PUBLIC TRUST'S DUALITY IN THE CORPORATE SOCIAL PERFORMANCE – REPUTATION – FINANCIAL PERFORMANCE RELATIONSHIP ACROSS COUNTRIES

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INTRODUCTION

Within the literature investigating relationships among Corporate Social Performance (CSP), Corporate Reputation (CR), and Corporate Financial Performance (CFP) (Orlitzky, Schmidt, & Rynes, 2003; Waddock & Graves, 1997), we identify two lines of inquiry. First, scholars have investigated the effect that CSP has on CR, "the overall estimation in which a particular company is held by its various constituents" (Fombrun, 1996: 36). Most maintain that CSP enhances CR (Fombrun & Shanley, 1990; Wang & Berens, 2014), with some exceptions (Walker & Dyck, 2014). Second, scholars concur that CR enhances CFP (Newburry, 2010; Roberts & Dowling, 2002). We argue that public trust in business (Harris, Moriarty, & Wicks, 2014) plays an important moderating role in the CSP-CR-CFP relationship, as some have implicitly suggested (Barnett, 2007; Du, Bhattacharya, & Sen, 2010).

Public trust in business, or more accurately public trust in the institution (North, 1990) of business, is "the level and type of vulnerability the public is willing to assume with regard to business relations" (Bolton et al., 2009: 6). Public trust in business has been declining since the 1960s (Nye, Zelikow, & King, 1997) remaining at low levels since the 1990s (Wicks et al., 2014). Although both managers (Business Roundtable Institute for Corporate Ethics, 2004) and academics (Wicks et al., 2014) agree that low levels of public trust can harm, inadequate research has investigated its effect on firms (Harris et al., 2014; Bolton et al., 2009). We aim to partially rectify this deficiency.

Here, we draw on signaling theory to investigate the role that public trust in business (Bolton et al., 2009) has in moderating the relationship among CSP, CR and CFP. We argue that levels of public trust towards business influence the CSP-CR-CFP relationship and develop hypotheses regarding this influence. Given that national context may systematically influence the CSP-CFP relationship (Gardberg & Fombrun, 2006) and that public trust in business may vary cross-nationally (e.g. Chan, Lam, & Liu, 2011), we test our hypotheses on an unbalanced panel of 462 firms from 2006-12 from 9 countries (a total of 2534 observations).

THEORETICAL DEVELOPMENT

CSP refers to a firm's "configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the

firm's societal relationships" (Wood, 1991: 693). The current business paradigm contends that CSP should generate benefits in the short term. To that end scholars have tested increasingly complex CSP models based on signaling theory (Spence, 1973, 2002) and the resource-based view (RBV) of the firm (Barney, 1991; Boyd, Bergh, & Ketchen, 2010).

Signaling theory has been applied in linking corporate policies and actions to stakeholder perceptions. CSP serves as a positive reputational signal to external stakeholders, who mostly operate under incomplete information (Fombrun & Shanley, 1990). Given the information asymmetry that exists between different stakeholders and business firms (Stiglitz, 2000), and viewing the role of CSP from a signaling perspective (Connelly et al., 2011; Spence, 2002), CSP can be seen as a signal through which firm managers try to communicate their firms' underlying/ unobservable qualities to stakeholders. CSP signals information about organizational values, reliability and trustworthiness to stakeholders that reduces information asymmetry.

The second theoretical mechanism linking CSP-CR-CFP is RBV (Barney, 1991). According to RBV theorists, CR, an intangible resource that is valuable, rare and difficult to imitate, enhances CFP (Barney, 1991; Dierickx & Cool, 1989). Gardberg and Fombrun (2006) argued that CSP and particularly corporate citizenship, creates intangible assets such as CR by making the focal firm more acceptable within a specific national context. Roberts and Dowling (2002) found that firms with good CRs are better able to sustain superior CFP over time. Thus we expect that CSP contributes to the creation of CR, which in turn enhances the firm's CFP. Our expectation is consistent with Orlitzky et al. (2003), who in their meta-analysis of 52 empirical studies over 30 years, found that CSP and CFP were positively correlated.

Here, we propose a model of CSP, CR and CFP and argue that public trust moderates the mediation model's relationships. For CSP to reduce information asymmetry, stakeholders must perceive the signal as reliable, clear and credible. Extant research has found that prior reputation influences arbiters' attribution of authenticity to firms' corporate philanthropy (Bae & Cameron, 2006; Lii & Lee, 2012). Arbiters judge the philanthropy of firms with weak reputations negatively while judging the philanthropy of firms with strong reputations positively. We contend that levels of trust at the societal level have a similar conditioning effect such that the credibility of CSP signals will vary across countries due to variation in the levels of trust in businesses across countries and institutional environments (Stevens, 2013).

