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# The influence of Unions on Companies' CSR profiles: More Internal Policies and Programs, but not always at the expense of External Endeavors.

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## ABSTRACT

This paper compares the CSR profiles of companies operating under the same macroeconomic institutions but with different levels of union density. Drawing from stakeholder and neo-institutional theories that distinguish between internal and external actions, this paper finds that companies initially have to substitute internal for external CSR. After some experience dealing with unions, companies can complement both actions. There is perhaps a reinforcement of mutual trust and loyalty, and has implications for managerial prerogatives.

**Keywords:** Corporate Social Responsibility, Unions, Stakeholder theory

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\*I acknowledge the support from SustainAlytics, which provided me with the main data to undertake this analysis. Readers are advised to contact them directly for data access since their data is proprietary.

## INTRODUCTION

The spread of voluntary corporate initiatives in the environmental, social, and governance domains - commonly referred to as “corporate social responsibility (CSR)” - can be attributed to increased institutional and social pressures for ethical, responsible, and sustainable business practices (Carroll (1979); Aupperle (1991); Campbell (2007); Waddock (2008)). Firms can respond to such pressures by taking actions that are visible to its external stakeholders (e.g. investors, consumers) via better disclosure practices, branding, low involvement with ‘sinful’ industries, and improved product quality control. They can also take internal actions that are most salient to internal stakeholders (e.g. employees). Such actions can be in the form of setting up conditions and work environments that foster health and safety. The scope of CSR activities that a company may undertake can, therefore, affect multiple stakeholders both inside and outside the firm, and it has been shown that a wider gap between internal and external actions, one reflecting more “talk” and less “action” by firms, negatively affects financial performance (Hawn and Iaonnou (2016)). The latter in addition to other studies done over the last decade point to the multitude benefits of engaging in CSR. Indeed, a meta-analysis by Margolis et al. (2007) suggests a significant positive link between CSR and firm financial performance. While a big section of the literature on CSR has been populated with studies that have related social performance to financial performance, there still remains a relative paucity of papers with regards to the interaction between stakeholder demand and corporate supply of CSR. In other words, the link between the various types of CSR that a firm can enact and the particular stakeholder motivation or pressure (or simply the desire to improve corporate image) that leads to such CSR has not been well established. The gaps are both theoretical and empirical.

Consider, specifically, the case of employees as a stakeholder group. Do they have enough power internally - or can they draw sufficient attention to the company - such that their employment rights are upheld in the most suitable manner? Can they, as a stakeholder, pressure the company to mend and improve its health and safety procedures? Can they force the company

to indulge in practices that are also beneficial to society and to the environment? From the corporate point of view, do firms view CSR as a vehicle for better employment relations, better hiring and retention, better reputation building? Such interaction of stakeholder demand and corporate supply is missing in the CSR field, largely because CSR is still a burgeoning field and the spread of and benefits to CSR have only recently become apparent.

This study delves into this important issue by examining whether stakeholder demand and stakeholder pressure influences the CSR profile of a company. It is done in a CSR setting for a number of reasons. First, CSR incorporates many of the attributes that stakeholders desire and lobby for. Such attributes may be internal to the company but may also be external, suggesting a positive externality accruing to other related or non-related stakeholder groups. Second, we know that CSR profiles vary by country, by industry, but also by company. Most of the work in comparative CSR has tended to look at the effect or influence of country-level institutions on CSR differences across countries, with little emphasis on individual corporate constraints (e.g. Iannou and Serafeim (2012); Bluhm and Trappmann (2012); Williams and Aguilera (2008)). Some emerging literature have incorporated individual company variables, but the latter mostly revolve around financial resources (e.g. Gomez and Verma (2012); Hawn and Iannou (2016)). The stakeholder power/pressure aspect has not been explored in the literature, especially from an empirical perspective. Third, despite the best efforts of the company and its stakeholders to monitor and deliver best practices, accidents and controversies happen. In such cases, it would be important to know how the interplay and prior relationship between stakeholders and the company are able to help manage the situation and work out solutions to avoid such problems.

The main theoretical focus of this paper is the interplay of stakeholder pressure and corporate delivery of CSR. Stakeholder theory (e.g. Freeman (1984)) and neo-institutional theory (e.g. DiMaggio and Powell (1991)) are the main driving factors that guide this discussion. I take the view that companies want to meet the demands of their relevant stakeholders (consumers, suppliers, investors, employees). Further, drawing from neo-institutional theory, I posit that higher stakeholder power increases the company's self regulation and leads to the firm

institutionalizing best practices within the firm (internal CSR) and outside (external CSR). In particular, this paper looks at the role of trade unions in the British context. The British context of employment relations (in the private sector) probably offers the best setting to study this question because unions have not been eroded via anti-union legislation such as in the United States, and unions are not institutionalized such as in continental European countries. Instead, unions can (freely) organize bargaining units within individual firms (Metcalf (2003); Hyman (2010)), and this allows for a comparison between heavily-unionized firms and lesser-unionized firms to be able to characterize this interplay between stakeholder (union) pressure and idiosyncratic corporate delivery of CSR.

To test the theoretical predictions, I use an originally-crafted dataset on CSR from SustainAlytics. Financial data are added from DataStream to create a longitudinal sample of firms listed on the FTSE100 index, one of the main market indices in the United Kingdom. Using fixed-effects estimation techniques, this paper finds that in a similar institutional context, higher union density is associated with more internal CSR. Firms listed on the FTSE100 that have a higher union density create more policies and programs that are geared towards improving employee relations, even though this relationship is statistically weak. On the other hand, external CSR performance and union density are related in a U-shaped manner, implying that as union density picks up, companies initially have to “sacrifice” external CSR in order to meet the demands of unions. However, after a certain threshold of unionization, firms are able to invest in policies and programs that are more directly related to external stakeholders as well as meet the demands of employees and unions. As such, overall, this paper finds that the difference between internal and external CSR is positively related to union density but at a diminishing rate. At low levels of unionization, companies have to substitute internal for external CSR, but as unions become more entrenched and management becomes experienced in terms of dealing with unions, the company is able to simultaneously do both internal and external CSR. This is analogous to the economies of scale hypothesis although in this context it is in a much more positive tone given that more unions actually relates to better (external) social performance.

