THE RELATIONSHIP BETWEEN CORPORATE SOCIAL RESPONSIBILITY REPORTING AND FINANCIAL PERFORMANCE.

A literature study on the explaining factors

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Bachelor thesis.

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Abstract: The relationship between Corporate Social Responsibility (CSR) reporting and financial performance have been subject to many empirical studies. This paper discusses the different explaining factors behind this relationship, by first providing a theoretical framework on CSR reporting, different managerial motives and the General Reporting Initiative principles. Finally this theoretical framework will be underpinned by different empirical studies examining the relationship between CSR reporting and financial performance.
Preface

After almost 4 months of hard work I can finally present my Bachelor Thesis, which is the last course I have to accomplish in order to achieve my degree Bachelor of Science in Economics & Business Economics. I have learned a lot in the last 3 years at the Erasmus University Rotterdam. And I am hoping to be able to continue with my enthusiasm in a following master study at the Erasmus School of Economics. In this preface I would like to express my special gratitude to my supervisor Dr. S.M. Hoozée. The feedback she came up with was very helpful to successfully complete my Bachelor Thesis.
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1. Introduction

In 2008, the KPMG International Survey recognized a significant increase of sustainability reporting in the world economies. The data indicates that nearly 95% of the largest 250 companies from 22 countries were issuing stand-alone sustainability reports (KPMG, 2011). Especially in the last decade, corporate sustainability reporting is on the rise and thousands of medium and large-size companies worldwide are now producing sustainability reports. Investors at Wall Street are beginning to see a correlation between sustainability and financial performance. According to a new research on S&P 500 companies from the Governance & Accountability institute (G&A Institute), a majority of companies is now publishing sustainability reports. Where in 2011 19% of the S&P 500 companies were reporting on sustainability, in 2012 this more than doubled to 57% (Clark et al., 2012). This trend is a consequence of the increasing information gap in the past 20 years between organizations on the one hand and shareholders, investors, and other stakeholders on the other hand. Although organizations are mostly not required to disclose corporate sustainability information, organizations nowadays are supposed to be more open in their reporting. And supposed to disclose more information on economic forecasts, the consequences of their business activities and social/environment issues and activities.

Though issuing a sustainability report in accordance with the GRI framework or another standard, organizations obtain financial and social advantages that make it more than worth its costs (Ernst & Young LLP, 2013). In this thesis I am examining the relationship between corporate social responsibility (CSR) reporting and the financial performance of companies in different countries. Are there indeed certain performance effects and how can these effects be explained. Due to the wide interest of CSR reporting among companies world wide, CSR reporting is becoming gradually a core business practice for companies. The recovering of a major financial crisis and today’s challenging business environment requires organizations to focus more on stakeholders, especially the shareholders the cornerstones of the organization. Therefore companies have to be more transparently, accountable and responsible in their corporate behaviour to obtain a sustainable business and development.

By examining the relationship between the financial effectiveness of corporations and CSR reporting by current literature and empirical studies I tend to provide an explanatory study on the explaining factors of this relationship. For this research I have used several empirical studies,
providing mainly evidence for a positive relationship between voluntary CSR reporting and the financial performance.

In order to conduct this research I have stated the following main research question:

**How can the Corporate Social Responsibility reporting – Financial performance relationship be explained?**

In order to answer the main question I will be answering the following sub-questions in this thesis:

1. What is Corporate Social Responsibility (CSR)?
2. What is CSR reporting?
3. Which Theories can explain CSR?
4. Which reporting motives do managers have for voluntary disclosure?
5. What is the Global Reporting Initiative (GRI) reporting framework?
6. How can CSR reporting quality and financial performance be measured?
7. What are the results of prior research on CSR reporting and the financial performance of corporations?

The thesis is structured as follows. In the next chapter I provide a literature review on CSR in general and I discuss the aspect of voluntary disclosure. In Chapter three I analyse the GRI reporting framework, the most widely accepted global approach for sustainability reporting. Chapter four discusses several empirical studies and provides empirical evidence of prior research on CSR reporting and the financial performance. Furthermore I will give an interpretation of the results and discuss some limitations and critical notes. In chapter five I will present my conclusion by answering the main research question, discussing the limitations of this study and suggestions for future research.
2. Theoretical framework

2.1 Introduction.

In this chapter I will provide a literature review on the main topic Corporate Social Responsibility (CSR). By discussing Corporate Social Responsibility in the context of corporate financial performance effects, I provide a theoretical framework for the analysis of several papers in chapter 4.

2.2 What is Corporate Social Responsibility?

The term Corporate Social Responsibility (CSR) is a derived term from another well known traditional term in the accounting literature: corporate sustainability. We will formulate CSR later on this chapter, first we will take a broader look on the concept corporate sustainability.

The concept of sustainability dates back to 1970 when The Club of Rome reports the *Limits of Growth*. This report was probably the cornerstone that put sustainable development in the spotlight (Yang, 2002). It examined five factors that limit global growth: population, agriculture production, national resources, industrial production and pollution (Meadows et al., 1972). Officially, the term sustainability was founded in 1987 by activists John Elkington and Julia Hailes, the same year the World commission on Environment and Development came with the core idea of sustainability development in the publish *Our common future*. This report is also know as the Brundtland report and included the “classical definition” of sustainability development:

“*Development which meets the needs of the present without compromising the ability of future generations to meet their own needs*” (WCED, 1987).

Due to wide acceptance of the report by the United Nations General Assembly, the term gains political attention. And in 1992 the United Nations Conference on Environment and Development in Rio de Janeiro sets out the principles of sustainable development (Drexhage and Murphy, 2010). Since this general definition of the term sustainability development, the term has been subject to various interpretations. From value changing (Clark 1989) and social reorganization (Gore 1992) to a transformation process toward a desired future or better world (Viederman 1994) (Yang, 2002).

During the lately 90’s and middle 21st century, sustainability development has gained serious interest from the corporate sector. Risk managers became aware of the fact that creating
sustainable value for the company and the integration of environmental, social and governance issues were two main pillars of economic development and maybe more important, sustaining economic development. This changing mind set was followed by different revised definitions of corporate social responsibility:

- From “meeting the needs of a firm’s direct and indirect stakeholders, such as shareholders, employees, clients, pressure groups, communities, without compromising its ability to meet the needs of future stakeholders as well”. (Dyllick and Hockerts, 2002)
- To “The continuing commitment by business to behave ethically and contribute to economic development while improving the quality of the workforce and their families, as well as of the local community and society at large” (Holm and Watts, 2000) – defined by The World Business Council for sustainable development.

However, given the focus on listed companies in our paper, we will adopt another definition of CSR, given by the Dow Jones Sustainability Index (DJSI). The definition is focused more on the stakeholders and so on, more applicable for our analysis. The definition of CSu we will adopt in this thesis:

“Corporate Social responsibility is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments.” (Zink, 2008)

2.3 Corporate Sustainability Versus Corporate Social Responsibility.

Corporate sustainability (CSu) and Corporate social responsibility (CSR) are interrelated concepts and are both applicable in organizations that consider the social and environmental consequences of their business activities. As we have seen before CSR is an evolution from the more traditional concept corporate sustainability, but there are some important differences between these two concepts. Starting with a widely accepted definition of corporate sustainability I tried to map out these differences. Michael Hopkins (2003) defined CSU once as “meeting society’s expectations that companies add social, environmental and economic value from their operations, products and services.”

Comment that has to be made with the definition of CSu in previous stages, it was not aimed at promoting economic development but rather to actions that appear to further some social good, beyond the interest of the firm (McWilliams and Siegel, 2001). Long time, organizations were
truly convinced of the idea that how more CSR disclosure in their financial reporting the better. During the last years they became aware of the fact that only stand alone sustainability disclosures isn’t working out and the CSu strategies have to be implemented in the business strategies of the company to obtain sustainable value. This changing mind set was followed by a new concept of corporate sustainability in focussing more on the social and environmental responsibilities of an organization, which if good implemented, will lead to the organization being sustained.

Figure 1. Social, environmental, economic performance and disclosure (Gray, 2006).

According to Gray (2006), CSu has become one of the most sophisticated definitions and consists almost entirely of the company doing nothing particular about the planet or society beyond what might be thought of as best business practice. In his study ‘Does sustainability reporting improve corporate behaviour?: Wrong question? Right time?’ he seeks to investigate in detail what is meant by ‘sustainability’ and to what extent social and environmental disclosures can be said to be related to the social and/or financial performance of organisations.

Figure 1 represents, according to Grey (2006), an overview of the relationships between financial performance, social and environmental performance and social and environmental disclosures interrelated with CSR. By focussing more on both economic and social concerns and actual implication of sustainability strategies, CSR moved away from the purely environmental issues (Hopkins, 2003). Secondly, if we compare the definitions of CSR and CSu we see that CSu has not been applied in companies and is entirely unattractive to shareholders because it might be a cessation of dividends (Gray, 2006). CSR is focused more on the ethically behaviour, economic consequences and responsibilities of the organization with respect to their shareholders.

