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Sabbir Ahmed Bhuiyan

**Can Corporate Social Responsibility (CSR) mitigate
political risk among European firms?**

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Author: Sabbir Ahmed Bhuiyan
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ABSTRACT:

Growing political instability has led firms and scholars to rethink the role of non-market strategies, particularly corporate social responsibility (CSR), in addressing risk at the firm level. Political disruption—a rapid change in regulations, reversal of policies, and general instability of the environment—is a weighty threat to performance, especially where capital markets are concerned. While the finance and management literature has made considerable strides in its exploration of the financial implications of CSR, empirical evidence on whether it actually can serve as a CSR insurance policy against political risks is scanty and not definitive. To fill this void, this paper makes an attempt to examine whether involvement in CSR does really reduce stock-return volatility during periods of political turbulence for publicly traded companies in Europe.

Based on stakeholder theory, the study defines CSR not only as a mechanism of ethics or reputation but as a proactive and strategic part of corporate risk management. The paper uses an unbalanced panel dataset of 419 firms from the STOXX 600 index for the period between 2010 and 2022 to verify two hypotheses. First, study the direct effect that CSR engagement has on stock-return volatility. Second, analyze how CSR moderates the relationship between firm-level political risk and volatility.

This report uses a regression model with firm and year fixed effects, controlling for important financial and structural factors such as firm size, leverage, profitability, earnings per share, and market-to-book ratio. The empirical results strongly support both hypotheses. Firms with higher CSR engagement show lower stock-return volatility; political risk is harmed through the channel of affecting CSR firms' performance. Indeed, the interaction between CSR and political uncertainty means that in times of external political shocks, CSR serves as a resilience-enhancing mechanism for firms. This has robustly held across multiple model specifications and subsample analyses.

This study adds to the CSR and political risk management bodies of literature by providing evidence that volatile political environments can make CSR a strategic asset. Hence this study underscores the practical significance of CSR not only in fortifying stakeholder relationships but also in building financial stability. For corporate managers, this finding stresses the need to integrate CSR into the core business strategy as a tool for mitigating risks. For policymakers, this result is evidence-based advocacy for promoting socially responsible business practices as a pathway to institutional and economic resilience.

KEYWORDS: Corporate Social Responsibility (CSR); Political Uncertainty; Stock Return Volatility; Risk Management; Firm Resilience; Stakeholder Theory; Fixed Effects Regression

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1 Introduction

1.1 Background and Motivation

Corporate Social Responsibility (CSR) has become one of the integral parts of modern business policies because ethical, social, and environmental matters in the corporate world have gained much prominence. It includes activities on eco-sustainability and social equity & governance, intended to create good societal impacts as well as boost the image of the company and increase trust with stakeholders (Carroll, 1979; European Commission, 2011). The strategic implications for risk management and the assurance of financial stability are being viewed in the light of CSR as organizations, integrating CSR into their core operations.

CSR has evolved considerably over the decades. In the beginning, CSR was merely seen as a voluntary act by companies to engage in social welfare (Bowen, 1953). After pressures from social movements that occurred in the 1960s and 1970s; besides confronting others such as civil rights, they also confronted environmental issues and had problems with consumer activism, these reforms brought more structured CSR with an emphasis on business ethics responsibilities (Freeman, 1984). Today, in the 21st century, CSR is considered under a wider framework of sustainable development and shared value whereby business confronts climate change among other global issues, human rights, and governance (Porter & Kramer, 2011; Latapí Agudelo et al., 2019).

Political risk is the variation in government actions and policies, as well as harmful reactions in economic or financial markets. This type of risk poses great difficulty for firms operating in unstable environments (Pastor & Veronesi, 2013). Sources of political uncertainty include elections, change of hands, tension international or local, and different regulatory frameworks (Mei & Guo, 2002). Political risk often increases market volatility that interrupts corporate investment decisions and downgrades firm value overall (Kelly et al., 2016). For example, political uncertainty can cause volatility in the

exchange rate, interest rate, and inflation rate; macroeconomic conditions will then spill over to microeconomic dynamics (Mueller et al., 2017; Aisen & Veiga, 2008).

In this regard, corporate social responsibility initiatives can be viewed as a buffer against political shocks since they stakeholder goodwill, corporate legitimacy and increase operational flexibility (Garriga & Melé, 2004). CSR engagements also build firms' reputational capital and institutional legitimacy which help sustain investor confidence and ensure stability in operations during times of political turbulence (Flammer, 2015; Albuquerque et al., 2019). Firms that actively engage in social welfare, environmental protection, and governance will reduce firm-specific crises and regulatory penalties hence financial volatility (El Ghouli et al., 2011).

Notwithstanding the growing acknowledgment of the importance of Corporate Social Responsibility, empirical studies that explore the influence of CSR on the volatility of stock returns as well as its moderating role in political uncertainty are scanty. The bulk of studies present in this area have focused on a direct relationship between CSR and firm performance, resulting in inconclusive outcomes (Di Giuli & Kostovetsky, 2014; Becchetti et al., 2015). There is much need for better knowledge of how CSR can reduce political risk and improve financial stability, especially for European companies. This study fixes this lack by showing real data that explains the strategic part of CSR in managing risks, looking closely at the link between CSR and political uncertainty.

1.2 Research Problem

While corporate social responsibility (CSR) is increasingly recognized as a core part of modern business strategy, a big gap exists in knowing the effects of CSR involvement on the changes in stock returns and its influencing role amid political uncertainty. Past studies have mostly looked at the direct link between CSR and financial performance, which has led to unclear results. For instance, while some studies argue that involvement in CSR activities improvements in financial performance through building stakeholders' trust and reducing risks (Flammer, 2015; Albuquerque et al., 2019), the other research

has not found such a positive effect. Some studies even find detriment to financial performance (Di Giuli & Kostovetsky, 2014).

The extent to which political risks complicate how CSR affects firm performance further deepens the diversity of empirical findings. Political uncertainty is defined as government actions and policy uncertainties that elicit negative economic or financial market reactions. Therefore, firms operating within such environments face dire challenges (Pastor & Veronesi, 2013). Given that high political challenges can translate into serious market volatility, they tend to deter corporate investment decisions and hence overall firm value (Kelly et al., 2016). This relationship has not been as extensively explored given the significant implications it bears, particularly regarding European firms. These firms operate within a political setting that is highly diversified and continuously changing, presented with occurrences including Brexit and the conflict in Ukraine, alongside differing regulatory policies among nations. Companies thus must strategically navigate through a challenging set of political risks that significantly impact their operations and financial outcomes. The risks must be evaluated comprehensively regarding how responsible investment can mitigate them since that understanding is critical in developing effective risk management strategies. Empirical studies focusing on how CSR moderates the impact of political uncertainty on stock return volatility in European firms are minimal. The impact of social responsible investment is also researched poorly because existing studies in this area rely heavily on macro indicators like country-specific political risk indices or major political events to represent political uncertainty. These measures are useful but, in most cases, overlook firm-specific exposure to political risks.

Recent developments like the firm-level political risk metric created by Hassan et al. (2019) provide a more detailed perception of how political uncertainty personally affects individual firms. These have not been applied enough in studies that analyze the moderating role of CSR. Also, the sector-specific dynamics between CSR and political risk do not get enough attention. Different industries relate to different levels of political risk

and have different CSR practices that can be affiliated with the efficiency of CSR as a risk mitigation strategy. For example, regulatory pressures and stakeholder expectations would differ between the manufacturing sector and technology or healthcare sectors. It thus becomes urgent to carry out empirical research in exploring the link between CSR and political risk at the firm level, mainly involving European firms. This study intends to fulfill this gap by providing empirical evidence on how CSR engagement impacts stock return volatility and how it moderates the effects of political uncertainty. In bridging these research deficiencies, the study endeavors to further the CSR and political risk management literature with an eye to practical implications for corporate managers and policymakers.

