How Does Social Orientation Influence Firm Innovation?

1. Introduction
Over the past few decades, corporate social responsibility (CSR) has gained momentum as a driver of long term competitiveness (Freeman 1984). The literature has developed numerous theories to describe the challenges associated with managing a broad set of stakeholders and their desires, rather than a singular focus on shareholder value (Atasu and Tang 2016, Sodhi 2015). Most work in this area is focused on the buying decisions of consumers (Iyer and Soberman 2016) as well as the financial performance associated with CSR (Kang et al. 2016). Few studies to date have explored how CSR impacts innovation, which is critical for sustained growth (Flammer and Kacperczyk 2016). We develop a theoretical framework based on portfolio and resource allocation theory to understand how firms manage funding for CSR projects, and how the associated CSR improvement affects the innovation.

Two recent studies have explored the link between CSR and innovation at a marco level, such as the enactment of state legislations. Flammer and Kacperczyk (2016) consider the enactment of state-level constituency statutes. They find that laws that allow company directors to consider stakeholders’ interests when making business decisions can increase the quantity and quality of innovation. In a similar setting with the enactment of state-level employment nondiscrimination acts on sexual orientation and gender identity, Gao and Zhang (2016) provide evidence that firms with more open employment practices can attract more liberal and innovative employees, and ultimately increase innovation. These studies, however, provide little evidence regarding how the proposed mechanisms, or other mechanisms altogether, operate at the operational level. In contrast, this study applies resource allocation theory to understand CSR project funding and technological search at a detailed level, shedding light on how funding decisions regarding CSR projects can have implications for firm innovation.

Firms face many constraints in their ability to allocate funds for CSR projects, in addition to the inherent complexity associated with a portfolio that includes different types of innovation projects (Chao and Kavadias 2008). Firms’ decisions can be significantly shaped by the available resources, like financing supply from external creditors and capital markets. This is because the resource allocation management activities are essential in the innovation process, which lead to
different incentives for employees. Given the challenges inherent in innovation, stakeholder focus can have important implications for the decisions regarding innovation and technological search.

We empirically investigate how firms manage funding for CSR projects, and how the associated CSR improvement affects the innovation at an operational level of analysis. Firms’ socially responsible practices catering to the needs of stakeholders can improve their reputation of the workplace and reduce employees’ concerns, which may attract more knowledge workers and retain current ones. Given the high uncertainty in the innovation outcome and the resource constraints, the firm may establish different orientation, either proactive or reactive, to allocate resources to improve social responsibility. Proactive social orientation refers to firms’ proactive engagement with CSR practices to strengthen the relation with multiple stakeholders. In contrast, reactive social orientation stems from exogenous negative social events (e.g., BP’s oil spill in 2010), which force firms to take remedial action as a response. We examine the effect of both proactive and reactive social orientation on firm innovation, and the effects of firm contexts in technological span and business span. The questions that serve as the motivation for this study are:

1. How do proactive and reactive social orientation relate to firm innovation?
2. How do technological span and business span affect the impact of social orientation?

2. Methodology

We rely on the Kinder, Lyndenberg, and Domini (KLD) database to empirically measure corporate social responsibility. It is currently the largest publicly available database on multidimensional corporate social responsibility for publicly traded firms. It includes multiple stakeholder attributes and each includes multiple items, for which firms receive scores based on both their strengths and weaknesses. We relate these measures to the proactive and reactive social orientation for a firm. Meanwhile, we cross link KLD database with the USPTO patent database for innovation activities and Compustat database for financial and organizational controls.

One key challenge in the research with archival data lies in the identification of a causal relationship between CSR and innovation. We proceed in two steps to address this issue. First, we develop an approach to identify firm’s social performance events pertaining to resource allocation focus, and assign comparable sample into treatment and control groups. Second, such identification allows us to apply difference-in-difference methodology in our data, and the pre-
and post-comparisons among treatment and control firms make our findings closer to the causal relationship.

3. Results and Contributions

Our results show that in the long term, both positive and negative social orientation can strengthen firm innovation. However, such benefits are moderated by the firm’s technological and business contexts. Particularly, we find evidence that technology span has significant negative moderating effect with both orientation, while business span has marginally positive moderating effect with the reactive orientation. Our results highlight the different mechanisms embedded in two orientation during social responsibility improvement. This paper adds to a growing literature that evaluates the impact of social orientation on firm innovation process. We advance this line of work by providing a comprehensive comparison between the proactive and reactive social orientation and their effect on firm innovation. We demonstrate that the resource allocation can have long term effect on innovation projects in the firm.

References