This paper makes at least three contributions to the literature on CSR, and the impact of stakeholders on CSR profiles. First, from a theoretical point of view, although there have been many papers that have looked at institutional differences among countries leading to different CSR practices, there have been very few that have taken an inside look at the corporation, in particular with regards to its key internal and external stakeholders. The industrial relations literature and other literatures are ripe in terms of the influence of unions on R&D (Hirsch (1992)), innovation (Bradley et al. (2015)), and profitability and share value (Ruback and Zimmerman (1984); Abowd (1989); Lee and Mas (2012)). This paper, to the author's knowledge, is the first to look at the influence of unions on corporate social performance. Second, this paper adds a layer of complexity not studied before in the comparative CSR literature. While most papers that deal with comparative CSR ignore within-country idiosyncratic company differences, this paper proposes that these differences are important and play a significant role in explaining individual company responses to CSR at the lowest micro level of analysis. As such, future papers in the comparative CSR sphere could or should exploit these differences as well. Third, from an empirical perspective, this paper adds to a debate that has emerged in the literature about the substitutability or complementarity between internal and external CSR. On the one hand, Matten and Moon (2008) argue that there may be a *substitution* that is necessary between implicit elements of CSR (e.g. bounded by rules and regulations such as collective bargaining) and explicit elements (such as social community involvement and support). On the other hand, Gjolberg (2009) argue that they are complements. The findings of this paper, much more robust and much closer to the corporate stakeholder approach and not limited to using national proxies for collective bargaining strength, suggest that both are at play. At low levels of power exercised by internal stakeholders, substitution takes place, whereas at higher levels, there is complementarity. A finding which has interesting implications for management and perhaps union renewal debates.

The rest of the paper is organized as follows. Section 2 explains the theoretical lenses through which union influence on CSR will be analyzed and develops some testable hypotheses. Section 3 describes the data and methodology that will be used to test the hypotheses. Section 4 details the

results of the paper while Section 5 leads the discussions and concludes.

## **STAKEHOLDER INFLUENCE ON CORPORATE DECISIONS**

CSR proponents offer a somewhat more enlightened view of how firms achieve competitive advantage as opposed to neo-classical economists. The latter consider CSR to be an agency loss; managers pursue CSR for personal gain, not shareholder benefit (Friedman (1970)). This notion of agency loss is based on the definition of CSR in (McWilliams and Siegel, 2001, p.117): “we define CSR as actions that appear to further some social good, beyond the interests of the firm and that which is required by law”. Under this narrow definition of CSR, it is not surprising to come across notions of agency problems when discussing CSR. Proponents of CSR, however, argue that acting in a pro-social manner is actually in the firms’ best interests. Stakeholder theory (Freeman (1984)), the cornerstone of the business case for CSR, highlights the importance of a firm’s relationships with a broader set of individuals and organizations, beyond just shareholders.

Instrumental stakeholder theory (Jones (1995) further clarifies how CSR contributes to the bottom line via its favourable influence on the firm’s relationships with important stakeholders. The importance of stakeholders can be determined by their relative power, legitimacy, and urgency (Mitchell et al. (1997)). The overall logic is that CSR (e.g., generous giving to the community) increases the trustworthiness of a firm and strengthens relationships with important stakeholders (e.g., increases employee satisfaction), which decreases transaction costs and, therefore, leads to financial gain (e.g., decreased employee turnover and more eager talent pool). Such evidence is presented in earlier research such as Dutton et al. (1994); Brekke and Nyborg (2004). Neo-institutional theory posits, amongst other things, that firms strategically undertake two types of actions to meet institutional pressures and gain legitimacy. One type of action is internally focused such as through structural mimicry adopting best practices seen elsewhere, and another type is externally focused which seeks to gain legitimacy from external constituents (Sine et al. (2007); McDonnell and King (2013)). This distinction between internally- and externally-focused actions is analogous to the distinction between internal and external

stakeholders which results mainly from stakeholder theory.

### **Unions as a stakeholder**

One of the most powerful and legitimate stakeholders of a company is its labor unions (assuming there is at least one). How does one analyze the relationship between unions and CSR? A convenient place to start is to consider how European unions view CSR. In Europe, the industrial relations system is such that unions are heavily institutionalized (and protected) within the system. Research by Preuss et al. (2006) suggests five possible union responses to CSR, with most of the unions citing CSR as a threat since it transfers more power and discretion to managers. One of five possibilities that is discussed is that CSR is only a method to improving corporate image (to external stakeholders) while diverting attention from other less popular actions (typically towards internal stakeholders such as employees). This may indeed be true in both the U.S. case as well as the British case, where in the private sector unions are typically weaker than their European counterparts. At the same time, European unions do emphasize that there are some aspects of CSR that they find appealing. For example, (AKAVA, 2001, p. 1), a Finnish union for academic professionals suggests that: “CSR has many aspects, like welfare of personnel, ability to cope and safety at work, promoting equality and diversity, preventing discrimination, promoting lifelong learning, and management of change due to restructuring and ageing employees. These all have a direct impact in staff motivation and productivity”.

Overall, Preuss et al. (2006) finds that unsurprisingly unions emphasize the internal actions of CSR more than the external actions. Unions, for example, emphasize improved work-life balance, better child care facilities, flexible working arrangements. Another element that unions emphasize is that corporations anticipate industrial change and minimize the negative consequences on personnel due to restructuring. However, unions are less interested in company-external elements. Few unions in the research by Preuss et al. (2006) mention corporate community involvement, and even fewer unions are interested in the preservation of the natural environment. Overall, company-internal aspects of CSR dominate the CSR agenda of European unions, which are

largely institutionalized. This begs the question: in a country like the UK, where unions have not been stifled through anti-union legislation, and where unions are not institutionalized but rather free to organize within individual companies, how does the CSR profile of companies look like or differ contingent on their degree of unionization? Do heavily-unionized firms tilt more towards internal aspects of CSR, as opposed to external aspects? This certainly seems to be plausible given the European findings from the interviews in Preuss et al. (2006).

## **Hypotheses**

Despite the fact that CSR has been shown to be positively related to firm value (e.g. Margolis et al. (2007)), CSR remains a costly endeavour (Gomez and Verma (2012)). Further, Hawn and Iaonnou (2016) suggest that firms do not undertake both internal and external actions simultaneously. Few firms seek to “walk the talk”, i.e. internally improve their structures and employment relations systems, along with appeasing external constituents with community giving and other socio-environmental programs. Given that unions prefer to focus the CSR of their parent firm on internal aspects (Preuss et al. (2006)), I expect that in the British context, where unions are free to organize and bargain, they will press the company towards higher internal actions relative to external ones. In other words, the gap between external and internal actions will be lower in firms that are heavily unionized (i.e. complements) relative to firms that have fewer unions (i.e. substitutes). This is because unions are very much a stakeholder that have power, legitimacy, and urgency (Mitchell et al. (1997)). I, therefore formulate the following hypotheses:

**Hypothesis 1.** *Companies with higher union densities develop more internal policies and programs of CSR relative to companies with lower rates of unionization*

**Hypothesis 2.** *Companies with higher union densities develop less external policies and programs of CSR relative to companies with lower rates of unionization*

In order to really capture the influence of unions on internal and external CSR, the direction of influence is not the only consideration. A quadratic functional form of union density may also be

considered to get a better picture of how unions are affecting the CSR profile of their parent company. Given the stakeholder typology developed by Mitchell et al. (1997) that assigns stakeholders on the basis of power, legitimacy, and urgency, I posit that higher union densities put more pressure on companies to meet union demands in an urgent manner such that the internal CSR score of companies rises at an increasing rate with union density. At the same time, with CSR being costly and companies not engaging in both internal and external CSR at the same rate, unions may hinder the external CSR profile, given that larger unions have more power and urgency and pose a credible threat to the operations of the company, especially in a relationship of labour-management conflict such as in the UK. I posit the following hypotheses:

