

The Determinants of the Relationship of Corporate Social Performance and Financial Performance: Conceptual Framework¹

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Abstract

The objective of this paper is to investigate relationship between CSP and CFP using contingency perspective derived from the strategic management domain. The investigation will be done using lens of slack resource and good management theory. This study is expected to provide a new insight on the link between corporate social performance and corporate financial performance using contingency perspective as suggested in the strategic management and accounting literature, an area has not been examined in the prior studies. The result of this study can resolve the existing conflict in the literatures by developing an integrated model of the link between CSP and CFP and the notion of corporate performance which, in strategic management, is highly affected by four factors: business environment, strategy, organization structure, and control system. The model will explain in what condition the relationship of CSP and CFP is valid

Keywords: *Corporate social performance, corporate financial performance, slack resource theory, good management theory, contingency theory, and moderating effect.*

Introduction

So far the relationship between CSP and CFP has been investigated by researchers and produced inconsistent results: positive, negative, and inconclusive (see for example Worrell, et.al., 1997; Waddock & Graves, 1997; Frooman, 1997; Roman et.al., 1999; Orlitzky, 2001; Orlitzky & Benjamin, 2001; Ruf et al.,

2001; Murphy, 2002; Simpson & Kohers, 2002; Griffin & Mahon, 1997; McWilliams & Siegel, 2000; McWilliams & Siegel, 2001; Moore, 2001; and Wright & Ferris, 1997; Fauzi et al., 2007). Some attempts have been conducted to explain the conflicting results. According to some previous studies (Wagner, 2001; Ruf et.al, 2001; Husted, 2000; Orlitzky et al., 2003), the

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conflicting results had been caused by two main factors: lack of theoretical foundation and methodological problem.

The absence of sound theoretical foundation to explain CSP construct has contributed to the conflicting result of the relationship between CSP and CFP. From the theoretical ground perspective, basically theories used in defining CSP construct have been derived from thought of neoclassical economic theory and stakeholder theory. Those who developed CSP construct using neoclassical economics paradigm found a negative result of the CSP and CFP relationship, while proponents of the stakeholder theory showed the positive result. Furthermore, variation in the stakeholder theory itself in defining CSP such as Carroll's and Wood's model has contributed to the conflicting result due to mismatching of the theory in empirical studies (Wood and Jones, 1995). One of causes for the mismatching is due to the fact that in empirical studies researchers operationalize the CSP construct based on certain type of industry and it leads to the contribution to the inconsistent result (Rowley and Berman, 2000). To solve the weakness, it is suggested to operationalize the construct in terms of company's relationship with its stakeholders (Clarkson, 1995a and 1995b; Husted, 2000; Rowley and Berman, 2000; Wood and Jones, 1995). In this regard, Husted (2000) defines CSP as "the ability of the firm to meet or exceed stakeholder expectations regarding social issues".

In addition, some previous reviews and theories² have been proposed to explain

the relation of CSP and CFP, but they fail to provide clear answer (Aupple et al., 1985; Ullman, 1985; Wartick and Cochran, 1985; Wood 1991; Wood and Jones, 1995; Pava and Krausz, 1996; Griffin and Mahon, 1997; Husted, 2000). One reason is due to the neglecting of the contingency aspect (Ullman, 1985). Other researchers also do suggest that variations in the result of the relationship between CSP and CFP be solved by using contingency theory perspective (Wagner, 2001; Husted, 2000; Margolish et al., 2003; Orlitzky et al., 2003). Due to the fact that CSP and CFP are not related under all condition, the contingency perspective needs to be used to examine under which condition the relation will be valid (Hedesström and Biel, 2008). In addition, Orlitzky et al., (2003) found that strong of the relationship will be dependent upon contingency such as reputation and construct operationalization. Some other researchers also have shown that CSP and CFP relation is positive using resource-based view (strategy) as contingent variable (Hilman and Keim, 2001; Orlitzky et al., 2003; Pos et al., 2002).

So far the use of contingency perspective in explaining the relationship of CSP and CFP has been argued by some researchers that CSP is the result of the fit between endogenous organization variables of CSP and exogenous contextual variables (Russo and Fouts, 1997; Rowley and Berman, 2000; McWilliam and Siegel, 2001; Husted, 2000). For example, Russo and Fout (1997) found that the type of industry will determine

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² For example The extended values and principles of the CSR (Aupple et al., 1985), social issues management (Wartick et al., 1985), institutional, organizational, and individual level of CSP theory (Wood, 1991a and 1991b), Mismatching stakeholder (Wood et al., 1995), and paradox of social cost (Pava et al., 1996)

the relationship of CSP and CFP, while Husted (2000) argues that the relationship of CSP and CFP depend upon stakeholder issues.

Despite the importance of the use of contingency perspective proposed by previous studies, there is still the following one major gap. They do not integrate the contingency factors into the important determining variables in corporate performance both in the conceptual framework level and in the empirical perspective. This effort is needed because CSP is an extended corporate performance in the context of Triple Bottom Line (TBL) concept.

Based on the review of accounting and strategic management literatures, it can be found that corporate performances are matching of business environment, strategy, internal structure, and control system (Lenz, 1980; Gupta and Govindarajan, 1984; Govindarajan and Gupta, 1985; Govindarajan, 1988; Tan and Lischert, 1994; Langfield-Smit, 1997). Thus it can be argued that corporate performances referred to the notion of TBL should be affected by some important variables: business environment, strategy, structure, and control system. Therefore, better attempts to seek explanation of the relationship between CSP and CFP need to be conducted using the integrated model as suggested in the accounting and strategic management literatures and considering the suggestions of Savage et al (1991), Husted (2000 and 2001), Orlitzky (2002), Rowley & Berman (2000), Orlitzky et.al. (2003), Itkonen (2003), and Brammer & Pavelin (2006).

In the level of the conceptual framework, some previous studies (Hilman

and Keim, 2001; Husted, 2000; Pos et al., 2002; Orlitzky et al., 2003; Neville, 2005) did not clearly relate their contingency variable (strategy) to the corporate performance in the context of TBL. The variable (strategy) specifically is focused on handling social issues not integrated into business strategy. Furthermore in the level of empirical perspective, the contingency variables used are beyond the TBL factors. Rather, they use industry type and company size as moderating variables, that is, variables affecting other relationship, to explain the relationship between CSP and CFP (Fauzi, 2004; Brammer & Pavelin, 2006 and Fauzi et.al, 2007).

