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Corporate Reputation and an Insurance Motivation for Corporate Social Investment

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This paper explores an under-researched motive for corporate social investment (CSI): that of insurance. Building on a paper by Godfrey (2005), we argue that social investment insures companies against stakeholder reactions to socially irresponsible acts. We offer predictions regarding the distribution of insurance-motivated social investment across firm characteristics, and highlight the possibility that this form of insurance drives firms towards greater social irresponsibility. Thus, we argue that the overall impact on social welfare of insurance-motivated social investment is ambiguous. An exploratory analysis shows the pattern of charitable giving among large UK companies to be broadly consistent with an insurance motivation for such expenditures, and we discuss a case study that is indicative of an insurance function for CSI.

- **Corporate social investment**
- ***Corporate philanthropy***
- **Corporate reputation**

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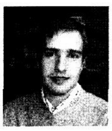

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IN RECENT YEARS, MULTIPLE STAKEHOLDER GROUPS HAVE EXERTED INCREASED pressure on organisations to demonstrate their social responsibility. This has, in turn, increased the strategic significance of corporate social responsibility (CSR). In a recent speech the UK's Chancellor of the Exchequer, Gordon Brown, highlighted the evolving nature of social responsibility, stating that,

> corporate social responsibility is a recognition, in part, that in business trust is critical to success; that reputation management is essential; that a brand must enjoy people's confidence; that long-termism matters; and that there is something in corporate responsibility that is the smart solution for business and for long-term economic growth (Brown 2003).

The increasing importance of corporate social performance (CSP) has been recognised within the academic literature by a proliferation of conceptual and empirical work. The literature has paid particular attention to the relationships between CSP and corporate financial performance (Waddock and Graves 1997; McWilliams and Siegel 2000), consumer perceptions of product quality (Sen and Bhattacharya 2001), employee morale, productivity, recruitment and retention (Turban and Greening 1997), and company ownership characteristics (Graves and Waddock 1994; Johnson and Greening 1999).

Conceptual and empirical work has argued that social responsibility is motivated by a desire to improve relationships with key members of a firm's stakeholder constituency, either in an attempt to better manage their impact on the firm or to enhance the organisation's legitimacy (Hillman and Keim 2001). Other literature has suggested that social responsiveness results from the exercising of managerial discretion, or arises out of an altruistic desire to contribute to the advancement of society (Young and Burlinghame 1996). Some contributions have stressed the compatibility of social responsibility with the financial performance of the organisation, while others have argued that increased social responsiveness promotes the misallocation of firm resources and therefore to reduced financial performance (Griffin and Mahon 1997; Jensen 2002).

This paper explores an under-researched motivation for corporate social investment (CSI): that of insurance. Godfrey (2005) hypothesises that stakeholder perceptions of corporate social responsiveness influence the propensity for society to punish socially irresponsible acts by companies. He goes on to argue that CSI protects the value of reputational capital and concludes that, 'Corporate Citizenship creates shareholder value' (Godfrey 2005). Indeed, the idea that social investment helps protect a firm against potential reputational losses fits well with empirical evidence that the link between philanthropy and reputation is stronger among companies that more frequently violate occupational health and safety and environmental regulations (Williams and Barrett 2000).

In the next section we outline explanations for social investment that represent the received wisdom in this area. We then describe the case for an insurance motive for CSI provided by the insights of Godfrey, before turning to the two key contributions of this paper. First, we draw on standard models of insurance in examining the implications of this motive for firm behaviour. In particular, we highlight the ambiguous social consequences of insurance-motivated social investment. Second, we build on our earlier discussions and develop testable hypotheses that arise from modelling social investment as a form of insurance. We then conduct an exploratory empirical analysis of the cross-industry pattern of corporate philanthropic expenditures, in which we find significant cross-industry variation in the pattern of philanthropic expenditures that is consistent with an insurance motivation. Furthermore, we discuss a case study that is indicative of an insurance function for CSI.

