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MONITORING ABNORMALITY IN RETURNS OF COMPANIES AROUND CORPORATE SOCIAL RESPONSIBILITY ESG-RATING

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ABSTRACT

This study will analyze whether and how corporate social responsibility affects the financial performance of the listed companies. According to agency theory, Corporate Social Responsibility engagement should be negatively related to financial performance. By contrast, from the stakeholder perspective and according to the resource-based view, Corporate Social Responsibility should positively impact companies' financial performance. Net interest income and profitability increase with the increase in the social performance of banks; as stated by previous research work at the same time, Corporate Social Responsibility is negatively related to non-performing loans. Therefore, this research analyzes the relation between two in Indian companies' corporate social responsibilities and performance compared to the trade-off model.

KEYWORDS: *Corporate Social Responsibility, E-Garch, ESG rating, Event study, Nifty.*
JEL Code: P43, G3, and G28

1. INTRODUCTION

(Commission, 2001) defined "Corporate Social Responsibility as a concept whereby companies integrate social and environmental concerns in their business operations and their interaction with their stakeholders on the voluntary basis."Corporate Social Responsibility has broadened the domain of the corporate sector from stockholders to stakeholders by assigning responsibility towards all those institutions affected by the company.

Corporate social responsibility is a self-regulating business model that helps a company be socially accountable — to itself, its stakeholders, and the public. By practicing corporate social responsibility, also called corporate citizenship, companies can be conscious of their impact on all aspects of society, including economic, social, and environmental. To engage in Corporate Social Responsibility means that, in the ordinary course of business, a company operates in ways that enhances society and the environment instead of contributing negatively to them. The Companies Act 2013 made Corporate Social Responsibility mandate for the companies having a turnover of 1000 crore or more, or net worthmore than 500 crores or more, and those companies which has anet profit of five crores or more should contribute two percentof its net profit towards corporate social responsibility **(section135, Companies Act 2013)**.

Corporate social responsibility is an expansive idea that can take numerous structures relying upon the organization and industry. Through Corporate Social Responsibility projects, philanthropy, and volunteer endeavors, organizations can profit society while boosting their brands. As significant as Corporate Social Responsibility is for the network, it is similarly vital for an organization. Corporate Social Responsibility exercises can help fashion a more grounded bond among workers and enterprises; they can support the spirit and support the two representatives and managers to feel progressively associated with their general surroundings.

Most of the examinations of CSR show up in corporate sustainability reports. Be that as it may, depending on the individual corporate CSR report has inherent inadequacies, for example, a one-sided divulgence issue because of the lack of the company's disclosure instrument, viz. uncovering just the association's only translation of its CSR and its operationalization**(Pae, 2011)**. Subsequently, to explore the connection between CSR and Financial Performance impartially, a few investigations analyzed the relationship dependent on outsider evaluations of environmental, social, and corporate governance. **(Nollet J, 2016)**tried both direct and non-direct connections between CSR execution and Financial Performance. They likewise utilized an elective outsider inspectors' informational collection, viz. Bloomberg's ESG (Environmental, Social, and Governance) exposure score, as another intermediary for CSR.

(Jae-Joon Han, 2016) The ESG exposure score is essentially utilized as one of the crucial files in the ID of CSR exertion. It is utilized to comprehend the general CSR exercises, how companies create CSR issues concerning their destinations and techniques for long haul development, oversee chances and other hierarchical qualities in general administration rehearses, etc. Initially, ESG wording first showed up in the United Nations Principles of Responsible Investment.

The significance of this research is to add to retail financial specialists, corporate investors, and corporates about their venture choices. In this research, all the companies have been taken from all sectors, contributing to the Indian economy.

2. Review of literature

Corporate Social Responsibility is something that all organizations take as liability, or we can say that with its obligation of the organization, it contributes to society in different manners. It can be community involvement, environmental contribution, workplace, and diversity**(Shafat Maqbool, 2018)**

As said by **(Shafat Maqbool, 2018)** corporates should not consider Corporate Social Responsibility as a legal obligation; instead, it should be treated summed up in long-term business strategy. When a company organizes Corporate Social Responsibility activities appropriately, it becomes easy for the company to achieve the target, be it financial performance, including shareholders' wealth maximization. Corporate Social Responsibility should be taken as a voluntary initiative rather than a legislative mandate.

