AN EMPIRICAL EXAMINATION OF CORPORATE SOCIAL RESPONSIBILITY ON FINANCIAL PERFORMANCE - A SURVEY OF LITERATURE

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ABSTRACT

Financial Performance is the central element for any profit based organization. Corporate Social Responsibility (CSR) becomes a necessity when it has an impact over various dimensions of the business & forced by law. The CSR may create positive, negative or neutral signals with respect to the financial performance based on the company’s contribution towards the factors contributing to CSR for the industry in concern. This paper reviews the literature on: 1) definition or meaning of CSR; 2) factors contributing to CSR and CSR influence on financial performance; 3) research techniques employed in similar studies.

Key words: Corporate Social Responsibility (CSR), Definition or Meaning of CSR, Corporate Financial Performance, Financial Performance, Factors contributing to CSR, CSR in India and Sequential Equation Modeling (SEM).

(1) INTRODUCTION

According to Zhi Tang, Clyde Eirikur Hull & Sandra Rothenberg (2011) the benefits of Corporate Social Responsibility (CSR) to Corporate Financial Performance (CFP) have been debated over decades, and several amendments to improve the modeling of this relationship have been proposed.
According to AupperJe, CarroIJ, and Hatfield (1985), the reason for compounding difficulties in studying corporate social responsibility has been the lack of an effort to empirically test definitions, propositions, and concepts: researchers have tended to create their own measures rather than to use one of the many preexisting definitions in the literature. Not only has this hindered inter-study comparisons and analyses; it has limited development of a research base in the social issues area.

According to Nuanlaong Attharangsun & Yongyut Ratchawetawetchakul (2012), the concept about corporate social responsibility (CSR) has been issued to study for a longtime.

Yongtae Kim, Myung Seok Park, Benson Wier (2010) Corporate social responsibility (CSR) is an issue of growing interest, and the reporting of socially responsible activity is becoming more prevalent as investors, customers, and other stakeholders demand greater transparency about all aspects of business. As the importance placed by stakeholders on socially responsible behavior has increased, the attitude toward CSR has changed dramatically over the last few decades.

The extract from Seong Cho, Cheol Lee, and Cheong K. Park (2012), study on “Measuring corporate responsibility” quote recent financial crises and a growing call for sustainability reporting guidelines like those from the Global Reporting Initiative (GRI) have placed pressure on corporate executives to provide the public with information that goes beyond a company’s standard financial reports. These nonfinancial performance measures are more important than a company’s current economic performance in creating long-term shareholder value, according to a survey of top executives (“Management Barometer Survey,” PricewaterhouseCoopers, 2002). These reports are often evaluated, and a company’s performance of corporate social responsibility (CSR) is generally quantified by rating agencies. They also specify Accordingly, researchers and business professionals have begun to focus on this new kind of nonfinancial measurement.

(2) ORGANIZATION OF THE ARTICLE

The article is organised into different subdivisions so as to improve the understanding of the available body of research knowledge. In the first part we review the available literature to understand the definition or meaning of CSR provided by various researchers and CSR in India. Subsequently, we have reviewed literature that provides the understanding on the various factors contributing to CSR. We further proceeded to identify the impact of CSR on financial performance. Finally we try to understand the research techniques that that are adopted by various researchers for such studies.

(3) DEFINITION OR MEANING OF CSR

CSR has been studied by many researchers in various industries like retailers, wholesalers, service; etc. A universally accepted definition of the concept is yet to emerge (Khanna, 2008). This has led to a limited conceptual understanding of CSR (Idemudia, 2008). According to Bowen, father of CSR (1953) “Businessmen should pursue those policies, decisions, lines of action which add objectivity and value to our society”.

