Research on the Influence Mechanism of Corporate Social Responsibility on Financial Performance

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Abstract. In the process of social development, corporate social responsibility and corporate financial performance have widely concerned. In academia, there is numerous researches on the connection between the two. Reviewing pertinent academic writing on the CSR and financial effect is the goal of this study, sorting out how the two elements are related and guiding corporate participation in community responsibility functions. The study of this paper draws several conclusions. First of all, most businesses that participate in social responsibility initiatives can improve their financial performance. What’s more, the participation of a few companies in social responsibility activities has nothing to do with company performance or even hinders the company's business performance. The different impact results are related to the company's operating conditions, the purpose of participating in social responsibility activities, and social recognition. If companies wish to increase their financial returns through social responsibility, they must excel at strategic management.

Keywords: Corporate Social Responsibility; Financial Performance; Stakeholder Theory.

1. Introduction

1.1 Research Background

In the complicated corporate world of today, the concept of social responsibility is becoming more and more familiar to people. These few years, because of the problems of product quality and safety, destruction of the ecological environment, and uneven distribution of medical care, Corporate social responsibility (CSR) has drawn interest from many spheres of life, and people are calling on enterprises to assume this responsibility and obligation.

After decades of development, more and more companies have participated in social responsibility activities, which have increased corporate profits while fulfilling social obligations. Entrepreneurs and company management gradually recognized the importance of CSR and incorporated it into the company's operating system. Nonetheless, some companies are reluctant to take on social responsibility. However, due of the controversy surrounding CSR's effect on financial success, some businesses are hesitant to engage in social responsibility. On the one hand, some academics think that undertaking CSR will not boost the companies’ economic profit but will instead driving up costs. On the other hand, other academics think that if managed properly, a commitment to society can have a favorable effect on financial performance.

In addition, the company's participation in public welfare, charity, and other social activities will virtually improve the company's social image and help the company establish a more complete and friendly corporate culture, which is an effective way to gain social recognition. The development of any social organization is inseparable from the recognition of the masses. Therefore, the development of enterprises should not only focus on their interests but also consider contributing to society.

1.2 Research Significance

CSR has a beneficial effect on social advancement. Participation of the business in CSR is conducive to improving social problems and promoting social progress. Still, it requires more costs for companies, which violates the goal of maximizing profits to a certain extent, making many companies unwilling to participate. However, from a long-term perspective, fulfilling social responsibilities is essential to both business and society. This essay examines the connection between the CSR and firms' economic profits, which is particularly significant in theory and practice.

Theoretically, it strengthens the assertion that CSR has a beneficial impact on the economic profits. This essay examines the influence of CSR on the company and its shareholders using the stakeholder theory, not only enriches and supplements the stakeholder theory but also contributes to the study of its relationship with financial performance to a certain extent. What's more, theories that relate to CSR are not only theories of stakeholders but also can be studied from the aspects of life cycle theory and sustainable development theory. Contribute to linking theory with practice in this field.

From a practical point of view, it provides a practical reference for enterprises to fulfill their social responsibilities. With the deepening of the impact of economic globalization, all countries are paying more attention: to climate, resources, environment, and other issues. Therefore, CSR has become an important topic of international and domestic attention. Enterprises must take social responsibility in this environment if they want to develop. This paper provides guidance for enterprises to fulfill their social responsibility by sorting out the relationship between different scholars on social responsibility and financial performance.

1.3 Chapter Organization

There are three sections to this article. The first section is the introduction, which respectively introduces this article's research background and research significance. There is critical theoretical and practical relevance to the study of the relationship between CSR and financial performance. In the following context, these points will be discussed one by one. The second part is the literature review, which is the central part of this article. The literature review will be divided into academic research and empirical research. Among them, the theoretical part mainly discusses the influence of stakeholders in enterprises on enterprises' participation in social responsibility activities. The empirical part summarizes the connection between CSR and financial results. Academics will typically draw three conclusions: positive correlation, negative correlation, and irrelevance.

2. Literature Review

The importance of CSR has gradually increased with the emergence of a series of social issues, such as environmental issues. Today's society expects businesses to perform social functions in addition to their conventional roles of producing things and offering services. In recent years, companies have begun to recognize the importance of CSR because outside investors prefer to invest the firm that actively undertake social responsibilities and contribute positively to social development. Therefore, more and more enterprises have begun to participate in social governance. How CSR initiatives impact a company's financial performance is a crucial CSR problem. This paper critically evaluated the correlation of CSR and corporate economic profits from theoretical and empirical perspectives. Theoretical aspects mainly take stakeholder theory as the primary research object. On the practical side, the previous research on connection between enterprise engagement in community responsibility and economic performance has yielded conflicting consequences.