As far as leverage ratios like debt-to-equity ratios are concerned **(Francesco Gangi, 2018)**, the Corporate Social Responsibility activities positively impact the performance of banks. Until banks initiate corporate Social Responsibility activities in the European market, they positively impact the performance of banks. The increase in Corporate Social Responsibility activities incorporate risk perception also goes down, which eventually leads to the positive performance of banks **(El Ghoul, 2011)**. Suppose we focus on the size of the companies, large-cap companies, and mid-cap companies. In that case, reveals as per **(Perrini F. &., 2008) and (Perrini F. R., 2007)** that large-cap companies have a significant effect on their Corporate Social Responsibility activities on the company's performance.

Researchers are giving negative views, such as **(Sorumluluk 2015)**, that with an increase in Corporate Social Responsibility scores, the company performance is going down in the market of Turkey. Since the firm's point is maximizing shareholders' wealth, research studies connect the Corporate Social Responsibility practices to money-related execution measures. Nevertheless, at the same time, writing is uncertain about the Corporate Social Responsibility and financial performance relationship. In the conventional perspective on the organization, the firm's obligation is constrained to meet the requirements of shareholders. As **Friedman (1962:63)** states that "The responsibility of business is to increase the profits." Despite the suggestion still, many researchers reject Friedman's view.

(McWilliams, 2001) commented that dependent on a market interest hypothesis of the firm the generation of execution. It is also accepted that excellent management administration will perform well in each part of the business, even in social responsibility **(Waddock, 1997)** and **(Preston, 1997)** analyzed ta firm with better financial performance has slack resources directly proportional to the social performance. Research done by **(Saed Adnan Mustafaa, 2012)** in the Malaysian market again carried positive results that Corporate Social Responsibility activities have a significant impact on the performance of corporates. Large-cap companies are showing the significant effect of Corporate Social Responsibility on the company's performance. In contrast, small-cap or mid-cap companies are not able to show such a significant effect.

Another research done by **(Lin Lin, 2019)**in the Taiwan market shows a positive signaling effect, which shows that broader categories of corporate social responsibility and subcategories impact companies' shareholders. The returns of the company and profitability of the company are both increasing. Some researchers **(Ester Gras-Gil, 2016)** are finding a negative impact of Corporate Social Responsibility on the company's performance in the Spanish market. Research done by **(Ester Gras-Gil, 2016)** for 7 years among non-financial companies shows a negative impact. With an increase in spending on corporate social responsibility, the company's financial performance is going down. While interviewing the company officials, the author found that the company cannot fund new projects or expand its corporate social responsibility. More research done by **(Jesús Herrera Madue˜noa, 2016)** in the Spanish market only in financial companies shows positive results. In small and medium enterprises, which is more conditioned by their competitive performance. With the help of socially responsible actions, strategic incorporation will result from improved companies' financial performance. With the research in 481 companies' researchers concludes that the Corporate Social Responsibility activities impact the company's performance directly or indirectly. **(Waddock, 1997)** calculated seven types of relationships between Corporate Social Responsibility and the financial performance of the company. Among positive relationships between Corporate Social Responsibility and the performance of companies **(Freeman, 1984)** also suggest that higher the competency of Corporate Social Responsibility activities will be better than the company's performance.

As per the study conducted by **(Camilleri, 2016)**the Environmental Protection Agency (EPA) has likewise built up an assortment of techniques, instruments, what is more, direction programs that are pointed toward supporting the utilization of natural supportability, the Bureau of Energy Resources (ENR) propels U.S. interests concerning secure, solid and ever-cleaner wellsprings of energy. ENR advances excellent administration and straightforwardness in the energyarea as it upholds the Extractive Industries Transparency Activity (EITI).

Again, one more study done in the Spanish market for the companies listed in the Madrid Stock Exchange **(Rodriguez-Fernandez, 2016)** shows the positive relationship between Corporate Social Responsibility activities and profitability. This study also demonstrates that being profitable is social and social is profitable in the Indian market research done by **(Anjali P, 2016)** which also shows the positive results like Spanish and Malaysian markets. With the increase in Corporate Social Responsibility spending, return on equity, return on assets, and earnings per share also improve. The shareholder's wealth gets maximized and, in return, boosts the company's financial performance. However, with the Corporate Social Responsibility activities, price to book value goes down. In Indian market research executed by **(Anjali P, 2016)** shows the public sector banks are the ones that are contributing the highest amount in Corporate Social Responsibility activities.

