

A Theoretical Study of The Relationship Between Corporate Social Responsibility and Financial Performance

دراسة نظرية للعلاقة بين المسؤولية الاجتماعية للشركات والأداء المالي

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Abstract:

This research aims to clarify the relationship between corporate social responsibility and financial performance, as most of the results of previous studies indicate a positive relationship between them, Other studies indicate that there is no direct relationship, based on a survey of a sample of economic institutions, while few see that there is a relationship or an opposite effect.

The most important finding of this study is that the most correct decision, according to the analysis of some studies, is that there is of course an effect of social obligation on financial performance, but this effect is not direct.

Key words: Corporate Social Responsibility; Financial Performance; Profitability.

ملخص:

يهدف هذا البحث إلى توضيح العلاقة بين المسؤولية الاجتماعية للشركات والأداء المالي، حيث تشير معظم نتائج الدراسات السابقة إلى وجود علاقة إيجابية بينهما، مع اختلاف أدوات القياس والتقييم، سواء في قياس الأداء المالي (المحاسبة أو القيمة السوقية أو معايير أخرى)، أو عند تقييم التزام المؤسسة تجاه المجتمع. وفي المقابل تشير دراسات أخرى بناء على مسح لعينة من المؤسسات الاقتصادية إلى عدم وجود علاقة مباشرة بين المتغيرين.

وأهم ما توصلت إليه هذه الدراسة هو أن القرار الأصح بحسب تحليل بعض الدراسات هو أن هناك تأثير للالتزام الاجتماعي على الأداء المالي، لكنه تأثير غير مباشر.

الكلمات المفتاحية: المسؤولية الاجتماعية للشركات، الأداء المالي، المردودية.

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1. Introduction

As a result of economic, political and social developments, the last decades of the twentieth century witnessed a development in the view of the objectives of business organizations, as the evaluation of companies no longer depends on the profits they achieve, but rather recently realized that they are not isolated from society, and alerted to the need to consider corporate governance, Ethical behaviors, ocean priority and social responsibility.

So, the business sector has become subject to many criticisms from society and its various bodies, for the negative effects of companies' practices as a result of their lack of commitment to social responsibility. Thus, it has become a strategic decision that companies adopt at different levels, as some of these companies apply social responsibility, compelled by law, so we see that they provide the community with less than what is required of them, and others apply it voluntarily and with a desire to contribute to achieving the welfare of society.

That is why many studies have emerged that have tried to measure the extent to which companies carry out their social responsibility and the relationship of this practice to some variables such as financial performance. By establishing the rules of the relationship between social responsibility and financial performance, in an attempt to understand and analyze them in order to reach practical results that can be applied, and guiding tips that can be useful to managers and businessmen.

Through this research paper, we will address the theoretical framework to determine the importance of social responsibility in influencing the financial performance of companies, which includes:

The first axis: Concepts about corporate social responsibility, where we will learn about the concept of corporate social responsibility, its development and models. The second axis: the areas of corporate social responsibility and its relationship to financial performance, where we will learn about the parties to which the corporate social responsibility programs are directed, the relationship of corporate social responsibility with stakeholders, and the relationship of the latter to the financial performance of companies. The third axis: the pillars of the success of companies in adopting corporate social responsibility, where we will learn about the motives for adopting corporate social responsibility and its importance, as well as international experiences in the field of corporate social responsibility.

2. Conceptual framework for corporate social responsibility

In light of recent developments and social and environmental awareness, the view of business organizations has expanded, as they are considered as an open system that affects and is affected by the environment in which they live, and companies have recently realized that they are not isolated from society, so they had to adopt new strategies that consider the requirements of their environment

and the interests of other parties. In society, hence a new concept known as corporate social responsibility. On this basis, we will try to identify this concept.

The concept of social responsibility was not clearly known in the first half of the twentieth century, as business organizations were trying to maximize their profits by all means. However, with the continuous criticism of the concept of profits, motives emerged for organizations to adopt a greater role towards the environment in which they operate, and drew attention to the need to consider the three aspects defined by the World Business Council for Sustainable Development, which are economic growth, technological progress and environmental protection. So, maximizing organizational wealth is by bringing the relations between managers and stakeholders to an optimal level, and companies have established organizational units whose mission is to communicate with stakeholders, called the Communications Department or the Corporate Social Responsibility Committee.

This is why there are many definitions that dealt with the concept of social responsibility, according to the different nature of the companies' work and their material, human and environmental capabilities, as well as the regulations and legislation that govern and regulate their work.

