


The Effects of Corporate Social Responsibility on Financial Performance

2016

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THE EFFECTS OF CORPORATE SOCIAL RESPONSIBILITY ON
FINANCIAL PERFORMANCE

by

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A thesis submitted in partial fulfillment of the requirements
for the Honors in the Major Program in Finance
in the College of Business Administration
and in The Burnett Honors College
at the University of Central Florida
Orlando, Florida

Spring Term, 2016

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ABSTRACT

Companies have taken the initiative to be socially responsible over the years. In the past, the focus for companies has been on maximizing wealth. With the growth of corporate social responsibility (CSR), there has been many debates regarding its benefits. More companies are beginning to realize the value of being socially responsible and how critical it is to business function. This paper researches past studies on the relationship between corporate social responsibility and financial performance. This relationship is then tested using a reliable source of data on corporate social responsibility performance. This study uniquely looks at the accounting and market-based measurements of financial performance. The dataset includes most of the S&P 500 firms and covers years 2005-2014. An empirical model is constructed which includes factors that were found significant in the works of Capon, Farley, and Hoenig (1990). The relationships are tested using cross-sector/panel data time-series regressions. Results indicate that CSR and the accounting measurements of financial performance are positively related. CSR and the market-based measurements of financial performance are negatively related. This suggests that CSR positively affects a company's profits and negatively affects future stock returns. One interpretation of this result is that socially responsible stocks have a lower required rates of return. The results indicate that since investors are more willing to invest in CSR stocks, these firms end up experiencing lower future stock returns. The results are consistent with past studies and support the hypotheses.

DEDICATIONS

For my parents and brother, thank you for always believing in me.

For my professors, thank you for guiding me throughout my college career.

For my friends, thank you for keeping me sane.

ACKNOWLEDGEMENTS

I would like to thank everyone who has supported and aided me throughout this process. Thank you to Dr. Robin Roberts for your encouragement and assistance. I could not have done this without you. I have grown tremendously because of you. To Dr. Vladimir Gatchev, thank you for providing the data that I needed. Your knowledge and expertise has helped improve my thesis. To Dr. Yoon Choi, thank you for serving on the committee and for proofreading my paper. To Denise Crisafi, thank you for always being available to answer my questions and for making the process smoother. To my family and friends, thank you for your patience with me over the years. To my parents, this is for you.

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INTRODUCTION

There has been a growing of concern for the environment and social issues. More people are becoming aware of the effect they can have on the planet. The public pays attention to the different social initiatives taken by companies. Companies are quickly beginning to realize that to have a competitive advantage on the market they need to invest more in social issues. This is evident in the steady growth of social and environmental disclosures. Companies are becoming more transparent regarding how they are being socially responsible. Consequently, this growing concern for our environment has led to a growth in the study of corporate social responsibility (CSR). One area of focus in this field is the effect of CSR on financial performance. Some critics argue that it is too expensive for a company to be socially responsible. While others argue that the benefits of CSR exceed the actual costs. Many studies have been done to investigate this relationship. These studies have produced contradicting results in part-aware to the inconsistent measures of CSR and financial performance. Also the methodologies vary among studies. This paper attempts to investigate the relationship between corporate social responsibility (CSR) and financial performance by utilizing a more accurate measure of CSR and by utilizing a rigorous methodology.

CSR can be defined as “a business organization’s configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the company’s societal relationships” (Wood 1991). CSR is more than just following the law (McWilliams & Siegel, 2001). It is actions that companies take that goes

beyond legal obligations. For CSR to be effective companies need to tie CSR principles with their objectives and it is important for the workers of the company to be committed to these principles.

Corporations have been devoting their time and money to all sorts of philanthropy issues. Each corporation differs in their focus on specific social initiatives. Wang and Tuttle (2014) argue that benefits of high corporate social activities are greater for managers who want to establish long-term credibility than they are for managers with short-term goals. This is partly due to the fact that long-term management can better afford to incur high costs related to corporate social responsibility activities as they anticipate future profits. This reasoning suggests that corporate social responsibility does not directly affect financial performance. It directly affects an investor's perception of managers' credibility. An investor's perception of a manager is important when evaluating financial disclosures. Based on the results of their study, they found that corporate social responsibility performance influence an investors' perception of the amount of bias in management earnings reports. This paper investigates past findings, such as this one, of the relationship between CSR and financial performance. Using these past findings, a model was formed to test the relationship and to come to a conclusion that could contribute to the field of CSR.

LITERATURE REVIEW

Even though CSR has been researched extensively, some results are inconsistent. Critics of the value of CSR argue that a company does not have the ability to influence social issues and thus should not waste resources. According to Friedman (1970), a company has only one goal which is to increase profit. That is a company's only responsibility. He believes that social issues should be addressed by the government. The agent, management of a company, has an obligation to serve the interest of the principal, the shareholders. Friedman argues that if a company invests in social issues it will take money away from the principal.

On the other hand, there are many studies that show the benefits to adopting CSR principles. Some studies show evidence of how CSR initiatives play an important role in increasing a company's value. Although companies are not solely responsible for addressing social issues, the power that companies have could lead to a positive impact in the world. Also even though companies incur costs associated with being socially responsible, researchers argue that these costs are minimal and short term. The benefits that have been identified as a result of a company being socially responsible are long term in nature.