Thus, this paper will address the gap by using the variables affecting (moderating variables) the corporate performance as contingency factors to explain the relationship of CSP and CFP. More explicitly, how variables such as business environment, business strategy, organizational structure, and control system can affect the relationship between CSP and CFP.

Relationship between CSP and CFP

There are two important issues in the relationship between CSP and CFP: direction and causality of the relationship (Preston and O'Bannon 1997). The direction of the relationship refers to positive, negative and neutral of the relationship. The positive direction of the relationship of CSP and CFP is that increase in CSP results in increase in CFP as well, while the change in CSP leading to the change in CFP in different way is negative direction of the relationship. If a change in CSP does not affect the change in CFP, neutral effect direction

of the relationship will occur. The causality of the relationship denotes which one between CSP and CFP will be becoming independent or dependent variable. In this case, there are two possibilities: CSP as independent variable and CFP as independent variable. If CSP as independent variable, it come first to affect CFP, while if CSP as dependent variable, CFP will come first to affect CSP.

Based on the literature review, the relationship between corporate social performance and corporate financial performance could be positive, negative, or neutral. But most of the result of studies indicated the positive relationship and very few provided the negative and neutral relationship (Worrell et al., 1991; Preston et al., 1997; Waddock et al., 1997; Frooman, 1997; Roman et al., 1999; Orlitzky, 2001; Orlitzky et al., 2001; Rufel et al., 2001; Murphy, 2001; Simpson et al., 2002; Griffin et al., 1997; McWilliam et al., 2000 and 2001; Moore, 2001; Wright, 1997; Itkonen, 2003).

The conclusion that can be drawn from the previous findings is that the relationship between CSP and CFP is not under all condition. The use of contingency perspective is needed to understand under which condition the relationship will be valid (Hedesström and Biel, 2008). This paper study will address the gap of unsound theory on the relationship of CSP and CFP by developing the integrated model derived from accounting and strategic management literature. The model to be developed, derived from Langfield-Smith's (1997) proposition on corporate performance, explains

that the relationship of CSP and CFP will be contingent upon four variables: business environment, business strategy, organization structure, and control system.

The second issue that Griffin and Mahon raised is about the causality of the relationship of CSP and CFP. Waddock and Graves (1997) and Dean (1999) put forward two theories to explain the causality: Slack resource theory and good management theory. Under the slack resource theory, a company should have a good financial position to contribute to the corporate social performance. Conducting the social performance needs some fund resulting from the success of financial performance. According to this theory, financial performance comes first. Therefore, CFP is independent variable to affect CSP. A good management theory holds that social performance comes first. Based on the theory, CSP is independent variable resulting in CFP and a company perceived by its stakeholders as having a good reputation will make the company easier to get a good financial position (through market mechanism). The two theories can be diagrammed in the figure 1 (see the next page).

The two theories will be used to model contingency perspective to explain the relationship of CSP and CFP using the variables of business environment, strategy, internal structure, and control system as contextual variables or moderating variables (Lenz, 1980; Gupta and Govindarajan, 1984; Govindarajan and Gupta, 1985; Govindarajan, 1988; Tan and Lischert, 1994; Langfield-Smit, 1997).

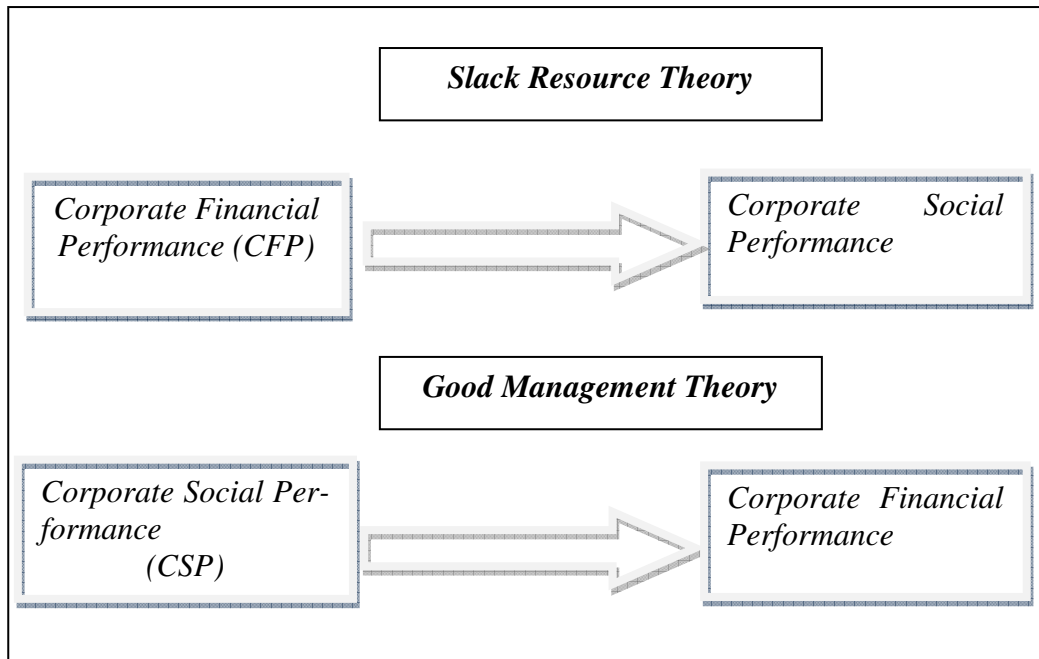


Figure 1: Causality of the Relationship of CSP and CFP

Contingency Approach to Study on CSP and CFP Link

Generally contingency theory states that organization's effectiveness will be contingent upon some factors often called contextual variable (see for example Hambrick and Lei, 1985; Gerdin and Grave, 2004). Furthermore, focus in contingency theory will be on fit between organization characteristics or management practices and the contextual variable in achieving the organization effectiveness (see for example Alexander and Alan, 1985; Doty et al, 1993; Gerdin and Grave, 2004). The organizational effectiveness can include economic or financial performance and other criteria such social and environmental performance as referred to the concept triple bottom line (TBL). The use of the contingency view as an alternative view to extreme view of business in both situations: specific and univer-

salistic view is common and applied in any setting of management practices (Alexander and Alan, 1985; Gerdin and Grave, 2004) and also in corporation social performance (see for example Husted, 2000). One of the reasons of the commonly used contingency approach is due to the focus on the organizational effectiveness, a general and important organizational goal-related concept.

