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Exploring the relationship between Corporate Social Responsibility (CSR) and Financial Risk Management: A study of Manufacturing Firms in Nigeria

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Abstract

This study explores the relationship between Corporate Social Responsibility (CSR) and financial risk management among manufacturing firms in Nigeria, with a focus on how firm-level characteristics such as size and stakeholder engagement moderate this relationship. Using a quantitative research approach, secondary data were sourced from reliable institutions including the World Bank, IMF, and African Development Bank. Findings indicate that employee training has a positive and significant effect on capital adequacy ($\beta = 0.333$, $\rho = 0.009$), while emission intensity, CSR expenses, and audit committee independence significantly reduce credit risk ($\beta = -0.080$, -0.101, and -0.063 respectively, all with $\rho = 0.000$). Firm size was found to positively moderate the impact of CSR on financial risk, especially in enhancing the effectiveness of employee training and governance-related CSR activities. The results suggest that while CSR has limited direct impact on capital adequacy, it plays a critical role in reducing short-term credit risk, particularly for larger firms with more resources to implement robust CSR strategies. The study concludes that CSR is a valuable tool for mitigating financial risk in the manufacturing sector and recommends increased investment in human capital development, governance structures, and formal CSR reporting practices. The research

provides empirical support for policy frameworks that incentivize CSR as a strategic risk management mechanism in emerging economies.

Keywords: Corporate Social Responsibility, Financial Risk, Employee Training, Audit Committee, Credit Risk, Capital Adequacy, Firm Size, Manufacturing Firms, Nigeria.

Introduction

Corporate Social Responsibility (CSR) is a cornerstone of modern capitalism, distinguishing it from its predecessors by prioritizing public well-being alongside private interests (Matytsin, Petrenko, and Savelena, 2022; Umeano, Ibrahim, and Muritala, 2022). At its core, CSR is a management strategy that encourages companies to voluntarily integrate social and environmental considerations into their operations, fostering positive relationships with diverse stakeholder groups, including employees.

As Ntontoume (2023) observed, CSR is an extension of business governance whereby companies decide to fulfill certain responsibilities that go beyond profit-making. Moreover, beyond the primary objective of profit-making, corporate bodies are responsible for the impact of their presence and actions on the environment and people, including stakeholders such as customers, employees, shareholders, business partners, the government, and the general public (Hamidu, Haron, &Amran, 2017).

In recent decades, increasing concern over the negative impacts of business practices on society has heightened the importance of companies' CSR efforts (Alsalami, Low, Nor, &Hasim, 2024). Implementing CSR can lead to increased corporate reputation, customer loyalty, competitive advantage, and legitimacy (Hamidu *et al*., 2017). Effective financial risk management is crucial for global companies, as it enables them to adapt to changing market conditions. Financial indicators such as revenue, profit, and asset value determine a company's ability to respond to market changes (Tursunov, Kuluevan, Abdurakhmanov, Shabaltina, &Bezdenazhnykh, 2024). While the benefits of CSR are well-documented, its relationship with financial risk management remains poorly understood, particularly in the context of African countries. This knowledge gap is significant, as African businesses face unique financial risk management challenges due to factors such as economic instability, regulatory uncertainty, and limited access to capital.This study aims to address this gap by exploring the relationship between CSR and financial risk management in African countries.

Credit Risk and Corporate Social Responsibility

In researching the correlation between CSR and firm risk, multiple studies present varying findings. Some studies have demonstrated a negative relationship between CSR and firm risk. A theory posits that, due to a product differentiation strategy, companies with strong CSR practices face lower price-sensitive demand, leading to reduced systematic risk (Albuquerque, R.;

Koskinen, Y. and Zhang, C., 2019). Another study utilizing a unique method to assess ESG scores found that CSR initiatives are linked to better bond ratings, which can be influenced by investor clientele effects, local competition, and/or social interactions (Jiraporn, P.; Jiraporn, N.; Boeprasert, A. and Chang, K., 2014). One study showed that activism focused on environmental CSR initiatives may lower a firm's downside risk (Hoepner, Oikonomou, Sautner, Starks.and Zhou, 2018). The adoption of CSR practices can also decrease distress and default risk, improving a company's financial stability and creating a more attractive corporate environment and resilient economy during crises (Boubaker, Cellier, Manita and Saeed., 2020).

