



The Complexity of Relationship between Corporate Social Responsibility (CSR) and Financial Performance

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Abstract

This study argues that, inconsistent results of the Corporate Social Responsibility (CSR) relationship with financial performance is due to the complexity of relationship between two variables. The complexity of relationship stems from the nature of CSR, which is unseparable from its environment. This nature of relationship brings unfavourable impact on empirical research. The conclusion obtained from empirical evidents of such relationship will be highly contextual and lack generalization. This study proposes variables that led to the complexity of CSR relationship and financial performance, which are country characteristics as well as CSR forms and dimensions. Country characteristics determine the tendency of CSR practices, which finally influence the strength of CSR relationship with financial performance. The selection of CSR forms and dimensions to be done is part of a company's strategy in an effort to achieve legitimacy.

Keywords: CSR, Financial Performance, Country Characteristics, Form and Dimension of CSR



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1. Introduction

This study argues that, the inconsistent results of previous studies on the relationship between Corporate Social Responsibility (CSR) and financial performance is stemmed from the complexity of the relationship, which cause limitations to the empirical research of such relationship (Macdonald & Maher, 2013). Empirical research limitations on CSR relationship with financial performance even occurs on the conceptual level.

CSR is a concept with a wide and detailed nature (Valiente et al, 2012; Hutchins & Sutherland, 2008; Jamali and Mirshak, 2007; Mehar and Rahat, 2007). The concept of CSR is even embedded with other concepts such as citizenship, ethics, sustainability, corporate governance, etc (Sprinkle & Maines, 2010; Kang et al, 2010; Grosbois, 2012; Zheng et al, 2014; Weber, 2008; Taysir & Pazarcik, 2013). This nature of CSP concept raises the operational and methodological differences on examining the relationship between CSR and financial performance (Aupperle et al., 1985; Griffin & Mahon, 1997). In collecting CSR data, it is often difficult to determine whether a particular activity is included in the CSR definition or not. The wide and detailed nature of CSR concept on the other side, creates problems of measurement. Different CSRs may require different measurements. CSR studies tend to have conceptual and methodical social critics (Elsayed and Paton. 2005; Filbeck & Gorman. 2004; Brammer and Millington. 2008). Testing the relationship between CSR and financial performance suffers from procedural and methodological limitations (Aupperle et al., 1985; Griffin & Mahon, 1997).

On the practical level, CSR practices can not be separated from the environment, because CSR issues are basically environmental issues. Institutional characteristics such as economic condition, social issues, culture, law etc. determine the tendency and preference of companies in doing CSR. Institutional factors also influence forms and intensity of CSR practices. CSR practices are changing over time along with the changing environment. In the beginning, CSR issues were only issues related to employees and firm owners. As the environment changed, new issues emerged and the issue of CSR became wider and detailed. Currently, the issues

of corporate governance and environment have become more critical as well.

Therefore, empirical testing of CSR and financial performance generates contextual conclusions. It will be difficult to make a generalization on CSR research as explained by Griffin and Mahon (1997). CSR research nature is actually far from the ideal research (Macdonald & Maher. 2013). The inconsistent results of previous studies on CSR and financial performance proves the imprefection of that kind of research. This study aims to disclose the complexity of the relationship between CSR and financial performance.

2. CSR Relationship with Financial Performance

Previous research on the relationship between CSR and financial performance showed inconsistent results. Among those research, some proved and indicated positive relationship between the two variables (Wang et al. 2011; Jo & Harjoto, 2011; Mishra & Suar, 2010; Cheung et al.2010; Rettab et al.2009; Sembiring, 2005; Goll & Rasheed, 2004; Billings, 1999; McGuire et al. 1988). Analysis of the relationship between CSR and financial performance on different dimensions such as employees, customers, social issues, environment and suppliers showed a positive relationship between CSR and financial performance (Mishra & Suar, 2010). Research also found out that, environment variables determine the relationship between CSR and financial performance (Goll & Rasheed, 2004). Discretionary CSR environment enhances financial performance and vice versa.

