

Understanding the Relationship between CSR and Dividend Policy: Review and Future Prospects

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Abstract: The study explores and highlights the relationship between dividend payout (DP) policy and corporate social responsibility (CSR). For this purpose, the author used a survey method to find previous research articles that have discussed this relationship. The study's findings suggest that CSR and DP, individually and with other variables, have been considerably researched. However, when it comes to the relationship between the two variables, the research is only about a decade old. Thus, minimal research has explored this relationship and has concentrated only on developed economies. Most of these researchers have found a positive relationship between the two variables, despite taking different proxies to measure CSR, which is contrary to the Resource-Based Theory. The author concluded that there is a lack of research focusing on the relationship between the two major corporate decisions. Thus, no theory(ies) explains the relationship, and corporate managers, policymakers, investors, and even researchers have not paid enough attention to the association and its implications.

Keywords: corporate social responsibility, dividend payout, resource-based theory, value creation.

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INTRODUCTION

For many years, corporate firms have been using Dividend pay-out policies (DP) and Corporate Social Responsibility (CSR) activities to improve their reputation. The dividend pay-out policy and CSR activities also help firms attain a competitive edge and better their financial performance (FP), which is reflected through an increase in the firm's overall value. The concept and construct of Dividend pay-outs have remained more or less the same. On the other hand, the concept and construct of CSR have undergone tremendous change, especially in the past few decades. This change can be attributed to the different approaches taken by the corporates concerning CSR activities (Robinson et al., 2011).

Research on CSR has focused on its relationship with Corporate Financial Performance (CFP) (Ronald et al., 2019) and how CSR is associated with creating wealth (Hasan & Yun, 2017). Most of this research studying the relationship between CSR with CFP or wealth creation has concluded that CSR positively affects both (Orlitzky et al., 2003; Walsh et al., 2003). Lately, researchers have shifted their focus on several other themes in corporate finance and its relationship with CSR, such as – 1) information asymmetry (Dhaliwal et al., 2011),



2) dividend policy/pay-outs (DP) (Rakotomavo, 2012), 3) cost of capital (Attig et al., 2013), 4) the capital structure (Girerd-Potin et al., 2013), 5) debt maturity (Benlemlih, 2015), 6) corporate life cycle (Habib & Hasan, 2017), 7) investment efficiency (Benlemlih & Bitar, 2018), 8) corporate reputation (Park, 2019; Usman, 2020), and many more.

On the other hand, most of the prior research on DP, be it empirical or theoretical, has focused on the relationship between DP and firm value and has also confirmed DP as an essential determinant of firm value (Karpavicius & Yu, 2018).

The above argument brings out two interesting yet vital questions. First, if CSR positively impacts CFP and helps in wealth creation, then in what form are this wealth and values distributed? Second, Does spending on CSR activities impact DP or vice versa. This paper tries to analyze the literature studying the relationship between CSR and DP. Though the literature studying the said relationship is minimal, research in this area is at a novel stage. There have not been many studies confirming a relationship between the two.

As a concept, CSR and DP are both a mechanism for pay-out devices for corporate stakeholders and shareholders. The literature review findings suggest that most research has been conducted in developed countries, and CSR measurement is not consistent. Nevertheless, all these studies have found a positive relationship between CSR and DP. Thus, suggesting that corporate firms that spend on stakeholders also take care of their shareholders or Vice versa. The result is not consistent with the theoretical concept of Resource-Based Theory (which confers that pay-out is dependent on the availability of resources in an organization). If Resource-Based Theory is applicable, an increase in DP should negatively affect CSR activities, as DP and CSR are pay-out devices. For years, managers have used DP and CSR spending to issue signals to the market about a firm's financial health. Although both DP and CSR decisions are important to the corporate decision-making process, very thin literature discusses the relationship between the two variables. Despite the fact that there is little literature exploring this particular association, it is still of great importance for researchers to know what kind of relationship exists between the variables, both for corporate managers and investors. From the point of view of corporate managers, they can enhance firm value by simultaneously engaging in DP and CSR activities and finding the best possible mix as both these decisions have a synergistic effect on the firm value. From the investors' viewpoint, it is essential that DP and CSR activities are not looked into individually or are not downplayed for valuing firms. It may lead to significant errors in the selection of their equity investment.

