The Impact of Other-regarding Behavior and Bounded Rationality on Decision Making and Corporate Social Performance

by

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ABSTRACT

Both the business press and academic journals have increasingly been inundated with discussions and examinations of issues related to corporate social responsibility (CSR). It would be hard to find many business leaders or academic scholars who do not agree that firms are increasingly called upon to contribute benefits to society beyond those resulting directly from their profit making function. These benefits include both increasing the positive and decreasing the negative impacts of business activity on individuals (both inside and outside the firm), communities (both local and global) and the natural environment. Economists often retain the strict rationality assumptions from neoclassical welfare economic theory when analyzing this issue. This perspective leaves firm and industry characteristics as the only factors creating differences in corporate social performance (CSP) between firms. The purpose of this dissertation is to examine the impact of firm leader characteristics on CSP using more realistic assumptions of human behavior.

The contributions of this thesis are both theoretical and empirical. First, I use findings from behavioral and experimental economics, evolutionary game theory, neuroscience and strategic management to relax the rationality assumptions from neoclassical theory, to include other-regarding preferences and bounded rationality. Without these modifications, the empirical analysis of this thesis would be impossible and irrelevant. Specifically I, (1) challenge the normative justifications for, and operative feasibility of, profit maximization as a decision rule for firm leaders, (2) demonstrate the evolutionary feasibility and pervasiveness of other-regarding behavior, and (3) combine these arguments to propose that firm leader beliefs, concerning the degree to which people are self-regarding or other-regarding, influence their assessment of the financial impact to the firm of CSR initiatives.

Grounded in this modified framework, I use upper echelon theory to show that observable CEO characteristics, as indicators of cognitive biases, value preferences and behavioral beliefs, predict differences in corporate social performance between firms, even when firm and industry characteristics are controlled for. Although prior studies have been done that analyze either the causes of corporate social performance (CSP), or the impact of firm leaders on other strategic outcomes, little has been done in examining the effect of leaders on CSP.

Using a broad sample of companies from the S&P1500, I find that strong or exemplary corporate social performance is positively related to the CEO having a bachelor's degree in humanities, having a breadth of functional career experience and being female. I find strong or exemplary CSP is negatively related to the CEO having a bachelor's degree in economics and to the level of CEO short term compensation. Preliminary tests of causality support the assertion that these effects reflect CEO discretion rather than being an artifact of reverse causality. I find no significant relationships between CEO characteristics and poor social performance. This suggests that CEOs have more discretion in influencing strong and exemplary social performance than in impacting poor CSP. Implications and areas of future research are discussed.