It was pointed out by that trying to find a clear and comprehensive definition of the concept of corporate social responsibility, which has emerged under various names, including: social accountability, corporate citizenship, social solidarity, social conscience... (Carter, A & Burritt, R, 2007, pp. 17-27)¹ It is a difficult task, as the This term is complex, as is the term globalization and sustainable development, these terms have many meanings whereby clarifying one of them shows a new understanding of the term.

In general, there are three directions for the interpretation of social responsibility by companies: (Jean-Marie, 2012)²

* **Ethical approach:** appeared in the United States of America in the fifties of the last century and is based in its concept on the moral and religious values of the manager. Infringement of the rights of others, as well as the obligation of wealthy people to help the poor, and thus the first concept of social responsibility based in its essence on charitable works and the responsibility of the two leaders towards society appeared.

* **The utilitarian approach:** It emerged in the eighties of the last century as a fundamental problem in strategic management and is based on economic performance as the ultimate goal of the institution, considering social responsibility as a means to achieve its financial performance.

* **The “Business and Society” approach:** This approach is embodied through the concept of sustainable development as its first conception. The American approach based on ethics has replaced the dimensions of sustainable development by dropping the dimensions of sustainable development on social responsibility represented in the economic, social and environmental dimension, the problem of the first trend in this approach, while the second embodiment is represented in The theory of stakeholders and what they expect as returns from

the institution, which in their entirety constitute the basic basis for putting social responsibility into practice.

The ethical approach stems in its concept from the personal values of the individual, which leads us to consider social responsibility that is reflected in the benefit of society without the institution, as it is based on a set of morals.

Which the manager may adhere to in his decision-making or decide not to abide by it, and this is in contrast to the utilitarian approach, which considered the social responsibility of institutions as a tool to achieve its economic goal. The three approaches to sustainable development are combined with the first and second approaches, as they work to achieve profit for the institution, considering the social and environmental impact of its activity.

On this basis, we can say that corporate social responsibility is: ethical and environmental commitment to the company's internal and external community, meaning that financial success alone is not enough, but other factors must be considered.

3. Conceptual framework for financial performance

The financial performance of the institutions is measured by three basic indicators that reflect the financial activity of the institution during a certain period of time. The economic profitability is measured by calculating the return on assets index (ROA), the financial one is measured by the return on equity index (ROE) and finally the commercial profitability measured by the turnover. (Christophe & Tensaout, 2014, pp. 73-99)³

The financial performance of the institution reflects the extent of its ability to meet the aspirations and desires of its shareholders. The institution that is considered to have the highest financial performance is the one that fulfills the financial desires of its shareholders. As for the institution that is characterized by poor financial performance, it is the one whose financial results do not aim at the aspirations of shareholders according to the previous definition which in its aspects, it does not address the stakeholders, and in its content, it is satisfied with the shareholders as the only party that the organization seeks through its financial performance to meet their ambitions.

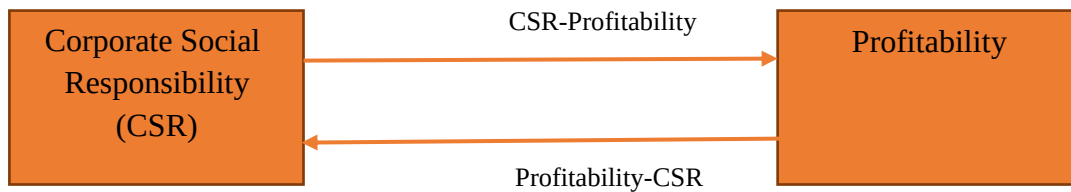
4. The relationship between CSR and profitability

The relationship between CSR and profitability, or firm's financial performance, has been discussing for many years. Many empirical studies carried out by different researchers show diverse findings. Since most articles do not determine the difference between profitability and financial performance of a company specifically, in this dissertation, the profitability of the company not only narrowly means the net profit, but also refers to a positive financial performance of the company from a holistic point of view.

Moreover, the relationship between CSR and profitability is a two-way association (Figure 1). Researchers not only study how a firm's CSR influence the financial impacts, but also focus on how financial performance has impacts on

CSR. However, in this mutual association, some researchers generated more detail research and pointed that, the causality between CSR and profitability is actually unequal. According to the researches from Scholtens (2008) and Peloza (2009), it is proved that profitability has much more positive impacts on CSR than CSR has on profitability. (Yingxi & Wenjun, 2013,)⁴ Nevertheless, this article is going to analyze the CSR-profitability relationship, viz., the financial impacts from CSR performance.

