

KEEPING YOUR FRIENDS CLOSE AND YOUR ENEMIES CLOSER: INVESTIGATING FIRM INCENTIVES TO PARTICIPATE IN STRATEGIC CoCSR

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ABSTRACT

We investigate firm incentives for engaging in collaborative corporate social responsibility (CoCSR) tasks. Our investigation continues in the vein of earlier theoretical research that established the branding role of strategic CSR. We first consider the case of strategic partners collaborating on CSR tasks. We demonstrate that CoCSR will not always be sustainable as it will be subject to free-riding. We then consider the case of competing firms collaborating on CSR tasks. We demonstrate that firms will be more likely to engage in CoCSR with their closest competitors than with indirect competitors or even firms selling complementary goods.

Key words: Strategic CSR; Managing CSR; Collaborative CSR

INTRODUCTION

CSR has steadily emerged as a dominant paradigm amongst firm management across the globe. Theoretical underpinnings that can explain this victory and proliferation of selfless firm-level behavior, that at first sight would appear to contradict foundation assumptions of neoclassical economics, have been proposed. This has helped to justify and pave ways for establishing a stream of research that investigates the CSR function itself and yields useful and robust managerial guidelines.

Whether it is a free clinic established by a pharmaceutical company or an ocean-floor clean-up program sponsored by a ship builder, a CSR project offers greater yield with higher investment. It is reasonable to assume however that firms have significant limits on the amount of resources they can expend on CSR projects. That leaves one to wonder whether many CSR projects, being auxiliary endeavors of firms, are deprived of success simply because firms are unable to inject critical doses of resources necessary for those projects to gain productivity inertia.

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It is quite reasonable then to ponder about the potential for collaborative CSR efforts (CoCSR) to improve the viability and productivity of otherwise ordinary CSR projects. In such an arrangement, different firms could pool in a variety of resources so that the CSR project itself could gain the momentum necessary for flourishing. Indeed, there can be many advantages of CoCSR efforts. At the very least, a larger number of contributors to a given CSR project would relieve capacity constraints arising due to resource constraints. Also, different firms could offer their various comparative advantages and improve the quality of the production engine of CSR projects.

To argue in favor of CoCSR by focusing solely on the viability of CSR projects, one needs to use a myopic lens. In particular, while it is easy to argue that CoCSR is good for CSR projects, it may not be as easy to argue that CSR is unconditionally good for firms, at least from a strategic viewpoint. For example, firms aiming to achieve differentiation by engaging in CSR may forego opportunities to collaborate on CSR with their competitors. Since it is reasonable to assume that the pervasiveness of CoCSR will depend largely on firm-level incentives for doing so, it is important for investigating those incentives.

In this paper we consider the strategic value of CoCSR to firms, and thereby investigate their incentives to participate in CoCSR. We consider two broad cases: that of firms which are competitors, and that of firms which are strategic partners (sharing some common goal). For our analysis, we set up a simple model and use it to derive the equilibrium output for the various scenarios. The next section provides a review of the literature, while the model and analysis follow that.

LITERATURE REVIEW

CSR or Corporate Social Responsibility is the term used for the “action of firms that contribute to social welfare, beyond what is required for profit maximization” (McWilliams, 2015). Today, CSR is a well-accepted phenomenon among practitioners and academics alike, even though implementation continues to be challenging (Kotler and Keller 2008; Lindgreen et al. 2009). Many major corporations such as Cisco, Microsoft and Accenture have even created entire departments or foundations to execute CSR activities (Brindley 2015).

There is a large and still growing body of literature on CSR (c.f. Greenfield 2004, Lindgreen and Swaen 2010, Maignan and Ralston 2002, McWilliams et al. 2006, Pearce and Doh 2005). They primarily addresses such topics as the motivation for CSR, the antecedents for increased CSR activities.

Despite the prolific investigation of CSR by academics today, the fact remains that CSR had a bumpy start. Perhaps the most famous critic of CSR was the late Nobel laureate Milton Friedman (Friedman, 1970). As an economist, Friedman argued staunchly against CSR as it

is incoherent and often antithetical to the profit-making goal of a firm. While this view of CSR was popular among economists, recent studies have indicated the strategic value of CSR using economic rationale. Rahman (2008) for example indicated the financial returns to CSR via signaling. The study belongs to a growing stream of literature known that can be labeled as strategic CSR (c.f. Brammer et al. 2007, Fombrun and Shanley 1990, Kotler and Lee 2005, Maignan et al 1999, Porter and Kramer 2006, Rupp et al 2006, Valentine and Fleischman 2008, Vogel 2005). Lindgreen and Swaen (2010) provide an excellent review.