2.4 Corporate Social Responsibility Reporting

In accordance of our definition of CSR earlier this paper and the focus on stakeholders I will adopt a similar definition for CSR reporting: ‘Sustainability reporting is the practice of measuring, disclosing and being accountable to internal and external stakeholders for
organizational performance towards the goal of sustainable development’. CSR reporting is a broad term and considered to be made up of three elements: economic, environmental and social. These three elements are linked to one another and have a long-term view. For example, although an organization can take certain actions that have positive economic pay off in the short run but negative affects on the social environment of the organization the action should not be undertaken.

Corporate Social Responsibility reporting covers the information of situations in the example above. It involves the provision of information by a company to its stakeholders so that they can evaluate the performance of the company to determine whether or not the company’s operations are sustainable (Chiong, 2010). More on this topic in chapter 3: Corporate Social Responsibility Reporting and the Global Reporting Initiative.

Figure 2. The three pillars of sustainability by the United Nations General Assembly (2005).

2.5 Corporate Social Responsibility Disclosure.

Corporate Social Responsibility Reporting distinguishes two types of disclosure: mandatory disclosure and voluntary disclosure. To give a good explanation of both types I will first briefly provide a definition of disclosure and the two types of disclosure. Secondly I will provide different perspectives for CSR disclosure.

Corporate Disclosure according to Madhani (2008) was defined as “to communicate information about firm’s performance and value to public, outside investors and other stakeholders”. During the years many have argued that the lack of transparency and accountability of financial reporting statements of organizations increased the financial weakness and the financial crisis. Nowadays organizations are asked to be more open in their reporting, not only on financial numbers, they have to disclose information on social, ethical and environment issues as well. The reason, in the eyes of Mr. Madhani, for this new issue is that full disclosure and transparency in financial information improves the efficiency of capital allocation and helps to perform a business sustainable and maximizes the shareholder value.

Mandatory disclosure is ruled at the national or regional level through professional organizations or government authorities and is being practiced by all the firms within that particular level. It refers to aspects and information firms must publish due to statutory laws and regulations. We see this in the definition by Adina and Ion (2008), “mandatory disclosure refers to those aspects and information which must be published as a consequence of the existence of some legal or statutory stipulations, capital markets, stock-exchanges commissions or accounting authorities regulations”.

Voluntary disclosure on the other hand is not ruled/regulated and refers to additional information disclosed beyond the mandatory information. It’s the organization’s free choice whether to or not to disclose additional financial information like management forecasts, earnings forecasts and other corporate reports on long-term strategies and performance. Various comparable definitions of voluntary disclosure have come along in the literature:

- Yuen and Liu (2009): define voluntary disclosure as: “the free choices on the part of managers to provide information to users of the annual reports to satisfy their needs”.
- Financial Accounting Standard Board (FASB, 2000): defined voluntary disclosures as: “information primarily outside the financial statements, that are not explicitly required by GAAP or an SEC rule”.

Although the different definitions, they both imply a certain freedom of what to disclose. Overall, we can say that voluntary disclosure fills the gap in the need of information by stakeholders that isn’t fulfilled by the mandatory disclosure. In other words, voluntary disclosure comes to complete the mandatory reporting process that often seems to be inadequate for satisfying user’s needs (Adina and Ion, 2008).

2.6 Which theories can explain Corporate Social Responsibility?

In this paragraph I will seek to find different theories explaining Corporate Social Responsibility reporting in relation with voluntary disclosure. Prior to this research I make a distinction between positive accounting theory and normative accounting theory. According to Deegan and Unerman (2011), normative accounting theory is a theory to prescribe how an accounting particular practice should be undertaken. For example it can explain what measurement bases should be used or what kind of additional disclosures should be made in an annual report. It is based on logical argument and what the researchers believes should occur in particular circumstances.
Because normative theories are not based on observations, it has been criticized for the lack of empirical background.

In contrast to normative accounting theory, positive accounting theory is based on logical deduction (empirical observations). Starting with assumption, and through logical deduction (using real data) make a prediction. It is a theory that seeks to explain and predict particular phenomena. For example, why do managers want to report earnings, higher than investors’ expectations? It focuses on the relationships between various individuals involved in providing resources to an organization and how accounting is used to assist in the functioning of these relationships (Deegan and Unerman, 2011).

Many theoretical perspectives and theories are derived from the political economy theory and grounded within the positive accounting theory which we discussed earlier this paragraph. The political economy theory is defined as ‘the social, political and economic framework within which human life takes place’ (Gray et al., 1996). Theories derived from this broader political economy theory are the legitimacy theory and the stakeholder theory. These theories we will discuss later this paragraph, first of all the perspective embraced is that society, politics and economics are inseparable. And economic issues cannot meaningfully be investigated in the absence of considerations about the political, social and institutional framework in which the economic activity takes place (Deegan and Unerman, 2011). Political economic theory has been divided into branches and labeled according to Gray (1996) as ‘classical’ and ‘bourgeois’ political economy. The classical stream is related to the work of philosophers such as Karl Marx. The bourgeois political economy theory ignores these philosophical aspects and, as a result, is content to perceive the world as essentially pluralistic.

**Signaling theory**

The signaling theory asserts that the most profitable companies signal their competitive strength by communicating more and better information to the market than their competitors who are less profitable (Bini et al., 2011). This theory was founded at the beginning of the 1970 and original founded for the labor market. But according to Morris (1987), signaling is a general phenomenon and therefore applicable in any market with information asymmetry. It is used for describing behavior when two parties (individuals or organizations) have access to different information (Connelly et al., 2011).
Legitimacy theory

The legitimacy theory states that organizations continually seek to ensure that they are operating within the bounds and norms of their respective societies. That is, in other words, they attempt to ensure that their activities are perceived by outside parties as being ‘legitimate’ (Deegan and Unerman, 2011). According to Deegan (2002), entities assumed to be influenced by, and in turn to have influence upon, the society in which it operates. Society, politics and economics are inseparable and economic issues cannot meaningfully be investigated in the absence of considerations about the political, social and institutional framework in which the economic activity takes place (Deegan, 2002). However, during the years the bounds and norms of this framework can change and thereby organizations need to be responsive to the ethical environment in which they operate. It is a relative concept within a socially system of norms, values, beliefs and definition within a specific time and place (Deegan and Unerman, 2011). In the last decades, legitimacy theory has been subject to numerous empirical studies. One of the more recent studies is that by Haji and Ghazali (2011). They examined whether the 2007/08 financial crisis had impact on corporate voluntary disclosure of 85 Malaysian companies listed on Bursa Malaysia. The study showed, in line with legitimacy theory, that the sample companies significantly increased their corporate voluntary disclosure in the annual reports following the global financial crisis. And increased their involvement in corporate sustainability programs to reduce the possibility of a ‘legitimacy’ gap.

Stakeholder theory

Where legitimacy theory discusses the expectations of society in general. Stakeholder theory provides a more refined resolution by referring to particular stakeholder groups, focusing on how an organization interacts with these particular stakeholders (Deegan and Unerman, 2011). Stakeholder theory has both an ethical aspect and a positive (managerial) aspect. The ethical or moral branch states that all stakeholders have the right to be treated fairly by an organization and that issues of stakeholder power are not directly relevant. All the stakeholders have the same intrinsic rights and these rights should not be violated. This in contrast to the managerial branch of the stakeholder theory, where the attention of corporate management is more aimed at particular (typically powerful) stakeholders. The stakeholders are identified by the organization of concern, by reference to the extent to which the organization believes interplay with each group needs to be managed in order to further the interest of the organization (Gray et al., 1996). Empirical research on trade organizations, operating within a developing country, showed that disclosure policies of senior executives were indeed influenced by the demands and expectations
of their most powerful stakeholders (Islam and Deegan, 2008). Due to bad employee conditions and use of child labor, factories of multinational companies like Nike and H&M were subject of negative media attention for a timely period. Only when the western consumers started to boycott the products of the multinationals, they came in action and started to fit with global requirements on working condition and the use of child labor.

**Institutional theory**

The institutional theory provides a powerful complementary perspective within organizational analysis to both stakeholder theory and legitimacy theory. It considers the forms that organizations take, and provides explanations for why organizations within a particular ‘organization field’ tend to take on similar characteristics and form (Deegan and Unerman, 2011). Drawing on Scott’s institutional approach (1995) by Bebbington et al. (2009), three pillars of institutional structure can be differentiated in terms of how institutions influence organizations. The cognitive pillar of institutions emphasizes activities enacted in relatively taken-for-granted ways. It reflects systems that have been shared among individuals and are seen as “normal” in various circumstances. The normative pillar values what is socially acceptable/desirable to pursue and norms ways of acting and being (Bebbington et al., 2009). It relies on values, beliefs, social norms and assumptions that are socially shared and carried out by individuals to influence organizational and individual actions by normative processes (Trevino et al., 2008). The regulative pillar of institutions influences behaviour because of the potential for reward or threat of punishment. According to Scott’s institutional approach it can be characterize as “existing laws and rules in a particular environment that promote certain types of behaviors and restrict others” (Trevino et al., 2008).

