A Theoretical Framework for the Mediation Analysis on the Relationship Between Corporate Social Responsibility and Financial Performance

Esti Dwi Rinawiyanti(✉)

Study Program of Industrial Engineering, Faculty of Engineering, University of Surabaya, Surabaya, Indonesia
estidwi@staff.ubaya.ac.id

Abstract. Several studies have investigated the impact of corporate social responsibility (CSR) on financial performance (FP). However, little research has been done on how CSR affects non-financial performance and how this performance mediates the CSR-FP relationship. This study aims to develop a theoretical framework for the relationship between CSR and company performance, as well as to analyze a mediating effect on the CSR-FP relationship. Stakeholder theory is employed to emphasize the importance of incorporating the interests of key internal and external stakeholders, including employees and customers, into CSR practices. The theoretical framework describes CSR in four areas: economic, legal, ethical, and philanthropic responsibilities. The impact of CSR is measured not just in terms of FP, but also in terms of customer, employee, and operational performance. The remaining three performances are then evaluated to see if they mediate the impact of CSR on FP. Seven propositions are proposed in the framework, each of which can be tested using survey data. As a result, the framework presented in this paper can be used to assess the impact of CSR on both financial and non-financial performance, as well as to investigate the mediating effect of non-financial performance on the CSR-FP relationship.

Keywords: CSR Practices · Mediating Effect · Operational Performance · Stakeholder

1 Introduction

Business and society interdepend intensely and dynamically [1]. Corporate social responsibility (CSR) is the most used term to suggest the correlation between the two [2] for various literature and business practices [3]. CSR underlines that business has a responsibility to bear its social and environmental responsibilities beyond legislative compliance and individual liability demands [4]. Consequently, regardless of their size, sector, or location, companies pay attention to CSR [5] and have attempted to comply with legislation and seek its advantages [6].

Several studies have highlighted that companies can add value and obtain a competitive advantage through their CSR practices [7, 8]. Nonetheless, limited researches

E. H. Saragih et al. (Eds.): APMRC 2022, AEBMR 658, pp. 720–730, 2023.
https://doi.org/10.2991/978-94-6463-076-3_55

have investigated the impact of CSR on financial performance (FP) and non-financial performance simultaneously. This research gap creates two research questions as follows:

RQ1: To what extent does CSR affect company performance?
RQ3: To what extent does non-financial performance mediate the relationship between CSR and financial performance?

This study aims to establish a theoretical framework that investigates how CSR affects company performance and uncovers the mediating role of customer, employee and operational performance in the CSR-FP relationship to address those research questions.

This study contributes to the development of a CSR-performance framework by assessing CSR's impact on company performance financially and non-financially, as well as analyzing a mediating effect on the CSR-FP relationship using stakeholder theory. This study also encourages companies to incorporate CSR into their operations because it can improve their performance.

2 Theoretical Background

2.1 CSR Definition

The extensive literature provides various definitions of CSR [9]. The World Business Council for Sustainable Development declared CSR as a continuous business agreement to have ethical behavior and to benefit sustainable economic development; while at the same time enhancing the quality of life of the employees, their families, the local community as well as the wider society [10]. Then, [11] expressed CSR as the behaviors of a company that aims to positively impact social and non-social stakeholders and go beyond their economic interests. CSR is generally regarded as an approach that can make business processes more open and socially accountable [12] and can be considered as the companies' ability to be socially responsible for the development and growth of the societies where they run their businesses [13].

Consolidating the multiple views and economic and social orientations, [14, 15] defined CSR as a multidimensional concept with four dimensions as follows:

1. Economic responsibility: business has traditionally been conceptualized as an economic entity with a responsibility to produce and provide goods and services as efficiently as possible while making an acceptable profit.
2. Legal responsibility: business is expected to comply with the laws and regulations promulgated by federal, state, and local governments as the ground rules under which it must operate.
3. Ethical responsibility: ethical responsibilities embody the standards, norms, or expectations that reflect a concern for what customers, employees, shareholders, and the community regard as fair, just, or in keeping with the respect or protection of the stakeholders' moral rights.
4. Philanthropic responsibility: philanthropy is discretionary or voluntary despite societal expectations that businesses have.