Many scholars in various fields have tried to define/understand CSR in specific context. Table below shows some definition or quotes regarding CSR. The definitions are listed in chronological order to study trends of the definitions. Unfortunately there is no proper trend in understanding the meaning of CSR and it is still at the nascent stage where people are yet to identify the universally accepted definition.
<table>
<thead>
<tr>
<th>Author</th>
<th>Definition/ Meaning</th>
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<tbody>
<tr>
<td>Bowen (1953: 6)</td>
<td>Businessmen’s obligation to pursue those policies, to make those decisions or to follow those lines of action which are desirable in terms of the objectives and values of society</td>
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<tr>
<td>Davis (1960: 70)</td>
<td>Businessmen’s decisions and actions taken for reasons at least partly beyond the firms direct economic or technical interest</td>
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<tr>
<td>McGuire, 1963</td>
<td>CSR is fuzzy concept</td>
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<td>McGuire (1963: 144)</td>
<td>The idea of social responsibility supposes that the corporation has not only economic and legal obligations but also certain responsibilities to society which extend beyond these obligations</td>
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<td>Davis (1973)</td>
<td>CSR begins where the law ends</td>
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<tr>
<td>Sethi (1975: 58)</td>
<td>Bringing corporate behaviour up to a level where it is congruent with the prevailing social norms, values and expectations.</td>
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<tr>
<td>Freeman (1984)</td>
<td>Defines “stakeholder” as any group or individual who can affect or is affected by an organisation’s objectives identifies two types of stakeholders. Owners, shareholders, employees, customers and suppliers represent the first (Primary) stakeholders-type.</td>
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<tr>
<td>Frederick, 1986</td>
<td>CSR is subjective</td>
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<tr>
<td>Wood (1991)</td>
<td>Corporate social responsibility is defined as “a business organization’s configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm’s societal relationships.”</td>
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<tr>
<td>McWilliams, 2001</td>
<td>CSR is unclear</td>
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<tr>
<td>Margolis and Walsh, 2001</td>
<td>CSR is amorphous</td>
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<tr>
<td>Mohr, Webb and Harris (2001)</td>
<td>CSR as “a company’s commitment to minimizing or eliminating any harmful effects and maximizing its long run beneficial impact on society”.</td>
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<tr>
<td>Petkus and Woodruff (as cited by Mohr et al., 2001)</td>
<td>Social responsibility as “both avoiding harm and doing well”</td>
</tr>
<tr>
<td>Lantos, 2001</td>
<td>CSR is with unclear boundaries and debatable legitimacy</td>
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<tr>
<td>Mohr et al (2001)</td>
<td>“A company’s commitment to minimizing or eliminating any harmful effects and maximizing its long run beneficial impact on society”.</td>
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<tr>
<td>McWilliams (2001:117)</td>
<td>Actions that appear to further some social good, beyond the interests of the firm and that which is required by law</td>
</tr>
<tr>
<td>Dawkins &amp; Lewis, 2003; Maignan &amp; Ferrell, 2004; Ruf, Muralidhar, Brown, Janney, &amp; Paul, 2001</td>
<td>Stakeholder theory is one of the most important theories underpinning corporate social responsibility as consideration of the interests, rights and needs of different stakeholders of a business is an effective way of inculcating socially responsible behaviour among organizations</td>
</tr>
<tr>
<td>CSR Europe, 2001; Lantos, 2002; Maignan &amp; Ferrell, 2004</td>
<td>Organisations committing themselves to corporate social responsibility activities can achieve long-term benefits through brand enhancement, goodwill, differentiation, increased employees’ motivation, higher profitability and quality workforce retention</td>
</tr>
<tr>
<td>Williamson et al, 2006</td>
<td>CSR is vague</td>
</tr>
<tr>
<td>Van Marrewijk, 2003</td>
<td>As such there lacks any solid definition to form the basis of firm action</td>
</tr>
<tr>
<td>The Association between Commitment and Social Responsibility: A structural equation model</td>
<td>Corporate social responsibility performance in the current study refers to the extent of a corporation’s social responsibility to, and engagement with the community, as well as society in general. The items relating to social responsibility are: 1. Donations to community 2. Community engagement 3. Staffs are seconded to voluntary work 4. Water conservation 5. Educational scholarships given 6. Percentage of staff minorities.</td>
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<tr>
<td>Corporate social responsibility in a global economy Gopal K. Kanjia, and Parvesh K. Chopra</td>
<td>Corporate social responsibility (CSR) means operating a business in a socially responsible manner whereby the business: undertakes ethical practices in employment and labour by improving workplaces; is involved in building local communities and communicates with concerned communities regarding the consequences of its policies and products; invests in building social infrastructure; contributes to a cleaner environment, its protection and sustainability; and contributes by way of its corporate governance to economic development at large.</td>
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(4) CSR IN INDIA

