

## Corporate Social Responsibility As Moderator in CAPEX-Performance Relationship: Evidence from Indian Firms

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### JEL Classification

G31, M14, L25

**Abstract:** This study investigates the impact of Capital Expenditure (CAPEX) on company performance and examines the moderating role of Corporate Social Responsibility (CSR) in this relationship. While organisations invest in CAPEX to achieve strategic goals and enhance shareholder value, integrating CSR into these decisions can align business growth with societal and sustainability objectives. Focusing on Indian companies listed on the NSE from 2016–17 to 2023–24, the study employs panel data regression analysis to evaluate the effects of CAPEX on performance indicators such as return on assets (ROA) and Tobin's Q. The findings reveal that CAPEX has a negative effect on both ROA and Tobin's Q; however, engagement in CSR initiatives can help offset these negative impacts. These results provide valuable insights for corporate managers, highlighting the importance of strategic CSR integration to improve investment decisions and resource allocation. The study contributes to existing literature by offering a novel perspective on the CAPEX-CSR-performance nexus and opens new directions for future research.

## 1. Introduction

Capital Expenditure (CAPEX) is generally perceived as a strategic tool for businesses to maintain and expand their operations. It plays a pivotal role in enhancing firm performance. While it requires significant financial commitment, the long-term benefits such as growth, efficiency, competitive advantage, and sustainability far outweigh the initial costs. Effective management of CAPEX ensures that firms remain agile, profitable, and well-positioned for future challenges. Research suggests that CAPEX leads to an enhanced market value of firms and operating efficiency, which in turn positively impacts firm performance (Abel & Eberly, 2011).

In India, CSR has progressed from philanthropic gestures to a further deliberate business function. It was mandated by the Companies Act 2013 for firms above thresholds to allocate a minimum of 2% of average net profits towards CSR activities. The regulatory backing has pushed Indian firms to rethink their social engagement strategies (Sengupta & Bhowmick, 2020). CSR in India generally focuses on areas like education, health, rural development, and environmental sustainability. Firms that actively engage in CSR can gain competitive advantages such as better reputation, increased customer loyalty, and enhanced stakeholder trust (Mishra & Modi, 2013). From a financial perspective, firms with robust CSR initiatives tend to have lower risks and greater opportunities for sustainable growth, especially in sectors where customer or stakeholder scrutiny is high.

One of the keyways CSR moderates the relation of CAPEX and firm's performance is by acting as buffer against risks. CAPEX is inherently risky due to the uncertainty of returns and the long gestation periods involved. Firms that are heavily invested in CAPEX may face short-term financial instability. However, CSR can mitigate some of these risks by enhancing stakeholder trust and creating goodwill among customers, suppliers, and regulators. Research indicates that firms with strong CSR records are better equipped to deal with operational risks and regulatory challenges

(Porter & Kramer, 2006). In India, CSR initiatives focused on community development and environmental sustainability often generate goodwill, which can translate into more favorable market perceptions. CSR initiatives improve a company's goodwill, which further enhances its financial performance. For instance, firms that engage in CSR may find it easier to access capital, as investors are increasingly prioritising firms with strong social and environmental records (Moser & Martin, 2012). Thus, the study holds significance in understanding how CSR influences the CAPEX-Performance relationship that gives rise to the following research questions:

1. Does capital expenditure influence the firm's performance?
2. Does CSR moderate the CAPEX-Performance relationship?

Based on these research questions, the objectives developed for the study are:

1. To assess the influence of CAPEX on firms' performance.
2. To analyse the moderation impact of CSR on CAPEX-Performance relationship.

Further, study consists of literature review and hypothesis development in the second section, followed by research methodology, results and discussions, findings of the study, and finally the summary and conclusion.

## **2. Review of Literature**

CAPEX have been recognised as a crucial factor in determining firm performance, as they contribute to enhancing a company's productive capacity, operational efficiency, and competitive edge (Abel & Eberly, 2011). In the context of India's rapidly growing economy, CAPEX is essential for companies to seize growth opportunities. However, while CAPEX can foster growth, it also presents certain risks. Overinvestment in CAPEX may stretch a company's financial resources, impacting its liquidity and short-term profitability (Gupta & Banga, 2020). Additionally, Chen et al. (2003) demonstrated that firms with higher CAPEX tend to see improvements in revenue growth, profitability, and return on investment (ROI), especially in industries like manufacturing, energy, and technology. According to Doms et al. (1995), investments in new technologies and equipment boost productivity and reduce operating costs, with CAPEX in technology and automation enhancing both labor and capital efficiency.

