CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL CRISIS

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Abstract: This paper studies the effect of financial crisis on Corporate Social Responsibility (CSR) practices and their performance during the financial crisis. Researchers have underlined that CSR practices can act as a radar (Hohnen (2007), could break or be aware of a potential economic and/or a financial shock (Thorune, 2009, Hohnen, 2007) and reduce the risks (Testa, 2008). Starting from the reference literature on CSR this paper empirically analyze Romanian companies listed on Bucharest Stock Exchange (BSE) in order to determine whether the CSR practices can be linked to companies financial performance during an economic downturn. From a total of 81 companies listed on BSE were considered only companies that are active in CSR. The period analyzed is between 2006 and 2012. Results suggests a positive relation between CSR practices and companies financial performance. Moreover this paper underlines the benefits of CSR practices as a strategy for long term business leading to competitive advantage and win-win opportunities.

Keywords: Corporate Social Responsibility (CSR), financial performance, Romania, CSR practices, financial crisis

JEL Classification: G34, L20

INTRODUCTION

The financial crisis started in USA in 2007 because of the liquidity problems faced by the banks (Taylor & Williams, 2009). As result worldwide economies and financial systems were affected. The period between the third quarter of 2007 until the 2009’s first quarter had been considered the peak of the financial crisis (Filardo et al., 2010). European Commission (2009), mentioned that in Europe and in USA the financial crisis harsh results were in 2008 particularly in the second quarter of 2008 (Wyplosz, 2010).

The liquidity shortfall had a severe impact on many companies confronted with difficulties whenever they attempt to borrow money (financial capital) from the banks (Njoroge, 2009). As consequents, the recent financial crisis resulted in fall of investment,
stock indexes, demand, financial institutions collapse, increased poverty, high unemployment rate worldwide and governments need it financial help to bail out their financial systems (Adamu, 2009). Even today are still doubts regarding the recovery of some countries (UK, USA, and Greece) economy (Eatwell, 2010) while Foroohar (2011) discuss the probability of a double recession. The slow and rough recovery of worldwide economy will take a longer time than previous recessions (McKinsey Global Institute, 2011). In the face of the crisis many companies were struggling to stay “alive”. The survival of the business becomes important against the increased corporate wealth (Ali et al., 2010).

The financial crisis had revived the interest of an old and familiar concept: responsibility. The need for responsibility focuses mainly on companies and their business practices (Peters, 2009). The concept of responsibility refers to actions that can be done now in order to meet the future challenges (Peters, 2009). Companies that understand and implement the social responsibility strategy into their business core are able to anticipate changes through their CSR practices (Hohnen, 2007). These companies are with the “ear to the ground” and are in a better position to anticipate and to respond to legal and economic framework, environment and social changes that might occur (Hohnen, 2007; Thorme, 2009).

The current crisis made shareholders to rethink their business strategies and to consider environment and social responsibilities important practices for the society and economic system. The CSR benefits have received increased attention from researchers, scholars and international organizations bodies. Corporations use CSR practices as strategy to strengthen their relations with employees, investors, suppliers, government and customers. These strengthens link the corporations to loyalty brand (Wu, 2011), competitive advantage (Porter & Kramer, 2002), opportunities and reduces the risks (Porter & Kramer, 2006; Testa, 2008). Many researchers have focused their studies on the relation between CSR and corporate financial performance (Cochran & Wood, 1984; Waddock & Graves, 1997; McWilliams & Siegel, 2001; Tsoutsoura, 2004), consumer behavior (Ali et al., 2010) and companies effects on environment and society (Marcus & Fremeth, 2009). Little research has focused so far on company’s financial performance during financial crisis and their relation with CSR practices. Therefore, the aim of this study is to analyze the financial performance of companies that continued their CSR practices during the financial crisis.

The rest of the paper is organized as follow: section 2 presents the literature review of previous studies regarding CSR and financial crisis. In section 3 the methodology is presented. Section 4 discusses the regression results and in the last part, the conclusions are presented based on the empirical results.