In contrast, some private sector banks not even contributing to the Corporate Social Responsibility the minimum legislative requirement.**(Carroll, 1979)** endeavored to orchestrate the central rule of social obligation. He clarified the reasoning behind social duty activities and proceeded to depict the corporate reactions to social issues.

Research is done by **(Khurshid Djalilov, 2015)**in transition countries of the former Soviet Union and Central and Eastern Europe. This research author tried to find the link between 254 banks during a stable and turbulent economic period. In both periods, corporate social responsibility activities and factors contribute positively to the company's performance.

Thus with 18 companies, we can say that 12 studies are showing positive or neutral results. The remaining 6 shows negative results. Corporate Social Responsibility activities are showing mixed results in different economies and different sectors.

3. Statement of the problem

In this research article, the impact of ESG rating has been studied with an effect on the financial performance of corporates. Business organizations in India follow different methods to measure CSR activities. One such among them is the ESG rating. Though in India, ESG rating is a very immature stage. Not all organizations are disclosing their ESG data in CSR disclosure reports. There is not any standard opted by corporations to publish CSR reports.

4. Need of the study

This study mainly focuses on the relationship of rating of corporate social responsibility of a company with its return. The MSCI (Morgan Stanley Capital International) company is providing Corporate Social Responsibility-ESG (Environment, Social and Governance) rating using KLD data analytics. Since this company provides the data on an annual basis and the date of announcement is not available. To avoid mismatching of data, April 1st of the year is taken to measure the change in this research. In this research, ten listed companies from various NIFTY 50 are taken to measure the change. For some companies, their ESG-rating does not change, but every year it is announced. So, this is research will be giving results for the positive, negative and neutral ESG-rating.

5. Objectives of the study

The objectives of the study are following:

1. To measure the impact of ESG rating on the financial performance of the company.

2. To analyze the importance of the ESG framework in the Indian business context.

6. Hypothesis of the study

H_0: ESG rating affects the financial performance of a company.

H_a: ESG rating does not affect the financial performance of the company.

7. Research methodology

7.1 Sample Selection

In this paper, ten listed companies from the National Stock Exchange data as per their market capitalization. The list of companies, along with their ESG rating, is in Table 1.

7.2 Sources of data

The data collected in this research is the secondary database:

- ESG reports from respective company websites.
- Financial reports data from www.nseindia.com.
- ESG rating from Morgan Stanley published reports.

7.3 Period of the study

Data collection is daily stock prices of 10 companies for one year of the financial year 2019-20.

7.4 Tools used in the study

To research ESG rating impact, the event study method has been used by using E-GARCH. E-GARCH is Exponential Generalized Autoregressive conditional heteroskedasticity. Since the date of the ESG rating is not mentioned so, April 1st of the year is taken into consideration. As the event date. A selection of event window for 21 days, i.e.,ten days beforethe event date and ten days after the event date.

8. **Data analysis**

To research ESG rating impact, the event study method has been used by using E-GARCH. E-GARCH is Exponential Generalized Autoregressive conditional heteroskedasticity. Since the date of the ESG rating is not mentioned so, April 1st of the year is taken into consideration. As the event date. A selection of event window for 21 days, i.e.,ten days beforethe event date and ten days after the event date. The mnemonic to write event window is [-10,0,10]. -10 means 10 days before the event, and +10 means 10 days after the event. For calculation of expected return E-GARCH formula is used in MS EXCEL. The E-GARCH formula is used to determine the expected return. The primary objective of the research is to determine to examine the ESG-rating on the performance of companies.

Steps of methodology:

Step 1: Event 0 denoted as on event date on which the ESG rating is announced.

Step 2: Next step is to select the event window. As research was done by (Francesco Gangi, 2018) says that the impact of any significant event will start ten days prior and will not remain in the market for more than 10 days. So, the event window will be [-10,0,10].

Step 3: Estimation of the window will be for 100 days.

