



CURRENT RESEARCH DEVELOPMENT

An analysis of linkage between economic value added and corporate social responsibility

Economic value added and CSR

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R.K. Mittal, Neena Sinha and Archana Singh
USMS, GGSIP University, Delhi, India

Abstract

Purpose – Research findings indicate that there is positive relationship between corporate social responsibility (CSR) and company's reputation but relationship between CSR and company's profitability has not been explored in the Indian context. CSR level of business firms in India is increasing in terms of both amount of the disclosure and the number of participating firms. Therefore the purpose of this paper is to explore the link between good financial performance measure and other indicators of corporate responsibility. This paper also aims at studying the trend of disclosure of CSR reporting by Indian companies.

Design/methodology/approach – This study seeks to investigate the relationship between ethical commitment and financial performance over the four-year period, through statistical regression and correlation analysis. Studies of few Indian companies who have successfully implemented CSR initiatives have also been analyzed to investigate the level and nature of engagement of Indian companies in social responsibility initiatives.

Findings – It has been reported that there is little evidence that companies with a code of ethics would generate significantly more economic value added (EVA) and market added value (MVA) than those without codes.

Practical implications – Indian corporations need to develop a proper strategy to integrate CSR goals with stockholders' goals. Top management should create a dedicated CSR team, which should identify the core areas of CSR and strengthen internal practices such as corporate governance, transparency and disclosure issues.

Originality/value – In the Indian context very few studies have analyzed the linkages between CSR and Organizational profitability. This article presents a new approach to correlate the relationship between CSR and Organizational profitability in terms of EVA and MVA.

Keywords Economic value added, Corporate social responsibility, Market value added, Business ethics, India

Paper type Research paper

Introduction

Corporate social responsibility (CSR) is a business approach that views respect for ethics, people, communities and the environment, as an integral strategy that improves the competitive position of a firm. Over the past decade, a growing number of companies have recognized the business benefits of CSR policies and practices. Companies also have been encouraged to adopt or expand CSR efforts due to the pressures from customers, suppliers, employees, communities, investors, activist organizations and other stakeholders. As Indian firms enter the global marketplace, increasing obligations will be placed on them to divulge information to the public.



The growing demand for CSR from various sectors of society has sparked the proliferation of a number of CSR-related instruments. These pro-CSR instruments are classified into three categories:

- (1) codes of conduct;
- (2) (management standards; and
- (3) accounting/reporting standards.

The growing concern over the CSR and the feel good factor has led Indian organizations to be more committed and answerable to shareholders. This concern about how reputation affects shareholder's perception has forced large companies to consider not only financial performance but also their environmental and social performance. In annual reports it is often called triple bottom line reporting. There are sound commercial justifications for companies structuring their activities in order to make them attractive to investors. Corporations develop and communicate substantial amount of information concerning their activities. Most large companies issue annual reports concerning the year's activities and financial status. A number of corporations have responded to the need for more information concerning social performance by developing some sort of corporate social reporting.

CSR can be understood in terms of corporate responsibility, but additionally focuses on the obligations a company has to the community and the environmental stewardship. There has been a plethora of information readily available on the topic of CSR (Kenneth *et al.*, 1985; Jean *et al.*, 1988; Blackburn *et al.*, 1994; *Business Week*, 1999; Kumar *et al.*, 2001; Nelling and Webb, 2006). A large body of literature has also emerged on why the corporations should or should not engage in socially responsible behavior. Proponents of CSR claims that CSR leads to improved financial performance, enhanced brand image and reputation, increased sales and customer loyalty, increased productivity and quality, among other benefits. The opponents of CSR argue that it takes away precious times of firm's CEO and other top executives. A review of similar research shows that the relationship between good financial performance and other indicators of corporate responsibility (environmental management, corporate social responsibility, sustainability etc.) is positive but not definitive. However, Verschoor (1998) has shown that there was superior market value added in companies, which referred to their ethics programmes in the annual report, compared with those who did not, in a study related to American organization. Yet another research study (Webley and More, 2003), has also shown that companies with a clear commitment to ethical conduct outperform those, which do not. After the adoption of CSR practices these firms are more profitable than other comparable firms, holding other factors constant. Laffer *et al.* (2004) found that the claim that CSR is positively correlated with business profitability is not true. A number of surveys have been conducted in India to understand what corporate social responsibility (CSR) means in the Indian context, what the expectations of different stakeholders are and the drivers and barriers to adoption of CSR initiatives.