1.3 Research Objectives and Questions

The primary aim of this study is to examine the link between a company's social responsibility and financial risk, particularly concentrating on CSR's hedging ability to handle the unsteady political situation. This study examines the European firms' data to uncover how CSR affects the volatility of stock returns and the ability to reduce the negative impacts of political risks. This study adds to the broader discussion on CSR as a strategic management tool for risks and gives strong recommendations for business leaders and lawmakers who work in times of political instability. The study's research questions are to unveil the hedging ability of CSR during political uncertainty.

How does CSR engagement impact the stock return volatility in European firms? More precisely, the study checks if companies that show more social responsibility have less volatile returns compared to those that do little or no such activity. Answering this question helps build the picture of CSR's part in encouraging financial stability and reducing firm-specific financial risk.

What is the moderating effect of CSR on political uncertainty and stock return volatility? The investigation assesses whether CSR serves as a buffer that reduces the financial risk stemming from political uncertainty. The process involves an assessment of CSR and

political risk, assessing CSR's capability to firms' resilience amidst political turbulence. The question seeks to uncover the heterogeneous effects of CSR intensity on different levels of CSR engagement, against political shocks. Moreover, differentiating among firms with high, moderate, and negligible CSR engagement, will give distinct idea of the intensity of CSR influences on firms' ability to withstand political instability while maintaining financial performance.

1.4 Contributions of the Study

This study is likely to contribute significantly to the existing literature on Corporate Social Responsibility and political risk management. The analysis to deepen the understanding of the relationship between CSR engagement and stock return volatility in European firms provides strong evidence of CSR as a strategic engagement that reduces political uncertainty while increasing financial stability.

1.4.1 Empirical Evidence

One of the crucial inputs of this study is the practical proof showing the effect of CSR engagement on stock return volatility. While earlier studies have produced varied results about the straight link between CSR and firm performance (Flammer, 2015; Di Giuli & Kostovetsky, 2014), this study looks directly at the part in financial stability and shows that CSR activities greatly lower stock return volatility. This finding highlights the importance of CSR as a management tool for risks especially in firms that are working in politically volatile environments.

1.4.2 The Role of CSR in Managing Political Risk

The study adds to the literature by looking at how CSR moderates return volatility during political uncertainty. The empirical study uses firm-level political risk data and CSR score (ESG score as proxy of CSR) that proves CSR activities can act as a buffer against political shocks, increasing firms' resilience when there is turbulence in the politics (Pastor &

Veronesi, 2013; Kelly et al., 2016); which is a major contribution since European firms face varied and dynamic political landscapes.

1.4.3 Extension of Stakeholder Theory

This research adds to the development of stakeholder theory by demonstrating that corporate social responsibility (CSR) engagement can bring immediate operating advantages in the form of stakeholder goodwill generation and organisational legitimacy creation. First, by systematically responding to the needs of key stakeholder groups—such as employees, customers, suppliers, investors, and the surrounding community—organisations strengthen their resilience to external disruption (Freeman, 1984). This heightened resilience—manifested through faster crisis containment and decreased susceptibility to reputational or regulatory sanctions—then translates into enhanced financial stability and performance (Garriga & Melé, 2004).

1.4.4 Real-World Impact

The study results show how important it is for corporate managers to integrate CSR within the core business strategies if they want to steer successfully in a politically volatile environment. Corporate Managers might think of extending the focus on CSR activities as a risk mitigation and financial stability tool. Besides, policymakers may get insights from the study findings while shaping the strategies to foster sustainable business practices through the augmentation of economic resilience.

1.4.5 Changes in How Political Risk Management Is Understood

This study explores Corporate Social Responsibility (CSR) in the context of strategic and proactive management of macro-political uncertainties. The framework further integrates into the existing literature on political risk management that socially responsible practices—involving stakeholder engagement, transparent governance, and community partnerships—are internalized augmenting firms' abilities to deal against changes in regulation and governmental disruptions as well as institutional crises

(Hassan et al., 2019). CSR is not only viewed as an ethical commitment but also a craft strategic tool whereby firms manage risks connected with politically unstable environments.

The present study adds to the literature by giving proof about the changing role of Corporate Social Responsibility (CSR) in managing risks and keeping financial stability. This empirical study will be very helpful to both scholars and other stakeholders, who know that modern businesses cannot stop from taking part in CSR tasks.

2 Theoretical Background

2.1 Corporate Social Responsibility (CSR)

Investors consider CSR a key investment factor driven by tomorrow's profit anticipation. However, we need to define CSR and spell out the elements. Different people use different words to express the same content, and there are many approaches to addressing CSR from various angles. Votaw (1972) asserts that Corporate Social Responsibility (CSR) is an imprecise and elusive concept. Several stakeholders assign different meanings. For some, CSR represents ethical business behaviour; for others, this relates to compliance with cultural norms or philanthropic activities.

Carol's (1979) standard definition of CSR is *"the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time."*

The European Commission has delivered a more straightforward definition in 2011:

"The responsibility of enterprises for their impacts on society and outlines what an enterprise should do to meet that responsibility."(The European Commission, 2011).

Sometimes, there is an argument regarding CSR and ESG that both serve the same purposes, and which one has broader perspectives. Stellner et al. (2015) assert that companies' considerations of environmental, social, and social governance (ESG) aspects to their operations, decision-making, and stakeholder interactions reflect CSR activities. The paper also uses the terms CSR and ESG interchangeably, where ESG ratings from Thomson Reuters Refinitiv measure CSR performance. Therefore, in this thesis, Corporate Social Performance (CSP) is the same as CSR as which has been used in several research to refer to companies' engagement in CSR.

2.1.1 The History of CSR

The topic of corporate social responsibility has become a definitive word in businesses in recent decades, though the roots can be traced back to earlier centuries. The perception regarding CSR has developed over time. In the 1930s and 1940s, CSR started to be addressed in businesses. Even the beginning can be tracked in the early 20th century. During this period, an increasing number of scientists and business executives recognized that corporations should evaluate and fulfill their social and environmental responsibilities rather than just making a profit. There have also been demands on business for society throughout the centuries (Latapí Agudelo et al., 2019).

Howard Bowen, the so-called "Father of CSR," gave the most influential definition of CSR when he published the basic paper entitled "Social Responsibilities of the Businessman" in 1953. This was an important step in defining a modern understanding of CSR practice. Bowen (1953) argued that businesspeople should act according to a set of social values and goals. Thus, the period is marked for more structured and systemic thinking on CSR about emphasizing the ethical obligations of business.

The 1960s and 1970s were critical decades for corporate social responsibility, engineered by pressures from social movements. The civil rights campaign, environmentalists, and consumerism all compounded pressures to make corporations more accountable. This era is when stakeholder theory gained prominence, indicating the demands and interests of all stakeholders that enterprises must address rather than merely those of shareholders (Freeman, 1984).

In the 21st century, Corporate Social Responsibility (CSR) has transformed the subject to Sustainable Development coupled with Creating Shared Value. Business enterprises are pressed to mainstream CSR into their core business objectives and operations to handle global challenges that affect climate change, human rights, and ethical governance (Latapí Agudelo et al., 2019). The concept of Creating Shared Value (CSV) by Porter and Kramer (2011) also expanded the concept of CSR by placing companies to solve pressing

social problems and make money, not only within the area of the former but also for the good of society.