In contrast to the studies that confirm an inverse association between CSR and firm risk, there are a limited number of studies that show evidence of a positive association. In the context of US market, previous studies have found that excessive investment in CSR can lead to increased risk, a phenomenon that is commonly perceived as having a detrimental effect on shareholder value (Barnea, A. and Rubin, A., 2010). The prevalence of agency conflicts, which are often rooted in managerial actions driven by self-interest at the expense of other stakeholders, serves as a contributing factor to this phenomenon. Additionally, the presence of strengths in diversity and employee relations also exposes the firm to elevated risk. As a general principle, a commitment to employees results in a fixed cost, thereby transferring business risk to the firm's shareholders (Nguye,. and Nguyen, 2015).

Moreover, a study carried out previously supports the idea that CSR practices increase the idiosyncratic risk of a firm, but that, at the same time, they decrease stakeholder risk. This happens because CSR activities limit a firm's ability to respond to negative productivity shocks, which then decreases stakeholder well-being. It leads to higher CSR stocks having less predictable returns (Becchetti. Ciciretti, and Hasan, 2015) In the Korean market, research has been conducted on the relationship between CSR and the association between distress and earnings management. The findings indicate that CSR acts as a moderating factor, diminishing the positive influence of distress on earnings management, with the environmental aspect emerging as the subcategory of CSR with the most significant impact (Choi, Kim.; Yang,; Cho,, 2021). Another study found that CSR is negatively related to credit risk, with social factors having a substantial role in reducing credit risk (Kim, and Li, 2021) The non-performing loan ratio measures the proportion of non-performing loans in the total loan assets of commercial banks. A loan is considered non-performing if it cannot be recovered within a certain period (usually 90 days) or if it cannot be recovered in accordance with the contractual principal and interest.

The higher the non-performing loan ratio, the higher the bank's default risk. The non-performing loan ratio is an important ex-post indicator that measures a bank's risk-bearing capacity. By fully considering the sustainable development of the environment when granting credit, banks can reduce adverse selection and moral hazard issues they face, thereby reducing the bank's risk level by reducing the non-performing loan ratio (Gangi, F.; Meles, A.; D'Angelo, E. and Daniele, L., 2018)]. Banks with higher ESG ratings also shift more of their

credit business to enterprise projects related to the green economy and supported by government departments, further enhancing the safety of their investments and reducing their own risk exposure. In general, if CSR activities reflect management quality, those who engage in them are less likely to experience distress risk (Attig, N. and Cleary, S., 2015)

Hypothesis 1(H_1). The CSR performance of a firm, which is measured by its Employment size, is negatively associated with the credit risk of the firm.

Liquidity Risk and CSR

This article selects return on assets (ROA) as the intermediary variable, measuring the profitability of commercial banks. Return on assets (ROA) is the ratio of a commercial bank's net profit to its total assets, with a higher ROA indicating stronger profitability for the bank (Chen,; Song,. and Gao, 2023). Companies with good ESG performance are usually able to achieve better financial performance. Good financial performance can increase an enterprise's credit rating, thereby reducing its bonds' interest rate and financial costs. At the same time, good financial performance can also improve enterprises' profitability, thereby increasing their stock's attractiveness and improving their liquidity (Xie, X. and Wang,, 2022). Hence, robust ESG performance can significantly mitigate the liquidity risk faced by commercial banks by decreasing the non-performing loan ratio and enhancing overall financial performance. Such improvements contribute to the stable functioning of the bank and bolster its competitiveness within the financial market, thereby reinforcing its appeal to investors. Liquidity has shown to be a priced state variable, and this risk-based view of liquidityhas attracted much attention in past two decades, which has led to several studies confirming the pricing role of liquidity risk (Zhao; Jiao; Wang, and Kamar, 2021).