It could be argued that a company does not only have the interest of the shareholders to uphold, but also the interest of people who are impacted by the actions of the company. That is why companies are focusing more on the needs of their stakeholders. In their assessment of corporate social responsibility, Pelozo and Papania (2008) argue that "When managers respond to issues of concern among salient stakeholders –those stakeholders who possess the ability to impact the reputation and operations of the company –improved financial performance is

expected to follow” (p. 170). By fulfilling stakeholder needs, a company can create a competitive advantage. According to Turker (2009), a company has four stakeholders. The first stakeholders include the society. Companies have an obligation to make sure that they are not harming the environment of the society. The second stakeholders are the employees. A company has an obligation to make sure that their employees are safe and content. The third set of stakeholders are the customers. The final stakeholders are the government in which companies need to make sure they abide by their rules. A company that incorporates CSR can have an effect on all of its stakeholders and can yield benefits. Prior studies contain empirical evidence of a positive relationship between CSR and employee productivity, reputation, customer loyalty, competitiveness, and company’s share price.

Turban and Greening (1997), asserted that an increase in the ability of a company to attract and to retain employees is a benefit of CSR. Their results indicated that “companies higher in corporate social performance (CSR) have more positive reputations and more attractive employers than companies lower in CSR. Such results suggest that potential applicants are aware of companies’ corporate social performance and that those with more positive ratings may have competitive advantages because they attract more potential applicants than companies with lower CSR ratings” (p. 666). The competitive advantages that relate to attracting more potential applicants include a lower turnover rate and lower training costs.

Companies that practice CSR can also experience an increase in employee productivity, morale, and job satisfaction. According to Valentine, S., & Fleischman, G. (2008) “management should consider invigorating the ethical focus and culture of the organization with ethics codes,

training, and CSR activity, which might prompt more positive beliefs about the company, as well as the immediate work context and culture” (p.167). Based on a survey that they did, they realized that there is a positive relationship between CSR and employee job satisfaction. A company that is practicing CSR may adopt policies that improve working conditions and labor practices. An employee who is working under good conditions will be more satisfied and their productivity will increase. The increase in employees’ attitude and productivity will contribute to a company’s profitability. A company that is socially responsible can also experience increases in its positive reputation and social identity theory states that employees are more likely to want to be a part of these types of companies (Peterson, 2004).

Investors often use additional cues, such as information about a company’s corporate social performance, to determine a management’s credibility. Due to recent scandals, it is sometimes hard for investors to entirely trust companies’ financial disclosures. Corporate social responsibility does not only influence an investor’s assessment of financial disclosure, but it also influences the price that they are willing to pay for a company’s stock. An investor will trust a company’s financial disclosure if they believe it to be unbiased and accurate. That is often hard to observe. Nearly 40% of investors question the credibility of management earnings (Wang, 2014). Investors have to rely on the management’s reputation for issuing accurate and unbiased financial disclosures. Corporate social responsibility performance is part of a company’s reputation that gives investors an overall impression that managers are competent and trustworthy. Social initiatives also are effective marketing tools. It is strategic for a company to invest in social activities because it can bring forth consumers’ positive product and brand

evaluations, choice, and brand recommendations. A company's reputation is very important and the type of social activities a company participates in can affect its reputation.

Another important research finding comes from Byus, Deis, and Ouyang (2010) in which they focused on the association between corporate social responsibility and various measures of company financial performance. The measurement used to assess corporate social responsibility is the Dow Jones Sustainability Index (DJSI). They collected nine years of data from 240 companies who have adopted the DJSI criteria. They also did a matched sample test in which 120 DJSI American companies were matched with 120 non-DJSI American companies based on industry, year, and size for nine years. The DJSI measures were regressed against measures of financial and market value performance. Five regression models were used to come to a conclusion. The data indicate that there are operational (income statement) effects and long-term strategic (balance sheet) effects between and among DJSI companies. What was found in this research is that DJSI companies have a higher gross profit margin and higher return on assets than non-DJSI companies. Based on the results, there is a positive relationship between a company's financial performance and a company's adoption of the DJSI criteria. The DJSI companies researched have higher profits and ROAs than the non-DJSI companies. The research suggests that the higher profits may have resulted from the willingness of customers to pay a higher per unit price or from lower costs to produce the good or service. Also they suggest that the higher ROAs possibly come from customer loyalty, brand name, or trust.

McGuire, Sundgren, and Schneeweis (1998) not only looked at the relationship between corporate social responsibility and company financial performance in terms of accounting- and

stock-market-based measures, but they also explored the link in terms of risk. They argued that low levels of social responsibility may increase a company's financial risk. Investors may consider a company with low social activities as a riskier investment because they see management skills at the company as low and they may also anticipate an increase in company costs. This perception of low social responsibility will cause a company's cost of capital to be volatile. In contrast, a high degree of corporate social responsibility may decrease financial risk as the result of more stable relations with the government and the financial community. Also, it may result in a lower percentage of total debt to total assets. The impact of social responsibility on measures of a company's systematic risk may, however, be minimal, since most events affecting a company's level of social responsibility do not systematically affect all other companies in the marketplace. They also argue that a company with relatively high past financial performance may be more willing to undertake socially responsible actions. In this article, financial performance variables were averaged over two periods. The research resulted in an insignificant correlation between social responsibility and stock-market-based measures of performance. However, the accounting-based measures used for performance were found significantly correlated with corporate social responsibility. The accounting- and stock-market-based risk measures tend to be negatively associated with social responsibility. They also ran regression analysis. Based on the results, accounting-based performance had a higher explanatory value than stock-market performance. Accounting risk variables also appeared to produce a better explanatory model than stock-market risk variables.