In the context of CSR, there are some previous studies suggesting the contingency approach (Ullman, 1985; Husted, 2000; Wagner, 2001; Margolish et al., 2003; Orliztky, 2001). Ullman (1985) argued that one reason of failure of studies on CSP and CFP to explain the conflict results is due to the neglecting of the contingency aspect. Other researchers also do suggest that variations in the result of the relationship between CSP and CFP be solved by using contingency

theory perspective (Wagner, 2001; Husted, 2001; Margolish et al., 2003; Orlitzky et al., 2001 and 2003). Due to the fact that CSP and CFP are not related under all condition, the contingency perspective needs to be used to examine under which *condition* the relation will be valid (Hedesström and Biel, 2008). In addition, Orlitzky et al. (2001 and 2003) found that strong of the relationship will be dependent upon contingency such as reputation and construct operationalization. Some researchers also have shown that CSP and CFP relation is positive using resource-based view (strategy) as contingent variable (Hilman and Keim, 2001; Orlitzky et al., 2003; Pos et al., 2002).

Concept of Fit in contingency theory in the context of CSP can be traced the in accounting and strategic management literatures. Based on the review of the literatures, it can be concluded that corporate performances are matching of business environment, strategy, internal structure, and control system (Lenz, 1980; Gupta and Govindarajan, 1982 and 1984; Govindarajan et al., 1988; Govindarajan, 1988; Tan and Lischert, 1994; Langfield-Smit, 1997). Thus corporate performances referred to the notion of TBL should be affected by some important variables: business environment, strategy, structure, and control system. Therefore, better attempts to seek explanation of the relationship between CSP and CFP are needed to conduct using the integrated model as suggested in the accounting and strategic management literatures and considering the suggestions of Savage et al. (1991), Husted (2000 and 2001), Orlitzky (2000), Rowley & Berman (2000), Orlitzky et al. (2003), Itkonen (2003), and Brammer & Pavelin (2006).

Some important studies had been conducted to investigate the relationship of business strategy, control system, and organizational structure and environmental and social performance (Gerde, 1998; Pondeville, 2000; Husted, 2000, and Husted, 2001). In an effort to investigate stakeholders and organization design, Gerde (1998) used business strategy, control system, and organizational structure as the predictors of corporate social performance including the environmental aspect. His findings were that the variables did not increase the social performance. In his deductive study, Pondeville (2000) synthesized that control system and business strategy, as well as organization design (structure) have contributed to the environmental performance. In an effort to get good understanding of corporate environmental and social performance, Husted (2000) had constructed contingency model of corporate social performance. The fit between social issues and business strategy and structure had been predicted to affect the corporate social performance. Husted et al. (2001) in his deductive approach of another study developed a model called integrated view of business and social strategy. In the model, business strategy had been predicted to affect financial and social performance.

Business Environment and CSP-CFP Link

Investigation on why an organization or corporate has higher performance than other organization can be found in three bodies of research: industrial organization, business policy, organization theory research (Lenz, 1980). Based on review of the bodies of research, it can

be found that performance variation in an organization or corporation can be explained using the variables of environment, strategy, and organization structure used (Lenz, 1980; Gupta and Govindarajan, 1984; Govindarajan and Gupta, 1985; Govindarajan, 1988; Tan and Lischert, 1994; Langfield-Smit, 1997). In addition, accounting literatures also contributed to explanation of the organization's performance variation (Gupta and Govindarajan, 1984; Govindarajan and Gupta, 1985; Govindarajan, 1988; Langfield-Smit, 1997; Albernetty et al., 2004 and 2005).

As one of the factors affecting the high of organization performance, organization or business environment can be defined as conditions that are normally changing and unpredictable an organization is facing. Lenz (1980) included market structure, regulated industry, and other relevant environments in the concept of the business environment as the factors to be affecting the corporate performance defined as corporate financial performance (CFP). Jaworski and Kohli (1993) extended the definition of business environment as including market turbulence, competitive intensity, and technological turbulence. The market turbulence that is understood as the rate of change in the composition of customers and preferences can be a predictor of business performance (Jaworski and Kohli, 1993). An organization operating under market turbulence will tend to modify its product or services continually in order to satisfy its customers. Adversely, if the market is stable indicated by no change in customers' preference, the organization is not likely to change its product or service. Therefore, the market turbulence is expected to relate positively to organization performance. Competitive intensity is referred

to market condition in which a company has to compete with. In the absence of competition, a company can perform well with no significant effort as the customers have no choice or alternative to satisfy their need. However, in the high competition indicated by so many alternatives for customers to satisfy their want, a company has to devote its best effort to satisfy the customers. Therefore, the competitive intensity is expected to relate positively to organization performance. The last aspect of business environment is the technological turbulence that is *meant* simply as the rate of technological change. For a company having characteristic of sensitive to technological change, innovation resulting from the technological change can be alternative to increase the company's competitive advantage without having to focus more on the market orientation. By contrast, for the company with no innovation in technology, it should strive to focus more on market orientation. Therefore, the technological change is relating negatively to organization performance. This concept of business environment is in line with Simons' (2000) concept of strategic uncertainty including technological dependence, regulation and market protection, value chain complexity, and ease of tactical response. Technological dependence has been close to the technology turbulence, while regulation and market protection can be referred to competition intensity. The strategic uncertainty variables of value chain complexity and ease of tactical response parallel the concept of market turbulence. Furthermore, based on review of organization environment literature, it can be found that business environment can be defined in general way as the source of information (Duncan, 1972; Lawrence and Lorsch, 1967; Tung 1979 and cited

