Journal of Advances and Scholarly Researches in Allied Education
Vol. 3, Issue 6, April-2012, ISSN 2230-7540

Corporate Social Responsibility and Financial Performance

Rekha Kinger

[1]Research Scholar, Singhania University, Rajasthan India

ABSTRACT:-The field of corporate social responsibility (CSR) has grown exponentially in the last decade. Nevertheless, there remains a protracted debate about the legitimacy and value of corporate responses to CSR concerns. There are different views of the role of the firm in society and disagreement as to whether wealth maximization should be the sole goal of a corporation. Using extensive data over a period of five years, this study explores and tests the sign of the relationship between corporate social responsibility and financial performance. The dataset includes most of the S&P 500 firms and covers the years 1996-2000. The relationship is tested by using empirical methods. The results indicate that the sign of the relationship is positive and statistically significant; supporting the view that socially responsible corporate performance can be associated with a series of bottom-line benefits.

---------------------------♦----------------------------

INTRODUCTION

The field of corporate social responsibility has grown exponentially in the last decade. More than half of the Fortune 1000 companies issue corporate social responsibility (CSR) reports. A larger number of companies than at any time previous are engaged in a serious effort to define and integrate CSR into all aspects of their businesses. An increasing number of shareholders, analysts, regulators, activists, labor unions, employees, community organizations, and news media are asking companies to be accountable for an ever-changing set of CSR issues. There is increasing demand for transparency and growing expectations that corporations measure, report, and continuously improve their social, environmental, and economic performance.

The definition of corporate social responsibility is not abstruse. According to *Business for Social Responsibility* (BSR), corporate social responsibility is defined as "achieving commercial success in ways that honor ethical values and respect people, communities, and the natural environment." McWilliams and Siegel (2001:117) describe CSR as "actions that appear to further some social good, beyond the interest of the firm and that which is required by law." A point worth noticing is that CSR is more than just following the law (McWilliams & Siegel, 2001). Alternatively, according to Frooman (1997:227), the definition of what would exemplify CSR is the following: "An action by a firm, which the firm chooses to take, that substantially affects an identifiable social stakeholder's welfare." A socially responsible corporation should take a step forward and adopt policies and business practices that go beyond the minimum legal requirements and contribute to the welfare of its key stakeholders. CSR is viewed, then, as a comprehensive set of policies, practices, and programs that are integrated into business operations, supply chains, and decision-making processes throughout the company and usually include issues related to business ethics, community investment, environmental concerns, governance, human rights, the marketplace as well as the workplace.

Each company differs in how it implements corporate social responsibility, if at all. The differences depend on such factors as the specific company's size, the particular industry involved, the firm's business culture, stakeholder demands, and how historically progressive the company is in engaging CSR. Some companies focus on a single area, which is regarded as the most important for them or where they have the highest impact or vulnerability—human rights, for example, or the environment—while others aim to integrate CSR in all aspects of their operations. For successful implementation, it is crucial that the CSR principles are part of the corporations values and strategic planning, and that both management and employees are committed to them. Furthermore, it is important that the CSR strategy is aligned with the company's specific corporate objectives and core competencies.

The Dean of Rotman School of Management, Roger L. Martin (2002), developed the "virtue matrix" as a framework for how socially responsible behavior enters business practice. The matrix is framed by four quadrants. The two bottom quadrants include socially responsible conduct in which corporations engage by choice, by following norms and customs, or by compliance to existing laws or regulations. Those actions both promote social responsibility and enhance shareholder value. On the other hand, the two top quadrants of the matrix include the strategic and structural frontiers, which include activities whose value to shareholders is either clearly negative or not immediately apparent. The boundaries between the different categories of socially responsible conduct are porous, since a change in the law or in common practices can cause an activity to migrate from the upper quadrants to the bottom ones.

THE POINT OF TENSION

There is a protracted debate about the legitimacy and value of corporate responses to CSR concerns. As CSR comes into contact with many of the issues traditionally addressed by government, like human rights and community investing, there is strong criticism that societal problems are best solved by freely elected governments. The resources of a corporation are poorly suited for addressing those social problems, and therefore, it is argued, they should not be misallocated.

According to Friedman (1970), in a free society, “there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.” He prefers that the state address social problems, arguing that an executive, by taking money and resources that would otherwise go to owners, employees, and costumers, and allocating them according to the will of the minority, fails to serve the interests of her or his principal. In this way, the executive imposes a tax and spends the proceeds for “social” purposes, which is intolerable, since she or he has neither the skills nor the jurisdiction to do so.