We first test if the CSP-CR-CFP relationship exists beyond the UK and the U.S., as the national institutional environment, in which CSP occurs, reputations are perceived and CFP is accrued, could affect signal transmission. Thus our baseline hypothesis explores this relationship among the general public across 9 clusters identified in the Project Globe study (House, Hanges, Javidan, Dorfman, & Gupta, 2004) and Hofstede's framework (1980). Thus, we hypothesize:

H1: CR partially mediates the relationship between CSP and CFP.

The Moderating Role of Public Trust

Because firms can transmit false signals via their CSP, stakeholders seek ways to classify signals' reliability (Connelly et al., 2011). Firms often signal a particular behavior (e.g. stock repurchases) but do not actually engage in it, a phenomenon known as 'decoupling,' that also could apply to CSP (Westphal & Zajac, 2001). Stakeholders, then, will have to develop ways to interpret the reliability of CSP signals, since their usefulness depends on whether they correspond to reality (Connelly et al., 2011). Moreover, uncertain receivers will seek guidance

from others about how to interpret these signals (Branzei, et al., 2004; Sliwka, 2007). We argue that stakeholders draw on the prevailing public trust in business to interpret CSP signals.

Public trust in business stems from the cumulative experiences that individuals, comprising the public, in their different stakeholder roles, have had with specific firms (Harris & Wicks, 2014). We emphasize four points. First, trust in business differs from trust in specific firms with trust in (the institution of) business being the generalized view that individuals have induced from their experiences with specific firms over time (Harris & Wicks, 2014). Second, public trust refers to trust that individuals in their multiple stakeholder roles share. Third, different elements on which individuals can base their trust in firms exist. Harris and Wicks (2014) identified two elements: competence and goodwill; Mayer, Davis, and Schoorman (1995) found three: ability, benevolence and integrity; and Pirson and Malhotra (2008) found six: benevolence, integrity, managerial competence, technical competence and value congruence. Fourth, different stakeholders value these elements in distinct ways.

We argue that stakeholders use public trust as a filter/heuristic to interpret CSP signals and decide if such signals are reliable and whether they should be influenced by them. Further, public trust in business can positively moderate the degree to which CSP contributes to CR for two reasons: (1) the effect public trust in business can have on the way individuals perceive and interpret the CSP of particular firms and (2) the history of events that led to the particular levels of public trust towards business.

First, public trust in business influences how various stakeholders perceive and interpret firms' CSP and in turn the degree to which CSP adds to firms' CR. Trust is essential if various stakeholders want to know about the firm's CSP, given that they cannot always directly verify the firm's CSP actions and often have to depend on the firm's communications (Du et al., 2010; Illia et al., 2013). If stakeholders do not trust businesses, they will view with suspicion what a firm tries to signal through its CSP. Trust then can act as a heuristic when individuals are faced with social dilemmas (Kramer, 1999; Uzzi, 1997). Stakeholders will use their trust in business as a rule of thumb to decide if they should believe a firm's CSP claims.

Second, public trust in business does not happen in a historical vacuum. It results from positive or negative experiences that various stakeholders have had with firms. These histories that make it easier/harder, for firms to gain CR through their CSP. Janoff-Bulman (2010) argued that it is easier to destroy trust than to build it and Slovic (1993) found that negative events are more noticeable and influential than positive ones. These findings imply that corporate scandals can damage trust in business more than positive CSP actions of particular firms can repair it. Stevens (2013) observed that trust in business has declined in the U.S. due to very visible corporate scandals (i.e. Enron). Barnett (2007) argues that the stakeholder influencing capacity of firms depends to a great extent on the firm's history. We make a similar argument: firms' ability to build CR via CSP depends not only on their own history, but also on their society's history of businesses. Hypothesis 2 follows:

H2: The public's trust in the institution of business positively moderates the positive effect that CSP has on CR.

We also expect trust to shape firms' ability to use their CR for financial benefits. Scholars have found that CR contributes to CFP in many ways. Firms can use CR to attract talented employees (Windsor, 2006) or charge higher prices (Stigler, 1962). CR enhances CFP via its compensation for information asymmetries that various stakeholders face, as CR allows a firm to

differentiate itself, by making stakeholders trust it, in spite of information asymmetries. For example, employees looking for a job, but unsure which firm would be a good fit, might use CR to assure themselves that the firm earned its good reputation in part because it is a good place to work. A key contributor to CR is the trustworthiness that different stakeholders attribute to a firm (Fombrun, Gardberg, & Sever, 2000; Gardberg & Fombrun, 2002).