Where the legitimacy theory discusses how particular disclosure strategies might be undertaken to maintain legitimacy. Institutional theory seeks to explain how organizations understand and respond to changing social and institutional pressures and expectations. Among other factors, it links organizational practices (such as accounting and corporate reporting) to the values of the society in which an organization operates. And to a need to maintain organizational legitimacy (Deegan and Unerman, 2011).
Approach for this paper

For this paper I will use the positive accounting theory and rely on the stakeholder theory. Although the signaling theory provides a clear statement on good performing firm’s making relatively high-quality disclosures and less good performing firm’s making low-quality disclosures, regarding their future risk exposure for example. The stakeholder theory is for this research more applicable given the focus on disclosing, being accountable to internal and external stakeholders including transparent communication about firm’s financial performance to investors and other stakeholders within the definition of CSR (reporting). The figure below supports my approach. The table shows the results of a survey on different reporting motivations for organizations by The Boston College Center for Corporate Citizenship and Ernst & Young. They found that transparency with stakeholders was a key motivation for organizations to voluntary disclose on CSR (Ernst & Young LLP et al., 2013).

![Figure 3. What motivates organizations to report (Ernst & Young LLP et al., 2013).](image)

2.7 Motives and limitations of voluntary disclosure?

As we have seen in paragraph 2.4 we have two different types of disclosure. On the one hand we have mandatory disclosure, ruled by professional organizations and governmental institutions, and on the other hand we have voluntary disclosure. In this paragraph we will take a look upon different corporate motives for voluntary disclosure and their benefits.

Healy and Palepu (2001) discussed managerial motives for disclosing additional information on the basis of different economic hypotheses:
- **Capital markets transactions hypothesis:** in situations of capital market transactions where corporate managers are held accountable for the cost of capital and dealing with a certain information asymmetry. Managers have an incentive to provide voluntary disclosure to reduce the information asymmetry problem and thereby reducing the firm’s cost of capital (Healy and Palepu, 2001).

- **Corporate control contest hypothesis:** since managers of listed company’s mostly held accountable for current stock performance and CEO salary is associated with this stock path. Corporate managers have to keep a close watch on it. The corporate control contest hypothesis states that the risk of job loss, accompanying poor stock and earnings performance stimulates the use of corporate disclosures to reduce the likelihood of undervaluation (Healy and Palepu, 2001).

- **Stock compensation hypothesis:** using compensation packages like stock based performance pay, managers are directly rewarded on the basis of the stock price level. These types of compensation schemes provide incentives for managers to engage in voluntary disclosure due to insider trading rules. And reducing the contracting costs associated with stock compensation for new employees (Healy and Palepu, 2001).

Appendix I mentions a list of different drivers of corporate voluntary disclosure from different perspectives (Boesso and Kumar, 2006). For each group I picked out the most interesting perspectives:

1. **Investors:** stock performance, shareholder and investors return (dividends, trends, EPS, stock and debt ratings).

2. **Employees:** wages, contracts and benefits other than stock options (and pensions for US) (average amount by category).

3. **Customers:** main customers, customer satisfaction, retention and loyalty (indices, surveys, complains, defects, warranty claims, repeat sales).

4. **Suppliers:** main suppliers, supplier satisfaction, operational data, firm specific investments (value, percentage) and cost accounting for suppliers (cost savings and indices).

5. **Social and Environmental:** description of social, ethic and environmental activities and projects, donations and other social expenses, environmental performance and social impact (awards, consumption rate, toxic emission).

6. **Internal processes:** product capacity, synergies, manufacturing cycle time, productivity (hours, days, delivery and waiting time).
7. Innovation and Learning: new products, patents, R&D projects and expenditure, segments strategy and time to market of new products and strategy (days, months, costs).

Now we know several motives and benefits to disclose additional positive information we take a look on corporate disclosure benefits and the limits of voluntary disclosure. According to Chang (2002), voluntary disclosure of good news generally increases the net value of firms. And as we have seen earlier this paragraph, it reduces; the cost of capital, the likelihood of undervaluation and the contracting costs associated with stock for new employees. On the other hand according to Chang (2002), bad news forecast have negative average excess return. So why would companies choose to voluntary disclose negative information as well?

Prior research by Skinner (1994) showed that managers have incentives to preempt the announcement of large negative earning surprises to prevent large stock price declines on earnings announcement dates. If investors will surely become informed about the bad news, managers could be better off voluntarily disclosing the bad news early, than waiting till the earnings announcement date (Chang, 2002). It goes without saying that when a company comes with positive earnings forecasts, it will have a positive effect on the stock price. If it comes with negative (or less positively) earnings forecast it is the other way around and it will have a negative effect on the stock price. At the end, the company and its managers have to find a certain balance in the benefits and cost of whether to disclose or not to disclose negative information. This means that managers are often forced to choose between maximizing the competitive advantage of the firm’s market by not publishing information, which would affect the competitive position. Or to publish that information in order to help the capital market to achieve an efficient evaluation of the company’s shares (Adina and Ion, 2008).

2.8 Conclusion.

In this chapter I discussed the main topic of this paper, CSR and CSR reporting. CSR reporting is a broad term and considered to be made up of three elements: economic, environmental and social. I described different theories explaining voluntary CSR reporting: signalling theory, legitimacy theory, stakeholder theory and the institutional theory. At the end of this last paragraph I motivated why the positive accounting theory and the stakeholder theory is applicable for this research In the last paragraph I discussed three managerial motives for CSR reporting: capital market transactions, corporate control contest and stock compensation.

3.1 Introduction.

In this chapter I will discuss sustainability reporting in a broader perspective of the Global Reporting Initiative (GRI). Although the wide integration of the GRI framework in sustainability reporting among corporations worldwide, another sustainability reporting framework AA1000 is worth mentioning given the focus on the Stakeholder theory. The AA1000 Stakeholder Engagement Standard (AA1000SES) is a principle-based, opens-source framework for quality stakeholder engagement. According to AccountAbility, engaging with the individuals, groups of individuals or organisations that are affected by or can affect an organisation’s activities and responding to their concerns makes organisations perform better.\(^2\) This framework can be used as a standalone standard, or as mechanism to achieve stakeholder requirements of other standards including the GRI G4. Given the wide integration of the GRI framework worldwide, I will primarily focus on the GRI framework and their different principles for defining the report content and quality. I will also discuss the different features and key enhancements of the fourth generation Sustainability Reporting Guidelines G4.

3.2 What is the Global Reporting Initiative?

The Global Reporting Initiative (GRI) is a non-profit organization that works towards a sustainable global economy providing sustainability reporting guidance. GRI was founded in 1997 by the Coalition for Environmentally Responsible Economies (CERES). With their first mission of ‘developing globally applicable guidelines for reporting on economic, environmental and social performance’ they provide a long term, multi-stakeholder, non-mandatory and internationally reporting framework.\(^3\) The GRI provides according to Gordon (2004):

- A comprehensive introduction and approach to sustainability reporting
- Sector specific guidelines for both private and public entities
- Protocols for specific performance indicators
- A basis for credibility of reporting that is needed by exporters and companies with overseas shareholders

\(^2\) [http://www.accountability.org/images/content/5/4/542/AA1000SES%20202010%20PRINT.pdf](http://www.accountability.org/images/content/5/4/542/AA1000SES%20202010%20PRINT.pdf)

\(^3\) [https://www.globalreporting.org/information/about-gri/what-is-GRI/Pages/default.aspx](https://www.globalreporting.org/information/about-gri/what-is-GRI/Pages/default.aspx)
• An opportunity to report corporate performance in the context of important national and regional issues.

The foundation of the GRI framework is the sustainability reporting standards. These standards can be used to demonstrate organizational commitment to sustainable development, to compare organizational performance over time, and to measure organizational performance with respect to laws, norms, standards and voluntary initiatives. By reporting transparently and with accountability, organizations can increase the trust that stakeholders have in them and the global economy and reduce the information gap.

**Vision**

A sustainable global economy where organizations manage their economic, environmental, social and governance performance and impacts responsibly and report transparently.

**Mission**

To make sustainable reporting standard practice by providing guidance and support to organizations.  

The vision of GRI distinguishes three dimensions used in the evaluation of sustainability reports: the economic, governance, social, ethical and environmental dimension (officially there are five dimensions: economic, governance, social and ethical known as the EGSEE). The different subgroups of the three dimensions mentioned in the vision of GRI are presented in appendix IV (Quick, 2008). Among these three dimensions, GRI have developed the G4 guidelines for defining report content and ensuring the quality of reported information. These guidelines, consisting of a wide range of reporting principles for report content and report quality, will be discussed further in the next paragraph.

### 3.3 The GRI Guidelines

Wednesday, 22 may 2013, GRI has launched is fourth generation of Sustainability Reporting Guidelines G4. This next generation of the GRI reporting guidelines should address requirements for sustainability data, and enable reporters to provide relevant information to various stakeholder groups. It should also improve on content in the current guidelines G3 and G3.1. (*Later on this chapter I will discuss the improvements that GRI has made from G3.1 to G4.*)

4 https://www.globalreporting.org/information/about-gri/Pages/default.aspx
The GRI guidelines consist of principles for defining report content, which should be applied when preparing a sustainability report, and ensuring the quality of reported information. It includes standard disclosures made up of performance indicators and other disclosure items, as well as guidance on specific technical topics in reporting. These principles are fundamental manual to achieve transparency and accountability and therefore should be applied by all organizations when preparing a sustainability report. The table in appendix II (CGAAC, 2005) shows seven approaches for improving the credibility of sustainability reports. In the next two paragraphs I will discuss the 7th and last approach of this table: the principles of the GRI guidelines that are used for defining report content and quality of GRI sustainability reports.