On the other hand, there are many appeals by others for corporate adoption of the CSR principles. Although the government is mainly responsible for addressing those issues, the contribution of private firms can be substantial. There is also the argument of the shifting balance of power. According to the OECD, of the 100 largest global economies, as measured by GDP, 51 of them are US corporations, and only 49 are nation states. So economic power has shifted to the corporations; they, therefore, should have an increasing role in and responsibility for addressing social problems. For example, the government sets the regulations and the minimum standards for the workplace, but a company can further improve the work environment and the quality of living of its employees. A firm cannot ignore the problems of the environment in which it operates. The poverty of a nation state’s citizens, political unrest, and the exhaustion of natural resources can have destructive effects for a corporation. For example, resources that are inputs in the production process and which, at the beginning of the industrial revolution, were abundant are now in many regions of the planet scarce, polluted, or diminishing. Naturally, this imposes an extra cost to the corporations and may force them to relocate or to cease operations. From one perspective, companies may be poorly equipped to address some of the social or environmental problems, but from another perspective, no matter how poorly equipped, companies may still be best positioned to ameliorate the problems.

Certainly, adopting the CSR principles involves costs. These costs might be short term in nature or continuous outflows. These costs might involve the purchase of new environmentally friendly equipment, the change of management structures, or the implementation of stricter quality controls. Since being socially responsible involves costs, it should generate benefits as well in order to be a sustainable business practice. A corporation could not continue a policy that constantly generates negative cash flows. The shareholders invest their money in a corporation, expecting the highest possible risk adjusted return. Therefore, being socially responsible should have bottom-line benefits in order to be sustainable.

Socially responsible corporate performance can be associated with a series of bottom-line benefits. But in many cases, it seems that the time frame of the costs and benefits can be out of alignment—the costs are immediate, and the benefits are not often realized quarterly. Nevertheless, many benefits can be identified. Firstly, socially responsible companies have enhanced brand image and reputation. Consumers are often drawn to brands and companies with good reputations in CSR related issues. A company regarded as socially responsible can also benefit from its reputation within the business community by having increased ability to attract capital and trading partners. Reputation is hard to quantify and measure; it is even harder to measure how much it increases a company’s value. But since companies have developed methods to measure the benefits of their advertisement campaigns, similar methods can and should be able to be applied in the case of corporate reputation.

Socially responsible companies also have less risk of negative rare events. Overlooking negative social and environmental externalities when valuing a company might be equal to ignoring significant tail risk. The risks related to CSR could be grouped into three categories: corporate governance, environmental aspects, and social aspects.

Companies that adopt the CSR principles are more transparent and have less risk of bribery and corruption. In addition, they may implement stricter and, thus, more costly quality and environmental controls, but they run less risk of having to recall defective product lines and pay heavy fines for excessive polluting. They also have less risk of negative social events which damage their reputation and cost millions of dollars in information and advertising campaigns. The scandals about child–labor and sweatshops that affect the clothing industry are two fine examples. Thus, socially responsible businesses should have more stable earnings growth and less downside volatility. Since companies that adopt the CSR principles carry less risk, when valuing those companies, a lower discount rate should be used. In the company valuation this lower tail risk should be taken into account.

There are also other cases in which doing what is good and responsible converges with doing the best for the particular business. Some CSR initiatives can dramatically reduce operating costs. For example, reducing packaging material or planning the optimum route for delivery trucks not only reduces the environmental impact of a company's operation, but it also reduces the cost. The process of adopting the CSR principles motivates executives to reconsider their business practices and to seek more efficient ways of operating.

Companies perceived to have a strong CSR commitment often have an increased ability to attract and to retain employees (Turban & Greening 1997), which leads to reduced turnover, recruitment, and training costs. Employees, too, often evaluate their companies CSR performance to determine if their personal values conflict with those of the businesses at which they work. There are many known cases in which employees were asked, under pressure of their supervisors, to overlook written or moral laws in order to achieve higher profits. These practices create a culture of fear in the workplace and harm the employees' trust, loyalty, and commitment to the company.

Companies that improve working conditions and labor practices also experience increased productivity and reduced error rates. Regular controls in the production facilities throughout the world ensure that all the employees work under good conditions and earn living wages. These practices are costly, but the increased productivity of the workers and improved quality of the products generate positive cash flows that cover the associated costs. Thus, firms may actually benefit from socially responsible actions in terms of employee morale and productivity (Moskowitz, 1972; Parket & Eibert, 1975; Soloman & Hansen, 1985).

