



## Nikoleta Musiał

University of Economics in Katowice  
Faculty of Economics  
Department of Economics  
nikoleta.musial@edu.uekat.pl

# THE RELATIONSHIP BETWEEN CORPORATE SOCIAL RESPONSIBILITY AND CORPORATE FINANCIAL PERFORMANCE

**Summary:** It is extensively studied if the relationship between CSR (Corporate Social Responsibility) and CFP (Corporate Financial Performance) may be distinguished. All the evidence proving or denying the relationship is unambiguous. One of the biggest problems are the varied results connected with the lack of methods to compare CSR and CFP. The aim of this article is to indicate the importance of both, CSR and CFP. It is also important to mention the researchers' subjectivity and bias of selection. Companies may improve their position in the market by paying more attention to CSR issues and that may positively influence their CFP, which is the main target for all organisations.

**Keywords:** Corporate Social Responsibility, Corporate Financial Performance, CSR and CFP.

**JEL Classification:** P43, E62.

## Introduction

It is often believed that the most important and only responsibility of a company is to increase the value for shareholders. The main target for all organisations, especially for those in the private sector, is to constantly grow profits [Friedman, 1970]. Achieving the company's target should not cause any negative effects for other stakeholders and also society. Businesses are based on a given part of a society which are able to help achieve the economic goals. It is important to manage a long-lasting relationship with stakeholders which may positively influence a company over the time [Crane i in., 2008]. All the stakeholders may potentially influence a company performance. Market components, for

example customers, employees or suppliers, may directly induce deficiency by making unfavorable decisions for a given organization, for example based on their purchase choices [Delmas, Toffel, 2008]. Economic rents may be easily influenced because of the dissatisfaction of any of the stakeholder group despite all different transmission mechanisms [Clarkson, 1995]. The debate on the relationship between corporate financial performance (CFP) and corporate social responsibility (CSR) continues. Taking into consideration the nature of CFP and CSR it may be said that the relationship between these two concepts is equivocal. Some studies proved that the relationship is positive while various other studies found it rather negative. Despite the diversity, it may be stated that the positive relationship is more general than any other type [Orlitzky, Schmidt, Rynes, 2003]. A common distinguished reason of the equivocal character of the relationship is how CFP and CSR are measured and operationalised. The CFP concept is measured with the profitability of a given company that is relatively standardised and available. For several reasons the measurement of CSR is more problematic. The main problem is the lack of the agreement concerning operationalisation of the concept [Dahlsrud, 2008] and, because of the fact that the CSR concept is non-financial, there is only little reporting standardisation, because it is not mandatory [Tschopp, Natansky, 2014].

## **1. Corporate Social Responsibility and Corporate Financial Performance**

Corporate social responsibility (CSR), called also corporate sustainability, corporate citizenship or responsible business, is a kind of international self-regulations when it comes to business [Sheehy, 2015]. It may be also described as an internal policy or an ethic strategy. By time the CSR concept is connected with the development of new international laws. Various companies using their authority were able to push important initiatives among organisations [Dann, 2009]. It has been considered a way of creation of corporate self-regulation for some period of time. Nowadays, it has moved from voluntary choices and decisions in individual organisations to mandatory plans and schemes at regional, national and sometimes even translational level [Sheehy, 2015]. Corporate finance performance (CFP) refers to a level to which all financial objectives are accomplished. It is also a very important aspect of the financial risk management. Also, it may be described as a process of measuring results in terms of company's policies and all operations in the monetary term. Generally, it is used to

check and measure company's financial position over a certain period of time and compare similar organisations [Verma, 2017]. In both cases, there is a wide range of possible definitions and also perceptions from the point of view of different units, for example managers, customers or ordinary people [Lau, Hulpke, Kelly, 2007]. CFP is visible in a company and its presence is undeniable. Using the concept of CSR in a company is a choice made by authorities. Nowadays, more and more organisations decide to take advantages of using the concept of CSR. Organisations engage CSR activities for several reasons. The most important and crucial reason is philanthropy. It may be understood as actions which are taken to create a better world or society without expecting any payback. This reason may be caused by both – internal morals among a given company or pressure from the environment. In return, benefits, for example financial profits or stronger and more reliable reputation of a company, may occur [Lee, Shin, 2010]. Due to introducing CSR strategy, a firm may obtain higher quality employees and may become a source of the competitive advantage. It also may help achieve a long-lasting and more profitable relationship with customers [Weber, 2008]. A crucial case in a corporate governance and management is an influence of the CSR concept on organisations' performance, mostly financial performance. The CSR is very costly. The examples of CSR actions include benefits for employees, expenses connected with pollution reduction, donations and sponsorships. Worth mentioning is also the fact that some authors are convinced that CSR actions taken by organisations are only kind of a marketing strategy. In that situation the philanthropy of the concept may be doubtful [Stefaniak, 2019].

