Does Corporate Social Responsibility Affect Corporate Profit Margins?

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Abstract

Corporate Social Responsibility (CSR) is increasingly playing a major role in Corporate Business Strategy. Initially, many firms played "lip service" to CSR in trying to be compliant with a new initiative that perceived with being counter to the primary responsibility of having a sustainable business and making adequate returns to the shareholders. Today, CSR has had its profile raised in all major corporate firms and is a major topic not only in firm advertising, but also in the media and boardrooms. For example, recent studies are claiming that the Technology sector is in a unique position to assist corporations using their core competencies in data analytics. While many businesses understand that CSR is the "responsible" thing to do, very few have quantified CSR. CSR needs to be investigated and the only way to do so is to conduct studies on the full impact of this important corporate initiative.

This paper analyses the relationship between the major components of CSR and Corporate Financial Performance (CFP). Using a random selection of 100 companies from the Fortune 500, as well as four independent components of CSR, a multiple regression was performed. The four variables were selected from a CSRHub data collection of over 17,000 companies. The final model analyzed the following four independent components of CSR: (1) Community, (2) Employee, (3) Environment, and (4) Governance. The findings show that a linkage exists between firm's profit margin and CSR, with the primary effect coming from the CSR value of employees.

1. Background

Corporate Social Responsibility (CSR) is defined by Investopedia as "A mcorporation's initiatives to assess and take responsibility for the company's effects on environmental and social well-being. The term generally applies to efforts that go beyond what may be required by regulators or environmental protection groups." (Investopedia, 2018). Corporate Financial Performance (CFP) is a firm's Profit Margin as a percentage of Revenue. Such efforts normally come from firms that go beyond being simply "compliant" to EPA and other governmental agencies.

The largest companies in the US are spending in excess of over 15 billion dollars on different components of corporate social responsibility. Despite this massive investment, companies can rarely point at a direct positive link between the money spend on CSR and their financial performance in terms of profitability. This lack of direct cause and effect can often complicate financial prioritization for executives. When allocating company dollars, choices need to be made not just to what a company spends on total CSR, but what they spend against the different components of CSR.

Some might even argue that there is no reason to spend against CSR, in fact, Nobel Prize-winning economist, Milton Friedman, is famously quoted as saying "THERE is one and only one social responsibility of business, to use its resources and engage in activities designed to increase its profits" (Cash, 2014). This view has been widely debated in the business community and might mislead executives to think that activities within CSR will not drive profits. The notion has been countered in several studies, as will be discussed in the literature review section.

One company that has helped to organize the entire world of corporate social responsibility is called CSRHub (www.csrhub.com). This company is identified as the world's largest CSR intelligence database and thought leader in this space. Through their work, across +139 industries, they have divided CSR principals into four distinct components. These four elements are as follows: Environmental, Community, Employees, and Governance. (See Table I below). Thus, an opportunity exists to identify: (a) if CSR is having any impact on corporate profitability: and if yes (b) which specific component(s) should firms be concentrating on in CSR to have the biggest impact on corporate profitability.

2. Literature Review

The influence of CSR on companies' performance, especially financial performance has become a vital issue in corporate governance and management across the globe. There are two views that are held amongst researchers regarding CSR's relationship to CFP that have been studied over recent years. The first view is the conventional view which believes that in order to be socially responsible, additional expenses will be incurred resulting in CSR being a very costly initiative to undertake. For example, investments in pollution reduction, employee benefits packages, donations, and sponsorships to the community are all socially responsible actions that corporations have undertaken. One conventional view maintains that these expenses will deteriorate profitability and lead to a 'competitive disadvantage' for the firm (Alexander & Buchholz, 1978).

The second view that has been researched since 1984 is an opposite view promoted by stakeholder theory. Stakeholder theory rests on the notion that the dissatisfaction of any stakeholder group can potentially affect economic returns, and even compromise a company's future. (Clarkson, 1995). Because, stakeholders are not only external, managers should take account of all individuals and groups with a stake in or claim on the company, not just shareholders. (Melé, 2008). If managed properly, CSR will not only improve the satisfaction of these stakeholders, but also lead to improved financial performance (Aver & Cadez, 2009). For example, satisfied employees will be more motivated to perform effectively. Satisfied customers will be more willing to make repeat purchases and recommend the products to others. Lastly, more satisfied suppliers that are pleased with the relationship may be more willing to provide discounts, etc.

