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The collective effects of CSR performance and CSR reporting mandates on Corporate Financial Performance

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The views stated in this thesis are those of the author and not necessarily those of the supervisor, second assessor, Erasmus School of Economics or Erasmus University Rotterdam.

Abstract

The intensifying climate crisis led to Corporate Social Responsibility (CSR) gaining significant relevance in the academic, business and political worlds. Although, the impact of CSR on Corporate Financial Performance (CFP) remains a subject of ongoing debate. This thesis provides a comprehensive overview of what has been written about the effects of CSR performance on CFP and the impact CSR reporting mandates have on CFP. In order to address these relationships, a literature review is conducted that focuses on academic articles from 2014 onward, empirically studying the effects of both CSR performance and CSR reporting mandates on CFP. This review finds that the majority of researchers agree that there definitely exists a significant positive relationship between CSR performance and CFP, where some researchers argue there is a U-shaped relationship, instead of a positive linear relationship. Moreover, various researchers agree not all aspects of CSR are positively associated with CFP. The implementation of CSR reporting mandates on the other hand, is negatively associated with CFP in most instances, because these mandates trigger increased cost for affected firms that have not previously invested in CSR. Additionally, after thoroughly analyzing the existing literature, hereby identifying gaps in the existing literature, this thesis concludes with suggestions for future research.

Table of Contents

Abstract 2

List of abbreviations 4

1 Introduction 5

1.1 Introduction 5

1.2 Research problem and motivation 5

1.3 Research objectives 6

1.4 Research methodology 6

1.5 Thesis outline 7

2 Theoretical Framework 8

2.1 What is Corporate Social Responsibility? 8

2.1.1 The definition of CSR 8

2.1.2 The evolution of CSR 8

2.1.3 CSR performance & CSR engagement 9

2.1.4 CSR reporting 9

2.2 Measurement of CSR performance 10

2.3 Measurement of Corporate Financial Performance 11

2.4 Mechanisms through which CSR initiatives influence Corporate Financial Performance 11

3 Literature review 12

3.1 The effects of CSR performance on accounting-based CFP measures 12

3.2 The effects of CSR performance on market-based CFP measures 17

3.3 The effects of CSR reporting mandates on CFP 20

Conclusion 23

Bibliography 25

Appendix I 30

Appendix II 31

List of abbreviations

Abbreviation	Definition
CSR	Corporate Social Responsibility
CFP	Corporate Financial Performance
ESG	Environmental, Social & Governance
GRI	Global Reporting Initiative
CSRD	Corporate Sustainability Reporting Directive
ESRS	European Sustainability Reporting Standards
EPS	Earnings per Share
ROA	Return on Assets
ROC	Return on Capital
ROE	Return on Equity
OLS	Ordinary Least Squares
SEM	Structural Equation Modelling
LME	Linear Mixed Effects
GHG	Greenhouse Gas
EU	European Union

1 Introduction

1.1 Introduction

The importance of Corporate Social Responsibility (CSR) is increasing significantly in modern society, yet its impact on financial performance remains a subject of debate (Ali et al., 2020; Coelho et al., 2023; Hoque et al., 2018). Society now demands that companies operate not only in the interest of the owner and shareholders, but also in the interest of society (Cho et al., 2019). Also, recently new reporting standards have been introduced to increase firms' CSR transparency (Fiechter et al., 2022). These shifts have had a significant impact on business practices and the financial performance of these corporations. This research aims to investigate the impact of both CSR performance and CSR reporting mandates on Corporate Financial Performance (CFP).

1.2 Research problem and motivation

The urgency of this topic stems from the further and further escalating climate crisis, which led to companies earning a huge role in the mitigation of these environmental issues. Corporations experience stakeholders putting pressure higher than ever before to adopt sustainable business practices (Cho et al., 2019). Thus, the importance of conducting research regarding the effects of CSR on financial performance lies in its significance for both the business itself and its stakeholders.

There have been numerous studies that made significant contributions to the existing literature about the impact of both CSR performance and CSR reporting mandates on financial performance. Various aspects regarding CSR have been studied. Beck et al. (2018) conducted research regarding the impact of CSR engagement on CFP. Manchiraju & Rajgopal (2017) study the effect of mandatory CSR engagement on financial performance, the corporations in this specific study are obliged to spend 2% of their net income on CSR activities. Also, there have been several studies regarding the effects of mandatory CSR reporting on CFP (Chen et al., 2018; Fiechter et al., 2022).

This thesis will add value to the existing literature by comparing various sources, summarizing different views and by studying the effects of both CSR performance and CSR reporting mandates on CFP.

1.3 Research objectives

This thesis will study the impact of both CSR performance and CSR reporting mandates on Corporate Financial Performance. This leads to the following research question.

"How do CSR performance and CSR reporting mandates collectively influence Corporate Financial Performance?"

The answer to this question would be of interest to managers of companies mostly. Understanding both relationships can improve strategic decision-making regarding the allocation of resources. By becoming more aware of the benefits and drawbacks associated with CSR, businesses can optimize the use of resources to guarantee continued existence of the company and optimal long-term profitability.

