

# The Relationship between Corporate Social Responsibility and Financial Performance: A Literature Review

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**Abstract** – Corporate social responsibility (CSR) concept has been widely understood. Organizations should not only pledge on their economic consequences but environmental and social implications as well. CSR value has been attained interest among practitioners, most of them are eager to ascertain if the social responsibility can elevate its financial performance. Anyhow, heterogeneous results and contrary between analysis data has been observed. This paper's objective is to identify the relationship between CSR and financial performance. It contains the integration of literature review between years 2011 to 2015 from the academics and researchers relating to the CSR and financial performance. Despite from the main variables, other factors such as the mediating variables, the approach applied, the methodology techniques and the industries involved are being discussed. This paper draws a link between CSR and corporate financial performance more deeply through the literature reviews analysis. The segregation of the literature review is presumed to have the comprehensiveness added for the future studies. The findings appeared to be consistence where CSR has a positive relationship to the financial performance. It validated the worth for an organization's efforts to apply CSR. Additionally, this study provides greater insights for future researchers to scrutinize in more specific area that will help to groom CSR in the industry. **Copyright © 2015 Penerbit Akademia Baru - All rights reserved.**

**Keywords:** Corporate Social Responsibility (CSR), Financial Performance

## 1.0 INTRODUCTION

The reasons to begin a business maybe varies; however, profit has well recognized as one of the ultimate goals for the set up. Typical businesses adopted wealth conscious and aimed to maximize shareholders' investment. The stakeholder theory has been introduced later to raise the awareness on businesses that practice without obligation. There are people and other groups such as customers, partners, suppliers, community, and government, namely the stakeholders whom are either directly or indirectly engaged with the businesses. Disegni *et al.* [3] stated that corporate has encountered difficulties in providing feasible principles to deal with more ethical decision making which do not harm the current society as well as the natural environment. Hence, corporate social responsibility (CSR) has been implemented with the management concept to involve these two issues in their businesses. The corporate efforts in integrating social and environmental aspects have been costs incurred.

Public sensitivity towards the business ethical related issues such as moral deficiency recently has drawn attention to the corporation [5]. Management is soon acknowledged the importance of ethics standards establishment in their firms. This driving force is required to prop up the

business position in various ethical circumstances. CSR is one of the features that needed to be considered in their daily functions. Rationally, the arguments rose between their ethical stand and businesses that contemplated returns maximization. Once the two components are incompatible, strive toward economic purpose and profitability would against ethical matters, it would eventually weaken the power of ethical. Thus, Chun *et al.* [5] highlighted the necessity on systematic research and exploration into the relationship of ethical and organization performance, undoubtedly also the underlying mechanisms. As mentioned in the earlier part, corporate has been emerged into social responsibility with the intent to gain competitive advantages. Alongside, the relationship between CSR and financial performance has induced a large academic literature. Many researchers found a positive relationship on the topic of CSR and financial performance, while oppositely others contributed a negative result on both of the variables [8]. Also, there are numbers of them demonstrating a nonexistent relationship. The different research outcomes may due to vary of industries background [2,5], other aspects considerations, such as economic disadvantages or employees behaviors [5,8], and the techniques of research [1]. Therefore, it is necessary to come out with a literature review to summarize the recent researchers' works.

### **1.1 Research Gaps**

Many of the previous studies has been attempted to focus on these two variables, CSR and financial performance [1-4,6,7,9-10,12]. Undoubtedly, they have created a broad understanding about how CSR contributes to the organization's financial performance. Nevertheless, the ethics process that holds an organization values and principles to guide the employees towards better performance remain unclear [5]. Ahamed *et al.* [12] also indicated that the nexus between CSR and financial performance is indeed indecisive. The conceptual papers or related literature reviews regarding this topic are rarely found too. This paper aimed to focus on the recent five years literature review, which lead to the intense outcome of whether CSR influences the organizations' financial performance. Hereby, this review paper may extend our knowledge towards more condensed version of the relationship between CSR and financial performance.

## **2.0 LITERATURE REVIEW**

### **2.1 Corporate Social Responsibility (CSR)**

In the challenging business world today, CSR plays an important role. CSR was first introduced by Sheldon back in 1924 [4], where he urged for the needs of management in human relations approach rather than positioned the profitability as the primary motivator for work. CSR is defined as the process where engagement is voluntarily given to the environment and social [7]. In developed countries, large organizations treated CSR as a common practice but this phenomenon was not as usual in the emerging countries, there are still controversies between [12]. Companies that own abundant assets may have the power to dispose their cash into numerous of social conscious programs such as alternative energy and social welfare activities.