Figure 1. Evolution of the academic understanding of CSR. Reprinted from "A literature review of the history and evolution of corporate social responsibility," by M. A. Latapí Agudelo, L. Jóhannsdóttir, & B. Davídsdóttir, 2019, International Journal of Corporate Social Responsibility, 4(1), p. [17]. <https://doi.org/10.1186/s40991-018-0039-y>

As spectacles of sustainable operations unfold in many enterprises, Corporate Social Responsibility has greatly gained contemporary business fame. Pressures from consumers, investors, and regulators for greater transparency constrain businesses within the limit of totally comprehensive CSR initiatives aimed at ensuring damage control as well as promoting positive social and environmental outcomes.

2.1.2 CSR Theories

Different Corporate Social Responsibility (CSR) theories shed light on the importance of social obligations by businesses. They explain what motivates companies to engage in CSR and advise how profitability can be harmonized with the commitment to society. A critical review of these theories therefore lays the foundation for understanding, in depth, the philosophies embraced by organizations and their policies towards sustainable development. This is done in the next section where overviewed some leading theories and their impacts on business practice.

2.1.2.1 Instrumental Theories

The instrumental theories have assigned the implementation of CSR as an economic objective and an enhancement of shareholder wealth. In these theories, this is believed that socially responsible activities bring positive financial results to the company; therefore, CSR becomes part of the corporate strategy (Garriga & Melé, 2004). Freeman (1984) states that the stakeholder theory is one of them which has taken precedence in bringing forth the issues related to all categories of stakeholders such as employees, customers, suppliers, investors, and local communities. The author also expresses that direct relationships with stakeholders help companies shoulder risks, ease channel frictions, and build long-term trust, all of which contribute towards profitability in the long term. For example, fair labor practices make employees comfortable and more productive, while customer loyalty is enhanced through sustainability.

One of the powerful instrumental theories fragments is the resource-based view (RBV) underlining CSR as a strategic imperative to achieving a sustained competitive advantage. In addition, RBV claims that intangible resources like brand equity, goodwill, and social relations are very important to take explicit notice of the differences between one firm and its competitors among other factors include CSR activities (Barney, 1991). The theory further states that such resources of brand loyalty allow reducing risks on public perception. An example is when companies apply proactive environmental policies that keep them away from hefty regulatory fines, which guarantees profitability in the long term (Branco & Rodrigues, 2006). The proactive policies further create a win-win situation for both parties since the companies find a market for their environmental products (Branco & Rodrigues, 2006). Such branding leverages unanticipated complementary assets, like customer goodwill and regulatory ease, and intensifies attempts to attract environmentally conscious customers by signaling product quality (Saeed & Arshad, 2012).

In addition, instrumental theories have asserted that CSR activities can bring forth a reduction in the cost of capital and reduce operational risks for firms. These are companies that do get preferred over others by investors. Other things held constant, therefore, an investment in this company is much safer in the long run (El Ghoul et al., 2011). In the context of CSR, instrumental theories define this as a business-oriented orientation to social expectations, in which social responsibilities are not altruistic but serve to maximize wealth for the shareholder. This explains the pragmatic and strategic value that CSR adds to the realization of sustainable economic success (Garriga & Melé, 2004). Equity investors now place a valuation on firms with strong ESG (Environmental, Social, and Governance) performance attributed to their perception of reduced long-term risks and stability (Giese et al., 2020). Hence, these theories present CSR as an informed strategy that integrates social responsibility into continual economic success on the long run.

2.1.2.2 Integrative theories

Integrative theories are the ones that try to guide businesses toward meeting societal expectations by making business operations socially responsible, hence expressing the interrelationship between business and the larger society (Garriga & Melé, 2004). Among the most popular models in this aspect is Triple Bottom Line (TBL) that considers three dimensions of business operations: economy, society, and environment (Elkington, 1997). In contrast to the conventional view of business goals centred on profit maximization, TBL prefers a vision wherein social equity and environmental sustainability are given equal importance along with financial performance. By doing so, businesses can attend to stakeholder interests over the long run by reducing greenhouse gas emissions, for example, or promoting fair labor practices and community welfare to address some of their concerns (Elkington, 1997).

Integrative theories serve to direct businesses towards aligning their operations with the expectations of society, by fostering social responsibility, thus indicating the link between business and society at large (Garriga & Melé, 2004). The major one being the Triple Bottom Line (TBL) which encapsulates three dimensions of business operations; economic, social, and environmental (Elkington, 1997). Different from the old view which puts profit first, TBL suggests a picture where social fairness and green sustenance get equal importance with financial results. This method lets companies deal with what stakeholders care about over a long time by, for example, cutting gas emissions or raising fair work rules and community help to ease different issues (Elkington, 1997).

The integrative approaches underscore the dynamic nature of CSR practices, which needs to evolve as changing societal priorities continues to emphasize, among other things, climate change and social justice (Scott, 2008). In many instances, this has enlarged the mandate of corporate social responsibilities in firms to include diversity, equity and inclusion initiatives as well as net-zero emissions target i.e., diversity, equity and inclusion plus net-zero emissions. This approach not only reflects current societal

values but also shows the firm itself is a responsible corporate citizen (InHerSight, 2023). Hence, this makes much more strategic development integrate social issues into economic activities if that is what business requires to stay relevant and resilient in an increasingly fast-changing environment (Garriga & Melé, 2004).

2.1.2.3 Ethical Theories

All ethical theories place business in a set of moral responsibilities beyond profit-making, claiming that this social responsibility (CSR) is a duty rather than a strategy (Garriga & Melé, 2004). From theories that are themselves based on the principle of powerful social entities with obligations to realize the common good, normative stakeholder theory is essential; the acts to advance the interests of stakeholders as an end rather than merely as a means to the company's ends (Donaldson & Preston, 1995). This therefore requires that firms consider the ethics of their decisions in all aspects concerning stakeholder fairness, respectfulness, and transparency (Donaldson & Preston, 1995).

A major aspect of ethical theories is corporate citizenship. This implies that corporations act as a 'citizen' of the society in which they operate. Therefore, businesses have obligations to fulfil in their respective communities by contributing positively to the welfare of society by identifying the environmental and social issues those challenges bring directly confront with them. Such responsibilities can include philanthropy, ethical supply chain practices, and policy advocacy on sustainable and socially fair development. In this respect, such acts conform to the ideals of good governance which answer the calls of modern society that wishes to change the face of business not only as an enterprise that generates wealth but also as a constituent in establishing a more harmonious community. These will also promote goodwill among the companies doing these efforts. (Crane, 2005).

Ethical theories place the value of CSR within the framework of its obligation, regardless of any possible financial returns. to adopt environmentally friendly practices and reduce harm to the environment would be important even if they do not add directly to profits.

This holds more significantly in organizations having strong ethical leadership or in sectors which have heightened societal expectations.

Ethical theories, in the final instance, can be said to supply a prescriptive framework in which social responsibility is championed through commitments and duties to society. This view corresponds with instrumental and integrative views, which together bring out the Corporate Responsibility phenomenon's dimensional aspect. Companies can take any such view or blend them to develop CSR policies that reflect internal goals and meet external societal demands, if political risks are lowered for continuous growth. (Garriga & Melé, 2004).

2.1.3 CSR's Impact on Volatility

Corporate Social Responsibility (CSR) has been recognized as one of the determinants that would moderate the vulnerability of firms to such transition, especially in times of uncertainty. Theoretical models attribute the phenomenon to the fact that, in practice, CSR acts as an "insurance mechanism" through which risks can be diversified, therefore leading to a more stable financial benefit for the firm (Kang et al., 2016). Essentially, such a stabilization effect emanates from more trust and goodwill held by the stakeholders. Lowering the probability of their harmful reaction in those days of crisis celebrates the stakeholder theory (Freeman, 1984).

