Available online at www.elixirpublishers.com (Elixir International Journal)

Finance Management

Elixir Fin. Mgmt. 46 (2012) 8404-8409

ISSN: 2229-712X

Relationship between Corporate Social Responsibility (CSR) and Corporate Financial Performance (CFP): literature review approach

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ARTICLE INFO

Article history:
Received: 11 March 2012;
Received in revised form:
3 May 2012;
Accepted: 17 May 2012;

Keywords
Stock Market Returns,
Tobin's Q, CSR, CFP, ROA,
ROE, and ROS.

ABSTRACT

This study aims to analyze relationship between corporate social responsibility (CSR) and corporate financial performance (CFP) using content analysis from 1972 to 2012. In this study, strategy of Margolis and Walsh (2001), Orlitzky et al. (2003), and Dam (2008) is implemented and financial measures such as stock market returns, Tobin's Q, and accounting profits ratios e.g. return on assets (ROA), return on equity (ROE), and return on sales (ROS) are targeted. Study concludes that strong positive relationship exists between CSR and CFP using Tobin's Q as financial performance measure, mostly studies found positive relationship between CSR and CFP using ROA, ROE, & ROS as financial performance measure, and mostly studies found negative relationship between CSR and CFP using stock market returns as financial performance measures. This study will provide literature evidences as record about CSR and CFP to empirical as well as theoretical prospective researcher and limitations are discussed also.

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Introduction

Corporate social responsibility (CSR) and corporate financial performance (CFP) are linked with each other. CSR succors to improve employees' productivity and human relations. It also provides a way to avoid law suits, consumer boycotts, and environmental scandals. Baron (2001) reported that CSR is linked with role of civil society and modern political theory and Heal (2005) stated that "it involves taking actions which reduce the extent of externalized costs or avoid distributional conflicts." On the other hand, it is also supposed that CSR is linked with financial performance because similar results are found of financial performance measurements without external factors and different results are found of financial performance measurement with external factors. For instance, accounting profits are negatively correlated with external factors and lower profits negatively affect corporations' stock market value. Therefore, there is no directly proportional relationship between accounting profits and stock market prices.

In 2005, United States (U.S) invested one dollar out of every ten dollars on professional management as social responsibility and socially responsible investors were well known about the responsibility of production of external factors that external factors affect their shares' demand so they considered these factors as their property. It concluded that market value of corporate is affected by corporate social responsibility. It was recognized that corporates should maximize its market value through social planner's solution and competitive stock market. Coase (1960) claimed that when property rights are defined then external factors should resolve and Jensen (2002) argued that corporates should have objective of market value maximization because maximized profits and values are two different things.

During 1972-2001, round-about ninety-five empirical evidences have been provided by Margolis and Walsh (2001) and Orlitzky et al. (2003) regarding CSR and financial performance. In these studies, CSR was independent variable; whereas, financial performance was dependent variable. Fifty three percent showed positive relationship between them, twenty four percent shows no relationship between them, nineteen percent showed mixed relationship with them, and five percent showed negative relationship between them. Dam (2008) also further provided empirical evidences regarding CSR and financial performance but there was one uniqueness and common thing. The uniqueness of work was distribution of empirical findings in tabulated form on the base of return on assets (ROA), return on equity (ROE), return on sales (ROS), Tobin's Q, and stock market returns and common thing was that only empirical findings from 1972-2001 was tabulated.

This study aims to analyze the relationship between corporate social responsibility (CSR) and corporate financial performance (CFP) using content analysis from 1972 to 2012. In this study, strategy of Margolis and Walsh (2001), Orlitzky et al. (2003), and Dam (2008) is implemented and empirical findings from 1972 to 2012 are tabulated on the base of measures such as stock market returns, Tobin's Q and accounting profits ratios e.g. return on assets (ROA), return on equity (ROE), and return on sales (ROS). As regard to rationale of study, it will provide literature evidences as record about corporate social responsibility and corporate financial performance to empirical as well as theoretical prospective researcher.

Research questions of this study are:

RQ 1 Is Corporate Social Responsibility (CSR) positively correlated with Corporate Financial Performance (CFP) using Tobin's Q or Market to Book Ratio?

RQ 2 Is Corporate Social Responsibility (CSR) positively correlated with Corporate Financial Performance (CFP) using Return on Assets (ROA), Return on Equity (ROE), and Return on Sales (ROS)?