Many attentions have been given to the topic of CSR due to its benefits was highly concerned especially the financial issue [1,7]. DiSegni *et al.* [3] emphasized that expedite of corporate responsibility and environmental sustainability is clearly seen in the unpredictable global market. Typically, the recognition of monetary figure and the additional advantages are expected on top of the operating philosophies. In Whalen [8] opinions, published CSR has almost identical meaning to the CSR where it involved volunteer in our Mother Earth and

honour every stakeholders. CSR can be also referred as corporate citizenship, where companies expressed their citizenship through pollution prevention and waste minimization processes.

## 2.2 Financial performance

Financial performance is generally well-known. It is defined as the attempt of an organization to meet its goals or being effective in productivity [13]. It can be easily measured by using the organizations' assets to explain how well an organization is making profit or the overall financial health. Many factors have been influenced the organizational financial performance, CSR is one of them. Return of assets (ROA), return of equity (ROE), return on investment (ROI) and net profit margin is the regular measurement data for financial performance [8-12]. Nevertheless, Lu *et al.* [11] broke down financial performance into three-group classifications, namely, 1) accounting based, 2) market-based, and 3) perceptual measures. Accounting-based can be related to the majority of research measurement tools, such as ROA, assets turnover and others. It examines organizations' growth through profitability and assets utilization. Alternatively, market-based measures financial performance via share price appreciation, price per share, which including stock performance, market return, market value to book, and so on. Ultimately, perceptual measures of an organization financial performance are solely based on subjective perceptions or assumptions. For example, the financial goal achievement relative to competitors, financial target position, or wise use of corporate assets. Perceptual measures are remarked largely subjective compare to market-based, which is mentioned as partly objective; while accounting-based is known to be audited and totally objective [11].

## 2.3 CSR and Financial Performance

The recent studies [1-4,6-7,9-10,13] marked a similar results, CSR is positively associated to financial performance. Chen and Wang [4] investigated the bond between CSR and financial performance in Chinese companies by using the stakeholder theory, which has been developed since 1960s. The argument is, companies that acquired CSR dynamically have been inclined, and from the strategic perspective, the stakeholders' interest counted. In the papers, nine types of stakeholders, named shareholders, managers, employees, creditors, suppliers, retailers, consumers, government and community has been looked into. Within two years, the variation of CSR and financial performance is studied. The results showed that with good CSR, companies' financial performance has been improved and vice versa [4].

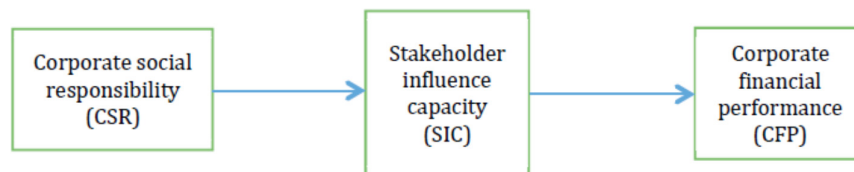
Quazi and Richardson [1] expressed that the possible connection between an organization's CSR and its financial performance is having an extent of contrast views. They explored two of the variables in three different aspects: time intervals (in five years' time), size of sample and the methodology employed. Quazi and Richardson [1] believed that the factors of sample size and statistical methodology are crucial as they may influence the outcome. It was concluded that results was more precise as time progressed and positive financial outcomes has been obtained. To put it another way, the longer term a firm is committed to CSR the greater the financial performance and thus the cycle continue. In order to interpret the data, meta-analysis has been used. For sample size, the results also became more significant when size increased. The meta-analysis by methodology is via t-test, confidence interval for the effect size is broadening compare to correlation employment [1].

Sun [7] successfully identified the association between CSR and financial performance by using a sample which is bigger and comparatively close to the present. As a control variable, the age of long-term assets is also been examined; its correlation with CSR is analyzed. Regression analysis method has been used in the paper. It revealed that CSR and financial performance obtain a significant and positive relation, as many prior studies [7]. It was

suggested that the firms with younger assets are tend to denote better CSR performance. For Ahamed *et al.* [12] study, the geographical choice is in Malaysia. The relationship between CSR and financial performance was measured in Malaysia's firms based on mainly four dimensions, the environment, marketplace, community and workplace. The two general terms for finance, return on asset (ROA) and return on equity (ROE) was used to test in regression analysis. CSR and finance performance has shown positive relationship when customized together [12].

