Corporate Citizenship of Multinational Enterprises and Financial Performance: The Moderating Effect of Operating in Developing Countries

Javier Aguilera-Caracuel, Jaime Guerrero-Villegas
Pablo de Olavide University, Spain
&
Matilde Morales-Raya
University of Granada, Spain

ABSTRACT. Multinational enterprises (MNEs) often locate facilities in developing countries to benefit from lax environmental and social regulations and to reduce their operating costs. MNEs can also contribute positively to those countries by improving their economic environment, facilitating relationships with governments and other social agents, and enhancing social welfare. We argue that MNEs that operate in developing countries may enhance economic and sustainable development in those countries and simultaneously improve their financial performance. We analyzed a sample of 113 US MNEs from the chemical, energy, and industrial machinery industries. Our findings suggest that their presence in developing countries moderates the relationship between corporate social performance (CSP) and financial performance (CFP). We found that MNEs with a strong presence in developing countries can take advantage of the implementation of philanthropic initiatives to significantly improve their CFP.

KEYWORDS. Multinational enterprises, corporate citizenship, corporate ethical initiatives, corporate philanthropic initiatives, corporate financial performance

I. INTRODUCTION

Multinational enterprises (MNEs) are very powerful actors in the current world (Gatto 2011), particularly in developing countries (Kumar 2002). In addition to compliance with legal responsibilities, MNEs – characterized by a set of separate units that are based in countries with different institutional profiles (Kostova and Roth 2002; Kostova *et al.* 2008) – can

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undertake voluntary activities to promote and pursue social goals that extend beyond their legal obligations to meet the demands of their stakeholders (Zhao 2012). Cross-country variations in stakeholders' expectations (Gardberg and Fombrun 2006) cause variations in the cost of gaining legitimacy across countries (Campbell *et al.* 2012). As a result, MNEs have tended to locate some of their subsidiaries in developing countries, in which stakeholders' expectations are lower, to reduce labour costs, raw material costs, and other expenses (e.g. Marsden 2000; Scherer and Palazzo 2007; 2008; Surroca *et al.* 2013; Witt and Lewin 2007). There are many examples of MNEs that have located their most polluting activities to countries with lax environmental regulations (Surroca *et al.* 2013). Similar opportunistic behaviours have extended to human rights issues, ethical labour practices, and product safety issues (Korten 2001).

However, MNEs can play an active role in less developed regions, in particular by contributing to public service health programmes, to the building of schools, or to the development of capacity building for trade (Valente and Crane 2010). Corporate Citizenship Theory describes firms as quasi-governmental actors because they have started to administer social, civil, and political rights in situations in which governments fail or are unable to do so (Ablander and Curbach 2014; Hahn 2009; Matten and Crane 2005). Corporate citizenship is especially relevant for MNEs operating in developing countries because they encounter public sector resource deficits and inefficiencies that place MNEs in situations in which they can do more than simply go about their business (Valente and Crane 2010). Therefore, governments' failure to fulfil basic needs in these less developed regions represents an opportunity for MNEs to fill those gaps and exhibit good corporate citizenship (Eweje 2006). MNEs can fill such gaps in the public sector by directly taking on public service roles through their corporate citizenship programmes, despite the fact that these programmes have a tenuous relationship with the core operations of the firm (Matten and Crane 2005; Scherer and Palazzo 2008). For example, IBM's Kidsmart programme provides a set of education services ranging from pedagogy to parent training for public schools in developing countries. Unilever cooperates with local governments in China to develop a technological base for the manufacturing and distribution of organic agricultural products (Zhao 2012).

Previous research on the relationship between CSP and CFP found mixed results (e.g. Hull and Rothenberg 2008; Margolis and Walsh 2003; Orlitzky 2011; Orlitzky *et al.* 2003; Vogel 2005). Whereas the *stakeholder approach* (Freeman 1984) states that there is a positive and direct relationship between CSP and CFP (e.g. Choi and Wang 2009; Margolis and Walsh 2001; Waddock and Graves 1997), the *neoclassic approach* (Friedman 1970) argues that the relationship between these two constructs is negative (e.g. Barnett 2007; Jensen 2001; Scherer and Palazzo 2011). Other studies suggest that there is no relationship between CSP and CFP (McWilliams and Siegel 2000) and that, if such a relationship exists, it is too complex to be found (Margolis and Walsch 2003). Consequently, a more detailed analysis of the different components of CSP is required (Taneja *et al.* 2011). Some studies have specifically focused on corporate philanthropy and argued that philanthropic activities have a positive influence on firms' profitability (e.g. Brammer and Millington 2005; Godfrey 2005; Porter and Kramer 2002; Saiia *et al.* 2003). However, minimal attention has been given to MNEs and the moderating role that the presence of MNEs in developing countries could play in strengthening the relationship between CSP and CFP (Wang and Qian 2011).

