
**IS THE HIGHER-QUALITY FINANCIAL REPORTING IMPROVES
CSR INVESTMENT EFFICIENCY AND FUTURE FINANCIAL
PERFORMANCE? - IN INDIAN PERSPECTIVE**

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ABSTRACT

This study searches for the role of financial reporting quality in disciplining managers' investments in corporate social responsibility (CSR) in Indian companies. While agency have similar kind of problems which relates to investment decisions, with respect to investment in CSR, the moral exposure problem that results in over-investment is likely exacerbated as CSR provides certain concealed benefits to managers that would not be anticipated from a typical investment. I have recognized that there is a positive relation between investment in CSR and future profitability for firms with high-quality financial reporting; whereas there is a negative relation between investment in CSR and future profitability for firms with low-quality financial reporting. In general, these outcomes has recommended that higher-quality financial reporting improves CSR investment efficiency by justifying moral helplessness, resulting in an investment in CSR that benefits stake holders by improving future financial performance.

Keywords: Financial Reporting, CSR, Profitability, Investment & Financial Performance

INTRODUCTION

In recent years is seen that there has been an amplified focus on corporate social responsibility (CSR) and keeping in observation of the studies which have taken place CSR has been critiqued by Milton Friedman and others, who argue that the responsibility of a

corporation is to earn profits and that CSR is a distribution of shareholder wealth for pursuit of managers' own interests (Friedman, 1970). On the other side of the CSR deliberate, some imaginary models and pragmatic findings indicate that CSR can be an inexpensively justified business expenditure that enhances a firm's future financial performance (e.g., Fisman et al., 2006; Lev et al., 2009) or reduces a firm's cost of capital (e.g., Dhaliwal et al., 2011; El Ghoul et al., 2011)

In this article, it emphasizes on exploring the role of financial reporting quality in disciplining managers' investments in CSR, as this is one point that is possible to affect; whether CSR results in enhanced financial performance and profitability. Particularly, it has been examined whether higher-quality financial reporting is connected with a reduction in over-investment in CSR and whether higher quality financial reporting results in CSR investments that enhance financial performance.

BACKGROUND

1. Corporate Social Responsibility

Today CSR is not optional and taking a shape of management principle as strategically vital which is progressively spreading across all companies in India regardless of sector or size. Corporate social responsibility (CSR) is a sunshade idiom for corporate responsibility, corporate citizenship, responsible business and corporate social opportunity whereby organizations judge the interests of society by taking responsibility for the impact of their actions on customers, suppliers, employees, shareholders, communities and other stakeholders, as well as the environment. In the year 2010, there have been so many talks, write ups, symposiums, conferences and research work published about CSR, Business ethics, societal marketing, cause initiative, conservation, go green and sustainability

2. Financial reporting quality and investment competence in India

Prior research suggests that higher-quality financial reporting can enhance investment efficiency by mitigating the moral hazard problem that results in inefficient investment decisions (e.g., Bushman and Smith, 2001).

Empirical results are also consistent with the prediction that higher-quality financial reporting enhances investment efficiency. For example, Biddle et al. (2009) find that higher-quality financial reporting improves investment efficiency by reducing over- and under-investment.

In India it is observed that the financial reporting quality has a close relation with management effectiveness. The manager of various firm are focus on the improvement of their work and achieving highest profitability for organization. This can only take place if there is proper investment made in CSR framework and building better place to actually make handsome profits with financial report quality.

3. Future profitability for firms with high-quality financial reporting

It is difficult to separate corporate financial reporting from corporate governance. There are two reasons for this. First, shareholders have the right to receive information timely

on the economic cost of transactions entered into by the company and other events on the financial position and performance of the company.

Therefore, timely presentation of financial information, which reflects the economic consequences of transactions and actions, is a part of good corporate governance. Second, high quality financial information helps the market to value the shares and other securities properly and thus strengthens the passive monitoring of the executive management by those who do not have controlling rights.

As a result, high quality financial reporting improves corporate governance. Therefore, it is not surprising that with increased focus on corporate governance, the focus on corporate financial reporting has also increased. Almost every country has initiated action to improve the quality of financial reporting in order to enhance the value relevance of the financial information provided in financial statements. Thus people have suggested in India that higher-quality financial reporting improves CSR investment efficiency by explanatory moral helplessness, resulting in an investment in CSR that benefits shareholders by improving future financial performance.

