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## The dynamic interplay between corporate social and financial performance: A literature synthesis

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### Abstract

The existing literature on social impact of corporate activities on business value of firms is still controversial, mixed and often inconclusive. There are conflicting views as to what constitutes the role of corporates in society? Thus, a much deeper analysis is required to resolve the complexities of divergent views on CSP-FP relationship so as to know that whether companies are benefitted by doing good to society or not. A review of relevant empirical and theoretical literature is conducted to study, analyse and summarize important findings of various past studies. This study of literature review is organised into different sections exhibiting concepts and models of corporate social performance, nature of association between social and financial performance from different aspects viz., negative, positive, neutral or inconclusive, mixed, virtuous circle and casual relationship and curvilinear relationship. In the final section main highlights and findings of rigorous study are concluded followed by identification of gaps that can be addressed in future study.

**Keywords:** Corporate social performance, corporate financial performance, stakeholder theory, sustainability

### Introduction

The nexus between social and financial performance have been investigated in past by varied researchers but the end results are mixed and indecisive. Some researchers have found negative linkage (Vance, 1975; Marcus & Goodman, 1986; Cordeiro & Sarkis, 1997; Wright & Ferris, 1997; Lerner & Fryxell, 1988) <sup>[66, 35, 11, 75, 29]</sup> while others concluded a positive relationship (Preston & O'Bannon, 1997; Waddock & Graves, 1997; Wokutch & Spencer, 1987; Simpson & Kohers, 2002; Krishnan, 2012; Lys *et al.*, 2015; Maqbool & Zameer, 2018) <sup>[52, 71, 74, 56, 28, 34]</sup>. Neutral association (Alexander & Buchholz, 1978; Abbott and Monsen, 1979; Cochran & Wood, 1984; Ullmann, 1985; Kraft and Hage, 1990; Patten, 1991; Hamilton *et al.*, 1993; Barnett, 2007; Mittal *et al.*, 2008; Lin *et al.*, 2009; Makni *et al.*, 2009; Tyagi and Sharma, 2013; Tripathi and Seth, 2014) <sup>[2, 1, 10, 65, 49, 20, 6, 41, 30, 31, 64, 63]</sup> between social and financial performance have also been reported in the literature along with mixed results (Hillman & Kiem, 2001; Margolis & Walsh, 2003; Manokaran *et al.*, 2018) <sup>[22, 36, 32]</sup>. The CSP-FP nexus have also been studied in a non-linear framework by various researchers (Barnett & Salomon, 2006; Barnett, 2007; Wang *et al.*, 2008; Barnett & Salomon, 2012; Han *et al.*, 2016; Nollet *et al.*, 2016; Wang *et al.*, 2016) <sup>[4, 6, 72, 7, 21, 45, 73]</sup> giving it a new angle for study. The proponents of curvilinear relationship between social and financial performance opined that such relationship is not a simple linear relationship. Thus, it needs to be studied in a distinct perspective assuming that CSP-FP linkage is dynamic at different intensity of social performance.

The different aspects of linkage between social and financial performance are detailed in below section.

### Literature Review

#### Negative Relationship

This tenet unfavourably posits the use of corporate resources to address societal concerns as it is believed to be contrary with the aim of profit maximisation. Supporters (Vance, 1975, Aupperle *et al.*, 1985; Barnett, 2007) <sup>[66, 3, 6]</sup> of this view argue that: Cost of undertaking CSR

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> Benefits derived. Investment in social domain is countered on the basis of trade-off between such investment and firm's profitability. Major proponent of negative association is Friedman, 1970<sup>[14]</sup> who quoted in his neoclassical thoughts that "Business of business is to do business only". The benefits of being socially embedded are less than its additional cost. Investment in social actions in fact create competitive disadvantage (Barnett, 2007)<sup>[6]</sup> which could otherwise be used in giving additional wealth and returns to shareholders, the true owners of the company. It is further asserted that it is the role of government to peep into the social matters or affairs of the country. Integration of CSR into company's strategy leads to multiplicity of goals which results into deviation from most important one. This view is parallel to the aim of the hardcore capitalist economy whose only aim is to maximise profit. This tenet posits that investment in social activities does not come in domain of company's objectives as it results in increase in administration cost, reduction in company's profit, creates competitive disadvantage, agency problems (conflicts in shareholders' interest) and divergence of funds which could better be allocated for productive investment. Scarce resources, if any, must be invested to enhance shareholders profitability. A brief review of literature quoting negative relationship is given below:

