A literature review of the relationship between CSR and CFP in China

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Abstract. Academic research on corporate social responsibility (CSR) gradually matures with developments and changes. Studies on the relationship between CSR and corporate financial performance (CFP) have clarified understanding in developed countries such as Europe and the United States. However, a historical review of this relationship is lacking for developing countries, especially China. This paper aims to review the relationship between CSR and CFP through theoretical, methodological, and empirical aspects, and in particular, how this relationship is applied to the development of Chinese firms. The results show that the correlation between CSR and CFP is diverse in academic cognition, and using CSR in different contexts is still of broad discussion value in future research. Finally, this paper provides a historical review of CSR and CFP study in Chinese enterprises, which not only has theoretical value to supplement the academic lack, but also offers practical value for the development and CSR implementation in Chinese enterprises.

Keywords: Corporate Social Responsibility; Corporate financial performance; Stakeholders.

1 Introduction

Researchers referred to the social performance as business social responsibility instead of corporate social responsibility (CSR) until the 1960s. Bowen initially proposed the systematic CSR notion that businessmen should take action and make judgments supporting the correct policies for social aims and values [1]. These acts simultaneously impact the stakeholders and the community standard where the company operates, both directly and indirectly. The majority of study on CSR and related topics is based on industrialized nations in North America and Europe [2]. There are numerous social issues involving the environment, consumer rights, privacy, and employee welfare due to managers' and owners' excessive focus on profit [3]. This research has also helped spread the CSR idea throughout the Chinese business community. This study aims to organize the relationship between CSR and CFP and its manifestation in China via a historical literature analysis.

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The remainder of the paper uses stakeholder theory to characterize CSR while summarizing various understandings of CSR from preceding research. The following review provides an overview of the growth and actual use of CSR in China. The limits of past study are then discussed, and the conclusions of several academic studies on the theoretical, empirical, and methodological aspects of the relationship between CSR and CFP are presented. Finally, this essay concludes the historical review.

2 CSR from the perspective of stakeholder theory

Due to the broad nature of CSR, different academics approach it from various angles or employ multiple methodologies. A separate study by Davis (1960) pointed out that businesspeople should uphold economic and human ideals, which contribute to corporate social rights [4]. Friedman (1970) asserted that the primary purpose of CSR is to boost profits and maximize shareholder returns and the expense of CSR operations represents an imprudent use of internal business resources [5]. McGuire et al. (1988) confirmed this claim [6]. CSR activities deplete resources that could be used to promote value-added activities and increase shareholder wealth. These costs are not necessarily translated into economic benefits. However, the company's strategic decisions may affect its choice of more profit-oriented decisions if they are not in line with CSR principles. According to Carroll's framework, CSR is defined as "the economic, legal, ethical, and discretionary expectations that society has of an organization at a given time." [7]. Based on this definition, companies must not only make economic profits, but comply with laws and regulations, adhere to social and ethical norms, and actively engage with the public as well. Therefore, these four expectations divide CSR into economic, legal, ethical, and discretionary responsibility [7].

In addition, business success depends on both interests of shareholders and a wide range of other stakeholders. They were first defined by Freeman (1984) as individuals affected by achieving business goals [8]. They are divided into shareholders, managers, employees, creditors, suppliers, retailers, consumers, government, and communities. By maintaining a positive relationship with relevant stakeholders, the strategic social responsibility of a company can contribute to its overall development [9]. In practice, however, companies have difficulties differentiating their daily business activities and CSR activities, thus preventing them from adequately disclosing CSR reports. As a result, companies find it challenging to formulate goals and strategies related to CSR.

Faced with requests from internal and external stakeholders, company managers need to consider their social responsibility to maximize shareholder interests and allocate company resources accordingly to provide value to other stakeholders. Otherwise, they may lose other stakeholders' support in their day-to-day operations. However, most stakeholders are dissatisfied with the company's CSR disclosure behavior, which are inadequate at this stage [10]. Voluntary CSR disclosures related to shareholder interests can increase stakeholder support [6], enhancing a company's reputation and competitiveness with positive acceptance of CSR practices.

