

Interplay between Internal and External Corporate Social Responsibility

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Abstract

Corporate social responsibility (CSR) is an intensively researched area. This study attempts to investigate the association between different types of CSR which is a largely overlooked area in the CSR agenda. Based on the target stakeholder group, we distinguish firms' CSR activities into internal and external CSR. We provide arguments favoring both a positive and negative association between the two types. The sample is consisted of 50 companies listed in the Colombo stock exchange, Sri Lanka. Multiple regression analysis was used to test the research hypothesis. The findings suggest that external CSR is negatively associated with internal CSR. Therefore, resource constraint dominates the stakeholder demands when making investments in different CSR types.

Keywords: Corporate social responsibility (CSR), Internal CSR, External CSR, Sri Lanka.

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Introduction

During the past few decades, the concept of corporate social responsibility (CSR) has been gaining an increasing interest and recognition among the academia, business practitioners and the general public alike. Apart from financial performances, firms are required to maintain an attractive social performances due to institutional pressures for responsible business practices (Campbell, 2007; Matten and Moon, 2008; Fernandez-Kranz and Santalo, 2010), instrumental motivations for gaining competitive advantages (Bansal and Roth, 2000; Siegel and Vitaliano 2007) and many more other social and environmental causes (Hawn and Ioannou, 2016). In attempt to fulfilling their

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responsibilities towards the society, firms undertake a wide variety of CSR activities targeting different stakeholders such as primary, secondary, internal and external and in different domains such as social and environment. Prevailing studies have distinguished CSR activities into different dimensions such as social, environmental and governance, however neither of them attempt to investigate any possible association among them. To close this gap, we delineate between internal and external CSR in line with the distinction between internal and external stakeholder groups in stakeholder theory (Freeman, 1984). Internal CSR activities address social concerns of internal stakeholders such as employees and managers while external CSR activities address broader social concerns of general stakeholders such as customers, suppliers and the local community. Firms may concurrently engage in both internal and external CSR activities. However, it is not economically feasible to invest equally in both groups simultaneously (Jensen, 2002; Amit and Schoemaker, 1993). Therefore, we argue that the two types of CSR activities are negatively associated such that increased investment in one type leads to reduction of engagement in the other type. Opposing to this view, we offer a counter argument such that internal and external CSR go hand in hand. Especially, increased external CSR may lead increased internal CSR, since internal stakeholders may place more demand for socially responsible behavior towards them as their organizations increasingly socially responsible towards external stakeholders (Zappala, 2004). Therefore, the purpose of the present study is to investigate the association between firm's internal and external CSR activities. The research hypothesis are tested using a data set of 50 companies listed in CSE (Colombo Stock Exchange) in year 2015.

In the next section, we review prior literature on CSR to define and distinguish internal and external CSR. The methodology section describes the sample, data collection and variable measures. Next section presents the results with a discussion of major findings. Finally, we end with a discussion and limitations directing future studies.

Literature Review

CSR is a difficult to define term since its multidimensional, dynamic and contested nature (Lindgreen, 2009). Therefore, to the date there is no harmonized or universally accepted definition of CSR. Extant literature on CSR shows various definitions of the concept (Carroll, 1979; Dahlsrud, 2008; Hopkins, 1998; European Commission, 2001; McWilliams & Siegel, 2001; Van Marrewijk, 2001; Turker, 2009a). A seminal scholar in the CSR field, Carroll (1979) defined CSR as “the economic, legal, ethical and discretionary expectations that society has of organizations at a given point of time”. Later on, the economic component was excluded when defining CSR since economic concerns are the exact reasons for businesses' existence but not their responsibility (Carroll, 1999; Turker, 2009a). Voluntariness and stakeholder orientation are another two dimensions that can be frequently found in most of the CSR definitions (Hopkins, 1998; Van Marrewijk, 2003). For the present study, a general definition of CSR is adopted as ‘firms' voluntary social initiatives aiming at stakeholders for a better society and a cleaner environment’ (Turker, 2009a, European Commission, 2001). Stakeholders are defined as “any identifiable group or individual who can affect the achievement of an organization's objectives, or is affected by the achievement of an organization's objectives” (Freeman and Reed, 1983). In literature, different divisions can be found between the stakeholders

(Verdeyen et al., 2004). One such division is distinguishing them as internal and external stakeholders. Internal stakeholders such as managers and employees lie within the firms' boundaries while external stakeholders such as customers, suppliers, government and the local community lie outside the organizational boundaries (Freeman, 1984). We conceptually made a distinction between internal and external CSR in line with the distinction between internal and external audiences in the stakeholder theory (Freeman, 1984).