Standard explanations of social investment

Stakeholder theory has become the dominant conceptual approach within the social investment literature[1] (e.g. Clarkson 1995; Mitchell *et al.* 1997; Hillman and Keim 2001). Within this view, implicit contracts exist between society and corporations such that society's willingness to sanction the economic activities of businesses is contingent on their operation 'within the bounds and norms of society' (Brown and Deegan 1998: 22). Social investment provides a means by which corporations can demonstrate legitimacy by being seen to behave as good corporate citizens.

Hence, stakeholder theory views social investment as a response to significant pressures from a firm's external environment. Such pressures may arise from pressure groups (Tilt 1994) or the general public (Neu *et al.* 1998), and may be specific to those industries where particular issues arise (Patten 1992). For example, an extensive literature argues that industries have inherently different environmental impacts (e.g. Halme and Huse 1996). Industries with a high environmental impact are characterised by their association with highly visible environmental issues (Bowen 2000) such as climate change and the risk of oil spills. The activities of firms in these industries are subject to intense scrutiny from environmental stakeholders. Earlier empirical work has identified a number of sectors as having high environmental impacts: for example, the metals, resources, paper and pulp, power generation, water and chemicals sectors (Morris 1997; Sharma 1997; Hoffman 1999; Bowen 2000; Clemens 2001). In contrast, other industries, particularly newer manufacturing industries and the service sector, have significantly lower environmental impacts and are associated with fewer highly visible environmental issues.

The tobacco and alcoholic drinks industries are associated with highly visible social issues. They are thought to produce large social externalities (e.g. crime and ill-health) and are subject to strong regulatory regimes (competition, safety and taxation). Similarly, the defence and pharmaceutical industries are subject to considerable pressure from ethical pressure groups. In the case of pharmaceutical companies this reflects concern over pricing and distribution policies in advanced and developing countries[2] and ethical concerns over experimental techniques (e.g. animal rights issues).

Also, it is rather more important in some industries than in others that customers trust the firm: for example, retailing, finance, consumer goods. In such industries, a firm's fortunes will tend to be more closely dependent on its reputation. Thus, in these industries one would expect a firm to accrue a greater reward from augmenting its reputation by means of a strong record of social investment.

Faced with such pressure, corporations have a variety of strategic opportunities available to them. Oliver (1991) establishes a typology of corporate response to institutional pressures from passive conformity or acquiescence to more active compromise, defiance or strategic manipulation. The choice between these options is contingent on certain firm attributes. Much of the social investment literature has emphasised the importance of corporate visibility, commonly proxied by firm size and media exposure. The media acts as an agenda setter, and not merely a mediator, in the relationship between companies and their stakeholders (Adler and Milne 1997; Brown and Deegan 1998). Media coverage 'influences the preferences of the populace and helps set the pub-

1 As mentioned at the beginning of the paper, another view, one that has received less attention in recent years, casts social responsiveness as a discretionary act of management. In focusing on stakeholder theory, we concentrate on the received wisdom in this area, and on an explanation of CSI that derives from an analysis of the firm as an optimising decision-maker.

2 Recent examples include concern over the pricing and distribution policies of AIDS-related drugs in South Africa and continuing concern over the marketing of prepared baby foods.

lic agenda' which, 'in turn generates constituency pressure' (Erfle and McMillan 1990: 123). Thus, organisations that have a higher degree of media exposure tend to be more prone to pressure from social and political stakeholders. This fact may stimulate a higher propensity to undertake social investment.

To summarise, the stakeholder perspective proposes that the motivation for social investment varies systematically across industries and firms. It predicts that CSI is positively related to firm size and media exposure, and is more common in industries with a highly visible environmental or social impact, and in industries in which reputation is relatively more important.

The insurance motive for social investment

At the heart of any act of insurance there is a party that makes a payment in order to mitigate its loss in some state of the world. Most crucially, for social investment to be plausibly thought of as a form of insurance behaviour it is necessary that we can identify the nature of the loss events, the sense in which those events are uncertain, and the mechanism by which CSI mitigates potential losses.

Before considering each of those points in turn, it is worth noting the absence of many institutional facets of conventional insurance markets. For example, there is neither an actual insurance company that pays out if a bad event occurs nor an insurance contract that details the schedule of benefits that the insured receives in particular states of the world. Nevertheless, social investments are a form of insurance in that they protect the value of a company's reputational asset from the harm that accompanies events that are perceived by stakeholders as indicators of social irresponsibility.