Understanding the relationship between CSR and DP is especially important for the researcher studying DP or CSR in the Indian context. This is particularly after enacting the Companies Act 2013 (which has made CSR spending mandatory for select companies fulfilling the provisions under section 135). Suppose researchers can establish a relationship between CSR and DP. In that case, it will help answer the questions mentioned previously in the paper.

The paper has employed a survey approach to review available literature studying CSR and DP and has tried to develop a framework explaining the association between the variables by understanding the existing literature and the theories therein. The findings of our review suggest that research is focused only on the developed economies ignoring the importance of the emerging economies where this relationship can be a very important factor for the corporate managers to take the managerial decision regarding pay-out. Also, it can be seen that most studies have used secondary data, and there is no consistency in the measurement of variables and methodology that has been used.

METHODS

The paper has tried to adopt a survey method as a literature review methodology to review and analyze articles exploring the relationship between CSR and DP. As there are plenty of research studies on CSR, one can also find ample research papers on DP. For this paper, the authors choose only those papers which have, in some way or the other, tried to shed light on the relationship between CSR and DP specifically. Therefore the keyword used to collect the data, i.e., articles, research papers, thesis, etc., has been “corporate social responsibility and dividend policy”. After choosing the keyword and establishing the search criteria and the database, the search was conducted in October 2020. The authors searched the same in the websites of leading publications like Emerald, Elsevier, Willy online library, Taylor & Francis, etc., which resulted in finding very few research papers discussing and analyzing the above-said relationship and hence thereafter, Google Scholar was used for the literature search with the same keyword. The inclusion criteria were that all articles and research papers should be published in English with full-text access. These articles must have the searched keyword in the title or the abstract. After completing the search, only 14 (fourteen) articles/research papers were found based on the search criteria. After reviewing the title and abstract, we could include only 12 articles for the review as per the inclusion criteria. The details of the papers found and selected for review are illustrated in Figure 1.

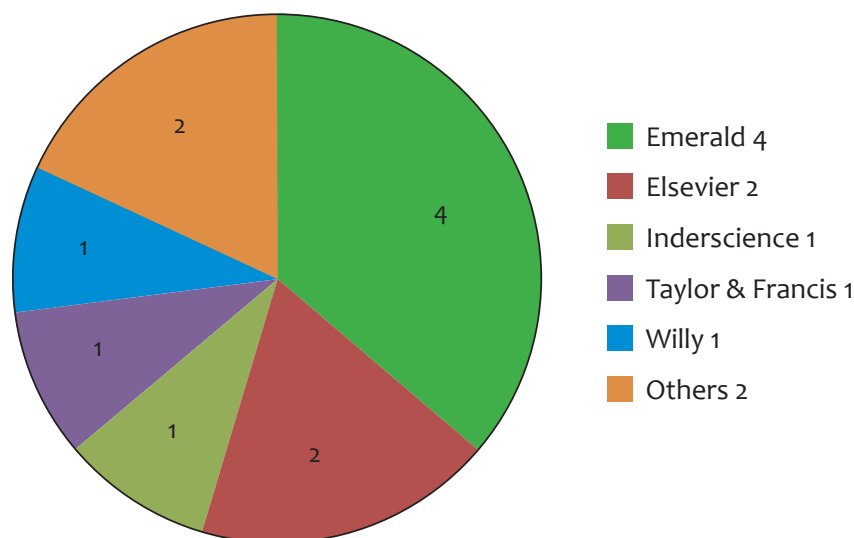


Figure 1 Publishers and Number of Papers

From Figure 1, we can see that the papers on CSR and DP have been published in renowned journals. However, the number of papers published has been very limited, and this shows the dearth of research studying the relationship between the two variables and their effects on each other. The names of journals in which these papers have been published are given in table 1 under the head empirical facet. Out of the total papers taken for review, i.e., 12 Emerald has the maximum publication of only 4, which is very low compared to any other relationship of variables with CSR or DP.