**Hypothesis 3.** *Companies with higher union densities develop internal policies and programs at an increasing rate relative to companies with lower rates of unionization. The curvilinear relationship between internal performance and union density is convex*

**Hypothesis 4.** *Companies with higher union densities develop external policies and programs at a diminishing rate relative to companies with lower rates of unionization. The curvilinear relationship between external performance and union density is convex*

Combining the above hypotheses allows to develop a further hypothesis with regards to the difference between internal and external CSR and degree of unionization. Given the curvilinear relationships expected, I would expect that the difference between internal and external CSR and its relationship to unionization will be positive and convex. That is, more and rapid expansion of internal policies and programs at the expense of external actions. The relationship is not expected to be zero because it has been shown in the literature that companies will always strive to maintain some level of external CSR due to branding, corporate image, and increasingly the positive effect on market value and Tobin's Q (Hawn and Iaonnou (2016)).<sup>1</sup>

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<sup>1</sup>The focus by Hawn and Iaonnou (2016) is on the difference between internal and external CSR only; they do not show results for internal and external CSR respectively.

**Hypothesis 5.** *The relationship between unionization and the difference between the internal and external CSR scores is positive and convex implying greater and more rapid expansion of internal policies and programs at the expense of external actions*

Managers and investors in particular may be interested in the opposite relation: how does the difference between internal and external CSR affect firm value? This was the main question explicated in Hawn and Iaonnou (2016). The main crux of the argument they make is that companies need to “walk the talk” and complement external CSR approaches with internal structures and policies that support those activities. They find that differences between external and internal CSR lead to lower firm value, as measured by Tobin’s Q. While the focus of their paper is different to the stakeholder power, legitimacy, and urgency approach of this paper, it is still beneficial to estimate this relationship, because it is of interest to a broader group of stakeholders. Both internal and external actions would contribute to higher firm value in this light, and for at least two reasons: a) each set of actions improves firm legitimacy, and b) they reduce information asymmetry between the firm and the investor community, some of whom (e.g. pension funds, and other ethical investors) may be interested in the CSR profile of the company they invest in (Cheng et al. (2014); Hawn et al. (2014)). Just like Hawn and Iaonnou (2016), I expect to find that larger differences between external and internal CSR are associated with lower firm value.

**Hypothesis 6.** *Larger differences between internal and external CSR scores are related to lower firm value*

## **EMPIRICAL METHODOLOGY**

### **Sample and data collection**

The sample is constructed from a number of databases. The CSR data for this study were provided directly by SustainAlytics, a global leader in sustainability reporting and Environment-Social-Governance (ESG) metrics. The primary objective of SustainAlytics, it

should be noted, is to provide reliable and comparable information to investors who want to integrate ethical and other social issues into their investment strategy and portfolio. For example, pension funds are often mandated to include CSR in their due diligence process of portfolio decisions. Analysts working for SustainAlytics collect raw data from company reports and other third-party reports (e.g. unions, NGOs, government and Stock Exchange documents) and standardize them into consistent units so that they can arrive at final scores that are comparable across companies. Usually, these scores are at three levels: 1) Environmental, 2) Social, and 3) Governance, and each firm is scored and ranked on a monthly basis relative to a comparable peer group. For example, oil and gas companies would typically be lower in terms of their environment score, as a result of which they cannot be compared to banks and other financial institutions. Rather, SustainAlytics analysts rank companies on a peer-group basis, where companies in similar ‘baskets’ of ESG are pooled together. This idiosyncrasy is not a problem for this paper because I will be using SustainAlytics’ raw scores and industry controls to create my own measures.

ESG data is divided into its three components and each component is then further subdivided into several subcomponents (see Figure 1 for the categories employed by SustainAlytics). For the purpose of this study, I will focus only on the social theme, and its three subcomponents because it is not clear which aspects of governance and environment apply more to internal or external stakeholders. The theoretical approach in Hawn and Iaonnou (2016) is mostly neo-institutional theories and they do consider some aspects such as “percentage of women on the Board of Directors” as internal CSR. However, given that the main theoretical driver of this paper is stakeholder theory, I cannot do that. Percentage of women on the Board of Directors may be appealing to internal stakeholders such as management and labour, but it may also be appealing to investors and potential investors who may view women as more ethical in their business conduct. Similarly, programs to reduce water and energy usage is viewed as an aspect of internal CSR in Hawn and Iaonnou (2016), which may be of interest to employee morale, but it may be of more interest to environmental stakeholders, the media, and other external stakeholders including “green” investors. In other words, I take the view that governance and environment are noisier

measures of internal and external CSR, and social is clearer given that SustainAlytics can delineate between CSR that affects employees (internal stakeholders), and suppliers, clients and the community (external stakeholders).<sup>2</sup> Internal CSR will, therefore, consist of elements of CSR that fall under the category ‘employees’, whereas external CSR will comprise of CSR elements that pertain mostly to suppliers, clients, and society, local communities and philanthropy. To give a couple of examples, under internal CSR, items such as policies with regards to health and safety, work-life balance are considered. For external, items such as policy on certifying suppliers, programs to increase purchase fair-trade materials, community engagement programs are used. Each item is scored out of 100, whereby best performance is 100, next best would be 75 or 50, and so on until the company scores 0 for an item where it fails considerably. In total, the data contains 14 items that make up the internal score (15 - 1(degree of unionization)), and 43 items that make up the external score. Degree of unionization is left out and is used separately as an explanatory variable.

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Insert FIGURE 1 about here.

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Financial data are obtained from Thomson Reuters DataStream database. In particular, the items used are size (market value), profitability (return on equity), opportunistic value or potential of the firm (calculated as Tobin’s Q), liquidity position (calculated as quick ratio). The final sample includes 1190 observations, an unbalanced panel with 96 unique firms from the FTSE100 during the period 2009-2013 (divided into quarters, with 1 quarter in 2009, and full quarters from 2010 to 2013, i.e. a total of 17 time periods). Note that the independent variables will be lagged by 1 quarter.

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<sup>2</sup>The summary statistics will nonetheless include the SustainAlytics measures of total, governance, social, and environment scores.