The nature of loss events

Following stakeholder theory, Godfrey (2005) argues that, in the context of social responsibility, loss events are socially damaging acts that reduce the value of a company's reputation in the eyes of its stakeholders. A firm is subject to the influence of a variety of agents on which it is reliant for its legitimacy and that, to varying degrees, have the power to affect the achievement of its objectives (Freeman 1984; Donaldson and Preston 1995). Both conceptual contributions and empirical findings suggest that negative stakeholder reactions to corporate social irresponsibility can have a significant impact on companies. For example, stakeholder reactions to alleged marketing abuses spawned the long-running series of boycotts of Nestlé products (Post 1985) and a large number of product safety crises have led to a variety of costly remedial actions (Siomkos 1999).

The uncertainty of loss events

We wish to argue that the incidence of reputational loss is uncertain, rather than the simple deterministic outcome of company decision-making. There are two senses in which loss events associated with social irresponsibility are uncertain, at least one of which must hold for insurance against such losses to be viable. First, there might be an uncertain relationship between company decision-making and the occurrence of a loss event. Note that this does not imply that companies are unaware of (or have no effect on) the likelihood of the loss event but simply that the link is not subject to certainty. For example, the likelihood that an airline experiences a plane crash, that an oil company's supertanker runs aground, that an energy company's nuclear generator melts down or that a drug company's new product has unforeseen side-effects can be estimated, and is influenced by company investments and policies. Nevertheless, those, and other events that might be interpreted by stakeholders as evidence of social irresponsibility, are uncertain in the sense that they occur with a probability that is positive but less than one. Furthermore, this uncertainty appears to be recognised by companies as some part of the motivation for social investment. The corporate communications manager at British American Tobacco recently acknowledged that 'its products are risky, and perceives its challenge as not just ensuring the company is responsible in a controversial industry, but being recognised as such by its stakeholders' (Beadle and Ridderbeekx 2001).

Second, an uncertain relationship could exist between the experience of a socially irresponsible event and the existence and severity of stakeholder reactions. Stakeholders might not become aware of socially irresponsible behaviour by companies and consequently such acts may go unpunished. As well as constituting an important stakeholder group in its own right, it has been argued that the media plays an important role as intermediaries between companies and other stakeholder groups as well as acting as an 'ombudsman' in evaluating corporate behaviour (Wright 2001). The role of the media can be particularly important during events that involve social irresponsibility. Murphy and Dee (1992) highlight the complex role that the media can play in mediating the relationship between Greenpeace and the DuPont company. Wright (2001) argues that effective management of company–media relationships can greatly enhance a company's ability to cope with a product safety crisis.

The loss-mitigation effect of CSI

Given the plausibility of uncertain losses in reputational capital, it remains to describe the mechanism by which social investments mitigate such losses. A close relationship between corporate reputational capital and social responsibility has been identified in the literature (McGuire *et al.* 1988; Fombrun and Shanley 1990; Fryxell and Wang 1994). Godfrey (2005) argues that stakeholders take evidence of a good corporate reputation, established through social investment, as evidence of good *character* when they decide how much to punish a company following a socially irresponsible act.[3]

One might argue that insurance-motivated CSI will be observed by stakeholders as such, judged to be cynical, and will fail to be regarded as evidence of good corporate character.[4] Indeed, if stakeholders can observe motive, there is little reason to believe that potential reputational losses would be mitigated by insurance-motivated CSI; that is, if widely observed, the motive disappears. Thus, we require there to be asymmetric information between the firm and its stakeholders regarding the motive for CSI, and feel that there are three reasons to expect that there is: (i) motive is far less (more) easily observed (concealed) than behaviour; (ii) firms can, and many firms do, undertake elaborate social reporting that casts in a favourable light their motivation for CSI; (iii) in the formulation of an insurance-motivated CSI strategy, there is no *requirement* for any easily observable relatedness to the firm's operations—a relatedness that may promote a connection in the minds of stakeholders between CSI and the core financial objectives of the firm—rather, the firm must merely seek to undertake whichever type or scale of CSI that will best engender assessments of good character among stakeholders.