in Tan and Lischert, 1994) and as source of scarce resource (Tan and Lischert, 1994). As source of information, business environment is focused on perceived information uncertainty and subjective in nature, as source of scarce resource; *business* environment is resource dependence (Tan and Lischert, 1994). Based on the understanding, corporate performance can be controlled by using management ability to control over the resource. Meanwhile, the concept of business environment can also be viewed as multidimensional construct including three variables: dynamism, complexity, and hostility (Duncan, 1972; Lawrence and Lorsch, 1967; cited in Tan and Lischert, 1994). In the last concept, components of dynamism and complexity have been close to the perceived information uncertainty, while hostility is similar to the resource dependence (Tan and Lischert, 1994). Following the concept of business environment as multidimensional construct, Scott in Tan and Lischert (1994) and Jauch et al. (1980) had extended the concept of business environment becoming institutional environment including larger components similar to stakeholder concept. The dimensions covered include: (1) competitors, (2) customer, (3) suppliers, (4) technological, (5) regulatory, (6) economics, (7) social-cultural, and (8) international. Based on the construct defined in the previous studies, The business environment will come up with the increase or decrease in corporate performance as suggested by Dill (1958). Organization facing high uncertainty in business environment has less ability to attain the organization's goal. This argument has been echoed by Simons (2000) by asserting that the business environment is one of the factors resulting in the strategic uncertainty and,

in turn, decreases the organization's ability to achieve the organization's goal.

Based on the theory of slack resource, the interaction or fit between business environment and corporate financial performance (CFP) can affect the corporate social performance due to fact that increase in CFP resulting from business environment aspect enables the company has more chance to do the CSP. Thus, it is reasonable to expect from this study that the business environment can moderate or affect the relationship between CFP and CSP. The proposition for business environment of the relationship of CSP and CFP is as follows:

P_{1a}: Business environment moderates the relationship between CFP and CSP based on the slack resource theory

In relating to the corporate social performance, Higgin and Currie (2004) had identified some variables affecting a corporate to be ethical or legal behavior in running the company resulting in the high of corporate social performance. The factors are: business climate, human nature, societal climate, societal climate, the competitiveness of the global business environment, and the nature of competitive organization Performance. Thus, arguments for business climate or environment discussed above, especially for the concept of business environment derived from the larger concept similar to stakeholder concept can be applied to the relationship between business environmental and corporate social performance. Furthermore, in an effort to seek the relationship between CSP and CFP derived from the good management theory indicating that conducting CSP can affect CFP, this variable will be ex-

pected to able to moderate the relationship between the link between CSP and CFP.

Based on the arguments and finding from the previous studies, it can be concluded that the link between CSP and CFP will be contingent upon the business environment variable. The following is the proposition of the relationship CSP and CFP moderated by business environment under a good management theory:

P_{2b}: Business environmental moderates the relationship between CSP and CFP based on good management theory.

Strategy and CSP-CFP Link

Concept of strategy is a complex concept and it leads to proliferation of definition of strategy (Lenz, 1980). Mintzberg (1987 and cited in Simons, 2000) had classified the views on strategy, including strategy as perspective, strategy as position, strategy as plan, strategy as patterns of action, and strategy as ploy. Strategy as perspective refers to mission and vision of a company to be a base for all activities of the company. This will determine core value of the company. Strategy as position indicates the way a company will pursue to compete in the market. This view will lead to the use of Porter's typology of strategy: differentiation and low cost (Simons, 2000). Strategy as plan suggests short-term plan as series of long term plan in the strategy as position. In this view, a company can evaluate the success of the implementation strategy. Strategy as pattern in action is a company's action plan to cope with the failure of the strategy implementation. It is in this view that emerge

new strategy called emerging strategy (Simons, 2000). The last, strategy as ploy is a tactic a company can do to fight with competitor. If the views of strategy can be well implemented, then strategy can be an important determinant of the company's performance. Furthermore, in practical, strategy choice for a company is depending upon the environment faced by the company. In this regard, Mintzberg (1973) defined the strategy as patterns of stream of decision focusing on a set of a resource allocation in an attempt to accomplish a position in an environment faced by the company. Using focus on decision as developed Mintzberg (1973), Ventakraman (1989), Miller and Frieson (1982), and Tan and Lischert (1994) extended the concept of strategy using dimensionality approach including: (1) analysis, (2) defensiveness, (3) futurity, (4) proactiveness, and (5) riskiness.

There are some studies on the fit between strategy and corporate performance (CFP) identified by Fisher (1995) using the product life cycle as contingency factor and performance appraisal system as dimension control, (Simons, 1987) utilizing competitive strategy as contingency factor and budget flexibility as dimension of control system, Govindarajan and Fisher (1990) employing Porter typology as contingency factor and behavior and output control as dimension of control system, Govindarajan (1988) exploiting Porter typology as contingency factor and budget evaluation style and locus of control as dimension of control system, and Fisher and Govindarajan (1993) applying Porter typology and product life cycle as contingency factor and incentive compensation as dimension of control system. Except for Fisher and Govindarajan

(1993) proving with conflicting result, they supported the fit relationship to the performance. In more recent studies, Liao (2005) and Sandino (2005) contributed to the same finding as the prior studies mentioned above. Using the same fit, but with different position for the contingency factor, Abernethy and Brownell (1999) also provided the fit relationship to the performance.

Based on *theory* of slack resource, the interaction or fit between strategy and corporate financial performance (CFP) can affect the corporate social performance due to fact that increase in CFP resulting from strategy enables the company has more chance to do the CSP. Thus, it is reasonable to expect from this study that the strategy can moderate or affect the relationship between CFP and CSP. The proposition for strategy of the CFP-CSP link is as follows:

P_{2a}: strategy moderates the relationship between CFP and CSP based on the slack resource theory

The conflicting results from empirical studies into the CSP-CFP relationship indicate to the need for a contingent perspective to determine the conditions that affect the nature of the CSP-FP relationship (Rowley and Berman, 2000). Husted (2000), for instance, proposed that the CSP-CFP relationship is a function of the fit between the nature of relevant social issues and the organization's corresponding strategies and structures. Further, McWilliams and Siegel (2001) proposed that the impact of socially responsible actions on financial performance would be contingent on the economies garnered from the organization's size and level of diversification, product mix, advertising, consumer income, government contracts and competitors'

prices. The products, markets and activities that define organizational strategy also define the organization's stakeholder set. Consequently, a firm pursuing socially responsible initiatives that lack consistency with its corporate strategy is not likely to meet the particular expectations of its stakeholders.