Collaborative CSR has only recently received attention. Most of these are in the form of articles in the popular press, while rigorous academic studies have not generally been conducted directly in the area of collaborative CSR. Murray et al. (2010) is an exception as they investigate in broad terms the possibilities and problems of collaborating on CSR. They note that collaboration between agencies would be the next recommended step. They do not however rigorously assess any particular mode of collaboration, and focus instead on stimulating a research agenda. Patel (2015) observes that companies can effectively collaborate on CSR, particularly after recently passed legislation (the new Companies Act) in India, where CSR is mandatory for firms Brindley (2015) suggests in the popular press that collaborative CSR is the true form of CSR. In a publication by the Network for Business Sustainability (2013), it is observed that there are three major challenges to collaborative CSR: (i) high expenses of making organizational changes to execute it, (ii) power differences between partners, (iii) generation of similar economics value. While these are excellent insights, none of these conclusions have been rigorously determined. In fact, to the best of our knowledge we are not aware of another study other than this paper that investigates rigorously the incentives to participate in CoCSR.

MODEL AND ANALYSIS

Assumptions:

Strategic Role of CSR:

In the same vein as earlier theoretical research on strategic CSR, we assume that firms are interested in CSR if and only if it leads to positive financial returns. Further, we are interested in the case where a branding role of CSR is the mechanism linking it to profits.

Market Structure:

We assume an oligopoly market where there are n identical firms who are selling in the same market. Because these firms are identical, they do not possess any incentive to signal their brand value to consumers.

External Environment:

Each firm has one strategic partner firm such that they both benefit from any contribution to a CSR project made by either firm.

CSR financial returns model:

We assume that for each firm, engaging in any level $x \geq 0$ of CSR activities will result in a net payoff of

$$f(x) - cx < 0$$

That is the firm will not be able to engage in any CSR activity without incurring a financial loss. This is a valid assumption in light of the assumptions made regarding the strategic role of CSR and the market structure above.

We also assume that the function f is sigmoid. That is the CSR activity first benefits from high contribution, while later is subject to exhibiting diminishing marginal benefits. We further assume that when the n competing firms each contribute a level $x \geq 0$ in CSR activities, the net payoff for each firm is

$$\frac{1}{n} f(nx) - cx$$

Finally, we assume that when two strategic partners contribute amounts x_1, x_2 to a CoCSR project, firm i receives the following payoff

$$f(x_1 + x_2) - c_i x_i$$

Firm incentives for engaging in CoCSR with competitors

Suppose an opportunity arises for every firm to contribute a level $x \geq 0$ to a common CSR initiative. Each firm will decide to contribute whenever

$$\frac{1}{n} f(nx) - cx > 0$$

That will be the case iff

$$\frac{1}{n} f(nx) > cx > f(x)$$

We can investigate the situation graphically. In figure 1a, the solid line represents the cost function, whereas the dashed line represents the individual returns to each firm from engaging in CoCSR. Clearly, in this case, firms will not engage in CoCSR.

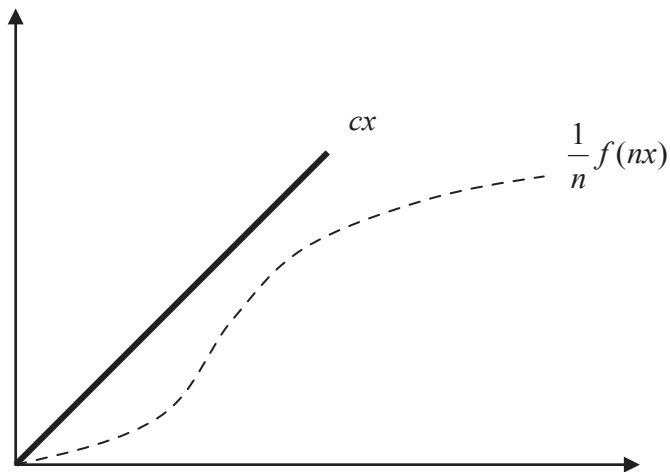


Figure 1a: No firm incentives to engage in CoCSR.

Figure 1b however shows a different situation, where firms will have the incentive to engage in CoCSR.

