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Incorporating CSR Activities into the Company's Financial Strategy: A Case Study

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This paper aims to answer what are the necessary methods and criteria of being successful in incorporating corporate social responsibility (CSR) programs, while remaining in line with the strategic financial objectives. This paper also investigates what are the key measures and methods of evaluation the success in CSR and financial performance. The paper does this by first examining the theoretical framework for financial health, CSR, and finally shareholder value creation. The established framework is then applied to a Finnish retail company. Kesko, as a case study. The study found, that Kesko has been able to create shareholder value by increasing its financial performance, by strategically incorporating its CSR strategy into its business activities.

Keywords	CSR, corporate social responsibility, shareholder value, sustainability

Contents

1 Introduction 1

2 Theoretical framework 2

2.1 Financial health and performance 2

2.1.1 Financial statement reliability and accounting fraud 3

3 Corporate Social Responsibility 6

3.1 Notion and value of CSR 6

3.2 The impact of CSR on CFP 7

3.3 Gaps in literature 8

3.4 Investing behaviour **Error! Bookmark not defined.**

3.4.1 Corporate governance perspectives 9

3.5 Investor behaviour 12

3.5.1 Financial analysis tools 13

3.5.2 ESG indices 14

3.5.3 The UN's sustainability goals as a direction for CSR conformity 15

3.5.4 CSR performance tied corporate loans 17

4 Methodology 22

5 Case Study: Kesko Oyj 23

5.1 Company Background 23

5.2 Kesko's financial health analysis 24

5.2.1 NET MARGIN 25

5.2.2 Return on invested capital (ROIC) 25

5.3 Kesko's CSR performance analysis 25

5.3.1 The extent of sustainability reporting 26

5.3.2 Reporting reliability 26

5.3.3 Target setting and target reaching ability 27

5.4 Kesko's stock performance analysis 27

5.4.1 Share price and P/E analysis 28

CONCLUSION 30

References 31

1 Introduction

To provide a concise overview on how companies can successfully incorporate CSR activities to their business, this paper is using established theoretical frameworks for three business aspects and then applying them to a case study about a Finnish retail company, Kesko.

The aspects of evaluation have been based on the topic that is being discussed, and the real-world limitations and requirements for businesses to exist and operate.

First aspect is concerned with the company's financial health. This aspect was chosen by the author because any business ought to be regarded as a going concern, which is a necessity for the company to make sensible business decisions. Also, the investors are interested in the financial health of the company, so it is key to investigate the financial measures. Additionally, in this chapter, the worries and the risks of trusting the financial information are discussed, alongside questioning of the auditing companies' behaviour. The chapter concludes that *net margin* and *return on invested capital* provide a quick and reliable way to examine Kesko's financial health.

The second aspect is the societal and environmental performance of the companies; their CSR performance in other words. This section of the paper discusses the measures and reporting of CSR, the difficulty of measuring CSR success and its relation to profitability. The chapter also discusses Kesko's CSR-tied syndicate loan, that is a method of bringing CSR performance and financial performance to the same terms.

The third aspect is about the investors' behaviour. This was chosen because it is the other side of the topic at hand; staying profitable and investment-worthy, while incorporating CSR activities that are not direct investments to shareholder wealth growth. This chapter also discusses the discussion between the shareholder perspective and the stakeholder perspective, and the recent shift in investing behaviour regarding these two perspectives. The chapter concludes that a stock's *share price* and *P/E* are good measures to check if Kesko is a good investment.

The three aspects also need reliable measures for comparison and to view companies' performance in these aspects. The measures are chosen based on literature and research, that conclude which are the most important, but also reliable and accurate. As a case company is analyzed later, the selected measures must be applicable to the company in question. Selecting reliable CSR measures is especially critical, and difficult, owing to CSR's ambiguity and relative fast growth in the recent years.

After the aspects have been analysed and the measures have been defined, the paper will examine Kesko as a case company. The paper aims to analyze Kesko's performance in each of the three aspects, with the established measures, to provide a real-life example, to investigate if Kesko's actions and measures support the current literature and research. The findings of the case study are presented in the conclusion.

2 Theoretical framework

2.1 Financial health and performance

This chapter begins by defining which financial measures and ratios should be considered in determining a company's financial health. For those who have not taken a class in accounting or finance, key ratios and different metrics in the financial statements will seem confusing and just as a collection of random numbers. However, the significance of these numbers is great and become very useful when one is trying figure out which company to invest in, and when. A company's financial statements can provide an easy access to important information quickly if one knows what to look for.

It is better to evaluate a company through ratios, rather than standalone numbers. For example, gross profit margin gives an idea how much cash is generated for unit of currency spent on supplies. Margins and ratios also make it easier to compare companies of different size within the same industry. (Maverick, 2020)

Maverick's article on Investopedia lists four different metrics that are important in measuring the firm's financial health: liquidity, solvency, operating efficiency, and profitability. Out of these four, profitability is considered to be the most important, as no firm can survive indefinitely generating only loss, however rich owners can sustain a losing company for a long time.

A company's profitability can be evaluated through different metrics, but according to Maverick (2020), the best metric is net margin. Net margin is calculated by dividing net income by total revenue times hundred, where a higher percentage is better. A higher net margin means that the company is better at managing costs and can keep more money in the company for the sales it makes. A low percentage means that an increase in the costs can turn the profit into loss. (Maverick, 2020)

Margin ratios, such as net margin, provide information on how well a firm generates profit from revenue, which is important to know. However, because the topic discussed in this paper is also concerned with shareholder value, a return ratio is needed to analyse how well the company is creating value for its shareholders.

Return on invested capital formula produces a percentage of how much value was created with the capital invested on a time period (Net operating profit after tax / average invested capital) (Kenton, 2020). The outcome of the formula is meaningful for both shareholders and lenders, as it shows how well their investment is being used in the company.

With profit, a company can invest directly to buy more supplies to make more products or invest in the efficiency of making the product, e.g. economies of scale. Profit can also be used to share among the owners of the company as a compensation in investing and/or contributing for the company.

Investing in marketing (branding, communication channels, packaging improvements) could be seen as an indirect method to help grow the sales or improve customer satisfaction. However, from shareholder theory perspective, investing in CSR activities, that can also be indirect method of increasing sales through better brand image, have been seen as a bad business decision for monetary reasons. Return on invested capital ratio is being used in this paper to investigate if that is the case. The relationship between CSR and financial performance and cause-effect of the factors is discussed separately in the CSR chapter.