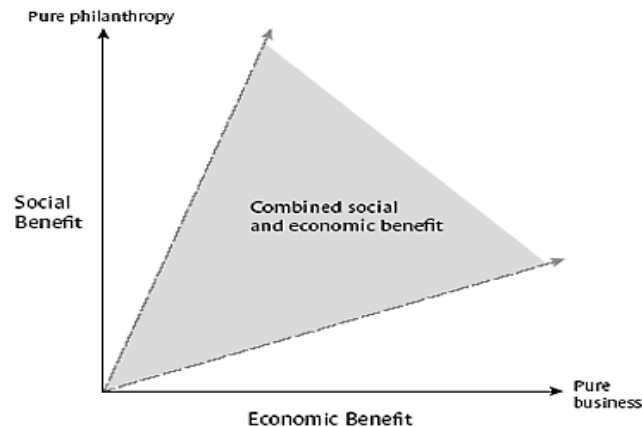
Figure 1. The two-way relationship between CSR and profitability



Source: Yingxi, J., & Wenjun, X. (2013, June). How does CSR influence a firm's profitability? -A case study of Sandvik-. Student thesis, Bachelor, 15 HE. Industrial engineering and management: Gävle, p19.

Porter and Kramer (2002) discuss strategic philanthropy. They state that the common belief that the social and economic objectives are separated is a misconception. Instead, they believe that companies can use their charitable efforts in order to achieve economic benefits. This is shown in figure:

Figure 2. A Convergence of Interests



Source: E. Porter, M., & R. Kramer, (2002). The competitive advantage of corporate philanthropy. competitive strategy.

We can study the relationship between social responsibility and financial performance or profitability by analysis some previous studies as in the following table, and then judge this relationship:

Table 1. CSR-profitability relationship

Profitability-CSR relationship

Majority of empirical researches indicate that CSR has positive impacts on the firm's profitability. **(Peloza, 2009, pp. 1518-1541), (Choi, Kwak, & Choe, 2010, pp. 291-311), (S. Hermawan & G. Mulyawan, 2014, , pp. 15-31), (Gaio & Henriques, 2020)^{5 6 7 8}**

According to the research includes company's profitability of net profit margin, ROA and ROE, in relation to number of lines in CSR disclosure. Firm's size, Kompas100 companies and industry-specific are included as control variables. The samples are taken from 543 listed companies in Indonesia from 2007 to 2009 after fulfilling certain requirements. The result suggests not all profitability ratios are significantly correlated to CSR disclosure. Kompas100 and industry-specific tend to have a relationship with number of lines in the CSR report. **(S. Hermawan & G. Mulyawan, 2014, pp. 15-31)⁹** This study suggests that the motivation of Indonesian CSR disclosure is merely to maintain good reputation to shareholders, rather than a consequence of allocating surplus funds.

Also, sed that There is a small, but positive, that the relationship between corporate social performance and company financial performance. However, research in this area has provided little guidance to managers on how they should measure the financial impacts of their Corporate Social Performance strategies. **(Peloza, 2009, pp. 1518-1541)¹⁰** Commonly used market measures, such as share price, or accounting measures, such as return on equity, are impacted by a host of other variables. These metrics do not provide the necessary level of detail for managers who want to establish an optimal level of Corporate Social Performance investment for their company. Further, academic research has tended to overlook the mediation process between Corporate Social Performance and financial performance. This gap limits the practical application of research and leaves the question of causality unaddressed. The author reviews the research examining the business case for Corporate Social Performance from both the academic and practitioner literatures, and provide recommendations for managers interested in measuring the impacts of Corporate Social Performance investment on financial performance.

Moreover, good CSR performance improves the company's reputation and opportunities in the market. It is the subject of study where the main objective of their study was to analyze whether or not companies that follow corporate social responsibility (CSR) policies have a higher level of financial performance than those that do. **(Gaio & Henriques, 2020)¹¹** In addition, the impact of the recent financial crisis on the relationship between corporate social responsibility and financial performance has been studied in order to find out whether or not companies that share these environmental and social concerns have higher financial performance than their peers.

Results of the paper suggest that companies pursuing CSR-based policies have, on average, higher financial performance than those that do not. In the same way, during the period of financial crisis, companies pursuing CSR-based policies are found to have outperformed other companies in line with existing literature trends.