However, some research found inconsistent relationship between CSR and financial performance (Aupperle et al. 1985; McGuire et al., 1988; McWilliam & Siegel, 2000; Seifert et al. 2003; Brammer et al., 2006; Mehar & Rahat, 2007; Chih et al.2010). Empirical evidence of the previous reserach indicated a non-linear relationship between CSR and financial performance. Brammer & Millington (2008) and Barnett & Salomon (2006) for example, found that, the relationship between CSR and financial performance varies according to disclosure of CSR intensity. On low and high level CSR disclosure enhancing financial performance, low level CSR enhances short term financial performance, and high level CSR enhances long term financial performance.

Inconsistent results of previous studies analyzing the relationship between CSR and financial performance, criticize the work of stakeholder and legitimacy theories in explaining CSR relationship with financial performance. Stakeholder and legitimacy theories suggest that, the relationship between CSR and financial performance is positive. However, testing the relationship between CSR and financial performance using stakeholder and legitimacy theories is oversimplifying the relationship and ignoring the complexity of the relationship that generates very contextual conclusions. Analyzing CSR relationship with financial performance should include institutional characteristics, which influence CSR practices.

Country characteristics also determine the tendency of CSR practices (Falck & Heblich, 2007).

Previous research generally classify CSR practices under developed and developing countries. CSR practices in developing countries to some extent are different from CSR practices in developed countries (Beddewela & Herzig, 2012; Welford R, 2004; Baughn et al, 2007). Economic development influences CSR practices as well. Companies in developed countries do more CSR practices than companies in developing countries (Baughn et al, 2007). Many developing countries are rich of natural resources, but because of weak terms of corporate governance, CSR practice is even proving what is called resource curse, instead of providing benefits (Wiig & Koldstad, 2010). So far, analysis about CSR relationship with financial performance are done more in developed countries than in developing countries (Rettab et al, 2009).

Motivation of doing CSR practices influences companies in selecting forms and dimensions of CSR that will be done. Companies in Asia and developing countries tend to engage in philanthropic activities compared to companies in developed countries (Beddewela & Herzig, 2013; Jamali & Mirshak, 2007). Zheng et al (2014) stated that, philanthropic actions are expected to gain external legitimacy, while CSR sustainability is generally expected to gain internal legitimacy. Therefore, company's preference for CSR forms and dimensions carried out describes the company's strategy.

3. The Relationship of CSR and Financial Performance

Stakeholder Theory (Freeman, 2001) and Legitimacy Theory (Zheng et al, 2014; Tilling, 2004; Suchman, 1995) indicate that, CSR generates benefit for the company. Stakeholder Theory explains the certainty relationship of a company and its stakeholders. As a consequence, companies should maintain their relationship with stakeholders for the continuity of their business. CSR is considered as an important tool in maintaining the relationship with stakeholders (Jones, 1995).

Legitimacy theory requires companies to be legitimate for keeping their business, enabling continuity and securing the organization from external or internal threats. Companies with higher legitimacy get access to varies resources easier, which bring benefit to the organization. Internal legitimacy encourages employees' performance, which finally enhances financial performance (Wang et al, 2011; Harjoto & Jo, 2011; Mishra & Suar, 2010; Cheung et al, 2010; Rettab et al, 2009; Sembiring, 2005; Goll & Rasheed, 2004 ; William & Siegel, 2001; Billings, 1999; McGuire et al, 1988). The inconsistent findings of CSR and financial relationship is due to the complexity of the relationship (Valiente et al, 2012; Hutchins & Sutherland, 2008; Jamali & Mirshak, 2007). CSR practices are related to social issues as well (Husted, 2000), which are very dynamic.

Fiori (2007) summarized that, the increasing attention towards CSR begins with the awareness that, CSR practices will enhance a company's performance. Stakeholder theory perceives that, stakeholder fulfillment expectation improves financial performance (Porter &

Van der Linde, 1995). Stanwick (1998) and Verschoor (1998) emphasized that, good CSR will simplify the relationship between company and its stakeholders. According to the instrument theory, CSR issues can be managed to generate profit for company (Jones, 1995). If a company communicates its CSR practices well which satisfy the stakeholder needs, it can affect financial performance for the organization (Rettab, 2009).

