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Positive and Negative Corporate Social Responsibility, Financial Leverage, and Idiosyncratic Risk

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Abstract

Existing research on the financial implications of corporate social responsibility (CSR) for firms has predominantly focused on positive aspects of CSR, overlooking that firms also undertake actions and initiatives that qualify as negative CSR. Moreover, studies in this area have not investigated how *both* positive and negative CSR affect the financial risk of firms. As such, in this research, the authors provide a framework linking *both* positive and negative CSR to idiosyncratic risk of firms. While investigating these relationships, the authors also analyze the moderating role of financial leverage of firms. Overall, analysis of secondary information for firms from multiple industries over the years 2000–2009 shows that CSR has a significant effect on the idiosyncratic risk of firms, with positive CSR reducing risk and negative CSR increasing it. Results also show that

the reduction in risk from positive CSR is not guaranteed, with firms having high levels of financial leverage witnessing lower idiosyncratic risk reduction.

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Notes

1. Our modeling approach (see Eqs. [2a-c](#)) allows for lagged effects of independent variables on the positive and negative CSR-dependent variables. As such, our balanced panel has 1,728 firm-year observations instead of 1,920 firm-year observations that would be expected if we had used contemporaneous relationships in our estimations.
2. Table [8](#) in the [Appendix](#) provides the details of the items used to construct the PCSR and NCSR measures. Additionally, KLD also provides ratings on controversial business issues including: Alcohol, Gambling, Tobacco, Firearms, Military, and Nuclear Power. Since these are only rated as concerns and are not applicable to many firms, we excluded them from analysis, which is in line with existing research (e.g., Bird et al. [2007](#)).
3. Human Rights include strengths and concerns related to controversies faced

in operations in South Africa, Northern Ireland, Burma, Mexico, Labor Rights, Indigenous People Relations, and others. Since not all companies have operations in these locations, this information is often missing in the KLD database, and therefore we exclude it from our analysis.

4. We thank an anonymous reviewer for suggesting this analysis.

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Appendix

See Table [8](#).

Table 8 KLD items for evaluating PCSR and NCSR

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