Based on the empirical survey carried out in India by German development institute, CSR has become a sustainable business strategy. The trends of CSR are changing from charity to responsibility in India was one of the finding of KPMG (2008) in association with ASSOCHAM. In the global front, according to Norwegian ministry of foreign affairs, companies are not just operating in a market; they are also operating within a culture, a local community and a political system. The debate surrounding corporate social responsibility (CSR) is concerned with the role companies play in this broader social context.

SEBI vide its recent circular has made it mandatory for top 100 listed companies to report certain critical information as part of their business responsibility like CSR spending as a percentage of its net profit, the number of stakeholders’ complaints received and resolved, details of any pending case filed by stakeholder against any unfair trade practice, irresponsible advertising or anti-competitive behavior adopted by the company.

(5) FACTORS CONTRIBUTING TO CSR

The extract from Seong Cho, Cheol Lee, and Cheong K. Park (2012) presents CSR covers various nonfinancial issues, such as the environment or community relations, and companies are increasingly beginning to create separate CSR reports detailing their environmental concerns or social relations.

The model proposed by Leonard A. Jackson & H. G. Parsa (2009) has five dimensions that must be assessed to effectively evaluate the firm’s CSR initiatives. The included dimensions are: 1) community involvement, 2) treatment of its employees, 3) environmental sustainability initiatives, 4) fair corporate governance and 5) involvement or lack thereof in controversial business practices. In terms of community involvement, the evaluator could examine the firm’s philanthropic activities within its operating environment. This will involve the firm’s host or the parent company as well as the foreign locations if the firm is a multinational corporation. The model also proposes that the firm should be evaluated on how it treats its employees. In this regard, its diversity efforts and Green initiatives should be examined. The model also proposes that companies should be evaluated based on company’s environmental initiatives. In this regard, the firm should be examined based on its efforts or contribution to the protection of the ecosystem, its investment in sustainable development and its recycling efforts and programs. The model also proposes that the company should be evaluated based on its corporate governance and involvement or lack thereof in business practices that are deemed to be controversial.

According to Aupperle, CarroJ, and Hatfield (1985), there are many other methods available to assess the relationship between corporate social responsibility and profitability. Some studies have chosen to measure managers’ behavior, commitment, or reputations in regard to their orientation toward social responsibility; this study assessed CEOs’ orientations.

Yongtae Kim, Myung Seok Park, Benson Wier (2010) included corporate governance, community relations, diversity, employee relations, environment as CSR dimensions.

(6) CSR RELATIONSHIP WITH FINANCIAL PERFORMANCE

Waddock and Graves (1997) and Dean (1999) put forward two theories to explain Slack Resource Theory and Good Management Theory. Under the Slack Resource Theory, a company should have a good financial position to contribute to the corporate social performance. Conducting the social performance needs some fund resulting from the success of financial performance. According to this theory, financial performance comes first. Good Management Theory suggests that
social performance comes first. Based on this theory, a company perceived by its stakeholders as having a good reputation will make it easier for the company (through market mechanism) to get a good financial position.

Hasan Fauzi (2009) has observed that corporate social performance (CSP/CSR) has no effect on corporate financial performance (CFP) under slack resource and good management theory in his study on Corporate Social and Financial Performance. The objective of this study is to address the issue of the relationship between corporate social and financial performance by moderating company size and financial leverage with the help of two types of industry as control variable. The corporate social performance (CSP/CSR) is measured using seven dimensions developed initially by Michael Jantzi Research Associate, Inc and used by Mahoney and Robert (2007). To attain the main research objective, the measure of CSP composite is used.

