Corporate Social Responsibility-Financial performance relationship in firms: A Review

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ABSTRACT

Corporate Social Responsibility (CSR) is a self-regulatory mechanism with the help of which a business enterprise monitors and ensures its compliance with law and socio-ethical standards.it involves going beyond the interests of the firm and focussing on social good. It involves a positive impact of a business on all its stakeholders which include communities, investors, employees and customers. The increasing involvement of companies in social activities has led to the emergence of Corporate Social Responsibility as a widely researched area at the global level. Also, the CSR-financial performance relation is being widely studied around the world. This paper aims to review the literature pertaining to the relationship between Corporate Social Responsibility and financial performance. The study conducted a review for the literature available for the time period 1988-2016. Different empirical research papers with different research criteria and methodologies employed were reviewed for the said period. The results revealed mixed results as some show a positive, some show negative and some show no relationship between the variables included in the study.

Keywords: Community, Corporate Social Responsibility, Performance, Social obligation, Stakeholders.

I. INTRODUCTION

Corporate Social Responsibility (CSR) has been defined by Bowen as an obligation for the companies to consider certain factors during the course of their businesses (Bowen, 1953) [1]. The traditional concept of Social Responsibility (SR) states that if a company produces goods and provides services for profit maximisation, then it is socially accountable and has to fulfil its social obligations towards the society (Agatiello, 2008 [2]; Cochran & Wood, 1984 [3]; Greenwood, 2001[4]). Some perceive CSR as an ethical behaviour, some as a legal obligation, some as a cost, and for some it is about making profits in the long run (Friedman, 1970) [5]. The modern concept of CSR states that as a company is a social entity, in addition to being an economic entity. It therefore must pay attention to the society as a whole and must work for the benefit of the people in the community (Sarkar, 2005) [6]. With an increasing focus on CSR, companies are integrating it with their strategies and management processes by shifting their focus to the triple bottom line. According to this concept, every business enterprise must give equal importance to environment, society and the economy (Elkington, 1994) [7]. Also, all the CSR activities are published in the form of a Sustainability Report or Business Responsibility Report.

According to Sarkar (2005), the modern concept of CSR states that in the due course of business, enterprises should pay due attention to social interests of the community as a whole and should consider it in decision-making [6]. As most of the decisions taken by a company affect all the stakeholders (i.e. creditors, employees and society at large) in addition to its stockholders, due consideration should be given to their interests as well. Further, Tarrant (1976) added to this by saying that a company is not just an economic entity, but is also a social and political entity [8].

For a firm seeking profit, the financial implications of investments in socially responsible activities have to be taken into consideration. For this purpose, the financial performance of the firms is taken into consideration. A CSR-Financial Performance relationship needs to be established to check whether socially responsible investment by a firm leads to a better financial performance or not. It is to be established whether active participation by firms in CSR leads an improved performance by them when compared to firms that do not show the same degree of participation in CSR (Lee & Park, 2009 [9]; McWilliams & Siegel, 2001[10]). CSR supporters say that CSR is a source of competitive advantage (Porter & Kramer, 2006) [11]. It positively affects firm reputation (Brammer & Millington, 2005 [12]; Turban & Greening, 1996 [13]), plays a role in customer satisfaction (Luo & Bhattacharya, 2006) [14], increases the attractiveness of a firm as an employer (Backhaus, Stone & Heiner, 2002 [15]; Turban & Greening, 1996 [13]) and increases organizational commitment among employees (Peterson, 2004) [16].

The empirical studies studying the relation between CSR and the financial performance of the firms show mixed with some revealing a positive relation, some a negative relation and others showing no relation between the two variables. Thus, the evidence regarding the association remains divided.

II. OBJECTIVE

The aim of this paper is to study the relationship between the Corporate Social Responsibility and the financial performance of the firms employing CSR. This study outlines all the essential information regarding the variables and also extensively reviews the relation between the two key variables.

III. METHOD

Various research articles related to Corporate Social Responsibility and financial performance were identifies from various research databases including proquest, jstor, springer link, wiley online library, science direct, Elsevier, etc. The articles published between 1988 and 2016 were the main focus for this study. The various combinations of the variables and the keywords were used to gain access to the articles related to this study.

IV. LITERATURE REVIEW

Corporate Social Responsibility is generally believed to have a positive impact on the financial performance of the firms. But the literature reveals a mixed set of results between the two variables which include positive, negative and neutral associations, thus leading to a lack of agreement on whether an increase in CSR spending leads to an improvement in the financial performance or not. There is a good amount empirical literature in its favour, still the results are considered to be inconclusive (Godfrey & Hatch, 2007 [17]; Margolis & Walsh, 2003 [18]; McWilliams & Siegel, 2000 [19]). Further, different methods have been used to measure CSR and financial performance. This also influences the CSR-Financial performance relations.