Carroll's classifications address the entire range of obligations that businesses have to society [16]. These classifications have been one of the most accepted and widely used definitions of CSR in academic research [17] and are recognized as both comprehensive and integrative by numerous theorists and empirical researchers [18].

2.2 Stakeholder Theory and CSR

Stakeholders are groups and individuals who can affect, or are affected by, the achievement of a company's mission [19]. Stakeholder theory argues that companies have obligations not only to shareholders but also to stakeholders [19]. Internal stakeholders consist of the owners, managers and employees of a company who stay within the company's borders, whereas external stakeholders include the suppliers, customers, communities, and government [19].

Businesses are under great pressure from stakeholders to include social and environmental issues in their business decisions and strategy [20]. Stakeholder theory lays the groundwork for a strategic view of the issue of corporate responsibility [21]. Moreover, stakeholder theory can aid in understanding the CSR practices of companies to address stakeholder interests. Company behaviors reacting to stakeholder expectations of being a socially responsible corporate citizen in society can be demonstrated by how they identify and implement CSR activities [22].

2.3 Company Performance

A key and divisive debate in literature have long been about the relationship between CSR and company financial performance (FP). Several studies have found that CSR has positive effects on financial performance [3, 22, 23], but prior empirical research draws inconsistent conclusions [24, 25]. There are contradictory results in the extant literature about the effect of CSR on FP.

For example, [26] affirmed that companies that engage with CSR show better financial performance compared to other companies that have no commitment to CSR as measured by higher sales growth, earnings before tax, return on assets (ROA), and cash flows from operations. Reference [27] also contended that companies can achieve better profit from CSR practices if they engage in them consistently. Based on a sample of US companies in nine years, [28] comprehensively analyzed the relationship between seven areas of CSR (environment, community, corporate governance, diversity, employee relations, human rights, and product quality) and FP in terms of short-term accounting-based measures, long-term accounting-based measures, and market-based measures. The results revealed that companies that prioritize CSR activities have superior financial performance.

Conversely, using the annual reports of publicly-listed companies in the Indonesian Stock Exchange (IDX) in 2008–2010, [5] investigated that CSR has no significant effect on FP, measured by ROA.

Prior studies addressed the effect of CSR on customer performance. For example, [29] found that customers are more likely to trust responsible companies that operate honestly and reflect the interests of all parties when making decisions. In addition, customers are likely to support and reward the companies that spend most on socially responsible programs by showing the greatest loyalty. Reference [30] investigated the relationship between CSR and customer performance, particularly customer satisfaction measured through the American Customer Satisfaction Index (ACSI), which ranges from 0 to 100. Their findings claimed that CSR has a positive impact on customer satisfaction. Moreover, [31] identified the fit between consumer values and the objectives of CSR activities and corporate ethical standards as two main determinants of CSR quality and commitment. Working with collected data from 931 retail consumers in South Korea, the results revealed that a company's CSR commitment encourages greater satisfaction and trust in the company and its services, which in turn encourages consumers to remain loyal.

In addition to customers, employees are key stakeholders who directly contribute to company performance. Thus, understanding CSR's effect on employees can answer questions about whether and how CSR impacts companies [32]. Therefore, an understanding of the relationship between CSR and employee performance is crucial because the success of a company depends very much on its employees [33]. The current empirical literature provides a small but growing body of evidence demonstrating that CSR affects the perceptions of employees and prospective employees regarding companies and behavior in the workplace [32, 34].