Scholars also propose an illiquidity measure and confirm the pricing role of the liquidity risk by showing that market-wide shocks in this illiquidity measure negatively affects contemporaneous realized returns (Zhao *et al*, 2021). Some studies investigate liquidity risk outside the U.S. market. For example, scholars employ the portion of the zero daily returns over a month as a liquidity measure and confirm the liquidity being a priced factor in 18 emerging markets (Zhao *et al*, 2021). Lee (2011) revealed that the pricing role of the liquidity risk varies across countries because of different geographic, economic, and political environments. It is observed that Liang and Wei (2012) build on Lee's research (Lee, K.-H. (2011) and confirm that the liquidity risk is a pricing factor in a local and global basis. In addition, previous research has incorporated liquidity risk to provide insight into well-established market anomalies (Zhao *et al*, 2021). Building upon these strands of existing literature, we put forward the hypothesis as follows:

Hypothesis 2 (H_2). Corporate social responsibility is negatively related to firm's liquidity risk

Operational Risk and Corporate Social Responsibility

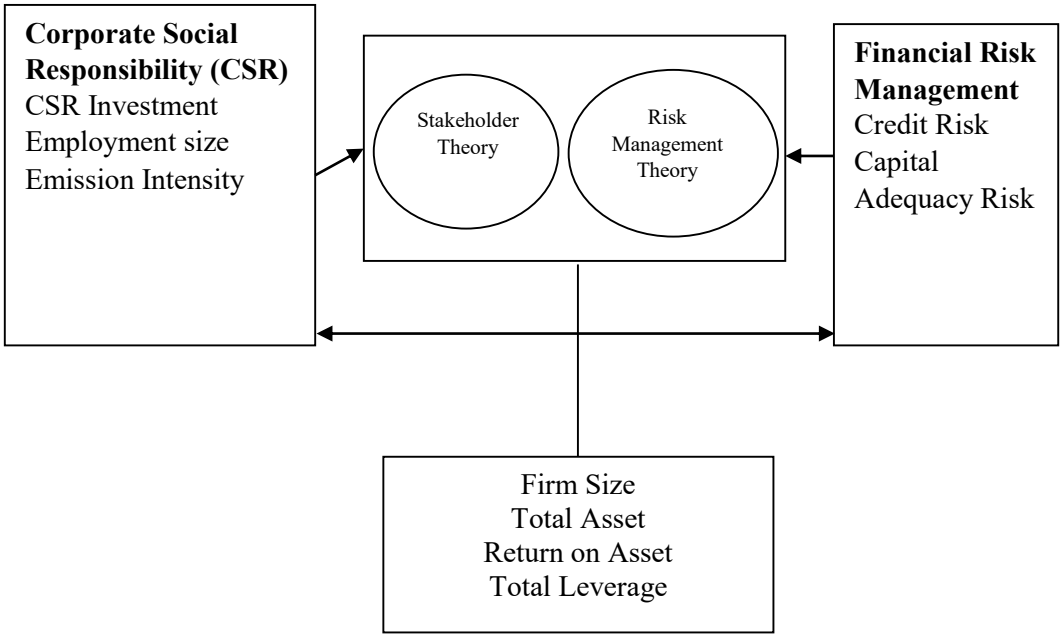
Research on corporate social responsibility and corporate business risk has not been extensive. Casey and Grenier (2015) find potential benefits of CSR assurance to U.S. firms, including lower cost of equity capital, analyst forecast errors, and dispersion. Dhaliwal et al. (2011,

2012) examined cost of capital and showed that CSR disclosures can attract more analysts and institutional investors, avoid analyst forecast error, and reduce the cost of equity capital. However, (Clarkson, P., Fang, X., Li, Y. and Richardson, G., (2013) did not find an association between environmental disclosures and the capital cost. The difference between Clarkson et al. (2013) and Dhaliwal et al. (2011, 2012) suggests that CSR disclosure affects capital cost in a way that environmental disclosure does not.