Moussa and Elmarzouky (2023) took a closer look at how CAPEX impacts ESG (Environmental, Social, and Governance) reporting, with a particular focus on the role of CG. They found that investing in CAPEX can actually boost ESG performance. Additionally, strong corporate governance helps companies communicate their ESG initiatives more effectively to stakeholders. Moser et al. (2019) assessed the interaction between market conditions, CAPEX, manufacturing elasticity, and production volume, providing insights into the effects of manufacturing investments. Their findings revealed that firms in process industries tend to follow market trends in their investments, influencing both short-term operations and long-term capacity growth. Taipi and Ballkoci (2015) examined CAPEX-Performance relationship in the Albanian construction sector, concluding that CAPEX and leverage ratio positively and significantly correlate with financial performance, while firm size is negatively correlated and not statistically significant. Kim et al. (2021) revealed a negative correlation between CAPEX and near-term earnings, while investigating the link between CAPEX and short-term earning performances for loss-making firms. Jaisinghani et al. (2018) analysed CAPEX-Performance relationship in the Indian automobile industry and reported a negative and persistent connection between CAPEX and performance.

Numerous research was conducted at how different factors, like investment choices and capital structure, affect company's performance. However, not many studies have really dug into the link between CAPEX and a firm performance. In this context, one of the hypotheses of the study can be proposed as:

*Hypothesis 1 (H<sub>11</sub>). Capital expenditure of firms has a significant impact on performance.*

A lot of research revealed that corporate social responsibility (CSR) is linked to better performance for companies, like higher profits, return on assets (ROA), and rising stock prices. For instance, Orlitzky and his colleagues conducted a meta-analysis of 52 studies back in 2003 and found a strong connection between CSR and improved financial results. The study suggested that companies that prioritise CSR tend to do better financially. Similarly, Porter and Kramer introduced the idea of "Creating Shared Value" in 2006, arguing that CSR helps businesses set themselves apart by adding social and environmental value to their products and services. This not only gives them a competitive edge but also boosts their brand image and fosters customer loyalty.

On another note, research by Turban and Greening in 1997 highlighted that companies with a solid CSR reputation would attract more potential employees and enjoy better employee retention rates. Brammer and his team found in 2007 that when employees see their company as socially responsible, they tend to be more engaged and productive. Jo and Harjoto added to this in 2011, pointing out that companies with strong governance and CSR initiatives often outperform those that don't have these frameworks in place. So, it can be inferred that embracing CSR can really pay off in various ways for a business!

Gaba & Madhumathi (2023) observed that CSR and its relationship with value creation is still in its early stages compared to the more established links between CSR and financial performance. The evolving nature of value, influenced by globalisation and changing business landscapes, necessitates that managers adopt a more immediate and practical approach to address stakeholder expectations while also enhancing competitive advantages through reputation and investor value. Similarly, Kansal et al. (2018) discovered that CSR disclosures positively impact firm performance in India, particularly in sectors like manufacturing and energy. Their study attributed these better financial outcomes to the reputational advantages and operational efficiencies gained through CSR practices. Furthermore, Narwal and Sharma (2008) observed that Indian companies with well-established CSR practices generally outperform those without, as CSR fosters trust among stakeholders, leading to improved long-term financial returns on CAPEX. Kansal et al. (2018) also noted that the combination of CSR engagement and significant CAPEX investment has strong positive effect on firm performance in industries where environmental and social factors are critical, such as manufacturing, energy, and natural resources.

The association of CAPEX and firm performance is pretty intricate and can be influenced by several factors. One of these factors CSR. A study by Singh and Agarwal in 2019 found that CSR initiatives can actually boost the positive impact of CAPEX on firm performance, particularly in industries where social and environmental issues are important. Their findings showed that companies with strong CSR programs often enjoy better long-term returns on their investments because they build stronger relationships with their stakeholders and enhance their social capital.

While there are various studies that have looked at CSR as a moderating factor in performance-related research, the researcher noticed a gap. Specifically, there seems to be a lack of studies focusing on CSR spending as a moderating element in the correlation linking CAPEX and firm performance, especially from an Indian perspective. Since Companies Act 2013 requires certain Indian firms to spend on CSR, it's crucial to understand how this regulation might influence the role of CSR in the CAPEX-performance dynamic. In this context, the second hypothesis for the study can be proposed as:

*Hypothesis 2 (H<sub>12</sub>). Corporate Social Responsibility moderates the effect of capital expenditure on firm performance.*

