Does CSR ImpactFinancial Performance Of IT Companies in India? – An Analytical Inquiry

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Abstract- **Section 135 Companies Act of 2013 mandates companies to spend a minimum of 2% of the average net profits of the company made during the three immediately preceding financial years towards corporate social responsibility. The present study covering a period of five years from 2015 to 2019, tries to investigate the impact of CSR spending on the financial performance of private-sector IT companies in India – covering both IT enabled services (ITES) and computer software companies. RoA, RoC and RoNW are used as metrics for financial performance in this study, which is then included inthe model as the dependent variable while the independent variable considered isthe CSR spending during the year. Besides CSR, other control variables such assize of the firm, leverage, R&D intensity and profitability were also included in the study. The researchers use Ordinary Least Squared (OLS) models to understand the impact of CSR and other control variables on the return metric of IT companies in India. The data for the study is taken from CMIE Prowess database. The study would be of interest to policy makers as it covers how spending in CSR is impacting the financial performance of one of the major exporting industries in India.**

Keywords: **CSR, corporate social responsibility, financial performance, IT companies**

I. INTRODUCTION

Corporate enterprises have been active agents of progress and they have been doing this through invention and innovation of new products, spread of technology, cost reduction, enhancing services and quality and thus they are providing good things of life to the people. Irrespective whether it is because of need to provide the ROI to the investors or due to the pressures of competition, this in itself is a noble cause. Traditionally companies have been looked as commercial enterprises with economic motives and profit-making objectives, their success being measured in terms of high returns on equity at individual plane and its contribution to the nation's economic growth on a collective plane (Das, 2015).

Of late, as a result of globalisation and also rising ecological issues, the responsibilities of firms have been redefined by including society and environment besides financial goals. The corporates are expected to behave ethically with relation to the workers, their families, the society and the environment and wider society (World bank, 2013). Society is an important stakeholder in a company. Article 14(2) of the German constitution states "Property imposes duties and its use should also serve the public welfare" which imposes a responsibility on the part of the companies towards the society at large.

Sustainable development, corporate responsibility, corporate citizenship, triple-bottom line, corporate ethics are some of the names by which Corporate Social Responsibility is called. CSR is no longer viewed as an optional social aid or corporate charity but as an indispensable to a business strategy. As stated by the department of Trade and Industry in the United Kingdom, CSR represent "the integrity with which a company govern itself, fulfils its mission, lives by its value, engages with its stakeholders, measures its impact and reports on its activities". CSR, is the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life, in ways that are both good for business and good for development(Blowfield, 2004). It is essentially a concept whereby companies decide voluntarily to contribute to the society to make it better and environmentally cleaner(European Commission, 2001).

II. LITERATURE REVIEW AND THEORETICAL BACKGROUND

The existing literature on Corporate Social Responsibility expenditure covered a very diversified areas, though much of it was concentrated on the positive effects and the firm characteristics that contributed to it. For example Bowen, 1953; Brown and Fraser, 2006; Drucker, 1984; Freeman, 1984; Kotler and Lee, 2005; Mintzberg, 1983; Porter and Kramer, 2006 find that the benefits of CSR far outweigh the costs and also look at it more as a necessity than looking only at the economic benefits that CSR provides. Yoon, Y., Gürhan-Canli, Z., & Schwarz, N. (2006) find that CSR activities improve a company's image when consumers attribute sincere motives to those activities and are ineffective when sincerity of motives is ambiguous and hurt the company's image when motives are perceived as insincere.

P Jiraporn, P Chintrakarn, 2013 find that CSR expenditure help resolve the conflicts among various stakeholders Jo and Harjoto (2011) find a very strong positive correlation between the CSR expenditure and firm value. Fisman, Heal and Nair (2006) find the positive effect of CSR on profits in competitive industries especially when there are not many firms undertaking such actions. Arshad, Othman and Othman (2012), Samina (2012) found a positive relationship between CSR and the financial performance in the context of Islamic banks.

We also find litereature that has a totally conflicting view on the CSR expenditure incurred by a firm. For example CSR expenditure incurred by firm have been considered an illegal waste of resources that clash with its responsibility towards its stock holders and by extension with the actual purpose of business in present societies (Friedman, 1970; Henderson,2001; Jensen, 2002; Levitt, 1958; Sundaram and Inkpen 2004). Wright and Ferris (1997) found a negative relationship between a firm's CSR expendiute and its financial performance. Marsat and Williams (2011) record strong evidence of a negative impact of responsible behaviour on corporate market value. Barnea and Rubin (2010) find that the managers and shareholders with large holding induce firms to over-invest in CSR for improving their reputations of global citizens while they bear little of the cost of doing so. Devinney (2009) argues the notion of a socially responsible corporation is potentially an oxymoron because of the naturally conflicted nature of the corporation.