## Dependent variables

Both of the CSR scores (i.e. internal and external) are obtained by totalling the scores for all of their respective items, and this is done for each company  $i$  at time  $t$ . Note that SustainAlytics usually uses a proprietary weighting standard to score and rank companies contingent on industry (or peer group) belonging. However, I will not use this approach for this study because I have no method to validate or invalidate their proprietary weighting standard. Instead each item that forms the internal CSR score and each item that forms the external CSR score will be assigned equal weight. This follows the convention in the literature from Waddock and Graves (1997); Hillman and Keim (2001); Iannou and Serafeim (2012) and others. Nonetheless, the scores may still be heavily tilted in terms of industry dependence (e.g. certain industries may have more supply chain monitoring issues in general), and therefore, relative standardized scores are then calculated for each of internal and external CSR with respect to an industry  $j$  benchmark at time  $t$ .

$$RelCSRscore_{it} = \frac{CSRTotal_{it} - Min(CSRTotal_{jt})}{Max(CSRTotal_{jt}) - Min(CSRTotal_{jt})} \quad (1)$$

where CSR refers to any *one* of Internal (INT) or External (EXT) CSR score. This method also allows to bound the measures between 0 and 1, and make interpretations more standard, as per Baron (2009).

## Independent variables

With regards to independent variables, union density, as provided by SustainAlytics is used. Some companies have zero unions and, therefore zero union density. Natural logarithmic transformation is applied to market value given the large variation in the data, while the other variables (Return on Equity, Quick Ratio, and Tobin's Q) are kept the same.

## Econometric specification

With the unbalanced panel of 96 firms observed over 17 quarters and to test the aforementioned hypotheses, I adapt a specification that has been used in the CSR literature by Baron (2009) and Iannou and Serafeim (2014). Equation 2 gives the specification that will be used in this analysis.

$$RelCSRscore_{it} = \alpha_i + \beta_0 + \beta_1 QuickRatio_{it-1} + \beta_2 \ln MarketValue_{it-1} + \beta_3 ReturnonEquity_{it-1} + \beta_4 UnionDensity_{it-1} + \beta_6 UnionDensitySquared_{it-1} + \varepsilon_{it} \quad (2)$$

where  $RelCSRscore_{it}$  can be either Internal or External CSR score of company  $i$  at time  $t$  or the difference between the Internal and External CSR scores.<sup>3</sup> Equation 2 is estimated using the fixed effects methodology, as a result of which industry controls are not used. Random effects were used as a check but a Hausmann test suggested that fixed effects estimation will produce more consistent results (p-value of test was around 0.03).

## RESULTS

Table 1 reports descriptive statistics for the main variables of interest. The means, standard deviations, minimums and maximums are shown both across firms and within firms. The summary statistics reveal that there is quite a large variation in the data, whether it be the scores provided by SustainAlytics, or my calculated internal and external CSR scores. The same observation holds for the independent variables as well. Overall, most of the variation happens across firms rather than within firms. However, the variations within are substantial enough to warrant the use of fixed effect modelling. The results that follow will control for these variations by clustering standard errors at the firm level. Note that calculating standard errors for 96 clusters greatly reduces the degrees of freedom of the models and reduces the significance of many

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<sup>3</sup>I also use the scores provided by SustainAlytics (i.e. Total, Environment, Social, Governance) but these are much more noisy than the measures I am using given it is not clear what components of Governance for instance matter most to internal rather than external stakeholders. Also, the weights used by SustainAlytics is proprietary and serves towards purposes of ranking companies: not an objective of this study

variables. Separate results (not shown) using White’s method of controlling for heteroskedasticity show qualitatively similar results but the levels of significance of some variables are higher.

Table 2 shows the pairwise correlations between the main variables of interest. Significance levels are not shown but one observation about union density and company measures is that unions tend to organize more in larger firms, as measured by market value. Also, and this goes in line with Metcalf (2003), unions overall are associated with under-performing firms, as measured by both the Tobin’s Q and Return on Assets. However, with regards to CSR, they do seem to be associated with more socially responsible firms, across all dimensions and measures used. Interestingly, the correlation between unions and internal CSR is much higher than the correlation between unions and external CSR.

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Insert TABLE 1 about here.

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Insert TABLE 2 about here.

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Table 3 presents the main regression results of estimating the internal CSR scores with standard errors clustered at the firm level. Model 1 represents a basic model without the main independent variable of interest: union density. The results show that firms that have a better liquidity position (higher quick ratio) in period  $t - 1$  are able to score higher in their internal CSR policies and programs given that they invest in more internal quality programs and monitoring. Return on Equity in period  $t - 1$  is negatively correlated with internal CSR in period  $t$ . This is an interesting finding, implying that companies that financially do poorly in a certain period will increase the quality of their internal policies and programs in the next period. This is akin to the “damage mitigation” hypothesis posited by Gomez and Verma (2012). Model 2 adds a linear measure of union density, and we find that the previous observations remain (albeit return on assets is insignificant) and that union density in period  $t - 1$  is positively related to internal CSR. A 1 standard deviation increase in union density is associated with a 0.02 (obtained by

multiplying the coefficient with the standard deviation of union density in Table 1) standard deviation increase in internal CSR. Model 3 also adds the square term of union density in order to capture non-linear trends of internal policies and programs as a function of union density. Results show that there is no non-linear trend. Hypothesis 1 is, therefore, sustained while Hypothesis 3 is rejected given that the relationship between internal CSR and unionization seems to be only linear. In specifications that use White's method of controlling for heteroskedasticity instead of firm-level clustering of standard errors, the non-linearity is sustained even though the coefficient on the quadratic term is negative, implying slower rate of expansion of internal programs and policies as union density rises.

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Insert TABLE 3 about here.

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Table 4 presents the main regression results of estimating the external CSR scores with standard errors clustered at the firm level. Model 1 again represents a basic model without the main independent variable of interest: union density. The results show that Return on Equity in period  $t - 1$  is positively correlated with external CSR in period  $t$ , going against the “damage mitigation” hypothesis posited by Gomez and Verma (2012). Firms work more with suppliers, clients, and the community when they perform better in the previous period. This result stands in contrast to the result that is obtained when internal CSR is considered. Different corporate approaches to CSR seem to be working here. When results are bad in a certain period, firms invest more in internal CSR and less in external CSR in the next period. Perhaps, British firms view CSR as a morale and productivity-boosting endeavour. The fact that liquidity position and size and opportunistic value of the firm are not correlated with external CSR in a significant manner also adds credence to the idea that (external) CSR is perhaps a marketing tool employed to improve performance, rather than reflect past performance (the insurance hypothesis in Gomez and Verma (2012)). Model 2 adds a linear measure of union density, and results show that union density in period  $t - 1$  has no significant relationship to external CSR in period  $t$ . However, and as Model 3 shows, this is because there is a very high non-linearity in the relationship between union

density and external CSR. The linear effect of unions on external CSR is negative, implying that there is a substitution effect that takes place. With unions, companies invest less in external CSR, perhaps because they have to devote more resources to internal policies and programs, as argued above in the results of internal CSR. However, this substitution is not binding. The high positive on the square term suggests that substitution ends after some degree of unionization, and in fact the trend reverses such that external CSR and internal CSR go hand-in-hand. In other words, results show that there is both a substitution effect (Matten and Moon (2008)) and a complement effect (Gjolberg (2009)) between internal and external CSR. Hypothesis 2 is, therefore, mildly sustained while Hypothesis 4 is rejected given that the relationship between external CSR and unionization is highly concave.