As is seen in Table 2, there have been many studies that have found a positive, negative, no relationship at all or a U-shaped/inverted relationship between CSR and CFP. As Table 2 outlines, there have been three studies that identify a positive relationship between CSR and CFP. These suggest that being socially responsible improves profitability. It can be concluded from these studies that CSR has a positive effect on CFP. Therefore, it is likely that socially responsible investments have a positive, rather than a negative effect on shareholder value (Moser & Martin, 2012), meaning that CSR is also favorable for the shareholder.

Table 1. Definitions

Variable	Scheme		
	Subcategory	**Description**	**Data Range**
Community %	Human rights, supply chain, product quality & safety, product sustainability, community development, philanthropy	The Community Category covers the company's commitment and effectiveness within the local, national and global community in which it does business. It reflects a company's citizenship, charitable giving, and volunteerism. This category covers the company's human rights record and treatment of its supply chain. It also covers the environmental and social impacts of the company's products and services, and the development of sustainable products, processes and technologies (CSRHub Data Schema Description – https://esg.csrhub.com/csrhub-data-schema).	0-100% (compared to all companies rated by CSRHub)
Employees %	Diversity, labor rights, treatment of unions, compensation, benefits, training, health, worker safety	The Employees category includes disclosure of policies, programs, and performance in diversity, labor relations and labor rights, compensation, benefits, and employee training, health and safety. The evaluation focuses on the quality of policies and programs, compliance with national laws and regulations, and proactive management initiatives. The category includes evaluation of inclusive diversity policies, fair treatment of all employees, robust diversity (EEO-1) programs and training, disclosure of workforce diversity data, strong labor codes (addressing the core ILO standards), comprehensive benefits, demonstrated training and development opportunities, employee health and safety policies, basic and industry-specific safety training, demonstrated safety management systems, and a positive safety performance record (CSRHub Data Schema Description – https://esg.csrhub.com/csrhub-data-schema).	0-100% (compared to all companies rated by CSRHub)
Environment %	Environmental policy, environmental reporting, waste management, resource management, energy use, climate change policies and performance.	The Environment category data covers a company's interactions with the environment at large, including use of natural resources, and a company's impact on the Earth's ecosystems. The category evaluates corporate environmental performance, compliance with environmental regulations, mitigation of environmental footprint, leadership in addressing climate change through appropriate policies and strategies, energy-efficient operations, and the development of renewable energy and other alternative environmental technologies. Also included are disclosure of sources of environmental risk and actions to minimize exposure to future risk, implementation of natural resource conservation and efficiency programs, pollution prevention programs, demonstration of a strategy toward sustainable development, integration of environmental sustainability and responsiveness with management and the board, and programs to measure and engage stakeholders for environmental improvement (CSRHub Data Schema Description – https://esg.csrhub.com/csrhub-data-schema).	0-100% (compared to all companies rated by CSRHub)

Governance %	Leadership ethics, board composition, executive compensation, transparency and reporting, stakeholder treatment.	The Governance category covers disclosure of policies and procedures, board independence and diversity, executive compensation, attention to stakeholder concerns, and evaluation of a company's culture of ethical leadership and compliance. Corporate governance refers to leadership structure and the values that determine corporate direction, ethics and performance. This category rates factors such as: are corporate policies and practices aligned with sustainability goals; is the management of the corporation transparent to stakeholders; are employees appropriately engaged in the management of the company; are sustainability principles integrated from the top down into the day-to-day operations of the company. Governance focuses on how management is committed to sustainability and corporate responsibility at all levels (CSRHub Data Schema Description – https://esg.csrhub.com/csrhub-data-schema).	0-100% (compared to all companies rated by CSRHub)

Table 2. CSR-CFP Relationship

Nature of the CSR–CFP Relationship	Representative References
Positive	Al-Tuwaijri et al., 2004; Burnett & Hansen, 2008; Rodgers et al., 2013
Negative	Baird et al., 2012;Peng & Yang, 2014
No relationship	Alexander & Buchholz, 1978; Aupperle et al., 1985; Sun et al., 2010; McWilliams & Siegel, 2000.
U-shaped/inverted	Barnett & Salomon, 2012; Bowman & Haire, 1975.