As mentioned earlier, although it is rather straightforward to identify the above benefits as being socially responsible for businesses, it is an arduous task to quantify and measure them. Since CSR is integrated into the business practices, it is by definition complicated to try to measure its effects separately. Ideally, it should be possible to keep all other factors constant and measure a company's financial performance and volatility of cash flows before and after adopting the CSR principles. As this is not possible, however, empirical methods are used to identify the relationship between a company's socially responsible conduct and its financial performance.

EMPIRICAL STUDIES OF CSR AND FINANCIAL PERFORMANCE

According to Margolis and Walsh (2002), one hundred twenty-two published studies between 1971 and 2001 empirically examined the relationship between corporate social responsibility and financial performance. The first study was published by Narver in 1971.

Empirical studies of the relationship between CSR and financial performance comprise essentially two types. The first uses the event study methodology to assess the short-run financial impact (abnormal returns) when firms engage in either socially responsible or irresponsible acts. The results of these studies have been mixed. Wright and Ferris (1997) discovered a negative relationship; Posnikoff (1997) reported a positive relationship, while Welch and Wazzan (1999) found no relationship between CSR and financial performance. Other studies, discussed in McWilliams and Siegel (1997), are similarly inconsistent concerning the relationship between CSR and short run financial returns.

The second type of study examines the relationship between some measure of corporate social performance (CSP) and measures of long term financial performance, by using accounting or financial measures of profitability. The studies that explore the relationship between social responsibility and accounting-based performance measures have also produced mixed results. Cochran and Wood (1984) located a positive correlation between social responsibility and accounting performance after controlling for the age of assets. Aupperle, Carroll, and Hatfield (1985) detected no significant relation between CSP and a firm's risk adjusted return on assets. In contrast, Waddock and Graves (1997) found significant positive relationships between an index of CSP and performance measures, such as ROA in the following year.

Studies using measures of return based on the stock market also indicate diverse results. Vance (1975) refutes previous research by Moskowitz by extending the time period for analysis from 6 months to 3 years, thereby producing results which contradict Moskowitz and which indicate a negative CSP/CFP relationship. However, Alexander and Buchholz (1978) improved on Vance's analysis by evaluating stock market performance of an identical group of stocks on a risk adjusted basis, yielding an inconclusive result.

MEASUREMENT PROBLEMS

Measures of Corporate Social Responsibility

Determining how social and financial performances are connected is further complicated by the lack of consensus of measurement methodology as it relates to corporate social performance. In many cases, subjective indicators are used, such as a survey of business students (Heinze, 1976), or business faculty members (Moskowitz, 1972), or even the Fortune rankings (McGuire, J. B., A. Sundgren, and T. Schneeweis 1988; Akathaporn and McInnes, 1993; Preston and O'Bannon, 1997). Significantly, it is unclear exactly what these indicators measure. In other cases, researchers employ official corporate disclosures—annual reports to shareholders, CSR reports, or the like. Despite the popularity of these sources, there is no way to determine empirically whether the social performance data revealed by corporations are under-reported or over-reported. Few companies have their SCR reports externally verified. Thus, information about corporate social performance is open to questions about impression management and subjective bias. Still other studies use survey instruments (Aupperle, 1991) or behavioral and perceptual measures (Wokutch and McKinney, 1991). Waddock and Graves (1997) drew upon the Kinder Lydenberg Domini (KLD) rating system, where each company in the S& P 500 is rated on multiple attributes considered relevant to CSP. KLD uses a combination of surveys: financial statements, articles on companies in the popular press, academic journals (especially law journals), and government reports in order to assess CSP along eleven dimensions[1]. Based on this information, KLD constructed the Domini 400 Social Index (DSI 400), the functional equivalent of the Standard and Poors 500 Index, for socially responsible firms.

Measures of Financial Performance

Although measuring financial performance is considered a simpler task, it also has it specific complications. Here, too, there is little consensus about which measurement instrument to apply. Many researchers use market measures (Alexander and Buchholz, 1978; Vance, S. C., 1975), others put forth accounting measures (Waddock and Graves 1997; Cochran and Wood 1984) and some adopt both of these (McGuire, J. B., Sundgren, A., Schneeweis, T., 1988). The two measures, which represent different perspectives of how to evaluate a firm's financial performance, have different theoretical implications (Hillman and Keim, 2001) and each is subject to particular biases (McGuire, Schneeweis, & Hill, 1986). The use of different measures, needless to say, complicates the comparison of the results of different studies.

In other words, accounting measures capture only historical aspects of firm performance (McGuire, Schneeweis, & Hill, 1986). They are subject, moreover, to bias from managerial manipulation and differences in accounting procedures (Branch, 1983; Brilloff, 1972). Market measures are forward looking and focus on market performance.