Even though a company may spend a lot of resources to execute CSR, according to Williams & Siegel, (2001), market equality will work to compensate the cost of CSR activities with profit. However, some CSR activities require too much resources in a way that can worsen a company's competition (Friedman, 1970). In that case, CSR behavior may generate negative relationships with financial performance, since it violates against company's value maximization due to social constraints (Jensen, 2001). Negative relationship can also occur when a manager misuses CSR discretionary to fulfill his or her interest, instead of considering shareholders or other parties (Williamson, 1964; Jensen & Meckling, 1976).

Husted and Allen (2009) argued that, the relationship between CSR and financial performance is positive as long as CSR is directed on value creation drivers. Husted & Allen (2009) also identified ways to manage CSR for value creation drivers which are centrality, visibility, and voluntarism. Company's ability to manage CSR determines its effectivity in influencing financial performance. CSR will generate financial performance if it is managed in an appropriate way.

4. Country Characteristic on the Relationship of CSR and Financial Performance

Stakeholder and legitimacy theories indicate a positive relationship between CSR and financial performance. However, both theories are absent in explaining the complex process of CSR in influencing financial performance, so that the inconsistent results of CSR relationship with financial performance examination can be explained. Institutional theory explains the process of CSR in influencing financial performance along with institutional factors. Previous researchers have recognized institutional influence on CSR practices at the country level (Husted & Allen, 2006; Baughn et al, 2007). Husted & Allen (2006) recognized that, institutional pressure takes more important role in CSR decision making than strategic related social and stakeholder issues. Wiig & Koldstad (2010) indicated that, institutional factors determine the effectivity of CSR practice as a company strategy.

The strength of CSR relationship with financial performance is influenced by a country's institutional factors (Li et al, 2010; Griffin & Mahon, 1997). Countries which have similarity in terms of institutional characteristics tend to have a lot of similarity in CSR practices. Generally, analysis of CSR practices on the country level refers to institutional characteristics.

Previous researchers did tend to classify CSR practices based on developing and developed countries characteristics (Beddewela & Herzig, 2013; Jamali & Mirshak, 2007; Baughn et al, 2007; Chapple & Moon,

2005; Ewing & Windisch, 2007; Kimber & Lipton, 2005; de Oliveira, 2006; Qu, 2007; Roper & Weymes, 2007; Welford, 2004), because grouping countries under specific classifications results similarity in terms of analyzing CSR practices (Baughn et al, 2007). Firstly, economic conditions is important in understanding CSR practices. On the country level, CSR practices are influenced by economic development (Baughn et al, 2007). Resource base view states that, CSR practices depend upon a company's resources, since the cost of CSR commitment in many cases is high. Generally, economic conditions of developed countries are better than developing countries. Previous research on CSR practices on the country level prove that, CSR practices in developing countries tend to be lower than those in developed countries (Welford, 2004), because economic development in those countries is lower than in developed countries (Baughn et al, 2007).

Secondly, governance of developing countries is generally weaker than developed countries (Beddewela & Herzig, 2013; Jamali & Mirshak, 2007). Institutional legal framework of developing countries that have not yet well developed, weakens companies' efforts in doing CSR practices (Rettab et al., 2009). Beddewela & Herzig (2013) found what is called "duality" on Multination Corporations (MNCs) in developing countries, which is the contradiction between the government institution of the host (parent) company and the government institution of the country where the subsidiary operates. Institutional Duality causes differences in CSR practices between two countries.

Thirdly, CSR practices on the country level is also influenced by culture, social issues and politics (Gerson, 2007). Differences in culture and other social contexts explain differences in CSR practices (Halme & Laurila, 2009; Midttun et al, 2006). Many companies in developing countries lack awareness of good communication of CSR to stakeholders (Rettab et al. 2009), due to cultural, social and political issues.

