<td>0.0000</td>
<td>9.0000</td>
</tr>
<tr>
<td>10 Relative Cash Flow</td>
<td>0.2014</td>
<td>0.4242</td>
<td>-3.1627</td>
<td>1.4146</td>
</tr>
</tbody>
</table>

N = 184
### Table 3.8
Correlations for 2006 Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
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</thead>
<tbody>
<tr>
<td>1 Corporate Social Report Publication</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Hazardous Industry Membership</td>
<td>0.14</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Participation in Controversial Business Issues</td>
<td>0.04</td>
<td>-0.17*</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Advertisement Intensity</td>
<td>0.05</td>
<td>0.17*</td>
<td>-0.13</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Internationalization</td>
<td>0.05</td>
<td>0.18*</td>
<td>0.05</td>
<td>0.09</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Sales</td>
<td>0.36***</td>
<td>0.20**</td>
<td>-0.03</td>
<td>0.05</td>
<td>0.03</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 Media Coverage</td>
<td>0.18*</td>
<td>0.13</td>
<td>0.07</td>
<td>0.16*</td>
<td>0.09</td>
<td>0.57***</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 Stakeholder Strengths</td>
<td>0.21**</td>
<td>0.14</td>
<td>0.03</td>
<td>0.09</td>
<td>0.16*</td>
<td>0.12</td>
<td>0.00</td>
<td>1.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9 Stakeholder Concerns</td>
<td>0.16*</td>
<td>0.06</td>
<td>0.09</td>
<td>-0.04</td>
<td>0.03</td>
<td>0.15*</td>
<td>-0.06</td>
<td>0.55***</td>
<td>1.00</td>
<td></td>
</tr>
<tr>
<td>10 Relative Cash Flow</td>
<td>0.11</td>
<td>0.20**</td>
<td>0.11</td>
<td>0.08</td>
<td>0.14</td>
<td>0.09</td>
<td>0.08</td>
<td>0.00</td>
<td>0.01</td>
<td>1.00</td>
</tr>
</tbody>
</table>

N = 184  
* p < .05  
** p < .01  
*** p < .001
Table 3.9
Regression Models for 2006

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Model 1 Corporate Social Reporting</th>
<th>Model 2 Corporate Social Reporting</th>
<th>Model 3 Stakeholder Strengths</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hazardous Industry Membership</td>
<td>0.266</td>
<td>0.404</td>
<td>0.587</td>
</tr>
<tr>
<td>Participation in Controversial Business Issues</td>
<td>0.275</td>
<td>0.268</td>
<td>0.324</td>
</tr>
<tr>
<td>Advertisement Intensity</td>
<td>1.434</td>
<td>2.903</td>
<td>7.763</td>
</tr>
<tr>
<td>Internationalization</td>
<td>-0.089</td>
<td>0.154</td>
<td>1.262*</td>
</tr>
<tr>
<td>Sales</td>
<td>0.929***</td>
<td>0.904***</td>
<td>0.383†</td>
</tr>
<tr>
<td>Media Coverage</td>
<td>-0.104</td>
<td>-0.091</td>
<td>-0.213</td>
</tr>
<tr>
<td>Stakeholder Strengths</td>
<td>0.214*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stakeholder Concerns</td>
<td>0.053</td>
<td>0.166†</td>
<td></td>
</tr>
<tr>
<td>Relative Cash Flow</td>
<td>0.383</td>
<td>0.361</td>
<td>-0.271</td>
</tr>
<tr>
<td>Constant</td>
<td>-9.178***</td>
<td>-8.983***</td>
<td>-1.044</td>
</tr>
<tr>
<td>Pseudo R^2 / Adjusted R^2</td>
<td>0.1344***</td>
<td>0.1205***</td>
<td>0.0305*</td>
</tr>
</tbody>
</table>

N = 184  † p < .10  * p < .05  ** p < .01  *** p < .001

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### Table 3.10
Summary of Mediation Tests

<table>
<thead>
<tr>
<th>Condition</th>
<th>1997</th>
<th>2002</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>In the model</strong></td>
<td>Model 2 Media Coverage is significant (satisfy)</td>
<td>Model 2 Media Coverage is not significant (violate)</td>
<td>Model 2 Media Coverage is not significant (violate)</td>
</tr>
<tr>
<td>$Y = \beta_{10} + \beta_{11} X + \varepsilon_1$</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>In the model</strong></td>
<td>Model 3 Media Coverage is significant (satisfy)</td>
<td>Model 3 Media Coverage is significant (satisfy)</td>
<td>Model 3 Media Coverage is not significant (violate)</td>
</tr>
<tr>
<td>$Me = \beta_{20} + \beta_{21} X + \varepsilon_2$</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>In the model</strong></td>
<td>Model 1 Stakeholder Strengths is significant (satisfy)</td>
<td>Model 1 Stakeholder Strengths is significant (satisfy)</td>
<td>Model 1 Stakeholder Strengths is significant (satisfy)</td>
</tr>
<tr>
<td>$Y = \beta_{30} + \beta_{31} X + \beta_{32} Me + \varepsilon_3$</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>ABS ($\beta_{31}$) &lt; ABS ($\beta_{11}$)</strong></td>
<td>0.410 $&lt;$ 0.485 (satisfy)</td>
<td>0.064 $&lt;$ 0.299 (satisfy)</td>
<td>0.104 $&gt;$ 0.091 (violate)</td>
</tr>
<tr>
<td><strong>For complete mediation,</strong></td>
<td>0.41 is not significant</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Conclusion</strong></td>
<td>Complete mediation is supported</td>
<td>Mediation is not supported</td>
<td>Mediation is not supported</td>
</tr>
<tr>
<td><strong>Condition</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table 3.11
Comparative Summary of Pseudo $R^2$ and Regression Coefficients

