CORPORATE SOCIAL RESPONSIBILITY AND ITS FINANCIAL PERFORMANCE

Raluca Miruna Zapciu[1]
Gheorghe Hurduzeu[2]

The field of corporate social responsibility (CSR) has grown exponentially in the last two decades. There are different views of the role of the firm in society and disagreement as to whether wealth maximization should be the sole goal of a corporation. Nevertheless, there still remains a debate about the legitimacy and value of corporate responses to CSR concerns.
This paper examines the effect of CSR on financial performance. It examines the effect CSR- related shareholder proposals lead to positive announcements returns and superior accounting performance. Also, the channels through which companies benefit from CSR are examined.
The paper finds that CSR improves employee satisfaction and helps companies cater to customers that are responsive to sustainable practices and that the adoption of CSR proposals is associated with an increase in labor productivity and sales growth. The results indicate that the sign of the relationship is positive and

[1]**RALUCA MIRUNA ZAPCIU**, Ec. PhD student, affiliation: Department of International Business and Economics, University of Economic Studies from Bucharest, Department of International Business and Economics, e-mail: miruna.zapciu@yahoo.com;
[2]**Gheorghe Hurduzeu,** Professor, affiliation: University of Economic Studies from Bucharest, Department of International Business and Economics, e-mail: geohurduzeu@gmail.com

statistically significant relationship between corporate social responsibility and financial performance, supporting the view that socially responsible corporate performance can be associated with a series of bottom-line benefits.

Keywords: Corporate Social Responsibility, Value enhancement, Corporate governance, Financial performance, Sustainability
JEL Classifications: A13; M14; O16; O35

Introduction - review of the scientific literature

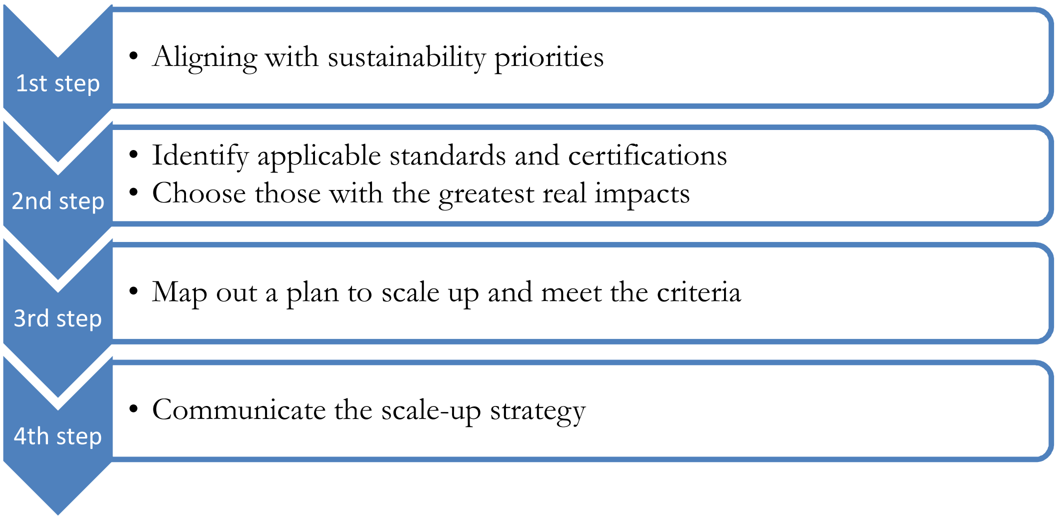
The main approach in modern social and environmental policies aiming at society sustainable development management is switching from administrative instruments to economic and ethical tools of social and environmental regulation: environmental management systems - ISO 14000, SA 8000, ethical codes and voluntary initiatives. In the decision making process, environmental awareness makes good conditions for social partnership and mutual responsibility development according Tukker A. (2008).

Also, over the past decade, consumers have become increasingly interested in learning more about the way in which their purchasing decisions may affect the environment, according ECD (1998) and ISO 14000 Series (1997).