Cordeiro and Sarkis (1997)<sup>[11]</sup> studied the sample of 523 US firms to investigate the linkage between proactive environmental actions and firms' bottom line. To measure environmental proactivism TRI data on emission and waste is used to check its impact on financial performance measured via industry analyst earnings forecast (1 year and 5year growth forecast). The result using multiple regression model documented significant negative relationship between proactive environmental behaviour of firms and Earnings per share (EPS) performance of firm after controlling for firms' size and leverage. Peng and Yang (2014)<sup>[50]</sup> investigated a sample of ten years data of Taiwan polluting industries to measure influence of ownership concentration on CSP-FP linkage. The study found that irrespective of time frame higher divergence between control-cash flow rights adversely affects the social and financial performance relationship. The affect is more when such divergence is accompanied with poor corporate governance. Owing to agency issues, there is negative moderation effect of ownership concentration on CSP-CFP linkage. Such issues are suggested to be resolved with the help of robust mechanism of corporate governance. Mukhtaruddin *et al.* (2019)<sup>[43]</sup> applied partial least square approach on banking companies listed in Indonesia stock exchange. The study over a period of five years resulted that firm's value is negatively affected by corporate social responsibility. This is attributed to perception of investor that assumption of social behaviour results into agency issues and diversification of resources.

Zhou *et al.* (2021)<sup>[76]</sup> used a sample of 11 years data of state owned and joint stock banks in China to examine the impact of CSR on bank's financial performance along with green credit perspective. The study found negative impact of social behaviour on bank financial performance in short run as opposed to long run. The mediating role of green credit is observed to be significant which affects the CSP-FP relationship.

### Positive Relationship

First study conducted in 1972 opined that socially

responsive firms outperform than those who don't (Moskowitz, 1972)<sup>[42]</sup>. Positive linkage is based on Stakeholder theory. Positive linkage (Parket and Eilbirt, 1975; Sturdivant and Ginter, 1977; Waddock & Graves, 1997; Margolis & Walsh, 2003; Mishra & Suar, 2010; Viswanathan, 2016; Guzman *et. al.*, 2016; Maqbool & Zameer, 2018)<sup>[48, 60, 71, 36, 40, 19, 34]</sup> substantiates that benefits of socially embedded actions are large as compared to tenuous costs attached to it. Integration of sustainability parameters into business credo ensures long term success. It is thus believed that CSP is not detrimental to firm's financial health. CSP initiatives results into burgeoning trust, loyalty of both customers and investors, conducive and long-term relations with stakeholders, reduces transaction cost (Jones, 1995)<sup>[24]</sup>, fights fierce competition, high productivity by employees, lower attrition rate, strengthen relationship with society, better terms with suppliers, less penalties, avoids litigation cost associated with misconduct and thus enhancing competitive edge. Increasing legitimacy of business case for CSR posits that impact of CSR cost is reduced by government support and incentives in form of concession in taxes, tax breaks, duty waivers. In addition to this, companies are rewarded in capital markets in terms of inexpensive cost of capital. CSP is also expected to create comparative advantage and overcoming adverse economic shocks (Lin *et al.*, 2009; Oikonomou *et al.*, 2012)<sup>[30, 46]</sup>. There is positive rate of return to CSR when it comes to financial performance measures (Barnett, 2007)<sup>[6]</sup>. Like insurance policy, benefits of investment in social actions accrue in the long run. Socially responsible investing (SRIs) considers social investment ratings before investing. Non-financial reporting captivates investments not only domestically but also from international markets. Social actions not only benefit the society but also firms in light of financial performance consequences as a result of which it is now being considered as an investment with a rate of return.

Cochran and Wood (1984)<sup>[10]</sup> used Logit analysis and regression to examine relationship between CSR and financial performance by controlling for specific industry. Social responsibility is measured with the help of Moskowitz list and reputation index. Excess values, ratio of operating earnings to assets and to sales are used to measure accounting returns of the companies. Quantitative analysis posits that there is weak but positive link between CSR and financial performance when asset age is used as control variable. Age of assets is strongly correlated with CSR rankings. Thus, omission of asset age variable into the model might distort the results.

Preston and O'Bannon (1997)<sup>[52]</sup> used longitudinal dataset of 67 large U.S. corporations over a period of 1982-92 for empirical analysis of all possible social-financial performance association. The study used correlation analysis to investigate direction, nature and causality of such association in both contemporaneous and lead lag framework. By using social performance reputation ratings given by Fortune magazine, the results are consistent with shareholder theory highlighting strong positive association between social and financial performance as measured by ROA, ROE and ROI. The study also percolates either available funding or contemporaneous association between the two.

Stanwick & Stanwick (1998)<sup>[59]</sup> explored companies listed in Fortune Corporate Reputation Index over a six-year

period ranging from 1987 to 1992. The results asserted positive impact of size and profitability on CSP whereas it is negatively impacted by level of pollution emission used as proxy to measure environmental performance.

Simpson & Kohers (2002) <sup>[56]</sup> using Ordinary Least Square Regression analysis reported strong positive association between social and financial performance on a sample of 385 companies from banking sector. The study focusing on single industry examined all national banks having Community Reinvestment Act ratings as a measure of corporate social performance in the year 1993 and 1994 vis a vis their financial performance as reflected in ROA by holding industry and R&D constant. Sample banks were divided into two groups; one having outstanding ratings (284 banks) whilst others having low social performance ratings (101 banks) for analysis. Though, the study ignored to explore causal and feedback nexus between social and financial performance of banking industry but it corroborated strong empirical support of positive linkage between the two.