Zhi Tang, Clyde Eirikur Hull & Sandra Rothenberg (2011) hypothesize that CSR engagement involving a slow pace, a consistent approach, a focus on related CSR dimensions, and an internal-to-external path will enhance the positive contribution of CSR to financial performance. In their research titled “How corporate social responsibility is pursued affects firm financial performance” they have mention to the authors who had positive and negative arguments. Berman et al., 1999; Carmeli et al., 2007; Haley, 1991; Orlitzky et al., 2003; Waddock & Graves, 1997 have argued for a positive relationship between CSR and companies financial performance (CFP), because CSR can improve firm-stakeholder relationships and enhance the organizational reputation among customers, employees, regulators and suppliers. Cornell & Shapiro, 1987; Friedman, 1970 are authors arguing for a negative CSR-CFP relationship. Consistency in CSR engagement indicates that a firm involves itself with CSR activities in a systematic and regular manner (Vermeulen & Barkema, 2002). A consistent pace of engagement helps firms to better and more strategically plan their CSR activities. Thus, path dependence theory suggests that firms with very consistent engagement in CSR are able to accumulate and absorb CSR knowledge in an incremental manner, build complementary resources in a more systematic way, and convey to their stakeholders the image of serious and persistent CSR rather than an irregular, ad hoc approach to CSR (Husted & Salazar, 2006; Vergne & Durand, 2010).

Leonard A. Jackson & H. G. Parsa’s (2009) Corporate Socially Responsible and Financial Performance (CSRFINP) model proposes that a firm can be assessed and assigned a score based on its performance on predetermined CSR dimensions as well as it financial performance on predetermined financial criteria. Firms can fall into one of the model’s four quadrants based on their CSR and financial performance scores. If a company is pursuing purely financial initiatives and performs well on those initiatives, it will find itself in the black or the “Aggressive” quadrant. Conversely, if a company is a nonprofit entity and pursues purely social responsibility initiatives, then this company will be a truly “Green” company and be placed in the “Green” quadrant. Companies that perform well on both social responsibility and financial initiatives will fall into the “Blue” or progressive quadrant. Companies that underperform on both financial and socially responsible initiatives fall into the yellow or “Repressive” quadrant.

AupperJe, CarroIJ, and Hatfield (1985) concluded that it was not possible to support the notion of a positive or negative relationship between profitability and an orientation toward corporate social responsibility.

John Peloza (2006) Attempts to accurately measure the financial return from CSR are more than an academic exercise. Many nonprofit organizations are now reliant on corporate sources of support, and without sustained support many may not have the ability to pursue their missions. The increased pressure faced by managers to justify the allocation of scarce resources means that dollars spent on CSR activities are becoming more closely scrutinized, and these dollars are at risk of being withdrawn.

Rocío Durán-Vázquez , Arturo Lorenzo-Valdés, G. Einar Moreno-Quezada (2012) used corporate social responsibility as one of the variable to study the financial performance of selected
Mexican companies. According to the author one issue that has recently become more important is the practice of corporate social responsibility; currently companies not only aim at generating profits but also at ensuring that their operations are sustainable economically, socially and environmentally. The results provided empirical evidence of the interrelation of CSR on the stock market returns of the selected companies.

According to Orlitzky et al., 2003 that current CSR has a stronger relationship with current Corporate Financial Performance (CFP) than with later CFP

(7) RESEARCH METHODOLOGY

Leonard A. Jackson & H. G. Parsa (2009) model to study the corporate social responsibility and financial performance under five different dimensions was based on the analyst obtaining data from secondary sources or via direct interviews with the firm’s agents relating to these dimensions.

AupperJe, CarroIJ, and Hatfield (1985) used a Forced-Choice Survey Instrument in their study on the relationship between corporate social responsibility and profitability ie Respondents were asked to allocate up to 10 points to each of 20 sets of statements measuring corporate social responsibility. The survey also used the reliability and content validity. The final questionnaire included additional questions in a Likert format including two questions that asked whether or not the respondents' organization engaged in social forecasting or had a corporate social responsibility committee on its corporate board. The final instrument was mailed. A factor analysis of the 80 item instrument was performed to determine whether the 4-part construct defining corporate social responsibility offered by Carroll could be supported. We used an N-factor, principal components factor analysis with a varimax rotation; it produced 22 factors with eigen values greater than 1.0. Further parsimony was required, particularly since the factor loadings for the 22 factors were low. Also, the eigen values and explained variances declined rapidly following the extraction of the first factor. In order to identify the relevant number of factors inherent in the construct, they performed a scree test, which suggested that either three or four factors existed. They therefore performed both 3-factor and 4-factor principal component factor analyses.