Whalen [8] conducted a further contribution respecting the CSR and financial performance which has been lacking in healthcare industry and whether it resembles others. It was learned that CSR reacted positively towards the financial metric, return on assets (ROA); while it was not found in CSR with others sub-variables, the return on equity (ROE) and earnings per share (EPS). Mallin *et al.* [2] looked for the interrelationship of CSR and financial performance in the banking sector. Islamic bank was being focused, and the CSR index which covered ten dimensions is used. The CSR disclosure index consist the mandatory and voluntary disclosures as recommended in the Accounting and Auditing Organization for Islamic Financial Institutions, AAOIF Standard; and it was categorized into two parts, the items which are supposed to be in common bank and those which are only specialized in Islamic [13]. The empirical analysis showed the higher the CSR disclosure index, the better the bank performance.

For the more recent papers, in-depth research was involved as researchers aware on the mediating mechanism effects on the relationship [10,13]. Karaye *et al.* [13] proposed a conceptual framework that described in what manner CSR stimulates financial performance and the reason behind, along with the probable mediator, stakeholder influence capacity (SIC). The SIC definition was again referred back to stakeholder theory, similar instrument method as Chen and Wang [4]. They discovered that companies that generated return has practiced SIC, the stakeholder management which are divided into two major areas, internal and external. The research framework was designed as below:



**Figure 1:** Research Conceptual Framework, Karaye *et al.* [13]

Saeidi *et al.* [10] performed three potential mediators in the relationship between CSR and firm performance, namely sustainable competitive advantage, reputation and customer satisfaction. In the 21<sup>st</sup> century, concerns towards social responsibility has deliberately increased due to the stiff competition, enlighten of stakeholders and environment and rise of firm transparency demand [10]. Hence, for consumers' assurances and further ecological protection, it is debatable that CSR should not only affect directly towards firm performance but entirely mediated by competitive advantage, reputation and customer satisfaction. Firm performance is determined by balanced scorecard methodology, which is measured using ROA, ROE, return on investment (ROI), and net profit margin. In Saeidi *et al.* [10]'s findings, CSR is given positive effect in the relation to firm performance with the mediated of customer satisfaction, competitive advantage, and reputation.

By manipulated evidences from Global Reporting Initiative (GRI) reports, Chen *et al.* [6] addressed the relationship of CSR and financial performance concentrated in manufacturing industry. Stating that the connection between both variables are uncertain, structured content analysis method is being applied to identify the relationship. Overall, the CSR indicators have a significant positive correlation with financial performance, which is in the form of ROE. Chen *et al.* [6] also reported that companies that have performed well in GRI report likewise carried strong financial background. They closed by saying that CSR and financial performance are mutually dependent to each other.

### **3.0 RESEARCH METHODS**

First and foremost, the applicable studies regarding CSR and financial performance published in recent five years, 2011-2015 are selected randomly. A total of 13 journal articles are chose to analyze the contents of the documents. Each of the papers is outlined in a summary table ranked in ascending order of publication years. This literature review examines the industries involved, associated countries, the control variables, results and also measurement methods of the research papers. The main correlation between CSR and financial performance during these periods will be presented later.

### **4.0 DISCUSSION**

As can be seen from Table 1, the articles are distributed corresponding to the year of publication. The overall results of the relationships between CSR and organizations' financial performance appeared against one side, which indicated that they are positively associated to each other. CSR is measured via its own specific indexes based on the papers itself, for instant, CSR disclosure index covering ten dimensions [2], Dow Jones Sustainability Indexes (DJSI) [3], self-designed questionnaires of CSR [4], KLD index (a Boston-based consulting firm rating data) [7], CSR data rating or CSR index (CSRI) [8], CSR practices which represented by CSRD [12], and many more. List of industries and countries examined are provided to have a clearer view on the recent studies directions. According to Lu *et al.* [11], the understanding of relationships between some specific CSR and financial performance aspects can assist business management to leverage their CSR strategies and attain better organization performance with restrained financial resources. For different countries, industries or companies, the management can make their own comparison and create appropriate CSR activities that suitable to their own organization. Majority of the financial performance type is from accounting-based, which is exclusively objective and unbiased. Control variables are also generally stated in the articles, where firm size, industry, and financial/capital structures obtained the highest considerations. It can be concluded that, when the CSR practices increase, the profitability of the organization is increase as well.