Marom (2006) <sup>[37]</sup> purported economic theory to elucidate CSP-CFP link. The model considered social impact by addressing both marginal cost and dividend of pursuing social activities based on business-CSR analogy. Financial performance as measured by all stakeholders utilities summation derived from social product is proposed to have positive association with firms' social product. Thus, a firm benefit financially by addressing stakeholder concern where CSR is considered similar as other business products produced by firms giving utility to consumers namely stakeholders.

Lin *et al.* (2009) <sup>[30]</sup> studied 1000 Taiwanese companies by incorporating R&D investment to examine effect of social responsibility on business performance using donation ratio as CSR proxy over a period of 3 years viz. 2002-2004. The study found that there is no immediate (short run) positive impact of CSR on financial performance but positive effect can be witnessed in long run in both manufacturing and non-manufacturing companies of Taiwan.

Vasal (2009) <sup>[67]</sup> compared average fortnightly risk adjusted shareholder return of ESG, NIFTY and market portfolio i.e., CNX 500 for a very short period from Jan 2005-September 2008. The results appears to be inconsistent with Friedman theory as they showed though statistically not significant; superior ESG return (proxy of socially responsible companies) vis a vis market portfolio evidencing that socially responsive companies are rewarded in Indian capital market. It also points out that socially responsive stocks bring more and better capital investments both domestically and internationally.

Vergalli & Poddi (2009) <sup>[69]</sup> used econometric model to test impact of social certification on firms' profitability by using perfect analysis database. The study shortlisted 317 CSR certified firms by identifying those that prevails in at least two of three main international stock option indices namely Domini 400 Social Index, Dow Jones Sustainability World Index and FTSE4Good Index and 100 Non-CSR firms using the Dow Jones Global Index in 2004. The results of panel data ranging from 1999-2003 reveals positive relationship between socially responsible certification and performance as measured by various accounting, market and mixed indicators. As per the study there is considerable growth of firms certified as socially responsible over last decade but there also exists a delay period amongst the impact of

independent variable on dependent i.e., the relationship between CSR and performance indicators is long run. An enterprise is benefitted by being responsible due to enhanced reputation and reduced long run cost of social activities as it takes a temporal lag to perceive a certain status.

Perrini *et al.* (2009) <sup>[51]</sup> gave a theoretical model rejecting the idea of studying the CSP as an aggregate measure or score and promotes the disentangling of CSP performance factors for a better understanding at different levels explaining the translation of specific activities into performance results. The study focused primarily on the role and power of stakeholders in implementation and disclosure practices, while admitting that CSR is now a universal phenomenon to be followed.

Mishra & Suar (2010) <sup>[40]</sup> aggregate and segregate CSR impact towards key stakeholders on both financial (tangible assets) and non-financial performance (intangible assets) by controlling for ownership pattern, firm size & stock listing. Perceptual data on CSR & NFP is secured through questionnaire using 5-point scale from a sample of around 150 listed and unlisted manufacturing companies covering 18 industries. Industry adjusted ROA is used as a proxy of financial performance for a period of 3 years (2003-2006). It is inferred from the study that stock listing substantiates financial performance but not non-financial performance whereas there is lack of evidence of influence of ownership and firm size on FP, NFP & CSR. Results corroborates favourable relationship between CSR & firm's performance both financially & non-financially.

Rajput *et al.* (2012) <sup>[54]</sup> studied the relationship between CSR & CFP in Indian context by taking the data of two years i.e., 2008-09 & 2009-10. The study theoretically revealed three school of thoughts on CSR i.e., Sceptic, Idealistic & Pragmatist. Empirical findings of the study assumed a time lag of one year in each dependent & independent variable between the measures of CSR and CSP. To measure CSR, CSR ratings were taken & financial performance is measured by sales and profit before tax figures. Results of the study revealed that expenditure on CSR in previous year results in increase in average profits in the following year and also firms having greater average sales and profits spend more on CSR activities in the following year.

Oikonomou *et al.* (2012) <sup>[46]</sup> examined linkage between CSP, financial risk and investor utility by using a panel data of S&P 500 US companies ranging over a period between 1992-2009 rated by KLD at some point in time. Aggregate strengths and concerns over dimensions of community, diversity, employment, environment, product safety and quality were calculated using KLD methodology as benchmark. The result of association using control variables concluded that relationship between social performance and risk is moderated by volatility of market and risk aversion of investors. Irresponsible behaviour has more prominent impact than being responsible as social behaviour is negatively but insignificantly related to risk.