Investors and other stakeholders are increasingly considering Environmental, Social & Governance (ESG) factors to evaluate companies' performance. Thus, by outperforming competitors on ESG performance, firms can improve their reputation and enhance their brand image. Firms can attract additional investment, which leads to a higher access to capital (Dhaliwal et al., 2011). Meaning that capital will be driven towards companies with robust CSR practices, which will incentivize an even broader adoption of sustainable business practices.

1.4 Research methodology

To answer the research question, a literature review will be conducted. Data will be gathered by delving through top accounting journals, which originate from a study conducted by Lowe & Locke (2006). Furthermore, this thesis will also take academic journals into consideration, which are not in the specific list. Only journals of sufficient importance are included in the research, which will be guaranteed by analyzing the impact factor of these journals. This thesis focuses on findings of the last ten years, therefore, only academic articles from 2014 onward fall within the scope of this thesis. Lastly, secondary data will be used in this research, since there is no empirical research conducted.

1.5 Thesis outline

The second chapter will present the theoretical framework, in which several key concepts are explained. Also presented in the theoretical framework is how different variables are measured and what factors can influence them. The third chapter consists of the literature review, where the sub questions will be introduced first. The literature review is divided into several paragraphs regarding the sub questions, these sub questions are all standalone questions that individually support the main research question. After studying numerous academic studies in depth, this thesis will conclude with an objective, unbiased conclusion, followed by a paragraph describing opportunities for future research.

2 Theoretical Framework

In this paragraph the concept of CSR will be introduced. It is important to have an adequate understanding of CSR, because this is necessary to understand the relationship of CSR with financial performance. Additionally, the theoretical framework will explain how CSR performance and Corporate Financial Performance can be measured, based on the existing literature. Lastly, the theoretical framework will elaborate on the concept of CSR reporting and CSR reporting mandates.

2.1 What is Corporate Social Responsibility?

2.1.1 The definition of CSR

The definition of CSR is an extensively discussed topic and there does not exist one universal definition of CSR in the existing literature. Dahlsrud (2008) and Barauskaite & Streimikiene (2021) show a total of 44 existing definitions of CSR in their studies. This thesis will use the following definition, because it is very comprehensive and explicit. The idea of CSR is that socially responsible companies take responsibility for their impact on the environment and harmonize their interests with the interests of their stakeholders. (Barauskaite & Streimikiene, 2021).

2.1.2 The evolution of CSR

The idea of social responsibility of corporations has been around for centuries, but the modern definitional construct of CSR dates to the 1950's and 1960's. Although, several authors state that social responsibility dates to the eighteenth and nineteenth century, where so-called "welfare schemes" were created to protect and retain employees, the interest in CSR started to rise in the 1960's due to growing awareness in society and social movements of the time. Globalization, which started towards the end of the 20th century, led to the recognition of CSR on a global level. Around this time, corporations started to take a strategic approach to CSR. Corporate policies changed as a response to public interest. This is when the modern definition of CSR was introduced, that firms have obligations towards stakeholders, which exceed the legal requirements and the responsibilities of the firm towards its shareholders (Agudelo et al., 2019).

2.1.3 CSR performance & CSR engagement

As stated already, CSR is hard to define. Several researchers study the effects of CSR engagement on CFP (Beck et al., 2018; Ting & Yin, 2018). While others really delve into the, possibly inaccurate or deceiving, databases to gather CSR scores and measure the impacts on CFP (Cho et al., 2019; Nollet et al., 2016; Pan et al., 2014; Wu et al., 2020). We can expect firms to not engage in CSR when they know it will not increase CSR performance. Therefore, this thesis assumes that a company engages in CSR activities only when it is expected to be beneficial. Therefore, the terms CSR performance and CSR engagement are used alternately throughout this thesis.

2.1.4 CSR reporting

The European Union (EU) law mandates all large and listed entities to report on financial aspects, as well as non-financial aspects of the entities' performance. Non-financial performance ranges from social matters to the externalities of the business operations on the environment (European Commission, n.d.). CSR reports show a corporations' commitment to becoming more sustainable. Firms started to report on their CSR performance during the start of the 21st century, along with the introduction of the Global Reporting Initiative (GRI) standards (Tschopp & Huefner, 2015). Today, different CSR reporting standards, so-called CSR reporting mandates, are used in various parts of the world and a recent standard that is introduced is the Corporate Sustainability Reporting Directive (CSRD), which came into effect at the beginning of 2023 in the EU. Entities that fall within the scope of the CSRD, will be required from 2025 onward to disclose non-financial information according to the European Sustainability Reporting Standards (ESRS). The objective of the CSRD is to enhance and update regulations regarding CSR reporting. These updated regulations enhance transparency and credibility of the reports, to ensure stakeholders have sufficient information to evaluate firms' CSR performance (European Commission, n.d.).

Before, firms were pushed to the use of stand-alone reports to disclose CSR information (Michelon et al., 2015). Although, later on, global pressures drove firms towards integrated reporting (Rupley et al., 2017). Now we know that firms are subject to these aforementioned reporting standards, but firms are allowed to disclose more CSR information voluntarily. It is commonly observed that better performing CSR firms tend to publish CSR reports of higher disclosure quality (Koh et al., 2023).