2.1 Theoretical Research

In 1984, Freeman put forward the stakeholder theory, which means that the management of the company adopts a series of management methods and measures to balance the interests of various departments of the company so that all stakeholders can benefit from it and avoid the imbalance of interest distribution [1]. Because each stakeholder has different resources, their impact on the enterprise is also different. This theory can be regarded as the theoretical support for companies to implement corporate social responsibility governance because social responsibility governance will affect the income status of company shareholders. However, the definition of CSR is wide-ranging, and the academic community has not reached a consensus on the impact of CSR on companies. There are 37 alternative definitions of CSR, according to Dahlsrud (2008) [2]. The perceptions and definitions of these CSRs vary widely. For instance, Friedman (1970) contends that a company should only be accountable to shareholders and that a company's social obligation is to augment its revenue [3]. On the contrary, Davis (1973) argues that in addition to shareholders, the interests of other stakeholders should also be considered [4].

The former, economic responsibility is the primary responsibility of enterprises. Enterprises should achieve the goal of maximizing shareholders' wealth without violating legal provisions [5]. Consequently, the involvement of enterprises in social activities, that is, the consumption of company resources, will also damage the profits of shareholders. Therefore, some scholars such as McWilliams and Siegel believe that the purpose of companies is to make profits and create more employment opportunities [6]. That is to say, maximizing shareholder wealth is to fulfill social responsibility. The latter, considering other stakeholders, will bring higher social benefits to the company. The company actively participates in social activities such as charity, fundraising, and volunteer service, which will improve the corporate image virtually. However, not all companies that participate in CSR governance can benefit, and it also depends on the purpose of the company's participation. Companies implement social responsibility governance for different purposes. Tortuga and O'Donohue, 2012 argue that companies that implement CSR governance can achieve a more competitive advantage. However, the implementation of CSR governance also consumes a lot of corporate resources, and the cost is too high for some small companies, which may be reluctant to invest. Therefore, Kim et al. (2012) summarise theoretical recommendations in the literature and classify CSR companies into two categories: Firstly, companies actively participate in corporate social responsibility governance while investing significant resources to improve environmental conditions to achieve broader societal benefits. Such companies produce positive results on issues related to corporate social responsibility [7]. The other category is "greenwashing" enterprises. The enterprises themselves have a limited resource base. They have not substantively participated in the governance mechanism that is responsible for the environment and society. They have not made substantial investments and contributions to society. Therefore, CSR will not bring higher benefits to the company.

It can be seen that people should concentrate on the connection between firm accountability and social duty on the basis of the stakeholder theory.

2.2 Empirical Research

As mentioned above, the main objective of business operations is to gain profits, and enterprises need to pay certain resources to fulfill their social responsibilities. Because the primary goal of the company is to generate profits, the company is more concerned with whether the economic benefits of fulfilling social responsibilities outweigh the costs. So far, there is no consensus in the academic circle and the research on the relationship between the three. Mainly focus on two aspects: positive correlation, negative correlation, and neutral correlation [8].

2.2.1 Positive Correlation

Utilizing return on investment (ROI), return on equity (ROE), and return on total assets as the financial indicators, Preston and Bannon (1997) examined 11 years of data from 67 companies. Taking CSR and financial indicators as independent variables and dependent variables, in turn, the research shows that the results are all positive correlations [9]. Chuck and Nina (2008) selected the stocks of 56 US-listed companies as sample data and found that participation in social responsibility was closely related to stock growth. Companies that actively fulfill their social responsibilities also have better stock growth than other companies. This further demonstrates the link between CSR and improved financial results [10]. Devie et al. (2019) measured and studied the social responsibility activities of the natural resource industry in Indonesia and conducted a partial least squares analysis of listed companies, and the results showed that CSR drives the growth of financial performance. At the same time, CSR is an effective tool for managing corporate risks and performance, and companies should attach importance to corporate social responsibility and incorporate it into strategic investment plans [4].

Cho et al. (2019) performed a regression analysis on 191 companies listed on the Korea Stock Exchange, using profitability and company value to evaluate the financial success of the enterprises. This result confirmed that there is a positive correlation between the CSR performance and profitability, as long as corporate value [11]. These reports emphasise the social function of business and are highly pertinent based on the stakeholder paradigm. Companies' social obligations expand along with their size and impact, plenty of enterprises are not only profit-seeking organizations but should also strive to gain the support of society [12]. They contend that the CSR initiatives were able to reduce interest conflicts between businesses and the stockholders, which would eventually boost economic results and the company's worth [13].

In today's society, the participation of enterprises in economic activities will inevitably lead to many problems. While creating economic benefits, enterprises have the responsibility to solve these problems by themselves. If enterprises continue to ignore the expectations of society, it will exacerbate social problems and lead to increased operating costs for enterprises. Furthermore, corporations are primarily responsible for economics, but as members of society, they must also assume legal, moral, and philanthropic responsibilities [14,15].