RESULTS AND DISCUSSION

The literature posits multiple theories on CSR and DP, respectively. However, few important theoretical arguments (such as Life Cycle Theory, Signalling Theory, Agency Theory, Resource-Based Theory, and Stakeholder Theory) could explain why CSR activities may affect firm dividend policy or vice versa.

First, the Life Cycle Theory posits that people and so firms plan their spending throughout their lifetimes after factoring in their future income. Accordingly, after considering the stage of their life-cycle, firms decide about spending on dividends and/or CSR activities. Thus, firms' fund outflow increases during such activities when they enter the maturity stage (Lee & Choi, 2018).

Second, Signalling Theory by Spence (1973) emphasizes on disclosure of corporate actions to signal to the market. Therefore, when a company spends on CSR activities or dividends, it sends a signal to the market with regard to the future prospects of the firm. For example, an increase in CSR spending and dividend pay-outs indicates that the company's financial health is sound, and it informs the market about expected good results for the firm.

Third, Agency Theory's free cash flow argument by Jensen & Meckling (1976) also raises a conflict as to who is liable for making socially responsible investments, especially when it comes to CSR besides, most discussed horizontal (Type-II) and vertical (Type-I) agency conflicts in finance literature. From the perspective of CSR, since socially responsible investments helps managers to be identified as socially responsible, this, in turn, gives personal benefits to the managers by increasing their social worth. However, with large free cash flows, they may tend to overinvest in social and environmental activities beyond the optimal level (Barnea & Rubin, 2010), and high dividend pay-outs will reduce this capacity.

Fourth, the Resource-Based Theory propounded by Wernerfelt (1984) was highlighted by Barney (1991), who suggested that valuable, rare or non-substitutable resources can put a firm in a better position in the long run and can be detrimental to the success of the firm. As these resources are limited in nature, they should be used strategically. So, firms often may face a dilemma as to which pay-out device, viz., CSR or DP, will give them a strategic advantage and therefore, investment in one type of pay-out device may reduce investment in the other.

Lastly, The Stakeholder Theory given by Freeman (1984) makes it explicit that a firm has material and/or moral reasons to consider its relationship with stakeholders more than just investors (Blowfield & Murray, 2011). Thus, firms have to honour both explicit and implicit claims of the financial and non-financial stakeholders. These claims can be honoured by using a tool such as DP for financial stakeholders. In contrast, for non-financial stakeholders, the same can be done with the help of CSR activities (Arouri et al., 2018).

As mentioned before, earlier research on CSR has mainly focused on its relationship with CFP. The research has largely concentrated on its association with firm value when it comes to DP. As CSR activities and DP are commonly used as a vehicle for transferring value to stakeholders and shareholders, respectively, the relationship between CSR and DP can be looked at from two aspects, namely the theoretical aspect and empirical aspect. The theoretical aspect will explain the relationship between the two variables theoretically. In contrast, the empirical aspect will analyze and explain the relationship based on the previous research.

In theory, CSR can affect DP in two major ways. Firstly, by affecting the earnings and secondly by affecting the cost of capital: 1) By affecting the earning: Literature has shown a positive relationship between CSR and FP of firms (Wang et al., 2015). Therefore, through firms' financial performance, CSR affects earnings and thereby affects DP as earnings (through profitability and FP) are key determinants of DP (Gul, 1999; Michaely & Roberts, 2012). These enhanced earnings due to CSR activities are expected to flow to shareholders through dividends,