In an effort to seek the relationship between CSP and CFP derived from the good management theory, the strategy variable will be expected to able to moderate the link between CSP and CFP. Based on the arguments and finding from the previous studies, it can be concluded that the link between CSP and CFP will be contingent upon the strategy. The following is proposition on the effect of strategy of the relationship of CSP and CFP:

P_{2b}: strategy moderates the relationship between CSP and CFP based on good management theory.

Organization Structure and CSP-CFP Link

Study directly relating to organization structure fit and performance is Sandino (2005). He found that interaction between control system and organization structure affected company's performance. In addition, the insight regarding this fit relation to the performance can be predicted based on the direct relationship between organization structure and job satisfaction variable (Ali and Ali, 2005). If employees feel satisfied it can be expected to increase the company's performance.

Corporate performance is highly determined by how effectively and efficiently

the company's business strategy is implemented (Walker et al., 1987 and cited in Olson, 2005). The success of the company's strategy implementation is highly influenced by how well the company is organized (Vorhies et al., 2003; Olson, 2005) and the use of strategic behavior such as customer focus, competitor analysis, and innovation (see for example Chen, 1996; Gatignon, 1997; Olson, 2005). The organization structure is needed to manage the works in organization that are divided into small parts to achieve the intended strategy. It is the management of works leading to the emergence of variety of alternative of organization structure and, in turn, can shape the company. The organization structure can be defined using three constructs: formalization, centralization, and specialization (Walker et al., 1987; Olson et al., 2005). The three components are central points of Mintzberg's analysis of organization structure (Olson et al., 2005).

Formalization refers to the level of formality of rules and procedures used to govern the works in a company including decision and working relationship (Olson, 2005). The rule and procedure can explain the expected appropriate behavior in working relationship and address the routine aspect of works. As a result, people and organization itself can gain the benefit of using the rules and procedures. In this regard, the use of the rules and procedures can lead to the increase in efficiency and the decrease in administrative cost especially in the normal environment situation characterized by simple and repetitive tasks (Ruekert et al., 1985; Walker et al., 1987; Olson et al., 2005). A company with highly formal rules and procedures is called mechanic organization, while one with

fewer formal rules and procedures is referred to organic organization (Burns and Stalker in Olson et al., 2005). Organic organization enables people in a company to have vertical and horizontal communication to manage the company's works. Therefore, benefit that can be gained from using the organic organization include rapid awareness of and response to the changes in competition and market, more effective information, reduced lag time between decision and action (Miles et al., 1992; Olson, 2005).

Centralization is a condition on whether autonomy of making decision is held by top manager or be delegated to the lower manager. In management literature, this construct *includes* two terms in the opposite ends: centralized and decentralized organization (Olson, 2005). In centralized organization, autonomy to make decision is held by top manager. Although fewer innovative ideas can be created in centralized organization, implementation of the decision is straight forward after the decision is made (Ullrich and Wieland in Olson, 2005). However, the benefit can only be realized in stable and in noncomplex environment (Olson et al., 1995; Ruekert, 1985; Olson et al., 2005). In unstable and complex environment indicated by rapid changes in competition and market, the use of organization structure providing the lower manager with autonomy of making decision is needed. In the decentralized organization, a variety of views and innovative ideas may emerge from different level of organization. Due to the fact that autonomy of making decision is dispersed, it may take longer to make and implement the decision (Olson et al., 1995; Olson et al., 2005). However, in the non routine task

taking place in complex environment, the use of decentralized organization is more effective to achieve the organization goal as the type of organization empower managers who are very close to the decision in question and to make the decision and implement it quickly (Ruekert et al., 1985).

Specialization is the level of division of tasks and activities in organization and level of control people may have in conducting those tasks and activities (Olson, 2005). Organization with high specialization may have high proportion of specialist to conduct a well-defined set of activities (Ruekert et al., 1985; Olson, 2005). Specialist refers to someone who has *expertise* in respective areas and, in certain condition; he or she can be equipped with a sufficient authority to determine the best approach to complete the special tasks (Mintzberg in Olson, 2005). The expertise is needed by organization to quickly respond the changes in competition and market in order to meet organization goal (Walker et al., 1987).

Based on theory of slack resource, the interaction or fit between organization structure and corporate financial performance (CFP) can affect the corporate social performance due to fact that increase in CFP resulting from organization design enables the company has more chance to do the CSP. Thus, it is reasonable to expect from this study that the organization structure can moderate or affect the relationship between CFP and CSP. The proposition on organization structure of the CFP-CSP link is as follows:

P_{3a1}: Formalization moderates the relationship between CFP

and CSP based on the slack theory

P_{3a2}: Decentralization moderates the relationship between CFP and CSP based on the slack resource theory

P_{3a3}: Specialization moderates the relationship between CFP and CSP based on the slack resource theory

As mentioned above, another factor affecting corporate financial performance (CFP) is the use of strategic behaviors in organization. In the context of corporate social performance, the concept strategic behaviors can be extended using the stakeholder theory to explain the fit between organization structure and corporate social performance (CSP). According to Chen (1996); Gagnon et al. (1997); and Olson et al. (2005), the strategic behaviors can be identified into some components: customer-oriented behavior, competitor oriented behavior, innovation-oriented behavior, and internal-cost behavior. The concept can be extended using components of stakeholder as contended by Donaldson et al. (1995). Supplier-focused behavior, employee-focused behavior, society aspect-focused behavior, and environment-focused behavior are stakeholder-based strategic behavior to be expected to improve corporate financial performance. Using the argument, CSP will affect CFP.

In the formalization aspect, typical bureaucratic structures normally may work well. In the typical structure, Information can be routed to the relevant specialist who can make decisions on the basis of standard corporate policies (Thompson & Tuden in Husted, 2000). However, Information is not dissemi-

nated widely, but directly to the individual decision maker. For example, rules in the form of ethics codes can work effectively to resolve problems to the satisfaction of stakeholders where stakeholders and the firm share similar values and understandings of what happened. To cope with the problems, companies create organization units (decentralization and specialization structure) to handle some tasks such as environmental assessment, corporate philanthropy, and public relations. It is usually the units that assume responsibility of the companies' ethics program (Center for Business Ethics, 1986). According to Reed, Collin, Oberman, and Toy in Husted, (2000), the presence of such routinized structures can have a positive impact on corporate social performance.