Most consumers declare they are willing to pay more for a product which they perceive as environmentally or ethically superior. When making their purchasing decisions, consumers are unaware of these products' characteristics or must spend very strong information costs to learn about them (Sampson G., 2005).

Firms' sustainability actions refer to the concept of Corporate Social Responsibility (CSR). Firms' CSR initiatives depend on their ability to valorise such practices (Ukaga O., Maser C., 2004).

Figure 1
How a business might determine what standards to meet



Source of data: Caroline Flammer "*Does Corporate Social Responsibility Lead to Superior Financial Performance? A Regression Discontinuity Approach*", University of Western Ontario, (2013).

Aligning with sustainability priorities is a good start, as long as this addresses the enterprise's biggest impacts, needs and opportunities (Figure 1). This will maximize positive impact where it is the most needed: for the business, stakeholders and the environment (Flammer C., 2013). With a well-developed strategy, these will align with consumer concerns, advancing both sustainability and marketing goals. As an example, manufacturers of household cleaning products might focus on certifications and standards around non-toxicity and biodegradability, while paper products companies would be wise to hone in on post-consumer recycled content and non-toxic processing. When specific areas are identified, a good next step is to *identify applicable standards and certifications and choose those with the greatest real impacts* (inside and outside the business), which lies above current performance and the status quo. Companies can do side-by-side comparisons for various standards and talk to peers. As a simple example, a 100 percent recycled content label effectively addresses both environmentally preferable sourcing and end-user recyclability, adding value over a recyclable label alone (Bansal P., 2012).

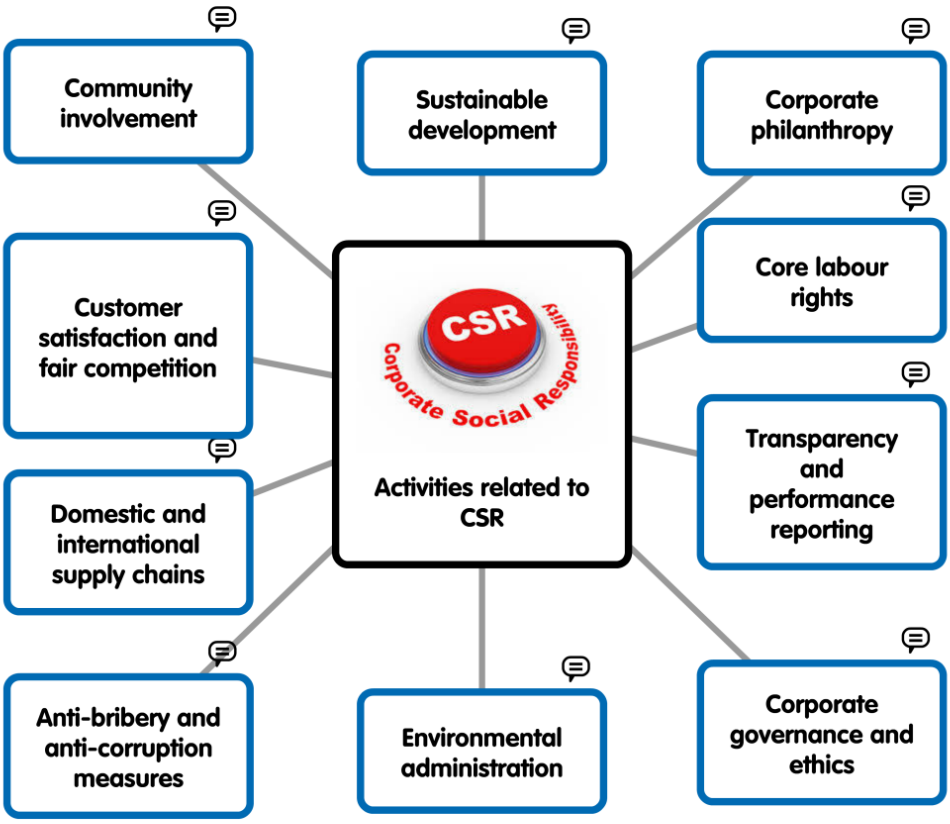
The WBC (World Business Council) for Sustainable Development has described CSR as the business contribution to sustainable economic development. CSR typically includes "beyond law" commitments and activities being related to:

- corporate governance and ethics;
- health and safety;
- environmental stewardship;
- human rights (including core labor rights);
- sustainable development;
- conditions of work (including safety and health, hours of work, wages);
- industrial relations;
- community involvement;
- involvement of and respect for diverse cultures;
- corporate philanthropy and employee volunteering;
- customer satisfaction;
- anti-corruption measures;
- accountability, transparency; and
- supplier relations, for both domestic and international supply chains.