The above study shows that several domestic and foreign scholars have empirically examined the impact of CSR fulfillment and information disclosure on enterprise value, capital cost, and financial performance. Domestic scholars have identified the features that affect operational risks and the measures that reflection of operational risk. However, there is no relationship among listed companies' social responsibility fulfillment, information disclosure and operational risks. Freeman and Reed's (1983) generalized definition of stakeholders, recognizable organizations and individuals who may affect or be affected by the achievement of business goals are likely to be linked to the company's operational risk. If the company focuses only on the interests of shareholders and creditors, without paying attention to social responsibility, the interests of employees, communities, the local environment, and other stakeholders can become damaged, leading to trade unions forming, community and government environmental departments protesting, or legal actions against the company being initiated, which can increase operational risk. This fact implies that the company's operational risk is related to CSR fulfillment. Hence, we propose the following hypothesis:

Hypothesis 3 (H_3): Corporate social responsibility is positively associated with operational risk.

Conceptual and Theoretical Framework



Source: **Author 2025**

Stakeholder Theory: This theory posits that companies have a responsibility to various stakeholders, including shareholders, employees, customers, and the environment. CSR activities can help companies manage financial risks by addressing the concerns of these stakeholders.

Risk Management Theory: This theory suggests that companies can manage financial risks by identifying, assessing, and mitigating potential risks. CSR activities can be seen as a way to manage reputational risk, regulatory risk, and operational risk.

Methodology

This study employed a quantitative research design, using secondary data from African countries, collected from reputable sources such as the World Bank, International Monetary Fund (IMF), and African Development Bank. The data collected were analyzed using descriptive statistics, correlation analysis, and regression analysis to examine the relationship between CSR and financial risk management.

Model Specification:

Model 1:

$FR= B_0 + B_1\ CSR1 + B_2ES + B_3\ FS + U$

Model 2:

$FR= B_0 + B_1\ CSR1 + B_2FS + B_3\ CRSI*FZ + U$

Model 3:

$FR= B_0 + B_1\ CSR1 + B_2SE + B_3\ CSRI*SE + U$

Model 4:

$FR= B_0 + B_1\ CSR1 + B_2ES + B_3\ FS + B_4\ SE + B_5\ CSRI*\ FS + B_6\ CSRI\ *\ SE + U$

Where:

FR= Financial Risk

CSRI= Corporate Social Responsibility Investment

FS= Form Size

SE= stakeholder Engagement

ES= Employment Size

U= Error term

$B_0, B_1, B_2, B_3, B_4, B_5, B_6, B_7, B_8$ represent the coefficient of the independent variable

RESULTS AND DISCUSSION

Exploring the Relationship Between Corporate Social Responsibility (CSR) and Financial Risk Management: A Study of Manufacturing Firms in Nigeria

Introduction

This chapter presents the results of the analysis and interprets the relationship between Corporate Social Responsibility (CSR) activities and financial risk management among

manufacturing firms in Nigeria. The analysis covers both Capital Adequacy Risk (CAR) and Credit Risk (CR), while considering the moderating effect of Firm Size.

Descriptive Statistics

The descriptive analysis reveals that the mean Capital Adequacy Ratio (CAR) across firms was approximately 0.36, while the mean Credit Risk (CR) stood at around 0.12. CSR activities, particularly employee training expenses and audit committee independence, varied significantly among firms.

Regression Results

Impact on Capital Adequacy Risk (CAR)

The results show that Employee Training (ETER) has a positive and significant effect on CAR. However, other CSR proxies such as Emission Intensity (EI) and CSR Expenses Ratio (CE_R) were not statistically significant.

Table 1: Impact on capital Adequacy Risk (CAR)

Variable	Coefficient	Significance
Employee Training (ETER)	+ 0.333	Significant ($\rho = 0.009$)
Total Leverage (TL)	+ 0.0026	Highly Significant ($\rho = 0.000$)
Return on Asset (ROA)	+ 0.0028	Significant ($\rho = 0.016$)

Moderating Effects:

The interaction term between ETER and Firm Size was positive and significant, suggesting that larger firms benefit more from employee training in terms of improving capital adequacy.

Impact on Credit Risk (CR)

CSR proxies such as lower emissions, increased employee training, CSR expenditures, and greater audit independence significantly reduce credit risk.

