

# Nexus between Corporate Social Responsibility and Corporate Financial Performance: An Empirical Evaluation

## Abstract

This research examines the influence of corporate social responsibility (CSR) initiatives on corporate financial performance (CFP), focusing on a sample of 150 manufacturing firms listed on the Nifty 500 index over the period from 2014 to 2019. The findings provide valuable insights into the ongoing discourse regarding the CSR-CFP nexus, demonstrating a significant and positive association between the two. Empirical analysis utilizing multivariate regression techniques confirms that CSR activities undertaken by the selected manufacturing firms are positively linked to enhanced financial performance.

**Keywords:** *CSR; Corporate financial performance; Multivariate analysis; Firm size; Manufacturing sector*

## 1. INTRODUCTION

For decades, CSR has developed as a buzzword in the business world. Nowadays, investors and stakeholders look into qualitative parameters that reflect upon social commitment and environmental aspects when determining the true worth of a firm. Previously, financial disclosures were adequate to respond to stakeholder demands. When it comes to deciding and analyzing a company's long-term value, nonfinancial data are often given precedence over financial data [1]. As a result, a company's ethical behavior has gotten a lot of attention.

Hence, Globally, the significance of CSR and sustainable studies is increasing. There has been increasing discussion and debate in industry and academic literature regarding Corporate Social responsibility and corporate financial performance nexus[2].

Despite a growing corpus of studies on the subject, the link between corporate social responsibility and CFP remains ambiguous[3]. Nonetheless, there are diverse arguments; there is no consensus or consistent outcome regarding the link between CSR and corporate performance [4]. The purpose of this study is to investigate the association between corporate social responsibility and CFP. Hence the current study answers the following questions.

- 1) Is there any linkage between CSR and Corporate financial performance?

The following is how the manuscript is organized: The literature review and hypotheses are developed in Section 2; the methodology and analyses are presented in Section 3; the results and discussion are presented in Section 4.

## **2. LITERATURE REVIEW**

CSR is "Corporate social responsibility implies bringing corporate behavior up to a level where it is congruent with the prevailing social norms, values, and expectations" [5]. However, there is a great deal of ambiguity and disagreement about the true definition of corporate social responsibility and the motivations for businesses to embrace it [6].

Over the past decades, CSR has gotten the attention of corporate[7]. Corporate firms realized the importance of corporate social responsibility. CSR has been interpreted through various arguments, ranging from the Friedman model to the corporate citizenship model. A company has no social responsibility; serving stockholders and shareholders is its crucial goal [8].

In contrast, the importance of CSR is emphasized[9]. Later in 1991, a new CSR model is presented and held that an organization's first and foremost objective is to make a profit, that is, "economic responsibility "[10] . Once this objective is accomplished, then comes "legal responsibility" and "ethical responsibility." The ultimate aim is "philanthropic," being a good corporate citizen by doing charity and helping the poor; this ensures social welfare and goodwill.

CSR's best conceptualization is developing even though CSR has potential benefits in satisfying stakeholder needs; moreover, there are various unanswered issues in the literature, such as how companies implement their CSR policies[11]. CSR and firm performance went through diverse arguments. Theoretically, neoclassical theory suggests CSR activities act as a financial disadvantage to the firm, resulting in an adverse relationship between CSR and firm performance[12]. Additionally, CSR appears to affect an organization's overall appeal to potential employees. Nonetheless, CSR practices impact a company's stakeholders' attitudes and behaviors, but it is still underdeveloped[13]. Also, awareness of CSR policies and activities appears to positively influence consumers' judgments of product characteristics[14]. Several studies have looked at the increased performance benefits of a company's commitment to CSR[15]. A favorable relationship suggests that CSR allows businesses to increase sales while cutting costs [16].

Another set of research claims that there is no link between CSR and performance. As a result, a neutral association between CSR and performance is asserted[17]. On the other hand, prior research reveals that investing in CSR has a negative impact on performance[18].

### ***2.1 CSR and Corporate financial performance***

A different approach has been offered in connection with CSR and firm performance relationships. The "Social impact hypothesis" of stakeholder's theory suggests that meeting the expectations of employees and customers will enhance the corporate image and reputation. Ultimately, this will improve the financial result of the firm[19]. Additionally, the socially responsible initiatives help reduce the cost of capital, subsequently resulting in improved financial performance[20]. Furthermore, increased CSR initiatives allow businesses

to take on less financial risk, resulting in enhanced economic stability and government relations[21]. Hence based on the literature review, we hypothesize that

H<sub>1</sub> – There is a significant association between CSR and corporate financial performance.

### 3. Methodology

#### 3.1 Data

This study examined secondary data of 150 manufacturing firms. The PROWESS IQ database was used to gather all of the data used in the analysis, including CSR expenditure from 2014 to 2019. Data was collected throughout six years.