## **2. The relationship between concepts**

The conventional view assumes that the expenses deteriorate profitability and may lead to competitive disadvantages [Alexander, Buchholz, 1978]. Freeman in 1984 introduced the opposite view which was promoted by the stakeholder theory. If any of the stakeholder group is dissatisfied with a performance of a company, it may potentially influence economic rents and compromise a firm's future [Clarkson, 1995]. A company needs to learn to manage CRS properly. It may not only improve stakeholders' satisfaction but it also may improve a financial performance of a company, for example if an employee is satisfied, he or she will be much more motivated to perform more efficiently and effectively, as well as a satisfied customer will be willing to purchase a product again and recommend a company to other potential customers, which may lead

to obtaining a discount provided by a satisfied supplier [Aver, Cadez, 2009]. The positive and negative relationship between CSR and CFP may be distinguished. A positive relationship suggests that CSR improves profitability. If a positive effect of CSR on CFP may be observed, it is also possible that the socially responsible investments may have positive impact on shareholder value. On the contrary, corporate social responsibility is very expensive and may influence a company's profit. Investing in the CSR concept may be highly irresponsible and risky because the main and the most important reason of the existence of a company is the profit. However, it must be admitted that the negative link between these two concepts does not influence the decision connected with the introduction CSR in an organisation. Most of the managers believe that it is crucial to be corporate citizens, even if it may seem to be expensive [Moser, Martin, 2012]. Additionally, shareholders may be also very ethical and may require the CSR concept actions, even if it may negatively influence a company's financial performance [Mackey, Mackey, Barney, 2007]. The most important relationship between CSR and CFP is that firms which have very low CSR performance have also very low CFP performance and companies with relatively high CSR performance have relatively high CFP performance. That may strongly suggest that there is a visible relationship between CSR and CFP concept, which, based on the strategy of a company, may be positive or negative [Bowman, Haire, 1975]. The problem with a simple comparison between CSR and CFP is that there is a lack in CSR measurement. Firstly, there is still missing a theoretical meaning of corporate social responsibility concept [Dahlsrud, 2008], and secondly, the concept seems to be multidimensional with heterogeneous dimensions [Carroll, 1979]. Different approaches and methods were used to measure the CSR concept due to the complexity of CSR. It is possible to distinguish the following groups ordered by the frequency of use. First of all, reputation indices is the most common and popular way of measuring the CSR concept. The reputation indices acknowledge the nature of CSR which is multidimensional. The key themes are very similar, like for example natural environment, society, employees [Griffin, Mahon, 1997]. The most common index used to measure CSR is MSCI KLD. It is very popular because of its comprehensive data on the stakeholder management and the public data commonly available [Coombs, Gilley, 2005]. The MSCI KLD index was for the first time introduced in 1990 and it was created to help socially conscious investors include the social and environmental factors in all their investment choices and decisions. The index is universal for all companies and in a very simple way may influence a company's performance. The

biggest disadvantage of the MSCI KLD index is the limited coverage of the firms due to the geographic area. Many of the indices are able to cover only a particular region or a country. Generally, the indices try to concentrate on large companies. It is also very important to mention that the indexes, such as MSCI KLD index, does not include operating in non-sustainable industries, for example tobacco, alcohol or adult entertainment. All in all, many socially and also environmentally responsible firms may not be taken to the list due to the size, geographic location and affiliation [Adam, Shavit, 2008]. Content analysis is the second most popular way of measuring the CSR concept. Content analysis mostly includes establishing the constructs of interest, looking for the information about the constructs and codifying information to inquire quantitative scales which may be easily used in the further statistical analyses. The content analyses differ with numbers of dimensions and sophistication of the coding system. One of the relatively simple ways of coding may be counting words or sentences in every report and also publications connected with the CSR specific issue and determining binary variables in a case of mentioning a particular issue [Aras, Aybars, Kutlu, 2010]. More advanced way to code is pre-specification of CSR dimensions connected with the interest and determining interval scores to the certain issue which is to be considered. It is very similar to Likert scales. Social Involvement Disclosure (SID) scale is an attempt to introduce pre-specification of dimensions. There are 24 CSR indicators which are divided into 6 categories (environment, opportunity, personnel, products, community involvement and other) [Abbott, Monsen, 1979]. In recent studies [Yang, Lin, Chang, 2009] the 5 groups were introduced (employee and shareholder relations, environment, quality of a product and relations with providers and customers and community) on the 0-5 rating scale (0 means fulfillment of any of given criteria and 5 means fulfillment of all given criteria) [Karagiorgos, 2010]. The main advantage of the method is its flexibility for a researcher. The researcher may specify the CSR dimensions of interest collect all data according to the dimensions and at the end code the data for the further use in other statistical analyses. The most important disadvantage of this method is the researcher subjectivity settled in the stages of all the process [Turker, 2009]. Moreover, questionnaire-based surveys are used when a given company is not rated by any rating agency and its corporate reports are insufficient or unavailable to maintain a meaningful analysis. In such case, a responsible person needs to collect data about the CSR concept by sending surveys to respondents. This method is very similar to the content analysis. It may provide flexibility for the researcher while specifying the interest and col-