Internal CSR is conceptualized as "firm's actions to pursue social goals to promote the well-being of internal stakeholders such as the employees" (European Commission, 2001; Turker, 2009b; Vives, 2006). Internal CSR is expressed in concern for employee training and development, their health and safety, work place diversity, equal opportunities, work life balance, work environment and participation in business (European Commission, 2001; Turker, 2009b; Vives, 2006; Lindgreen et al., 2009). External CSR can be conceptualized as "firm's concern and response to society at large and its interaction with the physical environment" (Carroll, 1979; Brammer et al., 2007). External CSR typically includes activities such as cause related marketing, volunteerism, donations, philanthropic activities, community projects and environmental protection programs (Brammer et al., 2007; Cornelius et al., 2008).

In a given point of time, a firm may concurrently engage in both internal and external CSR activities. Firms are having limited resources for which different business units may compete each other. CSR activities incurred a cost, therefore, it is not cost effective for a firm to invest equally in different types of CSR activities simultaneously (Amit and Schoemaker, 1993; Jensen, 2002). Therefore, "firms may attempt to offset the costs of external CSR activities by compromising internal CSR activities such as employee welfare, their training and development and working conditions" (Royle, 2005). In line with this, we argue that firm's decision to invest in one type of CSR activities (say internal CSR) may lead to reduced investment in another type (external CSR) due to resource constraint. The research hypothesis is drawn as follows;

H₁: External CSR is negatively associated with internal CSR.

Alternatively, arguments can be made favoring a positive association between internal and external CSR. Firms' CSR implementation typically tend to address more the interests of external stakeholders with the purpose of gaining legitimacy and building corporate reputation (Bansal and Roth, 2000; Siegel and Vitaliano 2007). However, employees and other internal stakeholders expect and demand that if their organizations are socially responsible toward external stakeholders, then they should also be socially responsible toward internal stakeholders in a similar manner (Zappala, 2004). In line with this fact, as firms increase engaging in external CSR, they may have to increase their engagement with internal CSR simultaneously. This leads to the following hypothesis;

H₂: External CSR is positively associated with internal CSR.

Methodology

Sample and Data Collection

Sample is consisted of 50 companies listed in Colombo Stock Exchange (CSE), Sri Lanka. CSE has 295 companies representing 20 different business sectors as at 30th September 2017, with a market capitalization of 2,919 billion Sri Lankan Rupees. We selected 50 companies for our sample based on the availability of CSR data that may enable us to distinguish and measure internal and external CSR in an accurate manner. Annual/sustainability reports of the sample companies in 2015 were referred to measure the study variables. Table 01 presents the profile of the sample. Fifty companies represent six industries while majority of the companies (30%) are in banking, finance and insurance industry.

Table 1 Sample Profile

Industry Sector	Number	Percentage (%)
Banking, Finance and Insurance	15	30
Beverage, Food and Tobacco	10	20
Chemicals and Pharmaceuticals	5	10
Diversified Holdings	5	10
Manufacturing	10	20
Plantations	5	10
Total	50	100.00

Source: CSE website (Industry Sector Classification)

Measures

We used CSR expenditure data to measure internal and External CSR. Internal CSR is measured by cost of employee training and development (Brammer et al., 2007; Turker, 2009b; Vives, 2006; Lindgreen et al., 2009) and external CSR is measured by philanthropic donation (Amato and Amato, 2007; Godfrey, 2005).

Control Variables

We used three control variables, firm size, financial leverage and industry. Size of the firm may influence its capacity to engage in social activities (McWilliams & Siegel, 2001; Amato and Amato, 2006), therefore firm size is controlled by adding the natural logarithm of total assets in the regressions acknowledging the evident positive skewness. Firms operating in different industries may have different benefits and pressures for pursuing CSR activities (Hull & Rothenberg, 2008). Therefore, studies have considered industry factor as a controlling variable since some industries tend to be more socially responsible than others. We use five industry dummy variables to control the differences in six industries. Finally, firm's leverage ratio which is measured by the ratio of total debts to total assets was included as a proxy for firms' financial leverage (Flammer and Luo, 2016).

The basic empirical model expresses internal CSR as a function of external CSR, few firm variables and industry environment variables. We use the following equation to test the research hypothesis by means of regressions.

$$ICSR_{it} = \alpha_0 + \alpha_1 ECSR_{i,t} + \sum_{j=1}^J \gamma_j C_{ij} + \alpha_2 \sum_{k=1}^{M-1} IND_k + \varepsilon_{li} \quad (1)$$

$i=1$ to N represents number of firms and $j=1$ to J represents number of control variables.

$ICSR_{it}$ and $ECSR_{it}$ represent the number of internal and external CSR activities in year t for firm i respectively. C_{ij} represents the j^{th} control variable for firm i . IND_k represents the industry fixed effects where m being the number of industries in the sample. ε_{li} is the uncorrelated error term.

Results

Table 2 reports the descriptive statistics and correlations of the variables in our study. Favoring hypothesis one, external CSR is negatively related with internal CSR. Table 3 summarizes the coefficients obtained from the estimation of equation (1) by means of multiple regression model.