Thus, companies with a strong CSR effect tend to impede large variations associated with the flow of returns on stocks. CSR minimum net benefits are wider than mere prosperity effects. Firms that address the environmental, social, and governance aspects indicate sensitivity and take precautionary measures toward proactive risk management — they explicitly make companies less risky in their operations and thus more attractive to investors (El Ghoul et al., 2011). For example, performers with established CSR practices often fare well under regulatory changes and heightened public attention, meeting the demands of stakeholders amidst turbulence at either the political or economic level. Such adaptability and management of pressure from the outside make

their operations more stable and reduce cash flow as well as return on stock variance (El Ghoul et al., 2011).

Corporate Social Responsibility may as well enhance labor satisfaction, hence curbing the problem of operations disruption: happier workers are more productive, and production levels increase, thus indicating stability in the institution during crises (Espasandín-Bustelo et al., 2020). Furthermore, improved customer trust through ethical conduct maintains businesses' revenues at a time when the market is not doing well (Islam et al., 2021). All these would work together to decrease risks and assure financial stability. Even empirical studies support this very idea— which provides evidence that indeed CSR does mitigate volatility. To illustrate, a study by Andriosopoulos and Deepty (2022) reveals that companies with high CSR ratings witnessed relatively lower stock return volatility during political crises. All these studies prove that CSR is not just a corporate obligation toward society but also an investment strategically to build the company's capacity, lower the financial cost of risk, and therefore enhance the place of CSR in contemporary business strategy.

2.2 Political Uncertainty

Political uncertainty is defined as the variability of government actions, policies, and adverse politically related economic or financial market reactions (Pastor & Veronesi, 2013). Sources of uncertainty may be elections, changes in authorities, policy adjustments, international or domestic tensions, and other forms of regulations (Mei & Guo, 2002). Political risk has implications for the macroeconomic state and microeconomic dynamics hence this plays a fundamental role in driving investor behavior, corporate decision-making, and market stability (Kelly et al., 2016).

At the macroeconomic level, political uncertainty is very likely to bring about overshooting of exchange rates as well as interest rates and inflation (Mueller et al., 2017). Reasons are the incomplete information, sluggishness, and shock to tastes and technologies (Aisen & Veiga, 2008). On the global front, an uncertain political

environment can postpone government expenditure, disrupt trade agreements or lead to shifts in monetary or fiscal policy; hence, there will be turbulence in the global markets (Brogaard et al., 2020). The long-drawn-out period of economic uncertainty elicited by events like Brexit and trade tensions between the U.S. and China have dampened corporate investments and consumer confidence (Campello & Kankanhalli, 2022).

Political uncertainty therefore increases the risks and costs of doing business (Atanassov et al., 2024). Firms facing regulatory ambiguity may reduce capital expenditure, take precautionary steps such as holding more cash, or change their business plans to avoid risk (Campello & Kankanhalli, 2022). The change of the political scene makes some very controlled sectors—like energy, healthcare, and finance—more dependent and open to changes (Schedler, 2013).

Study has shown that unknowns bring risk costs for investors, making the extent of stock markets move more and pushing up the choice for safer assets (Pastor & Veronesi, 2013). Firms that have large exposure to politically sensitive regions or industries tend to experience stock returns, which are significantly more volatile in periods of uncertainty (Kelly et al., 2016). This situation highlights the great importance that should be given to the management of political risk by firms that are striving for stability and resilience in tumultuous conditions (Mei & Guo, 2004).

2.2.1 Impact of Political Risk on Firms

Political risk is a major concern for firms, which typically exerts direct impact on their operations, financial performance, and strategic decisions. The unpredictability that surrounds political risks often forces stakeholders to think of other added uncertainties. This therefore underscores the seriousness of political risk in influencing corporate decisions as well as market outcomes (Henisz & Zelner, 2010).

Political risks can displace the normal course of business, including abrupt emerging supply chain interruptions, delayed project approvals, and compliance costs that are inappropriately rising because of the fast-implemented new regulations (Lu et al., 2023). For example, governments may suddenly decide to impose stricter environmental regulations or import bans and force big changes in corporate operations or even higher capital spending (Sottilotta, 2016). Also, riots might lead to stopping work, and in bad cases, especially where there is unsteady politics, property could be taken away (Lu et al., 2023).

The financial effects are among the most substantial that political risk has on firms. Greater uncertainty typically translates into higher volatility in stock returns as the market evaluates the changing politics. There is also the argument that firms with high political risk exposure will bear higher costs of capital since lenders and investors will charge a risk premium to indemnify themselves against the extra uncertainty. Firms may also face difficulty mobilizing funds in a politically unstable environment, a situation that could stifle their investment and growth prospects (Ma et al., 2024).

Political risk has long played a major role in the shaping of long-term business strategy. Such risk frequently forces companies to cut back on their investments restrain alter plans for expansion or even leave certain markets (Henisz & Zelner, 2010). Firms located in areas with high policy volatility for example, may delay large capital investment projects because they fear reversals (Sottilotta, 2016). Political risk also hampers mergers and acquisitions since foreign companies might be dissuaded by the perception of government instability in ineffective nations. Also, the not trusting the governments of these countries makes it hard to be sure that a foreign company's right to property will be safe by the local people in charge (Henisz & Zelner, 2010).

2.2.2 Measuring and Assessing Political Uncertainty

This study uses qualitative and quantitative methods in assessing political risk. The qualitative evaluation is merged with quantitative text-analysis indicators to come up

with the final risk measurement (Sottilotta, 2016). Indices at the national level, such as the Political Risk Index, produce scores that embody governance quality, regulatory stability, and geopolitical conditions (Graham et al., 2016)., Hassan et al. (2019) carried out an original measure at the corporate level by assessing politically important vocabulary in company reports and earnings calls to quantify firm-specific exposure to political uncertainty. These index- and text-based measures make it possible to pinpoint countries or business units likely to display heightened sensitivity to political instability (Henisz & Zelner, 2010). Qualitative methods, expert surveys, scenario planning exercises, and case study analyses provide an understanding of how firms might respond under particular political conditions (Kachuyevski & Samuel, 2018).

In addition, software tools fall into the second category of quantitative post dictions, left unfulfilled expectations of predictive power: nowcasting political speeches and text analysis, respectively (Nath, 2008). These methodologies allow firms to evaluate political risks systematically and take proactive actions that may include such things as diversification of operations or engaging in stakeholder dialogue to mitigate adverse outcomes (Sottilotta, 2016). This approach delivers a much more comprehensive assessment that will help firms to sail through political uncertainty and its attendant complexities with as much effectiveness as possible (Kachuyevski & Samuel, 2018).

2.2.3 Theoretical Perspectives on Political Uncertainty

Political uncertainty is, by nature, a multidimensional phenomenon but deeply affects the economic and financial systems. The translation of political uncertainty into market dynamics, corporate behavior, and general economic stability is what the theories about political uncertainty involve (Schedler, 2013).

Uncertainty about a regime relates to unpredictability of government switching which can happen either from elections coups or some other kind of change in politics (Bas & Orsun, 2021). The pertinent theoretical framework suggests that changes in leadership at the political institutions can bring about changes in policy orientation, regulatory

frameworks, and economic priorities. These changes create some level of uncertainty among business leaders and investors about the future policy decisions and their likely impacts on the economic setting (Makridakis et al., 2009).