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Insert TABLE 4 about here.

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The relationship between unionization and the difference between internal and external CSR scores can be looked at in a more coherent way from the results shown in Table 5, where the dependent variable is ‘internal MINUS external’ scores. The three models follow the same procedure as before, with unionization entering in phases. Model 2 suggests a positive relationship between unionization and the difference between internal and external CSR, although the result is statistically insignificant. When union density is entered in as a square term, the results show that the difference increases with union density but only up to a point, after which the reverse happens. A 1 standard deviation increase in union density is correlated with a gap of 0.0785 between internal and external CSR. External CSR picks up more pace so that the difference reduces and even flips in favour of external CSR, given the size of the linear and square-term coefficients. Hypothesis 5 is correct only to a certain extent, and it is, therefore, rejected.

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Insert TABLE 5 about here.

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Post-regression estimates of internal and external CSR scores as a function of union density are shown in Figure 2. As can be seen, internal CSR scores rise with union density but at a diminishing rate. Statistically, given the conservative methods used for estimating standard errors, the observed effects are not significant. With regards to external CSR scores shown on the right panel, we note that external CSR initially falls as union density starts to pick up, but after about 40% union density, the trend is reverse. External CSR picks up rather significantly. With regards to the difference between internal and external CSR, there is quite much to observe from Figure 3. First, the post-regression estimates, holding all else at their means, show that below 10% unionization, companies invest more in external rather than internal policies and programs. Between 12% to 90% unionization, the trend changes and companies score higher on internal CSR rather than external CSR.

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Insert FIGURE 2 about here.

---

More importantly, a further observation is that there are both substitution and complement effects between internal and external CSR. Companies substitute internal for external CSR up to union density levels of approximately 50%. The upward trend means that the difference between internal and external CSR keeps growing as a function of union density, albeit at a diminishing rate. After 50% unionization, internal and external CSR work in tandem. They complement each other, and from Figure 2, we can attribute this to a sharp improvement in external policies and programs. As such, the difference between the two measures falls, and quite dramatically too given that external CSR goes beyond internal CSR after about 90% unionization.

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Insert FIGURE 3 about here.

---

Finally, I also estimate the effect of the difference between internal and external CSR on firm value, as measured by its Tobin's Q. I use a similar approach to Hawn and Ioannou (2016), and carry out this analysis in order to show whether huge differences between internal and external

CSR are detrimental to the firm, i.e. a firm that does not “walk the talk”. The results from Table 6 show that this is not the case, even if I do not control for union density.

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Insert TABLE 6 about here.

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### **Robustness checks**

One of the interpretative concerns of the above results is that union density within firms can change because of two factors, given that union density is measured as the ratio between unionized employees and total number of employees. If we consider specifically the case where union density is rising within firms, there could be two broad reasons for this. First, unions may be getting better at organizing within firms over time. Second, firms may be shrinking in size and total employment, where presumably non-union employees are being laid off rather than union employees, who are generally better protected (Freeman and Medoff (1984)). As such, union density rising may not necessarily mean that unions are getting better at organizing and at (directly) influencing internal CSR, and the difference between internal and external CSR. It may be the case that the company is shrinking in size, as a result of which union density is going up. To consider this aspect, I estimate equation 2 and add the difference in firm size between times  $t$  and  $t - 1$  as an independent variable. Size is here measured by total assets, rather than market value, since it is more correlated with total number of employees at the firm level.<sup>4</sup> This will help control for firm size variations over time. If results are consistent with the earlier reported main estimations, then the interpretation can be that union density is more closely measuring unions’ ability to organize and influence the CSR profile of companies. Table 7 reports the results when difference in size is considered. Models 1 and 2 report results for internal CSR, with union density entering as a linear term only in Model 1 and as a quadratic term in Model 2. The same exposition is done for external CSR (Models 3 and 4), and difference between internal and external CSR (Models 5 and 6).

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<sup>4</sup>Note that I do not have total number of employees in my dataset, which is why I am using the size proxy.

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Insert TABLE 7 about here.

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A comparison between the estimates in Table 7 and the earlier estimates in Tables 3, 4, and 5 show that the earlier results are robust to the inclusion of size difference within firms. While size difference is significant in several specifications, the union density measures have not changed much, both in terms of economic as well as statistical significance. Union influence on internal and external CSR seems to be occurring because unions are better at organizing and/or better at driving corporate policy.

## **DISCUSSION AND CONCLUSIONS**

In order to gain a better understanding of the stakeholder approach to CSR, it is critical to investigate CSR as a good. On the one hand, who demands CSR, and on the other hand, how much CSR can be supplied by a company? This paper uses the stakeholder approach (Freeman (1984)) and a neo-institutional approach distinguishing between internal and external actions (Jones (1995)) to investigate how unions wielding their power, urgency, and legitimacy as stakeholders (Mitchell et al. (1997)) can affect the CSR profile of companies their members work for.

In this endeavour, this paper has attempted to bridge a gap between two streams in the CSR literature. As Bluhm and Trappmann (2012) point out, Matten and Moon (2008) propose that there is a substitution effect between “implicit” CSR and “explicit” CSR, whereby some firms generally devote more attention to following rules and regulations and maintain their image as such, while other firms are more explicit in their CSR practices, often with outlandish community and other social programs. Similarly, Gomez and Verma (2012) and Hawn and Iannou (2016) point that CSR is costly and companies do not actually do both internal and external CSR concurrently and at the same rate. The flip side comes from Bluhm and Trappmann (2012) and Gjolberg (2009) who argue that in certain countries, internal and external CSR are actually complements, and both serve to reinforce each other. The findings of this paper, which uses more

detailed data and analyzes companies rather than country-wide averages mostly used in cross-country comparisons of CSR, show that both elements of substitution and complementarity are at work. A result that was mostly unexpected. At very low levels of unionization, companies do more external than internal CSR, catering to the needs of outside stakeholders more than internal stakeholders. Then, after approximately 10% unionization rate, companies start substituting internal for external policies and programs and this substitution goes on, albeit at a diminishing rate. However, unlike my initial prediction that this substitution goes on until unionization reaches 100%, the trend actually reverses after unionization reaches approximately 50%. External CSR gathers pace and work more as a complement to internal CSR such that the difference between the two narrows. More surprisingly, after 90% unionization, external CSR is higher than internal CSR.