**CSR: LITERATURE REVIEW**

According to Selvi (et.al, 2010), CSR can be defined as the “role of business in society as a social performance”. The Commission of the European Communities (2001) has defined CSR as “a concept whereby companies integrate social and environmental concerns in their business operations …on a voluntarily basis”. In Kitchin (2002)
opinion, CSR meaning changes over time while Lantos (2001) sees CSR as a useful marketing tool. There is no single definition regarding CSR and the role in society.

The literature on financial crisis and CSR is limited. Researcher’s opinions are not unanimous: some argues that CSR is a threat for the company survival while others underlines the great opportunities ready to be discovered by the companies and on the positive side are the authors that look forward considering CSR practices as a long–term and sustainable business strategy regardless any financial and or/economic downturn. Various studies have been conducted to analyze the effects of CSR practices on company’s financial performance. Among these studies, Fernández & Souto (2009) argue that CSR has a negative effect on company financial performance because of the extra costs imposed by CSR practices on businesses. This argument reinforce Friedman (1970) theory and his supporters in that the resources allocated to CSR practices fall as direct costs reducing shareholders profit shares. Therefore, this theory suggests that it not necessary for a company to become socially responsible because these costs reduce the company profitability (Orlitzky et al., 2003).

Karaibrahimoğlu (2010) studied financial performance of 100 socially responsible companies before the crisis and when the crisis started, 2007 and 2008 respectively. The results indicated significant reduction of CSR projects during the financial crisis while other companies cut their expenses staring with CSR projects that were about to start (Kemper& Matin, 2010).

Arevalo & Aravind (2010) also investigate the effect of financial crisis on CSR. They considered for their study companies that adopt the principles of United Nation Global Compact (UNGC). The conclusion of the study was that companies that integrated UNGC principles in their business strategy in a responsible way, will not be affected by financial downturns or by any economic shock while companies that treat UNGC principles as a fashion will be more affected by financial downturns or any shock. The study also underlines that in some cases CSR principles are considered important starting points in improving business operation. In the face of the crisis many companies need to change their business strategy (Peter, 2009) and objectives in relation with social expectations (Porter & Kramer, 2002).

The questions raised in this study refer to those companies that continue their CSR activities without interruption even in times of crisis, supporting various social, environmental and artistic activities. Thus, the following questions are addressed: How financial crisis affected these companies’ financial performance? Was the effect positive or negative? If positive then Does CSR practices can be linked to company’s financial performance?

CSR: THREAT OR OPPORTUNITY?

The financial crisis has shaken many companies, had caused losses and damage. However, in these uncertain situations, the crisis had brought not only threats but opportunities as well. The financial crisis can be a good indicator of socially responsible business activity. It highlights if companies connected their CSR practices to their core business in a responsible way or they fall victim to cost-cutting measures. Measuring
CSR performance, one can identify companies strengths and weaknesses, can define (new) opportunities or modify their business strategy (Kok et al., 2001).

Different variables and methods were used to test the effect of financial performance but there is no single approach to evaluate CSR performance. This research analyzes companies listed on BSE in Romania between 2006 and 2012. The data was collected from BSE were companies made public their profit and loss accounts and balance sheets. This paper fallow McWilliam & Siegal (2001) CSR measurement where CSR was considered dummy variable and as in Waddock & Graves (1997) model where CSR is an independent variable. The hypotheses are:

H₀ CSR practices influence positively company’s financial performance, ceteris paribus
H₁ CSR practices influence negatively company’s financial performance, ceteris paribus

In order to test the hypothesis, the OLS method was used.

The dependent variable in this study is ROE (Return on Equity). ROE show company financial leverage and is calculated as net income over shareholders equity. The independent variables are CSR, ENV (environment) and SOC (Social) and are dummy variable. Thus, if a company is socially responsible and maintained their social and environmental practices during financial crisis has a value of one and if not zero (Gujarati 1999; Wooldrige, 2008). Risk (is a proxy measured as long term debts over total assets) and size (total assets is a proxy for size) are controlled variables (Waddock & Graves, 1997; Tsoutsoura, 2004). For this study were considered only companies that have or they applied for ISO 14000 (environment certification), follow ISO 26000 standards and their CSR rapports are published, corporate governance or ethics codes. From a total of 81 companies listed on BSE remained only 19 companies which were corresponding to above conditions.