3.3. Reporting principles for defining report content

Stakeholder inclusiveness
The reasonable expectation that stakeholders belong to the main interest group of the sustainability report makes them the key reference point for many decisions in the preparation of the report. Therefore it is important that organizations identify its stakeholders and tries to explain how it has responded to their reasonable expectations and interest.

Materiality
The sustainability report should cover the most relevant topics reflecting the organizations significant economic, environmental and social impacts. Due to the wide range of topics organizations have to make a weighted selection. Relevant topics
Due to the wide range of topics on which organizations can report, a selection of the most relevant topics is very important. Relevant topics are topics that substantively influence the decision of stakeholders and therefore important enough to report.

Completeness
The report should give a clear, appropriate and fair view about the relevant topics. It has to be sufficient to reflect significant economic, environmental and social impacts. And enabling stakeholders to evaluate the organization’s performance in the reporting period.

Sustainability Context.

The report should not only reflect organization’s performance on sustainability at firm level but on a wider concept of sustainable development. This involves discussing the performance of the organization in the context of the limits and demands placed on environmental or social resources at the sector, local, regional, or global level.  

3.4. Reporting principles for defining report quality

Balance

The report’s content should provide a fair presentation and unbiased picture of the organization’s overall performance. Therefore it should reflect positive and negative aspects to avoid undesirable decisions by the report reader.

Clarity

The report should provide a clear view of the reported information in a way that is usable and accessible by the organization’s range of stakeholders. For example, avoiding unnecessary details and publishing the report in different languages.

Reliability

As well as the report should provide a fair view about organization’s overall performance. The information and process used in the establishment of the report therefore should be fair and reliable as well. The organization should collect, analyze and disclose information in a way that they can be subject to examination to obtain the desired quality and reliability of the information.

Accuracy

The information in the report needs to be accurate and detailed in such a way that stakeholders can easily evaluate the organization’s performance. For example, describing the data measurement techniques used for calculations, disclosure of underlying assumptions and the validation of qualitative statements.

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Comparability

The topics and information selected for the report should enable stakeholders to compare and analyze changes in the organization performance over time and to other organizations. Consistent reporting allows parties from inside and outside the organization to benchmark performance as part of other activities like investment decisions.

Timeliness

The sustainability reports should be published in time on a regular basis. The usefulness of the information in decision-making situations for stakeholders depends closely on the timing of publishing. Consistency in the frequency of reporting and the length of reporting periods is also necessary to ensure comparability of information over time and accessibility. For example, the disclosure of recent news relating to the relative reporting period and the aligning of new reporting information with the reporting schedule.  

3.5 Features and key enhancements of the G4 reporting guidelines

With the launch of the fourth generation of Sustainability Reporting Guidelines G4, GRI moves from the experimental and development phase to a more mainstream set of guidelines. The GRI improved the new guidelines in terms of focus, simplicity, clarity and better support to small business and beginner reporters. Primary objectives for the G4 were more user friendly guidance, improved technical quality of the content, alignment with relevant international frameworks, improved guidance for identifying material content and guidance on how to link the sustainability reporting process to integrated reporting. 

Big similarity with the prior guidelines is the principle-based approach as we discussed in the paragraphs 3.3 and 3.4. Big change is the replacement of the application levels by a two tier ‘In accordance’ system with different levels of required elements:
- ‘In accordance – Core’. The essential elements for a report, the baseline.
- ‘In accordance – Comprehensive. Additional standard disclosures on strategy, governance and ethics.

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8 https://www.globalreporting.org/reporting/g4/Pages/default.aspx
Focussing on clarity and materiality, the new G4 guidelines considers not only reporting on the core activities but also on their impacts throughout the entire value chain. It helps companies to understand the better picture of sustainability performance across all their activities. By conducting a value-chain management approach to understand where the biggest impacts of their business occur. Organizations will understand the biggest impacts of their value chain for possibly implementing this into their corporate strategy. Therewith, the GRI makes a stepping stone to offer guidance on integrated reporting, linking the sustainability reporting process to the financial reporting process.

3.6 Conclusion

In this chapter I discussed the GRI guidelines and the different principles for defining report content and quality. The guidelines address requirements for sustainability reporting and include standard disclosures made up of performance indicators and other disclosure items. Furthermore I have seen that the GRI is moving to a more mainstream set of guidelines, providing guidance on how to link the sustainability reporting to integrated reporting. This is according to Eccles et al. (2010), the combination of a company’s key financial and non-financial information into one single document. It means reporting on financial and non-financial information in a way that reveals their impact on each other.

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9 [https://www.globalreporting.org/resourcelibrary/G4-Exposure-Draft.pdf](https://www.globalreporting.org/resourcelibrary/G4-Exposure-Draft.pdf)
4. Empirical Results on CSR reporting - Financial Performance

4.1 Introduction

In this chapter I present different empirical studies examining to what extent corporate social responsibility reporting is affecting the financial performance. I present different measurements for CSR reporting quality and financial performance. In the fourth and fifth paragraph I will discuss and interpret the result of different studies on the relationship between CSR reporting and the financial performance.

4.2 Measuring CSR reporting quality.

In the last decades, CSR reporting and measuring CSR reporting quality has been subject to various empirical studies and therefore different methods have been developed for measuring CSR reporting quality. Because the different mediums such as company websites, conferences and stand-alone reports, each organization has found his own way of publishing their sustainability reports. In general, according to (Bachoo et al., 2013) we can identify two different types of measuring CSR reporting quality: measures that quantify the level of disclosure in the annual report (e.g. number of pages or words) and measures that assign a particular score to qualitative factors such as the existence of environmental policy, achievement of environmental goals and others. For example (Bachoo et al., 2013):

- Details of the firm’s main impacts/issues in all key areas such as energy, emissions and waste
- Quantitative data (including year-to-year data) such as graphs or tables in all key areas
- Measures of performance against targets in all key areas

More detailed measures, quantifying the level of disclosure, are presented in appendix III (Morhardt et al., 2002). Differentiated in 4 indices known as the community, diversity, ethical and environmental index. Another sustainability index is the KLD index launched by the FTSE group. This index allows investors to identify and invest in companies that are committed to long-term environmental, social and governance (ESG) sustainability. The ESG-ranked companies are identified by continental sectors to create a range of regional sustainability indices, useful to control for regional differences.

10 http://www.ftse.com/japanese/Indices/FTSE_KLD_Index_Series/index.jsp
A more well known index for measuring CSR reporting quality, based on the widely accepted guidelines by the Global Reporting Initiative (GRI) discussed in Chapter 3 of this paper, is the multi-level disclosure index by Clarkson et al. (2008). With the aim on measuring the extent of a firm’s disclosure in their sustainability reporting, he developed a scoring model containing 95 line items that reflect the main principles of the GRI guidelines.

Critical note that should be taken into account when analysing papers examining the influence of CSR reporting on financial performance is the difference between CSR reporting quality defined in chapter two. And the CSR reporting quality measured by rating agencies like the KLD and the multi-level disclosure index by Clarkson et al. Although sustainability indices are all aimed at measuring CSR quality. They rely somehow on different sustainability principles measuring CSR quality in different ways that can cause a biased view of the actual effect. Otherwise there would not have been different sustainability indices.

4.3 Measurement of financial performance

In this paper I provide a literature research on the relation between CSR reporting and the financial performance of listed corporations. When measuring financial performance I can think of many different ways: profit, return on assets, cash flows, cost of capital, balance sheet strength and debt-to-capital ratio. In this paragraph I will primarily focus on the cost of capital, the return on assets and profit.

The cost of capital is a term often used in the world of financial investments and represents the firm’s cost of both equity and debt. From an investors/shareholders point of view, the cost of capital represents the required return on a portfolio of company’s issued shares. According to Modigliani and Miller the cost of capital is the weighted average of the firm’s equity and debt cost of capital, better know as the firm’s weighted average cost of capital (WACC) (Berk & DeMarzo, 2011). It represents the discount rate used by investors when converting the expected future cash flows from an investment in a firm’s stock. Factors that affect the rate at which investors discount each dollar of future profits are the risk-free rate of interest, the perceived risk attaching to the firm’s expected profits and the investors risk tolerance (Bachoo, 2013). Where the cost of capital is primarily focused on the cost side, the return on assets (ROA) percentage is focused on the revenue side. It shows the profitability of a company’s assets in terms of generating revenue relative to its total assets (Berk & DeMarzo, 2011).
For this research I expect a negative relation between the cost of capital and the quality of CSR reporting. According to Clarkson et al. (2010) qualitative voluntary sustainability disclosures will reduce the information gap between the stakeholders and financial market and the firm. A higher availability of firm specific information allows shareholders and other investors for better assessing their investment. This will reduce the credit risk, and therefore will lower the cost of equity capital because shareholders will require a lower return on investment. Same story for the cost of debt capital, by reducing the information gap between the financial market and firm, financial institutions will estimate a lower credit risk and therefore asking a lower risk premium on the interest rate. This will lower the cost of debt capital.