Govindarajan, V.L. and Amilan, S. (2013) <sup>[17]</sup> focused on 12 companies from Oil and Gas products Industry in India to analyse the linkage between CSP with financial & market performance. To assess CSP score, CSR ratings by Karmayog, company's budget allocation for CSR activities and area of focus in CSR involvement in terms of Healthcare, Education, Environment, Rural development

and Other Community Welfare activities are used and to measure financial performance, parameters like Total Assets, Net worth, EPS, Profit before Tax and Debts are used. The study revealed significant relationship between CSP score and all the measures of Financial and Stock market performance.

Ghosh & Mondal (2014) <sup>[15]</sup> studied 85 selected Asian companies for the period 2010-2012 using multiple linear regression models. Stakeholder's value addition was also incorporated along with social performance and showed that firms with high growth in combination with better social performance and stakeholder value distribution have better market value (of equity).

Kim and Kim (2014) <sup>[25]</sup> demonstrated the influence of CSR strengthening and concerning activities of listed restaurant firms on equity return and systematic risk over a period of 1991-2011. The dataset includes ESG scores for quantifying CSR, Tobin's Q ratio and systematic risk using Carhart four factor model of such listed firms. Results of time series regression model showed that such firms get benefit from CSR actions in the form of enhanced shareholder value although indifferent in impacting systematic risk. On the other hand, negative events of hospitality industry do not reduce equity return directly but gets affected by increased systematic risk.

Flammer (2015) <sup>[13]</sup> studied the effect of CSR proposals that are accepted or declined due to narrow margin of votes by shareholders. Using regression discontinuity framework result showed positive impact of accepted CSR proposals by shareholders on accounting performance of companies. Such impact is attributed to enhancement in labour productivity, increased job satisfaction and growth in sales.

Viswanathan (2016) <sup>[70]</sup> explored and examined industry specific effect of 25 CSR & Non-CSR firms (listed on Bombay Stock Exchange) on significant factors contributing to financial performance. The study was divided in four phases viz comparative analysis, industry specific effect, feedback effect on CSR and marginal effect. Result confirms positive effect of CSR on variables of financial performance. CSR firms outperform non-CSR firms whilst service sector receiving more benefit. Positive feedback effect of financial performance improvement on CSR & marginal probability using PROBIT model was also observed.

Giannarakis *et al.* (2016) <sup>[16]</sup> investigated that whether involvement in socially responsible initiatives pays off financially for US listed companies over a period 2009-2013. ESG scores were used as a proxy to measure CSR initiatives by corporates along with women on board, CEO duality and director's compensation as control variables. The results of fixed effect model indicate positive impact of corporate social disclosure on financial performance of companies listed in S&P 500.

Guzman *et al.* (2016) <sup>[19]</sup> pointed out the structural relationship between CSR and business performance using structural equation model. The dataset includes 397 Mexican SMEs up to 250 employees. SMEs managers were interviewed on various parameters of social and business performance using 5-point Likert scale. Suggested that for SMEs to earn higher profit; implementation of CSR activities is inevitable as such activities positively impact performance of business.

Qiu *et al.* (2016) <sup>[53]</sup> tested causality between profitability and disclosure scores using Granger causality test. The

dataset includes FTSE350 index companies excluding financial companies over a period from 2005 to 2009. Environmental and social disclosure scores were taken from Bloomberg. The results shows that the past profitability is followed by current social disclosures but not by environmental disclosures. Firms with higher social disclosures have higher market values which is supported by higher expected growth rates in the cash flows.

Maqbool & Zameer (2018) <sup>[34]</sup> investigated impact of CSR on firm's stock market returns and profitability along with control variables of size, risk, capital intensity and age. Study focused on 28 commercial banks listed on BSE (Bombay Stock Exchange) for a 10 year period viz. 2007-16. The study used content analysis and factor analysis for CSR & CFP construct respectively. Result showed positive impact or effect of CSR on both Stock market returns and profitability though more positive impact was seen on the latter. He further added that CSR pays off in long run by creating competitive edge for the company.

Sila and Cek (2017) <sup>[57]</sup> used stakeholder theory framework for investigating impact of ESG dimensions of CSR on economic performance of Australian companies. The study used Thomson Reuters Asset 4 ESG dataset for Australian companies covering a period of 7 years i.e., 2010-16 by taking a lag of one year. Using regression analysis on longitudinal data study reveals a weak relationship between governance along with environmental dimension and economic performance. However, there is significant and positive impact of social performance on economic performance of Australian companies depicting the growing importance of intangible aspects of doing business.

Cherian *et al.* (2019) <sup>[9]</sup> explored the impact on financial performance of CSR reporting by Indian manufacturing companies over a period ranging from 2011-2017. CSR is measured with the help of disclosures on variety of measures related to education, community, customer, environment, employee benefits and products. Board size and number of employees are controlled for during the study. The results of regression revealed positive impact of CSR on firm's performance though individual CSR factors have mixed impacts like customer dimension negatively affects firm's performance.