Center for Corporate Research and Training (2001-2002) surveyed, through a structured questionnaire, 50 companies included in the NSE NIFTY Index. Result shows that about 57 percent of companies in the sample have a formally adopted ethics code. One third of the companies do not have a formally adopted code, while for 10 percent of the companies the information is not available. About the process through which the code has been evolved, most companies have chosen to remain silent. As far

as the areas of interventions or content of the social responsibility initiatives is concerned, these have been classified into seven major areas: education and training (80 percent), healthcare (66 percent), environment (60 percent), welfare of under privileged sections of the society (57 percent) and rural development (23 percent). Tata Energy and Resource Institute (2000), traces back the history of CSR in India and suggests that there are four models. Sahay (2004) reports that Indian corporations, like their counterparts in developed countries, took hesitant steps towards environmental protection – most of them driven by legal compliance. A selected few companies, however, took to environmental protection, enhancement and reporting through overall business considerations. Partners in Change (2000) showed that 85 percent of the companies surveyed mentioned that business has a role to play in social development. The focus of most of these companies in this context is on community development.

Hence, it is of utmost importance to study the link between good financial performance measure and other indicators of corporate responsibility. This paper is an attempt to fill this gap in research.

Objectives of the study

This study is undertaken to explore some indicative measures of ethical commitment/corporate responsibility and then to compare them against financial performance measures over a period of four years. In this way, the research sets out to investigate whether it can be shown that a commitment to business ethics does pay.

This study also aims at studying the trend and disclosure of CSR reporting by Indian companies and also identifies the factors that motivate Indian companies to undertake these initiatives (e.g. regulatory compliance, product market competition, attracting and retaining employees, protection of reputation).

Research method

For this research, three indicators are chosen – two of corporate financial performance (market value added, economic value added), and one of corporate social responsibility (having a code of ethics). The choice of EVA and MVA is relevant in today's context as these are the economic performance measures, which tell us as to how much in real sense the companies have created wealth for its stakeholders, and also as to how efficiently they are utilizing the capital raised from different stakeholders. If a company is creating positive EVA and MVA then it should be working in synchronization with corporate social responsibility. Hence, the hypothesis of the study can be stated as:

Companies with a code of ethics would generate significantly more economic value added (EVA) and market added value (MVA) than those without codes.

Case studies of few Indian companies who have successfully implemented CSR initiatives have also been analyzed to study the levels and nature of engagement of Indian companies in corporate responsibility initiatives. Accounting and reporting standards have led to increased public disclosure of an organization's economic, environmental and social performance and is linked with the increasing consensus that financial reporting alone no longer satisfies the need of shareholders, customers, communities, and other stakeholders for information about overall organizational performance.

The sample consists of 50 companies taken from the S&P CNX Nifty for which full and comparable company data is available for the years 2001-2005. It is divided into two cohorts: those who have had codes of ethics/conduct/principles listed in their annual reports and those who did not. First it was tried to statistically analyze the

correlation of CSR and EVA and CSR and MVA across the two cohorts. The second test conducted a dummy variable regression analysis. A “dummy variable” tests whether the existence of some attribute (in this case whether the firm has been deemed to be socially responsible) is related to another attribute (in this case profitability). Here, if a company has been deemed socially responsible the dummy variable is given a value of 1. If it has not been deemed socially responsible the dummy variable is given a value of 0. In this way, the analysis tests whether being a CSR company has a positive, negative, or no impact on profitability as measured by EVA and MVA (shareholder wealth measures) (Table I).

Key findings and conclusions

The research showed that over half of S &P CNX Nifty companies either produce a sustainability report or have a specific section on their website or in their annual report covering corporate responsibility.

As per the results displayed in Table II, correlation of CSR with EVA over the five-year period shows negative correlation in three out of five years and in two years when it shows positive correlation the figure is very low indicating insignificant correlation. Correlation of CSR with MVA indicates positive correlation but again the figure is very low to indicate any significant relationship.

Regression results

The beta coefficients indicate the strength and sign of the relationship between being a CSR company and each one of the two profitability measures. The *P*-value indicates at what level the results are statistically significant. Typically, results are considered significant if the *P*-value is at the 5 percent significance level or less. The adjusted *R*-Square measures the regression’s explanatory power. An adjusted *R*-square of 1 indicates that the independent variables (in this case CSR) explain all of the variations in the item of interest (in this case profitability). A value of 0 indicates that very little of the variation is explained by the independent variables.

Table I.
Correlation results

	2001	2002	2003	2004	2005
Correlation with EVA	– 0.22846	– 0.20846	0.068707	– 0.09186	0.051301
Correlation with MVA	NA	NA	0.160492	0.150702	0.185582

Table II.
Regression analysis
results: dependent
variable as a function of
CSR

Dependent variable	Adj. <i>R</i> -Sq	Beta coeff.	<i>P</i> -value
EVA01	0.032	– 0.228	0.111
EVA02	0.024	– 0.208	0.146
EVA03	– 0.016	0.069	0.635
EVA04	– 0.012	– 0.092	0.526
EVA05	– 0.018	0.051	0.723
MVA03	0.005	0.16	0.266
MVA04	0.002	0.15	0.296
MVA05	0.014	0.186	0.197

The results indicated that there is a significant and negative relationship between being one of the 31 CSR companies and EVA over two years i.e. FY01 and FY 02 of the sample period. The results for another two years i.e. FY03 and FY 05 are found to be positive, but not significant (at the 5 percent level); and we found a non-significant (at the 5 percent level) negative relationship between being one of the CSR companies and EVA in FY 04. Overall, none of the equations have much explanatory power with respect to changes in corporate profitability (as measured by EVA and MVA) – not surprising, given that the regression does not include any other determinant of profitability. Hence, no significant positive correlation between CSR and EVA was found as determined by standard measures.