McGuire et al (1988) conducted a study aimed to examine the extent to which social responsibility predicted financial performance and whether prior financial performance predicts social responsibility or not [20]. This study used both accounting and stock-market based measures to investigate the relationships between concurrently, previously, and subsequently measured firm performance and corporate social responsibility. Data on corporate social responsibility were obtained from Fortune magazine's annual survey of corporate reputations. Data on accounting and stock-market based measures of firm performance and risk have been obtained from the COMPUSTAT database. Market performance has been measured by risk-adjusted return, or alpha, and total return. Market risk measures used are beta, a measure of systematic risk, and the standard deviation of total return. Accounting-based performance measures used are return on assets (ROA), total assets, sales growth, asset growth, and operating income growth. The ratio of debt to assets, operating leverage, and the standard deviation of operating income are the accounting-based measures of risk used. Correlation and regression analysis has been used to analyze the data. Correlations between social responsibility and stock-market based measures of performance suggested a little contemporaneous association. Three of the accounting-based measures of performance, however, are significantly correlated with corporate social responsibility. The accounting- and stock-market-based risk measures tend to be negatively associated with social responsibility. Both beta and the standard deviation of total return show negative correlations. One accounting-based risk measure, the ratio of debt to assets, has a significant negative association with corporate social responsibility. The results suggest that low-risk firms and firms with a high return on assets will later have an image of high social responsibility. The results revealed that social responsibility perceptions are more closely linked with prior financial performance than with subsequent financial performance.

Preston and O'Bannon (1997) studied the type and the direction of the causation between CSP (Corporate Social Performance) and CFP (Corporate Financial Performance) [21]. The study analysed the relation for the 67 companies rated by Fortune and COMPUSTAT. CSP was measured using three social performance reputational ratings i.e. CERESP (Community and Environmental Responsibility), PEOPLE (ability to select and retain good employees) and PSQ (Quality of products and services). To measure CFP, Return on Assets (ROA), Return on Equity (ROE) and Return on Investment (ROI) have been included. The results reveal a positive relationship between the prior period corporate financial performance and subsequent social performance and between the contemporaneous CFP and CSP.

Further, Russo and Fouts (1997) measured the impact of environmental performance on the firm profitability. Environmental performance has been used as a substitute of CSR [22]. A sample of 243 firms was studied for this purpose. These firms were rated by FRDC (Franklin Research and Development Corporation) for the years 1991 and 1992. Size of the firm, capital intensity, growth rate of the firm, advertising intensity, industry concentration and industry growth have been used as the control variables. The results reveal positive relationship between the variables under study. Also, greater industry growth led to a greater positive impact of environmental performance on firms' profitability.

Wright and Ferris (1997) said that companies exhibiting socially responsible behaviour may have a competitive disadvantage as they have to incur unnecessary costs [23]. These costs reduce the shareholders profits and wealth as they fall directly on the bottom line. According to them, CSR spending thus has a negative impact on the financial performance of the companies.

Another important study was conducted by McWilliams and Siegel (2000) who assessed the CSR—CFP relationship for a period of 1991-1996 for a total of 524 firms [19]. R&D expenditure was also introduced as a control variable in addition to the other controls used by the prior researchers. No significant association was found between CSR and CFP. However, a positive association was found between R&D and CSR.

Another study conducted by Ruf et al. (2001) studied the effect of change in Corporate Social Performance on concurrent as well as subsequent changes in Corporate Financial Performance [24]. A total of 496 out of Standard & poor's 500 firms as been studied for this purpose. To measure CSP, a questionnaire spread over eight dimensions has been used. To measure CFP, ROE, ROA and Growth in Equity has been used. The results reveal that with an improved social performance by a firm, immediate as well as long-term financial benefits may be enjoyed.

Kargiorgos (2010) analysed the impact of CSR practices on stock market returns on the basis of the stockholder theory has been examined for a period of 2 years using one year lag [25]. Firm's financial characteristics have been used as the control variables [Market capitalisation (CAP) to control for firm's size, CAPM beta (BETA) to control for stock's risk (systematic risk) and previous years' returns (SR)]. One-year lag has been introduced between the dependent and the independent variable. Data on CSR has been collected by the method of content analysis on the CSR annual reports. The sample for the study consists of 39 companies from different industry sectors with a great range in market capitalization. Data for financial performance has been collected from Athens Stock Exchange and Hellastat. Descriptive statistics, Correlation and Regression have been used to analyze the data. The results reveal a positive and a significant relationship between CSR and stock returns.