resulting in a win for all stakeholders, including shareholders (Statman, 2000). There are plenty of empirical studies that have shown that: i) firms with good relationships with their stakeholders can reduce transaction costs (Jones, 1995); ii) healthy relationships among the firm and its stakeholders enhance competitive advantage by increasing customer and client loyalty (Choi & Wang, 2009; Hillman & Keim, 2001), and; iii) good relationship with stakeholders reduce the cash flow jolt when a pessimistic event occurs (Godfery et al., 2009). Thus, this provides a basis for why CSR and DP are related. 2) By affecting the cost of capital: Firms with higher CSR scores or activities are perceived to be less risky than firms with lower CSR scores or activities. This can be attributed to lesser information asymmetry due to better corporate governance (Jo & Harjoto, 2011), stronger customer relationship, admirable investor loyalty (Jo & Na, 2012; Luo & Bhattacharya, 2009), enhanced corporate reputation and good social capital (Luo & Bhattacharya, 2009). Thus, through CSR, firms can reduce the premium on the risk, eventually lowering the cost of capital, and as CSR lowers the cost of capital (opportunity cost), firms are encouraged to hold cash for future investments instead of paying it out as dividends (Kim et al., 1998). Firms' incentive to invest depends on their respective cost of capital (an external financial constraint), and that is binding on them, which determines their dividend-paying capacity by generating crowding-out or crowding-in effects from time to time. Therefore, through cost of capital CSR may influence the DP of a firm.

'Earning', as discussed above, forecasts a positive relationship between CSR and DP as former activities enhance earnings, which puts corporations in a better financial position to pay higher dividends. On the contrary, 'cost of capital' illustrates a negative relationship between CSR and DP. The former lowers the cost of capital, providing firms with an incentive to hoard cash rather than pay dividends. There is a relationship between CSR and DP if these theoretical arguments hold. It is important to know and understand whether this relationship is positive or negative, depending on the more dominating factor earning or cost of capital. Normally, both the earnings and cost of capital will be affected simultaneously. Or is there any other factor(s) that affects this relationship?

Empirically, few studies have looked into the relationship of CSR with DP. As the two variables have not been studied extensively together, the paper has tried to portray whatever empirical studies the authors could find in a tabular format with the names of the paper, the authors, and the journal, in which it has been published, including the sample taken, the hypothesis proposed or research questions and findings of the study.

Table 1 Summary of Empirical Research on CSR and DP

Sl. No.	Name of the Papers	Authors & Year	Journal of Publication	Sample Size and Period of Study	Hypothesis/Research Question of the Study	Findings
1.	Corporate investment in social responsibility versus dividends?	Rakotomavo (2012)	Social Responsibility Journal	The study covered US firms with 17,670 US 17,670 firm-year observations between the years 1991 to 2007.	1. CSR investment does not cause negative deviation to current dividend and past dividend policies.	The evidence supports the hypothesis and proves that CSR efforts and dividends increase together.
2.	Dividend policy and Corporate Social Responsibility: A comparative Analysis of Multinational Enterprise Subsidiaries and domestic firm in Korea.	Kim & Jeon (2015)	Emerging Markets Finance & Trade	The study covered 6,261 firm observations from 668 domestic firms and 19,866 firms from 2,390 foreign subsidiaries from 2000 to 2010.	1. Foreign subsidiaries CSR levels positively relate to the DP ratio. 2. At the same level of CSR, Foreign subsidiaries pay higher dividends than domestic firms.	The findings suggested that for domestic firms and foreign subsidiaries, DP is positively related to their level of CSR activities. Though for foreign subsidiaries, this relationship is stronger than their local counterparts.
3.	Corporate Social Responsibility and dividend policy	Cheung et al. (2016)	Accounting and Finance	The study covered 15,561 firm observations for 1,965 firms, covering a period from 1991 – to 2010 by using the KLD database.	1. Firms with higher CSR scores tend to pay more dividends than firms with lower CSR scores.	The study's findings confirmed the hypothesis and concluded that firms with higher CSR scores have a better DP ratio than firms with lower CSR scores.

