CHAPTER 3
RESEARCH OBJECTIVES AND HYPOTHESES

3.0 Chapter Introduction

This chapter discusses the research objectives followed by formulation of hypotheses based on the identified gaps, research objectives and hypotheses are formulated. The identified gaps are described in detail below.

3.1 Research Objectives

The proposed study is based on the research gaps identified in the Chapter 2. There have been several studies that take into account the manager’s point of view and customer’s perceptions to assess CSR activities of a firm. However, such data can be criticized on grounds that it suffers from a high degree of biasness as managers are the ones who formulate and implement the CSR activities of a firm. Hence it is crucial to get an unbiased view of CSR activities of a firm. In order to remove any biased opinion regarding CSR and CR, this study uses annual audited reports to capture CSR and third party reputation rankings (from Fortune India 500, Economic Times and Business Standard) to capture corporate reputation of firms. So, the proposed study intends:

a. To test the relationship between CSR-CR- FP relationship.

b. To analyze the effect Social Pressure (Initiative) and on CSR-Performance relationship

c. To capture the role of external (Competitive Intensity) and internal factors (reputation management capability) on the CR-FP relationship in the Indian context.
d. To explore the effect of power of three select stakeholders’ viz. employees, customer and suppliers and on the CSR-CR-FP relationship.

3.2 The Neville, Bell and Menguc Model

Neville, Bell and Menguc (2005) proposed a fairly comprehensive conceptual model to provide a better understanding of the role of corporate reputation on corporate social performance (CSP) and FP relationship, incorporating the role of contingencies. The authors used Stakeholder theory\(^1\), Legitimacy theory\(^2\) and the Resource based view\(^3\) to devise a model integrating the role

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\(^1\) The corporation is an organizational entity, serving the purpose of several participants rather than serving an entirely congruent purpose (Donaldson and Preston, 1995). Stakeholder theory is based on the belief that “the firm takes into account all those groups and individuals that can affect, or are affected by, the accomplishment of organizational purpose” (Freeman, 1984, pg. 25). As per Donaldson and Preston (1995), the stakeholder theory explains and guides the structure and operations of the ‘going concern’.

\(^2\) Legitimacy is “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” (Suchman, 1995, p.574). Initially, the term legitimacy was coined to address the issue of social contract between people and government. A company can be considered legitimate when it acts as per societal expectations or because it manipulates the perceptions of people towards the company (Dowling and Pfeffer, 1975). They can also become legitimate by opting for an explicit mode of communication more than actions, which subsequently affects the firm’s reputation (Dowling and Pfeffer, 1975). Organizational legitimacy is a variable state which changes with time across various stakeholders and cultural groups. Legitimacy theory is “somehow demonstrated (or rebutted), depending on the degree of association found between disclosure patterns and changes in societal opinions” (Campbell et al., 2003, p. 561). The theory is widely used to elucidate social disclosures (Deegan, 2002; Campbell et al, 2003) due to the presence of sufficient evidence to prove that managers adopt legitimizing strategies in times of need.

\(^3\) Resource Based View (RBV) is one of the concepts in strategic management that has been widely employed in the recent years. The concept was first coined in 1984 by Birger Wernerfelt. RBV provides a theoretical framework explaining how firms achieve competitive advantage and sustain it over a period of time. Strategic capabilities are considered to be a pool of internal resources strategically important for generating competitive advantage. The main idea of RBV is that internal resources are the source of company’s strengths and weaknesses. In order to compete, resources need to be heterogeneous among firms. The organization needs to first identify these resources and then create competence which is distinctive in nature. These key resources of the firm lead to sustainable competitive advantage resulting in superior performance. RBV accentuates strategic choice, afflicting important task such as
of corporate reputation in the CSP-FP relationship. The authors analyzed literature on CSP, organizational stakeholders and CR linking other factors such as reputation, corporate strategy, competition, and reputation management capability that affect the relation between CSP and FP. The authors developed six propositions based on the relationships shown in the model (see Figure 3.1).

The propositions of Neville et al. (2005, pg 1190) have been stated (rephrased) below.

P1. FP is directly and significantly related to CR.

P2. CR is directly and significantly related to CSP.

identifying, developing and deploying key resources for better profits, on the firm’s management (Fahy and Smithee, 1999). For a resource to lead to competitive advantage it should be valuable and facilitate value creation. If resources fail in creating values, they cannot be considered as a potential source of advantage (Barney, 1991).
P3. A fit between social initiatives and corporate strategy improves the CSP-CR linkage.

P4. An increase in Competitive intensity improves the relationship between CR and FP.

P5a. An increase in reputation management capability strengthens the relationship between CSP and CR.