Kim and Li (2021) <sup>[26]</sup> studied the impact of aggregate and individual Environment, Social and Governance (ESG) scores on financial performance of companies over a period from 1991 to 2013. The result indicates positive impact of overall ESG on profitability of corporates. Such impact is more prominent in case of firms with larger assets value. Firms with tenuous governance mechanism posits favourable linkage between corporate governance and its select financial measures. Except environmental dimension, all ESG measures severally and in aggregate have positive impact on credit rating whereby social factor is most dominant.

### Neutral or Inconclusive Relationship

Such viewpoint (Mc Williams & Sigel, 2000; Rim Makni *et al.*, 2009; Tripathi & Seth, 2014) <sup>[39, 31, 63]</sup> states there exist no or inconclusive relationship between social performance and financial performance. Inconclusiveness could be attributed to various mediating variables affecting CSP-FP relationship. It is of the view that there exist many intervening variables that mitigate relationship between CSP and FP (Ullman, 1985) <sup>[65]</sup>.

Rim Makni *et al.* (2009) <sup>[31]</sup> studied 179 publicly held Canadian firms & found no significant relationship between a composite measure of a firm's CSP & CFP. Though negative impact of environmental dimension of CSP on CFP was observed. The study concluded that, at least, in the short run socially responsive behaviour of the firms inhibits and reduce profits and shareholder's wealth. The outcomes are consistent with the neo classical economist thought i.e., even ethical responsibility of business is to generate profit (Waddock and Graves, 1997, Friedman, 1970) <sup>[71, 14]</sup>.

Alexander & Buchholz (1978) <sup>[2]</sup> studied the relationship between corporate social responsibility as measured by social responsibility rankings and stock market performance of common stock over a 5 year period viz 1970-1974. The said study incorporated risk by calculating monthly security return on both market and risk-free asset. Using regression model based on Sharpe Lintner Capital asset pricing model, the study indicates non-existence of any significant relationship between degree of social responsibility and stock market performance. Further, the study also failed to establish any significant relationship between risk adjusted performance or risk levels of stock and social responsibility.

Abbott and Monsen (1979) <sup>[1]</sup> analysed Fortune 500 companies by constructing corporate social involvement disclosure scale (SID). SID scale is a means of quantifying self-reported disclosures of companies using the technique of content analysis of annual reports of companies. Based on this methodology, the study affirmed that being socially active is neither beneficial nor dysfunctional for investors measured in terms of their annual percentage return. Thus, there exists no significant impact of social involvement on corporate profitability.

Aupperle *et al.* (1985) <sup>[3]</sup> study is based on Carroll's four component definition converted into 20 set of statements. Results reported no significant association between social orientation of firm and its profitability. In fact, empirical study resulted into strong negative association between economic and non-economic factors in construct particularly with its ethical dimension. Author also inferred no significant difference in profitability of firms with social forecasting policies, CSR committee on Board from that of other firms.

Ullmann (1985) <sup>[65]</sup> examined the relationship between social disclosure, its performance and economic bottom line by scrutinizing past literature. The study questioned extant literature by assessing their inconsistent criteria of measuring social and economic performance. It stated that there are numerous missing and intervening variables which are if once incorporated will neutralizes the social and economic performance relationship. Thus, any such relationship hardly exists between social and financial performance.

Kraft and Hage (1990) <sup>[27]</sup> studied a sample of 82 firms within six industrial and service sectors (namely: advertising, insurance, newspaper, electronics, pharmaceuticals and manufacturing industries) of economy with a view to understand drivers of community services done by firms. The impact of various organizational characteristics like profitability, prestige, size, asset growth, structural complexity, product quality, short term profit etc. were analysed on community services using multiple regression model and correlational analysis. The results substantiate no effect of community services on profit goals highlighting the fact that such services are performed more

for prestige of companies than for profit motive.

Patten (1991) <sup>[49]</sup> investigated whether the voluntary social revelations included in yearly reports are related with either open public pressure or profitability. Annual reports of 128 firms belonging to Fortune 500 companies were studied in 1985 whereby the firms were divided into high and low performers on the basis of content of social disclosure on a page of annual report. Using regression analysis, the study ideated that public pressure as proxied by size and industry classification affects social disclosures in annual report whereas there is neutral linkage between profitability variables (ROA, 5 year average ROE, one year lagged ROA) and extent of disclosure.

Hamilton *et al.* (1993) <sup>[20]</sup> examined the investment performance of socially responsible mutual funds over a period of January 1981-December 1990. The study took the sample of 32 socially responsible mutual fund and 320 conventional funds divided into two groups according to their fund age. Using risk adjusted expected return the result found no significant difference in returns of socially responsible portfolio and conventional funds with no social orientation. Socially responsible funds do not earn any excess return as compared to other traditional funds i.e., such funds are neither penalized nor rewarded in market.