These elements of CSR are interconnected, in interdependence, and apply to firms wherever they operate - wherever the domain of activity (Figure 2).

Figure 2

Activities related to CSR



Source of data: ISO 26000 - Social Responsibility components

The field of corporate social responsibility has grown exponentially in the last two decades. Almost all the big companies issue CSR reports. A larger number of companies than at any time previous are engaged in a serious effort to define and integrate CSR into all aspects of their businesses. An increasing number of shareholders, analysts, regulators, activists, labor unions, employees, community organizations, and news media are asking companies to be accountable for an ever-changing set of CSR issues.

There is increasing demand for transparency and growing expectations that corporations measure, report, and continuously improve their social, environmental, and economic performance. It is important that the CSR strategy is aligned with the company's specific corporate objectives and core competencies.

Every company implements differently its own corporate social responsibility, depending on the company's size, the particular industry involved, the firm's business culture, stakeholder demands, and how historically progressive the company is in engaging CSR.

The difference also consists on the areas it focuses on: some companies focus on a single area, which is regarded as the most important for them or where they have the highest impact or vulnerability—human rights, for example, or the environment—while others aim to integrate CSR in all aspects of their operations.

CSR translated into financial performance

First of all, adopting the CSR principles involves costs that might be short term in nature or continuous outflows. These costs might involve the purchase of new environmentally friendly equipment, the change of management structures, the change of marketing campaigns, or the implementation of stricter quality controls.

Since being socially responsible involves costs, it should generate benefits as well in order to be a sustainable business practice. The shareholders invest their money in a corporation, expecting the highest possible risk adjusted return. Therefore, being socially responsible should have bottom-line benefits in order to be sustainable. In addition, they may implement stricter and, thus, more costly quality and environmental controls, but they run **less risk of having to recall defective product lines and pay heavy fines for excessive polluting**. They also have **less risk of negative social**

events which damage their reputation and cost millions of dollars in information and advertising campaigns. The scandals about child–labor and sweatshops that affect the clothing industry are two fine examples.

Following a simple logical economical connection, socially responsible businesses should have **more stable earnings growth and less downside volatility**. Since companies that adopt the CSR principles carry less risk, when valuing those companies, a lower discount rate should be used. In the company valuation this lower tail risk should be taken into account. There are also other cases in which doing what is good and responsible converges with doing the best for the particular business. **Some CSR initiatives can dramatically reduce operating costs**. For example, reducing packaging material or planning the optimum route for delivery trucks not only reduces the environmental impact of a company's operation, but it also reduces the cost. The process of adopting the CSR principles motivates executives to reconsider their business practices and to **seek more efficient ways of operating** (Flammer C., 2013).

Companies perceived to have a strong CSR commitment often have an **increased ability to attract and to retain employees** (Porter M.E., 2011) which leads to reduced turnover, recruitment, and training costs. Employees, too, often evaluate their companies CSR performance to determine if their personal values conflict with those of the businesses at which they work. There are many known cases in which employees were asked, under pressure of their supervisors, to overlook written or moral laws in order to achieve higher profits. These practices create a culture of fear in the workplace and harm the employees' trust, loyalty, and commitment to the company.

Companies that improve working conditions and labor practices also experience **increased productivity and reduced error rates**. Regular controls in the production facilities throughout the world ensure that all the employees work under good conditions and earn living wages.