Step 4: Then the calculation of actual return is calculated by using the following formula

$$Actual\ Rteurn = \ln \frac{N+1}{N}$$

Where N is the price of the security on the Nth day

N+1 is the price of the security on (N+1)th day

Step 5: For the calculation of expected return, some exogenous variables should be used. The exogenous variable should be something that does not impact the independent variable directly. The exogenous variable used in this research is the NIFTY 50 index.

$$Expected\ return = \alpha + \beta \ln(nifty)\left(\frac{N+1}{N}\right)$$

Where, α= regression coefficient of security

β= regression coefficient of NIFTY 50

Step 6: Calculate abnormal return

$$Abnormal\ Rteurn = Actual\ Return - Expected\ Return$$

Step 7: The last step is to calculate cumulative abnormal return.

After the calculation of the t-test, a t-test is conducted to test the hypothesis. Table 3 refers to the P-value of the selected sample organization. This shows that the p-value is less than 0.05, which tends to accept the null hypothesis stating that the performance of an organization improves with ESG rating. Financial performance **(Maqbool, 2018)** is measured using abnormal returns of the stocks, increasing as shown in table 3. ESG outperformance openings exist in numerous spaces of the market.**(Gunnar Friede, 2015)**shows that in North America, ESG performance impacts the financial performance of the company.

Against this setting it very well may be perceived that ESG is currently a necessary piece ofworking of an association. The performance of a corporate ought to be judged past the monetary boundaries. The specialists need not just spotlight on the monetary execution yet to analyze into the ESG execution of the corporate. Keeping in see the significance of corporates in India, this examination is centered around the corporate social obligation exercises did by Indian corporates.

Nevertheless, there is a limitation in India since the ESG framework is not mandatory to be adopted. Many organizations do not follow the same. They are still following the traditional CSR culture. This narrows down the scope of ESG in Indian firms. Nevertheless, this research shows that ESG performance and rating impact the financial performance of companies. This makes Indian organizations adopt for ESG framework in their CSR disclosure reports to uniformity in reporting.In spite of the fact that there are numerous positive models for the ESG–CFP connection, scientists frequently claim that results are questionable, uncertain, or opposing**(Ester Gras-Gil, 2016).**

9. FINDINGS

To test the hypothesis of abnormal return with the actual return, a t-Test is conducted to test the significance of the hypothesis. A confidence level of 95% is used to conduct a t-Test hypothesis test. After the t-Test, all the selected companies in the sample show p-value less than 0.05, which shows null is accepted by rejecting the alternate hypothesis. Following findings are drawn from the data analysis:

- If we check the change in ESG rating company-wise out of 10 selected companies, five companies show a downgrade in ESG rating due to which the company's return goes down. Similarly, three companies show their upgrade, and two companies show no-change in ESG rating and show improved financial return and approximately zero abnormal return, respectively.
- With this observation, it can be considered that for a company’s financial performance, the ESG rating plays a significant role for long and short-term investors. With the announcement in ESG rating, the fluctuation in the price of companies is visible. Retail or corporate investors can consider ESG rating before investing, but that does not mean that ESG rating is the only aspect investors need to cover before investing in any company.
- Nevertheless, one thing here needs to be noticed why companies are getting downgraded in ESG rating despite being legally mandated by the Ministry of corporate affairs. 50% of companies from the selected sample show downgraded ESG rating, which shows either the companies are investing in corporate social responsibilities to save their tax or not covering all the aspects of ESG, i.e., Environment, Social, and Governance. Failing to comply with any of the ESG aspects will also lead to a downgrade in the rating. To get a good rating, a company needs to be vital in all aspects of ESG rating.

10. Suggestions

From this research following suggestions can be concluded:

1. Since the scope of the ESG framework is getting widened shortly. Every business organization should work towards implementing the ESG framework.
2. With the implementation of the ESG framework, CSR measurement for all Indian companies will be in a uniform manner.
3. With uniformity in the measurement scale of CSR, it will be easier for researchers to conduct research in the ESG framework and come to a conclusion.
4. ESG performance-based mutual funds are already attracting investors in the Indian market.

11. Conclusion

In the last, it can be concluded that CSR-ESG rating is an essential aspect for investors before investing in any company, but it is not the only aspect. There are other aspects as well which can be considered before investing in any company. Nevertheless, companies consider the public issue more than debt to raise funds if we consider the latest data. In 2019, this data increased to 29%. This data shows Indian market has many potentials which can be considered for investment.