For instance, [32] indicated that by providing individuals with opportunities to share their ideas, contribute to the community and society at large, and potentially create or at least be part of a legacy, CSR can have a similar impact. Employees can achieve greater satisfaction and enhanced emotional well-being by fulfilling their need for a meaningful existence. According to [35], employees satisfied with their company's commitment to CSR tend to be more positive, more loyal, and more productive than those who work for less committed employers. Furthermore, using data from the Indonesian manufacturing industry, [36] asserted that CSR strategic integration significantly affects employee performance.

Although very little is known about whether or how CSR affects operational efficiency, prior studies show that CSR positively impacts operational performance. For instance, [33] used Kinder, Lydenberg and Domini's (KLD) data to identify a positive relationship between CSR and operational performance, suggesting that employees in socially responsible companies generate better operational performance than their peers in less socially responsible companies. Consequently, employees work more productively in socially responsible companies in terms of sales per employee and net income per employee. Reference [37] analyzed the relationship between CSR and operational performance measured by labor productivity with a sample of 929 Spanish micro and small manufacturing companies. Their study revealed that CSR policies have a positive relationship with labor productivity. Particularly, CSR actions related to internal aspects of the company, such as a commitment to quality in internal operational processes, promotion of innovation and employee care, contribute to a short-term increase in labor productivity. Regarding CSR integration at the functional level, Cost and Quality significantly impact operational performance [38].

2.4 Mediating Effect on CSR-FP Relationship

The direct relationship between CSR and company performance could be affected by many factors [39, 40], such as mediators that help to understand this relationship and improve the reliability of results [41]. Companies explicitly emphasize responsibility, particularly economic responsibility, towards their shareholders [42]. Shareholders' needs cannot be met, and a company's financial performance cannot be maximized, unless other stakeholders, such as customers, employees, suppliers, and the general public, are satisfied [43]. Therefore, there is increasing consensus that stakeholders should be satisfied with a company's CSR implementation before any financial performance improvements can be achieved [43, 44]. By satisfying stakeholder needs, companies encourage their support, which in turn leads to better levels of performance [45].

3 Theoretical Framework

3.1 Propositions Development of Direct Effect of CSR on Company Performance

Several studies argue that CSR has positive effects on FP. For example, companies can get better profits from their CSR practices if they engage in them consistently, such as cost reductions, better profits, and superior financial performance [3, 27, 28]. Similarly, companies that engage with CSR show better financial performance than other companies that have no commitment to CSR by getting higher sales growth, earnings before tax, return on assets, and cash flows from operations [26]. The proposition for the impact of CSR on FP is as follows:

P1: CSR has a significant impact on financial performance.

CSR is a vital strategic tool, given its essential role in building customer satisfaction and loyalty [46]. Furthermore, CSR practices offer benefits to customers, such as reduced customer complaints, improvements in customer service, improvements in the relationship with customers, and increased customer loyalty [47]. Implementing appropriate CSR plans and activities contribute to higher customer satisfaction with the company [31]. The following is the proposition for CSR's impact on customer performance:

P2: CSR has a significant impact on customer performance.

Another way of measuring the effect of social responsibility strategies is by evaluating their impact on employees whether it is sincere or mere window dressing [48]. Employees satisfied with their company's commitment to society tend to be more positive, loyal, and productive than those working for less committed employers [35]. Prior studies argue that employees work more productively in socially responsible companies [33, 38]. A proposition for the impact of CSR on employee performance is as follows:

P3: CSR has a significant impact on employee performance.

Prior studies argued that if companies conduct their activities well and responsibly, they will undoubtedly impact operational performance [33, 36, 37]. Therefore, the following is a proposition for CSR's impact on operational performance:

P4: CSR has a significant impact on operational performance.

3.2 Propositions Development of Mediating Effect in CSR-FP Relationship

Several previous studies show that customer performance can mediate the relationship between CSR and FP. For example, [30] found that customer satisfaction mediates the relationship between CSR and FP. Reference [40] employed customer satisfaction as a mediator between CSR and firm performance. Their findings reveal that customer satisfaction mediates the relationship between CSR and financial performance. Moreover, [49] identified that CSR activities could help companies improve their financial performance by improving customer satisfaction. Thus, companies can improve the effect of CSR efforts on their financial performance by using the indirect role of customer satisfaction. Therefore, the mediating effect of customer performance on the CSR-FP relationship can be proposed as follows:

P5: Customer performance mediates the impact of CSR on financial performance.