Previous studies have yielded mixed results regarding the relationships between corporate social responsibility and measures of company performance. These differences may derive from

different financial measures. Stock-market based measures of return have reported mixed results and accounting-based performance measures have generally found positive results. Market returns are considered better than accounting-based measures because they are less susceptible to differential accounting procedures and managerial manipulation. Market returns represent investors' evaluations of a company's ability to generate future economic earnings rather than past performance. Accounting performance should be adjusted for risk, industry characteristics, and other variables.

Lin, Yang, and Liou (2009) raised an issue concerning studies of corporate social responsibility's effect on business performance. They suggest that some researchers use models that are not reliable because these researchers omit important variable that have shown to have an impact on profitability. Research and development investment is a variable that should be included. R&D costs are important because they have a strong positive long-term impact on profitability. R&D is considered technical capital because it results in increase knowledge that can help raise future capital. Also including CSR as an integral part of business strategy is highly beneficial in terms of CSR evaluation and measurement, and determining its impact on profit. This research looks at a sample of the top 1000 Taiwanese companies taken from the Common Wealth Magazine between 2002-2004 who have R&D expenditures and participate in charitable expenditures. To choose among these companies and to reduce bias, they set up three criteria: listed on the Taiwan stock exchange market for more than three years, ranked within the top 200 Taiwanese manufacturing companies, and donated a minimum of NT\$2.5 million in 2003. Based on these criteria, 33 companies were selected. The donation ratio was chosen as a corporate social responsibility proxy variable. Return on Assets was chosen as the short-term variable for

the financial measurement. Then they created two simulated corporate social responsibility companies' portfolios based on manufacturing companies and non-manufacturing companies. They ran regression analyses to test the data in the short term. To measure the long-term effect, five financial variables were used: the Jensen measure, the amended Jensen measure, the Treynor measure, the Sharpe measure, and the MCV measure. The research indicate that the performance of the higher-CSR portfolio is better than lower-CSR portfolio in both the manufacturing industry and the non-manufacturing industry, but especially in the manufacturing industry. It implies that the more a company invests in CSR, the better is its Corporate Financial Performance (CFP) over the long term. After using the five specialized financial indicators to verify this phenomenon, they find that during the short-term period, the financial performance of observed companies with low R&D expenditure is worse, whereas the financial performance of companies with high R&D expenditures is better.

Another relevant study on the relationship between corporate social responsibility and financial performance comes from Aleksandra Lech (2013). In the article, corporate social responsibility is defined as "Voluntary environmental protection activities, philanthropy, involvement in social issues, and high employee standards." The study looks at both types of arguments and tries to find an explanation from the stakeholders' perspective. A test was run on the relationship between corporate social responsibility and economic performance of selected Polish companies. Based on empirical research, those who claim that a negative relationship between social responsibility and economic performance exists argue that a company's only social responsibility is to maximize the profits of its owners. Also social responsibility results in additional costs which can put a company at an economic disadvantage compared to other

companies. Those who support that a positive relationship between social responsibility and economic performance exists argue that a company is not only responsible to its owners but to all stakeholders. There are primary stakeholders and secondary stakeholders. Primary stakeholders are people who have a stake in the company and without their support the company would not exist. Primary stakeholders of a company include employees, shareholders, consumers, suppliers, and local communities. Secondary stakeholders have a stake in the company and affect the corporation, but are not essential to a company's survival. The author researched the relationship between social responsibility and financial performance by looking at the biggest Polish companies listed on the Warsaw Stock Exchange between 2010 through 2012. ROA and ROE were chosen as a measure of financial performance. Risk (debt/assets ratio), size (total assets and number of employees), and industry were control variables. To control for possible differences in financial performance among industries the author included dummy industries representing selected sectors: the Financial Sector and Energy Sector. The Respect Index was used as a corporate social responsibility measure. CSR is expressed by a dummy variable with value of 1 if a company is included in the Respect Index, and 0 if a company is not included. The result indicated no significant impact of CSR on ROA/ROE. Participation in the Respect Index is not statistically significant in determining the financial performance of Polish companies. However, the author identified some weaknesses in the study. First, most of the expenditures incurred by CSR initiatives are short-term, while most stakeholder reactions to these initiatives play out over the long term. Second, the Respect Index eliminates information about the types of corporate social responsibility activities being undertaken and, consequently, predicting where and how any benefits may occur. Finally, there needs to be a deeper study of control variables.

RESEARCH QUESTION AND HYPOTHESIS

This study's purpose is to add to the discussion on the relationship between CSR performance and financial performance. To be more precise, factors of CSR are being tested to determine what kind of affect it has on accounting and market financial performance in the long-run. This study has insights for managers, stakeholders, and future research. The increase in CSR initiatives suggests that managers believe that it has value. Therefore, this study investigates the effects of CSR on financial performance that can provide managers information to be used on business strategies. Even though there are many studies done on CSR and financial performance, this study is unique because it looks at the most recent years (2005-2014). This study divides financial performance into two types of measures: accounting and market-based. The sign of the relationship of these financial measures are being tested with CSR. The sign may imply negative, positive, or neutral associations. Based on the literature review, there seems to be more studies reporting a positive association between CSR and financial performance. Due to this fact, I hypothesize a positive association between CSR and the accounting measurement of financial performance:

Hypothesis 1(a): return on assets (ROA) increases as CSR performance improves.