External stakeholders influence CSR practices. For example, when companies practice CSR, their customers are satisfied, loyal, and willing to pay a premium for their products and services. CSR, a driver of customer satisfaction, acts as a favorable factor to attract more customers and increase company value [11]. For internal stakeholders, CSR can motivate and attract employees within the company by generating social value. For example, by sampling and surveying 4,712 employees in a financial company, it has been shown that adequate internal training helps to improve employee identity [12]. Companies can benefit from CSR by enhancing their social values, which in turn can improve their social performance, thus strengthening their competitiveness in the job market. CSR also promotes the establishment and maintenance of good industrial relations for the mutual benefit of the company and its employees.

3 CSR in China

Although corporate governance in China is Anglo-American style, the concept of CSR cannot be directly applied to Chinese society due to the different national circumstances. Despite the gradual liberalization and opening of the Chinese economy, the Chinese political economy is characterized by the state's dominant role in regulation. Due to differences in geographic location, social environment, and political and economic factors, developing countries like China must generate CSR on their own terms [13]. For example, since Chinese society has slowly integrated into global development and has different regulations and government leadership styles than Western societies, new opportunities have arisen for CSR research and development [14]. However, relatively little literature has applied the new approach to examining CSR in China and this single market and institutional environment.

Based on the scholars' findings, the main reasons for the lack of progress in CSR in China can be divided into six areas. First, CSR disclosure in China is still in its infancy, implementation processes and standards are immature, and Chinese companies tend to be profit-driven and ignore social concerns [15]. Second, many companies focus on legal and regulatory requirements in fulfilling their responsibilities but overlook the social faults they should take on voluntarily [16]. Moon and Shen cited three reasons for this: the absence of benchmark Chinese companies, the insufficient investing resources in CSR and limited internal resources to share with society, and the lack of CSR education and staff training for managers and owners [2]. Furthermore, China still lacks contextualized rules for CSR regulation of corporate behavior [17].

China has encountered many social problems during its economic development in recent decades, making developing CSR particularly crucial. The main external factors come mainly from domestic actors: the first is the driver of "coercion," referring to the ability of the ruling party to enforce its will on the people. This factor comes from laws, regulations, and government decrees set by rulers. It can put pressure on companies to practice CSR [18]. For example, studies have shown that the Chinese textile and garment industry's mandatory requirements by law and policy have promoted CSR practices. Second, regulatory incentives often come from public opinion and media attention. These incentives affect firms' reputations and thus the market response [19]. Research showed that young Chinese consumers are increasingly interested in CSR, motivating firms to accelerate CSR implementation. Third, CSR implementation systems and imitation of successful competitors can improve companies' competitiveness, especially in international markets [18]. In China, the internal value of CSR can also act as a driver of CSR progress. Chinese companies generally link their inner core values to national and ethnic justice. Especially in times of catastrophe or economic recession, internal corporate values are related to overall responsibility at the national level. Although different from the intra-company values of developed countries, Chinese companies with high intra-company values similarly practice CSR [18].

Given the importance, challenges, and drivers of CSR in China, many Chinese companies have integrated CSR into their corporate governance to win consumer trust and strengthen their competitiveness in recent years. With better education and media campaigns, public awareness of CSR has become more sophisticated, and expectations of CSR have increased. At the same time, China has established RKS as an authorized third-party CSR rating agency to provide objective, fair, and reliable CSR rating information for responsible investors, consumers, and the public [3].

4 The relationship between CSR and CFP

4.1 The theoretical and empirical literature on the relationship between CSR and CFP

Generally, the relationships can be categorized as positive, negative, non-linear, and linear correlation. Of these studies, 63% reported a positive correlation, 10% reported a negative correlation, and 27% reported no significant relationship between the two.

Notably, scholars explain the relationship between CSR and CFP in different ways. First, some scholars believe that positive CSR increases economic efficiency. For example, high CSR performance raises the share price of companies. It can also reduce agency problems resulting from information asymmetries between stakeholders [20]. On the other hand, CSR can reduce political costs arising from social issues, enhance the company's reputation, promote higher customer loyalty, and thus stabilize the company's position in the market [8]. Some consumers are particularly willing to purchase products and services with CSR attributes. Second, sound financial performance can motivate social action, as companies have sufficient internal resources to share with society [6]. Third, CSR and CFP positively impact each other, and there is a two-way facilitating effect between the two [21]. Management's proactive CSR practices can contribute to sustainable improvements in CFP in the long run. A solid financial position can encourage CSR engagement, creating a virtuous cycle. Moreover, industry competitiveness, company reputation, and customer reputation indirectly impact the relationship between CSR and CFP [22]. By implementing CSR, companies can enhance these aspects and improve their CFP indirectly.

