Corporate Social Responsibility Activities and Investment Efficiency*

Joon Sun Yang**
Keehwan Kim***

〈ABSTRACT〉

This study examines whether firms exercising Corporate Social Responsibility (CSR) make optimal investment decisions. Prior research has suggested that socially responsible firms (CSR firms) are less likely to manage earnings and the managers of CSR firms produce high-quality financial reports. In addition, the literature relating earnings management and resource allocation argues that the earnings management reduces information contents used by those involved in firms' investment decision. According to the prior studies, we can expect that CSR firms have positive association with financial reporting quality and investment efficiency as well. However, no study to date has examined the relation between CSR and investment efficiency. This study examines that CSR firms are positively related to the investment efficiency in tangible and intangible assets. Also, this study investigates whether CSR firms increase expenditure on advertisement and vocational education expense to maintain the relation with stakeholders such as consumers and employees.

In this paper, we use KEJI (Korea Economic Justice Institute) index to measure firm's performance of CSR. The index is similar to the U.S. CEP (Council Economic Priorities) index. Korea Economic Justice Institute evaluated annually CSR activities of firms listed in the Korea Composite Stock Price Index (KOSPI) market. KEJI index includes seven criteria such as the sound of the management, the fairness of the management, social service, consumerism, environmentalism, employee satisfaction.
and the contribution to economic growth. Korea Economic Justice Institute published top 200 firms (KEJI index firms) after evaluating the KOSPI companies according to the criteria. We make matching sample including the KEJI index firms and non-KEJI index firms using propensity-score matching model (Lawrence et al. 2011) over the period 2003-2009.

We find evidence of higher investment efficiency of CSR firms in tangible and intangible assets. Also, we find the CSR firms increase advertising and training expense to meet the demand of consumers and employees. These results are robust with an alternative proxy for CSR, KEJI index frequency.

We make three contributions to the literature. First, this paper is the first study to investigate the relation between corporate social responsibility activities and investment efficiency. According to our empirical results, the CSR firms make investment decisions optimally which means that investment decision makers collect information about growth trend or investment opportunities correctly. Our study also contributes to the literature relating earnings management and resource allocation. Our results suggest that CSR firms save the cost of resource through the efficient investment decision by maintaining high quality of financial report. Finally, This paper also extends the study on the characteristics of CSR firms which are more likely to increase advertising and training expenses to meet the demand from consumers and employees for CSR.

Key Words: CSR, investment efficiency, earnings management, financial reporting quality

I. Introduction

This study examines whether firms exercising Corporate Social Responsibility (CSR) make efficient investment decisions. Firm's investment is an important decision for investors because the efficiency of an investment made by managers is directly related with costs and benefits to the investors (McNichols and Stubben 2008). Prior research has documented that socially responsible firms are less likely to manage earnings as well as drive managers to produce high-quality financial reports (Chih et al. 2008; Kim et al. 2012; Choi and Moon 2013). In addition, literature relating earnings management and resource allocation argues that decreasing earnings management reduces information asymmetry and agency problems in information used by those involved in firms' investment decision (Bushman and