These practices are costly, but the increased productivity of the workers and improved quality of the products generate positive cash flows that cover the associated costs. Thus, firms may actually benefit from socially responsible actions in terms of **employee morale and productivity (**Kytle B., 2005).
Since CSR is integrated into the business practices, it is by definition complicated to try to measure its effects separately. Ideally, it should be possible to keep all other factors constant and measure a company's financial performance and volatility of cash flows before and after adopting the CSR principles. As this is not possible, however, empirical methods are used to identify the relationship between a company's socially responsible conduct and its financial performance. The evidence reported so far suggests that CSR benefits shareholder value through an increase in **operating performance**. The results of the Harvard Business School 'Corporate Social Responsibility and Access to Finance' working paper suggest that superior **CSR performance causes lower capital constraints, lower capital costs, greater access to capital and improved earnings**. Lower capital constraints lead to an improvement in CSR performance, thus creating a vibrant cycle of mutual benefits.
Implementing CSR programs may be a way to cater to customers that are responsive to sustainable practices. In this case, one might expect an **increase in sales growth following the adoption of CSR proposals**, as they would allow companies to extend their customer base. It could be that CSR programs increase employee satisfaction. Several articles in the management literature argue that by nurturing the relationship to its employees, a company can attract, motivate, and retain the most talented employees in the industry (e.g., Albinger and Freeman 2000, Greening and Turban 2000, Peterson 2004, Pfeffer 1994, Turban and Greening 1996, Vogel 2005). Relatedly, Edmans (2011, 2012) shows that companies with higher job satisfaction earn higher abnormal returns compared to their peers.

CSR initiatives may foster the use of more **efficient technologies or production processes** (e.g., environment-friendly technologies).
In particular, Porter (1991) views pollution as a waste of resources (e.g., energy and material) and argues that efforts to reduce pollution might not only reduce a company's environmental footprint but also **strengthen its competitiveness**. A growing literature extends Porter's view (for reviews, see Ambec and Lanoie 2008, Berchicci and King 2007, Etzion 2007).
For instance, the literature on sustainability in business examines ways in which companies can become more environment-friendly and how these **greening initiatives influence financial performance**. In particular, companies can become more sustainable by leveraging the low hanging fruits of efficiency and waste management and hence achieve significant financial benefits (e.g., Clelland, Dean, and Douglas 2000, Rusinko 2007, Russo and Harrison 2005).

Conclusions

Given the significance of the concept of CSR and its potential to affect the financial performance of a company, it is high time for corporate leaders to envisage the wide spectrum of CSR initiatives for generating better financial numbers, attracting more skilled and qualified employee base, enhancing their stock market performance and inflating the value of the company.

The conclusions of this paper are synthesized in Figure 3:

- The first impact of CSR is on the customers. Increasing customers' loyalty and keenness to pay the product or service is the main aspect a company's strategy aims.
- The second positive impact can be felt inside the company, at both the employees' productivity level and the company's chain

of production effectiveness, or any other part of a company's activity that gets to lower its risks or even cut the operation costs due to CSR concepts.