### **3. Research Methodology**

The study focused on the Nifty 200 companies over the period from 2016-17 to 2023-24. The time period under study was selected on the basis of the period of implementation of Ind AS, which ensures data consistency and reliability. The financial institutions were excluded from the analysis since they have different accounting practices and reporting structures that could lead to skewed results. Further, based on availability, a final sample of 31 companies was selected, which gives a

total of 248 observations across different years. The data were gathered from the companies' published reports and the CMIE Prowess database. The variables taken for the study are described as below:

**Table 1: Variable Description**

Variable	Description
<b>ROA</b>	Return on Assets (ROA) is a financial ratio that measures a company's profitability relative to its total assets. It is calculated as: (Net Operating Income - Taxes) / Average Total Assets.
<b>Tobin's Q</b>	It is a financial ratio that measures the market value of a firm relative to the replacement cost of its assets. It is calculated as: Ratio of (Equity at market value & Liabilities at book value) to Total Assets of the Firms (Market performance Indicator).
<b>CAPEX</b>	Capital expenditure (CAPEX) refers to a firm's spending on acquiring, upgrading, or maintaining long-term assets. It is calculated as: Log of Sum of Non-Current Assets including Tangible assets, Intangible assets, and financial assets.
<b>CSR</b>	CSR expenditure of a firm refers to the total amount spent by a company on its Corporate Social Responsibility (CSR) activities, as mandated by law. This expenditure is typically calculated as 2% of the company's average net profit over the preceding three financial years. It is calculated as: Log of Total Amount of CSR spent during the year.
<b>Size</b>	Total Assets of the firms It is calculated as: Log of Total Assets.
<b>Leverage</b>	It shows the Debt to Equity ratio of the firms. It is a financial leverage ratio that compares a company's total debt (liabilities) to its total shareholder equity. It indicates the extent to which a company relies on debt versus equity to finance its operations. It is calculated as: Debt to Equity ratio.
<b>Sales Growth</b>	It refers to the percentage increase in a company's sales revenue over a specific period, typically a year. It's a key indicator of a company's financial health and success, reflecting its ability to generate more revenue from selling goods or services. It is calculated as: Rate of increase/decrease of total sales.

Source: Author's compilation.

For analysis, the study used panel regression, and to determine whether to use fixed-effect or random-effect models, Hausman test was conducted. Significance tests were also performed to understand how strongly the dependent variable is influenced. Each of the hypotheses is examined through four equations that form the backbone of our research model. For the developed hypotheses 1 and 2, the respective Research Models (i) & (ii) and (iii) & (iv) are as below:

$$ROA_{it} = \beta_0 + \beta_1 CAPEX_{it} + \beta_2 SIZE_{it} + \beta_3 LEVERAGE_{it} + \beta_4 SALES GROWTH_{it} + \varepsilon_{it} \dots \dots \dots \text{(i)}$$

$$Tobin's Q_{it} = \beta_0 + \beta_1 CAPEX_{it} + \beta_2 SIZE_{it} + \beta_3 LEVERAGE_{it} + \beta_4 SALES GROWTH_{it} + \varepsilon_{it} \dots \dots \dots \text{(ii)}$$

$$ROA_{it} = \beta_0 + \beta_1 CAPEX_{it} + \beta_2 CAPEX * CSR_{it} + \beta_3 SIZE_{it} + \beta_4 LEVERAGE_{it} + \beta_5 SALES GROWTH_{it} + \varepsilon_{it} \dots \dots \dots \text{(iii)}$$

$$Tobin's Q_{it} = \beta_0 + \beta_1 CAPEX_{it} + \beta_2 CAPEX * CSR_{it} + \beta_3 SIZE_{it} + \beta_4 LEVERAGE_{it} + \beta_5 SALES GROWTH_{it} + \varepsilon_{it} \dots \dots \dots \text{(iv)}$$

#### 4. Results and Discussion

This study attempted to analyse how capital expenditures (CAPEX) impact the performance of 31 companies in the NIFTY 200 index, using data from 2016-17 to 2023-24. An attempt was made to understand how CAPEX influences key performance metrics like Return on Assets (ROA) and Tobin's Q. It was also examined that how corporate social responsibility (CSR) might play a role in shaping the correlation of CAPEX and firm's overall performance.

#### 4.1 Impact on Return on Assets (ROA)

To determine whether a fixed-effects model or a random-effects model was more suitable for our analysis, Hausman test was conducted. The findings for ROA showed a statistically significant result, with a p-value of 0.0179, as shown in Table 2. This indicates that the fixed-effects model is the better choice for this analysis.

**Table 2: ROA Hausman Test**

Test Summary	Prob.
Cross-section random	0.0179

Source: Author's compilation.