McWilliams & Siegel (2000) <sup>[39]</sup> investigated economic model of CSP-CFP relationship by incorporating R&D and Advertising intensity into the model. A sample of 524 firms were regressed using KLD index and Compustat data to test linkages. With the aim to find the flaws in extant literature the result propounded misspecifications in the previous studies stating that inclusion of R&D and Advertising intensity into the model neutralises the relationship between CSP and profitability. There is evidence of positive correlation between CSP and R&D which calls for using latter as control variable to isolate the former's impact on profitability.

Mattingly and Berman (2006) <sup>[38]</sup> investigated compartmentalization in KLD Ratings used as proxy for corporate social actions. Applying techniques of Explanatory Factor Analysis (EFA) & Principal Component Algorithm (PCA) on dataset of 293 listed firms on S & P 500 index, it concluded existence of covariation among the variables in KLD ratings. Inconsistency of results in previous studies using KLD ratings is attributed to combining positive and negative social actions together which are in fact distinct conceptually & empirically.

Barnett (2007) <sup>[6]</sup> developed a conceptual framework by suggesting various set of propositions for emphasizing the variability of financial returns to social investment across firms and time. The study expropriated business case for CSR by percolating that relationship between CSR and financial merit is contingent upon various factors such as past stakeholder relations and social welfare orientation. Using stakeholder influence capacity (SIC) construct study suggested that the level of impact of social investment is contingent upon historical perception of stakeholders towards company i.e., past plays important role in influencing CSR-CFP dichotomy. Firms having prior appealing (inadequate) SIC will get positive (negative) rate of return out of their social investment. Thus, only some forms of social investment done at a suitable point of time payoffs financially as there is no direct relation between CSR and financial performance. It is path dependent on firm's stakeholder relation.

Mittal *et al.* (2008) <sup>[41]</sup> explore the relationship between financial performance measures (EVA & MVA) and corporate responsibility (as proxied by code of ethics). The study aimed at finding that whether code of ethics makes a difference in financial perspective or not. The dataset includes 50 companies from S&P CNX Nifty over a period of 2001-05. The companies are divided into two categories, one with code of ethics and others with code of ethics. Statistical results of regression and correlation indicates that financial performance is independent of CSR or code of ethics though market perception about company improves as a positive correlation has been found between CSR and MVA.

Nelling and Webb (2009) <sup>[44]</sup> used weighted average KLD Socrates Database ratings to measure CSR. This database rates companies on various parameters of social concerns on a broader range of firms. The results of OLS regression confirmed the existence of virtuous circle between CSR and financial performance of firms. However, the results of fixed effect model show weak relationship between the two. After controlling for the effect of unobserved variables, CSR fails to be the predictor of economic well-being. Thus, there is tenuous casual linkage between the two when modern statistical techniques are applied. The study suggested that CSR is influenced by factors other than profit motive.

Tyagi and Sharma (2013) <sup>[64]</sup> used econometric model to analyse the relationship between social and financial performance in Indian context. ESG scores were used as proxy for social performance whereas financial performance was measured with the help of ratios like ROE, ROA, ROCE, EPS, ROS. The study used both S&P ESG India 500 Index and NSE as sample for a period of 7 years. The study resulted into neutral relationship between corporate social and financial performance.

Jamel *et al.* (2020) <sup>[23]</sup> empirically investigated the impact of CSP on financial performance of 32 firms listed on Casablanca Stock Exchange. The study over a period of seven years using linear regression depicted no significant impact of social performance on financial performance measures namely; ROI, EPS and ROE. The absence of linkage is attributed to the fact that such relationship could be non-linear.

### Mixed Relationship

There are various studies where the impact of social performance on financial performance have been mixed. This is possible where the effect of varied dimensions (like environment, community, customer, workplace etc.) of social performance on financial parameters have been explored individually. Different dimensions of social performance could have different impact on various measures of financial performance. Some studies have been described below to shed light on mixed results:

Hillman & Kiem (2001) <sup>[22]</sup> tested the relationship between corporate social performance and financial performance using a sample of 308 firms belonging to S & P 500. Using Market Value Added (MVA) as a measure of shareholder value creation the study bifurcated social performance into stakeholder management and social issue participation. The result of regression analysis using KLD database posits that the issues directly related to stakeholder i.e., stakeholder management are beneficial and are thus positively associated with shareholder wealth whereas investing

outside the domain of stakeholder linkage harms financial performance. Therefore, using corporate resources for social issues does not create any competitive edge whereas better relations with stakeholders is harmonious to improved financial performance and value creation for shareholders.

Margolis and Walsh (2003) <sup>[36]</sup> compiled different findings on financial-social performance nexus of past literature. The study evaluated different theories like stakeholder theory, normative theory etc. and supported both divergent positions on the CSP-FP linkage. It argued that there is mixed viewpoint of compilation of findings on corporate involvement in social misery. The study of this relationship fortifies the inconsistencies rather than mitigating it as financial impact of social performance varies across different conditions. Thus, before investing in social domain it is important to identify favourable circumstances under which it gives positive rate of financial return.