How can we explain these pointedly unexpected but interesting results? The literature on strategic management and CSR may not be very helpful in this endeavour. However, the literature from labour relations may help explain why we see the aforementioned results. First, Metcalf (2003) points out that unions in the UK and USA have been shown to reduce investment in physical capital but increase investment in human capital. This aspect of increasing investment in human capital may extend to the CSR sphere but not necessarily in a narrow sense. It is possible that part of collective agreements and union pressure incentivizes or forces companies to invest in human capital inside but also outside the firm, through educational grants, health care grants, and other donations to the community (external stakeholders). This could be an explanation that could help understand why external CSR goes up after approximately 40 % unionization rate. Unions could achieve this through negotiations but also through their role of monitoring work. For example, Pencavel (1977) emphasizes the role that unions may play in overseeing work performance given that they are in a position of high power and have been allowed to disseminate work payments to workers. A trust-based relationship between management and labour could be at the core of why we see high external CSR when union density goes up. At low levels of unionization, management may have to deal with the shock factor of having to deal with a few

unions while maintaining fairness across the board. Metcalf (2003) terms this the shock effect of unionization, where management may have to initially “sacrifice” external CSR to deal with smaller levels of unionization. More importantly, Freeman and Medoff (1984) proposes that managerial responses to unionism take the form of more rational personnel policies such as lean production techniques and more careful monitoring of work, which reduces organizational slack. As such, it is possible that more rational personnel policies are leaving resources on the table, which the company is shielding from unions and giving to external stakeholders in the guise of external policies and programs. These would explain why we initially see a substitution effect between internal and external CSR and how the gap eventually narrows down such that both are complements given the trust and streamlining (productivity gains) that may take place.

One of the most surprising results is that at the highest levels of unionization (90% and above), the complementarity between internal and external CSR continues to the extent where external CSR is higher than internal CSR. I can attribute this finding to the following. First, as Metcalf (2003) suggests, union presence sometimes results in adversarial style of industrial relations, lowering trust and cooperation. This is certainly true for the UK (Hyman (2010)). At very high levels of unionization, the power struggle between union and management could be severe enough such that management focuses more towards earning warm glow from external stakeholders by investing massively in external CSR while unions battle management for legitimacy. This point was made by Freeman and Medoff (1984), whose argument is that for productivity to rise at the company level, there must be good industrial relations, where the profits can be increased. If industrial relations are poor, then common goals between labour and management will be ignored where each actor may set goals that go against the interests of the company. Further, the relationship between union and management may get even worse if there are multiple unions within the organization. This last point by Freeman and Medoff (1984) bears some resemblance to the CSR sphere here. At 90% or higher levels of unionization, it is highly likely that management is dealing with multiple unions. The relationship and political fights between management and unions, and between unions themselves may get so costly that management and unions lose trust

in each other and each prefer to follow their individual rather than collective goals. This could explain why after 90% unionization, external CSR goes above internal CSR: management is interested in embracing more external stakeholders to build support against unions, which it does not trust and which it finds very difficult to work with. Political explanations are possible.

From a managerial perspective, the results show that large difference between internal and external CSR may be detrimental to firm value. This goes in line with Hawn and Iaonnou (2016) and further adds credence to neo-institutional theorists' view that both internal and external actions need to corroborate for results to be effective.

In conclusion, this paper has demonstrated that unions using their power, urgency and legitimacy can influence a company's CSR profile. Companies initially have to substitute internal for external CSR, but after some experience with dealing with unions, they can do both together. There is perhaps a reinforcement of mutual trust and loyalty. Both are important from a policy perspective but also from a managerial and shareholder perspective, because both likely are associated with higher firm value.