Table 3 gives the results of our fixed-effects regression analysis, which looks at how CAPEX affects ROA while considering other factors like total assets (SIZE), the debt-to-equity ratio (leverage), and sales growth. The results reveal a noteworthy negative relationship between CAPEX and ROA ( $\beta = -0.287$ , SE = 0.093,  $t = -3.101$ ,  $p = 0.002$ ). This suggests that as CAPEX increases, ROA tends to decrease.

**Table 3: Impact of Capital Expenditure on ROA**

Variables	Coeff.	Std. Errors	t-Stats	P-value
Intercept	0.523	0.125	4.175	0.001
CAPEX	-0.287	0.093	-3.101	0.002
Size	0.011	0.049	0.203	0.839
Leverage	0.411	0.114	3.599	0.001
Salesgrowth	0.084	0.051	1.652	0.101
Effect Specification				
R-squared				0.547
Adjusted R-squared				0.475
F-stats				7.571
Probability (F-stats)				0.001
DW stats				1.704

Source: Author's compilation.

It was found that SIZE and SALES GROWTH of companies don't really have a significant impact on Return on Assets (ROA) in the model. On the other hand, Leverage stands out with a strong positive relationship to ROA. This suggests that companies with higher leverage often see better returns on their assets. Overall, the model does a decent job, explaining about 54.7% of the variation in ROA (with an  $R^2$  of .547). On adjustment for the number of predictors, the results get an adjusted  $R^2$  of .475, which indicates a good fit. The F-stats of 7.571 (with a p-value less than .001) shows that our independent variables are collectively significant. Plus, the Durbin-Watson statistic is at 1.704, which is comfortably within the acceptable range of 1.5 to 2.5, suggesting there aren't any autocorrelation issues.

#### 4.2 Impact on Tobin's Q

Moving on to Tobin's Q, a Hausman test was conducted to determine whether random-effect model or fixed-effect model would be more suitable for the analysis of how CAPEX affect this important measure of firm performance. The results yielded a p-value of 0.033 for the cross-section random effect, which is statistically significant at the 5% level ( $p < .05$ ), as shown in Table 4. This indicates rejection of the random-effect model and favouring the fixed-effect model for the analysis.

**Table 4: Tobin's\_Q\_Hausman Test**

Test Summary	Prob.
Cross-section random	0.033

Source: Author's compilation.

Table 5 gives the results from fixed-effect regression analysis, which examines how CAPEX, along with some control variables like total assets (SIZE), the debt-to-equity ratio (leverage), and sales growth, impacts Tobin's Q. The findings indicate that CAPEX has a significant negative effect on Tobin's Q ( $\beta = -0.306$ ,  $SE=0.082$ ,  $t = -3.720$ ,  $p < .001$ ). In simpler terms, as companies increase their CAPEX, their market valuation tends to drop. It seems like the market might interpret higher CAPEX as a sign of inefficiency or a delay in seeing returns, which can lead to a decrease in Tobin's Q.

**Table 5: Impact of Capital Expenditure on Tobin's Q**

Variables	Coeff	Std. Errors	t-Stats	P-value
Intercept	0.747	0.112	6.699	0.001
CAPEX	-0.306	0.082	-3.719	0.001
Size	-0.021	0.044	-0.462	0.644
Leverage	0.226	0.102	2.225	0.027
Salesgrowth	-0.027	0.045	-0.592	0.554
<b>Effects Specification</b>				
R squared				0.683
Adjusted R squared				0.633
F-stats				13.513
Probability (F-stats)				0.001
DW Stats				1.587

Source: Author's compilation.

The model explains 68.3% of the variation in Tobin's Q, with an adjusted  $R^2$  of .633, indicating a strong fit. The F-statistic (13.513,  $p < .001$ ) confirms the joint significance of the predictors. The Durbin-Watson statistic (1.587) indicates that there exists acceptable autocorrelation, since the value is within an acceptable range of 1.5 - 2.5. In conclusion, CAPEX and leverage significantly impact Tobin's Q, while firm size and sales growth do not show substantial influence on market valuation in this model.

### 4.3 Moderation effect of CSR

CSR is examined for significantly moderating the relationship between CAPEX and firm performance. The results in Table 6 reveal a significant interaction effect in both the ROA ( $p$  value = 0.009) and Tobin's Q ( $p$  value = 0.033) models, having the interaction coefficient for ROA in Model (iii) as 0.08999, while for Tobin's Q in Model (iv) as 0.05171, demonstrating how CSR spending positively augments the CAPEX to result in better performance.

**Table 6: Moderating Effect of CSR on CAPEX-Performance Relationship**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CSR*CAPEX on CAPEX-ROA Relationship	0.089989	0.034076	2.640858	0.0089
CSR*CAPEX on CAPEX-Tobin's Q Relationship	0.051710	0.030639	1.687710	0.0329

Source: Author's compilation.