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>2002</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall explanatory power of model: Pseudo $R^2$</td>
<td>0.1996</td>
<td>0.1848</td>
<td>0.1344</td>
</tr>
<tr>
<td>Hazardous industry membership coefficient</td>
<td>1.437**</td>
<td>1.754***</td>
<td>0.266</td>
</tr>
<tr>
<td>Participation in controversial business issues coefficient</td>
<td>1.056*</td>
<td>0.546</td>
<td>0.275</td>
</tr>
<tr>
<td>Stakeholder strengths coefficient</td>
<td>0.184*</td>
<td>0.320***</td>
<td>0.214*</td>
</tr>
<tr>
<td>Sales coefficient</td>
<td>-0.142</td>
<td>0.429</td>
<td>0.929***</td>
</tr>
</tbody>
</table>
Figure 3.1
Corporate Social Reporting Model
Figure 3.2
Corporate Social Reporting Model for 1997
Figure 3.3
Corporate Social Reporting Model for 2002
Figure 3.4
Corporate Social Reporting Model for 2006
Figure 3.5  
Trend of Pseudo R-Squared

Figure 3.6  
Trend of Coefficient Size for Hazardous Industry Membership

Figure 3.7  
Trend of Coefficient Size for Participation in Controversial Business Issues

Figure 3.8  
Trend of Coefficient Size for Sales
CHAPTER 4

CONCLUSION
This dissertation explored corporate social responsibility practices from two different angles: normative and behavioral. The normative investigation inquired about the moral underpinning of corporate social responsibility. In the process, it revealed the source, nature, components, and scope of corporate social responsibility. The behavioral analysis depicted the factors that affect firms’ actual behavior. Firms adopt new CSR practices in response to rational reasons related to the nature of their activities and scope of their business. However, the explanatory power of these rational factors diminishes as CSR practices become institutionalized.

**NORMATIVE JUSTIFICATIONS**

Corporate Social Responsibility (CSR) refers to the moral obligations of the corporation toward society as a whole and toward certain stakeholders. The source of this obligation is a hypothetical social contract to which all economic actors would agree in order to enter into the cooperative venture that is society. By virtue of this contract, economic actors would abide by a set of hypernorms that regulate their interaction. Two types of hypernorms are developed: competitive and cooperative. Competitive hypernorms aim at transferring the economic actors from the Hobbesian state of nature to an idealized market condition. Under idealized market conditions and within the boundaries set by the competitive hypernorms, economic actors are free to pursue their self-interest. However, the occurrence of market failure prevents the competitive hypernorms from creating the idealized market conditions. Due to market failure, the pursuit of self-interest results in suboptimal equilibrium. Cooperative hypernorms are, therefore, developed to eliminate the possibility of such a suboptimal equilibrium and ensure that the equilibrium reached is an optimal one. Within the boundaries set by the competitive and cooperative hypernorms, economic actors are free to pursue their self-interest. The moral
obligation of the economic actors, consequently, is to conform to the hypernorms that restrict
their pursuit of self-interest to the extent that a suboptimal equilibrium is avoided.

Idealized market conditions are feasible only under the protection of the “laws of justice.”
Primary among those laws are those that lead to the cessation of force and fraud prevalent in the
Hobbesian state of nature. To move away from the state of nature in pursuit of idealized market
conditions, economic actors would agree to the principle of negative rights and the principle of
true representation. The principle of negative rights prohibits the interference with economic
actors. The principle of true representation entitles economic actors to the true and complete
disclosure of the implicit and explicit terms of interaction. These two hypernorms provide the
necessary conditions for idealized market conditions.

Due to market failure, the idealized market conditions are not realized. Equilibrium is
not always optimal. Suboptimal equilibrium may result from the interaction of economic actors.
To eliminate the occurrence of suboptimal equilibrium, economic actors would agree to develop
further hypernorms aimed at ensuring optimal equilibrium. These hypernorms shape the
cooperative behavior of the economic actors.