2.1.1 Financial statement reliability and accounting fraud

Now that we have established the key ratios to measure a firm's financial performance and health, should we trust the numbers that we find from the financial statements?

There are a number of ways to practise creative accounting and accounting frauds, and these are usually well hidden in the books, and only an experienced forensic accountant can find them.

Michael J. Jones (2011) claims that financial statement altering needs a certain environment for both individuals and the company for the incentive to appear. He also states that a company is more likely to use fraudulent accounting methods when it is under financial stress or difficulty.

Governments and regulatory accounting bodies, both international and local, are trying to prevent the different workarounds and tactics by introducing new legislation and framework for detecting the frauds. As Jones (2011) suggests, the creative accounting will shape itself to adjust for the changes, which will always leave room for suspicion that the books may have been altered.

Another method that has been established to prevent accounting frauds; companies are audited by external auditing companies. However, Doty (2011), argues that it is not clear how well the audits catch accounting frauds, which in itself is not reassuring.

There exist several auditing companies, but the most notable are 'The big four'; KPMC, Price Waterhouse Cooper (PWC), Deloitte, and Ernst & Young (EY). The auditing firms exist to assure the market that the financial information provided to the investors is fair and true. However, as John Plender explains in his 2018 article, an auditing firm hired by the management of the audited company raises questions and controversy, as the audit firm's ethical responsibility is to the market, the financial responsibility is to the company hiring them.

The big four have been in the middle of multiple scandals, Enron being one of the most notable (Plender, 2018), that relate to them not being able, or not wanting, to accurately show the audited companies' financial health. In the case of Carillion, an UK government contractor, KPMC had looked past the over-optimistic estimations about the allocated revenues for the financial year, and then written them off the next year, showing a huge drop in the company's financial health. Plender explains this phenomenon in his 2018 article with management and executives are drawing bonuses based on artificial profit. This is just one of the examples that have been uncovered to date. (Plender, J, 2018)

One the reasons as to why these scandals happen, could be that the Big Four lack external governance. They are hired as trusted contractors to make sure the companies are abiding the law, and there are very few bodies to hold them true to the promise of fair and just auditing.

However, there have been instances where the new accounting regulation itself has created questionable changes on how the company's books can be managed, most present to date being the shift from historic value to fair value. Historic valuation method means that the cost of an asset will be marked as its value indefinitely, minus depreciation. This means that if a company has bought a building in 1950 for € 20 000, its value in 2020 would be € 20 000 (assuming no depreciation). Historic value is reliable and easily audited through purchase history, but the value will soon be lower than its actual resale value because of inflation and market shifts (Young, 2009).

Fair valuation method on the other hand uses current market value as the book value for the building. Increases (decreases) in the market value are accounted as net income (loss). This method can be problematic as we saw during the sub-prime crisis in 2008 (Young, 2009). Using fair valuation method caused big sudden increases in net income for companies owning buildings in the United States before the 2008 sub-prime crisis and was followed by drops in the "fair value" markings of the buildings during and after the crisis. (Young, 2009)

Nevertheless, if a company has shown good and consistent performance on their financial statements without any red marks, there should not be a reason for too high concern. Otherwise, it would be possible to end up in a loop of trying too hard to find fraud that one is able to convince themselves of fraud that cannot be detected. However, it is good practice to keeping informed with the current regulation and fraud schemes to recognize such doings in investments that seem "too good to be true".

2.2 Corporate Social Responsibility

2.2.1 Notion and value of CSR

The International Standards Organization’s (ISO) definition for CSR includes human rights, workplace and employee issues, ethical business practices, organizational governance and environmental aspect (Leonard and McAdam, 2003).

Howard Bowen can be considered as the father of the term Corporate Social Responsibility. He became known for it in his 1953 book “Social Responsibilities of the Businessman” (Acquier, et al., 2011). He defines CSR as the obligations of the managers and directors toward the values of the society. The obligations he mentions are outside the legal obligations that the businesses have by law.

The book is also concerning only big corporations in the United States, which makes sense, because the larger the company is, the larger the impact to the society can be. for good (e.g. helping working conditions) and bad (e.g. hurting the environment).

In his time, he was criticized by his fellow scholars for his anti-business ideology in his curriculum. The University of Illinois, where he worked as a dean, was divided to self-styled free marketers and Keynesians. The conflict between them ended in Bowen’s forced resignation (Solberg & Tomilson, 1997). The forced resignation was during the period called ‘McCarthyism’, which hurt a lot of people in influential positions, including scholars. McCarthyism means investigating individuals and trying to prove if they are politically or otherwise interested in communist ideologies. Bowen’s articles, as presented below, can be interpreted as sharing communist ideology to a minor degree.

Bowen thought that the companies are serving the society as a whole, and not just to provide the products, and they indeed have the obligation to follow the values of the society. The research does not dwell deeper on the statistics as the later studies have done to validate their hypothesis. This, in his time would have probably been beneficial to his reputation as he could have had more to show for his statements. However, his ideology and books keep on living in the newer studies, in an increasing manner, so he surely is one of the most influential authors in this area.

2.2.2 The impact of CSR on CFP

It is indeed a necessity to understand how CSR actions can and are being measured and presented. As the literature points out, there is a lack of consensus of how to create a reliable way of measuring the success of CSR activities, and secondly, how to measure its financial performance impact. There is no lack of literature on the topic, but the vastly different opinions and conclusions make it a difficult topic to get a reliable answer from.

The literature is clearly divided into three distinct conclusions: CSR has either 1) positive, 2) negative, or 3) neutral impact on corporate financial performance (CFP). The differences between the studies emerge from the different angles the studies take, in addition to different definitions of both variables, CSR and CFP (Galant, A; et al. 2017)

Various studies examine only specific aspects of companies' CSR and comparing them to the selected measures of CFP, such as systematic risk, firm value, portfolio performance (Benlemlih, et al., 2018). The legitimacy and accuracy of the measures of both variables is questionable, as the previous chapter explored the different ways financial statements can be fraudulent. This chapter will cover the issues concerning the reporting of CSR performance.

A problem that arose during the literature overview, is how do the studies establish a valid correlation link between the CSR acts and the CFP impact. Measuring the non-financial indirect investments and cause-effect to financial performance is difficult to prove.

