ROBBING PETER TO PAY PAUL: EXAMINING THE LINK BETWEEN MANDATORY CSR AND ESG PERFORMANCE

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Abstract

This study examines how India's mandatory corporate social responsibility (CSR) expenditure affects firms' environmental, social, and governance (ESG) performance within a unique dual regulatory setting. Drawing on stakeholder theory, we argue that CSR obligations prioritize indirect community stakeholders, while ESG performance reflects outcomes valued by direct stakeholders such as investors, employees, and customers. Using a panel of 500 non-financial National Stock Exchange of India (NSE)-listed firms from 2015 to 2022, we employ fixed effects regression and two-step system generalized method of moments (GMM) estimation. ESG scores are sourced from Bloomberg, which updates them annually based on firm disclosures and third-party assessments, capturing external perceptions of ESG in the Indian context. CSR expenditure values are obtained from the Centre for Monitoring Indian Economy (CMIE) Prowess Database and cross-verified with the National CSR Portal. Results remain consistent both with and without the inclusion of additional firm-level controls, and are further supported by two-step system GMM diagnostics, including the Hansen test and the second-order serial correlation test. Across all models, we find that higher mandatory CSR expenditure significantly reduces environmental, social, governance, and overall ESG scores. These results highlight the regulatory misalignment between mandatory CSR and voluntary ESG and reveal how resource diversion can weaken firm-level sustainability performance. The findings extend stakeholder theory to emerging economies, challenge assumptions of CSR-ESG complementarity, and offer actionable implications: managers should design CSR initiatives that align more closely with ESG metrics, while policymakers should refine CSR laws to better integrate ESG objectives.

Keywords: ESG Performance, Mandatory CSR, Emerging Economy, Stakeholder Theory, Regulatory Impact, Sustainability Reporting

Authors' individual contribution: Conceptualization — R.K. and R.P.J.; Methodology — R.K., R.P.J., and R.R.; Software — R.K.; Validation — R.K.; Formal Analysis — R.K., R.P.J., and R.R.; Investigation — R.K.; Data Curation — R.K.; Writing — Original Draft — R.K.; Writing — Review & Editing — R.P.J. and R.R.; Visualization — R.K. and R.P.J.; Supervision — R.P.J. and R.R.

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1. INTRODUCTION

Corporate sustainability initiatives have gained momentum over the past decade with the widespread adoption of corporate social responsibility (CSR) practices and environmental, social, and governance (ESG) standards worldwide. Both CSR and ESG emphasize a firm's ethical and pragmatic responsibilities toward society and the environment. Yet, despite their overlap, the two frameworks operate under different logics: ESG is primarily investor- and shareholder-driven, aiming to safeguard long-term financial and reputational value, whereas CSR is oriented toward broader societal welfare, often with weaker direct links to firm performance (Gillan et al., 2021). This distinction creates the possibility of regulatory misalignment when CSR and ESG obligations coexist.

Globally, ESG has become central to corporate governance. Research shows that firms with stronger ESG performance often achieve superior financial outcomes (Chen et al., 2023; Bodie et al., 2013). Investors increasingly rely on ESG ratings provided by established agencies (Manda & Polisetty, 2021), especially following governance failures after the 2008 financial crisis. In response, several jurisdictions, including the European Union, the United States, and Canada, have adopted stricter ESG disclosure requirements in recent years (Chen et al., 2024). Emerging economies have followed suit: India mandated ESG disclosure through the Securities and Exchange Board of India's (SEBI's) Business Responsibility and Sustainability Reporting (BRSR) in 2023, Vietnam issued ESG policy directives (Long et al., 2022), and the Philippines now requires listed firms to report ESG activities (Securities and Exchange Commission [SEC], 2019).

CSR, in contrast, has historically reflected a firm's broader legal, ethical, and philanthropic commitments (Bowen, 1953). While CSR can indirectly enhance shareholder value, it is often implemented as a social or moral obligation rather than as a tool for capital market signalling (Flammer et al., 2019). The nature and scope of CSR differ widely across contexts: in developed economies, CSR frequently emphasizes employment, climate action, and diversity, whereas in emerging markets it tends to focus more heavily on community welfare and philanthropy (Fortanier et al., 2011; Jammulamadaka, 2016, 2020).

India represents a particularly distinctive setting. In 2014, it became the first country to mandate CSR expenditure (2% of average net profits over three years) and subsequently introduced mandatory ESG disclosures in 2016, thus subjecting firms to overlapping but distinct sustainability requirements. These dual mandates are regulated by different authorities, CSR by the Ministry of Corporate Affairs, and ESG disclosure by SEBI, potentially creating competing resource demands. Prior work suggests that when regulatory obligations are not aligned, firms may reallocate resources in ways that undermine long-term sustainability goals (Roy et al., 2022; Li & Wu, 2020).

Recent evidence further indicates that mandatory CSR requirements can crowd out more strategic ESG investments, especially in emerging economies where compliance pressures dominate managerial decision-making (Revelli, 2017; Park & Jang, 2021). For example, firms may prioritize visible philanthropic projects such as schools or hospitals to meet CSR obligations, while postponing investments in energy efficiency or governance reforms that more directly improve ESG performance. This raises important theoretical and policy questions: Does mandatory CSR spending enhance or detract from genuine ESG outcomes? And how should regulators reconcile the dual pressures of social welfare and sustainable investment? Therefore, the main objective of this study is to examine the influence of mandatory CSR expenditure on firm-level ESG performance in India and to assess this relationship across the ESG pillars.

Against this backdrop, the present study investigates the unintended consequences of India's mandatory CSR spending on firms' ESG performance. Specifically, we examine two research questions:

RQ1: How does mandatory corporate social responsibility expenditure influence the overall ESG performance of firms?

RQ2: What influence does mandatory corporate social responsibility expenditure have on the individual dimensions: environmental, social, and governance of overall ESG?

The contribution of this study is threefold. First, it advances our understanding of the interaction between corporate governance and CSR initiatives by providing large-sample evidence from the only jurisdiction that mandates both CSR spending and ESG disclosure. Second, it highlights a regulatory misalignment that prioritizes CSR, potentially creating agency-like frictions and crowding out firm-level ESG performance. Finally, by translating these insights, the study offers practical guidance for top management teams, corporate boards, and policymakers on strategy formulation, capital allocation, and rule-making to better align CSR activities with ESG materiality.