In this study, we focused on CSP by examining corporate ethical and philanthropic initiatives of MNEs for two main reasons. First, these activities are voluntary and can be a source of differentiation that positively influences the CFP of MNEs. Second, ethical and philanthropic activities can significantly influence the welfare of developing countries in which MNEs operate. We argue that through the implementation of these social initiatives in developing countries, MNEs may improve the economic and sustainable development of those regions (Matten and Moon 2008; Porter and Kramer 2011) and, in turn, increase their own CFP. We analyzed a sample of 113 US MNEs from the chemical, energy and industrial machinery industries for the period 2005 to 2010. Our results reveal that

MNEs with a high presence in developing countries can take advantage of the implementation of philanthropic initiatives to improve significantly their own CFP. However, we did not find such evidence for the MNEs' ethical initiatives. The direct relationship between MNE's social initiatives (ethical and philanthropic) were likewise not supported by our data.

This study contributes to the literature in at least three ways. First, we advance previous studies by providing empirical evidence concerning the CSP of MNEs and their CFP. Second, using the *Corporate Citizenship Theory* as a framework (Carroll 1991; 1998; Matten and Crane 2005), we note the key role played by external factors – such as the level of development of a country – on the relationship between CSP and CFP. Third, this study highlights that the voluntary social dimensions of corporate social responsibility (CSR) – ethical and philanthropic initiatives – affect CFP differently when MNEs operate in developing countries. Finally, we incorporate longitudinal data to add robustness to our analyses.

II. Corporate Citizenship

Corporate Citizenship (CC) is a term that has garnered significant attention in academic circles (Andriof and McIntosh 2001). It is related to firms' role in assuming social responsibility (Matten and Crane 2005). The term 'citizenship' has a metaphorical meaning because, although corporate actions can be similar to those of real citizens in some aspects, firms cannot literally be considered citizens with real citizenship rights (Hahn 2009; Moon, Crane and Matten 2005).

CC has been used according to three different perspectives: the limited view, the equivalent view, and the extended view. First, the 'limited view' focuses on local communities as the main stakeholder of the firm (Altman 1998). Corporate citizenship includes charitable donations and other forms of community action (Carroll 1991) and is motivated by the firm's self-interest, which recognizes that a stable social, environmental, and political environment ensures profitable business (Windsor 2001;

Wood and Logsdon 2001). The 'limited view' of CC is used as philanthropic responsibility (Matten and Crane 2005).

Second, the 'equivalent view' implies that business is part of the public culture (Birch 2001). This view equates CC with corporate social responsibility (CSR) (Matten and Crane 2005). CSR includes firms' economic, legal, ethical, and philanthropic/discretionary responsibilities (Carroll 1991, 1998). *Economic responsibilities* are for firms to be profitable (Carroll 1991). *Legal responsibilities* imply that firms are expected to comply with the laws and regulations at local, national, and international levels to avoid penalties and legal sanctions (Carroll 1991; Surroca *et al.* 2013; Vernon 1992).

Ethical responsibilities are voluntary corporate actions that are 'expected' from business by society even when business is not compelled to maintain them by law. Society's expectations embrace emerging values, typically exceed the minimums required by law, and can even address issues not covered by the law (Carroll 1991; 1998). Ethical responsibilities include environmental and social standards, norms, and expectations that reflect what consumers, employees, shareholders, and the community consider right and fair or in keeping with the respect or protection of stakeholders' moral rights (Carroll 1991). For example, the British paper manufacturer Antalis voluntarily adopted a 'green' philosophy to reduce the negative effect of its operations on the natural environment (Carroll and Shabana 2010).

Philanthropic responsibilities are voluntary corporate actions that are 'desired' by society. These actions 'should' be undertaken by firms to act as responsible corporate citizens (Carroll 1991), but are not necessarily 'expected' (Matten, Crane and Chapple 2003). Corporate philanthropy includes monetary donations to social and charitable causes such as education, culture, the arts, minorities, or health care (Godfrey 2005; Seifert *et al.* 2004; Wang *et al.* 2008), and activities of collaboration related to firms' employees and customers (Carroll and Shabana 2010). For example, companies such as Ashland Oil, Microsoft, and JPMorgan Chase are members of the 'Workplace Giving' campaign, which is a programme sponsored by companies through which employees can make a charitable contribution through payroll deduction (Global Impact 2009a). Through corporate philanthropy, firms also engage in network relationships with communities, governments, and non-governmental organizations (NGOs). For example, the 'Workplace Giving' programme is coordinated by Global Impact, which is a not-for-profit organization devoted to helping the world's most vulnerable people (Global Impact 2009b).

In summary, economic and legal obligations are the mandatory part of business responsibility, whereas ethical and philanthropic responsibilities are voluntary and differentiate corporate behaviour from mere compliance (Matten, Crane and Chapple 2003). Carroll and Shabana (2010) suggested, "CSR are the nature and extent of corporate obligations that extend beyond the economic and legal responsibilities of the firm. It may be understood that the essence of CSR and what it really refers to are the ethical and philanthropic obligations of the corporation towards society" (2010, 90). In this regard, corporate citizenship has been defined as a company's engagement in activity that appears to advance a social agenda beyond what is required by law (Siegel and Vitaliano 2007).