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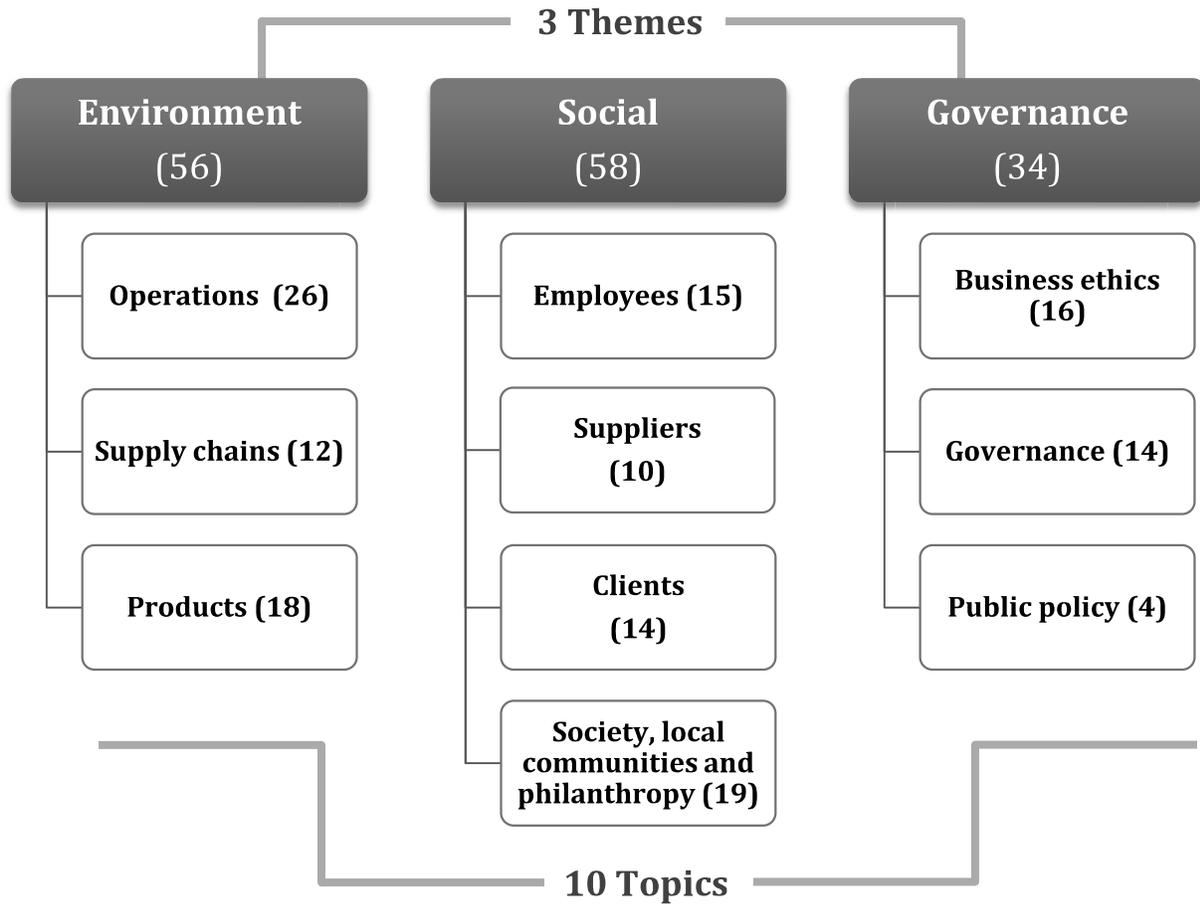
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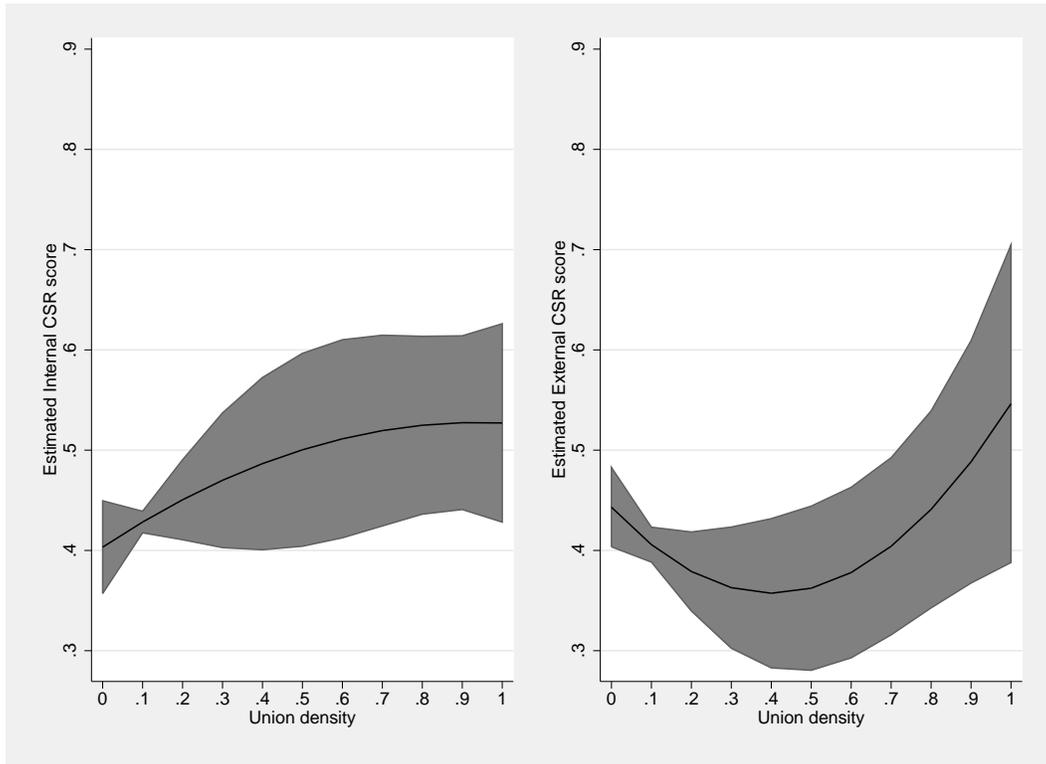
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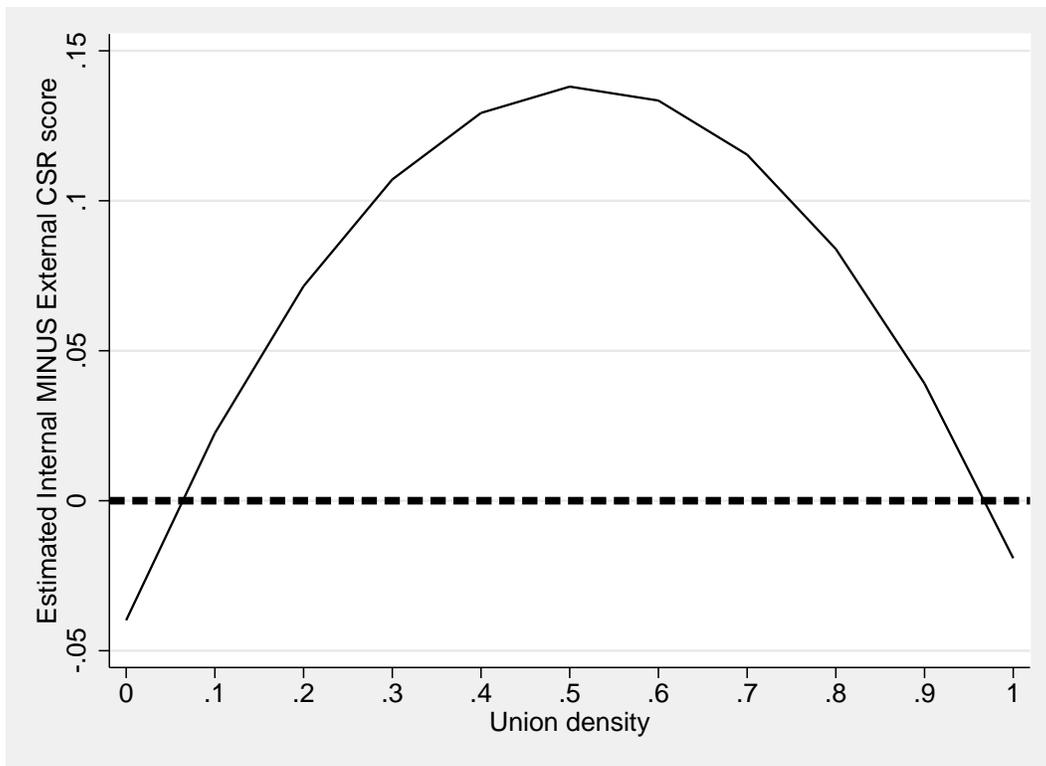
**FIGURE 1:** ESG categories from SustainAlytics



**FIGURE 2:** Estimated Internal and External CSR scores, by union density



**FIGURE 3:** Estimated difference between Internal and External CSR scores, by union density



**TABLE 1:** Summary statistics for main variables of interest

Variable	Variation	Mean	Std. Dev.	Min.	Max.
Total Score	overall	0.519	0.358	0.000	1.000
	between		0.331	0.000	1.000
	within		0.172	-0.364	1.166
Environment Score	overall	0.526	0.349	0.000	1.000
	between		0.318	0.000	1.000
	within		0.182	-0.359	1.173
Social Score	overall	0.506	0.358	0.000	1.000
	between		0.334	0.000	1.000
	within		0.168	-0.326	1.182
Governance Score	overall	0.504	0.359	0.000	1.000
	between		0.318	0.000	1.000
	within		0.196	-0.341	1.239
Internal Score	overall	0.428	0.370	0.000	1.000
	between		0.333	0.000	1.000
	within		0.192	-0.305	1.250
External Score	overall	0.415	0.351	0.000	1.000
	between		0.303	0.000	1.000
	within		0.186	-0.467	1.194
Quick Ratio	overall	0.409	1.399	0.000	21.195
	between		1.044	0.000	9.140
	within		0.876	-8.638	12.464
Tobin's Q	overall	1.599	0.949	0.547	9.949
	between		1.300	0.678	9.949
	within		0.261	0.407	3.302
Market value (£billions)	overall	12.209	18.653	0.00167	132.745
	between		16.868	0.00167	114.729
	within		3.416	-11.978	35.154
Return on Equity (%)	overall	33.876	266.166	-131.290	7206.450
	between		128.221	-131.290	1365.863
	within		231.809	-1195.717	5874.463
Union Density	overall	0.178	0.265	0.000	1.000
	between		0.229	0.000	1.000
	within		0.121	-0.347	0.693