Hypothesis 1(b): return on equity (ROE) increases as CSR performance improves.

Also, I hypothesize a positive association between CSR and the market-based measurements of financial performance.

Hypothesis 2: future returns increase as CSR performance improves.

MSCI ESG RATINGS

Social performance is the independent variable that is used to test the dependent variable. An inclusive, multidimensional CSR platform consists of three main groups which are environmental, social, and governance. Each group has their own specific CSR initiatives. The ESG ratings were used as a measurement for social performance. MSCI Ratings does a good job looking at both the internal and external factors of CSR. MSCI ESG Ratings are designed to satisfy the needs of investor's growing concern with ESG research and analysis. It allows investors to understand ESG risks and opportunities and to find ways to integrate these factors into constructing and managing their portfolio. ESG has become the criteria used in determining socially responsible investing. The ratings system are scores that indicate to investors how well a company has achieved its ESG practices. It is the first examination and ratings product that aims to offer an in-depth, integrated look at each of the three ESG components. By using a binary system, the company determines the ratings by looking at 7 attributes: diversity, environment, product, human rights, community, employee relationships, and governance. The database has a comprehensive assessment of each company's key ESG risks based on industry and geographic risk exposure. The companies that meet these attributes receives a 1. The companies receive a 0 if they do not meet these attributes. MSCI assess over a thousand data points across 37 ESG policies, programs, and performance. The company has collected 13 years of shareholder meeting results and data on 65,000 individual directors. The companies are rated on an AAA-CCC scale relative to the performance of their industry peers. Final scores of each component of ESG that contribute to the overall rating are reported. The companies' data sources include over 100 specialized datasets (government, NGO, models), company disclosure (10-K, sustainability

report, proxy report), and over 1600 media sources that are monitored daily. When new information appear on a company it is reflected in the report within a week and efforts are made to re-rate that company. Each company goes through a rigorous review at least annually. More details on the environment, social, and governance groups are described below:

Environment

The environmental factor is concerned with a company's effort to change the threat of climate change, depletion of resources, hazardous waste, nuclear energy, pollution prevention, and recycling. To be sustainable companies have to make the initiative to minimize the environmental footprint of its operations. An example of a company with an environmental sustainability focus is eBay. EBay makes it possible for people to exchange and reuse products. It could be seen as a form of recycling. It helps reduce the amount of products that end up in the trash. Also the company focuses on green supply chain management. It partners up with the United States Postal Service (USPS) to create a co-branded line of environmentally friendly Priority Mail packaging. The company is continually keeping a focus on environmental sustainability.

Social

A company's attractiveness as an investment is also dependent on the social factor of labor/hiring practices, reputational issues, diversity, human rights, consumer protection, animal welfare, etc. A company has to make a conscious effort to better the community. Companies can accomplish that by making a contribution or donating a percentage of revenues to community projects. These type of initiatives can help bring the community together. Companies could also

partner up with non-profit organizations to help battle an issue. An example of social initiatives is TOMS' one for one. Their goal of this initiative is to improve lives. With every product purchase, the company helps a person in need. The company helps provide shoes, sight, water, safe birth and bullying prevention services to people in need. The company partners up with nonprofit humanitarian organizations to provide services.

Companies who value human right have initiatives that is made to keep communication between employees, customers, and mangers transparent. Those companies go out of their way to make sure that right such as privacy and fairness is not infringed upon. It is important for a company to have good relations with its employees. Ways to help facilitate that include having good union relations, strong health programs, and strong benefit programs. Diversity initiatives include ways to broaden the gender and race populations of the company.

Governance

Corporate governance covers the area of exploration into the rights and duties of the management of a company which include its board, shareholders, and other stakeholders. The management of a company are required to be transparent and trustworthy with its practices. Governance is an important part of CSR because it relates to providing comprehensive and excellent CSR reports. In order for stakeholders to know about a company's CSR initiatives it needs to be reported. If it is not reported for the public to see then it might not have an effect on financial performance. Because of this, appropriate governance in CSR reporting is an essential part of an effective CSR program.

DATA AND SAMPLE

Financial performance is the primary construct being studied. These measurements were divided into two groups: accounting and market-based. The accounting financial measurements that were used are return on assets (ROA) and return on equity (ROE). The market-based financial performance that were used are the percentage of market value and the percentage change in stock price. These financial ratios were collected over the period of 2005 to 2014 for each company. COMPUSTAT was the database that was used to get the financial data needed to calculate these ratios. COMPUSTAT has finance information on active and inactive global companies throughout the world. The database was established in 1962. It was made to be used by different investors and institutions to extract information from companies that facilitate transparency. COMPUSTAT was also used to collect data for some of the independent variables.

To be included in this study, sample firms had to meet the following criteria:

1. They had to be listed in the S&P 500 between the years of 2005-2014
2. They had to be listed in the ESG ratings of Environmental, Social, and Governance
3. The data had to have data available in COMPUSTAT

The sample base had 3665 observations that met all three criteria. Table 17 reports summary statistics for the sample.