In contrast, concluded the empirical relation between corporate social responsibility (CSR) and corporate financial performance in Korea using a sample of 1222 firm-years during 2002-2008. **(Choi, Kwak, & Choe, 2010, pp. 291-311)¹²** it has been measuring corporate social responsibility by both an equal-weighted CSR index and a stakeholder-weighted CSR index suggested by Akpinar et al. (2008). Corporate financial performance is measured by return on equity, return on assets, and Tobinâ. it finds a positive and significant relationship between corporate financial performance and the

Negative relationship	However, Kolstad (2007) argues that firm's CSR performance cannot always go together with profitability, since the author believes that implementing CSR with a promoting profit aim in mind is narrow and unethical. Though a broad number of firms still pursue making a profit in their ethical CSR work, and stakeholders in a firm are not willing to forfeit profit to increase social responsibility performance. CSR requires a firm realizing its social responsibilities and then carrying out them, no matter whether they can lead adding profit or not for the corporation. However, it does not mean that there is no potential room for maximizing profit in ethics since Kolstad (2007) suggests that a company should have conditional consideration for maximizing profit and profit can be gained through fulfilling other duties. CSR and profitability can only go together in a systematical way. (Yingxi & Wenjun, 2013)¹³ Moreover, the researchers tried to examine the relationship between corporate social responsibility (CSR) and some corporate financial performance (CFP). Where CSR was measured by the CSR Disclosure Index while ROA, ROS and ROE were used to measure CFP. The CSR Disclosure Index provides information about a company's involvement in corporate strategy, CSR, employees, social, societal, political investment, the environment, consumers, suppliers, and voluntary reports and testimonials. Hypotheses were tested on a sample of 64 companies listed on the STAR market and a control sample, consisting of 20 listed companies with higher capitalization, with a total of 84 Italian companies listed. The data was collected manually from the annual report and any other available document found on each company's corporate website, for the 2012-2013 fiscal year. The Tobit Regression model was used, the analyzes of which were performed using the statistical software SPSS and Gretl. The result of this study indicates that it cannot be said that there is a positive relationship between CSR and CFP. (Nigro, Iannuzzi, Cortese, & Petracca, pp. 1456-1469)¹⁴
Unclear or neutral relationship	Differ from aforementioned views, some of study's from concludes that there is no statistically significant relationship between CSR and profitability. Some scholars believe that there is no definitive consensus in this relationship research due to its complexity and subjectivity and there is no clear pattern could be identified in this relationship. In the paper, researcher demonstrate a particular flaw in existing econometric studies of the relationship between social and financial performance. These studies estimate the effect of CSR by regressing firm performance on corporate social performance, and several control variables. This model is mis specified because it does not control for investment in R&D, which has been shown to be an important determinant of firm performance. This misspecification results in upwardly biased estimates of the financial impact of CSR. the researcher sed that When the model is properly specified, we find that CSR has a neutral impact on financial performance. (Abagail & Donald, 2000, pp. 603-609)¹⁵

Source: Prepared by the researcher based on different references

5. Conclusion

The overall purpose in this paper is to explore how does CSR have impacts on the financial performance firms in the analyses of many studies. The findings in this paper are organized as described in below sections.

First of all, a brief theoretical introduction, stakeholders' identification and an introduction of CSR performance are described and reviewed. After that, according to those collected qualitative data, the study focusses on defining the relationship between CSR and financial performance, at last, a list of empirical findings from an overall point of view is summarized. As follows:

- There is a small, but positive, relationship between corporate social performance and company financial performance. However, research in this area has provided little guidance to managers on how they should measure the financial impacts of their Corporate Social Performance strategies. Commonly used market measures, such as share price, or accounting measures, such as return on equity, are impacted by a host of other variables. These metrics do not provide the necessary level of detail for managers who want to establish an optimal level of Social Performance investment for their company. Further, academic research has tended to overlook the mediation process between Corporate Social Performance and financial performance. This gap limits the practical application of research and leaves the question of causality unaddressed.
- The corporate social performance (CSP)–financial performance relationship is affected by a myriad of contextual factors, such as firm size, industry, economic conditions, and regulatory environment. Many have argued that the relationship between corporate social performance and financial performance is nonlinear. Further, the lingering question of causality remains: Do companies that are more profitable engage in corporate social performance, or do companies that engage in corporate social performance become more profitable?

In the end, we can say that this topic still needs to be researched to confirm the nature of the relationship and decide on that. Therefore, our study is a simple contribution to presenting and analyzing some previous studies and giving a point of view for each study.

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