5. Forms and Dimensions Variation of CSR

Halme & Laurila, (2009); Zheng et al, (2014) emphasized that, a company's decision concerned with the forms and dimensions of CSR to be exercised is part of the company's strategy. Orlitzky et al. (2003) argued that, the effectiveness of CSR in improving financial performance also depends on how a company is managing its CSR initiatives. The CSR management strategy in finding the best way to implement CSR should also be mentioned at this point. How the CSR is planned and carried out also affects the expected outcomes such as financial performance (Halme & Laurila, 2009; Porter & Kramer, 2006).

Branco & Rodrigues, (2006); McWilliams et al, (2006), Porter & Kramer (2006), Donaldson & Preston, (1995) argued that, CSR is the source of competitive advantage if it is integrated with a company's strategy. Part of CSR strategy is to determine the forms and dimensions of CSR in an effort to achieve legitimacy. Issues about CSR forms have attracted the attention of researchers (Halme & Laurila, 2009; Porter & Kramer, 2006). Halme & Laurila (2009) suggested that, CSR

should be integrated with the core business to enhance financial performance.

Companies tend to adjust their CSR activities with contemporary issues. Currently, issues such as employment, environment and society are still attracting the attention of stakeholders. Many studies were run analyzing these issues and dimensions by Affif & Ananta (2013); Fiori et al (2007); Uadiale & Fagbeni (2012); and Brammer et al, (2006).

Other issues such as product, diversity and corporate governance are becoming more important as found out by Inoue & Lee (2012), Schreck (2011) and Michelin et al (2013). However, the attention towards CSR issues varies around the world. According to Visser (2009), CSR issues on economic dimension tend to occur in developing countries, since many developing countries are still having economic and poverty problems. On the other side, developing countries lack interest on CSR dimension of law.

Previous research also found significant relationship between philanthropy and company's reputation (Brammer & Millington, 2005). Philanthropy affects the perception towards varying stakeholders such as investors, customers, suppliers, employees and other stakeholders (Saiia, et al, 2003; Smith, 1994). Building public perception is increasingly important in condition, where stakeholders are getting stronger. Philanthropic activities are more easily seen by stakeholders compared to other forms of CSR activities, thus easier to build positive perceptions and gain a positive reputation in the eyes of stakeholders. Literature on reputation show the relationship between company reputation and CSR (Fryxell & Wang, 1994; McGuire et al, 1988).

According to Halme & Laurila (2009), philanthropy activities generate social outcome more than other CSR activities. Wang & Qian (2011) analyzed the effect of philanthropy on company performance in various conditions, and suggested that companies adopt philanthropy, because it made easier for companies to get socio-political legitimacy that brought positive stakeholder responses and facilitated political access.

Zheng et al. (2014) found out that, companies prefer philanthropy activities for the purpose of external legitimation. Through philanthropy activities, stakeholder trust can be achieved which will let the company to get easier access to the resources needed, alleviate business risks, reduce transaction costs (Hillman & Keim, 2001; Jones, 1995; Wang et al, 2008) and finally enhance the company's performance. However, it is still a debate whether philanthropy activities contribute to financial performance (Orlitzky et al, 2003; Saiia et al, 2003; Seifert et al, 2004). Muller & Kraussl (2011) argued that, stakeholders response on philanthropy is dependent on how they perceive genuity of the philanthropy action.

Philanthropy activities are expected to provide tangible benefits, if philanthropy strategy is connected to a whole business purpose (Muller & Kraussl, 2011; Hess et al, 2002; Porter & Kramer, 2002). However, philanthropy activities will negatively affect financial performance if it is perceived as a blunt effort (Godfrey,

2005). In return, philanthropy will positively affect financial performance if it is perceived sincere (Dean, 2003).

6. Conclusion

CSR improves financial performance, but the analysis of relationship between CSR and financial performance must also consider variables that affect the relationship between CSR and financial performance, including country characteristics as well as forms and dimensions of CSR. Future research should find and consider other variables in CSR relations with financial performance by expanding the analysis of institutional factors.

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