PRELIMINARY EMPIRICAL MODEL

This research draws from past research on CSR and corporate financial performance to develop and test an empirical model that examines how a corporation's CSR efforts may be related to its financial performance. Conceptually, the preliminary model includes determinants that were found significant in the meta-analysis work of Capon, Farley, and Hoenig (1990) and then includes a CSR construct that generate test variables in the empirical model. These determinants are strategy, organization, competitive environment, and social performance. Certain ratios are used in the regression model to represent each of these determinants. In order to produce an accurate and constant result for the dependent variable, these variables are controlled for. They are used as independent variable for the regression model. All of the information was taken in the COMPUSTAT database in order to make accurate calculations. Thus, the conceptual model is:

Corporate financial performance = f (Strategy, Organization, Competitive Environment, Social performance)

Strategy

Certain strategies that a company adopt have the ability of enhancing financial performance. According to past empirical research, the strategies that enhance a company's performance are growth, low capital investment, company advertising, market share and R&D, product and service quality, vertical integration, corporate social responsibility, and lower levels of debt and less diversification. For this particular determinant, the percentage of R & D expenditure and the percentage of advertising expense was used.

Organization

A company's organization is also an important determinant of financial performance. The only organization variable that has been thoroughly researched and that has been identified as having an impact on performance is capacity utilization. It has been shown that capacity utilization is positively related to a company's financial performance. The variables that was used for this particular determinant was total assets, long-term debt, long-term debt to total asset ratio, number of institutional investors, percentage outstanding stock hold by institutional investors, and capacity utilization (fixed asset turnover ratio).

Competitive environment

The environment that a company's industry is in could affect its financial performance. Industry concentration, industry growth, industry capital investment, industry size, industry advertising, industry minimum efficient scale, industry geographic dispersion, industry barriers to entry, and industry economies of scale all can play a role of increasing a company's financial performance. Most of these factors help protect companies in certain industries by preventing new competitors from coming in. The factors that can negatively impact a company's financial performance are industry imports and exports (Capon, Farley, and Hoenig 1990). For the regression analysis, industry of the firm will be controlled by using industry fixed effects based on 2-digit SIC codes. Using fixed effects for this model is considered better than constructing industry-wide variables.

Social performance

This paper focus is to prove that the social performance variable positively impacts a company's financial performance. As mentioned before the MSCI ESG Ratings of each company in the S & P 500 over the years 2005-2014 will be used in the regression model. The regression will be run on the environmental, social, governance, and the ESG overview section of the rating system. The main goal is to find out if the social performance measure have a significant impact on the accounting and market-based financial measures.

ANALYSIS AND RESULTS

Multiple regression analysis was used to test the hypotheses. The primary concern was to identify whether, consistent with significant results from the model, social performance effected financial performance. This relationship was tested by using companies in the S&P 500 between the years 2005-2014. ROA and ROE was the accounting measurement used as the dependent variable. Return on market value and return on price was the market-based measurement used as the dependent variable. Several factors were used to control the results for the dependent variables. These factors were included along with the social performance measurement as the independent variables. The regression included year fixed effects.

In table 1 on Appendix A, it appears that ESG Overview is positively related to ROA. The coefficient is 0.04 and is statistically significant at the 0.01 level. In table 2, it appears that Environmental is not significant at conventional significance levels. The coefficient is 0.0129. However, the 0.1030 p-value is only slightly lower from the 0.1 level. In table 3, it appears that Social is positively related to ROA. The coefficient is 0.0254 and is statistically significant at the 0.01 level. In table 4, it appears Governance is positively related to ROA. The coefficient is 0.0351 and is statistically significant at the 0.10 level. These estimates, provide strong support for *Hypothesis 1(a)*. In other words, CSR performance positively affects ROA.

In table 5, it appears that ESG Overview is positively related to ROE. The coefficient is 1.0218 and is statistically significant at the 0.10 level. In table 6, it appears that Environmental is positively related to ROE. The coefficient is 0.7839 and is statistically significant at the 0.10 level. In table 7, the coefficient of 0.5432 suggests that Social is positively related to ROE.

However, the p-value of 0.2200 is not significant at conventional significance levels. In table 8, it appears Governance is positively related to ROE. The coefficient is 1.8577 and is significant marginally at 0.10 level. These estimates, provide strong support for *Hypothesis 1(b)*. In other words, CSR performance positively affects ROE.

In table 9, it appears that ESG Overview is negatively related to percent return on market value. The coefficient is -1.5038 and is statistically significant at the 0.05 level. In table 10, the coefficient of -0.1047 suggests that Environmental is negatively related to percent return on market value. However, the p-value of 0.1610 is not significant at conventional significance levels. In table 11, the coefficient of -0.6504 suggests that Social is negatively related to percent return on market value. However, the p-value of 0.1720 is not significant at conventional significance levels. In table 12, it appears that Governance is negatively related to percent return on market value. The coefficient is -8.6929 and is statistically significant at the 0.01 level. These estimates, provide strong support for *Hypothesis 2*.

In table 13, it appears that ESG Overview is negatively related to percent return on price. The coefficient is -0.6018 and is statistically significant at the 0.01 level. In table 14, the coefficient of -0.0240 suggests that Environmental is negatively related to percent return on price. However, the p-value of 0.7890 is not significant at conventional significance levels. In table 15, the coefficient of -0.2812 suggests that Social is negatively related to percent return on price. However, the p-value of 0.1170 is not significant at conventional significance levels. In table 16, it appears that Governance is negatively related to percent return on price. The

coefficient is -3.2016 and is statistically significant at the 0.01 level. These estimates provide strong support for *Hypothesis 2*.