McWilliams and Siegel are known for their work in early 2000's in CSR with "Corporate Social Responsibility: A Theory of the Firm Perspective" (2001), where they claim that there is only neutral relationship between the variables (CSR and CFP). They conclude in their research that there is an optimal level of CSR in a company that the managers needs to reach for, meaning that too little can decrease CFP, but the research also states that the benefit from CSR investments is prone to diminishing returns.

Mcwilliams is currently a Professor of Strategic Management since 2000. She has a PhD in Economics and teaches business ethics, strategic management and sustainability management. Her portfolio of papers is impressive in the area of CSR,

and she has newer papers about the subject too, most important of which to this paper being *Managing the Triple Bottom Line: Data Envelopment Analysis and Making Socially Responsible Decisions* (Mcwilliams, A; Parhankangas, A; Coupet, J; Barnum, D., 2014).

Siegel also has PhD in Business Economics and he is a professor of public policy and management in the Arizona State University. Among other achievements, he has published over a hundred journal articles and 12 books, many of which concern the CSR. He also has a high citation count in google scholar of over 40 000. (Arizona State University web page)

2.2.3 Gaps in literature

One major gap that I found through the research is that none of the studies trying to establish a link between CSR and CFP have convinced the author about the legitimacy of their claims. Statistical error, poor evaluation of the variables, market environment and causalities can be often looked over in the studies. Later in this paper, the issue of transparency related to these factors is discussed briefly.

A 2017 study by Adriana Galant and Simon Cadez, carefully examines this problem, and tries to create a framework, on which managers can build to create a positive correlation between the CSR and CFP. The Study also claims that the simple existence of the correlation of these variables is over-studied already, and it would be the time to approach it from a different angle, as results are proven to be so prone to sway from negative to positive.

It is hard to find evidence and studies about the level of frauds in financial reporting and the auditing efforts toward the information that companies provide outside the legal requirements, such as CSR reports that are not tightly regulated, yet at least. Not knowing the level of fraud can make the analysis and conclusions irrelevant. Stating or promising a product is environment-friendly, healthy, produced in good factory condition or such claims can help the sales of product, but if these claims are not true, it is called “greenwashing”. A good example of this in the recent history is Volkswagen (VW), a German car manufacturer. VW had marketed their new diesel cars to be “greener” than ever with outstanding emission results. Later, it was found out that VW had installed a device, that recognized when the car was being tested for emissions

and changed the engine's behaviour and emission control. In real use case however, the car tested well above the allowed emission standards and regulations. (Pontefract, D 2016)

Even if read and analyzed in good faith, the companies that were studied, might or might not have such fraud in their books that it would make the acquired data inherently wrong, but it could change the way the results should be interpreted. However, an article by Sunita Rao (CPA Journal, 2017), suggests that with the increasing interest in CSR and sustainability reporting, comes greater need for credibility checks though external auditing. So, even though the sustainability reports as such are not mandatory or highly regulated, the increasing interest from investors demand a higher degree of credibility in the reporting. (Rao, 2017)

2.3 Shareholder value creation

Keeping the discussion only theory based, the arguments between the obligations of the managers would go on forever. The resulting conclusions would change for every situation and case. In one case, the importance, or the priority, of certain stakeholders exceed the priority of profit maximation, and the management decides to apply the stakeholder theory to their strategy. Some other case, it might go the other way around if for example the financial pressure in market is demanding more profitable actions to stay in the business.

2.3.1 Corporate governance perspectives

Corporate governance has as many definitions as there are articles about it. Therefore, this paper concentrates on the two management perspectives of it: the shareholder theory and the stakeholder theory, which are both explaining the definition through different view on business practice and management's responsibilities. The two theories are included in this thesis for their status as the base of the argument in the CSR discussion.

The focus on this section is to briefly introduce both theories, their origins and current literature. The analysis is focused on the investment perspective, and how the

companies can attract investors with an optimal mix of these ideologies. (Jones and Wicks, 1999)

These two theories are often misunderstood, especially with the existing three different versions: normative, descriptive and instrumental. The normative approach looks at the management of the company and dictates how they should act on behalf of the owners of the company. The descriptive version is more interested in describing the behaviour of the management, rather than telling them what to do. The instrumental approach looks at the predicted outcomes of specific behaviour of the managers.

In this paper, only the normative approach is used to maintain clarity, and also to shift focus away from comparison of these three approaches and focus on the differences in the attitudes of the investors, and how to effectively change these attitudes.

2.3.1.1 Shareholder theory

The father of the shareholder theory is considered to be Milton Friedman. He states in his article in New York Times (1970), that "In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business." Meaning, that although in charge of the business, executives are ought to act in the best interest of the shareholders.

According to this perspective, in the eyes of the shareholders, the company should only invest in projects with the maximum amount of profit, and therefore benefitting the shareholders the most, also called profit maximation. The shareholder perspective is disregarding the effects to other stakeholders and stating that businesses exist to do business; "The business' managers are obliged to act in the best interest of the shareholders." (Corporate Finance Institute, 2020)

This does not directly mean that charity work and other CSR activities would not be accepted by the shareholder theory approach. The managers are obliged to generate maximum amount of profit, and if for example a charity donation is the most profitable use of the capital at that moment, then it is accepted.

As discussed in the CSR literature review section later, the challenge has been measuring the correlation and especially causation between the CSR activities. For

example, donations, and the gain/loss they net to other increase in performance is hard to measure reliably, has been one of the arguments for the shareholder perspective to not invest in CSR.

An argument could be made that, as humans are not machines which are only concerned with numbers, we can and we should take into account what is done with the capital we invest, not only how much money it makes for us. Meaning, that we as human beings, with emotions and care for each other, should not choose to invest in a company that is harming its employees or the environment. This is more of a philosophical question, for sure, but it should be accounted for when determining when to pay the premium for a sustainable company. From the stakeholder perspective, we should ask if the company is using the investment capital to source materials that are produced sustainably or not, for example.

2.3.1.2 Stakeholder theory

Although Howard Bowen introduced the corporate social responsibilities of the company to the whole society (aka stakeholders), the founding father of stakeholder theory-title is often given to another author, R. Edward Freeman for his *Strategic Management: A Stakeholder Approach* publication in 1984.

In their more recent book, *A Stakeholder Approach to Strategic Management* (2001), Freeman and John McVea, review the history of the stakeholder approach and its recent studies. They argue that the studies are too general and that the normative approach is more of an ethical study into the morality of CSR activities.