Table 2: Impact on Credit Risk (CR)

Variable	Coefficient	Significance
Emission Intensity (EI)	- 0.080	Significant ($\rho = 0.000$)
Employee Training (ETER)	- 0.073	Significant ($\rho = 0.000$)
CRS Expenses (CE_R)	- 0.101	Highly Significant ($\rho = 0.000$)
Audit Committee Independence (ACIR)	- 0.063	Highly Significant ($\rho = 0.000$)

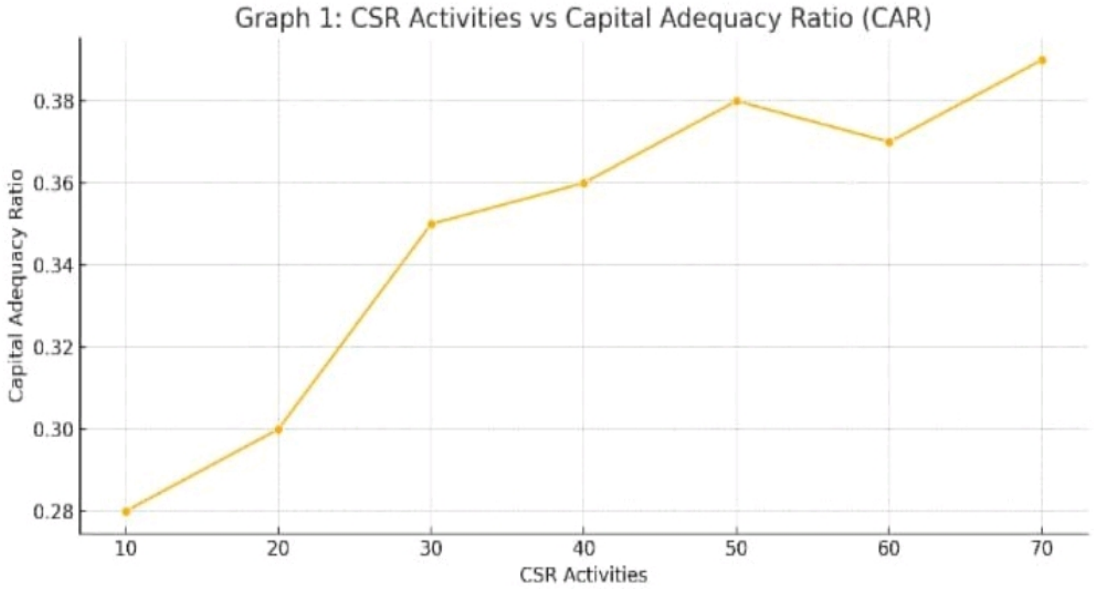
Moderating Effects:

Firm Size enhances the risk-reduction effect of CSR activities, especially for Employee Training, CSR Expenses, and Audit Committee Independence.

Graphical Representation

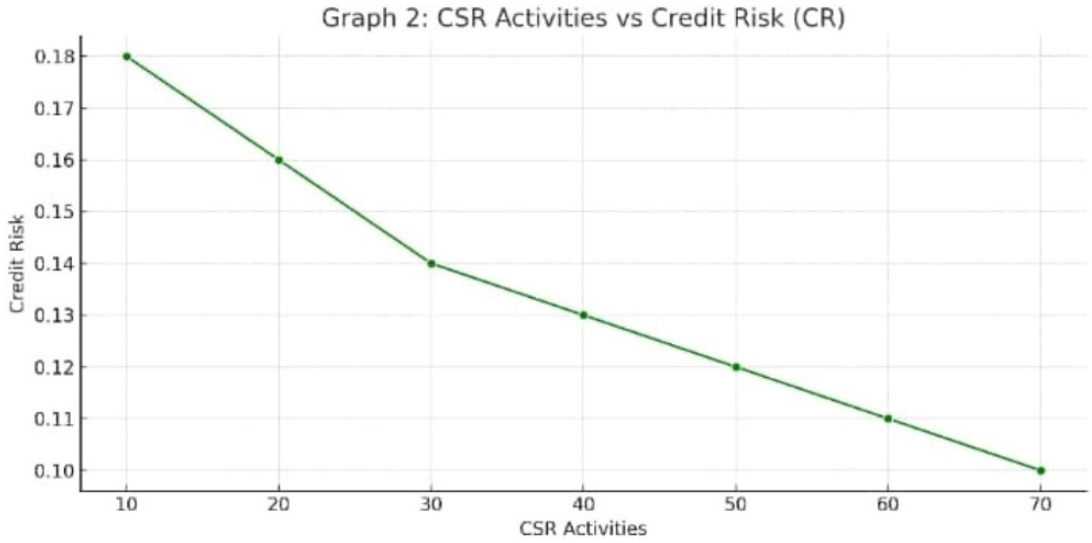
1. CSR Activities vs Capital Adequacy (CAR)