Using panel data from National Stock Exchange (NSE)-listed firms over 2015–2022, we employ fixed-effects regression and a two-step system generalized method of moments (GMM) approach to address endogeneity concerns. The study contributes by:

1) highlighting the tensions created by overlapping regulatory regimes in an emerging market context;

2) providing evidence on the potential crowding-out effect of mandatory CSR on ESG performance;

3) offering policy insights into how CSR and ESG frameworks might be better aligned to promote sustainable outcomes.

The remainder of this paper is structured as follows. Section 2 reviews the relevant literature and develops hypotheses. Section 3 outlines the research methodology. Section 4 presents the results and robustness checks. Section 5 discusses theoretical and managerial implications, highlights limitations, and offers directions for future research. Section 6 concludes the paper.

2. LITERATURE REVIEW

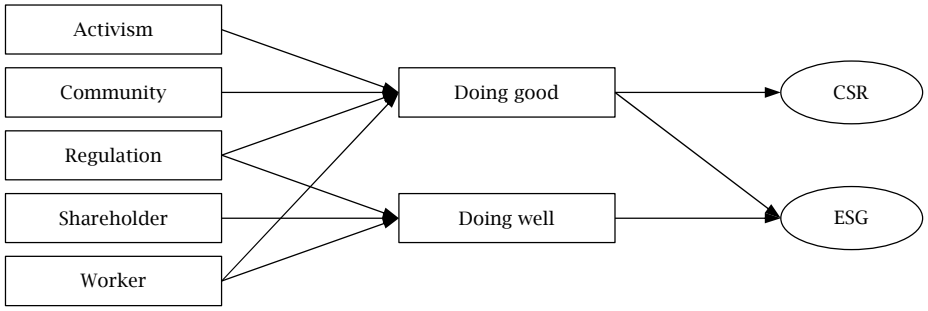
2.1. Conceptual framework

To begin with, we need to not only understand the nuanced meanings of CSR and ESG as they apply to the emerging economies context but also establish a comprehensive delineation of these concepts. The underlying phenomenon of CSR is based on three Ps: People, Planet, and Profit (van Marrewijk, 2003), where the focus is rather on "doing good". ESG, in contrast, comprises an exhaustive set of criteria encompassing

the environmental, social, and governance factors used for appraising a company's sustainability and ethical impact (Khamisu et al., 2024; Global Reporting Initiative [GRI], n.d.), which are considered crucial to comprehending a company's long-term performance. The purpose of ESG is not just "doing good" but also "doing well" in business (Mischke et al., 2021).

Recent studies emphasize that CSR and ESG differ not only in orientation but also in their institutional design. CSR is often embedded in philanthropic or compliance mandates, particularly in emerging markets, whereas ESG is largely investor-driven and linked to firm valuation (Gillan et al., 2021). This creates conditions for regulatory misalignment: CSR may satisfy community stakeholders but not directly improve firm-level ESG ratings. Figure 1 depicts the antecedents of CSR and ESG and the interconnectedness among them.

Figure 1. Antecedents and motives of corporate social responsibility and ESG



2.2. Evolution of corporate social responsibility

A relatively old concept, CSR adoption in the corporate world has grown significantly over the past few decades. The origins of CSR are much older than the concept itself. For more than a century, various scholars have argued about the ethical responsibility of the firm (Silver, 1905) and its philanthropic nature in taking care of the community it belongs to (Lewisohn, 1922). CSR espouses the view that rather than focusing merely on increasing shareholder wealth, managers should function as trustees, safeguarding the interests of all the stakeholders of an organization.

This perspective resonates with stakeholder theory (Freeman, 1984), which posits that managers balance the claims of multiple constituencies rather than only shareholders. It also explains why CSR obligations designed to benefit society at large may sometimes crowd out investments in ESG initiatives that are more closely tied to investors, employees, and regulators.

Interestingly, the evolution of CSR in emerging economies reflects the distinct historical and cultural trajectories, which are different from developed economies where CSR evolved under specific socio-economic paradigms. For instance, in India, CSR emerged with an emphasis on customs and fairness as a response to colonial exploitation (Jammulamadaka, 2016, 2020). Similarly, in countries like Indonesia (Waagstein, 2011), the Philippines (Bondy et al., 2012), China (Xu & Yang, 2010; Moon & Shen, 2010), and Vietnam (Nguyen et al., 2018), CSR evolved according to the unique indigenous characteristics, traditional philosophical foundations, late-stage development, colonial legacies, and institutional pressures. This evolution has resulted in a contemporary CSR framework in emerging economies, which prioritizes community relations and ethical responsibilities. Not surprisingly, the only two countries that have mandated CSR expenditure, India and Indonesia, are both emerging economies (Waagstein, 2011; Gatti et al., 2019).

2.3. The emergence of ESG standards

The concept of ESG was first articulated in the United Nations Principles for Responsible Investment (UNPRI, 2006) report, aimed at fostering sustainable investments. Sixty-three investment firms with a total of $6.5 trillion in assets under management endorsed this framework initially (Watchman, 2006). Emerging from investor concerns in a globalized world, ESG has achieved a near-uniform global presence since then. While organizations such as the GRI played a key role in standardizing ESG reporting and encouraging its adoption (GRI, 2021), financial institutions like S&P utilized these standards to develop ESG ratings. While CSR has historically varied in its trajectories and justifications due to contextual factors and stakeholder demands, the adoption and significance of ESG factors exhibit a notable degree of convergence across both developed and emerging economies.

From a stakeholder theory perspective, ESG adoption reflects firms' efforts to address the concerns of investors and shareholders as primary stakeholders. In doing so, firms may also reduce agency-like conflicts and signal strong risk management to capital markets (Roy et al., 2022). This differentiates ESG from CSR, which is more often driven by regulatory mandates or social legitimacy pressures.

2.4. The CSR-ESG relationship

The literature often suggests a positive, mutually beneficial relationship between CSR and ESG. For instance, CSR practices have been linked to stronger corporate reputation and, in certain contexts, higher ESG scores (Gillan et al., 2021). However, recent studies caution that such complementarities are not universal: one-size-fits-all CSR mandates may not necessarily improve ESG outcomes (Li & Wu, 2020) and, in some cases, mandatory CSR can even crowd out voluntary sustainability initiatives (Roy et al., 2022).

CSR spending and its influence on ESG ratings may vary depending on the sector as well as other factors. For instance, a mining firm or cement manufacturer may spend more on CSR compared to ESG, while a service firm may focus more on ESG. A firm that needs capital infusion from institutional investors may allocate more funds to improving its ESG score than it spends on CSR. A notable distinction between CSR and ESG is that CSR is "absolute", while ESG is "relative" to industry standards. This distinction, referred to as materiality (see Table 1), compares industry-specific ESG effects across different sectors (Sustainability Accounting Standards Board [SASB], 2024).