Stakeholder theory defines stakeholders to be everyone and everything that the company’s actions (or non-actions) influence positively or negatively. For example, a river (the environment) can be affected by the actions of a farm, where the soil is chemically treated. Another example could be a company closing a factory, which affects the lives of the workers’ families.

Influence on the stakeholders can be for example an increase in working conditions, pro-environment choices or charity donations. These good deeds can reflect well on the company in many ways: the consumers’ image of the company’s brand could improve (sales gain), or the company could gain status as a good employer and thus

attracting more skilled employees (Greening, W; Turban, D, 2000), are just a few examples. On the other hand, doing these good deeds are not usually free, and they are costing money for the companies, which raises the question of how much to invest, and in what?

Freeman and McVea (2001) review the history of the stakeholder approach and its recent studies. They argue that the studies are general and that the literature around it is far spread, ranging from the ethical perspective, paradoxical nature (Goodpaster, 1991), to creating a holistic view of relevant theories into one (Jones, 1995, Clarkson, 1995).

Stakeholder theory, being often put against the shareholder theory, shares the values and the ideas with CSR, that companies exist not only to benefit the shareholders monetarily, but to benefit the society in which the company operates. The theory was developed to counter the strategic management perspective of shareholder primacy, shifting the focus from the economic indicators to other, more social standards.

It must be noted here, that shareholders are indeed regarded as one of the stakeholders because they are affected by the financial performance of the company. And indeed, the shareholders must be satisfied with the financial and the actions of the company, because without them the company can lose value. Therefore, the company must balance the activities and obligations to the profit maximation and to the society.

The standards that lie outside the legal obligations and laws concerning business are without a doubt difficult to measure, as opposed to financial benchmarks. Financial statements are crafted from real-life transactions and business operations, while CSR impact must rely on qualitative information about the brand image, for example. As discussed previously in this chapter, financial information is often also problematic.

2.3.2 Investor behaviour

While the discussion between the two theories is about what the managers should decide, the shareholders or investors themselves have a decision to make. The investors can assess and review the management of various companies and choose a suitable company that fits their investment goals.

If the goal is to make a maximum amount of profit in a short period of time, then an "old-fashioned" company with a strong emphasis on the shareholder primacy in their strategy is a good option. Information on the near future events, for example product launches, can be helpful in creating a decent profit in a short period of time, for example the launch of AMD's new processors in 2019 (Hill, 2019). The free-market condition creates the competition between the companies to fight for the investors' money and valuation, and the one with the most solid history, and future expectations of profitability wins in this case.

2.3.3 Financial analysis tools

Tools and analysis are readily available for this kind of investment behaviour. Financial statements, forecasts and market analysis can be found for free for anyone to access, and to make decisions based on your financial preferences. This makes profitable, reasonable and easy investing attractive, in addition to the possible monetary gain.

However, it should be noted, that even the most solid seeming investments contain their fair share of risk. Companies' annual reports usually include a future projection based on managerial comments and analysis on the market condition, which can help understand the benefits and the risks related to the company. However, this is usually crafted in optimistic manner and cannot be hundred percent accurate, compared to the historic information on financial performance found on the financial statements. To eliminate some of the risk related to the industry or the market, smart investors have a portfolio of different shares with different betas to diversify and negate the risk.

The tools also apply to almost any financial instrument, not just to companies' shares. Indices that gather stocks of certain industry or market together, are a viable option for people looking for long-term investment opportunities with steady, differentiated returns. Indices group together an assortment of different shares, and they can be selected or screened through different methods to comply for example with certain criteria of performance. For example, the S&P 500 contains the 500 largest public listed companies in the US, based on market capitalization (Kenton, 2019).

2.3.4 ESG indices

The available tools are simple and straight-forward for the ones knowing how to read financial data, but the question arises when trying to compare companies from the CSR performance perspective. For example, it is simple to look up which company had a good profit margin last quarter, but checking which company saved more trees, if that is the investor's preference, is more troublesome, and the accuracy and reliability of the number is questionable because of varying measuring methods. The author is suggesting investigating different ESG indices, that may make it easier to find and select socially responsible firms for a portfolio.

Newer, "green-indices", are becoming more and more popular (GIIN, 2018). These indices are focused to include companies that are screened through different environmental, social and corporate governance (ESG) criteria. The stocks can be selected based on their ESG score, or financial performance. For a company, being selected into these indices, can signal a positive mark for the investors. As investor behaviour is turning towards favouring companies with good corporate governance and CSR plans, getting a place in the most reliable ESG indices is a great deal. (Rolandi, 2019)

Impact investing means to invest in financial instruments that generate and fulfil positive and measurable social impact and goals (GIIN, 2018). The impact investors are looking to make an impact alongside the return on investment. Recently, studies have shown that investors are more interested in the companies' CSR activities for their societal impact, shifting focus away from profitability and return on investment. This can be seen for example GIIN's annual survey's measure for impact investment assets, that have almost doubled from last year. (GIIN, 2018)

If an investor decides to choose only one company to invest in, and that company must be good to the environment, how does one measure the "goodness", and more importantly, compare that measure with others? In other words, the problem is to find an accurate and a reliable way to find the best company for impact investing. As discussed before in the CSR-literature section, the studies have used an array of different measures to test the results of different CSR activities.

A practical way to find out how well the companies are doing in their CSR activities and planning, is to go to their website and search for a sustainability section, or for the

listed companies, going to the financial reports that usually have a sustainability section. There, one can find all the information the company is offering from their CSR acts for the employees, environment and society. The scale of the reporting depends on their investment and dedication in CSR activities. The more data and transparency is included in these reports, the more likely it is that a company is committing to the causes they claim to commit.

Alas, yet another problem arises from the sustainability reports: transparency. For example, in the EU, the reporting on CSR is very loose and free form for the companies. Only companies that are large (>500 employees and >40 million turnover or >20 million balance sheet value) must issue a public report about their CSR that impact the society and the environment. The report does have guideline that the companies are expected to follow, but it is non-binding. (Ministry of Economic Affairs and Employment of Finland, 2019)

The investors must rely on these reports that the companies produce. It would be wise to read and analyze these reports with prudence, since they may or may not be close to the truth. Most of the companies are of course not going to report any negative effects that their operations might have in fears of investor disappointment.