2.2 Measurement of CSR performance

Evaluating CSR performance poses a significant challenge, due to the lack of a standardized definition of CSR and the absence of a generally established method to measure CSR performance (Barauskaite & Streimikiene, 2021; Gjølberg, 2009). Barauskaite & Streimikiene (2021) state that there are several different methods that can be used to assess CSR performance, but these methods come with advantages and disadvantages. The utilization of reputation indices is the prevailing method to establish CSR performance. According to Barauskaite & Streimikiene (2021), "many authors agree that the Dow Jones Sustainability Index is one of the best indices, because it covers all aspects of industry and CSR." (p. 4). Instances of other main indexes are the Fortune Magazine Reputation Index, the "MSCI KLD 400" Social Index and the Vigeo Index (Awaysheh et al., 2020; Barauskaite & Streimikiene, 2021). The use of indices can be beneficial because the data is easily accessible. On the other hand, the lack of one recognized index can make it difficult to compare the CSR performance of firms, because different indices use different criteria and methodologies to assess CSR performance (Barauskaite & Streimikiene, 2021).

Following reputation indices, content analysis is a generally utilized method to evaluate firms' CSR performance. The fundamental principle of this method involves identifying noteworthy units within the text of the disclosure, quantifying the frequency of their occurrence, and to analyze the relationships among the units, as well as the relationship of the units with the whole context. Although, to utilize this method, one must accept that social disclosure is a reliable indicator of a companies' social performance. Utilizing content analysis enables a comprehensive assessment of a firms' CSR activities, but the data provided by firms can be inaccurate or unverifiable. Moreover, the selected unit can be interpreted differently by individuals (Barauskaite & Streimikiene, 2021).

The one-dimensional approach concentrates solely on one aspect of CSR, such as the ratio of men to women among workers. The one-dimensional measurement approach can be quite a simple method to use, and a single metric can make it easier to compare CSR performance among firms. Though, using this method may oversimplify the concept of CSR, because CSR is multidimensional. This can lead to a biased assessment (Barauskaite & Streimikiene, 2021).

2.3 Measurement of Corporate Financial Performance

The accounting-based approach and the market-based approach are described as the two main methods to measure CFP (Barauskaite & Streimikiene, 2021). Accounting-based instruments reflect a firms' internal effectiveness. Accounting-based instruments include Return on Assets (ROA), Return on Capital (ROC) etc. Market-based instruments include firm value, shareholder value, Earnings Per Share (EPS) and other market-based instruments (Barauskaite & Streimikiene, 2021). Although Barauskaite & Streimikiene (2021) categorize EPS as a market-based CFP measure, in reality EPS can also be an accounting-based measure. EPS is calculated through dividing a companies' net income by the number of outstanding shares. Islam et al. (2014) state that while EPS can be influenced by market factors such as stock price movements, EPS is primarily derived from a companies' financial statements. Several sources make use of a combination of indicators from the marketing-based approach and the accounting-based approach, that is, Tobin's Q (Barauskaite & Streimikiene, 2021).

2.4 Mechanisms through which CSR initiatives influence Corporate Financial Performance

CSR is very multifaceted and CSR initiatives can influence CFP through various mechanisms. Various authors state that firms engaging in CSR activities can enhance their brand image and reputation (Ali et al., 2020; Khan & Fatma, 2023). Furthermore, when engaging in more green activities, overall costs can be drastically decreased (Ali et al., 2020). On the other hand, investing in these more sustainable activities may lead to high investment costs (Fiechter et al., 2022). Though, stakeholder engagement can resolve conflicts between primary shareholders and stakeholders to enhance CFP (Fiechter et al., 2022; Ting & Yin, 2018). Moreover, adopting sustainable practices can lead to a higher access to capital (Dhaliwal et al., 2011). Lastly, CSR can positively influence CFP through risk, because CSR reduces extreme risk taking and reduces extreme risk avoidance (Harjoto & Laksmana, 2018).

3 Literature review

After having introduced the key concepts of the thesis, the following questions will be addressed in the literature review. Firstly, "What are the effects of CSR performance on CFP, when utilizing the accounting-based approach?". Secondly, "What are the effects of CSR performance on CFP, when utilizing the market-based approach?". Lastly, "What are the effects of CSR reporting mandates on CFP?". After answering these sub questions, an answer to the research question can be formulated.

3.1 The effects of CSR performance on accounting-based CFP measures

It is particularly important to rule out biases to obtain a complete and objective view of the impact of CSR performance on CFP. Therefore, this thesis reviews numerous studies with different methodologies conducted in various regions of the world. This will lead to an objective view of the relationship between CSR performance and CFP, unrelated to specific locations or specific methodologies.

Regression analysis is a commonly utilized method to study the effect of CSR performance on CFP. Cho et al. (2019) utilize Ordinary Least Squares (OLS) regression analysis and investigate 191 firms in 2015. CSR performance data is gathered from the Korea Economic Justice Institute index and CFP is measured through profitability, which is represented by ROA. The authors find a partial positive correlation between CSR performance and CFP. The social dimension of CSR has a significant positive effect on CFP. However, the environmental dimension shows no significant effect on CFP. Not every aspect of CSR will have a positive impact on CFP, firms should prioritize CSR initiatives that contribute significantly to CFP (Cho et al., 2019). A comparable study is conducted by Wu et al. (2020), the authors utilize OLS regression analysis and ROA as CFP measure. CSR performance data is gathered from the RKS database. By examining data from 341 Chinese firms from 2013 to 2018, the authors find a positive significant relationship between CSR performance and CFP as well (Wu et al., 2020).