Third, the 'extended view' of CC goes beyond CSR. CSR highlights that business should or even must do something *additional* (Matten, Crane and Chapple 2003). However, the 'extended view' of CC describes the voluntary engagement of companies beyond good management practice in the sense of CSR (Ablander and Crubach 2014). Corporations form a community alongside other 'citizens' and have a place in society (Waddell, 2000). Society expects that corporations, as good citizens, contribute to their social and natural environment beyond their regular business activities. This view assumes that firms benefit from society and accordingly must give something back to the communities in which they operate. Under this view, firms are conceived as citizens that are responsible for societal issues in general (Ablander and Crubach 2014).

The 'extended view' of CC specifically focuses on the role of corporations as voluntary administrators of citizenship rights in cases in which national governments fail or are unable to do so (Matten and Crane 2005).

CC is linked therefore to a certain (national) territory governed by a sovereign state as the guarantor of citizenship and rights. Public goods, human rights, civil rights, and political rights are guaranteed in most industrialized countries. However, in many developing countries, governments fail even to provide basic public goods, which are those that are essential and universally provided to all citizens regardless of income such as education, health care, water services, policing services, waste management, telecommunications, social housing, public transportation, and security (Valente and Crane 2010). Under such circumstances, companies may take over "[...] certain functions with regard to the protection, facilitation and enabling of citizens' rights" (Matten and Crane 2005, 171). Accordingly, companies with a presence in developing countries can initiate positive changes toward the protection of such rights. Several ethical and philanthropic corporate activities illustrate corporate citizenship, for example, financing the building of a new medical facility in a district where there are no medical services. This firm's assistance to government is similar to public responsibility and differs from traditional philanthropy in the sense of CSR, which would consist merely of donating money to an existing medical facility (Valente and Crane 2010).

When non-state actors provide services such as health or education that are usually associated with the domain of the state, this can not only undermine state capacity but also lead to questions about its legitimacy and credibility (Kolk and Lenfant 2013; Idemudia and Ite 2006). Gatto (2011) has noted the complementary role of MNEs and states. Although MNEs' decisions and activities have a considerable weight in national and international policy making, they cannot replace the state as the unit of official power. Therefore, MNEs cannot, and should not, replace the legitimate role of governments in the development of social services.

The provision of citizenship rights by companies implies the establishment of power relationships between companies and the state. These power relationships vary among countries. Several studies have shown that different political contexts also imply different forms of companies-state power relationships and, therefore, different challenges for companies to manage the relationship with the state through CSR (Zhao 2012; Sharfman *et al.* 2004). For example, China and Russia have high levels of political hazards – which describes the extent to which a change in the preferences of political constituents may lead to a change in government policy (Henisz 2000). In these countries, the state controls crucial resources for the companies and maintains a regulatory system full of uncertainty. In contrast, OECD countries are commonly committed to the ideas of market economy and political democracy and mark a high level of policy consistency.

The national regulatory framework also plays a key role in firms' adoption of social initiatives (Matten and Moon 2008; Gugler and Shi 2009). Matten and Crane (2005) suggest that companies enter the arena of citizenship in which government has not yet administered citizenship rights, for example, ensuring a living wage for employees, improving working conditions in sweatshops, and financing the schooling of child labourers in the absence of legislation requiring this. CC is especially important in countries where environmental conditions are hazardous and in which regulatory protection may not be effective (Rondinelli and Berry 2000). In this sense, changing ethics or values precedes the establishment of law because they become the driving force behind the very creation of laws or regulations (Carroll 1991).

Governments and regulation in developing countries also play an important role in either fostering or hindering CSR practices (Idemudia 2011). Although legislation about citizens' rights and social issues in developing countries is behind legislation in developed countries (Mwaura 2004), some countries have made significant progress in strengthening the social and environmental aspects of their laws (Visser 2008). For example, Singapore has achieved a large degree of success in terms of environmental responsibility due to the strong capacity of the government to enforce legislation (Perry and Singh 2002). Other countries such as China, Cambodia, Indonesia, and Thailand have clear provisions of laws on maximum working hours, overtime hours, and minimum wages. However, laws passed at the national government level fail to be properly enforced at the local level (Gugler and Shi 2009).

III. Hypotheses

Corporate Social Performance and Corporate Financial Performance in MNEs

Firms face increasing pressures to maximize their CSP and CFP. The effect of CSP on CFP has been debated for decades (e.g. Hull and Rothenberg 2008; Margolis and Walsh 2003; Orlitzky 2011; Orlitzky *et al.* 2003; Vogel 2005). A first group of studies argued that there is no relationship between CSP and CFP (e.g. Margolis and Walsch 2003; McWilliams and Siegel 2000) because many contingencies affect variability in return to CSR (Aragón-Correa and Sharma 2003). For example, McWilliams and Siegel (2000) argued that the omission of the research and development variable could explain the wide range of mixed results found in previous research. Russo and Fouts (1997) posited that exogenous factors such as the growth of an industry moderate positively the relationship between environmental performance and economic performance.