Table 1. Comparison of industry-specific effects exclusive to ESG, but not to CSR

Materiality	*Chemical*	*Software*
Alternative raw material sources	Yes	No
Scope 1 + 2 emissions	Yes	Negligible
Scope 3 emissions	Negligible	Yes
Privacy protection (data)	No	Yes
Employee training	Environmental, health, and safety (EHS) only	Upgradation only
Waste and air pollution mitigation	Yes	No
Lost time incidents	Yes	No

2.5. Corporate social responsibility, ESG, and stakeholder centricity

Corporate social responsibility and ESG both emphasize a firm's ethical and pragmatic responsibilities towards people (customers, employees, community), planet (environment), and profit (shareholders), yet their stakeholder focus differs (Gillan et al., 2021; Freeman, 1984). CSR often targets stakeholders with both direct and indirect ties to the organization, whereas ESG primarily addresses the concerns of immediate stakeholders such as shareholders, consumers, and employees, aligning with the long-term interests of investors.

Within stakeholder theory, CSR activities directed at external communities help firms maintain legitimacy with indirect stakeholders, while ESG improvements are more directly aligned with investor trust and financial market expectations (Revelli, 2017).

For example, constructing a school may align with CSR objectives but not necessarily with ESG criteria, while investing in water-saving technology in a water-stressed region pertains more to ESG than CSR. As both ESG and CSR practices are significantly influenced by stakeholder dynamics (Khamisu et al., 2024), the stakeholder theory (Freeman, 1984) forms the foundational framework for this study.

2.6. Corporate social responsibility and ESG landscape in India: Significance for businesses

In 2011, following the global financial crisis, India introduced the National Voluntary Guidelines (NVGs) on social, environmental, and economic responsibilities of business, providing a comprehensive framework for stakeholder accountability and ethical business practices (Ministry of Corporate Affairs, 2011). Subsequently, through the new Companies Act in 2014, India became the first country to introduce mandatory CSR spending. Companies (public and private, domestic and foreign) that meet a specified threshold must allocate 2% of their three-year average net profit to community development in one or more of the seventeen designated areas. The legislation uniquely emphasizes CSR on community relations, diverging from the multi-dimensional CSR approach observed commonly. Showing a steady increase year on year, over 9,000 companies have complied with CSR expenditures totalling over USD 11,025 million since then[1].

Subsequently, in 2016, the SEBI made ESG disclosure mandatory for the top 250 corporations. This was revised to include the top 500 corporations in 2017 and the top 1,000 in 2022. With the new regulation, India became the only country to mandate both CSR (performance and disclosure) and ESG (disclosure). As the fifth-largest and fastest-growing major economy with a substantial domestic market, young and skilled workforce, and an improving business environment, India is a major destination for foreign investors. In addition, the ongoing geopolitical tensions between the West and China have prompted many multinational corporations to diversify their supply chains to include India (Bose, 2023).

From a stakeholder theory perspective, Indian firms face competing institutional pressures: CSR compliance is legally mandated by regulators representing community stakeholders, while ESG remains largely voluntary and shaped by investors and shareholders (Marano et al., 2017). This regulatory misalignment can create inefficiencies and resource diversion, where firms prioritize CSR compliance at the expense of ESG improvements (Li & Wu, 2020; Roy et al., 2022).

However, the altered CSR-ESG landscape in India might pose unique challenges to firms in their pursuit of environmental management and social responsibility initiatives. Thus, it becomes crucial to comprehend the nuanced differences between CSR and ESG implementation and examine how performance in one area affects performance in the other. The added pressures of mandatory CSR law in the absence of an ESG performance regulation can lead to manipulative practices in allocating resources for CSR and ESG (Park & Jang, 2021; Rydholm & Schultzberg Bagge, 2020; Jensen, 2002). In addition, the power dynamics and stakeholder expectations in India, which significantly differ from the West, may also act as an added challenge for multinational corporations (MNCs) (Jensen, 2002). Figure 2 illustrates the overlap between the common CSR dimensions and those in focus in the Indian context (hereinafter referred to as CSR-India) (Marano et al., 2017).

[1] Data available by subscription on National CSR Portal: https://www.csr.gov.in/content/csr/global/master/home/home.html

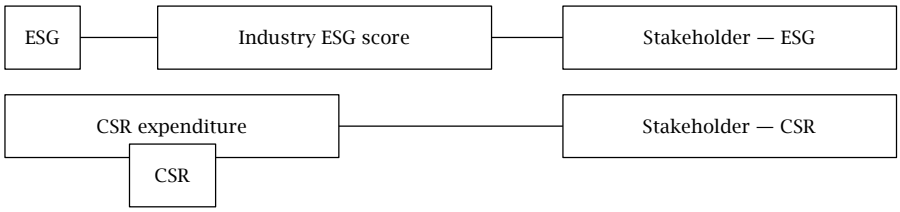
Figure 2. Corporate social responsibility dimensions in India (CSR-India) overlap with the common CSR dimensions

Source: Authors' elaboration.

2.7. Initial impressions

To explore managerial perceptions of the CSR and ESG mandates in India, we conducted an unstructured, qualitative, exploratory interview study with thirty sustainability executives, including chief sustainability officers (CSOs). The interviews revealed that although corporate CSR expenditure may exert some influence on ESG scores, its overall significance is minimal, largely because it seldom addresses employee rights directly. Instead, these initiatives primarily serve to meet the expectations of "only" external stakeholders, the chief beneficiaries of CSR efforts (see Figure 3).

Figure 3. Observational baseline



2.8. Environmental dimension

Emerging economies, unlike industrialised nations, frequently face pressing environmental challenges such as pollution, climate change, and resource scarcity (Xiong et al., 2024). The effectiveness of CSR initiatives in addressing these concerns depends heavily on local regulatory frameworks and access to technology. In India, mandatory CSR expenditure can only be used for environmental protection and climate change mitigation activities conducted *ex-situ*, that is, outside a firm's premises and beyond its immediate operations.

For example, a firm may use CSR funds for tree plantation projects in a different province but cannot use them to improve its own factory premises or meet environmental clearance norms, which require maintaining a minimum green cover (Ministry of Environment, Forest and Climate Change [MoEFCC], 2023). As a result, CSR initiatives may benefit broader societal stakeholders but fail to contribute to the environmental indicators measured in ESG scores, which emphasize firm-specific impacts.