In this paper I am examining the relationship between CSR reporting and the financial performance. When a company is disclosing more information about their financial forecasts, strategies and participation in social and environmental activities. The information gap between firm and stakeholders will become smaller, the uncertainty of future cash flows will become lower and thereby reducing the firm’s cost of external financing. Therefore I assume a negative relationship between CSR reporting and the cost of capital.

4.4 Empirical evidence from prior studies.

For this research I have used several empirical studies. The first study by Bachoo et al. (2013) contains a sample of 450 listed firms on the ASX 200 in Australia between 2003 and 2005. The potential sample of 600 firms was reduced because not all firms were having analyst forecasts for earnings and dividend one and two years ahead, in order to estimate firms’ cost of capital. Further, firms have been removed from the sample because there was insufficient stock return data to estimate equity betas. Bachoo et al. (2013) used an ordinary least squares (OLS) regression model where \( k_e \) stands for the cost of capital and REPTQUAL for the sustainability report quality. This variable is a measure of one ordinal variable named CLARKIND, the multi-level disclosure index based on Clarkson et al. (2008) we discussed earlier. And two other dichotomous variables: SUSTAIN and CLARKBIN. SUSTAIN takes value 1 if the firm is classified by CAER (Centre for Australian Ethical Research) as exhibiting acceptable sustainability disclosures and 0 if not. CLARKBIN takes value if CLARKIND \( \geq 3 \) and otherwise 0. With control variables SIZE, BETA and BtoM Bachoo et al. (2013) controlled for larger firms having lower cost of equity capital (SIZE). The impact of systematic risk on the cost of capital (BETA) and the market having less confidence in the economic value of high book-to-
market firms resulting in a more severe discount of future earnings (BtoM). To protect against selection bias, Bachoo et al. (2013) used a Heckman-type correction by estimating a probit regression of the probability of a firm producing high quality sustainability reports as a function of proxies for expected financial performance, poor and strong environmental regulations and political exposure.

Appendix V mentions the regression of this study by regressing the cost of equity against the sustainability reporting quality. Column 1 of panel A reports a negative and significant beta for SUSTAIN \((B = -0.0116; \ p = 0.031)\) for all firms, supporting my expectation that there is a negative relation between the cost of capital and the CSR reporting quality. Panel B, using the sustainability index based on Clarkson et al. (2008), reports a negative and significant coefficient as well \((B = -0.0044; \ p = 0.002)\). Working with the Clarkson sustainability index seems to result in a less strong, but more significant relationship. Furthermore, panel B reports negative association for the cost of equity in the regression for both large \((B = -0.0024; \ p = 0.001)\) and small firms \((B = -0.0042; \ p = 0.030)\).

The second study I will discuss is by Taib et al. (2002) and contains a cross-sectional sample of 100 companies in the UK and US over a five-year period 2005 – 2009 (Appendix VI). By using the score procedure by Morhardt et al. (2002), discussed at paragraph 4.2. Taib et al. (2002) evaluates the quality of CSR reporting at six sectors (materials, industrial, financial, energy, consumer staples and consumer) among four different indices (see Appendix III). Interesting is the difference in CSR reporting quality between the US and UK among the six sectors. The independent sample t-Test shows that the industrial, financial and material sectors in the UK have significantly higher values for the four indices in comparison to their counterparts in the US. The relationship between the reporting quality among the four indices and the ROA is examined by a multiple regression analysis (appendix VI). Column 1 shows significant negative coefficients for the sectors CONS, UTL, FIN, IND and MATR. However for the four indices, only DI has a positive significant coefficient \((B = 0.1158; \ p = 0.0478)\). Resulting from the UK and US companies’ efforts in promoting workforce diversity and active participation in diversity related issues affecting bottom line (Taib et al., 2002). By using a Fama-macbeth cross-section linear regression approach in column 2, the positive relation between CSR reporting on diversity and the ROA becomes a bit stronger \((B = -0.1282; \ p = 0.0231)\). Column 3 represents the Fama-macbeth cross-section linear regression of the ROE against the CSR reporting quality. Again, only DI has a significant positive coefficient \((B = 0.1121; \ p = 0.1055)\).
Where the first two studies are primarily focussed on cost of capital and ROA, the third study by Stewart Jones et al. (2007) takes financial performance to a broader range of financial perspectives such as working capital, leverage, earnings, operating and free cash flow, asset backing, capital expenditure and turnover. It contains CSR reports till 2004 from the top 100 listed firms on the ASX Australia. Again a sustainability index score, according to the GRI guidelines, have been used for measuring CSR reporting quality. Appendix VII mentions the multiple regression analysis table of this study, showing a positive relation between CSR reporting quality and several financial performance perspectives, particularly: operating cash flow, working capital, capital expenditure and interest coverage ratio. However, the cash position to total assets and price to book value is negative associated with the CSR reporting quality. This can be explained by higher levels of capital expenditure at CSR reporting firms and better firm valuation due to better sustainability disclosures (Jones et al., 2007).

Where the study by Bachoo et al. (2013) controls for firm size, this study indicates a strong firm size effect and industry backgrounds as we have seen in the second study as well. Large firms tend to reveal a statistically higher level of voluntary sustainability disclosure because they are bigger and the accounting information would have greater economic consequences given the dependence on a wider range of internal and external users (Jones et al., 2007).

To not discuss only studies examining a positive relation between CSR activities and the financial performance, I will elaborate a few significant studies reporting negative financial performance effects on CSR rankings and strategies.

Vance (1975) compared 14 firms that were identified as socially responsive by Moskowitz (1972) with firms listed in the NYSE Composite Index, The Dow Jones Industrials and Standard and Poor’s Industrial in terms of the percentage change in common stock prices between 1972 and 1975. Using a ranking of 45 leading firms on their degree of corporate social responsibility as independent variable and percentage change in the per share stock prices of the firms. He found a negative correlation between the CSR rankings and the stock market performance. Weakness of this study by Vance is that the rates of return are not adjusted for risk. Alexander and Bucholz (1978) did and found a not significantly relationship between the CSR ranking and stock market performance (Arlow and Gannon, 1982).

A more recent study is by Wagner (2005), examining the relationship between environmental and economic performance and the influence of corporate strategies with regard to sustainability and environment. Using two environmental performance indices representing different corporate environmental strategy orientations of firms from four European countries (Germany, Italy, the
Netherlands and United Kingdom). Wagner conducted a regression model and found for the inputs-based index (reflecting integrated pollution prevention) no significant relationship. For the emission-based index (reflecting end-op-pipe strategies) he found a significant negative relation between environmental performance and economic performance (Wagner, 2005).

Critical note that should be taken into account when discussing the two studies above is the difference in CSR reporting quality (disclosures) and the CSR reporting quality measured by rating agencies, discussed in paragraph two of this chapter. In contrary to the studies examining a positive relationship, these studies do not rely on typical CSR disclosures. Vance (1975) relies on a CSR degree ranking, Wagner (2005) relies on environmental performance and corporate environmental strategy orientation indices affecting the economic performance and not the financial performance (WACC and ROA). In the current literature, I could not find studies examining negative performance effects on typical CSR disclosures.

However, there are many more empirical studies examining this relationship. To give a good insight in the results of these studies, I included a summary table in Appendix VIII. This table provides a clear overview of selected studies and their results of the relation between CSR reporting and financial performance (Iqbal et al., 2012). Some of them I discussed above.

4.5 Interpretation of studied empirical results.

In this paragraph I will take a closer look on the empirical results from different empirical studies discussed in the previous paragraph including some other studies. The results imply consistency with the stakeholder theory, discussed earlier this thesis.

Today’s more than ever challenging business environments requires corporations to make high quality sustainability disclosures and being accountable to internal and external stakeholders. By doing so, the corporate financial reporting becomes more transparent within the definition of CSR resulting. And as we have seen in paragraph 4.3, resulting in a lower credit risk rate asked by the stakeholders.

If we only take into account the studies that propose a positive relationship between CSR reporting and the financial performance we can state that there is indeed a significant positive relation, but not very strong. The betas are generally very low and only a few of them are significant. The used regression models are according to the empiricist generally well fitted with values for R-squared between 0.1205 and 0.26. If we take a closer look on this relation in the study by Bachoo et al. (2013) we find that this relation is largely concentrated in industry sectors for which environmental performance is of particular relevance. In the study by Taib et al.
we find different financial performance effects for different sustainability disclosure dimensions (mentioned in appendix III). Disclosures for diversity-enhancing activities affect financial performance more positively than public disclosures related on community, environment and ethics.

However, the current empirical studies are not without limitations. Previous discussed and other current samples are containing only corporations from well-developed countries. According to Taib et al. (2002) are financially successful companies more likely to have funds to invest into CSR reporting activities. This implies a possible indirectly time series relationship with the corporations financial performance and reduction of the degree of generalizability for other (poorer) countries, sectors and corporations. A second limitation is that the empirical studies discussed earlier ignore the firm’s long run and short-run earnings performance in analysing the financial performance effects (for example cost of equity).