It is up to argument if all companies would benefit from being transparent, but a recent study about transparency suggests that customers would be willing to pay more for a product from a company that is wholly transparent (Label Insight, 2016).

Financial reporting and statements are very tightly regulated and controlled, and financial scandals, such as Enron's, make the news easily and attract the attention of angry investors, scared for their investments. If financial information can be manipulated, even under auditing and regulations, it is difficult to assess how much of the information in CSR reporting is fraudulent, even with external auditing.

2.3.5 The UN's sustainability goals as a direction for CSR conformity

The United Nations have issued 17 Sustainability goals for individuals and companies to follow. Some companies have adopted few of these goals on their websites to showcase their work in these aspects.

The UN sustainable development goal number 8: “Decent Work and Economic Growth”. is especially interesting regarding this paper. The description of this goal states that it is crucially important to create work opportunities with a decent wage, but without hurting the environment. Favouring greener factories, in areas that will not require taking down forests, trained staff, and a better wage for the employees will prove costly for the company. However, as investors, and consumers for that matter, are growing more interested in sustainability, investing in accordance with the guidelines may help the company avoid controversies later down the line.

A very recent noteworthy spokesperson on economic growth who made the headlines, is the 16-year-old Greta Thunberg. She, and 15 other children have come forth with a human rights complaint to the UN, regarding the climate change. (Independent, 2019)

The UN Sustainable Development Goals are the step to a right direction to create uniformity within the reporting. Companies can implement these guidelines in their CSR agenda. As of now, the companies may come up with their own benchmarks and goals, which they improve, track and report. For example, Disney reports the following sectors: “Environment” (emissions, waste, and water), “Healthy living” (licensed wholesale food sales, and global advertising), and finally “Volunteer hours” (community service) (Disney, 2020). It is showing transparency, but these figures are difficult compare to other companies’ different reporting sectors because not all companies report the same measures.

The varying size of companies also contributes to the difficulty of comparison. A larger corporation can promote relatively large spending on a charity, while a smaller business could donate the same percentage of its profits, but the amount would be significantly smaller. This makes it easier for larger firms to leverage their CSR “power” and make them look as the “better green-investment” than smaller companies that must invest to their own growth primarily. However, for the benefit of small, or new start-up, it is easier to start “green” from the beginning and have it as a permanent trademark, which gives them the competitive advantage of versatility and faster adaptation to new materials and methods.

2.3.6 CSR performance tied corporate loans

The section above talked about the decisions and the difficulties related to the decisions of the investors. The investors also look for profit maximisation, but with impact investing, it is only one of the cornerstones of choosing an investment opportunity, and companies have tools at their disposal to effectively turn CSR activities to concrete cost minimization and profit, as it is presented below.

While reporting, transparency and marketing material might be enough to raise the brand image of the company, the more prudent investors will be looking for hard data of benefits of the social activities the company is undertaking. This is where the applied methods of CSR value creation prove important.

One of the applied CSR value creation methods is to tie CSR activities and success to a loan's interest rate.

A company has two main ways of raising capital to fund business activities: debt or equity. Debt means either borrowing from a bank with interest, or by issuing bonds. Bonds are generally more expensive for the company as investors regard them riskier than government bonds. A bank loan is not free either, in a large and long fixed term loan, the interest rates may turn expensive as well. However, the more stable the company is seen, the better credit score it gets and thus lowering the required return from the investor's, or bank's, side.

Financing through equity is generally seen as the most expensive method of raising capital. A smaller business may sell a portion of the ownership of the business to a single angel investor, in exchange for capital. A bigger enterprise has the option to go public through initial public offering and raise capital through issuing shares of the company.

No matter how the company arranges its capital structure, there is bound to be cost of capital. Cost of capital means the cost that comes from raising funds. For example, the cost of a one-year € 100 000 loan with an annual interest rate of 10%, is € 10 000. The less interest a company pays, the better their net income after interest is.

However, corporations, investors and banks have come up with methods to bring down the cost of capital through certain CSR methods, like tying the CSR activities to the

loan's interest rate. In Finland, the most recent news comes from Kesko, one of the biggest trading companies in Finland. In 2016, Kesko placed 15th on the Global 100 Most Sustainable Corporations in the World list. Kesko also won the first place in the Food & Stables retailing sector as most sustainable company in the world. (Kesko, 2016)

On October 7th, the company informed that it has agreed on a € 300 million syndicate-loan with three banks, and the interest rate is tied to Sustainability Performance Targets (SPTs) of Kesko. The interest rate decreases or increases, depending on how well Kesko has delivered on the goals. Kesko commented that the base of the interest rate is fixed, and remains as the majority of the interest payment, but the reduction advantage (if the CSR goals are reached) is significant in business perspective. (Kauppalehti, 2019)

The sustainability report from Kesko is audited by an independent party for transparency and reducing bias to manipulate reporting of the activities.

The three sustainability areas are:

1) Reducing the carbon emission footprint incurred from own business activities and from the energy bought from somewhere else.
2) Reducing the food-loss.
3) CSR Auditing of the suppliers from the "risky markets"

This resembles a few important aspects to the CSR spending/profitability problems:

1) The CSR activities' costs can now be tied to actual financial benefits (reduced interest payments → reduced cost of capital)

2) As the company is showing sustainability in its business practices, it has a lower perceived risk of defaulting (from the bank's perspective), which should attract investors.

Such loan arrangements have grown in Europe in recent years tremendously (Nordea, 2019). Because the area of sustainably linked loans is recent, there was not proper framework or guidelines for it even couple of years ago. In 2018, first the Green Loan

Principles were introduced, and in March 2019, the Sustainability Linked Loan Principles (SLLP's) were announced.

The GLP's and SLLP's were developed by the Loan Market Association, Asia Pacific Loan Market Association, and the LSTA. The purpose of the GLP's is to support ecological activity and investment. (LMA, 2018)

The Loan Market Association (LMA) is the authority of the EMEA (Europe, the Middle East and Africa) market region's syndicate loans. They work with all of the actors in the loan sector, including regulators, to inform the market about the possibilities of the syndicate loan products (LMA, 2019). Asia Pacific Loan Market Association can be considered to have the same role as LMA, but working in different region.

According to the associations mentioned above, The GLP's consist of four principles:

1) Use of proceeds
   The use of the loan capital is important in selecting the borrowers. The companies must agree to spend the funding to a project, which has a clear positive impact on the environment.