THE WAY TO CREATE POSITIVE RELATION IN BETWEEN INVESTMENT IN CSR AND FUTURE PROFITABILITY FOR FIRMS WITH HIGH-QUALITY FINANCIAL REPORTING

Offering, attractive products to customers and to create valuable motivation for employees are the key responsibility taken by a company to take it to the corporate. This in turn contributes to an increase in production and cost savings (ÖhrlingsPricewaterhouseCoopers, 2008). Cost savings through CSR have been discussed (Weber, 2008) and both costs and risks can be reduced through a continuous commitment to CSR activities (Caroll & Shabana, 2010). Weber (2008) argues that CSR creates a higher level of efficiency where the material cost can be saved. Companies can thus have long-term financial advantages when investing in efficient technologies that reduce emissions and hence cost. Environmental efficiencies, for example by reducing waste, can also be achieved, which contribute to lower costs (Lynes & Andrachuck, 2008). It is both economically efficient and environmentally responsible for companies to efficiently use their resources and avoid unnecessary waste (De Schutter, 2008).

"In general, one can reduce the environmental impact by reducing consumption of resources and emissions and waste. It can also be good for businesses to reduce their bills for energy and waste disposal, and lowering input and decontamination. Individual companies have found that less use can lead to increased profitability and competitiveness "(European Commission, 2001, p. 10). Scientists therefore believe that if companies care about the environment, it will lead to a reduction in production costs as companies save on various costs, such as oil, water and various materials. This care for the environment can also result in less legal fees because the risk of litigation is reduced. By working with CSR, companies can therefore reduce the risk of disasters and scandals (Sprinkle & Maines, 2010). CSR efforts can contribute to better contact with company stakeholders, which among other things lead to improved access to capital from investors (Weber, 2008). Often researchers also argue that CSR increases revenues. It can be achieved indirectly through improved brand recognition by consumers or directly by CSR products and market development.

To determine whether CSR is profitable, there have been a variety of measurements of the link between CSP (Corporate Social Performance, a measure to capture CSR) and CFP

(Corporate Financial Performance). The methods have been inconsistent with many different approaches and results have varied. Margolis & Walsh (2003) present a report based on 127 empirical studies on the relationship between CSP and CFP which shows the imperativeness of high-quality financial reporting. They argue that there is sufficient evidence to suggest that there is a positive relationship between CSR and profitability, and that there is very little evidence to suggest that there is a negative relationship (Margolis & Walsh, 2003). A meta-analysis by Orlitzky et al. (2003) provides support for a positive correlation. Furthermore, a recent study by the Indians that most executives have accepted that there is a clear positive relationship between CSR and financial Performance (high-quality financial reporting) (Carroll & Shabana, 2010).

CHANGES IN ORGANIZATIONAL PROFITABILITY DUE TO CSR

Kramer and Porter (2006) added that corporations can think of CSR as a constraint or an additional cost, although it may be an opportunity for them to innovate and gain a competitive advantage. Kolstad (2007) has shown in his paper that the relationship between CSR and profit are a controversial issue. Friedman (as cited by Foote, Gaffney and Evans, 2010) was criticizing the money spend on CSR stating that the major responsibility of the managers is to maximize the profit of the organization as they contracted with the owners of the firm.

While McWilliams and Siegel (2000) added that a lot of empirical studies, showed that CSR and profitability can be engaged in a positive, negative or even neutral relationship. Kolstad (2007) stated that CSR can be seen as a way to reach the final goal of the organization which is increasing the shareholder returns but can't be considered as a goal itself. Kolstad (2007) added that executives used to care only about the profits and the benefits of the shareholders, while nowadays companies may have to widen their goals to include the CSR. Companies should balance sacrificing some financial profit and between satisfying its stakeholders at least on the short term. (Arin˜o, Canela & Garcia-Castro, 2010). Arin˜o, Canela and Garcia-Castro (2010) mentioned that CSR is not always providing a positive impact on the financial performance; some cases showed that it could have a negative impact as well.

Friedman (as cited in Kolstad, 2007) presented the idea that maximizing the profit is the only essential moral aspect that can be offered by the executive to the corporation and that idea was supported by four arguments. First, he mentioned that managers should follow the interest of the shareholders according to the legal contract they have. Second it will be illegal for managers not to follow the interest of the shareholders since this will be considered as taxation to the shareholders.

Third, he advised the corporations to focus more on its core operations to be more efficient. Fourth, since not all the corporations is engaged on CSR, then CSR can be an added cost to corporations that cares about society leading to unfair competition between companies Friedman (as cited in Kolstad, 2007). Kolstad (2007) strongly criticized the overstated idea presented by Friedman, saying that responsibility of business should be seen in a wider view and should take in consideration other agents and shouldn't only consider the shareholders' interest and that the provided idea will need more examination and analysis.

CONCLUSION

CSR as contributing to a long term thinking and holistic approach helps the company to focus on sustainable thinking and to take responsibility having the impact on environment; it also helps to reduce the focus on short term result. Hence, CSR help companies make investments that pay off in the future.

The basic aim of any organization is to survive in best possible manner and keeping in view of maximizing the profitability, but this would only be possible if we understand a direct relation between the investments done in CSR to high-quality financial reporting with idea to have better growth and sustainability. This article gives us the insight that CSR is of great importance not only for society, but for building image of company and financial stability.

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