Firms with higher CSR involvement can offset some of the negative impact of CAPEX on firm profitability, potentially by enhancing stakeholder relations or improving operational efficiency through sustainable practices. Again, firms engaging in CSR may improve their market valuation in the presence of higher CAPEX, perhaps due to enhanced reputation or long-term strategic benefits.

## 5. Findings

This study researched into how CAPEX influences a company's performance, particularly looking at financial returns like ROA and market valuation through Tobin's Q. It also examined the role of CSR in this mix. The various regression analysis provide some interesting insights into how CAPEX and firm outcomes interact, along with the impact of CSR.

One of the key takeaways is that CAPEX can actually have a significant negative effect on ROA. In simpler terms, when companies pour a lot of money into capital investments, it doesn't necessarily mean they'll see better returns on their assets right away. In fact, it can sometimes lead to a dip in profitability in the short term. This might happen because the benefits of these investments take time to kick in, especially when they're aimed at long-term assets. Initially, these spending sprees can increase costs without a corresponding boost in revenue or profits, which can lead to a temporary drop in ROA.

The study also shows that CAPEX tends to negatively affect Tobin's Q, indicating that the market often views high capital spending unfavorably in terms of a company's value. Investors may interpret these hefty expenditures as a sign of inefficiency or heightened risk, particularly if they're unsure about when the returns will start rolling in. This skepticism can result in a lower market valuation compared to the company's assets.

On a brighter note, the research highlights how CSR activities can help moderate the relationship between CAPEX and both ROA and Tobin's Q. It turns out that engaging in socially responsible practices can actually improve a company's performance, even if there are some short-term dips in profitability due to increased capital spending. Companies that are more committed to CSR often enjoy better relationships with stakeholders, a stronger reputation, and improved operational efficiencies. This can help offset some of the immediate financial pressures associated with CAPEX. Plus, CSR initiatives might even soften the negative impact of CAPEX on market valuation by enhancing the company's reputation or signalling to investors that there are long-term strategic benefits on the horizon. Firms that prioritise CSR tend to be viewed as more sustainable and forward-thinking, which can lead to a more favourable perception in the market, even when they're investing heavily in capital.

Indian companies can improve performance by prioritising strategic investments, focusing on sustainability, and aligning CSR initiatives with business goals. By integrating CSR with business strategy and measuring impact, companies can create shared value and contribute to sustainable development. This approach enhances stakeholder value and drives long-term growth.

**Policy Implications for Firms:** In line with this approach, business firms should reassess capital expenditure priorities to ensure alignment with business goals and conduct thorough cost-benefit analyses for projects. They should also focus on investments that drive long-term value creation. By adopting these strategies, companies can optimise their capital allocation, reduce risks, and improve their overall performance.

**Policy Implications for Investors:** Investors play a crucial role in ensuring companies make informed, value-driven decisions. To support this, investors should carefully examine companies' capital expenditure choices to assess their alignment with business strategy and evaluate the expected return on investment (ROI) and long-term value creation potential. By being transparent on capital allocation and vigilant, investors can make informed decisions and hold companies accountable for efficient capital utilisation.

## 6. Conclusion

CAPEX plays a crucial role in a company's success by driving growth, improving operational efficiency, and fostering innovation. The link between CAPEX and a company's performance is quite intricate but incredibly important. When companies invest wisely in capital projects, they can boost their revenue, streamline operations, and gain a competitive edge, which ultimately leads to better profits and higher market valuation.

This study conducted a deeper analysis of how CAPEX affects firm performance, specifically focusing on financial returns like ROA and Tobin's Q. The role played by CSR, as a moderating factor, was also studied. The findings revealed that CAPEX tends to have a significant negative impact on both ROA and Tobin's Q. However, companies that are more engaged in CSR activities seem to buffer these negative effects. In other words, those with strong CSR initiatives can improve their financial performance and market value, suggesting that CSR plays a strategic role in managing the challenges that come with hefty capital investments. It also helps build better relationships with stakeholders and enhances the company's reputation.

Looking ahead, there are plenty of avenues for future research. While this study focuses on CSR as a moderating factor, it would be worthwhile to explore other influences, such as innovation or governance practices, that might strengthen the connection between CAPEX and company outcomes. Additionally, examining how CSR and CAPEX interact in different regional or international settings could shed light on how local market dynamics or regulatory environments affect firm performance. By broadening the scope of research in these areas, scholars can better understand how CAPEX impacts company performance under various conditions and how strategic initiatives like CSR can be used to optimise results.

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