From a stakeholder theory perspective, this creates regulatory misalignment: managers are compelled to satisfy community stakeholders through CSR, even when this diverts resources from environmental practices valued by direct stakeholders such as regulators, investors, and employees (Li & Wu, 2020). Consequently, mandatory CSR expenditure may undermine a firm's environmental ESG performance.

H1: The mandatory corporate social responsibility expenditure negatively influences a firm's environmental pillar score within ESG.

2.9. Social dimension

Few studies have examined the influence of CSR on the social dimension of ESG. Prior work shows that firms with strong labour and civic engagement policies perform better on ESG's social pillar (Brammer & Pavelin, 2006). ESG rating agencies such as Institutional Shareholder Services (ISS), Morgan Stanley Capital International (MSCI), Bloomberg, Credit Analysis and Research Limited (CARE), and Credit Rating Information Services of India Limited (CRISIL) typically assign more weight to direct stakeholder issues, contract workers, employees, women in the workforce, suppliers, and customers than to broader community upliftment projects.

In emerging economies, CSR initiatives often address poverty, inequality, and community development. In India, the Companies Act requires firms to allocate CSR funds primarily toward disadvantaged communities, which often lie outside the immediate stakeholder group of the firm. For instance, a technology firm located in one state

may direct CSR funds to rural development in a distant region. From a stakeholder theory perspective, this creates a mismatch: CSR mandates prioritize indirect community stakeholders, while ESG social scores reflect outcomes for employees and other direct stakeholders (Gillan et al., 2021).

As a result, firms may comply with CSR regulations but neglect the very practices that enhance their ESG social performance. This stakeholder misalignment explains why mandatory CSR spending may weaken the social pillar of ESG.

H2: The mandatory corporate social responsibility expenditure negatively influences a firm's social pillar score within ESG.

2.10. Governance dimension

Good governance is integral to ESG performance. Strong boards promote transparency, accountability, equitable pay structures, and effective shareholder rights, all of which are linked to better firm outcomes (Baysinger & Butler, 2000; Ashbaugh-Skaife et al., 2006). From a stakeholder perspective, governance mechanisms balance the interests of shareholders with those of employees, regulators, and the wider community.

In India, however, the CSR mandate does not emphasize governance-related practices. Instead, CSR funds must be directed toward social and community development projects, which primarily serve external stakeholders rather than investors. This can reduce the incentive for boards to strengthen governance systems that directly influence ESG performance. Managers may allocate scarce resources to meet CSR compliance rather than invest in board independence, shareholder rights, or reporting practices that improve governance scores.

Within stakeholder theory, this reflects a trade-off in prioritizing stakeholder groups: regulatory stakeholders enforcing CSR obligations gain priority, while investor-focused governance stakeholders lose out. This helps explain why mandatory CSR expenditure may weaken governance outcomes in ESG (Manchiraju & Rajgopal, 2017).

H3: The mandatory corporate social responsibility expenditure negatively influences a firm's governance pillar score within ESG.

2.11. Overall ESG performance

Extensive literature has suggested that CSR activities are positively associated with ESG-related outcomes, including better financial performance, enhanced reputation, reduced risk, and improved employee morale (Waddock & Graves, 1997; Orlitzky et al., 2003; Luo & Bhattacharya, 2009; Khan et al., 2016; Flammer et al., 2019). Indeed, voluntary CSR has often complemented ESG performance in developed countries.

However, India's dual regulatory framework creates a regulatory misalignment: CSR is mandatory and directed toward broad social objectives, while ESG performance remains voluntary and largely investor-driven. From a stakeholder theory perspective, this forces firms to satisfy community and regulatory stakeholders first, often at the expense of direct stakeholders emphasized in ESG. Empirical evidence from our study supports this argument, showing that mandatory CSR obligations reduce not only individual ESG pillar scores but also the overall ESG score (Li & Wu, 2020; Roy et al., 2022).

H4: The mandatory corporate social responsibility expenditure negatively influences a firm's overall ESG performance.

3. RESEARCH METHODOLOGY

3.1. Sample and data collection

India is chosen for the present study because of its unique regulatory landscape, being the only country that mandates both CSR expenditure and ESG disclosure. The sample comprises NSE 500 firms between fiscal years (FY) 2015 and 2022, representing approximately 93% of the free float market capitalization of stocks listed on the NSE. Although CSR expenditure has been disclosed in India since FY 2014–2015, we restrict our analysis to the period 2015–2022 in order to align with the availability of Bloomberg ESG data. We excluded financial firms because their disclosure and statutory requirements differ significantly from non-financial firms, which may bias estimates (Mangena & Tauringana, 2007). Firms with missing CSR or ESG data, often due to mergers and acquisitions, were also removed. After these refinements, the final unbalanced panel consists of 414 firms, yielding 3,264 firm-year observations. The sample spans a diverse range of industries, including 102 firms in Industrials (24.64%), 87 in Consumer Discretionary (21.01%), 54 in Materials (13.04%), 52 in Health Care (12.56%), 30 in Consumer Staples (7.25%), 28 in Information Technology (6.76%), 19 in Energy (4.59%), 18 in Utilities (4.35%), 14 in Communication Services (3.38%), and 10 in Real Estate (2.42%), as classified under the Global Industry Classification Standard (GICS) framework.

3.2. Independent and dependent variables

Corporate social responsibility expenditure is the main independent variable, sourced from the Centre for Monitoring Indian Economy (CMIE) Prowess Database and cross-verified with the National CSR Portal. The Companies Act of 2013 requires firms to spend at least 2% of their three-year average net profit on CSR activities. In line with this regulation, we measure CSR expenditure as a percentage of average net profit over the past three years. To capture differences between minimum compliance and voluntary extension, we further construct a CSR intensity measure, where firms that spend exactly or just above the 2% threshold are categorized as compliance-oriented, and firms that exceed the threshold are categorized as high-intensity. All monetary values are reported in Indian rupees (INR).

The dependent variables are the composite ESG score and the three individual pillar scores (environmental, social, and governance), obtained from Bloomberg. Bloomberg ESG scores are scaled from 0 to 100, where higher scores indicate stronger performance. Bloomberg updates these annually, using both company disclosures and third-party verified reports. While these scores are widely used in finance and sustainability research, they are not without limitations in emerging markets, as they reflect externally perceived ESG outcomes rather

than audited sustainability performance (Gillan et al., 2021). We therefore interpret Bloomberg scores as proxies for externally assessed ESG performance in India.