However, there are contradictory studies listed in the table as well. Two suggest that there is a negative relationship between CSR and CFP. These findings are consistent with a view that social responsibility incurs costs and deteriorates profitability. It can be said that this type of behavior is socially irresponsible, because the sole responsibility of firms is profit. However, the negative link between CSR and CFP does not imply the complete abandonment of socially responsible corporate actions. Many managers believe it is important to be good corporate citizens even when doing so is at the expense of shareholders (Moser & Martin, 2012) In addition, shareholders can also be ethical and may require CSR action, even at the cost of reduced financial performance (Mackey et al., 2007). The third documented relationship is no relationship. Lastly, four studies suggest that being socially responsible does not improve profitability, but it also does not deteriorate it. The positive and negative effects of CSR appear likely to cancel each other.

The last detected relationship between CSR and CFP was U-shaped. Barnett and Salomon (Barnett & Salomon, 2012) found that companies with low CSR performance have high CFP, companies with moderate CSR performance have lower CFP, whereas companies with high CSR performance have the highest CFP. Interestingly, a much earlier study by Bowman and Haire (Bowman & Haire, 1975) documented similar results, an inverted U-shaped/inverted relationship. These studies suggest that mediocre CSR is related to the highest financial performance, whereas low and high CSR are related to lower financial performance.

In reviewing these studies, clear and coherent evidence is lacking on the relationship between CSR and CFP. Possible explanations for such inconclusive findings have been offered by many authors (Surroca et al., 2010.) These include, among others: (1) the poor theoretical foundation of the CSR concept (Ruf et. al., 2001); (2) the omission of relevant variables in model specifications (McWilliams & Siegel, 2000); (3) the lack of a clear direction of causality (Waddock & Graves, 1997);

and (4) measurement issues (Davidson & Worrell, 1990) and sampling limitations (Van & Gössling, 2008).

As seen in Table 1, sustainability is a key factor that cuts across virtually all of the four components of CSR. The initial concept of sustainability was initiated in 1962 by Rachel Carson's, "Silent Spring" which researched catastrophic levels of agricultural pesticides leading to damages in human and animal health (Carson, 1962). Building on this initial awareness, there has been a steady increase in the quantity and quality of research related to CSR and its relevance to corporate profitability and revenue. Based on the analysis conducted, a greater amount of research has been performed by third-party firms rather than internal analysis by those organizations that follow sustainable business practices. One consideration is that companies are mindful of communicating genuine intentions for social and/or environmental improvements rather than risk perceptions that they are greedily seeking revenue performance because of following sustainable practices. Additionally, there are different levels of importance for sustainability issues across industries that are challenging to capture, measure, and accurately apply to confirm relevance (Khan et al., 2015).

Specific to the linkage of sustainability and revenue performance, in 2010, the Boston Consulting Group partnered with the World Economic Forum to identify firms that had the most effective sustainability practices in the developing world. Results from the 1,000 companies that qualified for the study showed that more than 12 consistently generated above-average growth rates and profit margins (Knut, 2013). Also, in 2010, an article entitled "Does Corporate Social Responsibility Influence Profit Margins?" studied mechanisms for CSR that could increase profits specific to textile companies in the Norwegian market with a focus on distinguishing achievement of average profits versus above-average profits with CSR (Blomgren, 2010).

According to Andy Fyfe with the B-Corporation (https://bcorporation.net/), a business that is comparable to what USDA Organic certification is to milk. Companies are not looking to be certified for an increase in sales, but rather it is the attractiveness to lure in talent to work for an organization that represents higher standards. According to Andy, it is the human resource effect coupled with the increased draw to investors because the organization commits to meeting rigorous standards of social and environmental performance, accountability, and transparency. There are more than 2,500 b-corps in the world, but the B-Corporation does not measure if their certification yields revenue improvement. As a final example of previous analysis conducted, CH2M Hill produced a white paper report in 2013, "Sustainability Goals that Make an Impact," that determined firms that set tangible, public sustainability goals do improve their financial and environmental performance. Their methodology included analysis of publicly available sustainability and financial data, third party analysis and rankings, and interviews with sustainability executives (Hardcastle, 2013).

3. Hypothesis

H1: There is a positive relationship between corporate profits and corporate social responsibility specific to corporate governance, community, employees, or environment. Higher involvement in CSR will lead to higher corporate profits.