However, in countries with high trust in business most firms are considered trustworthy, which is not the case in countries with low trust in business. Therefore, firm trustworthiness should be rare in countries where the public's trust in business is low and commonplace in countries where the public's trust in business is high. By signaling credibility via their CR, firms in low trust countries will be signaling that they have something rare and valuable, whereas, firms in high trust countries cannot signal via their CR that they have something rare and valuable. In other words, we propose a masking effect. This will challenge firms with good CRs to differentiate themselves. Thus we suggest:

> *H3a: The public's trust in the institution of business negatively moderates the direct positive effect that CR has on CFP.*

> *H3b: The public's trust in the institution of business negatively moderates the mediating positive effect that CR has on CFP.*

METHODS

Data and Variables

We collected firm data from the Reputation Institute (RI), Thomson Reuters ASSET4, and country data from Edelman Public Relations, the World Bank's World Development Indicators, and the Heritage Foundation for the years 2006 to 2012. This process resulted in a sample of 462 firms from 9 countries (firms per country in parenthesis): Brazil (92), China (65), France (73), Germany (82), India (32), Japan (49), Russia (47), Sweden (40), and USA (351).

Dependent variable. We measure CFP by a firm's return on assets (ROA) (Miller, 2004).

Corporate Social Performance. We operationalize CSP with two different measures from Thomson Reuters ASSET4 database (Ioannou & Serafeim, 2012). We use the Social Pillar, which measures a firm's capacity to generate loyalty with its workforce, customers and society, via its use of best management practices and the Environmental Pillar, which gauges a firm's effect on living and non-living natural systems, including air, land and water, as well as complete ecosystems.

Corporate Reputation. We operationalize CR using the RI's RepTrak Pulse scores (Ponzi, Fombrun, & Gardberg, 2011). Firms were measured in their home country. The RI provided us with data from a representative sample of the public from nine countries described above, representing nine cultural clusters, consistently identified in the Project Globe study (House et al., 2004) and Hofstede's (1980) framework.

Trust in Business. We operationalize trust in business in each firm's home country with the Edelman Trust Barometer (Stevens, 2013) which examines trust in business, government, the media and NGOs worldwide via survey of key influentials within countries. Edelman's sample of 'informed publics' is skewed to higher income and higher education than the general public.

Control Variables. We also control for other factors both at the firm and country levels

that may influence a firm's CR or CFP. At the firm level we account for firm size with (the log of) number of employees, capital investments with capital expenditure to sales ratio, and slack with cash to sales ratio. At the country level, we use population size as a measure of market size (Alesina & Wacziarg, 1998), purchasing power with GDP per capita (Armstrong & Read, 2003), the ratio of internet subscribers to local population for the public's accessibility to firm information, and the technological environment (Narula, 2012) with (the log of) the number of patent applications. We also account for the country's level of economic freedom with the Index of Economic Freedom (IEF) constructed by the Heritage Foundation and the *Wall Street Journal*.

The merger of the different datasets yielded an unbalanced panel of 462 firms from nine countries from 2006-2012. This is translated to a total of 2,534 observations across the seven years. The descriptive statistics of the merged data set are available from the authors.

Statistical Analysis

We use hierarchical linear modeling methods because our observations are nested in three clusters: firms, industries and countries. We include random effects for country, industry, and firm levels as well as a random coefficient for 'year' at the firm level to account for multiple annual observations per firm. We test our hypotheses by juxtaposing estimated coefficients and comparing results of three different models (Baron & Kenny, 1986; Muller et al., 2005). We had multicollinearity from a high correlation between GDP per capita and IEF, and omitted IEF from the analysis. To reduce other sources of multicollinearity, we mean-centered all remaining independent variables before estimating our models (Muller et al, 2005). Variance inflation factors fell below the commonly accepted level of 10. Moreover, to enable causal inference, we lagged the main dependent variables one year. Results tables available from the authors.

RESULTS

In models 1 to 3, we test H1, which proposes that CR partially mediates the relationship between CSP and CFP. In Model 1, Social Pillar's effect on ROA is positive and statistically significant ($\beta = .001$; $p < 0.05$). In Model 2, Social Pillar's effect on CR is positive and statistically significant ($\beta = .04$; $p < 0.01$). In Model 3, CR's effect on ROA is positive and statistically significant $\beta = .003$; $p < 0.01$) and the Social Pillar's effect on ROA is not statistically different to zero, as its absolute value is less than its value in Model 1. Jointly, the above results support the existence of the proposed mediation effect, supporting H1.