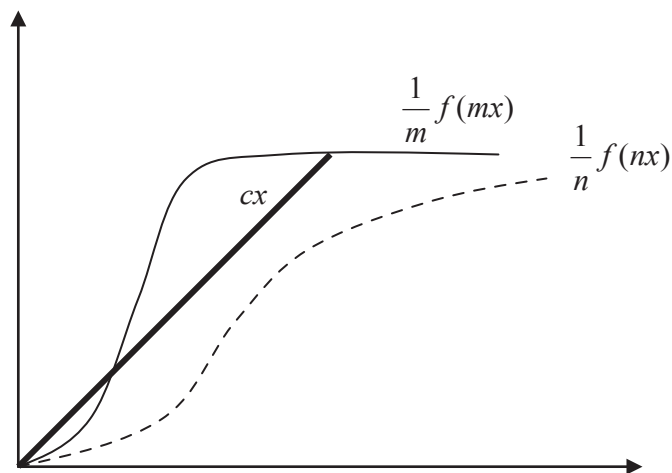


Figure 1b: Firms have incentives to engage in CoCSR when the number of firms m is larger.

The situation will arise whenever $\frac{1}{n} f(nx)$ is large enough for a given value of x . One necessary condition is that

$$\frac{1}{n} f(nx) > f(x) .$$

We can state that in another way

$$f(nx) > nf(x) .$$

In words, we can use a familiar phrase to describe that condition: that the whole needs to be greater than the sum of the parts.

Another condition is that n has to be large enough to cover the cost.

Proposition 1: *Each of the n firms will be interested to engage in CoCSR with its direct competitors only if*

- (i) *the project is such that $f(nx) > nf(x)$,*
- (ii) *c is sufficiently small, and/or*
- (iii) *n is sufficiently large.*

Finally, we note that when the firms will have an incentive to engage in CoCSR, then each will contribute an amount x^* which solves

$$\max_x \frac{1}{n} f(nx) - cx .$$

If f is twice continuously differentiable, and has an inverse, then x^* is given by

$$x^* = \frac{f^{-1}(cn)}{n} .$$

Firm incentives to engage in CoCSR with strategic partners

We now consider the incentives of two firms, $i = 1, 2$, to engage in CoCSR when they are strategic partners. For firm i , the net payoff after contributing a level x_i is given by

$$f(x_1 + x_2) - c_i x_i ,$$

given the other firm's contribution x_j , $j \neq i$. Note that because the firms are no longer identical, they have different cost functions as they face different opportunity costs. We can use the above expression to derive the reaction functions for the strategic partners

$$x_i(x_j) = \max \{0, f^{-1}(c_i) - x_j\} .$$

Based on those reactions, there can be two different kinds of Nash Equilibrium.

Case 1: When $f^{i-1}(c_i) < 0 \quad \forall i$. The reaction function is then simply reduced to the following

$$x_i(x_j) = 0$$

In this case as the figure below indicates, the only Nash equilibrium involves both firms abstaining from CSR tasks.

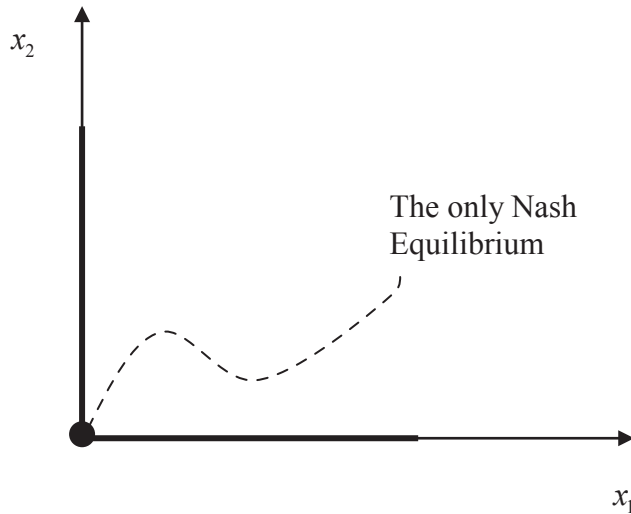


Figure 2a: When $f^{i-1}(c_i) < 0 \quad \forall i$, in the unique Nash Equilibrium in the game, no CSR takes place. Further, collaboration is not an incentive to encourage CSR.

Proposition 2a: *When any firm lacks the incentive to participate individually in CSR initiatives, the firm will not gain incentives to engage in CSR through CoCSR.*

Case 2: When $f^{i-1}(c_i) > 0$ for at least one i , and different for both. In this case, as the figure below indicates, there is always a Nash equilibrium in which CSR will take place, but CoCSR is not sustainable.