#### 3.2 Correlation for the total sample

Table 1 specifies the correlation of the total sample. A positive correlation between ROA and all the explanatory variables was noticed except leverage.

	ROA	Tobin's q	CSR log	Turnover	LIQ	Leverage	AD insity	VIF
ROA	1							
Tobin's q	.72	1						
CSR log	.154	.109	1					1.03
Turnover	.21	.26	.03	1				1.08
LIQ	.26	.17	.05	-0.17	1			1.10
Leverage	-0.32	-0.28	-0.16	.127	-0.26	1		1.11
AD insity	.27	.29	-0.040	.171	-.045	-.0451	1	1.04

However, there is no such strong correlation identified between the variables. We checked the variance inflation factor to investigate the potential multicollinearity problem. The

variance inflation factor ranged from 1.03 to 1.11, indicating multicollinearity is not a severe concern.

### 3.3 Empirical model

The researchers employed multivariate regression to determine the association between CSR and CFP. The stationarity of all the variables is tested using the Levin, Lin & Chu t\* test and discovered that all variables are stationary at level.

We have estimated the coefficients by using the following model. Both accounting-based and market-based measures are used for measuring corporate financial performance. The first model used to explore the linkage is explained here.

$$ROA_{it} = \alpha_{11} + \beta_{11}CSR_{it} + \beta_{12}TURN_{it} + \beta_{13}LIQU_{it} + \beta_{14}LEV_{it} + \beta_{15}AD_{it} + \varepsilon_{it} \dots\dots\dots (1)$$

CSR disclosure can be better predicted by using accounting-based measures (Murray *et al.* 2006). Hence, we used return on assets as a proxy measure for accounting-based performance. In the first model, other than CSR, various other variables are also included since the influence of these variables cannot be ignored from the model.

$$Tobinsq_{it} = \alpha_{21} + \beta_{21}CSR_{it} + \beta_{22}TURN_{it} + \beta_{23}LIQU_{it} + \beta_{24}LEV_{it} + \beta_{25}AD_{it} + \varepsilon_{it} \dots\dots\dots (2)$$

In the second model, we try to explore the impact of CSR on market-based measures. The market-based measure is proxied by Tobin's Q. The variables used in this model and their description are explained here in Table 2.

<b>Table 2. Variables used in this model and their description</b>		
<b>Variable Name</b>	Variable Abbreviation	Variable Description

<b>Independent variables</b>		
<b>CSR ex</b>	CSR expenditure	The logarithm of the total amount spends on CSR for the year
<b>TURN</b>	Turnover	Net sales divided by total assets
<b>LIQU</b>	Quick ratio (times)	Quick asset divided by current liability
<b>LEV</b>	Debt to equity ratio (times)	Total debt divided by total equity
<b>SIZE</b>	Size	Natural logarithm of total asset
<b>ADVinsty</b>	Advertising Intensity	Advertising expenditure divided by sales
<b>Dependent variables</b>		
<b>Tobin's Q</b>	Tobin's Q	Market capitalization plus long-term debt plus short-term debt divided by total asset.
<b>ROA</b>	Return on asset	Net profit divided by total asset of the company

#### 4. Analysis and Results

##### *Regression analysis*

Multivariate regression analysis was conducted to recognize variables that enlighten the variation in corporate financial performance. The study shows that all the variables are highly significant at a 1% level except liquidity in the model (2).

Table 3. CSR -CFP relationship and moderating role.

Variables	Tobin's q	ROA
CSR log	1.603*** (0.222)	3.705*** (0.918)
Turnover	1.018***	3.914***

	(0.149)	(0.618)
LIQ	0.118*	1.309***
	(0.0668)	(0.276)
Leverage	-0.728***	-3.040***
	(0.12)	(0.496)
AD intsty	26.47***	120.4***
	(5.889)	(24.38)
Observation	444	444
R –Squared	.67	.66

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Standard errors in parentheses \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

This shows that CSR positively contributes to corporate financial performance in both the model at 1percent level. Additionally, the  $R^2$  in the model mentioned above is .66 in the first model and .67 in the second model. However, this implies that the independent variables explain 66 and 67 percent of the variation in corporate financial performance. The result of the multivariate regression is given in Table 3.

The firm's CSR activities are positively related to corporate financial performance. The CSR variable coefficient is statistically significant and positive, implying CSR activities improve a firm's economic performance.

### **IMPLICATIONS AND CONCLUSION**

The study has several implications. Firstly the study found a positive relationship between CSR and CFP. The outcome will help the managers in strategizing csr decisions. Additionally, firms can implement obligatory spending because it has a favourable impact on their profitability. The study suffers from limitations only Indian manufacturing firms are considered; hence, the result cannot be generalized to other countries. Additionally, cross-country comparison, as well as sectoral comparison, can bring further insights into this area.

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