3.3. Control variables

We include firm-level controls that prior research links with CSR and ESG outcomes. Financial performance measures such as return on assets, return on equity, net income, and earnings before interest, taxes, depreciation, and amortization (EBITDA) capture profitability and operating performance (Waddock & Graves, 1997; Khan et al., 2016). Market-based variables, including market capitalization and equity per share, capture firm size and market valuation (Orlitzky et al., 2003). Leverage and liquidity are controlled using total liabilities and cash and cash equivalents, which account for a firm's financial flexibility to invest in ESG initiatives (Flammer et al., 2019). These controls allow us to better isolate the effect of CSR expenditure on ESG scores. All variables and their coding are reported in Table 2.

Table 2. List of variables used in the study

Code for variable	*Variable type*	*Variable definition*
esgscore	Dependent	ESG score
enviro	Dependent	Environmental pillar score
social	Dependent	Social pillar score
govern	Independent	Governance pillar score
percsrexp	Independent	CSR expenditure as a percentage (2%) of the last three years' profit
roa	Control	Return on assets
roe	Control	Return on equity
netinc	Control	Net income
ebidta	Control	Earnings before interest, taxes, depreciation, and amortization
cncet	Control	Cash and cash equivalents
eps	Control	Equity per share
mcap	Control	Market cap
totlia	Control	Total liabilities

3.4. Data treatment

Since CSR expenditure and financial variables in the sample display high variability and potential skewness, we adopt several standard procedures to improve the reliability of our estimates. CSR expenditure and other continuous financial variables are log-transformed where appropriate in order to reduce skewness and approximate normality. In addition, to mitigate the influence of extreme outliers, we winsorize all continuous variables at the 1st and 99th percentiles. These adjustments are consistent with recommended practices in panel data analysis and help to ensure that the results are not driven by a small number of extreme observations.

As a robustness check, we re-estimated the models using the log-transformed and winsorized variables. The direction, magnitude, and significance of the coefficients remained qualitatively unchanged, which increases confidence in the validity of our results. This approach follows prior research on mandatory CSR expenditure in India, which emphasizes the importance of addressing skewness and extreme values when analyzing CSR and financial data (Roy et al., 2022).

3.5. Econometric specification

To estimate the effect of CSR expenditure on ESG performance, we begin with a fixed-effects panel model of the following form:

$$ESG_{it} = \beta_0 + \beta_1 CSR_{it} + \beta_2 Controls_{it} + \lambda_t + \mu_i + \varepsilon_{it} \quad (1)$$

where, ESG_{it} denotes the ESG score of firm i in year t, CSR_{it} is CSR expenditure, λ_t is the year effect, μ_i is the firm effect, and ε_{it} is the error term. We also estimate the model separately for the environmental, social, and governance pillar scores. The fixed-effects approach controls for time-invariant firm-specific heterogeneity (Wooldridge, 2010).

3.6. Addressing endogeneity

A concern in estimating the CSR-ESG relationship is endogeneity, particularly reverse causality, where poor ESG performance might induce firms to increase CSR spending as symbolic compensation. Furthermore, ESG performance is highly path-dependent, raising the issue of dynamic endogeneity. To address these issues, we employ the two-step System GMM estimator (Arellano & Bover, 1995; Blundell & Bond, 1998), which accounts for unobserved heterogeneity, simultaneity, and dynamic persistence. We implement the model using the *xtabond2* command in Stata.

To ensure validity, we report standard diagnostic tests, including the Hansen J-test for over-identification of instruments, the Arellano-Bond AR(2) test for autocorrelation, and instrument count relative to the number of firms to avoid instrument proliferation. We also report partial R^2 statistics to demonstrate instrument relevance. These diagnostics enhance confidence in the robustness of our results.

3.7. Economic significance

In addition to statistical significance, we evaluate the economic significance of our results. A one percent increase in CSR expenditure is associated with a reduction of approximately 3.7 points in Bloomberg's ESG score. Given that the mean ESG score in our sample is around 15 with a standard deviation of 10, this effect represents nearly one-quarter of the mean, highlighting the magnitude of the trade-off created by India's regulatory framework. This result supports the argument that mandatory CSR expenditure may crowd out voluntary ESG initiatives, particularly in resource-constrained emerging economies (Roy et al., 2022).

4. RESULTS

Table 3 presents the descriptive statistics for the variables included in the analysis. The sample consists of 3,312 observations for the percentage of CSR expenditure to net profit (*percsrexp*). For the ESG score (*esgscore*), the sample consists of 3,264 observations, with a mean score of 15.198 and a standard deviation of 24.221. The ESG scores range from 0 to 93.101, reflecting the variability in ESG performance across firms. These statistics offer valuable insights into the variability in the distribution of variables such as CSR expenditure, ESG scores, and financial indicators across the sample. Understanding these measures is crucial for assessing the relationship between CSR expenditure and ESG performance, as well as for identifying potential patterns or trends within the data.

Table 3. Descriptive statistics

Variable	*Obs.*	*Mean*	*Std. dev.*	*Min*	*Max*
esgscore	3264	15.198	24.221	0	93.101
enviro	3264	13.7	24.187	0	96.534
social	3264	17.173	28.042	0	96.82
govern	3264	16.298	26.842	0	97.177
percsrexp	3312	0.011	0.282	-15.385	1.98
roa	983	3263514.1	10445985	-7400000	1.400e+08
roe	2428	0.166	0.236	-7.487	2.83
netinc	2496	2.071e+08	6.315e+08	-4.700e+09	8.100e+09
ebidta	2679	4.305e+08	1.158e+09	-8.800e+08	1.700e+10
cncet	3148	1.192e+08	3.999e+08	213.039	9.100e+09
eps	2533	0.713	2.935	-1.134	69.246
mcap	2838	1.293e+10	1.098e+11	8900000	4.460e+12
totlia	3159	2.032e+09	6.548e+09	399.324	9.500e+10

Table 4 presents the correlation matrix depicting the relationships between the variables under investigation. Notably, the correlations between ESG score and its constituent components, environment, social, and governance, are all statistically significant at the 0.001 level, suggesting a robust association among these dimensions. However, the correlation between *percsrexp* (CSR expenditure) and the dependent variables appears to be statistically insignificant. Similarly, variables such as return on assets (*roa*), net income (*netinc*), EBIDTA (*ebidta*), cash and cash equivalents (*cncet*), market capitalization (*mcap*), and total liabilities (*totlia*) demonstrate significant correlations with each other and with the ESG variables.