Sl. No.	Name of the Papers	Authors & Year	Journal of Publication	Sample Size and Period of Study	Hypothesis/Research Question of the Study	Findings
4.	The association between Corporate Social Responsibility and Dividend pay-outs.	De Villiers & Ma (2017)	International Journal of Critical Accounting	The study took 1,604 firm observations from 10 different US industries covering 2006 to 2008.	1. Firms with higher dividend pay-outs have better CSR performance.	Findings concur the hypothesis and concluded there exists a positive association between firms' DP and CSR performance.
5.	Corporate social responsibility and pay-out decisions	Samet & Jarboui (2017)	Managerial Finance	The study covered 397 companies from STOXX Europe 600 from 2009 to 2014.	1. CSR performance increases firms' pay-out level. 2. Preference for share repurchases is associated with the CSR performance of a firm. 3. The relationship between dividends and share repurchases is moderated by CSR performance.	Findings suggested that: i) firms that engage in high CSR activities also engage in more pay-out policy, ii) high CSR firms prefer share repurchases over dividends, and iii) the relationship between dividends and share repurchases is determined by CSR performance.
6.	Pay Dividends or Invest in Corporate Social Responsibility: Is there an Inverted-U relationship?	Arouri et al. (2018)	Finance Bulletin	The study covered 6,965 firm observations from multiple countries from 2006 to 2010.	1. An inverted U-shaped relationship between DP and corporate social performance exists.	The study's finding concurs with the hypothesis, and the justification given for it is that firms, after High dividends, subsequently try to satisfy other stakeholders' claims through CSR activities.
7.	Corporate life cycle, CSR, and dividend policy: empirical evidence of Indonesian listed firms.	Trihermanto & Nainggolan (2018)	Social Responsibility Journal	The sample for the study included 923 firm-year observations from 527 Indonesian listed firms from 2008 to 2015.	1. Firms increase CSR expenses at the maturity stage of the corporate life cycle. 2. CSR expenses and DP are positively related.	The study's findings suggested that: i) CSR expenses increase as the firm reaches the maturity stage of the corporate life cycle, and ii) CSR expenses are positively related to DP.
8.	Corporate Social Responsibility and Dividend Policy.	Benlemlih (2019)	Research in International Business and Finance.	The sample consists of 22,389 firm-year observations from 3,040 US firms from 1991 to 2012.	1. Firms with high CSR pay more stable dividends than firms with low CSR.	The findings validated the hypothesis and concluded that socially irresponsible firms adjust their dividends faster than firms with high CSR.
9.	Corporate Social Responsibility: Capital Structure and Dividend Policies in Europe	Heil (2019)		The dataset consists of 296 companies out of the Eurostox 600 for 2016.	1. Dividend policies affect CSR policies in Europe	The irrelevance of dividend policies for CSR is proved.
10.	Corporate Social Responsibility, Pension Liability, and Dividend Policy	Chen (2019)		Data from 1991 to 2016 provided by MSCI ESG KLD with 305 observation	1. Firms with higher CSR pay higher pensions and dividends.	Dividend-paying firms tend to have a higher CSR rating. The study also validates that the total pension liability of a firm is positively correlated with its CSR, regardless of its dividend policy. Moreover, lastly, provisioning for higher pension liability in the current year leads to a higher CSR rating.
11.	Does sustainability affect dividend policy? A panel data study on Nordic firms	Johansson & Fahlen (2019)		ESG and DP data of 117 firms for ten years (2008-2018)	1. What is the relationship between corporate sustainability and dividend policy in Nordic countries?	Their findings concluded that Corporate sustainability and DP ratio are positively related.
12.	The effect of corporate social responsibility transparency on corporate pay-out policies.	Zadeh (2020)	International Journal of Managerial Finance	The sample for the study consisted of 2,822 firm-year observations taken from the S&P 500 index for the period from 2012 to 2019.	1. There exists a positive relationship between a firm's environmental and social transparency with firm-level pay-outs. 2. Under which condition do the relations mentioned above become more pronounced.	The findings show that environmental and social transparencies are associated with higher firm-level pay-outs (i.e., dividend and share repurchase). This relationship is more apparent for firms exposed to high information asymmetry, weak governance, and low levels of financial reporting quality.