A second group of studies showed a negative relationship between CSP and CFP. These studies argue that firms that try to enhance CSP draw resources and management efforts away from core areas of business, resulting in lower profits. From this perspective, managers cannot make both social and competitive improvements (Klassen and Whybark 1999). For example, many firms lack the expertise for efficient investment in social causes, and top managers use philanthropy to boost their personal reputations and advance their careers (Haley 1991). Friedman (1970) and other neoclassical economists also argue that the implementation of social initiatives involves substantial cost that reduces profits and shareholder wealth.

A third group of studies based on Stakeholder Theory (Freeman 1984) argues that CSP is positively related to CFP. Advanced corporate social initiatives can lead to a reduction of transaction costs (Post *et al.* 2002; Tencati and

Zsolnai 2009) and an increase in market opportunities (Porter and van der Linde 1995) that yield a competitive advantage by attracting a higher quantity and quality of human resources (Fombrun and Shanley 1990).

Related to corporate ethical initiatives, the adoption of stringent environmental and social standards beyond legal requirements encourages firms to generate social consensus and accumulate trust and reputation (Bansal 2005). Reducing environmental impact leads to productivity gains and cost reductions by lowering the consumption of materials, energy, and services (Hart and Ahuja 1996; Wagner 2001) and leads to financial market gains by facilitating access to capital (Bauer *et al.* 2007; King and Lenox 2000). Achieving better CSP is a source of differentiation for firms (Klein and Dawar 2004). For example, consumers are willing to reward ethical firms by paying higher prices for such firms' products (Creyer and Ross 1997). Consumers' perceptions of a firm's ethical activities also had a positive effect on corporate reputation (Bendixen and Abratt 2007).

With respect to corporate philanthropy activities, previous studies have also shown their influence on stakeholders' perceptions of the firm (Himmelstein 1997; Saiia *et al.* 2003; Smith 1994). Firms that adopt philanthropic actions can develop a positive public image (Brammer and Millingron 2005; Godfrey 2005; Porter and Kramer 2002; Saiia *et al.* 2003), enhance their brand image, promote their products (File and Prince 1998), and secure critical resources from stakeholders that provide firms with insurance and long-term protection (Fombrun *et al.* 2000; Godfrey 2005).

MNEs could benefit particularly from corporate ethical and philanthropic initiatives because these voluntary activities can result in differentiation and reduction of costs. MNEs have a complex organizational structure because they operate in different countries with different institutional profiles (Kostova and Roth 2002). MNEs could significantly reduce their operation costs through the establishment of stringent and effective social and environmental standards within their internal network, including their headquarters and subsidiaries (Christmann 2004; Dowell *et al.* 2000). Accordingly, they could add internal coherence within their business model

(Bartlett and Ghoshal 1989; Kostova *et al.* 2008). MNEs could also increase their revenues by improving their reputation and gaining legitimacy in the various countries in which they operate (Bansal 2005).

Therefore, we propose that MNEs' ethical and philanthropic initiatives can contribute to enhancing their CFP.

Hypothesis 1a: MNEs' ethical initiatives are positively related to CFP.
Hypothesis 1b: MNEs' philanthropic initiatives are positively related to CFP.

The Moderating Effect of Operating in Developing Countries on the Relationship between CSP and CFP in MNEs

Some researchers have posited that firms implement CSR practices because of internal drivers, such as managerial values, CEO compensation, or board structure (e.g. Buchholtz *et al.* 1999; Deckop *et al.* 2006). In contrast, other researchers have proposed that CSR is a response to external pressures (e.g. Aguilera *et al.* 2007; Campbell 2007; Neubaum and Zahra 2006). Consequently, firms decide to perform ethical activities because they are more closely scrutinized by their stakeholders and society and are expected to be superior corporate citizens. Although CSP is not sufficient for legitimization, it appears increasingly necessary as part of firms' 'license to operate' (Chiu and Shafman 2011).

However, MNEs may also develop philanthropic initiatives. Communities desire that firms contribute money, facilities, and employee time to humanitarian programmes or purposes more than they actually do. Therefore, corporate philanthropy is more discretionary or voluntary despite the existence of a societal expectation that businesses provide it (Carroll 1991, 1998).

Both ethical and philanthropic initiatives can be considered a source of competitive advantage. From the resource-based view (RBV) perspective, investing in CSP allows firms to develop new competencies and resources in areas such as human capital, corporate culture, and technology (Barney 1991; Russo and Fouts 1997) that improve stakeholders' wealth in the long term. Godfrey (2005) also argued that philanthropy creates intangible assets for a firm by generating positive moral capital among communities and stakeholders. Thus, adherence to communal obligations and the generation of goodwill represent important sources of the strategic value of philanthropy.