Table 4. Correlation matrix

Variables	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*	*(10)*	*(11)*	*(12)*	*(13)*
(1) *esgscore*	1												
(2) *enviro*	0.943***	1											
(3) *social*	0.963***	0.930***	1										
(4) *govern*	0.883***	0.773***	0.816***	1									
(5) *percsrexp*	-0.0645	-0.0710*	-0.0477	-0.0591	1								
(6) *roa*	0.365***	0.426***	0.412***	0.187***	0.0107	1							
(7) *roe*	0.00798	0.0255	0.0146	-0.0111	0.0691	0.0489	1						
(8) *netinc*	0.446***	0.501***	0.508***	0.326***	0.0224	0.508***	0.187***	1					
(9) *ebidta*	0.510***	0.580***	0.596***	0.387***	0.0193	0.517***	0.134***	0.859***	1				
(10) *cncet*	0.436***	0.465***	0.457***	0.458***	0.0170	0.206***	0.0352	0.471***	0.487***	1			
(11) *eps*	0.0437	0.0707*	0.0647	0.0233	0.0238	0.120***	0.121***	0.0982**	0.0448	-0.0244	1		
(12) *mcap*	0.475***	0.513***	0.536***	0.438***	0.0144	0.440***	0.159***	0.793***	0.747***	0.442***	0.140***	1	
(13) *totlia*	0.363***	0.432***	0.453***	0.254***	0.0141	0.357***	-0.0199	0.469***	0.753***	0.282***	-0.0701	0.320***	1

*Note: * p < 0.05, ** p < 0.01, *** p < 0.001.*

4.1. Baseline results

Table 5 reports the results of the fixed effects regression models examining the relationship between mandatory CSR expenditure and ESG performance across its three dimensions — environmental, social, and governance, as well as the overall ESG score. Models 1 and 2 in Table 5 examine the effect of mandatory CSR expenditure on firms' environmental performance. In Model 1, with additional firm-level controls, the coefficient for CSR expenditure (*percsrexp*) is negative and significant (β = -3.873, standard error (SE) = 0.127). In Model 2, without including controls such as ROA, ROE, and market capitalization, the coefficient remains negative and significant (β = -1.938, SE = 0.368). The results indicate that increased CSR spending is associated with a decline in environmental performance, supporting *H1*. This finding aligns with the concerns in prior literature (Hong & Kacperczyk, 2009) that mandatory CSR expenditures may crowd out more effective voluntary sustainability initiatives, particularly in emerging markets where compliance often takes precedence over strategic environmental management.

Table 5. Fixed effects regression results for mandatory CSR expenditure and ESG performance

Variables	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
	enviro	*enviro*	*social*	*social*	*govern*	*govern*	*esgscore*	*esgscore*
percsrexp	-3.873***	-1.938***	-3.500***	-1.794***	-3.679***	-1.981***	-3.670***	-1.926***
	(0.127)	(0.368)	(0.114)	(0.421)	(0.102)	(0.491)	(0.102)	(0.403)
ara	4.10e-07		2.97e-07		2.99e-07**		2.63e-07	
	(2.88e-07)		(3.18e-07)		(1.45e-07)		(2.74e-07)	
roea	3.643		1.770		-2.457		0.686	
	(6.725)		(5.393)		(2.569)		(4.179)	
cncet	4.03e-09		7.81e-10		1.50e-09		1.91e-09	
	(3.50e-09)		(2.71e-09)		(3.22e-09)		(3.82e-09)	
nia	7.96e-09*		4.97e-09		-1.60e-09		5.36e-09	
	(4.48e-09)		(4.73e-09)		(2.43e-09)		(3.82e-09)	
ebdita	-5.44e-09*		-4.33e-09		1.23e-09		-5.27e-9**	
	(2.99e-09)		(3.35e-09)		(1.79e-09)		(2.45e-09)	
epsm	0.265		-1.848		0.131		1.676	
	(3.587)		(4.626)		(2.738)		(2.149)	
roica	-13.01**		-10.28**		-6.075*		-8.909**	
	(5.344)		(4.771)		(3.367)		(4.315)	
mcap	0		0		0		0	
	(1.36e-10)		(1.24e-10)		(6.22e-11)		(1.50e-10)	
totlia	1.37e-09*		9.74e-10		3.70e-10		8.74e-10	
	(8.24e-10)		(8.72e-10)		(4.70e-10)		(7.05e-10)	
Constant	16.50***	13.72***	23.88***	17.19***	18.82***	16.32***	18.96***	15.22***
	(3.215)	(0.00394)	(3.421)	(0.00450)	(1.885)	(0.00525)	(2.708)	(0.00430)
Observations	619	3,264	619	3,264	619	3,264	619	3,264
Year fixed effects	Y	Y	Y	Y	Y	Y	Y	Y
Firm fixed effects	Y	Y	Y	Y	Y	Y	Y	Y
R-squared	0.100	0.001	0.065	0.001	0.067	0.001	0.071	0.001
Number of firms	174	408	174	408	174	408	174	408

*Note: Robust standard errors in parentheses. *** p < 0.01, ** p < 0.05, * p < 0.1.*

Models 3 and 4 explore the influence on social performance. Similar to the environmental dimension, CSR expenditure is negatively associated with social scores in both models. In Model 3, with controls, the coefficient is -3.500 (SE = 0.114), while in Model 4, without controls, the coefficient is -1.794 (SE = 0.421). These findings provide empirical support for *H2*, suggesting that increased mandated CSR expenditure does not translate into improved social outcomes; rather, it detracts from them. This could reflect the tokenistic nature of compliance-driven CSR initiatives, which prioritize spending over substantive improvements in social practices (Velte, 2017, 2022). Our results are consistent with Tahmid et al. (2022), who also find limited evidence of positive social impact from mandated CSR in emerging economies.

The relationship between CSR expenditure and governance performance is analyzed in Models 5 and 6. CSR expenditure exhibits a negative and statistically significant association with governance scores across both models. Specifically, Model 5 reports a coefficient of -3.679 (SE = 0.102), with controls, and Model 6, without controls, shows a coefficient of -1.981 (SE = 0.491). These results support *H3*, indicating that increased CSR expenditure may correspond with weaker governance outcomes, which is somewhat counterintuitive, as governance mechanisms are typically seen as facilitators of effective CSR implementation (Fahad & Rahman, 2020). However, in contexts where CSR compliance is externally imposed, it is possible that internal governance structures play a diminished role, thereby reducing their positive influence on ESG outcomes (Wu et al., 2024).

