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THE IMPACT OF CSR ON FINANCIAL PERFORMANCE: CONTROVERSIAL EMPIRICAL EVIDENCE AND REASONS BEHIND IT

Business case for corporate social responsibility (CSR) is becoming increasingly relevant today because it allows companies to align interests of different groups of stakeholders through creating a shared value. To integrate CSR in a company's business model effectively, it is important to understand the relationship between CSR and financial performance. However, a large number of studies on the impact of CSR on a company's bottom line have yielded controversial results. The goal of this article is to provide an overview of discrepancies in the results of empirical studies on the relationship between CSR and financial performance reported in the literature and summarize the reasons and methodological issues underlying the lack of consensus regarding this relationship. We show that most authors observed a positive impact of CSR on financial performance, however some authors reported a negative, U-shaped, inverted U-shaped, and S-shaped relationships, as well as the absence of any impact of CSR on financial performance. The discrepancy in the results can be related to a multidimensional and heterogeneous nature of CSR, and hence, to the lack of uniformity in measuring it. Similarly, financial performance can also be measured through a variety of indicators, both accounting- and market-based. The differences in the measurement methodology make the results of different studies less comparable. The relationship between CSR and financial performance can also depend on the approach to CSR used by companies. If CSR serves as an instrument for wealth creation, its impact on financial performance should be positive by definition. If CSR is based on purely ethical considerations, it may be merely a cost-center with no economic benefits. The relationship between CSR and financial performance can be weakened or strengthened by a large number of external and internal situational factors, such as the institutional environment, industry dynamism, company size, form of ownership and many others that can have a moderating effect on the relationship. The causality within this relationship can be bidirectional and result in a virtuous cycle, but it can also be reversed and asymmetrical. The ambiguity of the results reported in the literature can be connected with a delayed effect of CSR on financial performance, when it takes some time for investments in CSR to pay off in terms of financial benefits.

Keywords: corporate social responsibility (CSR); financial performance; measurement methodology; measures of CSR; bidirectional causality; moderation effect

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ВПЛИВ КОРПОРАТИВНОЇ СОЦІАЛЬНОЇ ВІДПОВІДАЛЬНОСТІ НА ФІНАНСОВІ ПОКАЗНИКИ: СУПЕРЕЧЛИВІСТЬ ЕМПІРИЧНИХ РЕЗУЛЬТАТІВ ТА ЇЇ ПРИЧИНИ

Бізнес-обгрунтування корпоративної соціальної відповідальності (КСВ) сьогодні стає дедалі актуальнішим, оскільки дозволяє компаніям узгоджувати інтереси різних груп стейкхолдерів через створення спільної цінності. Для ефективного інтегрування КСВ у бізнес-модель компанії важливо розуміти зв'язок між КСВ і фінансовими показниками. Однак, велика кількість досліджень, присвячених впливу КСВ на фінансові показники, дають суперечливі результати. Мета цієї статті – провести аналіз розбіжностей у результатах емпіричних досліджень взаємозв'язку між КСВ і фінансовими показниками, про які повідомляється в літературі, і визначити причини та методологічні проблеми, пов'язані з відсутністю консенсусу щодо цього зв'язку. З проведеного аналізу випливає, що більшість авторів спостерігали позитивний вплив КСВ на фінансову результативність, однак деякі автори повідомили про негативну, U-подібну, інвертовану U-подібну та S-подібну залежності, а також про відсутність будь-якого впливу КСВ на фінансові результати. Розбіжність у результатах може бути пов'язана з багатовимірністю та різноманітністю форм КСВ, а отже, з відсутністю єдиного підходу до її вимірювання. Те ж стосується і фінансової результативності, яка може вимірюватися за допомогою різноманітних показників, як основаних на фінансовій звітності, так і на ринковій вартості компаній. Різниця в методології вимірювання ускладнює порівняння результатів різних досліджень. Зв'язок між КСВ і фінансовими показниками також може залежати від підходу до КСВ, який використовують компанії. Якщо КСВ служить інструментом для створення економічної цінності, її вплив на фінансову ефективність має бути позитивним за визначенням. Якщо КСВ базується на суто етичних міркуваннях, вона може бути просто центром витрат. Зв'язок між КСВ і фінансовими показниками може бути послаблений або посилений великою кількістю зовнішніх і внутрішніх ситуаційних чинників, таких як інституційне середовище, динамізм галузі, розмір компанії, форма власності та багато інших, які можуть створювати модераційний ефект на цей зв'язок. Причинно-наслідковий зв'язок між КСВ і фінансовими показниками може бути двонаправленим і приводити до позитивного циклу, але причинність також може бути протилежною – кращі фінансові показники обумовлюють вищій рівень КСВ. Неоднозначність результатів, наведених у літературі, також може бути пов'язана з відстроченим впливом КСВ на фінансові показники, коли потрібен деякий час, щоб інвестиції в КСВ окупилися з точки зору фінансової віддачі.