The major cause of economic uncertainty is politics because political decisions will directly affect the economy. The theories that inform economic uncertainty point out the great value that government policy has on economic outcomes. Examples are fiscal and monetary policies, trade barriers, and taxation that highlight the extent to which political factors can drive economic conditions. Businesses may therefore postpone investment decisions and consumers minimize spending until the uncertainty is settled; hence, there will be slow growth in the economy accompanied by high volatility in the market (Baker et al., 2016).

Institutional uncertainty is the unpredictability of the rules and norms that guide political and economic interactions, which springs up from changes in legal frameworks and regulations as well as in the mode of enforcement. Very unstable institutions, subject to frequent changes, can deter investment because investors may lose confidence (Kolomiets, 2020). Different theoretical perspectives highlight the pivotal role that stable and predictable institutions play in economic development (Bjørnskov & Foss, 2016). Political uncertainty goes a long way in affecting the strategic decision-making processes of firms and investors. The theoretical literature suggests that firms in political uncertainty adopt a conservative stance they increase cash reserves defer investments and focus on short-term objectives. In contrast, investors may raise their required rates of return hence firms face an increased cost of capital. These strategic adjustments can have deep implications for economic stability and growth (Bas & Orsun, 2021).

Behavioural theories of political uncertainty explain the construction of individual and organizational perceptions and responses to an unpredictable environment. It is from such theories that an explanation has been made that political uncertainty most times generates increased tendencies of being risk-averse and changes in behavior that may

be considered irrational. For example, during politically uncertain times, investors may overreact to news and events, hence high volatility in the markets (Brogaard et al., 2020). Firms might implement overly conservative strategies which forgo opportunities for expansion that would have been possible (Baker et al., 2016).

Political uncertainty comes out as a multi-dimensional phenomenon as has been vividly evidenced through the several theoretical frameworks of regime uncertainty, economic uncertainty, institutional uncertainty, strategic decision-making, and behavioural orientation (Schedler, 2013). Far from being mutually exclusive, they converge on the basic fact that a stable and predictable political environment is required for economic stability and growth (Baker et al., 2016).

2.2.4 Mitigation Strategies for Political Uncertainty

Political instability can result from a wave of atypical government actions, changes to the regulations, or geopolitical turbulence. This indeed poses great difficulties for many companies that are doing business in such erratic environments. To deal with such problems, firms typically adopt different approaches aimed at risk mitigation which will also enhance investor confidence.

Business diversification is considered a very effective strategy for diminished exposure to political uncertainty. This may involve extending operations to several regions or diversifying the range of products (Atanassov et al., 2024). A business that practices geographic diversification is not likely to be hurt very much by political movements that happen in one location, and so the possible effects of such disruptions get minimized (Chu et al., 2020). For instance, a company working in different geographies may discover that its operations become more aligned with the decentralization of operations according to Hofstede's cultural dimension theory, which allows it to adjust more appropriately to different market conditions (Hofstede, 2011). Therefore, even if some adverse events take place in one area, due to the sectoral diversification of the firm, its overall operational efficiency is affected to a very small extent. Also, by making product

lines wider and going into different industries a firm could mitigate sector specific political risks which could be changes in the regulations on an industry tariffs and subsidies such that it takes advantage of in different sectors whilst being resilient and adaptable to political turbulence (Atanassov et al., 2024).

A better way includes the joining of policymakers and stakeholders which can slowly lessen political uncertainty. This joining lets firms take part in policy talks through industry groups or direct lobbying, supporting a stable and clear rule-making environment (Hadani et al., 2016). Such participation gives power to firms to change the ruling system that forms and backs their working and planning goals (Kingsley & Vanden Bergh, 2012). To skilfully foretell and change with political shifts, a business must build open and good links with regulators and local government (Ennsner-Jedenastik, 2016). Such links make operations better. By creating trust with many people, groups raise their ability to lessen troubles that come from policy changes (Kingsley & Vanden Bergh, 2012).

For instance, firms that have built substantial goodwill with policymakers reach such companies can find channels where even legislative modifications' navigation leads to favourable outcomes for their business objectives. Moreover, interaction with the local communities and other relevant stakeholders enhances its brand value and social license, thereby reducing the risks accruing from political uncertainties. In a word, proactive policymakers' and stakeholders' engagements represent a critical strategy in the effective management of political risks to ensure unbroken operational stability (Hadani et al., 2016).

Corporate Social Responsibility ensures the firm's stability in periods of political instability through reinforced networking and the embracing of ethical practices. Focusing on engaging the stakeholders, socially investing, and conducting business ethically generates goodwill among customers, employees, and communities (Awa et al., 2024). This brand equity prevents the politically erratic markets from striking down the market value of shares at unfavourable moments. At such times, stakeholders will typically stand by companies that are viewed as socially responsible and working for

change (Saeed & Arshad, 2012). Additionally, CSR activities enable the company to prepare for the regulations by getting its operations in sync with popular expectations and regulatory requirements. For example, investments in CSR can help the corporation become prepared ahead of time for a potential change in legislation concerning stricter rules of environmental conduct. Such operations reduce the odds of conflicts and offer positive community support, providing a corporate social responsibility-motivated firm with a stronger social license to operate (Reinhardt & Stavins, 2010). In conclusion, diversification combined with stakeholder engagement, proactive planning, and CSR-driven initiatives will help firms mitigate political uncertainty in the short run to gain long-term stability and growth. It is through the mainstreaming of CSR in their core strategies that firms will become robust and adaptive to maneuverer within the intricacies of political environments (Awa et al., 2024).

3. Literature review

This chapter synthesizes previous literature for an in-depth discussion relating to the relationship between CSR and political risk. Therefore, it has tried to aggregate knowledge gained to date from prior studies, indicate the gaps that presently exist in the studies, and develop the empirical foundation of this research. Therefore, the paper will put forward, based on existing scholarly work, the contribution that CSR makes towards political risk mitigation and its effect on organizational performance.

3.1 Empirical Studies on CSR and Firm Performance

Diverse results from empirical research into the relationship between CSR and firm performance evidently underline the complex and multi-faceted nature of CSR activities. The paragraph that follows will review some key empirical studies that have tried to capture how and in what ways CSR influences different dimensions of firm performance, whether measured through financial performance, risk management capabilities, or even the overall value of the firm.

Multiple studies focused on the direct effect of CSR on financial performance. These are often measured by different metrics such as stock returns, profitability, and market value. For instance, a study by Albuquerque et al. (2019) developed a CSR model initiatives predicting that CSR could minimize risk and simultaneously maximize business value. Their empirical evidence supported such model observation as it finds that indeed companies with high CSR engagement tend to reflect low risk and high valuations. Such finding implies that indeed CSR activities can be value-creating for a firm's shareholders because it reduces the firm's risks on several fronts.

Towards similar objectives, Flammer (2015) applies regression discontinuity designs to assess if indeed CSR results in better financial performance. The study observes that companies that practice corporate social responsibility outperform their peers regarding

stock returns and profitability because such positive linkage results from the better standing and trust from stakeholders that corporate social activities create.

Not all studies found positive association between CSR and financial performance. Di Giuli and Kostovetsky (2014) examined the impact of CSR spending on the return of a company and did not find any explicit indication that profitability is enhanced by CSR measures. Indeed, their results showed a negative association between CSR expenditure and prospective earnings, a pointer to the fact that such expenditure may sometimes be at a cost far more than the benefits accrued.

For many years CSR has been thought of as an important risk management mechanism through which companies can avert a large number of risks- be it operational, reputational, or financial risks. Corporate social responsibility and its relation to stakeholder risk and idiosyncratic volatility were studied by Becchetti et al. (2015). Their research found that high-CSR firms exhibit stability through lower idiosyncratic volatility, meaning that engaging higher CSR firms as vendors can reduce firm-specific risks thus, stabilizing firm performance.