According to Gugler and Shi (2009), MNEs operating in developing countries understand the conception of CSR, often in a philanthropic and ethical sense, such as monetary contribution to communities. Those MNEs with a high presence in developing countries are able to perform a wider set of valuable ethical and philanthropic activities than in developed nations due to developing countries' needs for significant investment to improve sustainable and economic development (Kolk and van Tulder 2010; Porter and Kramer 2011). Through direct foreign investment, MNEs are able to diffuse much-needed resources into third-world countries, such as technology and labour skills (Drezner 2000). Furthermore, country development through foreign direct investment can improve both a country's values and institutions (Matten and Crane 2005). Dickson (2003) argues that corporate philanthropy is especially appreciated when governments do not have sufficient resources to engage in community and social welfare projects, and business contributions can help to alleviate their financial burdens. Wang and Qian (2011) show that firms that are not government-owned or politically well-connected benefit financially more from philanthropy because obtaining political resources is more critical for such firms.

We argue that through ethical and philanthropic initiatives, MNEs may enhance sustainable and economic development in developing countries (Moon *et al.* 2005) and, in turn, improve their own level of CFP. First, MNEs are able to increase significantly their reputation and legitimacy both at the local and global levels (Bansal 2005; Deephouse 2000; Dowell *et al.* 2000). Second, ethical and philanthropic initiatives can become a source of sustainable competitive advantage to MNEs because initiatives take many years to develop (Dierickx and Cool 1989), particularly in underdeveloped areas, and they are difficult to imitate or substitute (Barney 1991). Finally, ethical and philanthropic behaviours can help MNEs to collaborate with other public and private agents based in developing countries (i.e. research and development agencies) and to acquire valuable resources and capabilities that can be implemented within their internal network (including headquarters and subsidiaries) to improve their efficiency and legitimacy.

Therefore, we suggest that a higher level of involvement in developing areas is associated with a greater propensity for a MNE's ethical and philanthropic initiatives to encourage better CFP.

Hypothesis 2a: MNEs' operations in developing countries are likely to increase the positive relationship between ethical initiatives and CFP.

Hypothesis 2b: MNEs' operations in developing countries are likely to increase the positive relationship between philanthropic initiatives and CFP.

IV. Methodology

Sample

We studied a sample of MNEs from the chemical (SIC 28), energy (SIC 29), and industrial machinery (SIC 37) industries. These three industries are appropriate for our analysis because they have a prominent impact on social and environmental issues (e.g. King and Lenox 2000; King and Shaver 2001). We focused on MNEs that have US-based headquarters because of availability of data. US-based MNEs usually exhibit internationalization activities in developed and also in developing countries and possess a diverse institutional profile (Kostova *et al.* 2008).

We considered data available in Capital IQ provided by Standard & Poor's database and used a random sampling method. Financial data were obtained through Capital IQ, and social and environmental data through the KLD database. Our original sample included 300 US MNEs, 100 MNEs from each of the three industries identified above. Because of missing financial and/or social data, our final sample consisted of 113 US MNEs. We had 672 observations for the period 2005 to 2010: 49 MNEs from the industrial machinery industry (289 observations), 45 MNEs from the chemical industry (270 observations), and 19 MNEs from the energy industry (113 observations). We used longitudinal analysis to test our hypotheses.

Variables Measurement – Independent Variables

Percentage of sales in developing regions: To capture the presence of MNEs in developing countries, we divided the sales in developing countries by total sales (sales of all headquarters and subsidiaries were included). Developing countries are those that have not achieved a significant degree of industrialization relative to their populations and have a medium to low standard of living (World Bank 2011). The World Bank (2010) classifies countries into four income groups according to Gross National Income (GNI) per capita: low income countries (GNI per capita of US $1026 or less), lower middle income countries (GNI per capita between US $1026 and US $4036), upper middle income countries (GNI per capita between US $4036 and US $12476), and high income countries (GNI per capita above US $12476). The International Monetary Fund (IMF) uses a flexible classification system of developing countries that considers per capita income level, export diversification, and degree of integration into the global financial system (2009). Following the classifications provided by the World Bank (2012) and by the IMF (2009), we grouped developing countries into the following four regions: Eastern Europe, Latin America (excluding Mexico), Asia (excluding Japan), and Africa (excluding South Africa).

Corporate social performance: We used the KLD database, developed by the firm Kinder, Lydenberg and Domini, to assess the ethical and philanthropic initiatives of MNEs. KLD focuses on the assessment of CSP across eight dimensions related to stakeholders' concerns. To differentiate between *ethical* and *philanthropic initiatives*, we considered those social attributes that emphasized key stakeholder relationships and that have a greater influence on corporate strategy. These attributes were community relations, employee relations, treatment of women and minorities, performance with respect to the environment, and product characteristics (Waddock and Graves 1997). We considered that environmental aspects and product characteristics embrace ethical aspects because they reflect a concern for what the community considers important and fair, despite the fact that these issues may not be addressed by the law. However, we identified community relations, employee relations, and treatment of women and minorities as philanthropic initiatives because these issues are entirely discretionary and are not directly related to a core activity.