Ключові слова: корпоративна соціальна відповідальність (КСВ); фінансові показники; методологія вимірювання; показники КСВ; двонаправлений причинно-наслідковий зв'язок; модераційний ефект

Introduction. The inclusion of corporate social responsibility (CSR) in business models has long become a necessity for modern companies working in different sectors and industries. The need for socially responsible behavior of companies is dictated by the persistence of social problems, negative side effects of technological advancement, climate change and other environmental issues, the development of civil society, consumer activism, just to name a few. The accumulated global problems call for collective effort because they transcend national boundaries and cannot be solved by governments or individual organizations alone.

Business philosophies behind CSR may range from purely pragmatic to ethical and altruistic, however business case for CSR has been becoming more and more relevant because it allows companies to align interests of different stakeholders. When integrating CSR in business models or developing strategies, it is important to understand whether it is merely a cost center or it is one of the factors that contributes to фthe improvement of financial performance, at least in the long run.

Review of the recent literature and formulation of the research problem. There have been an enormous number of studies exploring the impact of CSR on financial performances of companies. However, almost all authors point out in the introductory part that there is no consensus on the relationship between CSR engagement and financial performances, and the review studies of the literature on the topic additionally confirm it (see for example [1-5]). Bruna and Lahouel describe the results on the relationship between CSR and financial outcomes as “contradictory and inconclusive, often tainted by epistemological weaknesses, theoretical inaccuracies and methodological biases.” [3].

Thus, while there is little disagreement about the need for companies to be socially responsible, it is not quite clear whether CSR activities are beneficial or disadvantageous for a company’s bottom line, whether they improve the competitive position or divert resources from economic to social investments. An in-depth understanding of the relationship between the financial performance and CSR (or particular aspects of CSR) and factors that can affect this relationship can help in making rational decisions and designing sound CSR strategies, which would align the interests of a company and its stakeholders. Having a clearer idea about this relationship is also helpful for law and policy makers, in particular when introducing changes in business regulation. To refine methodologies of measuring the relationship between CSR and FP, it is necessary to critically assess the existing results on this relationship and identify the possible sources of discrepancy in the form of this relationship reported by different authors.

The goal of this article is to provide an overview of discrepancies in the results of empirical studies on the relationship between CSR and financial performance reported in the literature, summarize the reasons for the lack of consensus on the form of this relationship and methodological issues accounting for the controversial empirical results. Thus, we intend to specify the factors that should be taken into account when critically evaluating the claims about either positive or negative or more sophisticated effects of CSR on financial performance and when choosing research methodology for studies on this topic.

The main results. Before we start discussing the reasons behind the contradictory results on the impact of CSR on financial performance, let us provide a brief overview of the character (shape) of the relationship between CSR and financial performance as reported in the literature. Based on empirical data, most authors found a significant positive impact of CSR on financial performance [4, 6-13]. However, some authors observed a negative relationship between the two. For example, Chen et al. show that mandatory CSR disclosure leads to changes in firm behavior, which generates a positive impact on community but at the expense of shareholders because CSR reporting firms experience a decrease in profitability [14]. Hamdoun et al. found no significant direct effect of CSR on financial performance, and even a negative effect of the social dimension of CSR on financial results [15]. However, the authors point out that CSR does improve a company’s competitive advantage through improving reputation and enhancing human capital [15].