Based on the finding and the logic, the concern of this study is that the fit between organization structure and CSP will affect the financial performance. The proposition can be then developed:

P_{3b1}: Formalization moderates the relationship between CSP and CFP based on good management theory

P_{3b2}: Decentralization moderate the relationship between CSP and CFP based on good management theory

P_{3b3}: Specialization moderates the relationship between CSP and CFP based on good management theory

Control System and CSP-CFP Link³

One important function of Management Control system or control system for

short is management tool to implement the organization strategy. Of the typologies in control system, Simons' (2000) typology is complete and comprehensive, including: belief system, boundary system, diagnostic control system, and interactive control system. In its development stages, the control system had undergone evolution in terms of approach used and complexity of environment faced by a company. The evolution included the use of direct control approach focusing on manager's observation of what is going on the company till indirect control approach relying upon accounting control. For the last evolution, it included using static and flexible budget till adopting the concept of profit or investment center (see for example Horngren, 1996). The concept of control system centers on the concept of bottom line (financial performance). Not only did the concept have some flaws on imbalances due to the domination of financial aspect, but also it created some paradoxical situation between control and innovation, opportunity and attention, and short term and long term goal, and human behavior. One reason of the problems is that the old concept of control had been defined as diagnostic control only. In that definition of control, the control process had been focused on the matter of routine mechanism or process of comparing some expected and realized performances. According to Simons (1995a, 1995b and 2000), to avoid the problem concept of control should be extended by adding three more levers: belief system, boundary system, and interactive control system. The function of belief system is to inspire the people in an organization to search for new ways and alternatives by

³ This section is adapted from Fauzi et al. (2008)

providing them with the organization's clear vision, mission, statement of purpose, and credos through using formal and informal system. It is expected from the belief system mechanism, creativity and innovation in the organization will be continuously updated to meet the expected growth. The use of boundary system lever is meant to prevent unwanted impact of creativity and innovation by setting some rules limiting people to do in the form of code of business conduct, strategic boundary, and internal control. The role of interactive control system is to provide an organization with solution to cope with emerging strategic uncertainty and with new strategy given that emerging situation.

The careful and consistent use of the control system typology, often called levers of control, can lead to the improved performance (CFP). The following is discussion on how the components of levers of control can be associated with the performance and, therefore, the expectation of the impact of the use of components of the control systems on the relationship between CSP and CFP can be based upon.

Belief system is the one used in an organization to communicate an organization's core value to inspire people in the organization to search for new opportunities or ways to serve customer's needs based on the core values (Simons, 1994, 1995, 2000). In an organization the belief system has been created using *variety* of instruments such as symbolic use of information. The instruments are used to communicate the organization's vision, mission, and statement of purpose such that people in the organization can well understand the organization's core value. Westley et al. (1989; cited in

Simons, 1995b) supported the use of the instrument by arguing that great leaders and competent managers understand the power of symbolism and inspiration. The benefit of using the symbolic instrument especially at individual level is also provided by Feldman et al. (1981) by delineating that symbols produce belief and belief can stimulate the discovery of new realities. In this regard, Westley (1990 cited Simons, 1994) contended that managers will not be very eager to participate in search for opportunities if they do not understand the beliefs of organization and are not get involved in converting the beliefs into actions and strategies.

There is a need for an organization to formally communicate the core value, especially when it is facing the dramatic change in business environment such as competition, technology, regulation and other factors. The Change in the business environment creates a need for strong basic values to provide organizational stability (Simons, 1995b). The importance of understanding the core is also supported by study of Kotter (in Simons, 1995b) concluding that inspirational motivation can be created by (1) communicating vision that can address the value of people in an organization, (2) permitting each individual to be pleased about how he or she can contribute to implementation of that vision, (3) Providing eager support for endeavor, and (4) promoting public recognition and reward for all success.

The belief system can make people in an organization inspired to commit to organization goal or purpose. In this regard, commitment means believing in organizational value and willing to attempt some efforts to achieve the organ-

izational goal (Simons, 1995). Therefore, the goal commitment can lead to improved corporate performance (Locke et al., 1988). The conclusion is consistent with what Klein et al. (1998) found in their study on situation constraints including goal commitment and sales performance. Chong et al. (2002) studying the effect of goal commitment and the information role of budget and job performance provides the same finding.

The resultant of belief system is new opportunities that may contain some problems. The boundary system concerns on how avoid some risks of innovation resulting from the belief system (Simons, 1994). The risks that possibly emerge can be operating, assets impairment, competitive, and franchise risks (Simons, 2000). On the other hands, the boundary system provides allowable limits for opportunity seeker to innovate as conditions encouraged in the belief system.

There are two instrument used in boundary system to establish the limit in order avoid the risks: business conduct and strategic boundaries (Simons, 1995b; Simons, 2000). The business conduct boundaries are focused on behavior of all employees in an organization. The source of the boundaries is of three folds: society's law, the organization's belief system, and codes of behavior promulgated by industry and professional association (Gatewood and Carroll, 1991; Simons, 1994). When uncertainty resulting from new opportunities is high or internal trust is low, the business conduct boundary is highly needed (Kanter in Simons, 1994). In the environment of high uncertainty, Merchant (1990) found that chances to manipulate the profit figures by managers is high.

The manipulation is one of risks that can endanger the managers' company. Therefore, the business conduct boundary will be imposed in that situation to avoid the risk and, in turn, improve the corporate performance. The low in internal trust can result in the absence of shared commitment to the organization goal. No commitment to goal can affect the corporate performance. The objective of applying the business conduct boundary is to maintain the employee's commitment to organization goal and, in turn, can improve the performance.

Strategic boundaries are defined as rules and limitation applied to decisions to be made by managers needing the organization's resource allocation as response of opportunities identified in the belief system (Simons, 1995b and 2000). Application of ROI of 20% as hurdle rate in the capital budgeting decision is one example. Updated of negative list on business area that is not allowed to go into is another example. In his study using case approach in UK Telecommunication company, Marginson (2002) found that the boundary system-strategic boundary can motivate people in that company to search for new ideas or opportunities within the prescribed acceptable area. Thus, if well implemented, this system can avoid the potential risks and, in turn, can improve the organization performance.