**TABLE 2:** Pair-wise correlations between variables of interest

	Total Score	Environment Score	Social Score	Governance Score	Internal CSR	External CSR	Quick Ratio	Tobin's Q	Market Value	Return on Equity	Union Density
Total Score	1										
Environment Score	0.824	1									
Social Score	0.810	0.553	1								
Governance Score	0.653	0.444	0.422	1							
Internal CSR	0.560	0.345	0.614	0.426	1						
External CSR	0.556	0.395	0.607	0.412	0.396	1					
Quick Ratio	0.0398	0.0249	0.0744	-0.00361	0.0261	0.0240	1				
Tobin's Q	0.129	0.164	0.141	0.0690	0.0257	0.0552	-0.0771	1			
Market Value	0.0851	0.0891	0.0442	0.0804	0.150	0.252	-0.0490	0.0676	1		
Return on Equity	-0.0137	0.00831	0.0115	0.000605	-0.0471	0.0235	0.00664	0.0483	-0.0246	1	
Union density	0.0650	0.0852	-0.00133	0.109	0.180	0.0251	0.00603	-0.155	0.174	-0.0410	1

**TABLE 3:** Fixed effects estimates of Internal CSR score

	(1)	(2)	(3)
	Internal CSR	Internal CSR	Internal CSR
Quick Ratio	0.0144** (0.00424)	0.0141** (0.00419)	0.0146*** (0.00413)
Tobin's Q	-0.0336 (0.0456)	-0.0356 (0.0450)	-0.0314 (0.0443)
Size (Market Value)	-0.0649 (0.0547)	-0.0592 (0.0539)	-0.0661 (0.0585)
Return on Equity	-0.00166*** (0.000303)	-0.00115** (0.000410)	-0.000928 (0.000653)
Union Density		0.154+ (0.0855)	0.265 (0.262)
Union Density squared			-0.141 (0.246)
Constant	1.049* (0.469)	0.975* (0.461)	1.022* (0.488)
Observations	1190	1190	1190
R <sup>2</sup> within	0.019	0.026	0.027

Standard errors clustered at the firm level in parentheses

+  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

**TABLE 4:** Fixed effects estimates of External CSR score

	(1)	(2)	(3)
	External CSR	External CSR	External CSR
Quick Ratio	0.00239 (0.00392)	0.00240 (0.00393)	0.000470 (0.00348)
Tobin's Q	-0.0103 (0.0317)	-0.0102 (0.0317)	-0.0259 (0.0309)
Size (Market Value)	-0.0401 (0.0549)	-0.0404 (0.0552)	-0.0145 (0.0553)
Return on Equity	0.00443*** (0.000519)	0.00440*** (0.000600)	0.00356*** (0.000759)
Union Density		-0.00899 (0.0950)	-0.426 <sup>+</sup> (0.233)
Union Density squared			0.530* (0.251)
Constant	0.781 <sup>+</sup> (0.445)	0.785 <sup>+</sup> (0.450)	0.611 (0.449)
Observations	1190	1190	1190
R <sup>2</sup> within	0.010	0.010	0.025

Standard errors clustered at the firm level in parentheses

<sup>+</sup>  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

**TABLE 5:** Fixed effects estimates of the difference between Internal and External CSR scores

	(1)	(2)	(3)
	Internal MINUS External CSR	Internal MINUS External CSR	Internal MINUS External CSR
Quick Ratio	0.0120* (0.00555)	0.0117* (0.00561)	0.0142** (0.00515)
Tobin's Q	-0.0233 (0.0568)	-0.0254 (0.0563)	-0.00551 (0.0544)
Size (Market Value)	-0.0248 (0.0661)	-0.0188 (0.0670)	-0.0516 (0.0689)
Return on Equity	-0.00610*** (0.000613)	-0.00555*** (0.000719)	-0.00449*** (0.000949)
Union Density		0.163 (0.118)	0.691* (0.306)
Union Density squared			-0.670* (0.304)
Constant	0.269 (0.556)	0.190 (0.561)	0.411 (0.564)
Observations	1190	1190	1190
$R^2$ within	0.009	0.014	0.028

Standard errors clustered at the firm level in parentheses

+  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

**TABLE 6:** Fixed effects estimates of the difference between Internal and External CSR scores on Tobin's Q

	Tobin's Q
Quick Ratio	-0.0655*** (0.00651)
Size (Market Value)	0.443*** (0.121)
Internal MINUS External CSR	-0.0337 (0.0603)
Return on Equity	0.00140+ (0.000771)
Union density	0.0520 (0.125)
Constant	-2.049+ (1.036)
Observations	1190
$R^2$ within	0.180

Standard errors clustered at the firm level in parentheses

+  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

**TABLE 7: Fixed effects estimates of Internal and External CSR scores, when size differences are considered**

	Internal CSR			External CSR			Internal MINUS External CSR		
	(1)	(2)	(3)	(4)	(5)	(6)			
Quick Ratio	0.0147*** (0.00427)	0.0152*** (0.00424)	0.00307 (0.00416)	0.00112 (0.00366)	0.0116* (0.00559)	0.0141** (0.00513)			
Tobin's Q	-0.0394 (0.0455)	-0.0355 (0.0448)	-0.0121 (0.0320)	-0.0280 (0.0312)	-0.0273 (0.0567)	-0.00749 (0.0549)			
Size (Market Value)	-0.0603 (0.0552)	-0.0667 (0.0597)	-0.0423 (0.0567)	-0.0160 (0.0569)	-0.0180 (0.0688)	-0.0507 (0.0705)			
Return on Equity	-0.00117** (0.000422)	-0.000961 (0.000682)	0.00438*** (0.000608)	0.00351*** (0.000776)	-0.00556*** (0.000726)	-0.00447*** (0.000974)			
Union Density	0.151+ (0.0879)	0.256 (0.273)	-0.0107 (0.0974)	-0.442+ (0.240)	0.162 (0.121)	0.698* (0.318)			
Union Density squared		-0.133 (0.254)		0.542* (0.256)		-0.674* (0.312)			
Size at <i>t minus</i> size at <i>t - 1</i>	-7.84e - 10** (2.34e - 10)	-7.62e - 10** (2.48e - 10)	9.24e - 10* (4.30e - 10)	8.34e - 10+ (4.29e - 10)	-1.71e - 09** (3.90e - 10)	-1.60e - 09*** (4.03e - 10)			
Constant	0.992* (0.471)	1.035* (0.498)	0.805+ (0.463)	0.630 (0.462)	0.187 (0.576)	0.406 (0.578)			
Observations	1190	1190	1190	1190	1190	1190			
R <sup>2</sup> within	0.028	0.029	0.011	0.027	0.015	0.029			

Standard errors clustered at the firm level in parentheses

+  $p < 0.10$ , \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$