

EFFECT OF CSR ON PRODUCT DIFFERENTIATION IN THE PRESENCE OF COST ADVANTAGE

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ABSTRACT

Corporate social responsibility (CSR), once thought of only a philanthropic activity of a firm, is now treated as a serious business strategy that can contribute to a firm's profitability. The seemingly altruistic activity helps build the firm's image with all the stakeholders including its customers so that it has the potential to increase the firm's profit. This fact is now well established in research literature. Product differentiation is another corporate strategy that is pursued by some companies in order to offer a distinctive product in the market to avoid competition, charge premium price, and increase profit. What is not known is that when two firms compete in a Hotelling type product differentiation line, how much this product differentiation is affected by the extent of the CSR activity of a firm. Our study is conducted in a game-theoretic setting where the CSR firm is competing with a non-CSR firm. The CSR firm maximizes a convex combination of its own profit and a form of social utility function, while the non-CSR firm maximizes its own profit only. The CSR firm is also assumed to have a technological advantage that reduces its production cost. The interaction of the effects of both the extent of CSR and the extent of this production cost advantage is also considered. We also study a scenario of asymmetric information. Our main results include that the degree of product differentiation is reduced when CSR is practiced. On the other hand, product differentiation increases with the production cost advantage. The interaction between the two factors –CSR activity and cost advantage –is also studied.

Keywords: Asymmetric information; Corporate social responsibility; Game theory; Product differentiation; Spatial price discrimination