2) Process for Project Evaluation and Selection
   The borrowers must indicate their sustainability goals, show how the funding is used on project that conform with the GLP principles, and display any risks related to the proposed projects.

3) Management of proceeds
   The funds must be deposited or credited to a project-specific account. This is to ensure transparency of the use of the funds between the borrower and the lender. The borrower is responsible to track the use of the funds towards green projects.

4) Reporting
   Until the loan principal amount is fully drawn, the borrower is responsible of keeping current and relevant information of the green projects that the funds have been used in. The information should include descriptions of the projects and the capital amount that was used in those projects. This applies to both

classes of information; qualitative and quantitative. The methods and principles used in the measuring of quantitative impact should be disclosed as well. (LMA, 2018)

The difference between the GLP's and the SLLP's come from the basic idea behind the funding: GLP's are tied to certain green projects, and SLLP's are not. In SLLP's, the capital may be used in whatever business activity the company chooses, but the interest rate is tied to the SPT's. SLLP's also have four principles, which are similar to the previously presented GLP principles:

1) Relationship to Borrower's Overall Corporate Social Responsibility (CSR) Strategy

   The borrower should state its suggested SPT's link to their overall CSR strategy. This indicated that the SPTs should not be created separate from the CSR strategy, and are therefore better fitted and more possible for the company to accomplish. Any standards that the company wishes and tries to fulfill, should be stated as well.

2) Target Setting – Measuring the Sustainability of the Borrower

   The SPT's must be agreed on between the borrower and the lender. The borrower may have a third-party as assistance in the negotiations as "Sustainability Coordinator(s)".

   The basis of setting relevant and appropriate is to "encourage ambitious, positive change through incentives". This suggests that the SLL's are a way to motivate companies to deliver their already-in-place CSR strategy objectives.

   There must be a set of recent benchmarks of the SPT's to set measurable, comparable and relevant targets. The beginning benchmarks are suggested to be six to twelve months old. The targets can be set either internally or externally. Internal target making should be based on the borrower's global CSR strategy. External parties (benchmarking industry) can also help in setting the targets against external CSR requirements. (LMA, 2018)

3) Reporting

   To lessen the worries of transparency issues, the borrowers are encouraged to make and keep at least annual records of the SPT's they have, for the parties invested in the loan agreement. This information is also encouraged to make public in their annual statements, or as a separate CSR report. The methods used to capture the data should also be disclosed. (LMA, 2018)

4) Review

   It is up to negotiation, if the borrowers need external parties to show and verify their SPT's against the agreed goals. The SLLP's highly recommend the use of external verification in the case of companies that do not disclose the SPT's publicly. For public companies, the public reporting may sufficient to get assurance of the borrower's target progress. The external reporting is suggested to be made public when possible. If relying on internal review from the borrower, they should still make public the methods and expertise used in the review process. (LMA, 2018)

As the agreements between the lenders and the borrowers are confidential, the investors are worried about the transparency issues regarding the sustainability linked loans. (Nordea, 2019) The borrower is required to present the sustainability measures only to the lender, while it is worthwhile for them to report their CSR-acts and investments in the public sustainability reports. Neither the lender, nor the borrower, usually disclose precise information about the interest rate to the public, which adds to the transparency issue (Nordea, 2019).

There are three layers of verification of the compatibility and correspondence with the agreed terms and the borrower.

First, the lead issuing bank in the syndicate loan has a responsibility to itself, and to the investors, to ensure the borrowing company is eligible for the loan, and its principles. This is why the recently released principles are warmly welcomed by the industry, as they provide uniformity across the lenders and the borrowers, creating the "rules of the game". (Nordea, 2019)

The second layer comes from the other banks in the syndicate, which perform their own processes to ensure the afore mentioned aspects of the borrower. (Nordea, 2019)

The third layer is to get an outsider party auditing for the processes used. This review ensures that all parties are acting towards reaching the STPs in the proper manner. (Nordea, 2019)

Nordea's Juho Maalahti states that the definitions and understanding of the sustainability field and loans still need redefinition and work. He also states that even though the common practice is to use external parties' information gathering and services, the banks are developing their own methods and capacity to assess in decision-making. Creating the systems, benchmarking and collecting the datasets are big initial investments for the banks, but yield profit in the long run, since the use of external parties and access to their databases is expensive.

3 Methodology

The research's main focus was to find the current understanding of the correlation between CSR investment and financial performance, but as the research progressed, it became apparent that it would be impossible to provide any sort of conclusion in a bachelor's thesis level paper. The case company, Kesko, has invested heavily in CSR activities and the consumer level marketing of the activities in the past years, so it was a fitting company to take a closer look at from this perspective.

The structure is based on the three aspects of the firm's performance, described earlier in the paper: financial health, CSR performance and shareholder value creation. Each aspect is evaluated separetaly, and then the study is summarized in the conclusion.

Kesko Oyj is an interesting case study company for several reasons, the main two reasons being:

1) Sustainability efforts

   Kesko, and its retailers, are visibly investing heavily in sustainability in their marketing. Sustainability issues and reporting are as present in their retail

stores as it is in their annual reports. The sustainability reporting is varied, well-defined and assured by an independent practitioner’s report by PwC. This makes it easier for the author to research and measure the CSR performance of the company, as it is one of the main aspects of this paper.

2) Availability of information for investors

When working on a paper that is highly interested in the performance measures that investors are looking for, a publicly listed company is almost a necessity. Annual reports provide more than enough financial information to assess the firm’s financial health and investment possibilities. The reports on financial information and sustainability aspect are both independently verified, which creates reliability and credibility for the study of the company.

4 Case Study: Kesko Oyj

4.1 Company Background

Kesko Oyj is the second biggest Finnish trading company and it was established in 1940 when four wholesale retailers fused into Kesko (Kesko, 2016). Kesko began its business operations in the beginning of 1941 with 2000 employees, and it has grown to employ approximately 25 000 employees at the end of 2019. Kesko had € 10 720 million net sales in 2019, with an operating profit of 4,3%. (Kesko, 2020)

Kesko’s business model is to have entrepreneurs (K-retailers) run retail stores. 45% of the net sales in 2019 came from the retailer operations, while Kesko’s independent retail sales were approximately 18% of the net sales. Kesko also increasingly relies on B2B trade (37% of net sales). 22% of the net sales were made from international operations, mainly from independent retailing and B2B activities. (Kesko 2020)

Kesko’s strategy and value creation stems from its vision “To be the preferred choice for customers and the quality leader in the European trading sector”. Kesko’s strategic focus areas are profitable growth, business focus, quality and customer orientation, best digital services, sustainability and combatting climate change, and one unified K.