H2 proposes that trust in business positively moderates the positive impact that CSP has on CR. Model 2 shows that the interaction effect between the Social Pillar and Trust in Business is positive and statistically significant ($\beta=0.001$; $p<0.01$) suggesting that the positive effect of the firm's Social Pillar on its CR is accentuated by higher Trust in Business in the country.

H3a (3b) proposed that the public's trust in business negatively moderates the direct (mediating) positive impact that CR has on CFP. Following Muller et al. (2005), we find support for the moderation effect (H3a) and the moderated mediation (H3b). In Model 1, the effect of the Social Pillar on ROA is statistically significant ($\beta=0.001$; $p<0.01$), but not the effect of the interaction between Social Pillar and Trust in Business ($\beta=-0.000$; $p>0.1$). In Model 2, the Social Pillar has a statistically significant effect on CR ($\beta=0.043$; $p<0.01$). In Model 3, the interaction effect between CR and Trust in Business is statistically significant ($\beta=-0.000$; $p<0.05$) and negative, suggesting that the expected positive mediation effect of CR in the Social Pillar-ROA

relationship is negatively moderated by Trust in Business. We find our theorized masking effect.

We repeated the analyses with Environmental Pillar. Counter to our expectations, Environmental Pillar lacked statistically significant relationships with CR and CFP. However, the interaction effect between the Environmental Pillar and Trust in Business is positive and statistically significant ($p < 0.01$) supporting H2.These two findings suggest that CR is affected by the joint effect of the Environmental Pillar and Trust in Business, not by either's individual effect. Further, in Model 3, the effect of CR on CFP is positive and statistically significant ($\beta=0.002$; $p<0.05$) and the interaction effect between CR and Trust in Business is negative and (marginally) statistically significant ($\beta=-0.000$; $p<0.10$). On one hand our analysis does not substantiate the moderating role of trust in the Environmental Pillar-CR-CFP relationship. On the other hand, trust attenuates the direct positive effect of CR on CFP, supporting H3a.

DISCUSSION AND IMPLICATIONS

Herein, we developed and tested a multi-country, multi-level model of CSP, CR, CFP, and trust to examine confounding conditions in the CSP-CR-CFP relationship. Our findings have several implications for signaling and reputation theories as well as practice.

Theoretical Implications. Scholars have observed a consistent pattern of results in the relationships among CSP, CR and CFP in UK and U.S. contexts (Orlitzky et al., 2003). We extend this research across different signaling environments (e.g. Connelly, et al. 2011) to assess its applicability across eight other cultural clusters (Gupta, Hanges, & Dorfman, 2002). Our analysis supports the mediating effect of CR on CSP and CFP and suggests that public trust in business acts as a signal filter (moderator) in the relationship. Firms' ability to enhance their CR and capitalize on CSP varies based on trust in business.

We contribute to the study of trust by considering the effect of society's trust on CFP. We show that society's level of trust has a conditional effect on individual firms such that firms do not operate in institutional vacuums. Over time corporate actions and especially misconduct enact the level of trust in the environment that shapes future stakeholders' evaluation of CSP.

Practical Implications. Firms perform purposeful and inadvertent activities that affect stakeholders across national boundaries. We find that overall the Social Pillar has a positive effect on both CR and CFP with no evidence of a negative effect. Managers, then, may be frustrated because they cannot capitalize on the positive relationship in different countries. Consistent with prior research (e.g. Orltizky et al., 2003) the Environmental Pillar did not contribute at the same level.

Limitations. We used the RI's RepTrak Pulse dataset, a measure of CR among the public and were unable to compare the model across stakeholder groups (e.g. Wang & Berens, 2014). However, Orltizky et al. (2003) found that the CSP-CR-CFP relationship was stronger among financial stakeholders than public stakeholders. Thus, our model may be a conservative test.

Contribution. With few exceptions (e.g. Orlitzky, et al., 2003; Wang & Berens, 2014) there is insufficient comparative research across types of CSP and stakeholder groups. By including trust in our CSP-CR-CFP model, we extend study of the CSP-CFP relationship cross nationally. We suggest that public trust in business has both positive and negative effects, with implications for MNE managers with CSP portfolios across countries. Also, we find the duality of public trust in business an intriguing contribution to the debate on business and society.

REFERENCES AVAILABLE FROM THE AUTHORS