They are less susceptible to different accounting procedures and represent the investor's evaluation of the ability of a firm to generate future economic earnings (McGuire, J. B., A. Sundgren, and T. Schneeweis, 1988). But the stock-market-based measures of performance also yield obstacles (McGuire, Schneeweis, & Branch, 1986).

REFERENCES:-

- "GEO and GCC". Tata Group. http://www.tata.com/aboutus/articles/inside.aspx?artid=HRrcG3jvdLA=&sectid=+WjDO3hy9ls=. Retrieved 2009-06-21.

- "Leadership with trust". Tata Group. http://www.tata.com/aboutus/sub_index.aspx?sectid=8hOk5Qq3EfQ=. Retrieved 2009-06-21.

- "Financial Times / PricewaterhouseCoopers World's Most Respected Companies Survey 2004" (PDF). The Financial Times. http://specials.ft.com/spdocs/wmrc2004_bycountry.pdf. Retrieved 2009-06-21.

- "Complete Rankings". World's Most Respected Companies. Forbes. May 21, 2007. http://www.forbes.com/2007/05/21/reputation-institute-survey-lead-citizen-cx_sm_0521companies_table.html. Retrieved 2009-06-21.

- "Tata Companies". Tata Group. http://www.tata.in/company/index.aspx?sectid=21vxqwHGkoo=. Retrieved 2009-06-21.

- "A tradition of trust". Community Initiatives. Tata.com. http://www.tata.com/0_our_commitment/community_initiatives/tata_trusts/overview.htm. Retrieved 2006-10-30.

- Sirkin, Harold L; James W. Hemerling, and Arindam K. Bhattacharya (11-06-2008). GLOBALITY: Competing with Everyone from Everywhere for Everything. New York: Business Plus, 304. ISBN 0-446-17829-2.

- "Tata Family Tree" (PDF). tatacentralarchives.com. http://www.tatacentralarchives.com/Heritage/FamilyTree.Pdf. Retrieved 2007-06-02.

- Kneale, Klaus (May 6, 2009). "World's Most Reputable Companies: The Rankings". Forbes. http://www.forbes.com/2009/05/06/world-reputable-companies-leadership-reputation-table.html. Retrieved 2009-06-21.

- "Our Heritage". Tata Group. http://www.tata.co.in/htm/heritage/HeritageOption1.html. Retrieved 2009-06-21.

- Huggler, Justin (February 1, 2007). "From Parsee priests to profits: say hello to Tata". The Independent. http://www.independent.co.uk/news/world/asia/from-parsee-priests-to-profits-say-hello-to-tata-434575.html. Retrieved June 21, 2009.

- Hazarika, Sanjoy (March 28, 1991). "BUSINESS PEOPLE; Nephew to Take Over Tata Company in India". The New York Times. http://www.nytimes.com/1991/03/28/business/business-people-nephew-to-take-over-tata-company-in-india.html. Retrieved June 21, 2009.

- "India's Tata Group to supply parts for Boeing Dreamliner". Agence France-Presse. Google News. February 6, 2008. http://afp.google.com/article/ALeqM5hPLDpu6bLmTgk5mXHXMgUR0moZSw. Retrieved June 21, 2009.

- "The rainbow effect". May 4, 2008. http://www.tata.com/_our_commitment/community_initiatives/overview.htm.

- "India's Tata Group: Empowering marginalized communities". May 4, 2008. http://www.synergos.org/globalgivingmatters/features/0503tatagroup.htm.

- "U.S. and Indian philanthropists recognized for conviction, courage and sustained efforts". May 4, 2008. http://www.carnegiemedals.org/news/2007medals.html.

- "Ratan Tata gifts $50m to Cornell varsity". The Economic Times. October 21, 2008. http://economictimes.indiatimes.com/ET_Cetera/Ratan_Tata_gifts_50m_to_Cornell_varsity/articleshow/3622427.cms. Retrieved June 21, 2009.

- Timmons, Heather (January 4, 2008). "Tata Pulls Ford Units Into Its Orbit". The New York Times. http://www.nytimes.com/2008/01/04/business/worldbusiness/04tata.html?sq=tata&st=cse&adxnnl=1&scp=7&adxnnlx=1238497443-4R16x3p9Aj5a8CErvf45bw. Retrieved June 21, 2009.

- www.rediff.com/money/2006/dec/09tata.htm Godhra train burning

- "Dar annoys neighbours over $400m soda ash project". The East African (Nation Media Group). November 5, 2007. http://www.theeastafrican.co.ke/news/-/2558/256646/-/t682syz/-/index.html. Retrieved June 21, 2009.