Sadeghi *et al.* (2016) <sup>[55]</sup> investigated social-financial performance linkage of companies listed on Tehran Stock Exchange particularly in the sector of manufacturing. The reference of stakeholder theory is made in the study over a period from 2006 to 2012. Primary and secondary data have been used to measure social performance and financial performance respectively. CSP score on various dimensions of customers, workers, environment and community was calculated for each manufacturing company. The results of multiple regression indicate mixed impact of social performance on its firm's respective financial performance. ROE is unimpacted whereas ROA is positively impacted by worker dimension but negatively affected by customer dimension.

Velte (2017) <sup>[68]</sup> investigated impact of ESG performance on financial performance of German companies by taking one year lag over a period of 2010-2014. Thomson Reuters ESG Asset 4 was used to measure ESG performance of firms whereas beta, debt, industry, R&D and size were controlled for in the study. The results depict positive impact of ESG performance as aggregate and individually on ROA but no significant impact on Market based financial performance measured by Tobin's Q.

Manokaran *et al.* (2018) <sup>[32]</sup> studied 13 domestically owned listed Malaysian insurance companies out of 55 listed companies over a period of nine years viz. 2008-16. The objective is to analyse impact of CSR disclosures on financial performance of companies. These 13 companies comprise of two elements i.e., CSR disclosures made and are locally owned. CSR disclosure index is created using content analysis of annual reports of selected companies whereby financial performance is measured in terms of ROA, ROE and EPS. Results depicted significant relationship between CSR related disclosures and firms' financial performance. CSR has not so significant impact on firms' ROE and Earning per share (EPS) whereby posing significant positive impact on firms' Return on assets (ROA).

### Virtuous circle & Causal Relationship

Academicians (see, Waddock and Graves, 1997; Orlitzky *et al.*, 2003; Nelling and Webb, 2009; Vergalli and Poddi, 2009) <sup>[71, 47, 44, 69]</sup> also proposed that there exists virtuous circle between CSP and CFP in the sense that there exist simultaneous interaction and reverse causality between these two variables. Both CSP and CFP influence each other forming a "virtuous circle" as each of them are predictor

and consequence of each other. Thus, there relationship is not unidirectional but bi-directional (Singal, 2014) <sup>[58]</sup> and mutually reinforcing (Dean, 1998) <sup>[12]</sup>. The formation of virtuous circle is ascribed to culture, reputation, human resources and innovation in growth industries (Surroca *et al.*, 2010) <sup>[61]</sup>. For example, positive impact of social performance on financial performance leads to improvement in latter which then leads to reinvestment in former, thereby a virtuous circle is created between two. Even the causation between the two have been explored in the sense who affects the other. In other words, it has been investigated that whether social performance influences (Preston and O' Bannon, 1997; Simpson & Kohers, 2002; Sila and Cek, 2017) <sup>[52, 56, 57]</sup> or gets influenced by financial performance (Waddock and Graves, 1997; Makni *et al.*, 2009) <sup>[71, 31]</sup>. Such argument is supported by slack resources and good management theory. As per the argument of good management theory, investment in social performance leads to image building of firm in public which in turn results into superior financial performance. In other words, as per this theory, investment in social domain leads to rewarding financial outcomes. In contrast to good management theory, slack resource theory argues that investment in ethical issues requires resources which are first provided by greater profitability of the company. Thus, better financial performance results in surplus resources which can further be invested for the upliftment of society and community at large.

Waddock & Graves (1997) <sup>[71]</sup> investigated 469 companies of S&P 500 firms where COMPUSTAT tapes and SMART technique are used for measuring financial performance and social performance respectively. The study posits that there exists a virtuous circle between social and financial linkage which may be ascribed to its simultaneous impact on each other. In other words, weighted average CSP is both predictor and consequence of firm financial performance when one year time lag is considered. Thus, other things remaining constant causation runs in both directions.

Surroca *et al.* (2010) <sup>[61]</sup> suggested that there is no direct relationship between corporate responsibility performance and financial performance when more than 500 companies from various countries are investigated for the study. In fact, there exists mediating role of intangible resources which affect social and financial nexus. Presence of intangibles leads to formation of virtuous circle between the two instead of direct linkage.

Bussoli & Conte (2018) <sup>[7]</sup> tested the existence of bi directional linkage between firm's social and financial performance forming a virtuous circle. The study used 71 listed banks in Europe as sample over a period of five years. The results of econometric analysis failed to substantiate slack resource theory as financial performance negatively affected the social performance. However, the impact is positive when investigated vice versa in case of good management theory.