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RQ 3 Is Corporate Social Responsibility (CSR) negatively correlated with Corporate Financial Performance (CFP) using stock market returns?

Empirical Literature Findings

Market to Book ratio is a vital indicator of financial performance which includes the effects of external factors on corporate's internal performance. Table 1 is showing the results of five studies which analyzed the relationship of corporate social responsibility and financial Performance. In these studies, market to book ratio was used as proxy of financial performance. All studies found strong positive relationship between corporate social responsibility and financial Performance using market to book ratio.

Return on Assets (ROA), Return on Equity (ROE), and Return on Sales (ROS) are accounting ratios which shows that how effectively and efficiently management use corporate's assets and equity to enhance inventory turnover and sales to earn profit. Table 2 is showing the results of forty-five studies which analyzed the relationship of corporate social responsibility and financial Performance. In these studies, Return on Assets (ROA), Return on Equity (ROE), and Return on Sales (ROS) were used as proxies of financial performance.

On the base of Table 2, out of forty-five studies, thirty-five studies found positive relationship between corporate social responsibility and financial performance, nine studies out of forty-five studies showed no effect of corporate social responsibility on financial performance, one study out of forty-five studies showed mixed, and, surprisingly, there was not a single study that showed negative relationship between corporate social responsibility and financial performance. On the other hand, seventeen out of forty-five found strong relationship, sixteen out of forty-five found weak relationships, ten out of forty-five found moderate relationships, and two out of forty-five found no relationship.

Stock market return is an external factor that reflects financial performance of an organization. Table 3 is showing the results of twenty-five studies which analyzed the relationship of corporate social responsibility and corporate financial Performance. In these studies, stock market returns was used as proxies of financial performance.

On the base of Table 3, eight studies out of twenty-five studies found negative relationship, seven studies out of twenty-five studies found positive relationship, seven studies out of twenty-five studies found no relationship, and three studies out of twenty-five studies found mixed relationship between corporate social responsibility and financial performance using stock market return. On the other hand, four out of twenty-five found strong relationship, seven out of twenty-five found weak relationship, thirteen out of twenty-five found moderate relationship, and one out of twenty-five found no relationship.

Conclusions

This purpose of this study is to analyze the relationship between corporate social responsibility (CSR) and corporate financial performance (CFP) using content analysis from 1972 to 2012. This study concludes from above empirical literature evidences that corporate social responsibility (CSR) is highly linked with corporate financial performance (CFP). Table 4 is reflecting the overview of empirical findings. Firstly, thirty-five studies out of forty-five found that CSR is positively correlated with CFP, one study out of forty-five found mixed correlation between CSR and CFP, no study out of forty-five found negative correlation between CSR and CFP, and nine studies out of forty-five studies found no relationship between CSR and CFP using ROA, ROE, and ROS. Secondly, six studies out of six found positive relationship between CSR and CFP using market to book ratio / Tobin's Q. Lastly, seven studies out of twenty-five studies found positive relation between CSR and CFP, three studies out of twenty-five studies found mixed relation between CSR and CFP, eight studies out of twenty-five studies found negative relation between CSR and CFP, and seven studies out of twenty-five studies found no relation between CSR and CFP using stock market returns.

This study is based on earlier literature evidences without any bias. It I probable that there would some other literature evidences that are not incorporated in this study. That's why, these results are not generalized because results can be changes through incorporated more literature evidences especially regard to relationship between CSR and CFP using stock market returns because seven studies found positive relationship, three studies found mixed relationship, eight studies found negative relationship, and seven studies found no relation between CSR and CFP using stock market returns.

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Table 1 Studies Using Market to Book Ratio /Tobin's Q

Sr. No.	Authors	Strength of Result	Relationship
1	Choi et al. (2010)	Strong	Positive
2	King and Lenox (2001)	Strong	Positive
3	Dowell et al. (2000)	Strong	Positive
4	Hamilton (1995)	Strong	Positive
5	Brown and Perry (1994)	Strong	Positive
6	Fombrun and Shanley (1990)	Strong	Positive