2.2.2 Negative Correlation

Davis (1973) looked examined the connection between CSR and the performance of corporate finances, taking British listed companies as the sample. Price-earnings ratio is used to assess financial performance (PE ratio), and CSR is analyzed by comprehensive performance indicators based on three different indicators: environment, employment and community service [15]. This study discovered a negative relationship about the price-earnings ratios and CSR performance, particularly in the environmental industry. Based on agency theory, Barnea and Rubin (2010) examined the connection between the CSR and company worth. The study found that some managers will spend too much on the CSR activities in order to seek private interests, which will lead to excessive agency costs and thus lead to a decline in company value [16]. Therefore, CSR's impact and financial performance are inversely related.

According to Shin (2011)'s analysis of the connection between charitable giving and company value, charitable giving can be seen as a component of the CSR. It is initially found that corporate donation expenditure is positively correlated with corporate value. However, when donations reach a certain level, the correlation between the two becomes negative [17]. Agency costs rise as managers overspend on CSR efforts for personal gain, thereby harming shareholders' interests and ultimately leading to a decline in firm value. Chinese scholar Zhao (2013) selected 35 business firms from the Shanghai and Shenzhen Stock Exchanges to study. The more actively the financial industry fulfills its corporate social responsibility, the lower its risk level, but the worse its financial performance [18]. To put it another way, there is a definite inverse relationship between the CSR and economic benefits.

The experts mentioned above emphasized the adverse correlation between financial indicators and CSR. This result supports the idea that social responsibility entails expenses while detriment to business. The absence of a link between the CSR and economic success does not, however, mean that corporations should stop taking part in socially duty initiatives. Many managers believe that being a good corporate citizen is also important, even at the expense of shareholders. However, shareholders should also be socially responsible, and sometimes they can be required to reduce their financial performance to fulfill corporate social responsibility.

2.2.3 Neutral Correlation

Aupperle et al (1985) believe that CSR will increase the cost of the company, but it will also lead to a reduction in other costs, such as technology costs, so the two offset each other and ultimately appear irrelevant [19]. Mc Williams and Donald Siegel (2000) believe that a very important reason for the different conclusions of research for the CSR and the economic benefits is the investment in research and development is not considered. The authors use R&D investment as an independent variable to study the impact of R&D costs on firm value during 1991-1996, and the results show that there is no relationship between the two [20]. Soana (2011) selected the data of 21 international banks in Italy in 2005 as a sample, and their economic benefits were calculated by the return on total assets and the ROE, respectively. Empirical study revealed that no connection between the CSR and financial success. The aforementioned study demonstrates that social responsibility neither increases nor decreases profitability. CSR's advantages and disadvantages are well balanced [21].

2.3 Literature Summary

There are three types of research on how CSR initiatives affect financial success, one is considered to be positively correlated, one is considered negatively correlated, and the last is considered irrelevant. The preceding research stream came to the conclusion that CSR generates more money for firms than it costs.

Furthermore, according to several research institutions, they believe the cost of CSR operations exceeds the profit of CSR operations, resulting in a decrease in the profits of CSR activities. However, it is worth noting that no single measure of CSR is without its drawbacks. In addition to the flaws in the research method, the assumptions made by the authors are limited and focus only on the part of CSR activities, not considering things as a whole. Thus, despite the diversity of results, positive relationships are more common than other types of relationships, based on extensive literature analysis.

3. Conclusion

This paper reviews academic research on CSR and financial performance through literature reading. On this basis, it is combined with the stakeholder theory to enrich the research on CSR. The academic exploration of the above connection often takes one of three positions: irrelevance, negative correlation, and positive association. Most scholars draw conclusions based on the combination of theory and empirical methods by proposing hypotheses, establishing data models, and regression analysis. Although the results were varied, based on extensive literature analysis, positive relationships were more common than other types of relationships. Enterprises face many problems in participating in social activities, which requires managers to take the initiative to take responsibility, rationally plan the company's business, make timely budget analyses, and control the cost of participating in social responsibility activities within the acceptable range of the company. This way, the company can increase its income and improve social recognition by fulfilling its corporate social responsibility.

However, it is worth noting that no single measure of CSR is without its drawbacks. In addition to the flaws of the research method, the assumptions made by the authors, the timing, and the sample objects may all be flawed, and they only focus on the part of the CSR activities and do not consider the whole. In addition, some literature was published earlier, after decades of development, and may not apply to the current economic environment. CSR has always been the focus of social discussion, and the research about how the CSR affected the economic benefits has always been a topic of concern to researchers. Through literature analysis, this paper draws some valid conclusions. Future research can further refine CSR and combine more theories with CSR to make the study of social responsibility more thorough.

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