As we have seen in the previous paragraph, the explanatory power of the relationship between Sustainability disclosures and financial performance depends on many different factors. When assessing this relation by evaluating prior empirical studies, two critical notes/limitations should be taken into account.

The first point of discussion is based on the different measurements of CSR reporting quality. We discussed three different studies and all were using a different measurement method for CSR reporting quality. Through the years many sustainability score indices have been used in empirical studies. For example the Clarkson sustainability index used in the study of Bachoo et al. (2013), or the score procedure by Morhardt et al. (2002) differentiating 4 disclosure indices: community, diversity, ethical and environmental. If we take a look on appendix VIII we find many more CSR reporting quality measurement methods. Although they are often based on the GRI guidelines discussed in chapter three of this thesis, this might constrain the robustness of the relation I am examining in this thesis. Using different standards for CSR reporting quality in different empirical studies can cause a biased view of the actual effect of CSR reporting on financial performance. For example, appendix V contains two regression models: panel A and panel B. Panel A relies on a sustainability index provided by CAER reporting and reports and SUSTAIN beta of -0.0116. Panel B relies on a sustainability index based on Clarkson et al. (2008) and reports a weaker relationship (CLARKIND Beta = -0.0044).
The second point of criticism is the wide range in aspects of evaluating the financial performance. Every empiricist examining the influence of CSR reporting on financial performance has his own vision on how to define financial performance. In paragraph two of this chapter I mentioned various elements of financial performance we have seen come along in paragraph four of this chapter. Although there are many studies reporting a positive influence of CSR reporting on financial performance, this may be a biased view due to different measurements on what is financial performance. For example, appendix VII shows the regression analysis of the study by Stewart Jones et al. (2007). This study relies on several financial performance measures reporting different positive significant betas all with different values. Therefore, counting on one financial performance measure can imply an over or under rated positive effect.
5. Conclusion

In this literature study I have investigated the relation between CSR reporting and financial performance. I did this by studying several empirical studies that have analysed this relationship in different periods. Almost all studies are reporting a positive effect on the financial performance by CSR reporting. Supporting the different managerial motives for voluntary disclosure discussed at paragraph 2.5 and my expectation for a negative relationship between the cost of capital and voluntary sustainability disclosures. Disclosing more firm specific qualitative sustainability information does indeed decrease organizations information asymmetry between firm, stakeholders and financial institutions providing capital. Implying a reduction in credit risk rate and a lower return on investment required by investors.

Throughout the years CSR reporting has become an important and value creating activity of corporations worldwide. Despite corporations are not fully obliged to disclose certain information in their annual reporting. Corporations encounter increasing pressure from accounting regulatory bodies like the International Accounting Standards Board and from society itself. You could say that CSR reporting, according to the stakeholder theory, is becoming a competitive factor among companies in the same industries. Not only investors demand high quality sustainability disclosures, clients, customers and other stakeholders will also prefer to elaborate with corporations who are managing their environmental and social impacts. This makes CSR reporting an important influencing factor of financial performance and therefore asks for a sustainable implementation in today’s business strategies.

As I mentioned before, this relation have been subject to a lot of empirical studies. And this is not because it is just interesting to study, it can be interpreted and analysed in many different ways. In paragraph 4.5 I discussed two critical notes on the explaining factors of the relationship be analysed, in the writing process I experienced some more limitations. First of all, the wide range of different sustainability indices used in evaluating CSR reporting quality possibly indicates a low comparability among CSR reports. Despite the GRI provides wide accepted well guidelines on different reporting sectors, they are apparently not able to provide an overall comparability among CSR reports. This can be caused by the fact that CSR reports do not require an auditing by an external auditor who ensures that the report is in accordance with for example the GRI guidelines.
A second limitation is the number of empirical studies, examining the CSR reporting quality – Financial performance relationship, discussed in this paper. Unfortunately I could only discuss a view studies, making my findings on the explaining factors not completely generalizable to a broader universe. However, this does not imply that this study is of no value. This study can be seen as a guide for further research on analysing the CSR reporting quality – Financial performance relationship. Current studies are not very clear what kind of sustainability disclosures in particular do really add value to the financial performance. Furthermore, CSR reporting is still not mature enough compared to financial reporting and it will need further improvements in for example mandatory CSR disclosures. For future standard setting, this is a point to take into account. By setting more clearly CSR guidelines among different smaller and bigger industries, the comparability among CSR reports will become clearer. Hereby, the quality of future studies on the relationship between CSR disclosures and financial performance will improve. Another important finding of this thesis is that the studies that have been discussed in this paper do not report strong relations and high betas on CSR disclosures affecting financial performance. This said, we could question the decision-usefulness for investors of CSR disclosures. For further research it is important to get clear if financial markets and investors do really care about CSR disclosures or if they are only interested in maximizing their returns.
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https://www.globalreporting.org/reporting/g4/Pages/default.aspx


http://www.ftse.com/japanese/Indices/FTSE_KLD_Index_Series/index.jsp
Appendix I

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Investor perspective
1. Stocks performance, shareholder and investor return (dividends, trends, EPS, stock and debt ratings)
2. Management's presentation of measures adopted as critical success factors (milestone achievements, goals)
3. Non-Mandatory analysis of profitability and financial structure (EBITDA, Cash Flow, ROI, ROE, Debt ratios, Proforma data)
4. Description of a total results by business/geographic units (percent of total, percent export)
5. Intangible assets monitor or Intellectual capital statement (value of assets internally developed)
6. Economic profit and value based management (Economic Value Added)

Employee perspective
7. Wages, contracts and benefits other than stock options (and pensions for US) (average amount by category)
8. Training and internal education (hours, number of employee involved)
9. Employee composition by professional category, business units, age, country, minority (percentage, trends)
10. Employee number, turnover and hiring/firing procedures (numbers, percentage, trends)
11. Productivity (volumes/sales/value added by employee)
12. Employee satisfaction, competence and commitment (indices, surveys)

Customer perspective
13. Main customers, contractual relationships, prices, bargaining power (average numbers, purchases, products or services bought)
14. Geographic diversification and characteristic of retail network (percent, number of dealers)
15. Market share, penetration and benchmarking with competitors (percent, trends)
16. Brands, license and trademarks (numbers, value creation, evaluation)
17. Customer satisfaction, retention, loyalty (indices, surveys, complaints, defects, warranty claims, repeat sales)
18. Customer profitability and reliance (indices, trends)

Supplier perspective
19. Main suppliers, contractual relationship and bargaining power (average numbers, discounts)
20. Geographic diversification & sub-supplier policies (percentage, trends)
21. Partnership, alliances' operational data and firm specific investments (value, percentage)
22. Certified quality of partners and inputs (numbers, quantities of raw materials, services)
23. Supplier satisfaction, retention, commitment (indices, surveys)
24. Cost accounting for suppliers (cost saving and indices)

Social and environmental perspective
25. Donations and other social expenses, without quoting the programs details and results (amount, percentage)
26. Description of social, ethical, environmental activities and projects (information about the project)
27. Diversity and equal opportunities (percentage, distribution)
28. Environmental performance and social impact (awards, consumption rate, toxic emissions)
29. Litigations, legal actions and claims, included accounting litigation (expenses, numbers)
30. Environmental profitability and cost accounting (ratios, trends, indices, value added)

Internal processes perspective
31. Product capacity, acquisition, synergies, reorganizations project, Analysis of services and investments for banks and insurance
32. Nature of the main industry: structure, cyclical, seasonality (timing, percentage trends) – direct quote to company's performance
33. Total quality management products and services (warranty claims, defects, ranking, ISO9000, ratings for banks' products)
34. Cost accounting and cost saving by country, production line or project (percentage, amounts, operating cost per employee)

(continued)

Table I. Voluntary disclosure perspectives and key performance indicators (KPI)

Corporate voluntary disclosure

<table>
<thead>
<tr>
<th>No.</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>35</td>
<td>Manufacturing cycle time, internal service responsiveness, effectiveness, and productivity (hours, delivery and waiting time)</td>
</tr>
<tr>
<td>36</td>
<td>Outsourcing, digitalisation and internationalisation of processes (percentage, geographical distribution, volumes)</td>
</tr>
<tr>
<td>37</td>
<td>Innovation and learning perspective</td>
</tr>
<tr>
<td>38</td>
<td>Processes innovations, patents, standards, suggestion developed (numbers, value)</td>
</tr>
<tr>
<td>39</td>
<td>R&amp;D projects and expenditure (numbers, employees, percentage, trends) – description of specific projects</td>
</tr>
<tr>
<td>40</td>
<td>New products, project, reserves, services, customers (numbers, objective, market share, investments)</td>
</tr>
<tr>
<td>41</td>
<td>Decision making, segments strategy and responsibilities maps (levels, objectives, parameters)</td>
</tr>
<tr>
<td>42</td>
<td>Time to market of new products/strategies/contracts (days, months, costs)</td>
</tr>
<tr>
<td>43</td>
<td>Historical product's cycle life analysis (timing, market share, trends)</td>
</tr>
</tbody>
</table>

Note: Examples of information included as a measure of each KPI are in parentheses.
Table 9: Approaches for Improving the Credibility of Sustainability Reports