Understanding the relationship between CSR and employee performance is crucial because the success of a company depends very much on its employees [33]. Reference [27] found that companies increase profits if they implement CSR strategy consistently, including related dimensions of CSR and starting with those more internal to the companies. In addition, [34] highlighted the need to understand the underlying mechanism that connects CSR activities and employee performance. The following is a proposition regarding the mediating effect of employee performance on the CSR-FP relationship:

P6: Employee performance mediates the impact of CSR on financial performance.

To comprehensively assess the mediating effect on the CSR-FP relationship, this study also investigates whether operational performance has a mediating effect on this relationship. A proposition for the mediating effect of operational performance on the CSR-FP relationship is as follows:

P7: Operational performance mediates the impact of CSR on financial performance.

Based on the theoretical background and propositions development, this study establishes the theoretical framework as illustrated in Fig. 1.

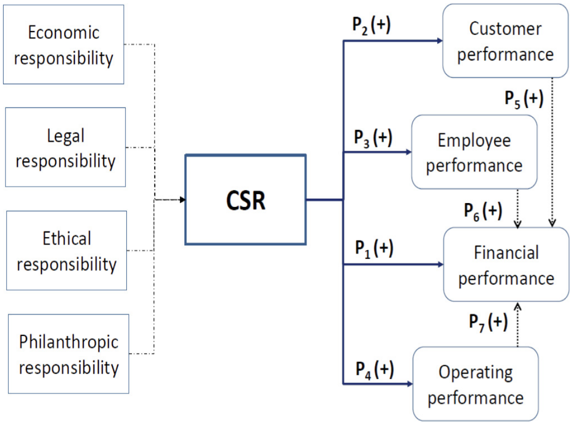

Fig. 1. A theoretical framework of CSR and company performance. Source: Author

Figure 1 shows that four propositions investigate the impact of CSR on four different company performances, while the other three look into the mediating effect of the customer, employee, and operational performance on FP.

3.3 Measurement Items

Reference [50, 51] developed an instrument to measure CSR practices based on Carroll's four dimensions [14, 15]. Their instrument has been one of the most widely used scales in CSR research [16] and adopted in several studies which examine the impact of CSR on organizational performance [11, 20, 52, 53]. Accordingly, their framework can be a reference to analyze the influence of CSR on organisational performance [54].

Measurement items are adopted from the strategic management, manufacturing and CSR literature. For instance, financial performance that reflects the economic dimension is measured by several monetary terms, such as profit, cash flow, sales growth, and return on investment [51, 54–56, 58–60, 62]. The impact of CSR integration on customer performance will be evaluated through customer complaints, customer satisfaction, customer loyalty and an increasing number of consumers [60–62]. Meanwhile, employee performance will be measured through employee training, employee motivation, career opportunities and employee turnover [56, 60, 61]. Furthermore, the impact of CSR on operational performance is assessed through customer service timeline and productivity, operational efficiency, and delivery [47, 57, 60, 62].

4 Conclusions

This study establishes the theoretical framework for evaluating CSR's impact on company performance financially and non-financially, as well as analyzing the mediating effect of non-financial performance on the CSR and FP relationship. This study presents seven propositions and provides several assessment items for assessing the relationship between items (constructs) in the framework. This study can enrich the CSR literature by incorporating financial and non-financial performance. This study also expands the CSR research by investigating how non-financial performance can mediate the impact of CSR on financial performance. In the future, a survey can be conducted to gather relevant data on CSR and company performance. The data from the survey can be used to verify the propositions. The framework can then be tested using statistical analysis, ensuring that the research questions are answered and the research objectives are accomplished.

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