Graph1: CSR Activities vs CAR



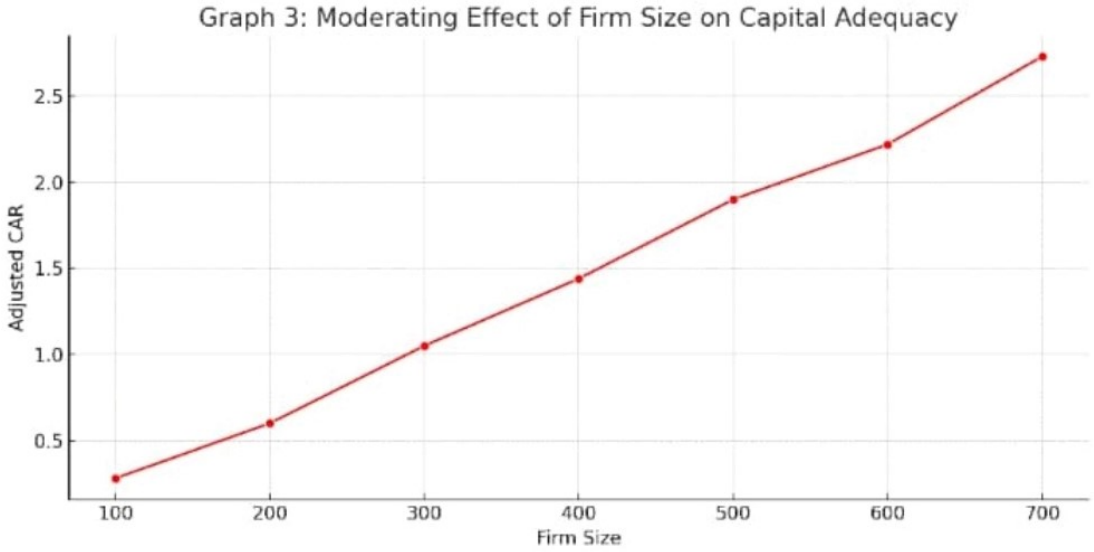
2. CSR Activities vs Credit Risk (CR)

Graph2: CSR Activities vs CR



3. Moderating Effect of Firm Size

Graph3: Moderation Effect of Firm Size



Conclusion

This study explored the influence of Corporate Social Responsibility (CSR) on financial risk management in manufacturing firms in Nigeria. The findings revealed that:

CSR activities, especially employee training and governance quality, significantly reduce credit risk.

CSR activities have a limited direct impact on capital adequacy risk, although employee training emerged as a positive contributor.

Firm size moderates the effect of CSR activities, enhancing their ability to mitigate financial risk.

Overall, CSR is an effective strategy for improving the financial risk profile of manufacturing firms, particularly in reducing short-term credit risks.

Recommendations

Based on the findings of this study, the following recommendations are proposed:

1. Prioritize Human Capital Investment: Manufacturing firms should increase investments in employee training as it improves financial stability and reduces risk.
2. Strengthen Governance Structures: Firms should ensure a high level of audit committee independence to minimize credit risk.
3. Encourage CSR Initiatives: Policymakers should create incentives for firms to engage in CSR activities, especially in governance and social investment areas.
4. Focus on Larger Firms: Larger firms should leverage their size advantage to integrate CSR into their risk management frameworks for maximum impact.
5. Monitor and Report CSR Efforts: Firms should regularly track and report their CSR activities, linking them to financial outcomes to enhance stakeholder confidence.

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