The relationship between ESG and ROA performance, which is the profitability variable, is significantly positive. The relationship between ESG and ROE, another profitability variable, is also significantly positive. My second hypothesis was correct. The relationship between ESG and the percentage return on market value, which is the market-based variable, is significantly negative. The relationship between ESG and the percentage change in stock price, which is the future stock return variable, is also significantly negative. Overall, based on the regression analysis social responsibility is positively related to profits. Social responsibility seems to be negatively related to future stock returns.

In comparison to the size of the coefficient and significance of ESG in independent variable ROA with ROE, the effect of ESG in ROE is much stronger than that of ROA. ROE's size of coefficient for the ESG overview is 1.0218, the Environmental factor is 0.7839, the Social factor is 0.5432, and the Governance factor is 1.8577. ROA's size of coefficient for the ESG overview is 0.0400, the Environmental factor is 0.0129, the Social factor is 0.0254, and the Governance factor is 0.0351. This means that the ESG variables in the ROE equation dominates the ESG variables in the ROA equations. The coefficient indicates that for every additional ESG score it is expected that ROA and ROE to increase by the coefficient value. In comparison to the size of the coefficient and significance of ESG in independent variable percentage return on market value with percentage return on price, the effect of ESG in percentage return on market value is much stronger than that of percentage return on price. The percentage return on market

value variable negatively impacts the ESG variables more than the percentage return on price variable. The coefficient indicates that for every additional ESG score it is expected that the market and future stock return variable to decrease by the coefficient value.

DISCUSSION AND CONCLUSION

With all of the debates concerning the effects of a company being socially responsible, it is important to research and test on this topic. As companies move away from the sole focus of wealth maximization, companies are beginning to realize the value of CSR. The benefits of CSR needs to be quantified and measured. This study attempts to find the relationship between CSR and financial performance. The sign of the relationship between CSR and financial performance was tested by incorporating an empirical model which was adopted from Capon, Farley, and Hoenig (1990). The data includes some companies from the S&P 500 during the period 2005-2014. Results indicate that the sign of the relationship between CSR and accounting measures of financial performance is positive. The results support past studies that report positive association. For example, the study by Orlitzky, M., F. L. Schmidt, and S. L. Rynes (2003) concluded that CSR has a positive influence on financial performance. They took it further by concluding that there is a bidirectional relationship between the two variables. The increase of the accounting measures with an increase in CSR can be explained in many ways. A company that incorporates CSR activities will have a competitive advantage against a company that does not incorporate CSR activities. The competitive advantage comes in the form of a better established reputation. A company who has a good reputation has the ability of attaining loyal customers and investors. CSR has another effect on employees. Employees' morale, productivity, and performance could increase as a result of CSR activities. Companies have the opportunity of decreasing risks by implementing CSR initiatives.

The results indicate that CSR is negatively related to market-based measurements of financial performance. One interpretation of this result is that socially responsible stocks have a lower required rates of return (i.e. lower discount rates). In other words, investors are willing to buy these stocks even if values are relatively high and expected future returns relatively low. This is consistent with a past study done by Kim and Venkatachalam (2011). They developed similar hypothesis to explain the expected returns of sin stocks. They looked at stocks publicly traded in the gaming, tobacco, alcohol, and adult entertainment industries. They suggest that these stocks are neglected by investors which cause these stocks to experience higher expected return. A similar study was done by Hong and Kacperczyk (2009) in which they concluded that sin stocks have higher expected returns than other stocks because they are being neglected by investors who want to follow social norms. Unlike these studies, which narrowly define sin stocks, I take a more general view of the social responsibility of companies. The negative association of CSR and market-based measurements support *Hypothesis 2*. If investors are willing to pay a higher rate for CSR stocks, then these stocks will have lower future stock returns.

Overall, this study has determined that CSR is a valuable source for companies. Customers, shareholders, employees, and other stakeholders do pay attention to the CSR activities of companies. Companies who make a conscious effort to report these activities will have a competitive advantage over other companies who do not.

APPENDIX A: REGRESSION TABLES AND DATA

Table 1

Dependent variable ROA (%)	Coefficient	Std. Err.	t	P>t
ESG Overview	0.0400	0.0100	4.0200	0.0000
R&D /COGS	-1.3565	0.1681	-8.0700	0.0000
Advertising / COGS	0.4476	0.2705	1.6500	0.0980
Assets (ln)	-1.6215	0.1329	-12.2000	0.0000
LT Debt/Assets	-8.7010	0.8961	-9.7100	0.0000
Number of Institutions (ln)	0.9045	0.1181	7.6600	0.0000
Percent Owned by Institutions	-0.0572	0.0082	-6.9400	0.0000
Fixed Asset Turnover	0.0037	0.0055	0.6700	0.5020

Table 2

Dependent variable ROA (%)	Coefficient	Std. Err.	t	P>t
Environmental	0.0129	0.0079	1.6300	0.1030
R&D /COGS	-0.2028	0.2065	-0.9800	0.3260
Advertising / COGS	3.9990	1.0971	3.6500	0.0000
Assets (ln)	-1.4956	0.1416	-10.5600	0.0000
LT Debt/Assets	-13.1170	1.1407	-11.5000	0.0000
Number of Institutions (ln)	0.9744	0.1252	7.7900	0.0000
Percent Owned by Institutions	-0.0695	0.0090	-7.6800	0.0000
Fixed Asset Turnover	0.0058	0.0099	0.5900	0.5580