We performed an exploratory factor analysis of these five attributes to test whether ethical and philanthropic initiatives were statistically different. We applied a varimax rotation and identified two factors (groups) that are shown in Table 1.

TABLE 1

Exploratory factor analysis of CSP

	Ethical initiatives	**Factor loading**	**Philanthropic initiatives (corporate citizenship)**	**Factor loading**
	Performance with respect to the natural environment	0.77	*Community relations*	0.73
	Product social characteristics	0.66	*Treatment of women and minorities*	0.73
			Employee relations	0.60
Eigenvalues	1.54		1.17	
% of variation	0.45		0.33	
% of acum. variation	0.45		0.78	
Cronbach's alpha	0.70		0.72	

The first factor includes performance related to the environment and product characteristics. Factor 1 is called *ethical initiatives*. The second factor includes performance in relation to community relations, treatment of women and minorities, and employee relations. Factor 2 is entitled *philanthropic initiatives*. Each factor has eigenvalues greater than 1, and all factor loadings are greater than 0.65. With respect to reliability, Cronbach's Alpha exceeded the minimum value of 0.7 recommended by Nunnally and Bernstein (1995) in all the measurement scales. The first factor accounted for less than 50% of the covariation (45% of 78%). The final value of each factor is calculated using the average sum of the attributes of each factor, considering their factor loadings.

Variables Measurement – Dependent Variable

Corporate Financial Performance: Return on assets (ROA) of MNEs was used as a proxy for CFP.

Variables Measurement – Control Variables

– *Type of industry*: To consider the possible effects of the three different industries in the sample, we included two dummy variables: industrial machinery and chemical industries. For each variable, we used 1 when the company belongs to one of these industries and zero otherwise.
– *Firm size*: Size has significant repercussions on organizations' social behaviour and CFP (Aragón-Correa 1998; Bansal 2005). We controlled for firm size using the total revenues for each MNE included in the analysis (sales of all headquarters and subsidiaries were included) (Hitt *et al.* 1997).
– *Financial slack*: Financial slack is used to recognize extra liquidity that could be invested in sustainable development activities. We computed financial slack as current assets of MNEs over current liabilities (Bansal 2005).
– *Percentage of sales abroad*: To capture the degree of firm internationalization, we divided sales in foreign markets by total sales (sales of all headquarters and subsidiaries were included) (Hitt *et al.* 1997).

V. Results

The hypotheses have been tested using panel data estimations. This methodology avoids problems caused by a possible correlation between non-observable firm characteristics and the individual variables (i.e. we eliminated the unobservable heterogeneity that the sample firms could present) (Hausman and Taylor 1981). Unobservable heterogeneity might result in spurious correlations with the dependent variables, which would bias the obtained coefficients.

We first estimated both the fixed effects and random effects models. The fixed effects specification assumes that company-specific effects are fixed parameters to be estimated, whereas the random effects model assumes that companies constitute a random sample. To identify which model is preferable, the Hausman test was performed to determine whether the unobservable heterogeneity is correlated with the explanatory variables (Hausman 1978), which in turn implies that coefficients estimated by fixed-effects estimator and those estimated by the random-effects estimator are not statistically different. Because the result of the Hausman test was not significant, we chose random effects.

We had previously assessed the likely extent of common method variance, the conformity of our data's distribution to the assumptions of our analytic tools and the extent of multicollinearity among the independent variables. Analysis of condition indices and variance inflation factors (VIF) showed that multicollinearity was not a problem for our analysis, with VIF values below five as recommended in the literature (Hair *et al.* 2009). To create the moderating (interacting) terms, we proceeded to fix both the independent and the moderating variables on their means to avoid multicollinearity (Venkatraman 1989). No high correlations among the variables were observed.

Table 2 presents the descriptive statistics and correlations for all variables. Table 3 shows the results of the regression. The model shows good fit, with an R^2 *within* of 0.16.

TABLE 2

Descriptive statistics and correlations

	Mean	Standard deviation	1	2	3	4	5	6	7	8
1. Financial performance (ROA)	0.06	0.04	1							
2. Industrial machinery	0.43	0.50	–0.03	1						
3. Chemical industry	0.41	0.49	0.04	–0.73***	1					
4. Firm size (total revenues)	21.45	45.34	–0.09	–0.05	–0.01	1				
5. Financial slack	0.6	0.43	0.25***	–0.10**	0.10**	0.10**	1			
6. Percentage of sales abroad	9.96	25.69	–0.01	–0.06	–0.02	0.09*	–0.01	1		
7. Percentage of sales in developing regions	0.26	0.26	0.05	0.01	0.03	0.05	0.14**	0.02	1	
8. Ethical initiatives	–0.18	0.58	–0.01	–0.01	0.01	0.05	0.01	–0.1*	–0.05*	1
9. Philanthropic initiatives	0.07	0.38	0.08*	0.08*	–0.03	0.01	0.02	–0.03	–0.07†	0.33***