4. Research Design and Methodology

The sample is composed of 100 randomly selected companies from the 2017 Fortune 500 from a rating system developed by CSRHub (https://www.csrhub.com/), which has over 17,000 companies listed. CSRHub provides consistent and unbiased data by performing the following steps: (1) map to a central schema in which 12 subcategories roll up into four categories

(Education, Governance, Employees, and Community); (2) convert to a numeric scale of 0 to 100 (100=positive ranking); (3) normalize the scores from different data sources for the same company to remove bias and create consistent ratings; (4) aggregate and weigh each source based on estimated credibility and value at the subcategory level and then aggregate to the category level; (5) trim the ratings that do not have enough information; and (6) research each rated company and attempt to determine which industries it participates in. Included in this data were 4 independent variables as defined by CSRHub, i.e., community, employees, environment, and governance. The purpose of the research is to determine whether CSR has an impact on the profitability of a company; also, if all or which segments out of community, employees, environment, or governance have a significant positive or negative influence. The dependent variable is a firm's profits (as percentage of revenue). The independent variables are community percentage; employee percentage, environment percentage and governance % (please refer to Table 1 for definitions)

The expectation is that, while not all four segments may have a significant impact on profit margin, they will, at least taken together, have an effect. When looking at the community percentage, it is hypothesized that if a company is active in its relationship with the community, there would be an uptick in their profit margins. The same expectation would go for the manner in which a company treats its employees. If an employee is treated more fairly and is fairly compensated, this would result in a more productive employee leading to a potential change in profits. This expectation could also carry over to the environment as well. If a company is strict on its waste and energy usage, this would transfer to an improvement in profits. The last segment of the model is governance. It is not as clear whether this segment will have an impact on profits. The compensation of the senior leadership team may have an impact on profits, but does that same thought process have any effect on the stakeholder?

The data was studied by using Statistical Package for the Social Sciences or SPSS. Using SPSS, the data was analyzed by using a multiple regression model. This model was designed to help answer the research question: does the community, employee, environment, and governance segments of CSR influence the profit margin of a company?

5. Analysis and Results

Figure 1 below identifies the multiple linear regression model summary and overall fit statistics for all the independent CSR variables of % Governance, % Employees, % Environment, and %, Community and the dependent variable of a Profit as a percent of revenue. It has been determined that the R^2 of the model is 0.145, which indicates that there is 14.5% of variability in the profit ratio that can be explained by the CSR components, as defined by the Community, Employees, Environment, and Governance ratings. The standard error of the estimate of 0.09.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.381[a]	0.145	0.109	0.091042

a. Predictors: (Constant), Governance, Community, Environment, Employee
b. Dependent Variable: Profit Margin

Figure 1. Model Summary

In Figure 2 below the significance value of the model is 0.005, which is below critical value of p-value of 0.05. This indicates that the regression model is significant. Hence, there is strong statistical evidence that CSR components in the aggregate are a significant predictor of corporate profitability.

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0.134	4	0.033	4.036	.005[b]
	Residual	0.787	95	0.008		
	Total	0.921	99			

Figure 2. Regression model significance

Figure 3 shows the detailed results of the regression. Column B identifies the profit for each CSR component. For a 1% increase in each component, there is a corresponding impact reflected in column B. The significance level was drawn at three decimal places to measure impact. Community is zero, indicating that there is nothing significant added to profit margin based on spending against this component. Employee is 0.002, the highest indicator of the four variables. For Employee, for every 1% increase there is an increase of 0.002% in corporate profitability. Lastly, Governance shows -0.001, which indicates that this component has a negative impact on profit margin.

		Unstandardized Coefficients	
Model		B	Std. Error
1	(Constant)	-0.004	0.028
	Community	0.000	0.001
	Employee	0.002	0.001
	Enviornment	0.001	0.001
	Governance	-0.001	0.001

a. Dependent Variable: Profit Margin
b. Predictors: (Constant), Governance, Community, Environment, Employee

Figure 3. Regression Unstandardized Coefficients

Figure 4 below is an indication of each of the predictor's significance as it relates to profit margin. Numbers less than 0.05 are statistically significant. In line with the information in Figure 4 below, community holds the least significance through the table below registering the highest p-value (0.867). Of the four components, Employee is the only independent variable to signal a statistical significance, with p-value falling below 0.05 at 0.013. Environment and Governance are both greater than the expressed threshold for significance.