### Curvilinear Relationship

It is of the view that "more is better". A new angle is also being tested on CSP-CFP relationship i.e., studying relationship from non-linear perspective (Barnett, M.L. and Salomon, R.M., 2006; Maqbool and Bakr, 2019) <sup>[4, 33]</sup> which gives a U shape relationship between social and financial performance. This view follows micro economic theory that initially when CSR expenditure is initiated it turns out

negatively on financial performance giving a negative relationship between them (a downward sloping curve) but as the company increases its expenditure on social dimensions there comes a stage where company is able to internalise CSR in its business which finally turns out positively on financial measures (positive relationship, upward sloping curve). Thus, there exist curvilinear relationship between social and financial performance which gives a U-shaped curve. Few extant literature which analysed non-linear relationship between social and financial performance are listed below:

Barnett & Salomon (2006) <sup>[4]</sup> tested social-financial performance relationship of socially responsible mutual funds which entails portfolio development on the basis of social screening. The study using multivariate statistical methods investigated 67 SRI funds over a period ranging 1972-2000. Variability in financial returns as measured by risk adjusted financial performance is explained by its contingency upon types of social screens namely labour, environment and community. Result using control variables like fund's age, fund size etc. affirmed U-shaped relationship between intensity of social screening and financial reward for SRI funds. It initially penalizes financial performance but then rewards it as social screening intensifies in number. Furthermore, paper document positive impact of screens based on community while performance is suffered when based on labour and environment screening strategy. By affirming both stakeholder and portfolio theory, the study reveals that firms get benefit of diversification of portfolio with minimal social screening while those following strict screening are also rewarded by better firm selection.

Barnett & Salomon (2012) <sup>[7]</sup> hypothesized that social-financial performance nexus is U-shaped based on the level of firm's SIC (Stakeholder influence capacity). The study examined the unbalanced panel of 1214 firms over a period of 1998-2006 using one year lag along with certain control variables like size, debt burden, R&D, advertising etc. The results documented asymmetric quadratic U-shaped relationship between CSP and CFP contingent upon SIC capacity. Initially, financial performance as measured by ROA and net income reduces with social performance, reaches at minimum level at moderate level of CSP and then rebound at its highest level of social performance. Net KLD score aggregated for strength and weaknesses were used to quantify social performance.

Maqbool and Bakr (2019) <sup>[33]</sup> empirically tested panel data of 43 companies covering nine industries listed in BSE 100 index for a period of ten years ranging from 2008-2017. The objective of the study is to investigate the CSP-FP nexus from both linear and non-linear perspective in Indian context using correlation and panel regression. Non-linear relationship is studied by using Thomson Reuters ESG score as proxy for CSP transformed into quadratic form i.e., by adding squared CSR into equation. Both accounting and market measures are used to measure financial outcome along with control variables of leverage ratio, size, capital intensity and R & D. The study found that there exists insignificant relationship between CSP and FP when studied linearly while a curvilinear relationship exists when studied from non-linear perspective. Thus, study suggest that as investment in CSR increases, initially financial performance decreases but as firm matures and further increases its social investment financial performance also improves. It is

concluded that CSR pays off in long run while hurting short run financial performance.

## Conclusion

Inconclusiveness of association between social and financial performance may evoke interest in further investigation. It has been witnessed from vast literature review that majority of the studies investigating social-financial association are carried out in developed countries as compared to underdeveloped and emerging economies. Thus, there is lack of insight from Indian perspective particularly when CSR is legitimised in India. Majority of the studies have been conducted in developed economies with major focus on Europe, U.S. and Canada (Talan and Sharma, 2019) <sup>[62]</sup>. Talan and Sharma (2019) <sup>[62]</sup> reviewed 213 papers, descriptive states that only 9% of the papers focused on developing economies. This data gives impetus to analyse relationship between social and financial performance in Indian context. From the past empirical researches, generalization can't be made for market outcomes of corporate social actions due to complexity, ambiguity and conflicting results on CSP-CFP linkage. Omission of control variables leads to spurious correlation between social and financial performance. There is improper identification and omission of control variables in previous studies which significantly affects profitability and CSP-FP relationship. Such issue can be addressed by undertaking relevant control variables in our study like size, advertisement intensity, research & development intensity, leverage, age and liquidity of the company. The major problem confronted by researchers is of the measurement of social performance accompanied by definition and methodological issues. There is no universal method of measuring CSP dimensions. Past study reports usage of unidimensional measure of CSP whereas it is multidimensional construct (Griffin & Mahon, 1997; Aupperle *et al.*, 1985; Perrini *et al.*, 2009; Rim Makni *et al.*, 2009; Mishra & Suar, 2010) <sup>[18, 3, 51, 31, 40]</sup> encompassing various domains like environment, shareholders, customers, employees, community etc. It measures organisational response across wide range of dimensions. Thus, measurement of CSP is required as a multi-dimensional construct by measuring it in the form of environment, social, community and employees parameters.

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