Number of observations (N) = 672; Number of groups = 113

† $p < 0.10$; * $p < 0.055$; ** $p < 0.01$; *** $p < 0.001$

TABLE 3

Results of the regression analysis with random effects

Intercept	7.74*** (1.98)
Industrial machinery industry	–0.20 (4.64)
Chemical industry	–0.57 (4.74)
Firm size	–0.22 (0.1)
Financial slack	0.31*** (0.03)
Percentage of sales abroad	–0.03 (0.03)
Percentage of sales in developing regions	–0.03 (0.05)
Ethical initiatives	–0.02 (0.02)
Philanthropic initiatives	1.34 (1.28)
Percentage of sales in developing regions x ethical initiatives	–0.01 (0.03)
Percentage of sales in developing regions x philanthropic initiatives	0.07*(0.03)
Wald χ^2	94.00***
R^2 *within*	0.16
Hausman	15.90
Number of observations	672
Number of groups	113

Dependent variable: financial performance (ROA).
Non-standardized regression coefficients are shown.
Standard errors are in parenthesis.
Number of observations (N) = 672.
Number of groups = 113.
† $p < 0.10$; * $p < 0.055$; ** $p < 0.01$; *** $p < 0.001$.

With respect to the control variables, financial slack is positively related to CFP. This result is consistent with previous studies (e.g. Bansal 2005; Orlitzky *et al.* 2003).

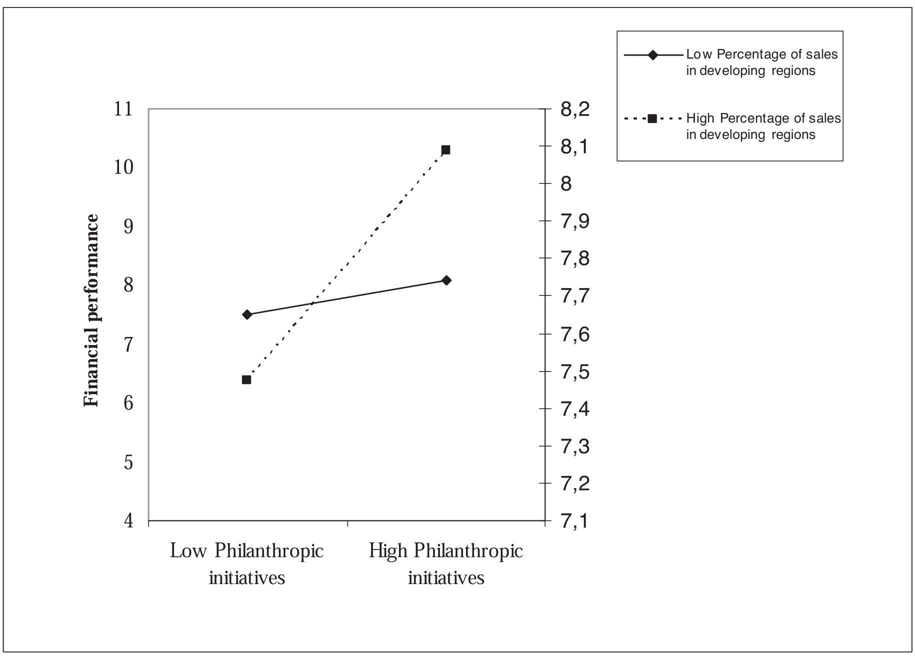
We did not find a direct effect of the MNEs' ethical initiatives on the CFP. Corporate philanthropic initiatives were positively related to CFP, but this relationship was not statistically significant. Therefore, hypotheses 1a and 1b are not supported by our data.

The presence of MNEs in developing countries did not lead these firms to strengthen the positive relationship between ethical initiatives and CFP. Thus, hypothesis 2a is not supported by our data.

Finally, the presence of MNEs in developing countries had a positive moderating effect on the relationship between philanthropic initiatives and CFP. Stated differently, MNEs with a higher presence in developing countries take advantage of corporate philanthropic initiatives to improve their CFP significantly (see Figure 1). Therefore, hypothesis 2b is supported by our data.

FIGURE 1

The moderating effect of MNE's sales in developing regions on the relationship between philanthropic initiatives and financial performance



VI. Conclusions and Discussion

Firms have recently started to engage in activities that have traditionally been considered government activities (Margolis and Walsh 2003; Matten and Crane 2005; Scherer and Palazzo 2008). This phenomenon is especially true for MNEs, which have engaged in public health, education (Matten and Crane 2005; Rosen 2003) and self-regulation to fill global gaps in legal regulation (Scherer and Smid 2000). Furthermore, MNEs can direct resources to protect the natural environment (Hart 1995; Marcus and Fremeth 2009) and promote societal peace and stability (Fort and Schipani 2004). These business activities exhibit a growing involvement of corporations in global business regulation and in the production of public goods (Vogel 2005).