3 This echoes recent work that has highlighted a tendency for a firm's reputational asset to protect its stock market valuation against shocks or crises (Jones *et al.* 2000; Fombrun and van Riel 2003).

4 This echoes arguments forwarded by Frank (1988), which propose that a record of strong CSP is difficult to sustain without an underlying organisational commitment to broader CSR issues.

Siomkos (1999) examines consumer perceptions of corporate responsibility in the context of product safety crises. He finds that firms are 'more likely to be held responsible for the harmful product if they are low in reputation' (Siomkos 1999: 23). Furthermore, he finds that 'consumers will be more likely to attribute the reason for the defective product to other factors, not controllable by the company' (Siomkos 1999: 23) arguing that 'a company's favourable reputation and image with consumers may act as a preventive device against negative consequences of a future crisis' (Siomkos 1999: 25).

Summary

Corporate reputations are vulnerable to significant losses that accompany instances of social irresponsibility as they provoke negative stakeholder responses. The incidence of such losses is uncertain owing to uncertain occurrence of, and/or stakeholder reaction to, socially damaging events. Social investment, by establishing a positive reputation in the eyes of stakeholder groups, helps to mitigate the impact of those negative events by reducing the likelihood that stakeholders attribute blame to the company concerned. Therefore, firms may pre-emptively insure against such losses by engaging in social investment.

Some lessons from insurance theory

In this section we introduce and explore the implications of two widely known phenomena from the insurance literature: adverse selection and moral hazard. Following this, we examine the implications of these phenomena for the impact of corporate social investment, thus motivated, on social welfare.

Adverse selection

In standard insurance theory the agent taking out insurance is commonly presumed to have greater knowledge than the insurance company concerning the likelihood of the events being insured against. Given the presence of asymmetric information, standard insurance theory predicts that the propensity to engage in insurance behaviour depends positively on both the probability of a loss occurring and the size of the potential loss. This is the phenomenon of **adverse selection** whereby the population of insured agents consists disproportionately of vulnerable agents for whom there is a high probability of a loss event.

In the context of social responsibility, these arguments suggest that companies choosing to engage in insurance-motivated social investment are likely to be those facing high probabilities of events that threaten the value of their reputational capital. Similarly, companies have more incentive to seek insurance the larger the losses they face. We address the empirical implications of this in the next section.

Moral hazard

The expected negative impact of an uncertain event can be mitigated either by insuring against losses that occur in bad states of the world or by taking steps to reduce the likelihood of such events. The seminal insurance literature introduces the concept of moral hazard, which describes 'the tendency of insurance protection to alter an individual's motive to prevent loss' (Shavell 1979: 541). There is widespread empirical evidence in support of the existence of moral hazard in insurance markets. For example, Doherty

(1980) finds a significant and negative relationship between the extent of company fire insurance and the propensity for companies to install fire prevention systems.

The existing literature has argued that CSR is a fundamentally multi-dimensional activity that encompasses a large and varied range of corporate behaviour in relation to its resources, processes and outputs (Carroll 1979; Waddock and Graves 1997). Some CSR behaviour reduces the impact the company has on society. For example, companies might invest in cleaner technologies, improve product designs to incorporate recyclability or institute systems that encourage non-discriminatory work practices. These aspects of CSR help to reduce the likelihood that a company is involved in socially irresponsible events. Other aspects of CSR, such as making social investments and increasing levels of reporting and disclosure, have no direct impact on the likelihood of negative events but help to manage stakeholder relationships.

Insurance theory predicts that decisions regarding these two types of social responsibility expenditure are interdependent. Specifically, moral hazard suggests that these two types of social responsibility are strategic substitutes in the sense that, other things being equal, companies that insure against loss of reputation will be less likely to engage in activities that reduce the likelihood of social irresponsibility. The presence of an insurance motive for social investment may therefore generate incentives for firms to avoid the costs of reducing the probability of acts of social irresponsibility and therefore contribute to a higher incidence of such events.