First, the economic actors would agree to internalize the total costs of their production
and consumption. Such that no economic actor bears a share of the costs for production from
which he/she has not benefited. Similarly, internalizing the total costs of consumption prevents
economic actors from benefiting from goods for which they have not borne their share of
production costs. Second, to reduce uncertainty, the economic actors would agree to conform to
the social institutions developed. Reducing uncertainty would encourage interaction between
economic actors and, therefore, increase their gains.
Third, economic actors would agree to institutions that divide the surplus generated in a just manner. A fair division of gains would assure that each factor of production receive the gains that he/she would have received in the absence of cooperation. In addition, the factor would receive a fair share of the cooperative surplus. How, then, may the cooperative surplus be divided among the cooperating factors of production? Since each of the factors needs the others to carry out the cooperative venture, such venture would not be possible in the absence of any one of the cooperating parties. Accordingly, each of the cooperating parties is entitled to an equal share of the cooperative surplus. Each one of the cooperating parties will then receive an amount equal to the economic surplus that he/she would have generated in the absence of cooperation in addition to an equal share of the cooperative surplus. This outcome is reached by maximizing equal relative benefits of the overall economic surplus (or by minimizing equal relative concessions of the overall economic surplus).

Fourth, economic actors would be permitted to maximize their self-interest through free allocation of their factors of production as long as the principles of cost internalization and uncertainty minimization are not violated. Fifth, economic actors would agree to distribute the surplus through the market mechanism under the constraints of cost internalization and uncertainty minimization. This distribution would be acceptable to all actors because the equilibrium reached through free market interaction is optimal. Finally, sixth, economic actors are permitted to reallocate the economic gains in a bargaining process in an effort to influence the payoff function of cooperating parties such that the desired institutions are maintained or changed.

The firm, like other economic actors, would be subject to the moral obligations dictated by the hypernorms. Accordingly, the firm would be able to discharge its fiduciary responsibility
toward its shareholders as long as such responsibility does not violate its responsibility toward society as a whole or toward other stakeholders. The firm’s primary responsibility is, therefore, to discharge its legal and ethical responsibilities. The firm’s legal responsibility represents the obligations of the firm mandated by formal social institutions; its ethical responsibility represents its obligations mandated by informal social institutions. Within the constraints set by the social institutions, the firm is expected to fulfill its fiduciary responsibility toward its shareholders. After fulfilling its legal, ethical, and economic responsibilities, the firm may engage in philanthropic activity.

**BEHAVIORAL DETERMINANTS**

The normative justification for CSR may provide motivation for some firms to engage in CSR practices or for the development of social institutions that promote and mandate CSR practices. However, the normative motivation alone is not the sole determinant of CSR. Behavioral factors play a significant role in influencing firms’ CSR practices. Firms adopt certain CSR practices as a response to social concerns as a result of business exposure, public awareness, or past performance. These social concerns develop social pressures that necessitate appropriate response.

At the earlier stages of the process, firms respond to mounting social pressure by adopting CSR practices that constitute a rational response based upon the firm’s specific situation. As the CSR practices take root, other firms are exposed to a social pressure of a different kind: a pressure to conform to the newly adopted CSR practice. Under the pressure to conform, more firms adopt the CSR practices through a process of institutionalization.

In the early stages (1997), rational factors predicted corporate social report publication. The odds of corporate social report publication were higher for firms operating in hazardous
industries than they were for other firms. Similarly, the odds of corporate social report publication were positively correlated with the level of participation in controversial business issues. Stakeholder strengths mediated the relationship between media coverage and corporate social report publication. As expected, the explanatory power of the rational factors faded in later years.

**FINAL COMMENTS**

Corporate social responsibility practices are determined by normative justifications and behavioral factors. Normative justifications depict how firms *should* behave. In contrast, behavioral factors influence how firms *actually* behave. The normative argument presented in this dissertation presents a contractarian approach that depicts competitive and cooperative hypernorms. Economic actors would agree to these hypernorms ensure that their cooperative venture will lead to optimal equilibrium.

Based on the hypernorms developed, corporate social responsibility is articulated as a hierarchical set of moral obligations that the firm has toward society and stakeholders. Highest in the hierarchy is the legal responsibility, which is the firms’ responsibility to abide by the law. Second to legal responsibility is ethical responsibility. Ethical responsibility refers to the obligations of the firm toward society and stakeholders resulting from the informal institutions of society. Within the boundaries set by the legal and ethical responsibilities, a firm may fulfill its economic responsibility toward its stockholders. Finally, the firm may engage in philanthropic activities to stabilize its social environment and strengthen its position in society.

Rational and institutional factors influence the firm’s actual behavior regarding social responsibility. Social responsibility practices start among a group of organizations as a rational
solution to a social concern. These practices diffuse to other organizational groups under the pressure of institutional forces through which organizations seek to enhance their legitimacy.

The proposed set of hypernorms represents a step toward a more comprehensive articulation of the principles of business ethics. Such an articulation would identify, with more clarity, the meaning of corporate social responsibility as well as the nature of the obligations economic actors have toward each other. Furthermore, this articulation facilitates a wider adoption of corporate social responsibility practices as the notion becomes clearer to the practitioner.

The behavioral model presented in this dissertation depicts the behavioral underpinnings of corporate social reporting. The model illustrates the role of rational and institutional factors in the institutionalization of corporate social reporting. The practice is introduced as an innovation that rationally addresses legitimacy challenges. Then, it is diffused among organizational groups under the pressure of institutional forces. While the model focuses on corporate social reporting as an example of corporate social responsibility practices, it may identify the elements of an institutionalization process that is generalizable to other corporate social responsibility practices.