There are studies that find no relationship between CSR expenses and the performance of firms. The study by Y Inoue, A Kent, S Lee (2011) in the context of sports companies do not find any positive relationship between a firm's CSR expenditure and its financial performance. Similar view was echoed by Thuhin M.H. (2014) in case of Islamic banks. Welch and Wazzan (1999), Fauzi (2009), found no relationship between CSR and financial performance.

There are a few studies that have dealt with the CSR in Indian IT companies. Dhanesh (2014) revealed strong, significant, and positive associations between CSR and organization–employee relationships. The study by Bernal-Conesa *et al* (2017) finds a singnificant contribution of a firm's CSR strategy to its performance. Bernal Conesa *et al* (2016)find a statistically strong relationship between integration of CSR and financial performance.

Variable identification from literature

One of the earliest studies in linking CSR with Company Finance Performance (CFP) was conducted by Abbott and Monsen in 1979, where the researchers attempted to understand the impact of CSR measured through developing a Social Involvement Disclosure (SID) Index based on content analysis of the company's annual reports (Abbott & Monsen, 1979). SID index covered the company's focus on education, health, environment, gender equality, community involvement etc. The study covering 450 companies, measured CFP as the investor's returns for a 10-year period 1964-74. This research found insignificant impact of SID on stock returns i.e. the amount of CSR spent neither improved the financial performance nor was detrimental to it. Ullmann (1985) conducted a systematic review of the literature available on the relationship between CSR and financial performance and concluded that the primary reason for the difference in findings between the studies was that there was no base theory which defined CSR and Financial performance. Hence studies covering different time periods, companies, industries, geographies etc. yielded varied results, making the findings inconclusive (Ullmann, 1985). Another study attempted to understand the causality of the relationship i..e whether CSR leads to better CFP or companies with higher CFP appears to spend more on CSR activities (Preston & O'bannon, 1997). In this study three ratings covering the social performance of companies, namely community and environmental responsibility, people focus and quality of products and services offered, were used as indicators of CSR activities. Financial performance indicators such as return on assets (RoA), return on equity (RoE) and return on investment (RoI) were used to measure CFP. This research concluded that there was a positive relationship not only between the CFP and CSR of one year but also that the CFP of one year influenced the CSR in the next year. Similar studies conducted in later half of the 1990s also indicated inconclusive relationship between CSR and CFP for specific industries and regions (Griffin & Mahon, 1997; Russo & Fouts, 1997). Both of these studied used similar dependent variable as the previous articles, primarily RoA. The independent variables used for the studies included along with the environmental performance, control variables such as size of the firm, capital intensity, growth rate of the firm, advertising intensity, industry concentration, industry growth rate etc. Studies specific to the chemical industry used Toxic Release Inventory (TRI) index and the Kinder, LyndenbergDomini & Co. (KLD) index as the dependent variable (Waddock & Graves, 1997).

Later studies have also used environmental compliance as a measure of CSR which was measured using the volume to penalties paid for non-compliance of environmental laws (Bhat, 1998). The financial performance in this study was measured through profit margin. Accordimg to this study firms complying with environmental laws had a higher profit margin, implying a direct relationship between CSR and CFP. Building on the model developed by Waddock & Graves, McWilliams & Siegel introduced research expenditure as another control variable impacting the financial performance (McWilliams & Siegel, 2000). Even with the addition of the R&D expenditure, no significant relationship could be established between CSR and CFP. Later studies (Moore, 2001; Ruf et.al, 2001; Simpson & Kohers, 2002; Tsoutsoura, 2004) have included growth in equity as a measure of CFP, along with RoE and RoS. These studies brought out that in the context studies, CSR had a positive impact on CFP.

From the existing literature, it is evident that CFP can be measured through accounting (RoA, RoE etc.) as well as market measures (stock return). Considering the popularity of accounting based financial performance measures in the previous studies as already stated, we have used accounting-based financial performance measures, namely, RoA, RoNW (RoE) and RoC. Amount spent on CSR, as reported in the company's annual statements, is used as the independent variable. Along with the CSR spent, we have used other control variables to denote size of the firm, leverage, R&D intensity and profitability of the firm. The variables chosen are consistent with the available literature (Waddock & Graves,1997; Simpson & Kohers, 2002; Tsoutsoura, 2004).The details of the variables used for the study is provided in the research methodology section of this paper.

Aim and objectives

In the current paper we aim to study the relationship between the expenditure made by IT companies towards Corporate Social Responsibility and their financial performance measured by the Return on Assets.

Research Question

1. Is there any relationship between an IT company's CSR spending and its financial performance?

III. RESEARCH METHODOLOGY

The data used for analysis covers the CSR and financial information of IT companies in India obtained from the CMIE Prowess database covering a period of 5 years from 2015 - 2019. Five-year averages of all the variables (financial performance, CSR and control variables) have been used for building the model. The mandatory 2% spending came into force in 2015 and hence we have taken the data right from the year of the mandation. The data was screened to identify companies with positive sales and CSR spent. A total of 2,390 entries were screened for the study.