<table>
<thead>
<tr>
<th>Approach</th>
<th>Description of Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stakeholder engagement</td>
<td>Dialogue with stakeholders to learn about their concerns and what information is important to them; will help eliminate &quot;trust barriers&quot; with stakeholders</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>Improving corporate governance through greater independence of boards and audit committees, and/or through the establishment and disclosure of corporate codes and policies related to sustainability reporting and CSR activities; will also help eliminate trust barriers</td>
</tr>
<tr>
<td>Internal audit or review</td>
<td>Implementing appropriate internal control procedures and reviews to ensure that management and reporting systems capture and report information accurately</td>
</tr>
<tr>
<td>Assurance statements by stakeholders or external experts</td>
<td>Independent statements or evaluations by external experts or specific stakeholder groups attesting to the validity of disclosures in sustainability reports</td>
</tr>
<tr>
<td>Third-party assurance</td>
<td>Independent opinion regarding the effectiveness of internal systems and processes and/or data contained in sustainability reports</td>
</tr>
<tr>
<td>Comprehensive reporting and the reporting of &quot;bad news&quot;</td>
<td>Reporting trends or presenting results based on achievements relative to targets or external benchmarks, regardless of whether the results are good or bad; reporting bad news demonstrates transparency and enhances credibility</td>
</tr>
<tr>
<td>In accordance with GRI</td>
<td>Preparing reports in accordance with GRI Guidelines (see Appendix 2 for criteria) requires the board or CEO to state that the report represents a balanced and reasonable presentation of their organization’s economic, environmental, and social performance</td>
</tr>
</tbody>
</table>

Appendix III

<table>
<thead>
<tr>
<th>Community Index (CI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Corporate giving program and amount given</td>
</tr>
<tr>
<td>2. Partnership with local schools or community-based groups</td>
</tr>
<tr>
<td>3. Public/private partnership</td>
</tr>
<tr>
<td>4. Community programs</td>
</tr>
<tr>
<td>5. Employee volunteer program</td>
</tr>
<tr>
<td>6. Exceptional and innovative charitable-giving programs</td>
</tr>
<tr>
<td>7. Current and former workforce volunteering (in percent)</td>
</tr>
<tr>
<td>8. Exceptional volunteer program</td>
</tr>
<tr>
<td>9. Contribution to charitable foundations</td>
</tr>
<tr>
<td>10. Performance in community activism</td>
</tr>
<tr>
<td>11. New initiative and awards received</td>
</tr>
<tr>
<td>12. Commitment to donating</td>
</tr>
</tbody>
</table>
**Diversity Index (DI)**

1. Commitment to workforce diversity
2. Recruitment and promotion
3. Hiring and promoting minority and women
4. Standards for overseas operations
5. Implementation of innovative work/life programs
6. Representation of women and minorities
7. Discrimination in hiring and promotion
8. Minorities constituents to have a voice
9. Women’s training for advancement
10. Training and advancement programs on diversity
11. Diversity related issues
12. Women in advertising and marketing materials
13. Participation in women and minority programs
14. Women and minorities at position with substantial profit (loss)
15. Diversity training for employees
16. Gender equality in wages

17. History of violations-abusive labour Conditions
18. Exclusion of women from top management position
19. Civil discrimination lawsuit against the company
20. Equal employment opportunity
21. Open work environment

**Ethical Index (ETI)**

1. Written code of business conduct
2. Beyond the legal minimums
3. Equal employment opportunity codes
4. Conflict of interest
5. Commercial bribery
6. International business relationships
7. Use of confidential and proprietary information
8. Export compliance and international economic sanctions
9. Political contributions
10. Antitrust and competition laws
11. Health, safety and environment
12. Harassment
13. Operated within framework of code of business conduct
Appendix IV

<table>
<thead>
<tr>
<th>Economic Dimension</th>
<th>Social Dimension</th>
<th>Environmental Dimension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers</td>
<td>Working conditions</td>
<td>Environmental input performance</td>
</tr>
<tr>
<td>Authorities</td>
<td>Health / Work safety</td>
<td>Environmental output performance</td>
</tr>
<tr>
<td>Neighbouring community</td>
<td>Diversity</td>
<td>Other environmental performance</td>
</tr>
<tr>
<td>Shareholders</td>
<td>Engagement in developing countries</td>
<td></td>
</tr>
<tr>
<td>Creditors</td>
<td>ther Internal social performance</td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>External social performance</td>
<td></td>
</tr>
<tr>
<td>Suppliers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other general economic aspects</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 1: Sub-groups used in the evaluation of sustainability performance
Appendix V

Table 4  Regressions of cost of equity against sustainability reporting quality

<table>
<thead>
<tr>
<th>VARIABLES</th>
<th>(1) All firms</th>
<th>(2) Large firms</th>
<th>(3) Small firms</th>
<th>(4) Endogeneity corrected</th>
<th>(5) Sensitive industries</th>
</tr>
</thead>
<tbody>
<tr>
<td>SUSTAIN (→)</td>
<td>-0.0116**</td>
<td>-0.0083**</td>
<td>-0.0003</td>
<td>-0.0281***</td>
<td>0.0034</td>
</tr>
<tr>
<td></td>
<td>(0.031)</td>
<td>(0.022)</td>
<td>(0.485)</td>
<td>(0.003)</td>
<td>(0.630)</td>
</tr>
<tr>
<td>BroM (+)</td>
<td>0.0229***</td>
<td>0.0098</td>
<td>0.0402***</td>
<td>0.0218***</td>
<td>0.0326***</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(0.190)</td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>(0.001)</td>
</tr>
<tr>
<td>BETA (+)</td>
<td>0.0084**</td>
<td>0.0013</td>
<td>0.0071**</td>
<td>0.0070**</td>
<td>0.0088**</td>
</tr>
<tr>
<td></td>
<td>(0.17)</td>
<td>(0.400)</td>
<td>(0.042)</td>
<td>(0.006)</td>
<td>(0.009)</td>
</tr>
<tr>
<td>SIZE (→)</td>
<td>-0.0019*</td>
<td>0.0043**</td>
<td>-0.0023</td>
<td>-0.0009</td>
<td>-0.0020*</td>
</tr>
<tr>
<td></td>
<td>(0.096)</td>
<td>(0.031)</td>
<td>(0.140)</td>
<td>(0.202)</td>
<td>(0.098)</td>
</tr>
<tr>
<td>SUSTAINxSENS (→)</td>
<td>-0.0263**</td>
<td>-0.0092</td>
<td>0.1882***</td>
<td>0.1162***</td>
<td>0.1240***</td>
</tr>
<tr>
<td></td>
<td>(0.035)</td>
<td>(0.00)</td>
<td>(0.001)</td>
<td>(0.000)</td>
<td>(0.000)</td>
</tr>
<tr>
<td>Constant</td>
<td>0.1298***</td>
<td>-0.0092</td>
<td>0.1882***</td>
<td>0.1162***</td>
<td>0.1240***</td>
</tr>
<tr>
<td></td>
<td>(0.035)</td>
<td>(0.00)</td>
<td>(0.001)</td>
<td>(0.000)</td>
<td>(0.000)</td>
</tr>
<tr>
<td>Observations</td>
<td>450</td>
<td>223</td>
<td>224</td>
<td>450</td>
<td>450</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.223</td>
<td>0.153</td>
<td>0.318</td>
<td>0.232</td>
<td>0.232</td>
</tr>
</tbody>
</table>

Panel B: Sustainability index based on Clarkson et al. (2008)

| CLARKIND | -0.0064*** | -0.0024*** | -0.0042*** | -0.0104*** | -0.0014 |
|          | (0.002)    | (0.001)    | (0.024)    | (0.015)     | (0.122)    |
| BroM     | 0.0239*** | 0.0108     | 0.0488***  | 0.0244***  | 0.0239***  |
|           | (0.000)    | (0.151)    | (0.000)    | (0.002)     | (0.001)    |
| BETA     | 0.0086** | 0.0019     | 0.0038**   | 0.0075**   | 0.0084**   |
|           | (0.016)    | (0.341)    | (0.005)    | (0.021)     | (0.022)    |
| SIZE     | -0.0015  | 0.0037** | -0.0031   | -0.0018*  | -0.0021*  |
|           | (0.078)    | (0.040)    | (0.156)    | (0.066)     | (0.099)    |
| CLARKINDxSENS | 0.0089** | 0.0057   | 0.1360** | 0.1502*** | 0.1314*** |
|             | (0.000)    | (0.894)    | (0.012)    | (0.000)     | (0.001)    |
| Observations | 450      | 223       | 227       | 450          | 450          |
| R-squared | 0.223      | 0.148     | 0.359     | 0.204        | 0.232        |

Appendix VI

Table 1
This table reports the distribution of the sample as per GICS industrial classification. The number of companies in GRI differs across years for the US and UK. Final sample includes only those companies, which have consistently reported using GRI sustainability guidelines over five years from 2005 to 2009.