Ting & Yin (2018) employ regression analysis concerning 420 Taiwanese firms, investigated from 2007 to 2016, to investigate how various aspects of CSR influence CFP. Corporate Citizenship Awards' CSR evaluation scores are inspected to measure

CSR performance and CFP measures include ROA and Tobin's Q. CSR initiatives aimed at customers, employees and the firms' community show significant positive effects on CFP. According to Ting & Yin (2018), CSR initiatives aimed at customers and employees "can resolve conflicts between the shareholders and the primary stakeholders" (p. 10), which will enhance CFP. Furthermore, the returns on CSR investments aimed at the firms' community can outweigh the actual investments, by enhancing their brand image. Lastly, investing in the environmental aspect of CSR hardly improves CFP (Ting & Yin, 2018).

Yang et al. (2019) comprehensively study the impact of CSR performance on CFP in the Chinese pharmaceutical industry. CSR performance data is gathered from the Hexun rating system and CFP measures include ROA, ROE and EPS. By examining 125 firms from 2010 to 2016, panel regression models show a positive significant relationship between all dimensions of CSR and CFP. However, Yang et al. (2019) state that the environmental dimension of CSR exerts the most significant influence on CFP, hereby disagreeing with the previously mentioned study from Ting & Yin (2018), and the shareholders and social aspects exert the least significant influence on CFP (Yang et al., 2019). Remarkable is that the environmental dimension of CSR exerts the most significant positive influence on CFP in the Chinese pharmaceutical industry. One would expect that significant investments should be made to increase environmental performance in the pharmaceutical industry, although the positive externalities from an enhanced reputation may outweigh these investments.

Delmas et al. (2015) zoom in on the environmental aspect of CSR and find a combination of the results from both previously mentioned studies (Ting & Yin, 2018; Yang et al., 2019). Delmas et al. (2015) employ fixed effects estimation, a form of regression an analysis, concerning 1,095 US firms investigated from 2004 to 2008. This specific sample period is chosen, because this is immediately after the Regional Greenhouse Gas Initiative was introduced in 2003 and up until the final refusal to pass the Waxman-Markey Bill in 2009. The authors study the effect of environmental performance on short- and long-term CFP, represented by ROA and Tobin's Q, respectively. Environmental performance is measured by greenhouse gas (GHG) emissions. Fixed effects estimation results show a decrease in short-term CFP and an increase in long-term CFP. The authors state that, in the long term, "markets recognize

the value of reduced emissions in the long-term and firms gain financial advantage from reducing GHG emissions" (Delmas et al., 2015, p. 11).

Pooled Least Squares regression analysis is utilized by Pan et al. (2014). The Pooled Least Squares regression is an appropriate method for this study, because this study includes only Chinese listed mineral firms. This study investigates 228 firms from 2010 to 2013. CSR performance data is gathered via the Hexun rating system. CFP measures include ROA, return on equity (ROE), Growth Rate of Main Operating, and Expansion Rate of Net Assets. The shareholders dimension of CSR is mainly positive in relation to CFP. On the other hand, the mineral industry is a significantly polluting industry, meaning that firms are obliged to spend significant amounts of money to increase environmental performance. Therefore, environmental responsibilities are negatively associated with CFP in the mineral industry. Both previous findings concerning the effect of the shareholders aspect and the environmental aspect of CSR contradict with the findings of Yang et al. (2019). The industry in which both of these studies are conducted play a key role in this context. The shareholders aspect of CSR, covering profitability for instance, is relatively less of a concern within the pharmaceutical industry, in contrast to the mineral industry. The opposite applies to the environmental aspect of CSR. Lastly, public responsibility shows no significant relationship with CFP, except for the oil and gas industry, which might explain why many mineral firms do not align their interests with the public (Pan et al., 2014).

Beck et al. (2018) state that OLS regression models "can be highly susceptible to violation of statistical assumptions, such as identical and independently distributed errors, which can significantly affect the interpretation of empirical results." (p. 4) Therefore, the authors use the Linear Mixed Effects (LME) model to analyze and interpret findings, Beck et al. (2018) state this model is more resilient to violations of distinct statistical assumptions. The authors investigate 116 firms in Australia, Hong Kong and the United Kingdom. CFP is represented by pre-tax ROE and the authors measure CSR performance by quantifying the amount of indicators, of the 123 indicators which are available, that firms address according to the GRI guidelines. The LME model shows CSR performance has a positive significant effect on CFP (Beck et al., 2018).

Ali et al. (2020) utilize Structural Equation Modelling (SEM) to measure the influence of CSR on CFP, mediated by corporate image and customer satisfaction, because

SEM is preferred when analyzing mediation. It can analyze relationships between multiple variables that influence each other at the same time. The authors use a sample of 229 companies listed on Pakistan stock exchange. Corporate image and customer satisfaction represent CSR performance measures and CFP measures include return on investment, assets, equity, sales and profit margin. Both corporate image and customer satisfaction exert a positive significant effect on CFP via increased sales. The authors state "the public likes to purchase goods and services of companies that follow CSR practices, and the public is also likely to pay an extra amount for products and services." (Ali et al., 2020, p. 8).