Table 3

Dependent variable ROA (%)	Coefficient	Std. Err.	t	P>t
Social	0.0254	0.0080	3.1800	0.0010
R&D /COGS	-1.3527	0.1689	-8.0100	0.0000
Advertising / COGS	0.4481	0.2718	1.6500	0.0990
Assets (ln)	-1.5468	0.1310	-11.8100	0.0000
LT Debt/Assets	-8.8228	0.9057	-9.7400	0.0000
Number of Insitutions (ln)	0.9228	0.1188	7.7700	0.0000
Percent Owned by Institutions	-0.0577	0.0083	-6.9600	0.0000
Fixed Asset Turnover	0.0032	0.0055	0.5800	0.5610

Table 4

Dependent variable ROA (%)	Coefficient	Std. Err.	t	P>t
Governance	0.0351	0.0203	1.7300	0.0840
R&D /COGS	-1.3386	0.1683	-7.9500	0.0000
Advertising / COGS	0.4498	0.2710	1.6600	0.0970
Assets (ln)	-1.5031	0.1300	-11.5600	0.0000
LT Debt/Assets	-8.8044	0.8978	-9.8100	0.0000
Number of Insitutions (ln)	0.9538	0.1181	8.0800	0.0000
Percent Owned by Institutions	-0.0596	0.0082	-7.2300	0.0000
Fixed Asset Turnover	0.0032	0.0055	0.5800	0.5610

Table 5

Dependent variable ROE (%)	Coefficient	Std. Err.	t	P>t
ESG Overview	1.0218	0.5595	1.8300	0.0680
R&D /COGS	-3.5044	9.4380	-0.3700	0.7100
Advertising / COGS	1.8845	15.1892	0.1200	0.9010
Assets (ln)	10.8199	7.4649	1.4500	0.1470
LT Debt/Assets	-23.5048	50.3188	-0.4700	0.6400
Number of Institutions (ln)	-7.7418	6.6303	-1.1700	0.2430
Percent Owned by Institutions	0.4188	0.4628	0.9000	0.3660
Fixed Asset Turnover	-0.0466	0.3073	-0.1500	0.8790

Table 6

Dependent variable ROE (%)	Coefficient	Std. Err.	t	P>t
Environmental	0.7839	0.4707	1.6700	0.0960
R&D /COGS	-1.7162	12.2365	-0.1400	0.8880
Advertising / COGS	-10.9101	65.0253	-0.1700	0.8670
Assets (ln)	-4.1806	8.3938	-0.5000	0.6180
LT Debt/Assets	186.0537	67.6072	2.7500	0.0060
Number of Institutions (ln)	-2.1899	7.4184	-0.3000	0.7680
Percent Owned by Institutions	-0.0301	0.5363	-0.0600	0.9550
Fixed Asset Turnover	0.1999	0.5887	0.3400	0.7340

Table 7

Dependent variable ROE (%)	Coefficient	Std. Err.	t	P>t
Social	0.5432	0.4427	1.2300	0.2200
R&D /COGS	-2.7121	9.3720	-0.2900	0.7720
Advertising / COGS	0.8589	15.0859	0.0600	0.9550
Assets (ln)	11.8127	7.2697	1.6200	0.1040
LT Debt/Assets	-11.0738	50.2607	-0.2200	0.8260
Number of Insitutions (ln)	-7.1303	6.5921	-1.0800	0.2790
Percent Owned by Institutions	0.2578	0.4604	0.5600	0.5760
Fixed Asset Turnover	-0.0481	0.3064	-0.1600	0.8750

Table 8

Dependent variable ROE (%)	Coefficient	Std. Err.	t	P>t
Governance	1.8577	1.1370	1.6300	0.1020
R&D /COGS	-3.0094	9.4361	-0.3200	0.7500
Advertising / COGS	2.1122	15.1919	0.1400	0.8890
Assets (ln)	12.2957	7.2871	1.6900	0.0920
LT Debt/Assets	-23.8908	50.3270	-0.4700	0.6350
Number of Insitutions (ln)	-7.3984	6.6184	-1.1200	0.2640
Percent Owned by Institutions	0.3970	0.4621	0.8600	0.3900
Fixed Asset Turnover	-0.0545	0.3072	-0.1800	0.8590

Table 9

Dependent variable				
% return on market value	Coefficient	Std. Err.	t	P>t
ESG Overview	-1.5038	0.5937	-2.5300	0.0110
R&D /COGS	3.1725	10.0040	0.3200	0.7510
Advertising / COGS	-1.2145	16.0927	-0.0800	0.9400
Assets (ln)	25.5489	7.9372	3.2200	0.0010
LT Debt/Assets	-79.3074	53.6137	-1.4800	0.1390
Number of Insitutions (ln)	-23.8865	7.0628	-3.3800	0.0010
Percent Owned by Institutions	0.5718	0.4908	1.1700	0.2440
Fixed Asset Turnover	0.0682	0.3254	0.2100	0.8340

Table 10

Dependent variable				
% return on market value	Coefficient	Std. Err.	t	P>t
Environmental	-0.1047	0.0748	-1.4000	0.1610
R&D /COGS	1.8036	1.9455	0.9300	0.3540
Advertising / COGS	-8.4822	10.3313	-0.8200	0.4120
Assets (ln)	1.9316	1.3353	1.4500	0.1480
LT Debt/Assets	3.8740	10.7918	0.3600	0.7200
Number of Insitutions (ln)	-5.4496	1.1845	-4.6000	0.0000
Percent Owned by Institutions	0.2499	0.0853	2.9300	0.0030
Fixed Asset Turnover	0.0482	0.0935	0.5200	0.6070