Lee et al. provide empirical evidence in favor of neutrality between CSR and financial performances both at a company and industry levels, thus showing that a company’s involvement in CSR “neither penalizes nor improves its financial indicators” [16]. Hirigoyen and Poulain-Rehm also demonstrate that greater efforts in the CSR sphere do not lead to better financial performance [17]. Broccardo et al. [18] make a similar conclusion in the context of a luxury company. Based on a longitudinal in-depth analysis of a leading luxury company, they show that CSR did not impact the financial performance of the company except for a negative event that adversely affected the company’s reputation. In fact, most authors consider only positive performance of companies in the CSR sphere, however, it is also important to understand how the obvious lack of CSR can affect financial results. Lin et al. consider the effect of “positive” and “negative” CSR and show that a positive CSR improves the financial performance of a company, whereas a negative one has a detrimental effect on financial performance [19].

However, the relationship between CSR and financial performance can be less straightforward and depend on the CSR level. In particular, a number of authors reported a U-shaped relationship between CSR and financial performance [20-22], an inverted U-shaped [23, 24] or inverted V-shaped [25] relationship, and even an S-shaped relationship [26, 27].

It is clear that a U-shaped and inverted U-shaped relationships imply the opposite dependence of financial performance on CSR. According to Barnett and Salomon, to benefit in terms of financial performance, companies should set the level of their CSR effort either low or high, because a moderate level of CSR yields lower financial outcomes [21]. They also show that companies with the highest level of CSR have the highest financial performance. At the same time, Sun et al. show that an initial increase in CSR engagement has a positive effect on a company’s shareholder value, but as the company continues increase its CSR engagement making it excessive, the effect on the shareholder value turns negative [24].

Such discrepancy in the results can be explained in the first place by the complexity and heterogeneity of the phenomenon of CSR and different impact of different dimensions of CSR on financial performance. The lack of a clear definition of CSR and its boundaries is one of the main reasons behind the controversies regarding the impact of CSR on financial results. Besides, in the literature the concept of CSR is often replaced by the related but not identical concept, such as ESG (Environmental, Social, Governance). While CSR is more about principles and responsibilities and may have a qualitative character, ESG is quantifiable, measurable and specific. Generally, it is easier to study the effect of variables that have quantitative values, standardized and comparable across business entities. In addition, there are ESG ratings, scores, and indexes readily available for large listed companies, which alleviates the burden on researchers to measure ESG themselves.

When measuring CSR, authors can (i) use different proxies; (ii) study the effect of different dimensions of CSR on financial performances separately. For example, some authors associate CSR with corporate philanthropy [4, 11, 20, 27], some use ESG indexes [10, 22, 28-31], others consider only social dimension [32]. Some authors utilize less common composite measures of CSR. For example, Cho et al. used a country specific KEJI (The Korea

Economic Justice Institute) index that includes such dimensions as soundness of governance, fairness, contribution to societal welfare, environmental protection, consumer protection, employee satisfaction [33]. Koptieva and Kozub used sustainability rankings of companies provided in the RobecoSAM Sustainability Yearbook, but converted qualitative descriptors into quantitative values [7]. Rodriguez-Fernandez constructed a social behavioral index that included four equally weighted components: the participation in the Global Reporting Initiative, inclusion in the Dow Jones Sustainability Index, compliance with the Good Corporate Governance Recommendations, and participation in the Global Compact [34].

Taking into account a heterogeneous character of CSR, i.e. its multiple dimensions and aspects, different aspects may have different effect on financial performance [31, 33]. In most empirical studies, the authors built multivariate regression models describing the relationship between CSR and financial performance, which included a number of explanatory variables associated with certain dimensions of CSR, thus showing different effect of different variables.

The second reason for the controversial results is related to the approach to CSR used by companies. According to Garriga and Mele, there are four approaches to CSR: instrumental, political, integrative, and ethical [35]. While the political and ethical are normative approaches, the integrative one is holistic, showing the dependence of a company on its stakeholders in the short- and especially long-term perspective, and the instrumental approach is purely pragmatic and economic-value oriented. The instrumental approach considers CSR as a tool for wealth creation, which by definition implies a positive relationship between CSR and financial performance. Within the instrumental approach to CSR, companies can adopt the Creating Shared Value (CSV) model proposed by Porter and Kramer [36], which implies the simultaneous creation of economic and social value through product or/and technology innovations, improvements in the efficiency within value chains, contributing to local cluster development. Sometimes it is argued that CSV is not CSR, but we treat CSR more broadly than a mere cost-center and discuss this issue in more detail elsewhere [37]. Thus, a CSR strategy can be aimed at improving financial performance rather than solely "doing the right thing".