The link between insurance-motivated social investment and social welfare

Despite the long-running controversy concerning the value of corporate social responsibility to society, much of the literature implicitly or explicitly supports the idea that, broadly speaking, social responsibility is *good* for society. For example, Godfrey (2005) proposes that the insurance argument he outlines provides 'a rationale for *every firm* to engage in sustainable Corporate Citizenship activities, based on the economic merits of wealth preservation' (Godfrey 2005: 121). If social investment leads to enhanced shareholder wealth and social investment has a positive direct impact on society, it is tempting to conclude that insurance-motivated social investment is generally beneficial (Godfrey 2005).

However, as we argued above, given that a firm makes social investments that protect the value of its relationships with its stakeholders, it has an incentive to avoid additional costs associated with reducing the likelihood or severity of damaging events. The fact of being insured alters the behaviour of insured companies in such a way as to increase the prevalence of events that bring negative consequences for society. Thus, the net welfare impact of CSR activities may be negative.

To summarise, moral hazard implies that firms engaging in insurance-motivated social investment will be less socially responsible than they would be absent the insurance afforded by social investment. This implies that social investment acts to promote both social responsibility and social irresponsibility.

The incidence of insurance-motivated CSI

Earlier, we suggested that standard insurance theory predicts that more vulnerable companies are more likely to engage in insurance-motivated social investment. In this section we address several influences on that vulnerability that are highlighted in the CSR literature.

The nature of activities

The probability that a company faces some event that threatens its relationships with stakeholders is, in part, determined by the industry in which the company operates. For example, we have discussed the manner in which industries differ in perceived social and environmental impact, and ethical positioning. High environmental impacts in the metals, resources, paper and pulp, power generation, water and chemicals sectors attract the attention of environmental pressure groups and lead other stakeholders to focus on environmental issues. High social impacts in the tobacco and alcoholic drinks sectors, and the ethical questions surrounding the defence and pharmaceutical sectors have corresponding effects on stakeholder activism.

Corporate visibility

The likelihood that stakeholders discover, and react to, negative events is influenced by organisational visibility. Specifically, organisations that are more visible to stakeholders will be subject to greater stakeholder pressure (Oliver 1991). Organisational size has been employed as a proxy for organisational visibility in several existing studies (Henriques and Sadorsky 1996; Bowen 2000; Clemens 2001). Larger organisations may be subject to higher levels of stakeholder pressure since they tend to have more employees, shareholders and customers. Echoing the previous section, one would also expect variation across sectors. Visibility would be expected to vary according to the presence of well-established pressure groups, and/or government regulation (e.g. the oil, energy, pharmaceuticals, chemicals, tobacco and alcoholic drinks sectors). Such stakeholder bodies are associated with relatively stringent scrutiny of corporate behaviour. Thus, for firms under such scrutiny, it is relatively more likely that any social irresponsibility will be detected.

The importance of reputation

The propensity for a company to engage in social insurance depends on the expected impact of reputational loss. Specifically, the more significant the loss events, the more likely the firm is to engage in social investment. Here, in referring to the impact of an act of social irresponsibility, we refer to the impact on the firm's profits rather than the impact on society as a whole. The greater a firm's dependence on its reputational capital for its financial performance, the greater the likely impact on profitability from a reputational loss. Therefore, such firms have a larger incentive to engage in insurance-motivated social investment. In contrast, a firm with no reputational capital will not engage in insurance-motivated social investment because it has nothing to lose if a bad event occurs. As mentioned previously, one would expect a relatively high dependence on reputation in industries where it is relatively important that customers trust the firm: for example, retailing, finance, consumer goods.

Summary

These discussions suggest that the propensity for a company to engage in insurance-motivated social investments will be systematically related to the likelihood that it faces a loss event and to the size of that event. The likelihood of experiencing a loss event is higher in industries with significant social or environmental impacts (e.g. the energy, chemical, tobacco, alcoholic drinks or pharmaceutical industries) and higher for firms who are highly visible to stakeholder scrutiny (because of their size, because of the presence of regulation or because of the presence of well-established pressure groups). The size of a loss event varies across industries, but is also determined by the size and strategic importance of reputational capital, such that firms with relatively important reputations have a relatively large incentive to engage in insurance-motivated social investment.