Finally, Models 7 and 8 examine the effect of CSR expenditure on overall ESG performance. Consistent with the results for the individual ESG dimensions, CSR expenditure remains negatively and significantly related to the ESG score. Model 7 reports a coefficient of -3.670 (SE = 0.102), while Model 8, without controlling for firm characteristics, shows a coefficient of -1.926 (SE = 0.403). These findings confirm *H4*, suggesting that higher mandatory CSR expenditures are associated with lower overall ESG performance. This aligns with a previous study by Atan et al. (2018), which argues that excessive regulatory pressure in emerging markets may lead to superficial ESG practices that fail to deliver substantive performance improvements. The results remain qualitatively unchanged when the models are re-estimated using log-transformed and winsorized variables (tables not reported for brevity).

4.2. Two-step system GMM estimation

To address potential endogeneity, including simultaneity, measurement error, and omitted variable bias in the relationship between mandatory CSR expenditure and ESG performance, we employ a two-step system GMM estimator. This approach is widely recommended for dynamic panel data models, as it effectively instruments for endogenous regressors using their own lagged values (Arellano & Bover, 1995; Roodman, 2009). The two-step system GMM not only enhances efficiency under heteroskedasticity but also provides robust inferences about causal relationships in the presence of dynamic endogeneity (Shahgholian, 2019).

Table 6 reports the system GMM results for environmental, social, governance, and overall ESG performance. The key explanatory variable — the differenced measure of mandatory CSR expenditure — consistently shows a significant negative correlation with all ESG dimensions. Specifically, in the environmental performance model (Model 1), the coefficient is -0.836 (SE = 0.116, $p < 0.01$). Similarly, the social performance model (Model 2) yields a coefficient of -0.701 (SE = 0.124, $p < 0.01$); the governance model (Model 3) shows -1.191 (SE = 0.120, $p < 0.01$); and the overall ESG performance model (Model 4) reports -0.946 (SE = 0.113, $p < 0.01$). These results reinforce the baseline fixed effects findings and support the hypothesis that increased mandatory CSR

expenditure adversely affects ESG performance (Hong & Kacperczyk, 2009). The diagnostic tests reported in Table 6 support the validity of our GMM estimation strategy. The AR(1) tests are significant, as expected for first-differenced models, while the AR(2) tests are not significant, indicating the absence of second-order serial correlation. Hansen test p-values are comfortably above conventional thresholds (0.77–0.93), suggesting that the instrument set is valid and exogenous. We also ensured that the number of instruments remained well below the number of firms to avoid instrument proliferation, following Roodman (2009). Although partial R^2 statistics for instrument relevance are not reported by default in our Stata estimation, we note this as a limitation and rely on the Hansen and AR tests as standard diagnostics (Hansen, 1982; Arellano & Bover, 1995).

Table 6. System GMM results for two-step GMM (mandatory CSR expenditure and ESG performance)

Variables	*(1)*	*(2)*	*(3)*	*(4)*
	enviro	***social***	***govern***	***esgscore***
d_percsrexp	-0.836***	-0.701***	-1.191***	-0.946***
	(0.116)	(0.124)	(0.120)	(0.113)
ara	-6.56e-07	-8.19e-07	-5.23e-08	-5.48e-08
	(9.92e-07)	(1.30e-06)	(1.47e-06)	(1.12e-06)
roea	-150.7***	-140.7***	-110.1***	-135.7***
	(19.64)	(18.57)	(18.95)	(18.25)
nia	-1.00e-07	-8.78e-08	-7.98e-08	-7.21e-08
	(7.61e-08)	(7.79e-08)	(7.37e-08)	(7.93e-08)
ebdita	4.42e-08	4.07e-08	4.48e-08	2.75e-08
	(3.30e-08)	(3.23e-08)	(3.37e-08)	(3.38e-08)
cncet	7.93e-08	4.88e-08	8.20e-08	8.30e-08
	(5.27e-08)	(5.17e-08)	(6.95e-08)	(5.42e-08)
epsm	35.89*	28.81	33.10*	35.79**
	(21.54)	(20.40)	(17.29)	(18.26)
mcap	1.96e-10	7.22e-10	9.77e-11	3.10e-10
	(7.93e-10)	(7.23e-10)	(8.36e-10)	(7.09e-10)
totlia	-1.36e-09	2.57e-10	-2.47e-09	-1.74e-09
	(4.34e-09)	(5.13e-09)	(5.82e-09)	(4.70e-09)
Constant	24.39***	25.11***	15.54**	22.40***
	(6.794)	(7.210)	(6.398)	(6.952)
Observations	617	617	617	617
Number of firms	145	145	145	145
AR(1) test (p-value)	0.032	0.041	0.038	0.029
AR(2) test (p-value)	0.293	0.967	0.220	0.368
Hansen test (p-value)	0.926	0.775	0.845	0.889

*Note: Standard errors in parentheses. *** p < 0.01, ** p < 0.05, * p < 0.1. AR(1) and AR(2) are Arellano-Bond tests for first- and second-order autocorrelation in first-differenced residuals. Hansen is the J-test for over-identifying restrictions. Non-significant AR(2) and non-rejected Hansen confirm instrument validity. Instruments were collapsed to reduce the risk of proliferation. Partial R^2 statistics for instrument relevance are not available in our estimation and are noted as a limitation.*

Control variables, such as *roea* (return on equity — actual) and *epsm* (equity per share — market), also demonstrate significant associations with ESG performance, although their magnitudes differ somewhat from those observed in the fixed effects regressions. Notably, *roea* remains negative and highly significant across all models, which underscores the persistent influence of financial performance on ESG outcomes in a dynamic framework. The robustness of these results, confirmed by both the GMM and fixed-effects methods, strengthens the finding that the relationship between CSR expenditure and ESG performance is both significant and negative, even after controlling for a range of firm-level factors.

5. DISCUSSION

We hypothesized that a mandatory CSR regulation, which leads to increased spending on CSR, would divert funds away from implementing ESG activities and thereby negatively affect ESG performance at both the overall level and across the three pillars. All four hypotheses are supported in our analysis.

The hypothesis *H1* is confirmed as CSR expenditure negatively influences the environmental pillar score. Under the current regulatory framework in India, CSR funds can be allocated to environmental initiatives outside the firm's operational boundaries (*ex-situ*), but such activities do not contribute directly to ESG environmental indicators. This misalignment can be understood through stakeholder theory, where managers prioritize compliance with mandated obligations to satisfy regulatory and community stakeholders, even when this diverts resources away from initiatives valued by investors (Roy et al., 2022). Our findings suggest the need for policymakers to reconsider the design of CSR regulation so that it better complements firm-level ESG objectives.