12. Limitations

Every research has its own limitations. If we consider the limitations of this research, it has majorly two limitations. First, only tenlarge-cap companies, which belong to Index Nifty-50, cannot explain mid-cap and small-cap companies. So, we cannot say that if large-cap companies are getting affected by ESG rating, mid-cap and small-cap companies will also.

Secondly, all the companies of NIFTY 50 are not available for ESG rating, with which we cannot say that all Indian companies are affected. Since out of selected companies, all companies show a p-value less than 0.05, which clearly shows the null hypothesis is accepted by rejecting the alternate hypothesis.

13. Scope for further research

This research can be extended in the future in the following areas:

1. Good ESG performing organization attracts equity analysts to invest more in the market **(Serafeim, 2012)**, which increases firm value **(Wieseke, 2009)**.
2. With improved ESG performance, customers **(Tamayo, May, 2013)** and employees **(Arenas, 2008)** are satisfied with their organization.
3. All these variables can be empirically tested and proved with a hypothesis in the Indian market.

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TABLE 1: ESG RATING OF COMPANIES

Sr. No.	**Company**	**ESG rating**	**Sr. No.**	**Company**	**ESG rating**
1	AXIS Bank	BBB	6	Maruti Suzuki Limited	BB
2	ICICI Bank	BB	7	Dr. Reddy Laboratories	B
3	Bharat Forge	B	8	State Bank of India	B
4	INFOSYS Limited	AA	9	Vedanta Limited	CCC
5	WIPRO	A	10	ZEE Entertainment Limited	BB

Source: www.msci.com (2020)

TABLE 2: CHANGE IN ESG RATING OF THE COMPANY

Sr. No.	**Company**	**Change in ESG rating**	**Sr. No.**	**Company**	**Change in ESG Rating**
1	AXIS Bank	Downgrade	6	Maruti Suzuki Limited	Upgrade

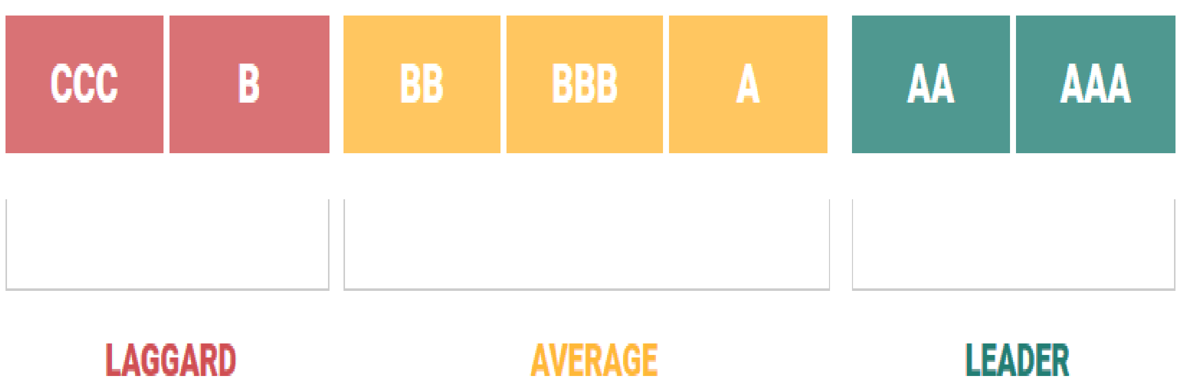
2	ICICI Bank	Downgrade	7	Dr. Reddy Laboratories	Downgrade
3	Bharat Forge	Downgrade	8	State Bank of India	No change
4	INFOSYS Limited	Upgrade	9	Vedanta Limited	No change
5	WIPRO	Downgrade	10	ZEE Entertainment Limited	Upgrade

Source: www.msci.com (2020)

TABLE 3: P-VALUE OF THE ORGANIZATIONS CALCULATED AFTER T-TEST

Organization	P-VALUE	Return of stock in the event window
AXIS BANK	0.0038	5%
BHARAT FORG	0.022	4.2%
DR. REDDY	0.01	7.3%
ICICI BANK	0.041	2%
INFOSYS	0.023	1.8%
MARUTI	0.034	5.6%
STATE BANK OF INDIA	0.088	10%
VEDANTA LIMITED	0.019	7%
WIPRO	0.06	6.2%
ZEE ENTERTAINMENT	0.024	3.7%

Chart 1: ESG RATING CHART



Source: www.msci.com (2020)