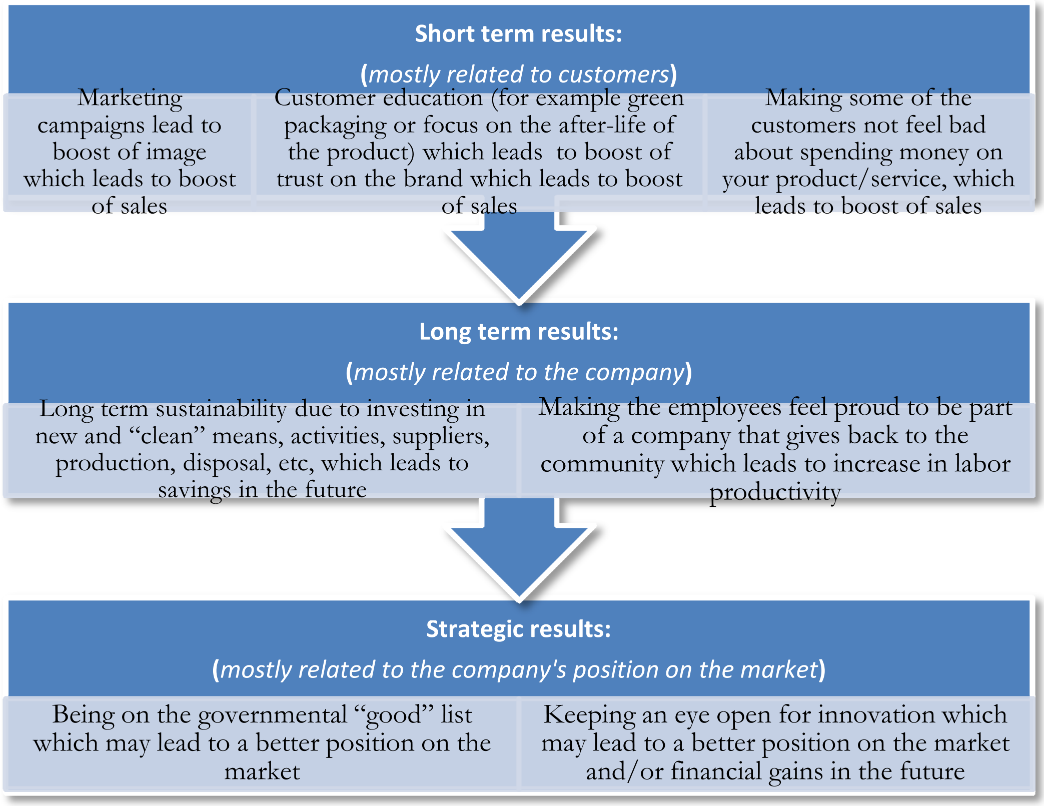
- Last but not least, on the long term, CSR programs translate into better positioning a company on the market, which creates important opportunities for the company's sustainable development.

An equally important aspect that should be taken into account is that CSR initiatives promote a good example of transparency, equity, responsibility over its own actions, leading the way for both young and old market actors.

Companies have already found worthwhile devoting a significant amount of resources to implementing and developing their CSR strategy, as part of the sustainable development strategy. By looking at the big picture, we could sum up that the most significant feature or quality of CSR is that *both stakeholders and shareholders win.*

Figure 3

CSR - read in financial terms



Source of data: Zapciu R.M. – PhD scientific report (2014)

Acknowledgements

This work was partially supported by the strategic grant POSDRU/159/1.5/S/134197 – PERFORMANTA, of the Ministry of Education and Scientific Research, Romania, co-financed by the European Social Fund – Investing in People, within the Operational Sector Program Human Resources Development, 2007-2013.

References

Tukker A., Charter M., Vezzoli Eivind M., Andersen S.M. (2008) „System Innovation For Sustainability 1", Green Leaf Publishing, Digest 2(39): 7-8.

ECD (1998): Review of the Development of International Environmental Management Standards — ISO 14000 Standards Series. OECD Group on Pollution Prevention. Environment Directorate. Environment Policy Committee. ENV/EPOC/PPC(98)6. May 4 1998, Paris.

ISO 14000 Series (1997) Environmental Management Standards, particularly on Developing Countries, and Opportunities and Needs in this Context." Trade and Development Board. Commission on Trade in Goods and Services, and Commodities. Held in Geneva, from 29-31 October. TD/B/COM.1/10, TD/B/COM.1EM.4/3.

Sampson G.P. (2005) „The World Trade Organization and Sustainable Development", United Nations University Press.

Ukaga O., Maser C. (2004) „Evaluating sustainable development: giving people a voice in their destiny," Stylus Publishing, LLC.

Bansal P. (2012), „The corporate challenges of sustainable development ACAD MANAGE PERSPECT" 16:2 122-131, May 1 2012.

Flammer C. (2013) "Does Corporate Social Responsibility Lead to Superior Financial Performance? A Regression Discontinuity Approach", University of Western Ontario.

Porter M. E., & Kramer M.R. (2011) "The big idea: Creating shared value." Harvard Business Review 89(1–2), 62–77.

Kytle B., & Ruggie J.G. (2005) "Corporate Social Responsibility as Risk Management: A Model for Multinationals. Corporate Social

Responsibility Initiative Working Paper No. 10" Cambridge, MA: John F. Kennedy School of Government, Harvard University.