As most of the earlier research concerning CSR has been empirically examined, the relationship between CSR with CFP finds a positive relationship among the two variables. Many research papers have not studied the association between CSR and DP. These studies which have explored the relationship between CSR and DP have found similar results and have established a positive association between the variables, except for Johansson & Fahlen (2019), who found a positive, but insignificant relationship between ESG scores, which they used to measure CSR and dividend yield, which is in contrast with the findings of other studies like Benlemlih (2019) and Samet & Jarboui (2017). Different results may be due to the sample and data used in these studies.

To contextualize research findings, the authors have used the theoretical arguments from previous research. The theoretical arguments and perspectives that have been used in these studies have been based on one or more of the following theories life cycle theory, agency theory, signalling theory and stakeholder theory. These theories have been used to explain the relationship between CSR and DP while simultaneously attempting to conclude if there is support for any of these theories. Notably, life cycle theory, stakeholder theory, and signalling theory present possible explanations for the positive relationship between CSR and DP. In contrast, the agency theory's argument is inconsistent with the overall results. As firms through CSR activities show consideration towards their non-financial stakeholders, the same firms do not ignore their financial stakeholders and give them equal importance through pay-outs policies. Hence, CSR and DP show a positive relationship with each other. Figure 2 explains the common determinants of CSR and DP, which explains the relationship.

The common factors that may influence the relationship between CSR and DP in the figure have been divided into three different segments viz., i) Firm's Business environment; ii) Perceived Benefits; and iii) Management Structure.