Table 2 Studies Using ROA, ROE, and ROS

Sr. No.	Studies	Strength of Result	Relationship
1	Ahmed et al. (2012)	Strong	Positive
2	Matin et al. (2011)	Strong	Positive
3	Vitezić (2011)	Strong	Positive
4	Setiawan and Darmawan (2011)	Strong	Positive
5	Keffas et al. (2011)	Strong	Positive
6	Choi et al. (2010)	Strong	Positive
7	Cheung et al. (2010)	Strong	Positive
8	Fauzi et al.(2007)	Strong	Positive
9	Tsoutsoura (2004)	Strong	Positive
10	Graves and Waddock (2000)	Moderate	Positive
11	Berman et al. (1999)	Strong	Positive
12	Johnson and Greening (1999)	Moderate	No Effect/Positive
13	Judge Jr. and Douglas (1998)	Strong	Positive
14	Preston and OBannon (1997)	Strong	Positive
15	Waddock and Graves (1997)	Strong	Positive
16	Russo and Fouts (1997)	Moderate	Positive
17	Turban and Greening (1997)	Moderate	Positive
18	Griffin and Mahon (1997)	Weak	Positive
19	Hart and Ahuja (1996)	Moderate	Positive
20	Simerly (1995)	Strong	Positive
21	Pava and Krausz (1995)	Weak	Positive
22	Greening (1995)	N/A	Positive
23	Brown and Perry (1994)	Strong	Positive
24	Dooley and Lerner (1994)	Strong	Positive
25	Graves andWaddock (1994)	Moderate	Positive
26	Herremans et al. (1993)	Moderate	Positive
27	Patten (1991)	Strong	No Effect
28	O'Neill et al. (1989)	Weak	No Effect
29	McGuire et al. (1988)	Moderate	Positive
30	Spencer and Taylor (1987)	Moderate	Positive
31	Wokutch and Spencer (1987)	Weak	Positive
32	Marcus and Goodman (1986)	Weak	Positive
33	Rockness et al. (1986)	Weak	No Effect
34	Aupperle et al. (1985)	Weak	No Effect
35	Cochran andWood (1984)	Weak	No Effect/Mixed
36	Freedman and Jaggi (1982)	Weak	No Effect
37	Anderson and Frankle (1980)	Weak	Positive
38	Chen and Metcalf (1980)	Weak	No Effect
39	Ingram and Frazier (1980)	Weak	No Effect
40	Abbott and Monsen (1979)	Weak	Positive
41	Bowman (1978)	Weak	Positive
42	Preston (1978)	N/A	Positive
43	Heinze (1976)	Moderate	Positive
44	Parket and Eilbirt (1975)	Weak	Positive
45	Bragdon Jr. and Marlin (1972)	Weak	Positive

Table 3 Studies Using Stock Market Returns

Sr. No.	Authors	Strength of Result	Relationship
1	Vitezić (2011)	Strong	Positive
2	Setiawan and Darmawan (2011)	Strong	Positive
3	Brown (1998)	Moderate	Positive
4	Blacconiere and Northcut (1997)	Moderate	Negative
5	Boyle et al. (1997)	Moderate	Positive
6	Guerard Jr. (1997b)	Moderate	Mixed
7	Guerard Jr. (1997a)	N/A	No effect
8	Klassen and McLaughlin (1996)	Moderate	Negative
9	Diltz (1995)	Weak	Mixed
10	Pava and Krausz (1995)	Weak	No effect
11	Blacconiere and Patten (1994)	Moderate	Negative
12	Hamilton et al. (1993)	Moderate	No effect
13	Davidson III andWorrell (1992)	Weak	Mixed
14	Freedman and Stagliano (1991)	Strong/Moderate	Positive
15	Patten (1990)	Weak	No effect
16	McGuire et al. (1988)	Moderate	Positive
17	Freedman and Jaggi (1986)	Moderate	No effect
18	Newgren et al. (1985)	Moderate	Negative
19	Stevens (1984)	Moderate	Negative
20	Shane and Spicer (1983)	Moderate	Negative
21	Chen and Metcalf (1980)	Weak	No effect
22	Ingram (1978)	Moderate	Positive
23	Alexander and Buchholz (1978)	Weak	No effect
24	Belkaoui (1976)	Weak	Negative
25	Vance (1975)	Strong	Negative

Table 4 Overview of Empirical Findings

Financial Performance Indicators	No. of Studies	Positive Relation	Mixed Relation	Negative Relation	No Relation
ROA, ROE, ROS	45	35 (77.8%)	01 (2.2%)	00 (0%)	9 (20%)
Market to Book Ratio	06	6 (100%)	00 (0%)	00 (0%)	00 (0%)
Stock Market Returns	25	07 (28%)	3 (12%)	8 (32%)	7 (28%)
Total	76	48(63.2%)	04(5.3%)	08(10.5%)	16(21%)