A consideration of empirical evidence on CSI

The findings of empirical work on corporate social investment form a broadly consistent literature. Taken together, it provides support for a positive effect on CSI from firm size and corporate visibility (McElroy and Siegfried 1985; Adams and Hardwick 1998; Saiia 2000) and for a systematic variation in social investment behaviour across business sectors. As mentioned previously, it provides evidence that the greatest incentives to undertake CSI are to be found in: the environmentally sensitive metals, resources, paper and pulp, power generation, water and chemicals sectors (Morris 1997; Sharma 1997; Sharma *et al.* 1999; Hoffman 1999; Bowen 2000; Clemens 2001); the socially sensitive tobacco and alcoholic drinks sectors; the ethically sensitive defence and pharmaceutical sectors; and the reputation-sensitive retailing, finance and consumer goods sectors.

Indeed, these findings seem to be echoed in the charitable contributions of the 500[5] largest publicly listed UK companies.[6] Corporate donations for 2001 were extracted from the annual report and accounts of these firms using DataStream. DataStream also identifies each firm's principal business activity (at a level of aggregation roughly equivalent to the three-digit SIC); on this basis, each firm was allocated to one of 13 sectors. Thus, we focus here on only one component of CSI, but, as charitable giving tends to be the largest component (Casson 1993; Adams and Hardwick 1998), any patterns observed will tend to exert a sizeable influence on overall patterns in social investment.

Table 1 provides a sectoral breakdown of corporate giving. Informed by our earlier discussions, we draw distinctions between those sectors that face significant risk to reputation (including the resource, paper and publishing, and chemicals and pharmaceuticals sectors), those sectors for which reputation is a relatively important competitive factor but which do not face significant risk to reputation (including the finance and retail sectors), and other sectors.

Cumulatively, these companies contributed over £500 million to charities in the fiscal year 2001. However, Table 1 indicates that aggregate charitable giving is spread very unevenly across sectors. For example, the 99 companies (comprising roughly 20% of the sample) identified as operating in 'high-risk' sectors collectively make over 53% of the total donations to charity made by sample companies. Similarly, the 127 firms (26% of the sample) classified as being active in sectors where reputation plays a highly significant competitive role contribute almost 39% of total donations. In contrast, while companies allocated to neither of these categories comprise the majority of the firms in the sample (271 firms, 54% of the sample), together they contribute less than 8% of total donations across the sample. Indeed, of the 40 pair-wise comparisons between each sector in the last group (others) and each of the sectors in the first two groups, 39 show the higher level of average giving per firm in the 'high-risk' and 'reputation-significant' sectors to be statistically significant at a 95% level of confidence.[7]

5 Complete data were available for 497 of these companies; these 497 firms constitute the effective sample.

6 The Companies Act 1985 obliges companies to disclose the level of their charitable giving in their annual report and accounts.

7 The exception is the difference between the rate of giving by utilities and transport sectors for which $p = 0.108$.

Sector	Number of companies	Total charitable contributions (£)	Average charitable contributions (£)	Average charitable contributions per employee (£)
High-risk sectors				
Chemicals/pharmaceuticals	25	91,435,000	3,657,400	58.6
Resources	32	106,424,000	3,325,750	56.4
Utilities	13	6,959,000	535,308	70.1
Paper and publishing	21	26,345,000	1,254,524	78.4
Alcohol and tobacco	8	39,488,000	4,936,000	105.6
Reputation-significant sectors				
Retail	39	32,227,000	826,333	17.8
Consumer goods manufacturing	34	43,015,000	1,265,147	12.9
Finance	54	121,049,000	2,241,648	141.8
Other sectors				
High technology	52	11,181,000	215,019	16.0
Transport	24	5,747,000	239,458	19.7
Construction	71	5,692,000	80,169	278.9
Engineering	34	7,277,000	214,029	10.2
Services	90	8,893,000	98,811	17.7

Table 1 BREAKDOWN OF FIRM CHARITABLE GIVING BY SECTOR

In addition to the disproportionate contribution to total corporate giving from the 'high-risk' and 'reputation-significant' sectors, giving per employee is also much higher in those sectors. This is particularly clear among the 'high-risk' sectors where, on average, firms give upwards of £55 per employee to charity each year compared with significantly lower rates of giving in almost all other sectors. The anomalously high level of giving per employee in the construction and real estate sector is probably explained by two factors. First, a number of these companies are large in terms of assets but very small in terms of employment. Subcontracting of work is prevalent in the sector and so the reported level of employment excludes the large number of workers indirectly employed by these companies.