These focus areas are put to action in Kesko's three divisions, and the value proposition is "the customer and quality – in everything we do". (Kesko, 2020)

In their latest financial statement Kesko claims that it is "the biggest trading sector operator in Finland, one of the biggest in Northern Europe". Kesko is operating in 3 trade sectors: Grocery, building and technical, and cars, with grocery trade being the biggest. For the Finnish food trade, Kesko lists its competitors as follows: S-Group, ABC, Lidl, Tokmanni, Minimani, Halpa-Halli and M-chain stores. (Kesko, 2020)

4.2 Kesko's financial health analysis

This section will go through the key measures of Kesko's financial performance and analyze it with the measures selected in the financial health literature chapter.

Overall, Kesko's fiscal year 2019 showed success on their growth strategy (Kesko, 2020). Their overall net sales grew by 1,4%. Kesko sees its investment into tailoring and remodeling the grocery sectors' retail stores to suit the local customer bases, has been one of the factors for success, though increased customer satisfaction. Kesko also exceeded its 100% increase in online grocery sale growth target by reaching a 106% increase.

For the divisions, the grocery trade and the technical trade saw growth in net sales and operating profits. The car trade division faced a challenging market environment but maintained its profit capacity.

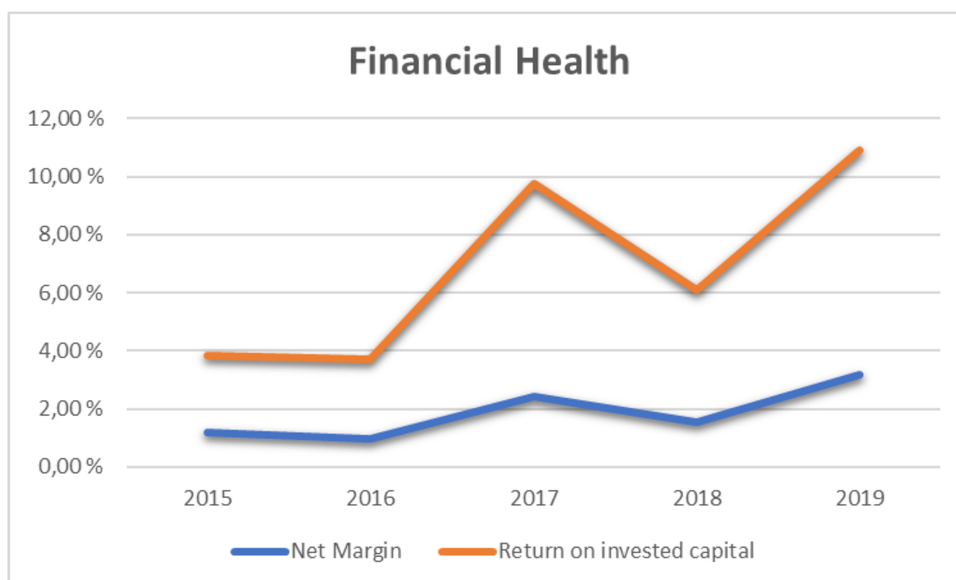

Figure 1. Both net margin and ROIC are showing a steady performance increase

4.2.1 NET MARGIN

Kesko's net margin has grown in the past five years steadily, partly thanks to increasing revenues and the use of IFRS 16 in the treatment of leases. Increase in net margin means that there is more excess capital left after all the costs are calculated in.

4.2.2 Return on invested capital (ROIC)

As shown above in Figure 1, Kesko has been able to earn more profit per every € invested. This gives a healthy indicator to the financial health of a company, as it measures how effectively the company is using the available capital to generate sales and profit.

4.3 Kesko's CSR performance analysis

Even without any analysis from the author, it can be said that Kesko is performing in an outstanding manner in its CSR activities, as it has been selected as the most sustainable company for five years in a row (Kesko, 2020). But for the research purposes, this paper will examine some of the causes for the performance, as demonstrated in the annual report of 2019.

As CSR performance is very hard to measure numerically with current tools, this paper will analyze different aspects of CSR performance of Kesko qualitatively, from the fiscal

year 2019. The aspects for the analysis were selected through the themes that the research found important in reviewing the performance of CSR activities of companies. The aspects are: Reporting extent, reporting reliability, and target setting and reaching ability.

As the investors will rely highly on information found on the financial statements (for reliability reasons), this paper will focus on examining the information in the financial statements only.

4.3.1 The extent of sustainability reporting

As with Kesko's marketing efforts in sustainability, the annual report does impress with the quantity of available information on sustainability aspects of the company. Not only does it have its own section over 70 pages, but it is brought up in different sections as well, either as a way of explaining or justifying focus areas and spending. According to Kesko, the company has reported its CSR activities in accordance with the Global Reporting Initiative (GRI). Kesko also employs the use of the UN's sustainability development goals, that create uniformity with global CSR goals.

The sustainability section covers areas such as society, procurement, environmental aspects, staff and community, stakeholder engagement, management approach, reporting principles, the GRI index, and the independent practitioner's assurance report. Each section has its own purpose, figures and reasoning for its existence and its importance.

4.3.2 Reporting reliability

PwC was hired as an independent practitioner for the sustainability reporting to assure that the provided information is true and fair. This is a must for a company that wants to show evidence of credibility. The assurance report's recommendations for the company mainly state that the company should keep investing in what they are doing, and keeping on pursuing to fulfill the guidelines' recommendations, which they already do. The assurance report also includes a section that explain their independence, qualifications and quality control in doing the assurance.

As discussed previously in the financial reporting problems section of the paper, the sheer existence and assurance of external auditing does not always guarantee a true and fair evaluation. The error of an individual, oversight, and fraud can produce

fraudulent reporting and false expectations of the reality of the business operations. As this paper cannot extend into investigating the validity of the sustainability report or the assurance report, it will be assumed that they are valid.

4.3.3 Target setting and target reaching ability

Whether a company reaches their CSR targets, or any targets for that matter, is reliant on two factors; is the target realistic and are actions of the company in line with the target. In other words, a company can do its best to achieve the target but fail, if the target is too difficult in the terms of scope and time. Another scenario that companies may abuse, is to set targets too easy to achieve, to make it seem that they are doing a lot for the cause. Having a balanced plan on setting targets and investing in them is crucial for success.