lecting data about the dimensions of the interest. The main disadvantage to the limitation of the survey is the response bias. The bias may appear in two levels: selection bias and attitude bias. Selection bias are connected with the fact the companies which are more socially responsible are more willing to respond than the ones which are less socially responsible [Cadez, Czerny, 2016]. Attitude bias may appear while a respondent could want to provide more desirable answers even if actual behavior of a company might be different [Epstein, Rejc-Buhovac, 2014]. Also, one-dimensional measures focus on a given dimension of CSR, for example environmental activities which include pollution control investment documents [Peng, Yang, 2014]. One of the advantages of one-dimensional indices are availability of data (simultaneously with minimising data gathering effort) and comparability across other organisations. Using of one-dimensional constructions may be very problematic because of that fact that the CSR concept is multidimensional, for example a given company may be strongly involved in one dimension and at the same time neglect other dimensions [Caroll, 1979]. CFP is generally measured with the accounting – or market-based indicators. Each of them may contain positive and negative traits. Accounting-based measures are commonly available for all organisations and reasonably comparable. The limitation is that they are available for publicly listed organisations only [McGuire, Sundgren, Schneeweis, 1988].

## **Conclusions**

The impact of CSR on CFP is an important issue for all managers [Cochran, Wood, 1984]. Despite all the evidence connected with the presence of the CSR concept in organisations, it is still very problematic to prove the relationship between CSR and CFP [Griffin, Mahon, 1997]. It must be admitted that there is no perfect and universal measure for CSR and CFP. Even though, the measurement issue is more efficient and effective when it comes to CFP because financial reporting is largely standardised, in contrast to the CSR concept, which still requires more standardisation and development [Tschopp, Natanski, 2014]. All known indices are still far from being perfect and reliable measures for CSR [Graafland, Eijffinger, SmidJohan, 2004]. It must be remembered that the lack of proper measurements determines the problem connected not only with the comparison these two concepts, but also with the detection the mutual relationship between CSR and CFP [Henriques, Sadorsky, 1999]. Corporate social responsibility may be considered as a strategy for a company which cannot be introduced

without a successful CFP concept. Satisfied employees are more productive and more motivated to work, which may lead to the improvement of the customer satisfaction. Satisfied clients may repeat their purchases and encourage other potential customer to purchase. That may lead the creation of a strong relationship between a customer and company. Through the good reputation of a company, clients may try to identify themselves with a given firm which may increase customer loyalty. Even if there are some evidence of negative relationship between CSR and CFP, it must be admitted that only combining a successful CSR concept with effective CFP concept is the most profitable solution for a company [Maqbool, Zammer, 2018].

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## ZWIĄZEK POMIĘDZY SPOŁECZNĄ ODPOWIEDZIALNOŚCIĄ BIZNESU A KORPORACYJNYM WYNIKIEM FINANSOWYM

**Streszczenie:** Artykuł analizuje związek pomiędzy społeczną odpowiedzialnością w biznesie a wynikami finansowymi przedsiębiorstw. Jednym z największych problemów są zróżnicowane wyniki związane z brakiem metod porównywania CSR oraz CFP. Celem tego artykułu jest wskazanie na znaczenie zarówno CSR, jak i CFP. Należy również wspomnieć o subiektywności badaczy i ich subiektywnych wyborach. Firmy mogą poprawić swoją pozycję na rynku, zwracając większą uwagę na kwestie związane z CSR, co może pozytywnie wpłynąć na CFP, który jest głównym celem wszystkich organizacji.

**Słowa kluczowe:** społeczna odpowiedzialność w biznesie, wyniki finansowe przedsiębiorstw.