Diagnostic control system is the one used by management to evaluate the implementation of an organization's strategy by focusing on critical performance variables, which is the ones that can determine the success of strategy implementation and, at the same time, can conserve the management attention through the use of management by ex-

ception (Simons, 1995b and 2000). As a system relying upon the feedback mechanism, the diagnostic control system is an example of application of single loop learning whose purpose is to inform managers of outcomes that are not meeting expectation and in accordance with plan (Argyris, 1977; Widener, 2006 and 2007). The single loop learning is a part of organization learning that indicates benefits of implementing management control system in general. Organizational learning originates in historical experiences that are then encoded in routines (Levitt and March, 1988; cited Widener, 2006 and 2007). Based on historical experiences, the organization adopts and formalizes "routines that guide behavior" (Levitt and March, 1998, 320). Therefore, control system can be said to be a learning tool. To support this conclusion, Kloot (1997), in his study using case study approach, investigated the link between control system and organizational learning and found that control system can facilitate organization control. Based on organization theory literatures, organization learning has impact on performance (Slater and Narver, 1995; Levitt and March, 1988). The argument underlying the association is that organization learning is very critical to competitive advantage. Organization with learning orientation will have improved performance (Tippin and Soha, 2003). Chenhal (2005) provided support for the finding by investigating the relationship of control system and delivery service using organization learning as *mediating* variable.

In addition to providing organization learning aspect, the use of diagnostic control system also can conserve management attention through the application

of management by exception tool (Simons, 1995b and 2000). With the tool, the control system reports to management only if the deviation things happen. Therefore, efficient aspect will be resulted from the use of the tool. Simons (1991) also provided empirical evidence from the health care industry that managers feel overloaded with information if their attentions are focused on broad scope of control attributes and concluded that diagnostic control system could facilitate the efficient use of their attentions. According to Schick et al. (in Widener, 2006 and 2007), the information overload occurs when demand for information exceeds its supply of time. To encourage the efficient use of management attentions (time), the management attentions should be focused on the critical success factors and core competence that are likely associated with improved performance.

In an attempt to implement the organization strategy, it is necessary to note that strategy initially set in strategic planning, often called intended strategy, in the classification of Mintzberg's (1978) typology of strategy, may not become realized strategy due to the fact that any strategy has inherent strategic uncertainty defined as external factors resulting from market dynamics, government regulation, and dramatic change in technology triggering the intended strategy become invalid (Simons, 1995b; Simons, 2000). He proposed the use of Interactive control system to solve the obstacles. The control system will detect the driver of invalidity of intended strategy and follow them up by working together between top managers and their subordinates to create dialog and to share information in order to solve the problems. This process, if well de-

signed, can stimulate double loop learning in which the search, scanning, and communication process allow the emergence of new strategies, strategy of which, in the Mintzberg's (1978) strategy typology, often called emerging strategy. Levit and March (1988) echoed that situation by stating that if the structural problems in organizational learning cannot be eliminated, they can be mitigated. In their study in the hospital area, Abernethy and Brownell (1999) also support the conclusion that interactive control system can facilitate the organization learning. Considering the importance of organization learning as mentioned above, the process in turn can improve the organization performance.

Based on theory of slack resource, the interaction or fit between control system, including belief system, boundary system, diagnostic control system, and interactive control system, as well as the corporate financial performance (CFP) can affect the corporate social performance due to fact that increase in CFP resulting from the appropriate use of control system components enables the company has more chance to do the CSP. Thus, it is reasonable to expect from this study to formulate the proposition of current study as follows:

P_{4a1}: reliance on belief system moderates the relationship between CFP and CSP based on the slack resource theory

P_{4a2}: reliance on boundary system moderates the relationship between CFP and CSP based on the slack resource theory

P_{4a3}: reliance on diagnostic control system moderates the relationship between CFP and CSP based on the slack resource theory

P_{4a4}: reliance on interactive control system moderate the relationship between CFP and CSP based on slack resource theory

As stated by Ouchi (1977) and Robbin (2002), organization behavior refers to work related activities of member of organization. That is the behavior of the organization members. Any company is very concerned about controlling the behavior. That is done using a well designed control system (Snell, 1992). One instrument to be used in the control system is strategic behaviors that can lead to the expected organization performance. Chen (1996); Gatignon et al. (1997); and Olson et al. (2005) listed the strategic behavior including: customer oriented behavior, competitor oriented behavior, innovation oriented behavior, and internal/cost oriented behavior. The list can be referred to input-output model of Donaldson et al. (1995). The list can also be extended using the contingency theory. Thus, corporate social performance is strategic behavior to be influenced using control system and, in turn, to be expected to improve the corporate financial performance.

Most prior literature considering the motives for socially responsive decision making derives from the business ethics literature. Considerable attention has been given to determining the factors that influence 'ethical' organizational decision making (Soutar et al., 1994). For example, models of ethical behavior have been developed which indicate that there is a set of situational variables which interact with and influence ethical decision making processes (Bommer et al., 1987; Stead et al., 1990; Trevino, 1986). One set of situational variables deemed to influence ethical decision

making include work environment and organizational factors (Bommer et al., 1987; Falkenberg and Herremans, 1995; Singhapakdi et al., 2000; Verbeke et al., 1996). For instance, employee socialization processes aimed at internalizing socially responsive/ethical standards within individual employees have been held to influence socially responsive decision-making (Smith and Carroll, 1984; Soutar et al., 1994). Control systems are deemed to form an integral part of employee socialization (Gatewood and Carroll, 1991). They support the development of an organization's culture, the system of shared beliefs, values, norms, and mores of organizational members (Gands and Bird, 1989), which is deemed to be a primary determinant of the direction of employee behavior (Robin and Reidenbach, 1987; Trevino, 1986).

Based on the finding and the logic, the concern of this study is that the fit between control system and CSP will affect the corporate financial performance. Proposition on the control system of the CSP-CFP link can be then developed as follows:

P_{4b1}: reliance on belief system moderates the relationship between CSP and CFP based on the good management theory

P_{4b2}: reliance on boundary system moderates the relationship between CSP and CFP based on the good *management* theory

P_{4b3}: reliance on diagnostic control system moderates the relationship between CSP and CFP based on the good management theory

P_{4b4}: reliance on interactive control system moderates the relationship between CSP and CFP based

on the good management theory

Based on the literature review and discussion in the previous section, conceptual framework for explaining the determinants of the relationship of corporate social performance (CSP) and corporate financial performance (CFP) under two theories can be diagrammed in figure 2 (see the next page).