Harjoto and Laksmana (2018) found that more socially responsible activities lead to less risk-taking behavior and, in turn, more firm value; CSR can then be a channel for improving the risk management qualities of an enterprise. This coincides with the idea that since CSR activities do produce goodwill and trust among stakeholders, they can act as a cushion against bad events and reactions from the market.

Lins et al. (2017) explored the relationship between social capital, trust, and business performance in times of the financial crisis. They find higher levels of CSR among active firms that performed better in those years of crisis. This provides a clear indication that CSR is important for building a resilient and stable company. Gregory et al. (2014) decompose the impacts of CSR on cash flow, risk, and growth. Empirically, they find that CSR positively affects cash flows and growth but negatively influences risks. These results

therefore provide a detailed view of how wide-reaching the advantages of good corporate social responsibility can be toward different aspects of firm performance.

Mixed Findings and Context-Dependent Results While a large number of studies have found positive relationships to exist between CSR and corporate financial performance, the results are mixed. A study by Krüger (2015) found that the impact of CSR on shareholder wealth is contingent upon the context and specific CSR activities. That is, the efficiency of CSR in optimizing firm performance may need to depend on such other factors as the characteristics of the industry within which the firm operates, the size of the firm itself, and the particular social and environmental issues involved in its CSR activities.

Thus, the empirical studies regarding CSR and firm performance are mixed as well, thus reflecting a rather complicated relationship that exists between the two. While there are those who believe that CSR can improve the financial performance of a corporation, reduce risks, and increase the value of the corporation itself, others point out the opportunity costs associated with CSR relative to its benefits. The mixed results indicate that more research is needed to understand better under what conditions CSR can create value for a firm and its stakeholders.

3.2 Empirical Studies on the Impact of Political Risks on Firm Performance

Political risks are very important and sometimes critical issues that significantly affect the firm's performance. This section describes various key empirical studies that explored various aspects of the relationship between political risks and different dimensions of performance, stock market performance, investment decisions, and overall value.

Political risk can emanate from the body of politics, hence causing higher market volatility, therefore, having an effect on stock prices. The literature is rich in several studies based on the impact of political risk on stock market performance. For example,

Pastor and Veronesi (2012) developed a theoretical model which explains how political uncertainty impacts stock prices. Their model claims that during politically uncertain times, the risk premium rises for investors, which in turn leads to a higher stock market volatility. This directly supports their model manifesting empirical findings wherein stock prices are indeed more volatile in highly politically uncertain periods. Another similar study was conducted by Boutchkova et al. (2012) for assessing the impact of political risk over different countries regarding stock returns. It thereby proved that the political risk effect is significantly negative on stock returns across all countries; the effect's intensity varies across the countries. This result, therefore, raises the need for taking country factors into account when studying how political risks affect stock market performance.

Political risk can also influence corporate investment decisions. When there is an increased level of political uncertainty, the firms would naturally adapt a more conservative investment strategy to postpone or minimize capital expenditure. Julio and Yook (2012) studied how political uncertainty relates to corporate investment cycles. Their research confirms that firms cut back on their investments when political uncertainty is high, especially close to national elections. Lower investment during such times is justified through the study as being related to doubts concerning changes and how they might influence the business environment. Gulen and Ion (2016) later studied the determinant effect of policy uncertainty on corporate investments. They find that higher levels of policy uncertainty are associated with lower corporate investments. Their study infers that corporations would tend to defer or cut back investment considerably with little information about future government policies, which can bear large implications on economic growth and firm performance.

Many empirical studies explicitly assess the political risks impacts on overall firm value. Political risks affect firm value through changes in the regulatory framework, changes in tax policy, and general government stability. In a study conducted by Jens (2017), data was utilized to explore the causal relationship between political uncertainty and firm value based on U.S. gubernatorial elections. The study finds that political uncertainty has

a significantly value-destructive impact on firms, especially those firms which are more dependent on government policies. Another one by Baker et al. 2016 did the same to see how economic policy uncertainty matters to firm performance. They find that variations in high levels of policy uncertainty led to lower valuations of firms and higher stock market volatility. Their findings highlight that firm value and market stability depend critically on relatively stable and predictable policy environments.

While most studies have discovered a relationship between political risks and firm performance, the results are mixed. This outcome is contingent on such factors as industry-specific determinants, firm size, and the very particular nature of political events. Colak et al. (2021) demonstrates that the influence of political risks on IPO pricing depends on local policy orientation and the political power of the place or region. Overall, empirical studies on political risks and firm performance have not arrived at an unambiguous result, because of the intricate nature of the relationship.

Most studies point toward political risks hurting not just stock market performance but also investment decisions and overall firm value, but again, results remain conditional on several other factors. These mixed results place a research gap that will warrant further inquiry into the conditions under which political risks impinge on firm performance, and the channels through which such risks can be mediated by firms.

3.3 CSR as a Mitigating Factor for Political Risk

Corporate Social Responsibility (CSR) has increasingly been recognized as a strategic tool for managing or mitigating political risk. In this section, the evidence, and the empirical data of the relationship between CSR and political risk will be discussed, as well as the ways through which these channels operate.

3.3.1 Empirical Evidence on the Role of CSR in Mitigating Political Risk

A number of empirical studies have been conducted to examine the relationship between the effect of CSR on political risk, finding evidence supporting the fact that CSR can be an effective risk management strategy. A study was completed by Andriosopoulos and Deepty (2022), which assessed the impact of CSR in the company as a hedge against political and market competitive risk. Their research finds that CSR activities significantly reduce stock volatility during political uncertainty times, inferring that CSR is likely to help stabilize firm performance in politically volatile environments. Another study by Chatjuthamard et al. (2021) examined firm-level political risk in relation to CSR. Higher CSR-intensive companies enhance their ability to withstand the impacts of political uncertainty, accentuating CSR's protective role in allowing businesses to recover from negative effects accompanying political risks. These studies indicate that CSR does make firms politically more resilient as this helps generate goodwill and trust between stakeholders and the firm.

Bae et al. (2021) exposes another view regarding the impact of CSR under conditions of the COVID-19 crisis, which was a moment marked with great political and economic uncertainty. According to their study, the companies with sound CSR strategies are better equipped to manage the crisis, since earlier CSR activities helped in building up trust and loyalty among stakeholders. This underscores the crucial importance of CSR in improving the ability of a firm to resist political and economic shocks. A case in point is the study by Harjoto and Laksmana (2018) who find that corporate social responsibility activities are negatively correlated with firms' risk-taking behaviours and positively associated with firm value; in essence, then, CSR can also improve a corporation's ability to manage risks. A further study carried out by Becchetti et al. (2015) discovers that the more active a firm is in engaging in CSR, the lower its idiosyncratic volatility, which means that CSR can work toward stabilizing the firm's performance by decreasing the vulnerability to firm-specific risks.

3.3.2 Mechanisms Through Which CSR Can Reduce Political Risk

CSR can mitigate political risk through Stakeholder engagement, Regulatory compliance, and Community support. Brand image building is the most important benefit from CSR that reduces political risk. A well instituted social responsibility profile is a political buffer; politically responsible firms are those which will not attract hostile political behavior since their stakeholders will come to their rescue in times of political uncertainty. Firms investing in environmental sustainability, and good labor practices, will gain a good image. This will shield them from stringent regulations and status risks (Flammer, 2015; Albuquerque et al., 2019).