Kesko divides its sustainability targets into six categories: Good corporate governance and finance, customers, society, working community, responsible purchasing & sustainable selections, and environment. Altogether, Kesko has set a total of 34 of objectives with progression update each annual report. Out of the six categories, environment has the most objectives with 9 objectives, which shows that either Kesko has a greater focus on the environment on its CSR preference, or that environmental aspect is difficult to have fewer targets because of its size as a problem.

Critically reviewing the progress details on sustainability objectives on Kesko's annual report, gives great confidence about their commitment and efforts in accomplishing the objectives. The reporting is of the progress is also often numerical, which indicates that there are adequate processes in place for measurement.

4.4 Kesko's stock performance analysis

Kesko has listed four reasons as to why one should invest in Kesko. They are, in order of mentioning:

1) Profitable growth strategy and strong track record in strategy execution
2) Strong market position
3) Ability to increase shareholder value
4) Corporate responsibility

Kesko's share price has been increasing steadily for the past five years, but the share price alone does not fully reflect the stock's performance and investors' interest in it. Kesko has two share types, A and B. A share grants 10 voting rights, while B shares grant only one. Both shares types grant the same dividend pay-out. (Kesko, 2020)

For example, earnings per share measures how much earnings the company is generating per share, although investors are more interested in the P/E ratio. The P/E ratio shows how much the investors are willing to pay per one euro of earnings generated by the company.

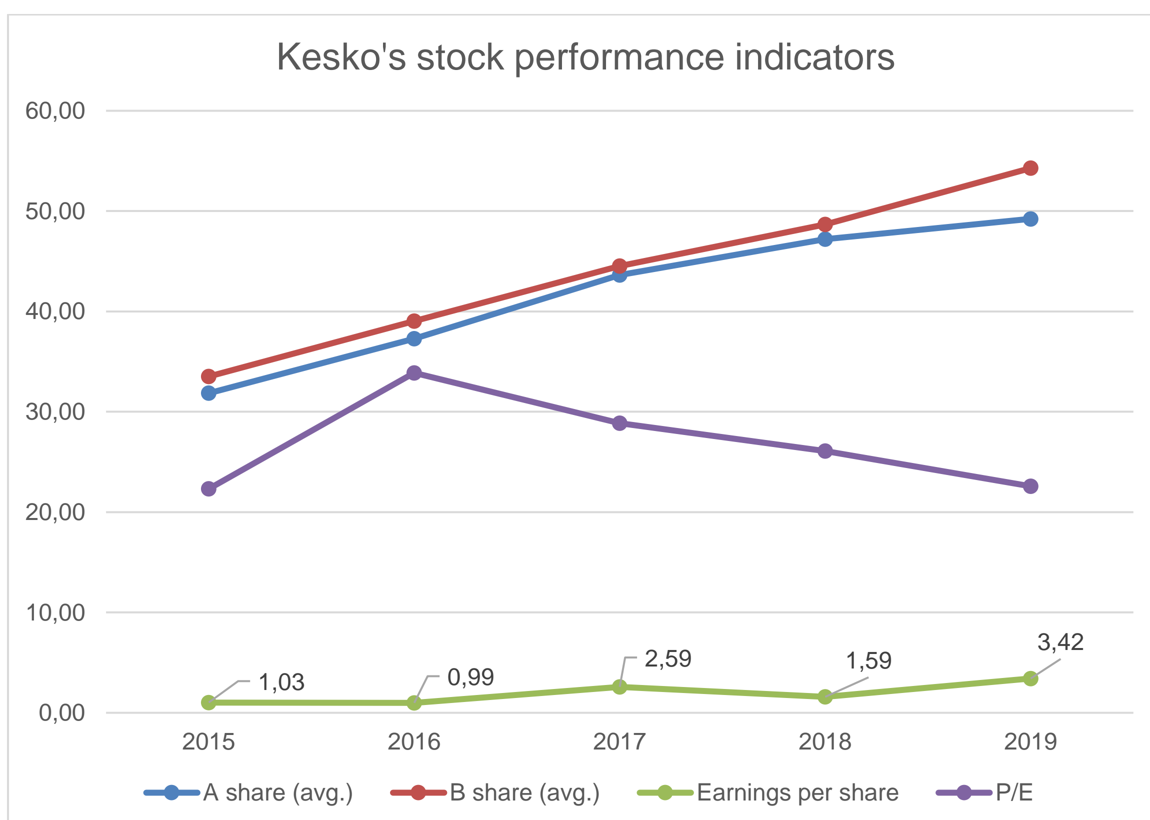

Figure 2. Kesko has experienced share price growth but decreasing P/E measure.

4.4.1 Share price and P/E analysis

Kesko's share price has been growing and so has the EPS (earnings per share), which shows increasing annual earnings. But as can be seen from the graph above, the P/E ratio is showing a decrease from 2016, where it saw an increase from 2015 figures. This means, that investors are willing to pay less for each euro of net profit the company generates. A general rule is that the higher the P/E value is, the higher the

investors’ expectations of future earnings are. A low P/E ratio on the other hand means that the investors expect less growth and less earnings, or that the company is undervalued now.

CONCLUSION

As a summary of the short case study findings, it can be stated that Kesko's strong financial position, customer-oriented strategy and shareholder trust has enabled the company to perform well in CSR activities as well. Kesko's healthy revenue and net margin increase is showing that the company is attractive to its customers, and that the company can minimize costs. Therefore, Kesko is showing itself as a good and profitable investment for investors, and Kesko has the stock performance to back up the claims. Kesko has also been investing in showing its long-term sustainability aspects in their CSR strategy, which is important in the growing ESG-market interest of the investors. As the case study analyzed, and as shown by the recognition of the title of "the most sustainable company in retail sector" for example, the CSR work from Kesko is impressive.

The main point of the paper was to investigate how a company can incorporate enterprise-wide and thorough CSR commitments profitably. Kesko has found a way to fuse the CSR activities into everyday business practices, making them practical and concrete, easily measurable investments. The strong presence and efforts of these CSR activities has helped to increase people's awareness of Kesko's activities, making it a more attractive retail sector company to shop and invest in. Kesko's financial and shareholder value creation performance shows, that it is indeed possible to be sustainable and profitable at the same time, provided that the company has the expertise and the right strategies in place.

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