Conclusions and directions for future research

Investigations of the relationship of CSP and CFP have produced the conflict results so far. There are some theories that have been developed to explain the relationship, coming from neoclassical theory of economy and stakeholder theory. But they failed to clearly and satisfactorily explain. The use of contingency has been highly recommended to explain the relationship. However, the contextual variables used in the previous studies are not related to the determinants of corporate performance as identified in the strategic management and accounting literatures. As discussed in the previous section, CSP is an extended corporate performance and, therefore, some aspects affecting the corporate performance should also apply to the CSP. The failure to include the dimensions of corporate performance: business environment, strategy, organizational structure, and control system as contextual variables in the relationship of CSP and CFP may add the reasons of the conflicting results.

Others issues of the conflicting result of the relationship are coming from methodology aspects, including: (1) mismatching measurement, (2) sampling

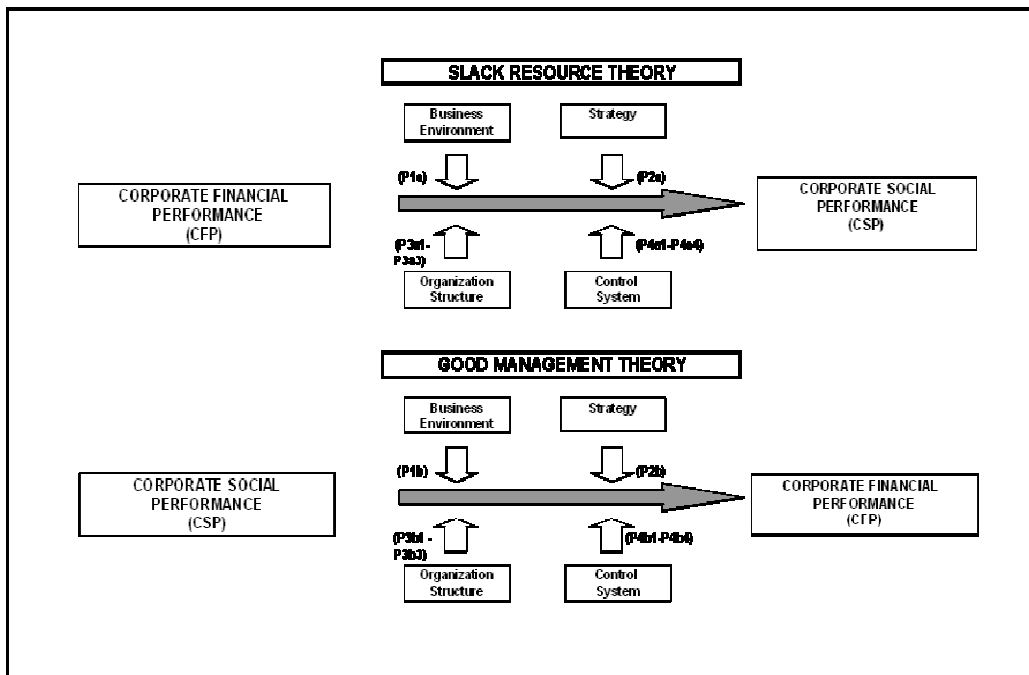


Figure 2
Theoretical Model of Determinants of the Relationship of CSP and CFP

error, and (3) measurement error. Mismatching measurement includes the choice of CSP measurement that does not fit CFP measurement. If the problem cannot be resolved, the conflict results will occur. Therefore, for direction of future research, the use of CSP measurement that can be theoretically linked to the corresponding CFP measurement is highly needed. Sampling error problem mainly resulted from the limitation of samples used in the previous studies. The measurement error of the constructs of CSP narrowly defined can also lead to the error in the result of the relationship between CSP and CFP.

The construct of CSP can be approached by using four types of measurement strategy: (1) disclosure, (2) reputation rating, (3) social audit; CSP process; and observable outcome, and (4) managerial

CSP principle and value (Orliztky, 2003). The disclosure approach is conducted by using content analysis method of documented materials such as annual report. The reputation rating is the approach to measuring CSP based on the company's perception of one of stakeholders using single or multi-dimensions of CSP. In so doing, it is assumed that the perceived items represent a good reputation of the company. The next category of measurement strategy for CSP is using social audit, CSP process, and observable outcome. This is a systematic way by third party to assess a company's behavior of CSP, normally using multi dimension measures to have a ranked index of CSP. The third party includes KLD (Kinder Lydenberg Domini) and CEP (Council on Economic Priorities). The final approach to measuring the CSP is using managerial

CSP principle and value. Under this approach survey research has been done to assess a company's activities using values and principles of CSR developed initially by Carroll (1979) and extended by Aupperle (1984). The values and principles of the CSR include four dimensions: economy, legal, ethics, and discretionary. In the simple way, Cochran and Wood (1984) contended that there are two generally accepted methods to measure CSP: content analysis and reputation index. Based on their argument, the last three classifications of Orlitzky et al (2003) fall into the reputation index method.

Meanwhile, CFP is also measured using three alternative approaches: (1) market based measure, (2) accounting-based measure, and (3) perceptual measure (Orlitzky et al, 2003). Under the first approach, the market value of a company derived from stock price of the company is used to measure CFP. This approach reflects notion that primary stakeholder of the company is shareholder. Accounting-based measure is one to measure CFP derived from a company's competitive effectiveness and a competitive internal efficiency as well as optimal utilization of assets, for some certain measures. Measures such as net income, ROA, ROE, and EVA are some examples of this approach. The last approach to measuring CFP is using perceptual method. In this approach, some subjective judgments for CFP will be provided by respondents using some perspectives such as ROA, ROE, and financial position relative to other companies.

As discussed in the previous section, the causality problem of the relationship between CSP and CFP is which one,

between them, is coming first? Whether companies having strong in financial performance can improve their social performance based on slack resource theory or whether practices of social activities done by companies can increase the companies' financial performance as explained in good management theory. Therefore, to resolve the problem it is highly needed to use the two theories to be tested.

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