One of the later studies conducted by Kapoor and Sandhu (2010) have studied the impact of CSR on CFP in terms of growth and profitability [26]. Also, the effect of other variables on financial performance has been controlled. The data for CSR has been collected using content analysis of annual reports of the 93 companies under study. The data has been collected for a 2005-06. The data for CFP and the control variables has been obtained from Prowess (electronic database for CMIE-Centre for Monitoring Indian Economy), for a seven-year period of 1999-2000 to 2005-06. The data has been analysed using multiple regression analysis. The results indicate a significant positive impact of CSR on corporate profitability and insignificant positive impact on corporate growth.

A study analysing the relationship between CSR and financial performance of Nigerian banks was conducted by Bonalne et al (2012) [27]. The author says that spending on CSR provide better results in the long run i.e. the impact of CSR on the financial performance can be seen over the years to come. He adds that there is a causal positive relationship between the two variables and the banks therefore must exhibit an increase in their social spending.

Also, Ghosh (2013) studied 200 companies listed in the National Stock Exchange of India to demonstrate the effect of CSR initiatives on Financial Performance [28]. The study covers a period of four years i.e. from 2009 to 2012. To measure CSP of the companies, S&P ESG India index has been used. ROA, ROE and Tobin's Q have been used as Financial Performance measures. The results reveal that superior financial performance is a result of increased CSR.

Anlesinya et al. (2014) analysed the effect of Corporate Social Responsibility on the Financial Performance of MTN Ghana Limited has been determined [29]. Also, the amount of variance in the financial performance due to various dimensions of Corporate Social Responsibility i.e. community, environment, employees and consumers/ customers has been ascertained. The study employs a cross-sectional research and collects data using questionnaires. Convenience sampling helped in selecting a sample of 35 participants which was determined using a sample-size calculator. The data was analysed using SPSS and the tools employed for analysis are standard multiple regression and hierarchical multiple regression. The results of this study reveal a positive impact of CSR on Financial performance. However, CSR doesn't significantly predict financial performance. Also, the results revealed a significant positive effect of Community CSR and a negative effect of environmental CSR on the financial performance of MTN Ghana Limited. On the other hand, employee and customer CSR do not significantly predict financial performance.

Reverte et al. (2015) study the impact of corporate social responsibility practices on a measure of organizational performance encompassing both financial and non-financial indicators, and by studying the potential mediating role of innovation in the corporate social responsibility-performance relationship [30]. Sector, firm's age, firm size and corporate strategy have been incorporated as the control variables. Online questionnaire was used to collect data from 133 Eco-Responsible Spanish companies. Structural Equation Modelling was used to analyse the data. The results reveal a significant positive effect of CSR on both innovation and company performance. Also, innovation is found to play a mediating role in case of manufacturing companies.

One of the latest studies conducted by Nollet et al. (2016) aims to study the relationship between CSR and CFP taking into account both linear and non-linear associations [31]. CFP has been measured using both accounting-based (Return on Assets and Return on Capital) and market-based measures (Excess Stock Returns). CSR has been measured using Bloomberg's Environmental Social Governance (ESG) Disclosure score covering the S&P 500 firms in the period 2007–2011. Leverage ratio, Sales revenue and R&D Expenditure have been incorporated as the control variables. Crisis has been used as the dummy variable. ESG has been disaggregated into three sub-components i.e. the Environmental Performance, social performance and governance performance. Descriptive statistics, correlation and panel regression has been used to analyse the data. The results reveal a positive correlation between ESG, its sub-components and the performance measures. Also, risk is negatively correlated with performance indicators. Sales are not positively related to ROA and Excess Stock Returns.

CONCLUSION

With countries like India making CSR spending mandatory, there is an increase in the focus towards CSR. Thus, its impact on the company needs to be understood. For this purpose many researchers have studied the CSR-financial performance relation. The literature reveals mixed results between the two variables. Various researchers have found a negative relationship between the two variables. This can be attributed to the costs involved in CSR spending. These costs have a negative impact on the firm's profit as it depletes the profit. Many other scholars have revealed a positive relationship between CSR and CFP. They mainly attribute it to the increase in public image of the company due to the increased CSR spending by them. A favourable image is created in the minds of the customers due to their involvement in socially responsible activities. This favourable public image in turn affects the performance of the companies which is reflected in the improved financial performance. Many other researchers have found no relation between the two variables under study. These inconclusive results between Corporate Social Responsibility and Financial Performance of the firms can be due to various intervening variables. Thus, future studies should focus on including all other variables that have an impact on financial performance. Also, the measures of CSR and financial performance must be selected carefully so that the lacunae in the research can be filled. Further, the disaggregated CSR measures should be taken into consideration and the studies should be carried out for a longer period of time. This will ensure establishment of a conclusive relation between the two variables.

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