Coefficients[a]

Model		Sig.
1	(Constant)	0.898
	Community	0.867
	Employee	0.013
	Enviornment	0.427
	Governance	0.377

a. Dependent Variable: Profit Margin
b. Predictors: (Constant), Governance, Community, Environment, Employee

Figure 4: Regression Significance of Coefficients (p values)

In summary, the significance of the coefficient below the 0.05 significance threshold allows the rejection of the null hypothesis i.e. that there is no relationship between corporate profits and corporate social responsibility specific to Corporate Governance, Community, Employees, or Environment. This is in line with the R2 value that there is a 14.5% of variability in profit ratio that can be explained by CSR values of Community, Employees, Environment, and Governance. Diving into each value separately, the model shows that the only value of significance is Employees. The value of Employees has a p-value of 0.013 which is less than 0.05. This allows rejection of the null hypothesis confirming that this CSR predictor may well have an impact on the profit of the company. Community has a significance level of 0.867, Environment has a level of 0.427, and Governance was found to have a significance level of 0.377. These scores were all above the threshold of 0.05 allowing us to accept the null hypotheses and determine that these CSR values are not significant and do not play a major role in determining the profit used a coefficient table. Very important is that for every 1% increase of Employee percentage of CSR component, there was 0.002% increase in profit margin.

6. Conclusions

In conclusion, the research done for this paper was to see if a relationship exists between CSR and corporate profit margin. In addition, it was to determine if Community, Employee, Environment, and Governance had any effect on the dependent variable of profit margin. With the use of multiple regression, it was determined that there may well be a relationship that exists between CSR and CFP. In addition, while the CSR values of Community, Environment, and Governance are important, they were not solely significant enough to influence the profit margin of a company. In this study, the only CSR value deemed significant by the models was the Employee component. Per the research and modeling for every 1% increase in employee % component of CSR, there is a corresponding increase of 0.002% in corporate profitability.

It should be noted that only 14.5% of the variation in the dependent variable (Profit Margin) is influenced in the full model. This seems logical as there are many other exogenous variables that could affect profit margin of a firm e.g. productivity, debt, the value proposition etc.

The findings show that there is a linkage between profit margin and CSR. In addition, the Employee component of CSR was most important. This linkage is inclusive of the attributes of Employee i.e. diversity among employees, labor rights, treatment of unions, compensation, benefits, training, health, and worker safety. While there is a relationship between employee CSR and profit margin, there was not a definitive causation where CSR could create major higher profit margins. It is important to note that it is imperative that companies continue their efforts in Community, Environment, and Governance. If these areas are not held constant, there could be a potential impact on the overall profit of the company.

7. Recommendations

It is recommended to take this study several steps further with initially, a deeper dive in the components of Community, Employees, Environment, and Governance. How do these components break down? What are the segments that are causing an impact, whether negative or positive? The predictor variable Employees was found to have a significant impact on profit margin, but within Employees what is moving the needle? Was it the diversity of employees, labor rights, treatment of unions, compensation, benefits, training, health, or worker safety? Within each component, are there places that companies should focus more time and effort? It may be found that some pieces are completely negating the significance of others. Thus, dropping such a piece could prove to make that component significant. From a methodology viewpoint, a Bayesian probabilistic approach could be used in the future to augment this study. It could be used to further show how various sub-categories may contribute to the argument considered.

The demand for socially responsible actions will continue to intensify as cultural awareness and expectations for sustainability increase from Employees, Communities, and the population as a whole. A plethora of information is available for demand and how companies are addressing sustainability. However, a clearer disclosure of the actual expenditures made by companies needs to transpire. The debate for mandatory disclosure in financial statements of the direct expenses for CSR has been ongoing, yet does not appear to be likely to occur soon. Upon review of many countries' policies, there were only a few that require close to what France and India have implemented:

- France: 2010 – Article 225 requires CSR reporting for listed companies with verification by a third-party.
- India: 2013 – The Companies Bill 2013 mandates that companies with a net worth more than $77 million USD to spend at least two percent of their three-year average annual net profit on social welfare initiatives and must be included in their annual reports (Initiative for Responsible Investment, n.d.).

Lastly, the addition of more independent variables such as diversity in executive leadership could be explored, i.e.:

- Gender: In 2016, 21 CEOs of the Fortune 500 companies were women and grew to 32 (a 52% increase) on 2017's list. Is there a significant relationship in CSR spending?
- Age: Is there a relationship between the age of a CEO and CSR spending?
- Multinational or Domestic Corporation: Is there a relationship between CSR spending and operating in more than one country?

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