The hypothesis *H2* is supported as CSR spending is negatively associated with the social pillar of ESG. This result highlights the stakeholder mismatch: CSR funds often target indirect or distant community beneficiaries, whereas ESG social scores emphasize outcomes for direct stakeholders such as employees, customers, and suppliers (Gillan et al., 2021). This mismatch underscores the importance of aligning CSR priorities with ESG metrics to avoid resource diversion away from employee welfare and workplace practices, which are central to ESG evaluation.

The hypothesis *H3* is also confirmed, as CSR expenditure negatively influences governance scores. One possible explanation is that boards under pressure to comply with CSR mandates may adopt a stakeholder-centric approach that prioritizes philanthropic spending, even if this weakens investor-focused governance practices such as transparency, accountability, and shareholder rights. This finding illustrates how mandatory CSR can exacerbate agency problems by misaligning managerial incentives and investor expectations, a dynamic that deserves greater attention in emerging economy contexts.

Finally, the hypothesis *H4* is supported as CSR expenditure has a negative influence on the composite ESG score. The cumulative evidence across all models suggests that mandatory CSR in India has unintended consequences, reducing the resources available for ESG initiatives and leading to weaker overall sustainability performance. These findings highlight the need for regulatory refinement to ensure that CSR and ESG policies are complementary rather than competing.

This study contributes to the CSR–ESG debate in emerging markets by moving beyond definitional differences between the two concepts and focusing instead on the mechanisms that explain why CSR spending might harm ESG performance. Grounded in stakeholder theory (Freeman, 1984), we show that CSR mandates can generate crowding-out effects by compelling firms to prioritize indirect community stakeholders over investors and employees, thereby producing agency-like conflicts in resource allocation (Roy et al., 2022). Unlike prior studies that emphasized a positive relationship between CSR and ESG (Margolis & Walsh, 2001; Marquis & Qian, 2014), our results demonstrate that when CSR becomes mandatory, it may compete with ESG initiatives rather than reinforce them.

The findings also carry important managerial implications. Firms subject to mandatory CSR expenditure should consider strategies to align CSR projects with ESG metrics, for example, by designing CSR interventions that improve employee welfare, reduce carbon footprints, or enhance governance transparency. For policymakers, the study highlights the risks of imposing rigid CSR mandates without integrating ESG objectives into the same regulatory framework.

A key contribution of this study is its reliance on Bloomberg ESG scores as the dependent variable. Bloomberg updates its ESG scores annually and bases them on a mix of company disclosures and third-party information. While widely used, Bloomberg scores reflect externally perceived ESG outcomes rather than audited performance, particularly in the Indian context, where disclosure quality varies (Gillan et al., 2021). Our results should therefore be interpreted as capturing external market perceptions of ESG rather than internal operational outcomes.

Similarly, our CSR measure is calculated as the percentage of average net profit allocated to CSR over the preceding three years, in line with the Companies Act of 2013. While most firms in India spend close to the mandated 2%, others exceed this threshold. Although our main models use CSR as a continuous percentage variable, future research could explore the difference between minimum compliance and higher-intensity CSR spenders and examine whether ESG outcomes differ across these groups.

The unstructured managerial interviews presented in Figure 3 were not intended as a systematically coded dataset but as anecdotal, semi-structured conversations conducted during the exploratory stage of the research. They provided preliminary insights into how executives perceive the CSR mandate and informed the hypotheses we subsequently tested. Their role in the paper is therefore illustrative and contextual rather than serving as a rigorously coded qualitative dataset.

This study has several limitations. First, although we employ system GMM to address endogeneity, issues of reverse causality remain: firms with weaker ESG performance might increase CSR spending as symbolic compensation. Second, it is possible that some firms engage in window-dressing by allocating CSR funds in ways that enhance external visibility without improving ESG performance, an avenue for future research to investigate more systematically. Third, while our sample includes 414 NSE-listed firms, Bloomberg ESG coverage remains limited to larger companies. Extending the analysis to unlisted firms or to other emerging economies with mandatory CSR laws, such as Indonesia, could yield further insights. Finally, future studies could examine heterogeneity in the CSR-ESG relationship by industry, ownership structure, or political connections, as these factors may shape how firms navigate the dual regulatory pressures of CSR and ESG.

6. CONCLUSION

This study investigated the effect of mandatory CSR expenditure on ESG performance in India, the only country to mandate both CSR spending and ESG disclosure. We find that CSR expenditure is consistently associated with lower environmental, social, governance, and overall ESG scores, suggesting that CSR mandates can crowd out resources for ESG improvements. The effect is economically significant: 1% increase in CSR expenditure is associated with an average decline of about 3.7% in the ESG score, a pattern consistently observed across the environmental, social, and governance pillars. The negative association remains robust across fixed-effects and two-step system GMM estimations with standard diagnostic checks, and persists both with and without common firm-level controls.

The results point to a regulatory misalignment: CSR obligations target indirect community stakeholders, while ESG metrics emphasize outcomes for direct stakeholders such as investors, employees, and customers. This mismatch, combined with resource constraints, creates agency problems and inefficient allocations (Roy et al., 2022; Li & Wu, 2020; Gillan et al., 2021). Viewed through the lens of corporate governance, these findings suggest that board composition, monitoring mechanisms, and stakeholder orientation influence how managerial attention and capital are directed toward — or diverted from — material ESG outcomes. This interpretation aligns with prior evidence that governance structures shape disclosure quality, earnings management practices, and overall firm value (Ayuso & Argandoña, 2009; Kao & Chen, 2004; Gupta et al., 2009). For top management teams, the strategic implication is to integrate CSR with ESG materiality in project selection and capital budgeting, while enhancing board oversight and internal assurance mechanisms to ensure that CSR commitments complement — rather than substitute for — core ESG practices (Hutchinson & Zain, 2009). For policymakers, the evidence highlights the need for closer alignment between eligibility rules and reporting requirements so that CSR initiatives reinforce, rather than dilute, ESG outcomes and the credibility of corporate reporting systems (Huse, 2005; Carels et al., 2013).

Our findings are limited to large listed firms and Bloomberg ESG scores, which reflect external perceptions rather than audited performance. Future research should consider heterogeneity across

industries, ownership structures, and political connections, as well as the possibility of reverse causality and window dressing. Quasi-experimental designs that exploit regulatory thresholds and phase-ins, comparative analyses with jurisdictions that mandate CSR, and the use of audit-based environmental and social measures would enable a more direct examination of underlying mechanisms and enhance the assessment of external validity. Overall, the study highlights how poorly aligned sustainability regulations may unintentionally weaken firm-level ESG outcomes, especially in emerging economies.

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