**Table 1:** Summary table of the relationship between CSR and financial performance, Modified from Lu *et al.* [11]

No.	Title	Author (s) Years	Industry	Countries examined	Results	Control Variables	Financial Performance Type
1	Corporate social responsibility and corporate financial performance in China: an empirical research from Chinese firms	Chen and Wang [4]	46.5% in manufacturing and information	China	Positive	Industry background, nature of property right, phase of life cycle	Accounting-based
2	Sources of variation in linking corporate social responsibility and financial performance	Quazi and Richardson [1]	nil	United States	Moderately Positive	Firm size	Accounting-based, market-based, perceptual measures
3	Further evidence on the association between corporate social responsibility and financial performance	Sun [7]	Mix (Agriculture, mining & construction, food, textiles & apparel, paper, chemicals, refining, rubber, & plastic, heavy manufacturing, computer & precision products, auto & aerospace, transportation, telephone & utilities, wholesale & retails)	nil	Positive	Size, risk, industry, and the age of long-term assets	Accounting-based
4	Corporate Social Responsibility and its relationship with Financial Performance	Whalen [8]	Mix (33 companies with only 5 healthcare companies)	United States	Positive	nil	Accounting-based
5	How does corporate ethics contribute to firm financial performance? The mediating role of collective organizational commitment and organizational citizenship behavior	Chun et al. [5]	Manufacturing, financial service, services, construction, and others	Korean	Positive	Firm size, the effects of firms' financial structures and slack resources, industry, the effects of firm strategies	Accounting-based



6	Corporate social responsibility and firm performance in the airline industry: The moderating role of oil prices	Lee et al. [9]	Airline	United States	Positive	Firm size, capital structure, profitability, dividend payout, and economic conditions	Accounting-based
7	The mediating effect of stakeholder influence capacity on the relationship between corporate social responsibility and corporate financial performance	Karaye et al. [13]	nil	nil	Positive	nil	Accounting-based, and perceptual measures
8	Does Corporate Social Responsibility Lead to Improve in Firm Financial Performance? Evidence from Malaysia	Ahamed et al. [12]	nil	Malaysia	Positive	Firm size (number of employee within the firm) and firm sales (total revenue for the firm)	Accounting-based
9	Corporate social responsibility and financial performance in Islamic banks	Mallin et al. [2]	Islamic banking	13 countries namely Bahrain, Bangladesh, Indonesia, Jordan, Kuwait, Malaysia, Pakistan, Qatar, Saudi Arabia, Sudan, Syria, United Arab Emirates (UAE), and United Kingdom (UK)	Positive	Board size and the proportion of non-executive directors (NEDs), the natural logarithm of total assets, the macro-economic factors, Islamic banks operating business efficiency, the bank is private or listed	Accounting-based
10	A decade's debate on the nexus between corporate social and corporate financial performance: a critical review of empirical studies 2002-2011	Lu et al. [11]	nil	Many countries included United Kingdom (UK), United States of America (USA), India, Pakistan, Sri Lanka, Thailand, China, Latin America, Europe, Spain, Netherland, Taiwan, Indonesia, Australia, Canada, Korea, North America, Dubai, Japan, Spain, Brazil, Turkey, German	Mostly positive	Top five: size, industry, capital structure, financial return (ROA, ROE, ROS and EPS) and risk	Accounting-based, market-based, perceptual measures
11	Corporate social responsibility,	DiSegni et al. [3]	Mix (Banks, financial services, home furnishing,	United States	Positive	Each performance measure's	Accounting-based and market-based

	environmental leadership and financial performance		homebuilding, insurance, investment services, real estate operations, residential & commercial)			potential impact on the industry, sector and market level	
12	How does corporate social responsibility contribute to firm financial performance? The mediating role of competitive advantage, reputation, and customer satisfaction	Saeidi et al. [10]	Manufacturing and consumer	Iran	Positive	Firm size, age, and sale revenue	Accounting-based
13	The relationship between disclosures of corporate social performance and financial performance: Evidences from GRI reports in manufacturing industry	Chen et al. [6]	Manufacturing (automotive, metals products, forest and paper, chemical and health care)	nil	Positive	Industry, company that introduce GRI reporting system, company that publish standard GRI report	Accounting-based

Note: nil = no research falling in this kind



## 5.0 CONCLUSION

Companies should be encouraged to capture social responsibility as it might imply the favourable results [4]. With the input of resources and efforts contribution, stakeholders would offer extra commitments internally and externally, it would possess a positive image for the public. In the meantime, good impressions would definitely gain the companies more opportunities and businesses; therefore generate a better growth and returns. From the literature review, all the articles illustrated that CSR is positively associated with financial performance. Future researchers are recommended to include a mix-method approach which involves a larger sample sizes, specified in different countries with different economic criteria; for example, the developed countries, the developing countries (less developed countries) and undeveloped countries. Indirectly, it will also point out the distinct culture factor. Furthermore, obstacles that hindered organizations from implementing CSR strategies might also be another aspect that future researchers should look upon [10]. The limitation of this literature review is pointed to a relatively small sample size. A future study with much larger sample size should be able to bear a more affirm evidence for the two variables, CSR and financial performance as examined in the current study. Last but not least, corporations should be reminded that no business runs alone, CSR is to ensure the interaction with stakeholders to generate positive effect to the society as well as environmental, whilst making money.

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