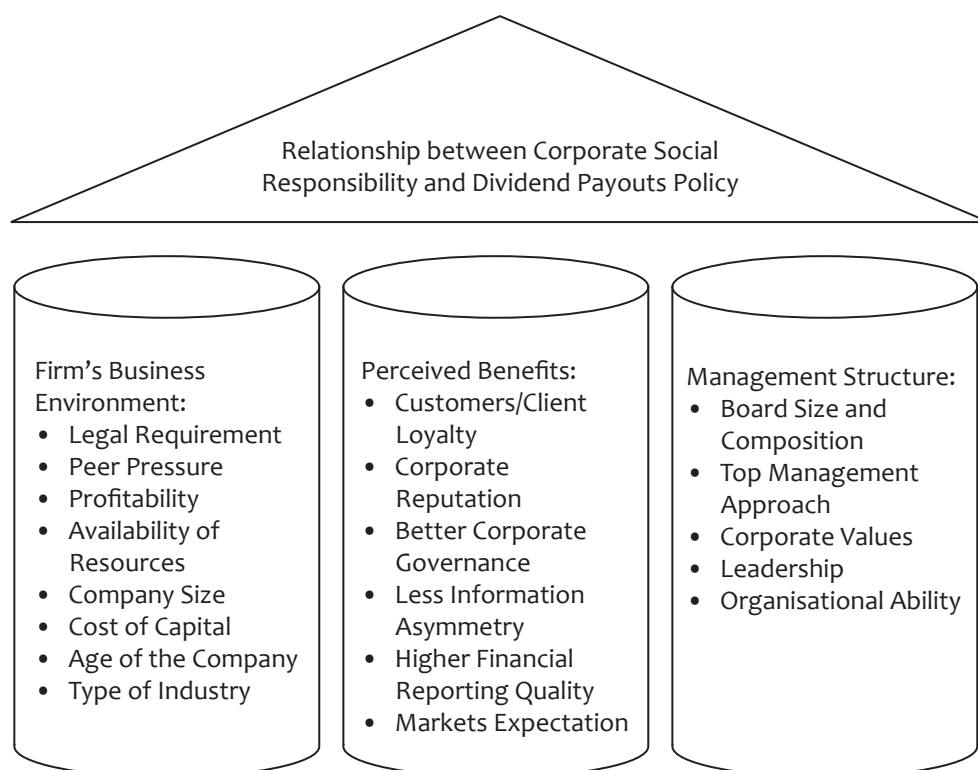


Figure 2 Common Factors Effecting Relationship between CSR and DP

A firm's Business Environment includes various factors, such as the legal environments in which the firm is operating, which may affect the relationship between CSR and DP. Another factor that may influence the relationship is peer pressure, i.e., policies adopted by similar firms operating in a similar environment. Profitability and availability of resources are also factors that will influence the CSR and pay-out policies, as only profitable firms with available resources can afford to invest in CSR activities and dividend pay-out. As CSR and DP are also a mode of signalling the market about the future prospects of a firm, and these activities may influence the presumed risk, and hence the cost of capital, including the cost of equity, and this will persuade present and prospective investors with regards to the future financing decisions. Company size is also a factor that has an influence on the amount of CSR activities and DP as bigger firms can have done more CSR activities and can invest more in DP compared to smaller firms. This also depends on the age of the firm, which in turn is related to the firm life cycle, as it is proven through literature that mature firms invest more in CSR and DP (Trihermanto & Nainggolan, 2018). Apart from the above-mentioned factors, the type of industry, stakeholders' involvement etc., also affect the CSR and DP policies.

Perceived Benefits for firms also affect the relationship as investing in CSR activities and DP will result in higher Customers/Client Loyalty, improves Corporate Reputation, and result in better Corporate Governance and less Information asymmetry, which also helps in higher financial reporting quality.

The management structure is another factor that affects the association between CSR and DP. By management structure, we refer to the board size and composition, the approach of top-level management, corporate values of the firm, leadership through ensuring value creation and ethos, and organizational ability can influence the prospective on CSR and DP.


There is ample academic literature that has flourished in the past four to five decades, which has discussed CSR or DP with other variables. In the past decade, researchers have started to look into the relationship between CSR and DP. Thus, very few published documents have studied the said relation. This review is a modest effort to include all the relevant studies that have discussed this relationship and identified the following issues relevant to this research area. The relationship between CSR and DP has come to focus in just recent years, and it has been found that research in this area has been conducted only in developed economies, which are known to have a stronger form of market efficiency, active and better regulatory framework, etc., like in the case of the USA and European countries. Research is focused on developed economies because developing economies' dynamics might be too volatile as the markets are still emerging. Researchers in future may also focus on developing economies to unify and establish the relationship among the variables. The researchers in India and those who wish to study variables in the Indian context may focus on this relationship even more after introducing the Companies Act 2013, which has made CSR spending mandatory for select Indian companies as per the provisions of section 135 of the Act. All the articles reviewed are empirical and based on secondary data.

CONCLUSION

Researchers in the future may focus on studying the same relationship with primary data. There have been only a few studies to describe and understand the relationship. Future researchers are encouraged to do more research and unify the findings by considering different theories, statistical tools, measurement methods, and variables to explain the association between CSR and DP. Future research studies can concentrate on emerging economies or developing countries and/or on studies where data is collected from multiple countries. Also, a longitudinal study will give a clearer picture of the relationship between the two variables. It has also been observed that

CSR and DP laws vary from country to country, which may cause the results to be varied in different scenarios, which gives the researcher a wide scope for future research endeavours. To better understand and analyze the relationship between CSR and DP, primary data-based research also needs to be considered. Suppose the studies are conducted using secondary data. In that case, researchers can use actual expenditure on CSR instead of using an index or any other measurement techniques as indexes are made based on various criteria, which will be different in each case. Researchers in future can also help in establishing which theory/theories best explain the relationship between the two variables. The outbreak of COVID has proved that businesses cannot survive when society is unwell and not healthy. The present uncertainty has thrown businesses into uncharted territories. The prevailing condition has created a higher need to align and integrate the CSR strategy with the business strategy. The Companies Act 2013 laid emphasis that CSR is no longer an obligation but compliance. Future researchers may conduct the studies towards the design thinking of a structured way of integrating the CSR and pay-out strategy. Researchers can conduct exploratory studies to understand the mindset to shift CSR to scientific, social responsibility in the present scenario. The emergence of a new class of Impact Investors also supports the need for more scientific studies on the flexibility of corporate decisions towards dividends and CSR spending. The researcher may design empirical studies to investigate the influence impact of investors on CSR spending.

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