Karnani shows conceptually that providing socially desirable outcome does not necessarily mean sacrificing financial interest. In a so-called "opportunity zone" the private (company) and public (society) interests can be aligned. However, there is a "trade-off zone", in which to serve public interest, a company has to sacrifice its profits [38]. Thus, the relationship between CSR and financial performance may depend on the zone, in which the company operates. Then, even using the same measure of CSR performance, such as corporate philanthropic contributions, does not make the relationship between CSR and financial performance comparable across companies, because some of them can engage in strategic philanthropy and create a shared value, while others may create solely social value.

Not only does the way of measuring CSR account for the character of the observed relationship between CSR and financial performance but also the choice of financial performance indicators, because the impact of CSR can be different for different indicators. Thus, the third reason behind controversies regarding the impact of CSR on financial performance is related to the choice of financial metrics or indicators. The measures of financial performance used in the literature on CSR can be divided into accounting-based measures and market-based measures. The most common accounting-based measures of financial performance used by the authors studying the impact of CSR on financial performance are ROA (return on assets) [4, 11, 14, 17, 30, 33, 34, 39] and ROE (return on equity) [7, 14, 17, 22, 34, 39]. Other accounting-based measures of financial performance are earnings per share and net profit margin [39], return on total costs [7], liquidity proxied by the cash conversion cycle [40]. Bruna et al. used a composite measure (overall score) based on five financial ratios reflecting liquidity and solvency, activity, and leverage [10]. The most popular among the market-based measures is Tobin's Q [30, 33, 34]. Another market-based measure of performance used by Brammer and Millington was calculated as the sum of share price growth and dividend payout over a year divided by the share price at the beginning of the period [20]. Other examples of market-based measures found in the literature are stock returns [41] and market to book ratio [17]. A more sophisticated approach than studying a direct relationship between CSR and financial performance was applied by Zhou et al., who used a market-based performance indicator (Tobin's Q) as an explanatory variable and financial performance as a mediating variable between market value and CSR (proxied by a ESG rating). The financial performance, in turn, was measured based on ROE, total asset turnover and net profit growth [28].

Some authors who used simultaneously several indicators showed that CSR has different impact on different indicators of financial performance. For example, Sin et al. found a significant impact of CSR on ROE and earnings per share but no significant impact on ROA and net profit margin [39]. At the same time, Rodriguez-Fernandez demonstrated that the companies with better sustainability ratings and higher compliance scores had superior financial results in terms of both ROE and ROA. However, she found no correlation of CSR with Tobin's Q ratio [34].

Indeed, the heterogeneous nature of CSR, as well as the multiplicity of financial performance measures, makes the results on the relationship between CSR and financial performance obtained by different authors less comparable.

Fourth, the controversial results of the studies of the relationship between CSR and financial performance can be explained by a myriad of situational factors, which can have a moderation effect on the relationship either strengthening or weakening it. The situational factors can be external or internal to companies, can be controlled or be beyond the company's control.

External factors include the instability of institutional environment, for example in the form of local officials turnover [42], mandatory disclosure [8, 10, 14] industry dynamism [26], industry competition [43], regional development [27] and others. There can be different effects for different industries, for manufacturing and service sectors.

Examples of internal factors are the form of ownership [27, 43], financial distress/stability [9], company size [26], marketing capability [41], quality management [22], CSR media coverage [44] and many others.

Definitely among the most important moderating variables is the quality of governance [34] and CEO capabilities [45]. There is an infinite number of CSR forms and, hence, strategies that can be chosen by a company's management given a set of situational factors. Thus, a positive impact of CSR on financial performance often depends on the soundness of strategic decisions regarding the forms of CSR and allocation of resources for and among CSR initiatives.