Lys et al. (2015) question the results of the aforementioned authors. The authors suspect that the positive association between CSR engagement and CFP is not solely because of the causality between CSR engagement and CFP. According to Lys et al. (2015), "the positive association between future performance and CSR expenditures is more likely due to the signaling value of CSR expenditures rather than positive returns on those investments." (p. 15). The authors test whether firms engage in CSR because due to the positive impact on CFP, and whether firms engage in CSR because these firms anticipate higher future CFP, resulting in a signal to the market that these firms expect an increase in CFP shortly. This sample used in this study includes 5,928 firms and the sample period spans from 2002 to 2010. CFP measures consist of the change in ROA and future changes in operating cash flow, and a two-stage approach is utilized to examine the direction of causality between CSR expenditures and CFP. By employing regression analysis, the authors find, at first, that an increase in CFP follows from an increase in CSR engagement. However, when evaluating the signaling hypothesis, where lagged values for CFP are included, the authors find that firms in fact anticipate an increase in future CF when investing increasingly in CSR. Therefore, the authors conclude that the positive impact of CSR engagement on CFP is due to the signaling value of these investments, instead of the actual increase in CFP following directly from those investments (Lys et al., 2015).

Nollet et al. (2016) question whether the relationship between CSR performance and CFP is purely linear. Therefore, the authors examine both linear and nonlinear relationships in their research. The S&P500 firms make up the sample of this study, which are investigated from 2007 to 2011. CSR performance data is gathered from Bloomberg's Environmental Social Governance Disclosure scores and CFP measures

include ROA and ROC. A negative significant association between CSR performance and ROC is found when inspecting the linear model, which contradicts with the results of almost every aforementioned author that conducted linear research. On the other hand, the non-linear model suggests that increasing CSR performance becomes profitable after a certain point. Thus, Nollet et al. (2016) confirm the U-shaped relationship between CSR performance and CFP, previously found by Delmas et al. (2015). Implying that the effects of an increase in CSR performance are positive in the long-term. This shows the negative side of linear analysis, which is used by the majority of researchers, because linear models do not always give an accurate representation of reality. The authors also find that governance, which represents the shareholders aspect of CSR, is the key driver affecting the relationship between CSR and CFP (Nollet et al., 2016; Pan et al., 2014). Furthermore, the authors state that firms should focus on the CSR activities that do positively impact CFP (Cho et al., 2019; Nollet et al., 2016). Although, it is questionable whether this will result in the greatest collective utility among all stakeholders.

Awaysheh et al. (2020) criticize the use of ROA as a CFP measure, which is used in various aforementioned studies, the authors utilize operating performance instead to assess CFP. According to Awaysheh et al. (2020), operating performance is the appropriate measure, because “it does not penalize firms for the use of leverage in their capital structure and exclude the effects of taxation.” (p. 6). CSR performance data is gathered from the MSCI ESG Stats Database. The sample consists of approximately 2,400 firms which are analyzed from 2003 to 2013. The authors want to assess the difference in CFP from the top 10% of firms (best-in-class) and the bottom 10% of firms (worst-in-class) in terms of CSR performance, through benchmarking. Awaysheh et al. (2020) conclude the worst-in-class are outperformed by the best-in-class regarding operating performance. However, when the authors controlled for endogeneity, the significant influence of CSR performance on operating performance vanished. Hence, it is questioned whether the relationship between CSR and CFP is causal (Awaysheh et al., 2020; Lys et al., 2015).

3.2 The effects of CSR performance on market-based CFP measures

Various authors conducted research regarding the effects of CSR performance on both accounting-based CFP measures and market-based CFP measures (Awaysheh et al., 2020; Cho et al., 2019; Lys et al., 2015; Nollet et al., 2016; Pan et al., 2014; Yang et al., 2019). By doing so, researchers aim to establish firms past performance, via accounting-based measures, and firms' future performance, via market-based measures (Gentry & Shen, 2010).

Pan et al. (2014) and Awaysheh et al. (2020) prove existence of a positive significant relationship between CSR performance and market-based CFP measures, while Yang et al. (2019) find a negative significant relationship. Pan et al. (2014) study the impact of CSR performance on EPS and hereby prove the positive significant relationship. Awaysheh et al. (2020) use Tobin's Q to compare relative financial market valuations from the best-in-class and the worst-in-class. The authors conclude there is a positive significant relationship between CSR and CFP, because the worst-in-class show lower values of Tobin's Q in comparison to the best-in-class. Yang et al. (2019) utilize Tobin's Q as well. While the authors conclude there is a positive significant relationship between CSR performance and CFP regarding the accounting-based CFP measures, the authors prove that there is a negative significant relationship between CSR and Tobin's Q. Suggesting that under these circumstances, firms' market performance is not positively influenced by improving CSR performance (Yang et al., 2019).