Table 11

Dependent variable				
% return on market value	Coefficient	Std. Err.	t	P>t
Social	-0.6504	0.4761	-1.3700	0.1720
R&D /COGS	2.7230	10.0737	0.2700	0.7870
Advertising / COGS	-1.1383	16.2075	-0.0700	0.9440
Assets (ln)	21.9326	7.8341	2.8000	0.0050
LT Debt/Assets	-73.5639	54.2806	-1.3600	0.1750
Number of Insitutions (ln)	-25.7766	7.1172	-3.6200	0.0000
Percent Owned by Institutions	0.6543	0.4951	1.3200	0.1860
Fixed Asset Turnover	0.0890	0.3291	0.2700	0.7870

Table 12

Dependent variable				
% return on market value	Coefficient	Std. Err.	t	P>t
Governance	-8.6929	1.2258	-7.0900	0.0000
R&D /COGS	2.2798	9.9403	0.2300	0.8190
Advertising / COGS	-3.1541	15.9976	-0.2000	0.8440
Assets (ln)	33.2555	7.7201	4.3100	0.0000
LT Debt/Assets	-90.6547	53.2837	-1.7000	0.0890
Number of Insitutions (ln)	-19.5083	6.9952	-2.7900	0.0050
Percent Owned by Institutions	0.3687	0.4871	0.7600	0.4490
Fixed Asset Turnover	0.0502	0.3233	0.1600	0.8770

Table 13

Dependent variable				
% return on price	Coefficient	Std. Err.	t	P>t
ESG Overview	-0.6018	0.2237	-2.6900	0.0070
R&D /COGS	2.3247	3.7692	0.6200	0.5370
Advertising / COGS	1.2001	6.0633	0.2000	0.8430
Assets (ln)	9.6607	2.9899	3.2300	0.0010
LT Debt/Assets	-14.7692	20.1906	-0.7300	0.4650
Number of Institutions (ln)	-9.7275	2.6591	-3.6600	0.0000
Percent Owned by Institutions	0.2708	0.1849	1.4600	0.1430
Fixed Asset Turnover	-0.0202	0.1226	-0.1600	0.8690

Table 14

Dependent variable				
% return on price	Coefficient	Std. Err.	t	P>t
Environmental	-0.0240	0.0894	-0.2700	0.7890
R&D /COGS	1.6948	2.3262	0.7300	0.4660
Advertising / COGS	-3.0996	12.3522	-0.2500	0.8020
Assets (ln)	1.0113	1.5964	0.6300	0.5260
LT Debt/Assets	6.0566	12.8918	0.4700	0.6390
Number of Institutions (ln)	-4.2044	1.4152	-2.9700	0.0030
Percent Owned by Institutions	0.1344	0.1020	1.3200	0.1880
Fixed Asset Turnover	0.0564	0.1118	0.5000	0.6140

Table 15

Dependent variable				
% return on price	Coefficient	Std. Err.	t	P>t
Social	-0.2812	0.1793	-1.5700	0.1170
R&D /COGS	2.1437	3.7950	0.5600	0.5720
Advertising / COGS	1.2271	6.1058	0.2000	0.8410
Assets (ln)	8.3141	2.9506	2.8200	0.0050
LT Debt/Assets	-12.4459	20.4387	-0.6100	0.5430
Number of Insitutions (ln)	-10.4603	2.6792	-3.9000	0.0000
Percent Owned by Institutions	0.3036	0.1865	1.6300	0.1040
Fixed Asset Turnover	-0.0118	0.1240	-0.1000	0.9240

Table 16

Dependent variable				
% return on price	Coefficient	Std. Err.	t	P>t
Governance	-3.2016	0.4617	-6.9300	0.0000
R&D /COGS	1.9711	3.7468	0.5300	0.5990
Advertising / COGS	0.4960	6.0301	0.0800	0.9340
Assets (ln)	12.2756	2.9087	4.2200	0.0000
LT Debt/Assets	-18.8896	20.0758	-0.9400	0.3470
Number of Insitutions (ln)	-8.1889	2.6352	-3.1100	0.0020
Percent Owned by Institutions	0.2004	0.1836	1.0900	0.2750
Fixed Asset Turnover	-0.0262	0.1219	-0.2100	0.8300

Table 17

Variable	n	Mean	Std. Dev.	25 th pctl	median	75 th pctl
ROA	3,665	6.2800	7.5700	2.6300	5.9100	9.7400
ROE	3,665	18.3100	367.7200	8.6800	14.7200	22.7100
dMKT_CAP	3,651	121.0500	391.0000	91.2500	109.9900	130.1300
dPRICE	3,653	115.8100	148.9100	90.5300	110.0300	128.9900
GOVERNANCE	3,665	55.9500	6.5500	51.7900	55.3600	58.9300
RDTOCOGS	3,665	0.1700	0.7100	0.0000	0.0000	0.0500
ADVTOCOGS	3,665	0.0600	0.4100	0.0000	0.0000	0.0300
LNASSETS	3,665	9.7500	1.3300	8.7800	9.6300	10.5600
LTDTOA	3,665	0.2200	0.1600	0.1000	0.2000	0.3100
LNNUM_INST	3,665	5.6700	1.7200	5.7200	6.0300	6.4300
PCT_INST_OWN	3,665	69.1200	25.3200	62.5900	74.8400	83.5700
FIX_TURN	3,665	9.4500	24.8500	2.2100	5.0600	8.8100

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