Fifth, the direction of causality is not quite clear: either better CSR performances lead to better financial performances or vice versa. The bidirectional causality in the CSR-financial performance relationship was addressed by many authors [4, 17, 34, 40, 46, 47, 48]. Practically all those authors show that the causal relationship between CSR and financial performance works in both directions. Hichri, using the data for a sample of Swedish companies, demonstrated that CSR performance has a positive effect on the company's financial performance and the opposite is also true, i.e. financial performance positively influences the company's CSR performance [46]. Likewise, the results reported by Uyar et al. indicate that firms with greater liquidity engage in CSR initiatives more actively, and at the same time, CSR promotes greater liquidity [40]. In the same vein, Rodriguez-Fernandez reports positive relationships between the four-component social behavioral index (described earlier in the article) and financial performance in both directions, thus finding the evidence for a virtuous cycle: "socially responsible policies transform into higher profits and higher profits transform into socially responsible policies" [34]. The latter sounds rather logical because the more financial resources a company has, the more it can afford to invest in CSR – in community projects, good causes, employee well-being, environmentally friendly technologies etc. However, Hirigoyen and Poulain-Rehm conclude quite the opposite: "The results show not only that greater social responsibility does not result in better financial performance, but also that financial performance negatively impacts corporate social responsibility" [17]. Still another result is reported by Garas and El-Temtamy who find a dynamic trade-off between CSR and financial performance. Out of the three ESG measures, only comprehensive environmental disclosure improves both ROA and Tobin's Q, however, better financial performance is negatively correlated with the combined CSR (ESG) disclosure [30]. Lin et al. make a conclusion that actually reverses the causality in the relationship between CSR and financial performance. They show that superior financial performance leads to a stronger CSR engagement, however more efforts in the CSR sphere do not necessarily result in better financial performances [47]. The latter finding is very much in line with what Lee et al. conclude *"Doing good" is not a panacea for corporate achievement with respect to market-facing activities… Investments in CR [corporate responsibility] practices alone do not guarantee improved financial performance"* [16].

Sixth, an additional complication that arises in the studies of the relationship between CSR and financial performance is that the effect of CSR can be a long-term one, which enhances the competitiveness and possibilities of sustainable development in the future rather than increases profitability or improves financial position in a short-term perspective. Barnett and Salomon point out that "In order for some firms to increase their capacity to benefit from investments in social responsibility, they might have to endure a period of decreased financial performance" [21]. Taking into account that the effect of CSR on financial performance is not immediate but rather delayed, some researchers who studied the relationship between CSR and financial results used time-lagged models [7, 10], however what time lag to choose is also a challenging question, which may affect the result of a study. Brammer and Millington addressed this problem in their study and found that firms with both unusually high and low corporate social performance show better financial performance than other firms. However, unusually poor performers in the field of CSR do best in the short run and unusually good social performers do best over longer periods of time [20].

Last but not least, the choice of firms for studies also matters. Usually large listed companies that are ranked and rated based on their financial and non-financial disclosures are studied. Such companies are highly visible and sensitive to reputation effects, possess sufficient financial resources and innovation capacity, can scale up CSR initiatives. The relationship between CSR and financial performance can be different for smaller and less visible companies with limited resources.

Conclusions and prospects for further research. In summary, understanding the relationship between CSR and financial performance is very important for integrating CSR in business models and developing CSR strategies. However, the results of studies on the impact of CSR on financial performance remain ambiguous and controversial. Although most authors found a positive relationship between CSR and financial performances, other possible relationships reported in the literature include negative, U-shaped, inverted U-shaped, S-shaped ones and also the absence of any impact of CSR on a company's bottom line. The reasons behind such a discrepancy in the results are multiple and are related to the multidimensionality and heterogeneity of the phenomenon of CSR, which, in turn, poses methodological problems connected with its measurement. Different authors may use different proxies for CSR performance making the results less comparable. Similarly, financial performances can be measured using different indicators both accounting-based and market-based.

Depending on the approach to CSR, companies can use it as an instrument for wealth creation, and then the impact of CSR on financial performance should be positive. However, if CSR is based on purely ethical considerations, it may be merely a cost center with no economic benefits. The relationship can be affected by a large number of external and internal situational factors, which can either weaken or strengthen the impact of CSR on financial performance. The causality within this relationship can be bidirectional and result, in particular, in a virtuous cycle: a better CSR performance leads to better financial performance, which makes it possible to invest more in CSR and so on. However, it is not always the case. The relationship can be reversed or asymmetrical, which is an additional evidence of a controversial nature of the results on the impact of CSR. Finally, the ambiguity of the results can be connected with a delayed effect of CSR on financial performance, when it takes some time for investments in CSR to pay off in terms of financial benefits. Taking into account a complex nature of the phenomenon of CSR, future research should focus more on specific mechanisms through which CSR can affect financial performance.

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