Harjoto & Laksmana (2018) investigate whether CSR acts as a control mechanism to minimize deviations of the level of optimal risk taking. The authors employ OLS regression analysis and path regression analysis among 1,718 US firms investigated from 1998 to 2011. Furthermore, the authors utilize five measures of corporate risk taking. This study concludes that there is an optimal risk taking level, and CSR performance is negatively associated with deviations from this optimal level. Though, when looking at the effects of CSR on risk taking on its own, little can be concluded about the effects on CFP, but Harjoto & Laksmana (2018) find a positive link between optimal risk taking and firm value, which is also verified by Nollet et al. (2016). Logically, the closer firms are to the optimal risk taking level, the higher firm value will be. It can be concluded there is a positive indirect link between CSR and firm value, because the

authors find CSR moderates the deviations from optimal risk taking, both extreme risk taking and extreme risk avoidance are reduced (Harjoto & Laksmana, 2018).

Other studies on the other hand, find positive but insignificant relationships between CSR performance and CFP (Lys et al., 2015; Nollet et al., 2016). Lys et al. (2015) study the relationship between CSR engagement and size adjusted stock returns and Nollet et al. (2016) study the relationship between CSR performance and excess stock returns. Since both of these studies conclude that the relationship between CSR performance and CFP is positive, yet insignificant, it cannot be proven there is a positive relationship. Lys et al. (2015) explain that the relationship might be insignificant, because the incentives of CSR investments might be different for different firms. In this study, the authors suspect firms investing in CSR to signal to the market that the firm is anticipating higher future profits, rather than investing in CSR because this directly positively impacts CFP. For a certain group of firms, an increase in CSR engagement will actually lead to an increase in CFP. However, a different group of firms might invest in CSR, while being aware of the fact that it will not directly positively influence CFP. Therefore, it cannot be concluded there is a positive relationship between CSR engagement and CFP (Lys et al., 2015). Nollet et al. (2016) explain that the relationship between CSR performance and excess stock returns might be insignificant due to the fact that stock returns are affected by multiple additional variables as well.

The ambiguous results in the existing literature regarding the CSR-CFP relationship is the reason for Sun et al. (2019) to investigate whether there is a more complicated mechanism at work, instead of the traditional linear models that are utilized most frequently. The authors examine an inverted-U-shaped model of the effects of CSR on shareholder value, which is represented by Tobin's Q. The sample of this study includes 468 firms that are investigated from 2000 to 2010. CSR performance data is gathered from the KLD database and to obtain an inverted-U-shaped model, the quadric term in the representation of CSR performance is included in the model. Sun et al. (2019) find a significant inverted-U-shaped relationship between CSR performance and shareholder value. At first, an increase in CSR engagement shows a positive impact on shareholder value, but if the firm engages CSR excessively, the positive impact disappears and eventually, turns negative. Notably, the authors prove that the inverted-U-shape does not apply to firms with high marketing capabilities,

these firms experience a purely positive impact of CSR performance on shareholder value (Sun et al., 2019). Cho et al. (2019) confirm the inverted-U-shaped relationship between CSR and CFP by measuring the impact of CSR performance on firm value, represented by Tobin's Q. The partial positive correlation between CSR performance and CFP can be explained by the fact that social contribution has a significant positive effect on CFP, environmental protection has no significant effect on CFP, but that consumer protection has a significant negative effect on firm value (Cho et al., 2019).

Similar to the previously described studies, Price & Sun (2017) find an inverted-V-shaped relationship between CSR engagement and CFP. The authors prove that firms with minimal CSR engagement outperform firms that are highly engaged in CSR activities in terms of CFP. Price & Sun (2017) include 562 firms in the sample of this study and the sample period spans from 2000 to 2010. CSR performance data is gathered from the KLD database and CFP is measured by Tobin's Q, which represents firms' market value. The authors employ a vector autoregressive model designed for panel data and find an inverted-V-shaped relationship between CSR engagement and CFP (Price & Sun, 2017). Remarkably, multiple authors proved the relationship between CSR engagement and CFP to be of an inverted-U-shaped or inverted-V-shaped form, which totally undermines the willingness of firms to invest widely in CSR.

Manchiraju & Rajgopal (2017) find that mandatory CSR engagement has a significant negative effect on shareholder value, unless firms invest relatively more in CSR reporting. The firms that invest in enhancing their CSR reports as well, after being obliged to invest in CSR are not negatively affected by this mandate. However, voluntary CSR reporting falls outside the scope of this thesis. The authors study the effects of the implementation Indian Companies Act 2013, where certain Indian firms were required to invest at least 2% of their net income in CSR initiatives. The sample consists of 2,120 Indian firms that were examined from 2009 to 2013. Manchiraju & Rajgopal (2017) observe through a regression discontinuity design a greater decline of firm value, measured by Tobin's Q, in firms that were obliged to invest in CSR, compared to firms that were not obliged to invest in CSR. Furthermore, the authors use an event study to investigate the effects of CSR engagement on stock prices. Around eight events that span from 2009 to 2013, the authors find that firms that were required to invest in CSR activities, experienced a 4.1% drop in the stock price. (Manchiraju & Rajgopal, 2017).

3.3 The effects of CSR reporting mandates on CFP

Now that CSR has developed into a globally recognized concept, which is integrated in the majority of firms' strategies, stakeholders are increasingly considering ESG factors to evaluate companies' performance. Therefore, it is beneficial for companies to disclose as much information as possible concerning their CSR initiatives. However, when CSR reporting was done voluntarily by firms, transparency and credibility of these reports was questionable, because firms had the freedom to communicate their CSR initiatives as they saw fit (Gatti et al., 2019). The lack of clear and accurate reports led to low comparability of CSR performance among firms, which was very inefficient for stakeholders that wanted to evaluate companies on their CSR practices. Therefore, CSR reporting mandates were introduced. By introducing a regulatory framework, stakeholders can easily access and compare firms' CSR data, hereby enhancing transparency and improving comparability between firms. However, introducing such mandates might be costly (Fiechter et al., 2022; Grewal et al., 2019).