Table 2. Descriptive Statistics and Correlations

Variable	Mean	SD	1	2	3	4
1. Internal CSR	3.87	9.66	1			
2. External CSR	2.64	5.92	-0.249*	1		
3. Firm size	10.18	0.92	0.115*	0.090*	1	
4. Leverage	0.17	0.15	-0.143	-0.019	0.232	1

$n=50$

* $P < 0.05$, ** $P < 0.001$

To investigate the predictability power of external CSR in explaining internal CSR, we used multiple regression analysis, since our dependent and independent variables are measured on a continuous scale. Second, according to the Durbin-Watson statistic (1.86), it can be assumed that the observations are independence. Third, linear relationships are exit between the dependent variable and each of the independent variables and between the dependent variable and independent variables collectively. Forth, the data approximately show homoscedasticity and correlations shown in table 2 reveal that there is no multicollinearity issues. Fifth, there is no significant outliers and according to normal P-P plot, the residuals are approximately normally distributed. The results of the multiple regression are given in table 3.

Table 3. Multiple Regression Estimates of Internal CSR

Variables	Model 1	Model 2
Intercept	0.0562 (2.21 [*])	0.1011 (5.33 [*])
External CSR		-0.2588 (2.04 [*])
Firm Size	0.0009 (5.02 [*])	0.0016 (1.00 [*])
Leverage	-0.0072(-2.33 [*])	-0.0012 (-1.20 [*])
R ²	0.0321	0.1436
F-Statistic	17.24 [*]	9.95 [*]
$ICSR_{it} = 0.1011 - 0.2588 ECSR_{i,t} + 0.0016 \text{ Firm Size} - 0.0012 \text{ Leverage} + \varepsilon_{li}$		

t-statistics in parentheses

Significance levels: *P< 0.05 (two-tailed tests)

The first column of table 3 reports the estimated regression coefficients only for control variables. An R² of 0.032 indicates a weak overall explanatory power of the model. In model 2 we add the main independent variable, external CSR. The addition of external CSR does not change the sign and significance of the coefficients of firm size and leverage. Coefficient of external CSR shows that it is negatively related to internal CSR ($\alpha = -0.2588$, $p < 0.05$) supporting the hypotheses one which argue for a negative association. The R² of model 2 is 0.1436 when compared to 0.0321 for model 1 which only includes the control variables. The addition of external CSR to the model increases the R² by 0.1115 (11.15%). External CSR approximately explains 11.15% of variability in internal CSR. One unit increment in external CSR leads to approximately 11.15% reduction in internal CSR investments. An R² of 0.144 indicates a moderate overall explanatory power of the model.

Discussion

The present study attempts to investigate the relationship between different types of CSR activities by distinguishing them into internal and external CSR primarily based on their target stakeholder group. Argument were made favoring both a negative and positive relationships between the two types of CSR. The research findings provide evidences supporting hypothesis one which theorize a negative association between external and internal CSR. Firms may engage in different types of CSR, for an instance as in this study internal and external CSR. According to the research findings, the proportion of investing in internal CSR is restricted by the proportion of investments in external CSR. Firms tend to offset the costs of external CSR activities by reducing the investments in internal CSR activities (Royle, 2005).

Limitations and Avenues for Future Research

The limitations of this study provides few avenues for future research. First, all the variables in the study were measured using company disclosure based data. Companies disclose the information which they want to make publically available (Ullmann, 1985).

The validity of these self-reported information is questionable since they may not represent the firms' actual social engagement and performance. Limitation of company disclosure based data can be mitigated by employing alternative data sources such as surveys and reputational indices to measure CSR more accurately. Second, industry factor determines a firm's CSR behavior to a greater extent (Amato and Amato, 2007). Fifty companies in the sample represent six different industries. Some industries may engage in CSR activities targeting their external stakeholders (or internal stakeholders) than internal stakeholders (external stakeholders), especially depending on the nature of their businesses. Future studies can draw the sample companies from a single industry which may help to mitigate the issues due to industry differences. Third, in our attempt to investigate the association between firms' internal and external CSR, we measured both of them in the same time period. Top management typically makes the CSR investment decisions, while less or no employee participation in this decision making process. Therefore, employees can hardly perceive firms' CSR activities before their implementation. Employees may demand their organizations to be more socially responsible towards them in next year by observing organizations' responsible behavior for external stakeholders in current year. Future studies can measure external CSR one year lag behind internal CSR to examine the relationship more precisely.

Conclusion

The nature of the association between different types of CSR is a largely neglected area in the CSR literature. Thus, the objective of this study is to investigate the association between different types of CSR activities. First based on the target stakeholder group, we distinguish firms' CSR activities into internal and external CSR. We make arguments favoring both positive and negative relationships between the two. The results indicate that external CSR is negatively associated with internal CSR. Firms are more likely to be socially responsible toward their external stakeholders to gain legitimacy and build reputation (Royle, 2005), while they try offset cost of external CST engagement by compromising internal CSR activities.

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