Some studies argued a negative relationship between CSR and CFP: Costs from CSR can reduce firms' economic efficiency and undermine the benefits of shareholder value maximization [5]; Brammer et al. conducted an empirical study using charitable giving as a measure of CSR and concluded that firms with high CSR scores tend to have lower stock returns than firms with low CSR scores [12]. Since China is an emerging economy where CSR is underdeveloped, most firms' goal is profit maximization, and only a few are willing to devote their limited resources to CSR implementation. The non-linear relationship illustrates an inverted U-shape [23]. The impact of CSR has an optimal value for management, and if a company is overly socially responsible, it will hurt CFP. When companies perform well, managers tend to spend less on CSR and increase compensation and profits linked to CFP for profitability and better management performance. Conversely, they tend to be more proactive on CFRs to attract public attention and earn a good reputation for bad business conditions.

Some researchers indicated CSR and CFP were not significantly related in their research findings. From a microeconomic perspective, the factors leading to changes in financial performance are complex, and research cannot control and assume all variables [11]. Therefore, their relationship cannot be expressed as a linear one. To prove this, they selected companies' annual turnover in the KLD database from 1991 to 1996 as an indicator of CFP. They used it as the dependent variable and R&D and capital expenditure as independent variables to investigate the lack of correlation in a regression model [24].

The findings show that the relationship between CSR and CFP is multifaceted and complex, and those uniform conclusions cannot be drawn. And factors include industry characteristics, company size, product life cycle stage, time choice, and data type [24]. Different circumstances and data may reveal other findings and vary from case to case.

4.2 Methodological literature on the relationship between CSR and CFP

The result inconsistency is due to the lack of a sound theoretical framework, a CSR evaluation framework, a research methodology, and a clear choice of variables [25]. The diversity of CSR and TFP indicators also contributes to the differentiation of results.

CSR reputation assessment, content analysis, surveys, and individual indicators are standard methods. First, the Kinder Leidenberg Domini (KLD) Index, a commonly used measure of CSR credibility and reputation, categorizes ratings into seven dimensions: corporate governance, employee relations, environmental issues, community, diversity, human rights, and products. [3]. Second, some use the content of a company's annual report as an indicator of CSR. However, annual reports and other documents published by companies lack credibility. It is impossible to know whether the content is a CSR disclosure or a positive signal to investors. In addition, the survey method is unsuitable for measuring CSR, as the results are biased due to differences in the sample selection.

Accounting methods and market indicators are often employed to measure a company's CFP [26]. The most common accounting indicators are the return on assets and return on equity [6]. However, accounting indicators can be ambiguous due to management manipulation of accounting standards and financial reporting. Tobin's Q or market share are often considered market indicators [26]. This method avoids accounting manipulation, but the market assumptions perceived by shareholders are subjective and may be inadequate to measure CFP accurately [6].

4.3 Limitations of the existing literature

A single indicator was analyzed in the previous literature, providing an incomplete quantitative representation of efficiency. Other efficiencies are not expressed in the corresponding PCPs. Many studies focus solely on CSR in developed countries, ignoring its relevance in developing countries. While Western companies have already adopted CSR at a high level, China is still in the immature stage of CSR research, and researchers have yet to propose a CSR evaluation framework there [24]. In addition, many researchers ignore the influence of the external environment and company characteristics on CFP and select companies from multiple industries and countries to study.

5 Conclusion

This paper mainly reviews the research results of historical literature on the relationship between CSR and financial performance. Firstly, it summarizes the basic meaning of stakeholder theory. At the same time, based on the stakeholder theory, this paper studies CSR and sorts out the specific definitions of CSR from different scholars from the perspectives of internal stakeholders and external stakeholders. Secondly, due to the lack of CSR research in developing countries such as China, this paper summarizes the origin, challenge, importance, and motivation of CSR development in China. It provides some references for future research on CSR in China. Finally, this paper organizes different scholars' views on the relationship between CSR and CFP. Overall, the relationship between CSR and CFP is diverse and complex because many factors influence the measurement of CSR and CFP. It further indicates that this field's research still has great value.

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