Ioannou & Serafeim (2017) were among the first researchers to study the effects of CSR reporting mandates on firm value. The study shows CSR reporting mandates have a positive significant impact on CFP. The authors employ differences-in-differences estimation among 10,472 companies China, Denmark, Malaysia and South Africa. From 2007 to 2010, these countries implemented their own CSR reporting mandates. Therefore, the authors chose a sample period which spans from 2005 to 2012, a few years before the mandates were implemented up until a few years after the implementation, to really capture the effects of the introduction of the reporting mandates. CFP is measured through firm value, which is represented by Tobin's Q. The implementation of these mandates led companies to significantly increase disclosure levels. Furthermore, disclosure levels are positively correlated with Tobin's Q. Therefore, the authors conclude that the implementation of CSR reporting mandates have a positive impact on CFP (Ioannou & Serafeim, 2017). Though, the authors do not mention anything about costs related to increasing disclosure levels. Furthermore, Ioannou & Serafeim (2017) mention their disclosure variable does not include certain disclosure items. Concluding, it is questionable whether the benefits of increased disclosure levels, driven by the reporting mandates, outweigh the costs that come along.

In 2014, the EU passed Directive 2014/95/EU, which mandates that large, listed EU firms to report on non-financial aspects of their performance. The entry-into-force date was in 2018. While Fiechter et al. (2022) and Loprevite et al. (2020) study the effects of the introduction of this mandate in 2018, Grewal et al. (2019) study the effects of the period from the proposal in 2013 to the passage of this mandate in 2014 by investigating whether there is an effect on stock prices when the probability of mandatory CSR reporting increases. Grewal et al. (2019) investigate the Bloomberg 2014 population, which consists of 12,162 firms, whereof 2,417 firms are subject to the directive. The remaining companies serve as the control group. The authors find that there is a negative market reaction of 0.79%, although it is stated that the effect is moderated for firms that had a relatively higher CSR performance and reporting levels before the passage of the mandate. This can be explained by the fact that firms with low CSR performance and reporting levels beforehand, have to invest relatively more compared to firms with previously higher CSR performance levels. Hence, leaving the firms with previously lower levels of CSR performance with relatively higher cost. Fiechter et al. (2022) and Loprevite et al. (2020) both find a negative significant association between the mandate and CFP. Fiechter et al. (2022) study the effects of the introduction of the mandate on Tobin's Q, which represents firm performance, from 2013 to 2018, ending one year after the implementation of the mandate regarding 576 EU firms. The OLS regression analysis results show a significant negative relationship between the mandate and Tobin's Q. Although, Fiechter et al. (2022) also find that this effect is moderated for firms with previously higher levels of CSR performance. Loprevite et al. (2020) investigate 44 Italian companies from 2016 to 2018. The authors measure CFP through profitability, which depends on ROA, ROE, the Operating Ratio and the EBIT to Net Income Ratio. Tobit regression results show a significant negative relationship between the level of disclosure and profitability, and they show that the implementation of the mandate decreases disclosure levels, leading to a decrease in CFP (Loprevite et al., 2020).

Chen et al. (2018) investigate the 2008 CSR mandate in China, by employing difference-in-difference analyses, the same mandate was studied by Ioannou & Serafeim (2017). Chen et al. (2018) investigate 1,674 firms listed on the SSE and SZSE from 2006 to 2011, a few years before the implementation up until a few years after the implementation of the reporting mandate, to really capture the effects of the

mandate. The researchers' findings suggest that, because of the implementation of the mandate, firms started investing increasingly in CSR activities, without a direct economic return on these investments, which ultimately leads to a decrease in profits for these firms (Chen et al., 2018).

Downar et al. (2021) investigate the effects of a reporting mandate, implemented in the UK in 2013 concerning GHG emissions, on firms' financial operating performance. The treatment group consists of 24 UK-incorporated listed firms, which are investigated from 2009 to 2018, and 104 firms are included in the control group. The authors utilize difference-in-differences design, which shows no significant impact on CFP. These firms experience a small, but insignificant increase in both costs and sales, leading to a net zero effect (Downar et al., 2021).

Conclusion

This thesis investigates the following research question.

“How do CSR performance and CSR reporting mandates collectively influence Corporate Financial Performance?”

To construct an answer to the research question, this thesis investigates the effects of CSR performance on both accounting-based- and market-based CFP measures, and the effects of the implementation of CSR reporting mandates on CFP. Furthermore, in order to mitigate biases, this thesis includes numerous studies employing different methodologies conducted in various regions of the world.