Cross-sectional OLS models are developed for predicting the dependent variable as:

Dependent variable: RoA

= *f* (company size, age, Profitability, CSR spent, Leverage, Research intensity)

$y_i = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \ldots\ldots + e_i$

where, $y_i$represents the dependent variable, x_1 to x_{11} are the independent variables as described in Table 3, $\beta_n$measures the coefficients of the variables used for analysis and e_i is the remaining error term. Table 1 provides a summary of the variables used for the study and the expected results. The descriptive statistics is given in Table 2.

Table 1: Variables used for the study along with the expected returns

Dependent variable	1. Return on Assets (RoA) in % 2. Return on Net Worth (RoNW) in % 3. Return on Capital (RoC) in %

Independent variables

Sl. No	**Variable**	**Measure used**	**Expected Relationship**
1	Company size	Sales in Rs.million (log) Number of employees Total Capital (log)	According to the economies of scale principle, larger firms are expected to provide higher RoA. However the theory is not valid in the software industry as there is a higher level of customization and hence the returns depend on the service provided. Hence, relationship is inconclusive
2	CSR	CSR spent in Rs.million (log)	Based on the existing literature, CSR spent has inconclusive relationship with financial performance. This study intends to understand this relationship for IT companies in India
3	Leverage	Non-current liabilities/capital Non-current liabilities/net worth	Based on Miller and Modigliani proposition with taxes, the capital structure will have an impact on the RoA of a company
4	Reseach Intensity	R&D spent / Total capital	Higher R&D indicates that the company is into innovation which could lead to better margins. However, the R&D expenditure reduces the net profit available which could impact RoA
6	Profitability	Net profit margin (%) Operating profit margin (%)	Higher the profitability, higher the return on assets.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Sales (log)	2390	1.72	6.78	3.96	0.67
CSR Spent (log)	2390	-1.00	4.28	0.96	0.85
Leverage (NCL/Tcapital)	2390	0.00	0.63	0.12	0.10
Net worth (log)	2390	1.53	6.56	3.64	0.72
R&D/Capital	2390	0.00	0.44	0.01	0.02
Op Margin	2390	-5.26	0.90	0.14	0.20
Tcapital (log)	2390	-1.00	5.01	2.27	0.75
RoA	2390	-22.19	78.88	8.65	6.32

IV. RESULTS

The results of the multiple linear regression is as given in Table 5

Table 5: Regression Results

	Dependent variable: RoA		Dependent variable: RoC		Dependent variable: RoNW	
Variables	Coefficient	Sig.	Coefficient	Sig.	Coefficient	Sig.
(Constant)	16.63	0.000*	22.98	0.000*	33.87	0.000*
Sales (log)	0.10	0.788	5.20	0.000*	20.21	0.000*
CSR Spent (log)	3.58	0.000*	6.20	0.000*	5.87	0.000*
Leverage (NCL/Tcapital)	-0.17	0.000*	-0.24	0.000*	0.08	0.003*
Net worth (log)	-2.75	0.000*	-9.36	0.000*	-27.96	0.000*
R&D/Capital	0.21	0.000*	0.30	0.000*	0.55	0.000*
Op Margin	0.07	0.000*	0.08	0.000*	0.08	0.000*
Tcapital (log)	-0.50	0.015*	-0.51	0.128	1.99	0.000*
R-squared	0.237		0.219		0.264	
F-statistic (p-value)	105.7(.000*)		95.299 (.000*)		122.344 (.000*)	

*p<0.05

The results clearly indicate that there is a significant relationship between CSR Spent and all the three proxies used for return, namely RoA, RoC and RoNW. The coefficient for CSR in all the three models is a clear indication that the CSR spent has a positive impact on the return metric.

V. CONCLUSION

The above study indicates that there is a significant positive relationship between financial performance and CSR for IT companies in India. The results are in tune with previous studies mentioned in the literature review above(Waddock& Graves, 1997; Posnikoff, 1997; Simpson & Kohers, 2002; Tsoutsoura, 2004; Dam, 2006). However, it is important to understand that these studies have been carried out for specific industries, countries etc. and hence it would be inappropriate to generalize across any industry or geography. In this particular study, the researchers have analysed the relationship the impact of CSR spent on the financial performance of IT companies in India. The study establishes a positive relationship between CSR and financial performance indicators, namely RoA, RoE and RoC. This would act as a motivation for organizations operating in this segment to further the spending on CSR activities. Hence, policy makers should continue utilising CSR regulations as an effective tool as it leads to better financial and sustainable performance, in the IT sector. Further studies can focus on the impact of CSR in other industries in India and introduce policy modifications accordingly.

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