The result also indicated positive and significant relationship between CSR and MVA for the three-year period of analysis (at the 5 percent level). However the correlation does not seem to be very strong. Hence the conclusion that can be arrived at is that although CSR is negatively related to EVA, which is an internal measure of profitability; the relationship of CSR and MVA (an external measure of profitability) is positive and significant. This means that improvement in the bottom line is not dependent on whether the company follows the code of ethics or not, but the perception of the investors and other stakeholders about the company definitely becomes positive as indicated by positive relationship between CSR and MVA.

Corporate responsibility in India

Corporate social responsibility in India has come out of its infancy and has become a business in itself. If one goes by the number of companies touting their achievements, civil society groups and consultants offering ethical corporate services, and government framing policies to involve business in development issues, then corporate social responsibility has evolved to be acceptable to all, at least in concept. Studies of few Indian companies who have successfully implemented CSR initiative have also been analyzed to indicate the level and nature of engagement of Indian companies in corporate responsibility initiatives as shown in Table III.

Analysis: corporate responsibility in india needs to wake up to quality reporting

Table III lists down some of the innovations in the field of CSR by Indian companies. However, despite all this frenzied activity, there is hardly any structured reporting by all these commercial and non-commercial organizations about their actions. More glaring is the extensive talk by companies in India about their community initiatives rather than internal practices such as corporate governance, transparency and disclosure issues. Furthermore, businesses do not want any corporate responsibility reporting to be mandated.

Thus, we see that although Indian corporates have already geared on the roadmap to CSR, what is required on their part is to develop a proper strategy to identify CSR goal with organization's goals. A dedicated CSR team should be formed which should identify the core areas where the organization should put its focus after performing a SWOT analysis. It is very important for any organization to be focused in its activities with clear-cut goals.

Conclusion and scope for future research

Our results, of course, do not conclusively prove that CSR initiatives have a negative impact on a business's performance for all the years. They are, however, strong

Issue	Company	Action
Community development	Hindalco	Asian CSR Award for its Integrated Rural Poverty Alleviation Programme
Health	L&T	One of first corporate to launch an HIV/AIDS programme
Community development	IOC	Dedicating 0.75% of net profit to community development initiatives
Gender equality	NTPC	One of the few organizations to have a policy for paternity leave
Labour standards	ITC	First company in India to be certified to the SA8000 social accountability standard for its Chirala facility
Human Capital	Infosys	Pioneering evaluation of human capital using an education index for its employees
Environmental management	BHEL Tata Steel	All BHEL units are certified to the ISO14 001 to the environmental management system Tata Steel was the first integrated iron and steel plant in India to have been certified with the ISO-14001 Environmental Standard
Energy conservation	Reliance Energy	Conservation measures are saving the company 1,150 million rupees per annum
Disability	HLL	Started "Kappagam" (means "shelter"), a second centre for special education of mentally and physically challenged children
Education	Grasim Ind.	The Aditya Birla Group believes that a sound education is key to the progress of our people and our nation
Disaster relief	Tata Steel	Tata Steel has been supporting the relief operations during disasters and calamities including earthquakes, cyclones, Kargil war etc.

Table III.
India Inc.: selected CSR innovations

Source: Compiled from published data on company web sites

evidence against the claim that CSR initiatives have universal or systematic positive financial impacts on companies. Perhaps the most that can be said at this point is that research in this area should continue.

It is important for researchers to keep in mind that CSR initiatives impose significant programmatic and administrative costs on businesses. It is likely, therefore, that the businesses that are inclined to engage in CSR initiatives tend to be those that are already financially successful and that can afford the added "CSR overhead." To properly compare companies that undertake CSR initiatives with those that do not, many factors need to be controlled including the two CSR bias issues we have identified as well as standard financial issues such as industry sector; mature versus growth industries; operating scope (regional, national and multinational); investment risk profile.

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About the authors

R.K. Mittal is Professor and Dean, University School Of Management Studies, GGSIPU, Delhi. He has obtained his PhD in economics. He has presented and published many research papers in international as well as national conferences and research journals. He has almost 20 years of rich experience in the field of education.

Neena Sinha is Reader, University School Of Management Studies, GGSIPU, Delhi. Her thrust area of teaching and research is strategic management. She has published over 20 research papers in management journals and proceedings of National and International conferences. Neena Sinha is the corresponding author and can be contacted at: dr_neenasinha@yahoo.com

Archana Singh is currently pursuing her doctoral studies At University School Of Management Studies, GGSIPU, Delhi in the area of Corporate Strategy. She is also visiting faculty at Amity Business School Noida, UP.

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