The majority of researchers conclude through linear research that CSR performance has a positive significant effect on CFP. However, there is a divergence among researchers regarding the effects that individual aspects of CSR have on CFP. A subset of researchers question whether OLS regression models suffice to investigate the CSR-CFP relationship. These authors employ more complex models. Nonetheless, the conclusion remains that, in general, the relationship between CSR performance and CFP is positive and significant. A smaller subset of researchers question whether a linear model actually presents an accurate image of reality. These authors demonstrate both U-shaped relationship and inverted-U-shaped relationships between CSR performance and CFP, rather than linear relationships. Lastly, a minority of researchers question whether the CSR-CFP is actually causal, suggesting there are different mechanisms at work.

CSR reporting mandates on the other hand, are considerably less favorable for firms. The majority of researchers conclude there is a significant negative relationship between the introduction of CSR reporting mandates and CFP. However, firms that had invested sufficiently in CSR prior to the implementation of the CSR reporting mandates experience a moderated negative effect, or even a positive effect, on CFP.

In conclusion, CSR performance and CSR reporting mandates collectively yield a positive impact on CFP. CSR performance independently can exert positive effects on CFP, when companies prioritize aspects of CSR that positively influence CFP and enhance their brand image. CSR reporting mandates often yield a negative effect on CFP. Nevertheless, when looking at the collective effects of CSR performance and

CSR reporting mandates, firms experience reduced negative effects, or even positive effects, on CFP when firms invest sufficiently in CSR prior to the implementation to the CSR reporting mandate.

This thesis makes some major contributions to the existing literature and it extends past research by investigating the effects of both CSR performance and CSR reporting mandates on CFP, a combined analysis not previously explored. Moreover, by presenting various empirical research methods and approaches to CSR, and thus, laying the foundation for future research.

This thesis is subject to limitations. Firstly, the page limit of 20 pages poses a challenge to include a larger number of empirical studies without risking superficiality. However, including more sources in the review could offer a more objective view and enhance credibility of the findings. Furthermore, this thesis focuses on the collective effects of CSR performance and CSR reporting mandates on CFP. This subject does not provide a comprehensive perspective of the effects of CSR reporting on CFP. It may also be of considerable interest to explore the collective effects of CSR performance and voluntary CSR reporting on CFP.

Future researchers might consider exploring the effects of the Directive 2014/95/EU on CFP, both Fiechter et al. (2022) and Loprevite et al. (2020) present early evidence in regard to the EU CSR reporting mandate. The sample period in their studies spans up until 2018, which is exactly one year after the mandate was introduced. Additionally, numerous studies conducted from 2014 to 2024, utilized data from the period between 2000 and 2015. Considering that an increasing number of firms have reported on their CSR initiatives, voluntarily and mandatory, and that reporting standards have been strengthened and modernized, a greater volume of more reliable CSR data is available for research.

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Appendix I

Table 1. Overview of empirical studies studied to answer the sub questions in chapter 3

Authors	Concepts			Effect
	Effects of CSR performance on accounting-based CFP measures	Effects of CSR performance on market-based CFP measures	Effects of CSR reporting mandates on CFP	
Cho et al. (2019)	X	X		Mixed
Wu et al. (2020)	X			Positive
Ting & Yin (2018)	X			Positive
Yang et al. (2019)	X	X		Positive
Delmas et al. (2015)	X			U-shape
Pan et al. (2014)	X	X		Mixed
Beck et al. (2018)	X			Positive
Ali et al. (2020)	X			Positive
Lys et al. (2015)	X	X		Mixed
Nollet et al. (2016)	X	X		Mixed
Awaysheh et al. (2020)	X	X		Mixed
Harjoto & Laksmana (2018)		X		Positive
Sun et al. (2019)		X		Inverted-U-shape
Price & Sun (2017)		X		Inverted-U-shape
Manchiraju & Rajgopal (2017)		X		Negative
Ioannou & Serafeim (2017)			X	Positive
Fiechter et al. (2022)			X	Negative
Loprevite et al. (2020)			X	Negative
Grewal et al. (2019)			X	Negative
Chen et al. (2018)			X	Negative
Downar et al. (2021)			X	Null

Appendix II

Table 2. Number of articles used by journal

Journal	Published articles*	Journal Impact Factor of 2023**
Sustainability	5	3.3
Corporate Social Responsibility and Environmental Management	2	8.3
Journal of Accounting and Economics	2	5.4
Journal of Accounting Research	2	4.9
Journal of Business Ethics	2	5.9
Australian Journal of Management	1	2.0
Economic Modelling	1	4.2
Journal of Business Research	1	10.5
Management Science	1	4.6
Organization & Environment	1	4.2
Review of Accounting Studies	1	4.8
Strategic Management Journal	1	6.5

*Ioannou & Serafeim (2017) wrote a working paper, instead of an academic article that is published in an academic journal. Since working papers are not published in academic journals, and therefore have no Journal Impact Factor that can be assigned to the journal, this study is not included in Appendix II. Therefore, the number of published articles is one lower in total than the number of authors in Appendix I

**Journal Impact Factors of 2023 are retrieved from Journal Citation Reports from Web of Science. Furthermore, according to SCI Journal, a citation index, journals fall within the top 40% of the business, management and accounting field with an impact factor of 2.54 and within the top 20% with an impact factor of 4.02 and higher. For the category of environmental science, an impact factor of 2.35 is required to be within the top 40% of journals and an impact factor of 3.84 is required to be within the top 20% of journals. https://www.scijournal.org/articles/good-impact-factor