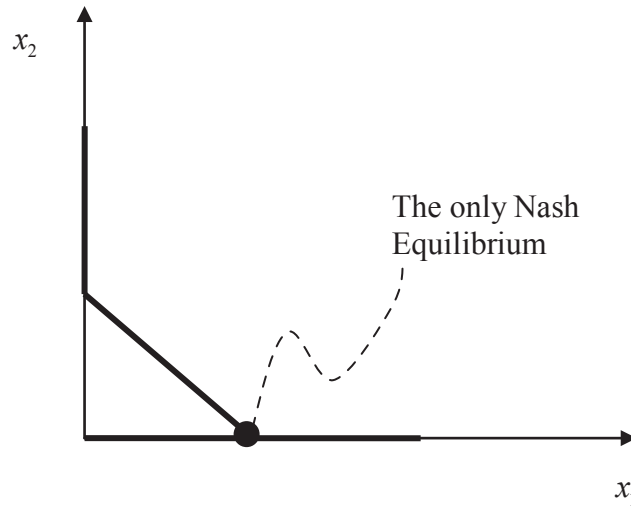


Figure 2a In the unique Nash Equilibrium in the game, no CoCSR takes place.

Proposition 2b: CoCSR among strategic partner firms will not be sustainable if one firm *likes* CSR more than another.

Case 3: When $f^{i-1}(c_i) = f^{i-1}(c_j) > 0$. In this case, a plethora of results are possible, as the figure below indicates.

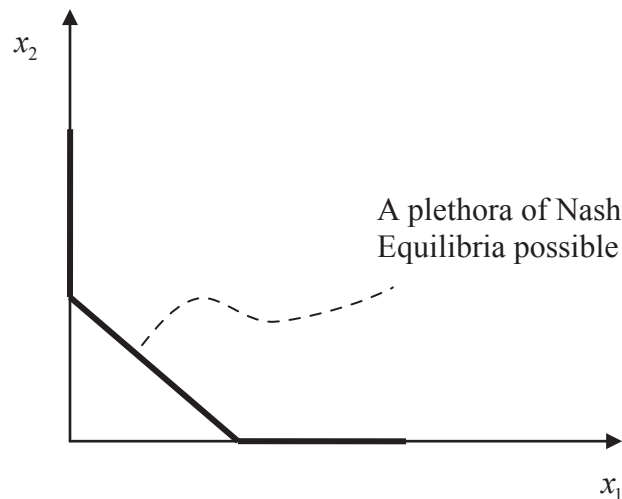


Figure 2c: CoCSR may take place only when both strategic partner firms like CSR equally. It is however possible that either partner, in equilibrium, will free-ride completely on the other firm.

DISCUSSION AND CONCLUSION

In this paper, we considered the strategic play of firms to collaborate on CSR. This is an important contribution to the literature as, to the best of our knowledge, this is the first technical assessment of the topic. Our analysis has resulted in three propositions that deliver insight on the nature of collaboration we can expect among firms on CSR. In particular, we have derived the conditions under which firms will collaborate when they are competitors, and conditions under which they will collaborate when they are strategic partners. When firms are competitors, they will be driven by the tendency to capitalize on exponential growth of project size/impact from greater investment. In many ways, this will be like pitching in to buy gifts; indeed it is a common practice for colleagues and friends to contribute to a common fund that results in a single but substantial gift. Although the intuition is quite simple, the result is impacting. Indeed, it is profound to consider that firms, even for strategic reasons, will actually collaborate with competitors on CSR, when strategic CSR is often associated with differentiation.

And when firms are strategic partners, we have demonstrated that in most cases, we will see free-riding. Once again, this is a surprising result, as free-riding is not typically an element of partnership. And intuitively, we would expect competitors to engage in less-than-noble acts such as free-riding. But our result does not defy intuition when we consider that strategic partners will work to maximize value generation, whereas duplication of efforts will be inefficient even if inequitable. Further, in light of our results, we can posit that partnerships can directly address equitable sharing of CSR activities a priori. We have demonstrated that those firms which like CSR will tend to engage in all of the activities. It may be that in real life, those same firms also have greater bargaining powers for a variety of reasons such as relative firm size, or by virtue of their position in the supply chain. For example, a major retailer and its supplier may involve a case of monopsony. Due to the retailer's branding efforts and/or its differentiation factor, it may be interested in engaging in a lot of CSR. Our result indicates that the retailer would engage in all of the CSR activities. However, due to its market power, it can force its suppliers to engage in CSR activities.

As future research in the area of strategic CoCSR, we encourage empirical work. Our results can be used to generate a series of hypotheses, and we offer a few examples. In observing CoCSR, our results suggest that we should observe that in the case of competitors, we should see firms that are similar in profile collaborating on CSR. The number of participants must be large, and the project itself must be large, offer visibility, and/or offer exponential returns on investment. We also expect to see less strategic CoCSR among firms that are vertically aligned, or are otherwise strategic partners.

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