Drawing on corporate citizenship (Carroll 1991; 1998; Matten and Crane 2005), we contribute to the literature by showing that the presence of MNEs in developing countries moderates the relationship between CSP and CFP. This finding is consistent with previous studies that argued that the relationship between CSP and CFP is moderated by internal (e.g. innovation capability) and external (e.g. environmental uncertainty) factors (Aragón-Correa and Sharma 2003; Hull and Rothenberg 2008).

In addition, we extend previous literature by distinguishing different dimensions of CSR. Following Wang and Qian's suggestion, we not only consider corporate philanthropy and its link with financial performance (Porter and Kramer 2002) but also examine ethical initiatives (Wang and Qian 2011). Including ethical initiatives in this study allowed us to consider important aspects of firms such as their environmental and product characteristics. Furthermore, the distinction between philanthropic and ethical activities leads us to a fine-grained analysis. Our findings showed that these two dimensions of CSR have a different impact on the CFP of MNEs that operate in developing countries.

We found that MNEs' presence in developing countries leads these firms to strengthen the relationship between CSR and CFP through philanthropic initiatives. However, we found that MNEs' presence in developing countries does not strengthen the relationship between ethical initiatives and CFP. Ethical initiatives embody standards and expectations that reflect a real concern for what consumers, employees, shareholders, and the community consider fair, despite the fact that these issues may not be addressed by law. In contrast, philanthropic initiatives are commonly believed to stem from a desire to help humankind through acts of charity and can be equated with corporate citizenship behaviour (Carroll 1998). Therefore, compared with ethical initiatives, philanthropic initiatives are more discretionary and contribute directly and to a greater extent to enhancing sustainable and economic development at the country level.

In many developing countries, MNEs' philanthropic initiatives are generally considered to be pragmatic responses to consumer and civil society pressures (Ite 2004). However, philanthropy plays a significant role in establishing and developing favourable relationships with stakeholders (Adams and Hardwick 1998; Berman *et al.* 1999). The reason might be that MNEs are perceived as socially responsible agents of change and global progress, evidenced by the implementation of philanthropic programmes in underdeveloped areas (Kolk and van Tulder 2010). Philanthropic contributions signal to government bodies that corporate managers are sincere in their dealings with stakeholders (Wang and Qian 2011). This phenomenon may mitigate the need for government to impose costly regulations (Adams and Hardwick 1998) and help firms to obtain favourable policies and other support from their governments. Consequently, these firms can clearly and effectively differentiate themselves from competitors, improve transparency (e.g. Christmann 2004), and gain legitimacy and reputation (Bansal 2005; Kolk and Pinkse 2008; Porter and Kramer 2002) because of their proven commitment to the enhancement of society's economic, social, and environmental advancement. Furthermore, philanthropy may also create intangible assets for a firm by generating positive moral capital in communities (Godfrey 2005). For instance, within the firm, an employer-friendly work environment contributes to attracting and retaining talented employees, enhancing employee commitment, reducing absenteeism, and enhancing the corporate reputation (Hemphill 2004; Levering and Moskowitz 2001; Turban and Greening 1997). In summary, this study shows that the impact of philanthropic initiatives on the CFP of MNEs operating in developing countries is greater than similar impacts produced by ethical initiatives.

Our research also has relevant implications for managers and policymakers. CEOs and managers of MNEs are required to focus on social issues by designing strategies that enhance sustainable and economic development worldwide, particularly in developing countries. MNEs can become agents of global change and can promote social and environmental values in society (Kolk and van Tulder 2010). Moreover, managers of MNEs in developing countries should be particularly active in corporate philanthropic activities because these countries are in greater need of political and financial support from governments (Wang and Qian 2011).

Finally, policymakers and regulators should try to homogenize the social and environmental requirements that organizations are required to comply with in the countries where they operate (regardless of the level of economic and social development of the countries). In addition, policymakers and regulators should create mechanisms beyond legal requirements to foster MNEs' adoption of socially responsible attitudes, such as collaboration with public and private entities in research and development activities, agreements with NGOs, or the development of rewards for firms to demonstrate socially responsible behaviours.

Although we made an important contribution, this study has also some limitations. First, all MNEs included in the sample were headquartered in the US. The home country's regulations and institutional conditions influence MNEs' social approaches in the countries where they operate (including developing countries) (Durán-Herrera and Bajo-Davó 2013). Future studies should validate our results using a sample of MNEs headquartered in different countries and/or by including other types of firms, such as export firms or small and medium-sized enterprises. In future research, KLD proxies of social practices could be complemented by other proxies, such as CEO's interviews and questionnaires. Finally, it may be useful to complement our research work by analyzing the role of specific agents such as NGOs or green activists who have the potential to limit or expand the influence of MNEs' social initiatives in developed and developing countries.[1]

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Notes

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