Zhi Tang, Clyde Eirikur Hull & Sandra Rothenberg (2011) used Community, Charity, Corporate Governance, Diversity, Employee Relations, Environment, Human Rights, and Product Quality and Safety as dimensions of CSR. Return on Asset was used to measure the firm financial performance.

Nuanlaong Attharangsun & Yongyut Ratchatawetchakul (2012) used five-point Likert-type scale, ranging from 1 (strongly disagree) to 5 (strongly agree) to measure the entire variable in their study “the roles of corporate social responsibility strategy in brand loyalty: an empirical study of the thai listed firms”. In the study questionnaire was sent to managers of the sample companies via mail. The effective response rate was approximately 21.85% (Acceptable if greater than 20% Aaker et al., 2001). Non- response bias was investigated by t –test and results were found insignificant. The internal consistency reliability was assessed by calculating Cronbach’s alpha values. The validity of data in the questionnaire was checked by factor analysis (Kerlinger, 1964). Factor analysis is employed to test the validity of data in the questionnaire. Because multi-item constructs measure each variable and factor analysis was employed to check unidimensionality among the items. This study used confirmatory factor analysis (CFA) to examine the validity of each construct.

According to Kline, 1998; Baines & Langfield-Smith, 2003, Sequential Equation Modelling (SEM) allows the analysis of multiple relationships simultaneously, provides measures of overall model fit, and explains the significance of relationships between variables. Viator (2001) SEM accounts the effects of measurement error in multi-item variables which is an advantage over path analysis.
Schumacher and Lomax (1996) suggested a 2 stage process, where the first stage is to conduct separate measurement models for each latent variable. The structural equation model is constructed as the second stage.

The study “Effects of corporate social responsibility on consumer retention in cellular industry of Pakistan” by Imran Ali, Kashif Ur Rehman, Ayse Kucuk Yilmaz, Sajid Nazir and Jawaria Fatima Ali (2010), has adopted structural equation modeling (SEM) technique to analyze data. The extract in the study quotes SEM is a statistical technique for testing and estimating causal relationships using a combination of statistical data and qualitative causal assumptions. This view of SEM was articulated by the geneticist Sewall Wright (1921), the economists Trygve (1943) and Herbert (1953), and formally defined by Judea (2000) using a calculus of counterfactuals. SEM normally starts with a hypothesis, develops it as a model, operationalises the constructs of interest with a measurement instrument, and tests the fit of the model to the obtained measurement data. Among the strengths of SEM is the ability to construct latent variables: variables which are not measured directly, but are estimated in the model from several measured variables each of which is predicted to 'tap into' the latent variables. This allows the modeler to explicitly capture the unreliability of measurement in the model, which in theory allows the structural relations between latent variables to be accurately estimated. Factor analysis, path analysis and regression all represent special cases of SEM.

(8) CONCLUSION

It is clearly understood from the literature that even though CSR is an old area of research there are lot of un-interpreted research questions & scope for new researches. In particular there is very less research studies in this area in Indian industries including financial services industries.

The understanding & definition of CSR varies from researcher to researcher along with their country of origin, industry and the time period of the study. Literature also emphasizes that a standard universal definition is yet to arrive. Each research study employs different factors contributing to CSR based on the industry under research. Common factors include environment, society, community, employee and customer.

Studies on CSR impact on financial performance has yielded all possible results like Positive, negative, no impact, etc… Generally all researches uses perception scales to evaluate the financial performance of an organization by sending questionnaire via mail or in person. Sequential equation modeling (SEM) is widely used because of its ability to construct latent variables, whose values are estimated in the model from several measured variables.

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BIOGRAPHICAL NOTES

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