P5b. An increase in reputation management capability strengthens the relationship between CR and FP.

P6. An increase in stakeholder power strengthens the relationship between CSP and CR negatively.

The theoretical model and propositions provided in this study needs to be empirically examined; scrutinizing stakeholders across the entire range of stakeholders. Studies have revealed a positive and moderating role on the effect of CR on FP (Sanchez and Sotorrio, 2007), and since different set of stakeholders affect a firm differently, testing the power of stakeholders would provide a more holistic and generalizable view on the relationship. Previous studies have analyzed the responsibility of managers and the nature of their dealings in an environment encompassing multiple stakeholders with multiple intents. However, they failed to take into account stakeholders who have the ability to alter the nature of resource distribution to the organization, and thus alter its performance. Addressing these issues would help understand the role of stakeholders in the CSR-FP linkage. Given the increasing role of stakeholders in business (Neville et al, 2005), an elaborate understanding of the CSP-FP linkage would be helpful for practitioners in designing their CSR activities.
3.3 Proposed Model

Based on Neville et al.’s (2005) study, the following model has been proposed for the study, by making suitable modifications in the existing model. These modifications were made based on certain considerations. Reputation of a firm is created in the short run, but is formed and could change over a period of time. Thus, the bond among CSR, CR and FP is a continuous process.

This study uses the lag effect of CSR on the reputation and performance in the subsequent years to capture the process. To portray performance effectively, operational measures, accounting measures and market measures have been employed in this study. Different stakeholders have the power to affect the organization in varying degrees. CSR activities can improve performance through non-economic criteria (Maignan et al.2002) by addressing the entire set of organizational stakeholders. This study, therefore, includes three major stakeholders in the model, namely employees, customers and suppliers; and analyzes their power in influencing
financial performance. This study intends to validate the modified Neville et al.’s (2005, p. 1190) model by focusing on three major stakeholders viz. customers, suppliers and employees in the Indian context. This section describes in detail the process of hypotheses development for the study.

3.3.1. CSR Intensity and Corporate Reputation

Reputation refers to stakeholders’ evaluation of the credibility of a firm’s projection (Neville et al. 2005). Reputation is subject to numerous factors like management quality of the firm, its financial soundness and display of social responsibilities. CSR activities have an influence on CR through marketing efforts of a firm such as corporate communications, reputation building, and branding. It involves the perceptions about an organization that result from the information conveyed through mass media and interpersonal communication (Dowling, 1986). Therefore, we hypothesize that:

H₁: CSR intensity has a positive impact on corporate reputation.

3.3.2. The Effect of Corporate Reputation on Financial Performance

Corporate Reputation represents a competitive advantage that cannot be replicated and can lead to superior performance (Roberts and Dowling, 2002) by attracting investors, providing access to capital markets and improving credit ratings of a firm (Fombrun, 1996). Additionally, CR helps a firm in demanding premium prices for the products and services of the company; cheaper raw materials; attracting more qualified employees; greater consumer/employee loyalty and stable income. Good reputation signifies quality and is a source of competitive advantage for a firm that aids in sustainable growth. By using CSR as a strategy, an organization tends to influence its
reputation. A positive reputation influences customers’ purchase intentions, supplier choice, finally supporting higher profits (Neville et al., 2005). Therefore, we hypothesize that:

\[ H_2: \text{Corporate reputation has a positive impact on a firm’s financial performance.} \]

### 3.3.3. Social Initiative/Corporate Strategy Fit and the CSR-FP Relationship

Husted (2000) proposed that the relationship between CSR and performance depends on the fit between relevant social issues and the firm’s corresponding strategies. This can be traced back to the stakeholder context that opines that a firm’s social initiatives will be assessed relatively to the standards considered significant by its stakeholders (Wartick, 2002). Invariably, products, markets and activities defining organizational strategy also define the firm’s stakeholder set. So, socially responsible firms whose CSR activities are inconsistent to its corporate strategy fail to meet its stakeholders’ expectations. Firms make profits by representing their socially responsible elements in their products (Berman et al. 1999). Hence, we hypothesize that:

\[ H_3: \text{The fit between social initiatives and corporate strategy plays a moderating role between CSR intensity and corporate reputation.} \]