The proactive approach to stakeholder relations will minimize the probability of some conflicts and sharpen the capability to influence policy choices (Harjoto & Laksmana, 2018; Becchetti et al., 2015). Moreover, the implementation of CSR activities can lead the firm to operate at an equilibrium level with the regulatory requirements as well. High corporate governance, sustainability, and social responsibility standards are excellent ways through which firms can maintain high standards of compliance to reduce the risk of regulatory burdens. For instance, a firm investing in renewables and reducing carbon emissions is directly pre-empting a likely shift toward tougher environmental regulations in the future.

Community engagement by a corporation through corporate-driven social responsibility can improve the social license of operations of a firm thereby reducing the likelihood of conflicts and inciting support in the local environment. Local relationships are a great buffer in political risks if firms invest in community development, education, and healthcare. For example, firms that improve the livelihood of the community are more likely to create favourability within the community during times of political uncertainty and vice versa (Chatjuthamard et al., 2021; Bae et al., 2021).

Collectively, CSR is a very effective avenue toward the attenuation of political risk since it works to enhance the firm's reputation plus ensure regulatory compliance,

encouraging stakeholder engagement and community support, which altogether works as mechanisms through which firms can attenuate political hardships and the adverse effects of political uncertainty on the conduct of their business and financial performance.

3.4 Gaps in the Literature

Although a significant body of research exists on the relationship between Corporate Social Responsibility (CSR) and political risk, limitations and several gaps remain, demanding further investigation. The study will be justified through the identification of these gaps, and the possible contributions that can be made to the existing literature will be highlighted.

First and foremost, a significant gap in literature is the scant focus on European firms. Many studies have looked at CSR's effect on political risk for different contexts, but not many specifically target European firms. For example, the paper by Andriosopoulos and Deepty (2022) and Chatjuthamard et al. (2021) studies the impact of CSR on stock volatility and crash risk in the USA. Few studies have focused on the European setting with diverse political and regulatory environments, different governance systems, and geopolitical tensions. This study tries to fill in this gap by considering European firms as their political risk is unique, especially due to events like Brexit and the Ukraine conflict.

Evidence on the relationship between CSR and firm performance and political risk, however, is mixed. On one hand, some assert that it positively affects financial performance and lowers risk as well as overall firm value (Flammer, 2015; Albuquerque et al., 2019). Others point to its likely costs and particular context as drivers of such provisions (Di Giuli & Kostovetsky, 2014). Such mixed results highlight precisely how complex the relationship between CSR and political risk would be in an interaction term loaded with such additional determinants as industry characteristics, firm size, and the specific nature of the political events. Future scholars could disentangle this inconsistency and reveal under what conditions CSR might help to mitigate political risk.

Most existing studies use macro-level indicators, such as country-specific political risk indices or major political events like elections, to proxy political uncertainty. While useful, such measures overlook the firm-specific exposure to political risks. More recent work, such as the firm-level political risk measure developed by Hassan et al. (2019), details for us how individual companies are affected by political uncertainty. To date, these measures have been underutilized in research on the mitigating role of CSR.

The effect of CSR on political risk is sector-dependent, and, thus, different sectors would be differently affected because the individual industrial peculiarities constitute salient political risks. This, however, is an omission in the existing literature in terms of sector-specific analysis. Future research should elaborate more on how CSR activities affect political risk depending on the spheres of production, for example, manufacturing, technological, healthcare, and financial activities. Therefore, such an assessment would by default underscore the specific challenges and at the same time, opportunities that the implementation of CSR strategies to fend off political risks can introduce for firms in different industrial domains (Gregory et al, 2014).

Moreover, the interaction between CSR and other strategies in political risk management should be given more importance. Firms ought to embrace diversified political risk insurance along with strategic flexibility approaches to mitigate exposure to political disruptions. Analyzing how CSR acts either as an enhancer or substitute of these traditional strategies would enable a comprehensive view through which firms can design integrated frameworks for managing risks that leverage the merits inherent in each approach (Lins et al., 2017).

In summary, while the present literature gives stronger arguments about the association between corporate social responsibility and political risk, several major gaps exist. More research is needed to explain how specific CSR practices influence firms' political risk

exposure. Filling these gaps will help businesses in designing better CSR strategies which would help them show better resilience in politically volatile environments.

3.5 Development of Hypotheses

The development of hypotheses is based on identified gaps from the literature review, and previously laid theoretical foundations. The focus of the hypotheses is to uncover whether Corporate Social Responsibility practices reduce stock return volatility arising from political risk, especially in Europe. This research will build up testable hypotheses which are developed mainly from the outlined methodology of the research design.

CSR actions are thought of as a device that institutions utilize to build social capital and enhance their reputation, which turns valuable particularly in situations of political instability. Firms that undertake CSR may be more sensitive to good business conduct and, therefore, liable to reduce the negative effect of political risk. For example, Andriosopoulos and Deepty (2022) note that CSR significantly reduces stock volatility during periods of political uncertainty. According to Albuquerque et al. (2019), the effect of CSR investments on the firm includes risk reduction as a source of potential competitive advantage. From these findings the following hypothesis is thereby derived:

H1: CSR has a positive effect in reducing return volatility.

Stock return volatility is one of the key measures of financial risk and reflects market participants' perception of the firm's stability. Therefore, less volatile stock returns may be an indication of increased investor confidence in companies with good CSR records, perceiving them as resilient amidst political uncertainty. These results are consistent with findings by Bae et al. (2021), who analysed the effect of CSR activities during the COVID-19 pandemic and established that indeed such corporate initiatives did not significantly influence stock returns during periods of economic turmoil. The study by Chatjuthamard et al. (2021) research is another evidence detailing the fact that high-CSR-firm stocks perform well when the situation normalizes.

The interaction between CSR and political uncertainty is thus very crucial in assessing the extent to which CSR may be a way to alleviate the adverse effects of political risk. An interaction term will be included in the regression model to capture this. Di Giuli and Kostovetsky (2014) put forward an argument that the investment in CSR does not always result in more profitability for the company but can ensure its quick recovery from political turbulence. From this, therefore, arises our third hypothesis:

H2: The interaction effect between CSR and political uncertainty is to negatively and significantly affect stock return volatility, implying that indeed, CSR activities can help mitigate the financial impact of political risk.

The literature review reflects the rising importance of CSR in managing political risks. Studies have given mixed reviews. CSR was to reinforce the effective firms' reputation damages due to political instability (Albuquerque et al., 2019; Andriosopoulos & Deepty, 2022). On the other hand, there are mixed reviews on the influence of CSR on financial performance, one of the studies being statistically insignificant (Di Giuli & Kostovetsky, 2014). Such a gap in the literature motivates further study of European corporations. The hypotheses set the level at which CSR lowers stock return volatility while reducing the political risk. This paper would try to enrich the literature on CSR and its management of political risks within the European view. The subsequent chapter details the data and methodology that will be applied in testing these hypotheses.

4. Data and Methodology

4.1 Sample Data

This study covers publicly traded companies from the STOXX 600 index, excluding financial companies because of their peculiar regulatory and financial structures. Geographically, it spans the entire pan-European range of countries and several industries to guarantee the most comprehensive analysis of Corporate Social Responsibility (CSR) and political risk. The exclusion of financial service companies can be defended by an entirely separate regulatory environment within which they work, which could introduce a certain bias in the assessment of the CSR and political relationships (Fatima & Elbanna, 2023). An entirely separate capital permission that is strict in the first and regulatory intervention in the second is applied to all financial service companies, on the other hand, usually work under price regulation and other forms of control by the government which could then distort a measurement of risk exposure. The diversity of industry and region penetration allows differentiation in the practices of CSR and political risk across several European markets.