Such patterns in charitable contributions, and social investment generally, have been interpreted in the literature as evidence in support of the standard explanations of CSI, as provided by stakeholder theory, and summarised above. There is certainly accordance between these findings and the *a priori* expectations derived from that analysis. However, we wish to make the point that the observed patterns in firm behaviour are also consistent with social investment that acts as a form of insurance. Indeed, given that empirical evidence appears to be consistent with both the standard and insurance explanations, it does not provide a diagnostic test of the validity of the standard, or indeed either, explanation. To gain some useful insights into the motives that can underlie activism in CSI, we will next consider a case study.

A case study on the insurance motive for CSI: Shell Australia

John Simpson, the Head of External Affairs at Shell Australia, characterises that company's social investment as strategic (Simpson 2005: 27). He states that 'we ask where it makes sense strategically to invest in the community'. Furthermore, among other factors, he argues that 'the business case for managing social performance is based upon . . . reducing risk to reputation'. Shell Australia runs a programme of community liaison groups, typically attended by 'local and state government and regulatory authorities (i.e. local councils, the environment regulator, water authorities), as well as industrial neighbours and the local community' (Simpson 2005: 27). Regarding the topics discussed at such meetings, he notes that

> the news is not always good, not what the community wants to hear. However, the forum provides the opportunity for better understanding of what's happening inside the plant, why it's happening and what is being done to mitigate the issues of concern to the community (Simpson 2005: 28).

John Simpson also gives an illuminating account of the effect of Shell Australia's strategic use of social investment. He gives the following account of the reputational impacts following a potentially damaging event, and the perceived effect of social investment in determining the extent of the associated damage to reputation.

> The community consultation systems assisted immeasurably when there was a 300-ton oil spill in Sydney Harbour in 1999. Because of the social performance infrastructure in place, Shell managed to enhance its reputation in the Sydney market. The media couldn't understand when they interviewed community members why they were so prepared to be generally supportive of Shell's response measures. The community of course disliked that there had been an oil spill, but the message conveyed repeatedly was that they trusted Shell to correct the problems that led to the spill and to tell the community the truth (Simpson 2005: 28).

This account describes the ability of CSI to mitigate the reputational losses following an event that may be interpreted as implying social irresponsibility on the part of a firm. Furthermore, this ability is cited by a manager as an identified return on CSI that should inform strategic decision-making regarding social investment. Thus, it provides some indicative case-study evidence that observed CSI is motivated, in some cases and to at least some degree, by its ability to insure the firm against reputational losses.

Conclusion

This paper has outlined a stakeholder-motivated view of social investment as a form of insurance. CSI protects the value of a firm's reputational capital against potential losses inflicted by stakeholders, prompted by evidence of corporate social irresponsibility. Drawing on standard insurance theory, we argue that firms' social investment decisions are characterised by both adverse selection and moral hazard. Owing to adverse selection, companies that are relatively vulnerable to significant loss events are more likely to engage in social investment. Owing to moral hazard, firms find it optimal to be more socially irresponsible than they would be if uninsured by social investment. Consequently, we suggest that insurance-motivated social investment has an ambiguous overall impact on social welfare.

It has been our aim to establish the plausibility of insurance-motivated social investment which complements other explanations of corporate social responsiveness previously advanced in the literature. It should be noted that the patterns in CSI that we associate with the insurance motive, and find in our exploratory analysis of charitable contributions by UK PLCs, are also consistent with standard explanations of CSI. Empirical work able to examine the relative strengths of the possible motivations for social investment would contribute greatly to the literature.

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