Table 1 provides correlation matrices and it can be notices that CSR is statistically significant and has a positive value on ROE. Also ENV and SOC are positive and statistically significant with ROE.

Table 2 presents the results regression of the OLS method used to test the hypothesis of this study regarding the positive or negative effects of CSR practices on company financial performance. The authors have found in a previous research, which is in process to be published, a positive and significant relation between CSR and financial performance of 21 companies in Romania.

Table 1 Correlation matrices for the key variable for the year’s btw 2006 and 2012

<table>
<thead>
<tr>
<th></th>
<th>ROE</th>
<th>CSR</th>
<th>Size</th>
<th>Risk</th>
<th>ENV</th>
<th>Social</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td>1.00</td>
<td>0.09</td>
<td>-0.04</td>
<td>0.01</td>
<td>0.22</td>
<td>0.15</td>
</tr>
<tr>
<td>CSR</td>
<td>1.00</td>
<td>-0.07</td>
<td>0.004</td>
<td>0.35</td>
<td>0.12</td>
<td></td>
</tr>
<tr>
<td>Size</td>
<td>1.00</td>
<td>-0.07</td>
<td>0.004</td>
<td>0.03</td>
<td>0.09</td>
<td></td>
</tr>
<tr>
<td>Risk</td>
<td>1.00</td>
<td>-0.07</td>
<td>0.003</td>
<td>0.04</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ENV</td>
<td>1.00</td>
<td>0.004</td>
<td>0.029</td>
<td>1.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1.00</td>
</tr>
</tbody>
</table>

*p≤0.1; **p≤0.05; ***p≤0.001
The results of this study show a positive relation between CSR practices (Env and Social) and financial performance. The value of $R^2$ is 0.72 and that is a good value. $R^2$ shows how good the model is. In other words, the total variation in the dependent variable is explained by the explanatory variables. The coefficient for Env is 0.034 and is statistically significant at 10% ($p≤0.10$). This means that, holding all other variable constant, a 1% increase in Env, ROE will increase with 3.4%. As well, the coefficient for Social is 0.54 and is statistically significant. An increase of 1% in Social coefficient, ceteris paribus, will result in a 5.4% positive increase on company financial performance. Therefore, we reject the hypothesis in which CSR practices have a negative effect on financial performance. This research have also used as dependent variable for regression model, ROA (Return on Assets) measured as net income over total assets and we found the same positive and significant effect of CSR practices on financial performance.

Table 2 Regression analysis

<table>
<thead>
<tr>
<th>Dependent variable</th>
<th>Independent Variable</th>
<th>ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSR</td>
<td>.0245*</td>
<td></td>
</tr>
<tr>
<td>Risk</td>
<td>-.056***</td>
<td></td>
</tr>
<tr>
<td>Size</td>
<td>.003</td>
<td></td>
</tr>
<tr>
<td>Env</td>
<td>.034</td>
<td></td>
</tr>
<tr>
<td>Social</td>
<td>0.54</td>
<td></td>
</tr>
<tr>
<td>R Squared</td>
<td>.7208</td>
<td></td>
</tr>
<tr>
<td>No of obs</td>
<td>133</td>
<td></td>
</tr>
<tr>
<td>F-stat (p-value)</td>
<td>3.390 (.000)</td>
<td></td>
</tr>
</tbody>
</table>

*p≤0.1; **p≤0.05; ***p≤0.01

4. CONCLUSIONS

This study empirically analyzes the effect of CSR practices on financial performance during the financial crisis on 19 companies listed on BSE in Romania. The period considered for analyses is between 2006 and 2012. Although, the financial crisis has “pushed away” many companies from CSR practices because of the costs, the benefits arising from maintain these practices were understood and fully developed by some companies. Companies that followed and implemented CSR principles into their business core were the companies that spot the opportunities during the financial crisis. For many companies CSR practices constitute a threat while for others an opportunity. This research has found a positive relation between CSR practices and financial performance. The positive effects of CSR practices does not positively affect only financial performance but also the company’s good reputation and differentiate the company from competitors through their goods and services (Thorme, 2009). There are some limitations of this study; it takes into consideration all companies regardless of industry and size. Further research should study if these CSR practices hold in time and whether any changes are made within these practices.
REFERENCES