### 3.3.4. Competitive Intensity and the CR-FP Relationship

Competitive intensity has been defined as “the extent of tension imposed by the firm’s rivals that might solicit strategic response”. Sen and Bhattacharya (2001) opined that when firms undertake CSR activities, consumers tend to like, respect, admire the firm, identify with it and consequentially act as its brand ambassadors (Springer, 2006). CSR activities aimed at employees reduces attrition rate and increases employee productivity (Huselid, 1995). Competitive intensity amidst the industry also plays a moderating role in the CR-FP relationship
(Sanchez and Sotorrio, 2007). In a highly competitive industry, more substitute products enter the market. Thus, the greater (or lesser) the level of competition in a sector, CR is more likely to play a more (or less) important role in the resource allocation decisions by stakeholders and, ultimately the performance of the firm. Hence, we hypothesize that:

\[ H_4: \text{Competitive intensity moderates the relationship between corporate reputation and a firm’s financial performance.} \]

### 3.3.5. Reputation Management Capability (RMC) and the CSR-FP Relationship

Reputation Management Capability (RMC) signifies the extent to which the firm is willing to spend on improving its reputation. RMC can be both proactive as well as defensive in nature (Greening and Gray, 1994; Shimp, 1997). Proactive RMC signifies that information regarding CSR activities is proactively provided to stakeholders to influence their perceptions about the firm. Defensive RMC, on the other hand, refers to the use of communications with significant stakeholders to improve or rectify the effects of any negative information regarding the firm. So, the capability of a firm to manage a reputation affects the extent to which CSR improves reputation and the extent to which reputation influences performance. Organizations make an effort to influence stakeholders’ understanding regarding the need for environmentally responsible products and sustainable methods of production. They use corporate communications and reputation-building activities like advertising (Roberts and Dowling, 2002) for this purpose. The underlying idea is that when firms communicate CSR activities being implemented by them to significant stakeholders, it will strengthen their reputation and hence improve their performance. Hence, we hypothesize that:
H$_{5a}$: Reputation management capability of a firm moderates the relationship between CSR and corporate reputation.

H$_{5b}$: Reputation management capability of a firm moderates the relationship between corporate reputation and financial performance.

### 3.3.6. Stakeholder Power and the CSR-FP Relationship

Stakeholders possessing power have the ability to enforce their wishes despite opposition (Weber, 1947). Studies have revealed that suppliers, customers, and employees are important stakeholders of a firm (Neville et al. 2005). Enhanced stakeholder relations can potentially improve the company’s reputation and financial performance (Mishra et al. 2010). Some stakeholders tend to affect FP more than others and so, their ability to influence the organization should be structured using stakeholder power concept (Mitchell et al. 1997). Reputation drives stakeholders to allocate greater amount of their resources, besides developing positive relations between the firm and the stakeholders.

Suppliers are considered as partners by the firms; and a partnership with suppliers ensures sustainable business. So, in higher profit making firms, suppliers act as partners rather than outsiders (Sisodia et al. 2007). Supplier power hence signifies the ability of suppliers to influence a particular firm, and high levels of supplier power may affect the firm positively (if their relationship with the firm is positive) and negatively (if their relationship with the firm is negative). Hence we hypothesize that:

H$_{6a}$. Supplier power moderates the relationship between corporate reputation and a firm’s financial performance negatively.
Customers are the most important stakeholder group of any firm; the profitability of a firm depends on the quality of firm’s relationship with its customers. Therefore, firms should understand their target buyers to ‘create superior value’ for them (Narver et al. 1990). Customers are the driving force behind various activities performed by a firm. Customers who purchase a large proportion of a firm’s products or services will have greater influence over the firm’s decisions owing to their prominence (Heide and John, 1992). They may therefore have a strong effect on the performance of a firm. Hence we hypothesize that:

\[ H_{6b}. \text{Customer power moderates the relationship between corporate reputation and a firm’s financial performance negatively.} \]

Employees are internal stakeholders (Greenley and Foxall, 1996), who are often considered as the most valued resource of a firm. Their needs have to be taken care of for their improved job performance (Webster, 1992; Lings et al., 2000). This can be inferred since satisfied employees have higher job motivation (Berman et al., 1999) that leads to better firm performance (Koys, 2001) and success of firms (Kotter and Heskett, 1992). So, at the fundamental level, employees have the power to influence their management and human resource related decisions. Higher the employee power, therefore, larger will be the amount spent on employee salary and welfare related activities. This may adversely affect firm performance. However, in the case of highly reputed firms, the bargaining power of employees declines as compared to the other firms in the industry. Such firms may spend no more than the industry norm on employee related activities. Hence we hypothesize that:

\[ H_{6c}. \text{Employee power moderates the relationship between corporate reputation and a firm’s financial performance negatively.} \]
3.4 Chapter Conclusion

Based on the research gaps identified in the previous chapter, we had developed the research objectives to arrive at the proposed model and formulated the hypotheses. Carrying forward, the next chapter discusses in detail the methodology used for conducting the study to test the hypotheses formulated in this chapter.