<table>
<thead>
<tr>
<th>Industrial sector</th>
<th>No of companies in GRI</th>
<th>Sample</th>
<th>No of companies in GRI</th>
<th>Sample</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy</td>
<td>15</td>
<td>5</td>
<td>4</td>
<td>4</td>
<td>9</td>
</tr>
<tr>
<td>Materials</td>
<td>11</td>
<td>7</td>
<td>12</td>
<td>10</td>
<td>17</td>
</tr>
<tr>
<td>Industrials</td>
<td>10</td>
<td>9</td>
<td>10</td>
<td>5</td>
<td>14</td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>10</td>
<td>7</td>
<td>8</td>
<td>6</td>
<td>13</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>10</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>Health Care</td>
<td>9</td>
<td>7</td>
<td>0</td>
<td>0</td>
<td>7</td>
</tr>
<tr>
<td>Financials</td>
<td>8</td>
<td>5</td>
<td>8</td>
<td>7</td>
<td>12</td>
</tr>
<tr>
<td>Information Technology</td>
<td>9</td>
<td>9</td>
<td>1</td>
<td>1</td>
<td>10</td>
</tr>
<tr>
<td>Utilities</td>
<td>8</td>
<td>6</td>
<td>5</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>90</td>
<td>61</td>
<td>48</td>
<td>39</td>
<td>100</td>
</tr>
</tbody>
</table>
B. Table 5
Multiple regression analysis

This table reports the regression results from the multivariate model:

\[ ROA_{it+1} = \alpha + \beta_1 CI_{it} + \beta_2 DI_{it} + \beta_3 EI_{it} + \beta_4 ETI_{it} + \beta_5 SG_{it} + \beta_6 IND_{it} + \varepsilon_{it} \]

where for firm \( i \), ROA is return on assets in year \( t+1 \). \( CI \) is the community index value at time \( t \). \( DI \) is the diversity index value at time \( t \). \( EI \) is the environmental index value at time \( t \). \( ETI \) is the ethical index value at time \( t \). \( SG \) is the growth in sales from year \( t-1 \) to \( t \). The industry dummy variables are industrial sectors - consumer goods (CONS), utilities (UTL), financial (FIN) industrial (IND), information technology (IT), and materials (MTR) respectively. *, **, *** denotes test statistic significance at the 10%, 5% and 1% level respectively.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Fixed effect estimates</th>
<th>Fama-MacBeth estimates</th>
<th>Fama-MacBeth estimates</th>
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</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Intercept</td>
<td>0.4739 (0.0097)</td>
<td>0.0108 (0.9376)</td>
<td>0.0213 (0.6225)</td>
</tr>
<tr>
<td>CI</td>
<td>-0.0482 (0.3631)</td>
<td>-0.0124 (0.3467)</td>
<td>-0.0165 (0.1055)</td>
</tr>
<tr>
<td>DI</td>
<td>0.1158 * (0.0478)</td>
<td>0.1282 *** (0.0231)</td>
<td>0.1121 *** (0.0125)</td>
</tr>
<tr>
<td>EI</td>
<td>-0.0318 (0.6470)</td>
<td>-0.0284 (0.7959)</td>
<td>-0.0369 (0.1002)</td>
</tr>
<tr>
<td>ETI</td>
<td>-0.0203 (0.7581)</td>
<td>0.0860 (0.4015)</td>
<td>0.0963 (0.2055)</td>
</tr>
<tr>
<td>SG</td>
<td>0.0010 (0.2173)</td>
<td>0.6753 (0.1104)</td>
<td>0.0012 (0.1214)</td>
</tr>
<tr>
<td>CONS</td>
<td>-0.5414 *** (0.0032)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>UTL</td>
<td>-0.8604 ** (0.0001)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>FIN</td>
<td>-1.1875 *** (0.0001)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>IND</td>
<td>-0.9731 *** (0.0001)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>MTR</td>
<td>-0.6762 ** (0.0012)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Adj. R²</td>
<td>0.1205</td>
<td>0.0432</td>
<td>0.0522</td>
</tr>
<tr>
<td>F-test</td>
<td>7.1400 **</td>
<td>-</td>
<td>-</td>
</tr>
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</table>
### Appendix VII

**Table 2: Regression Analysis — Financial Performance Variables and Sustainability Disclosure**

<table>
<thead>
<tr>
<th>Financial Variables</th>
<th>Coefficients</th>
<th>t-values</th>
<th>Probability</th>
<th>Collinearity statistics</th>
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</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>Beta</td>
<td>Std error</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash position to total assets</td>
<td>-.208</td>
<td>.046</td>
<td>-4.551</td>
<td>.000</td>
</tr>
<tr>
<td>Net operating cashflow to total assets</td>
<td>.127</td>
<td>.049</td>
<td>2.575</td>
<td>.011</td>
</tr>
<tr>
<td>Total liabilities to total equity</td>
<td>.003</td>
<td>.001</td>
<td>2.007</td>
<td>.046</td>
</tr>
<tr>
<td>Working capital to total assets</td>
<td>.137</td>
<td>.036</td>
<td>3.749</td>
<td>.000</td>
</tr>
<tr>
<td>Retained earnings to total assets</td>
<td>.078</td>
<td>.026</td>
<td>3.044</td>
<td>.003</td>
</tr>
<tr>
<td>Price to book value</td>
<td>-.219</td>
<td>.116</td>
<td>-1.884</td>
<td>.061</td>
</tr>
<tr>
<td>Net tangible asset per share</td>
<td>.460</td>
<td>.158</td>
<td>2.909</td>
<td>.004</td>
</tr>
<tr>
<td>Capital expenditure to total assets</td>
<td>.255</td>
<td>.077</td>
<td>3.303</td>
<td>.001</td>
</tr>
<tr>
<td>Interest cover ratio</td>
<td>.059</td>
<td>.028</td>
<td>2.126</td>
<td>.035</td>
</tr>
</tbody>
</table>

### Appendix VIII

**Table 1. Summary of Selected Empirical Studies**

<table>
<thead>
<tr>
<th>Authors</th>
<th>Sign</th>
<th>Measure of CSR</th>
<th>Measure of firm Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bragdon and Marlin (1972)</td>
<td>(+)</td>
<td>CEP index</td>
<td>EPS growth, ROE, ROC</td>
</tr>
<tr>
<td>Bowman and Haire (1975)</td>
<td>(+)</td>
<td>Carroll's (1979) CSR construct and CEP index</td>
<td>ROE</td>
</tr>
<tr>
<td>Fogler and Nutt (1975)</td>
<td>neutral</td>
<td>CEP index</td>
<td>P/E ratio</td>
</tr>
<tr>
<td>Sturdivant and Ginter (1977)</td>
<td>(+)</td>
<td>Moskowitz reputation index</td>
<td>EPS growth</td>
</tr>
<tr>
<td>Alexander and Buchholz (1978)</td>
<td>(+)</td>
<td>Reputation ratings</td>
<td>Market return on security</td>
</tr>
<tr>
<td>Spicer (1978)</td>
<td>(+)</td>
<td>CEP index</td>
<td>ROE</td>
</tr>
<tr>
<td>Aupperle et al., (1985)</td>
<td>(-)</td>
<td>Carroll's (1979) CSR construct</td>
<td>ROA</td>
</tr>
<tr>
<td>Conine and Madden (1987)</td>
<td>(+)</td>
<td>Moskowitz reputation and Morgan's corporate</td>
<td>Perceptual/expectational survey measures</td>
</tr>
<tr>
<td>McGuire et al. (1988)</td>
<td>mixed</td>
<td>Fortune index</td>
<td>ROA, sales growth, asset Growth</td>
</tr>
<tr>
<td>Fombrun and Shanley (1990)</td>
<td>neutral</td>
<td>Charitable contributions, Fortune index</td>
<td>ROIC, market-to-book ratio</td>
</tr>
<tr>
<td>Teoh and Shiu (1990)</td>
<td>neutral</td>
<td>CSR disclosure</td>
<td>Institutional investors’ survey questionnaire</td>
</tr>
<tr>
<td>Blackburn et al. (1994)</td>
<td>(+)</td>
<td>CEP index</td>
<td>ROA, abnormal return, ROC</td>
</tr>
<tr>
<td>Waddock and Graves (1997)</td>
<td>(+)</td>
<td>KLD index</td>
<td>ROA, ROE, return on equity</td>
</tr>
<tr>
<td>Berman et al. (1999)</td>
<td>(+)</td>
<td>KLD index</td>
<td>ROA</td>
</tr>
<tr>
<td>Teoh et al. (1999)</td>
<td>neutral</td>
<td>Divestment from South Asia</td>
<td>Abnormal return</td>
</tr>
<tr>
<td>McWilliams and Siegel (2000)</td>
<td>neutral</td>
<td>KLD index</td>
<td>ROA</td>
</tr>
<tr>
<td>Orltzky et al. (2003)</td>
<td>mixed</td>
<td>KLD index</td>
<td>P/E ratio, ROE, ROA</td>
</tr>
<tr>
<td>Akpinar et al. (2008)</td>
<td>(+)</td>
<td>KLD index</td>
<td>Stock return, Tobin's Q</td>
</tr>
<tr>
<td>Lev et al. (2008)</td>
<td>(+)</td>
<td>Charitable contributions</td>
<td>Sales growth</td>
</tr>
</tbody>
</table>