4.1.1 Data Sources

- i. **Firm-Level Political Risk:** Data on firm-level political risk is to be gathered from the Firm-Level Political Risk database created by Hassan et al. (2019) and can be accessed at firmlevelrisk.com. The dataset gives cross-sectional firm-level indicators of political risk exposure based on the textual content of earnings conference call scripts. In this, it quantitatively estimates the exposure to political risk from textual summaries—these are changes in regulations or geopolitical instability or a mere shift in government policy expressed via key terminologies and phrases, thus giving a unique and specific corporate measure of political uncertainty. Using this database, the political risk data will be reliable and comprehensive enough to cover a good number of factors that may affect the firms under consideration.

- ii. **CSR Data:** To measure Corporate Social Responsibility (CSR), Environmental, Social, and Governance (ESG) scores is used in this study. ESG scores can be considered a proper and quite broad indicator for CSR, which provides a benchmark approach within the context of environmental stewardship, social responsibility, and governance practices for a company's overall performance. The argument in favour of this choice is that ESG scores comprise numerous indicators concerning different aspects of corporate sustainable and responsible business conduct, therefore reflecting a comprehensive perspective on a firm's commitment to sustainability and responsibility (Cheng et al., 2014). Standardized in nature, this aspect further promotes comparability and shall be essential in conducting proper empirical research of the relationship between CSR and political risk in a company (Ioannou & Serafeim, 2017).

The firms' overall ESG scores are extracted from a database in Refinitiv Eikon known as Asset 4. Asset 4 contains extensive details on ESG, including extremely diverse performances in environmental, social responsibility, and governance practices. These details would enable the study to distinguish the influences different dimensions of CSR have on political risks.

- iii. **Financial and Stock Price Data:** The stock price and financial measures data emanate from the Refinitiv Eikon dataset. This dataset offers core firm-level financial metrics such as daily stock returns, EPS, leverage ratios, ROA, and market capitalization. Historical volatility is also factored into the estimates of the relationship between CSR engagement and political risk due to its ability to capture changes in returns over time variation. Such measures ensure robustness to the analysis in place.

4.1.2 Sample Period and Selection Criteria

The period of the sample presented in this study is between 2010 and 2022, therefore, there is a large amount of data available. In this case, it covers a large number of political and corporate social responsibility events over an extended period.

As for the construction sample, the values used fall within the period of 2009 to 2023. The omission of data for both the previous year and the following year (2009 and 2023, respectively) is due to stock return volatility and political risk data unavailability, respectively. From the initial 600 companies, 110 companies involved banks, and other financial services were eliminated. Seventy-one companies are excluded due to missing information while matching variables, stock data, and, at last, political risk data. This forms the final dataset of 419 unique firms, amounting to 4,341 observations. Data matching is done by following each company's ISIN code.

4.1.3 Data Frequency

All company-level factors in this work—covering stock-return volatility, CSR scores, political risk ratings, and usual financial controls—come from different time levels but are looked at in a common yearly regression setup. Stock-return volatility is first determined from daily return data and then made yearly by scaling the daily standard deviation by the square root of 252 trading days; this is in line with typical rules in practical finance (Campbell et al., 1997; Hull, 2012).

The political-risk index gets published every quarter. To make this series match our annual dependent and explanatory variables, the study uses the aggregation method suggested by Wooldridge (2016), which comes by adding the four quarterly values for each calendar year. The method retains the total size of political-risk changes over the year and lessens possible errors that could come from using the number from one quarter as a sample of the whole year.

4.2 Methodology

The analysis aims to determine CSR's hedging power on volatility during political uncertainty. This paper therefore used a panel regression model to determine the relationship between Corporate Social Responsibility (CSR) and Political Risk. The methodology is based on the regression framework of Andriosopoulos and Tanzila Deepty (2022), who used firm-fixed effects and year-fixed effects to deal with the problem of unobserved heterogeneity. With firm-fixed effects, the analysis controls for characteristics that are invariant over time about each firm, which therefore channels the analysis towards isolated impacts of CSR on Political Risk, not swamped by individual firm features. Year-fixed effects are also controlled for to include temporal changes where macroeconomic and political changes evolve over time. In effect, this allows for a strong investigation of the interplay between CSR initiatives and Political Risk dynamics to stay on the leadership trail in how corporate social responsibility efforts by organizations may ameliorate or exacerbate political uncertainties. The findings of the study may, indeed, help widen horizons in Corporate Social Responsibility amidst such turbulent political regimes, hence making more pragmatic recommendations to the leadership.

4.2.1 Empirical model

The regression model employs in the analysis to explore the relationship between CSR and political uncertainty:

$$\begin{aligned}
 Risk_{i,t} = & \alpha + \beta_1 \times CSR_{i,t} + \beta_2 \times Political\ uncertainty_{i,t} \\
 & + \beta_3 \times CSR_{i,t} \times Political\ uncertainty_{i,t} + \text{firm - level} \\
 & \text{controls} \\
 & + \text{firm - fixed effects} + \text{year - fixed effects} + \varepsilon_{i,t}
 \end{aligned}$$

Where,

Risk_{i,t} = stock return volatility of firms at time t

$CSR_{i,t}$ = firm's combined ESG score at time t

Political uncertainty $_{i,t}$ = firm-level political risk exposure at time t

$\varepsilon_{i,t}$ = error term

Variables:

Risk:

This study follows Hull, J. (2012) to calculate stock return volatility.

Daily Returns is the logarithm value of today's price divided by the previous day's price.

$$r_t = \ln\left(\frac{P_t}{P_{t-1}}\right)$$

Where, P_t is the stock price on day t .

Daily Volatility (Standard Deviation):

$$\sigma_{daily} = \sqrt{\frac{1}{N-1} \sum_{t=1}^t (r_t - \bar{r})^2}$$

where \bar{r} is the average of the daily returns and N is the total number of returns.

where \bar{r} is the average of the daily returns and N is the total number of returns.

Annualized Volatility:

$$\sigma_{annual} = \sigma_{daily} \times \sqrt{\text{Number of Trading Days in that year}}$$

Political uncertainty:

Political risk data frequency available in quarter. The date is converted by using the following equation (Wooldridge, 2016).

$$PoliticalRisk_t^{annual} = \sum_{i=1}^4 PoliticalRisk_{t,i}$$

4.2.2 Control Variables

To improve the efficiency and consistency of the regression model, appropriate control variables are introduced. Variables previously determined to have both theoretical and empirical importance within the sphere of financial and economic study comprise most control variables.

Debt-Equity (leverage) Ratio: This shall capture financial risk. High leverage tends to have an implicit reliance on debt financing which increases the risk profile of the firm as more obligations might mean more financial distress to the company. It is also critical in the understanding of the effect of financial risk on the performance and stability of a firm. Firms with relatively higher leverage would bear greater interest expenses and as such be more susceptible to the downturns of the economy; the influence on strategic decisions and operational outcome is of equal significance to them.

Profitability: Measured by Return on Assets (ROA). ROA is also an effective tool to evaluate the firm's management effectiveness and overall financial health. Controlling for profitability isolates the effects of operational performance on the dependent variable. Higher profitability also enables the firm to invest more in growth opportunities and withstand economic fluctuations. Therefore, this variable is also very important for a comprehensive analysis.

Market Capitalization: An aggregate measure that incorporates both firm size and investor sentiment is used. Market capitalization represents the total market value of shares outstanding, acting as a proxy to capture a firm's market credibility and degree of visibility perceived by investors. The study is prerequisite knowledge of the impact of market dynamics and investor behavior toward firm-specific outcomes. Higher market capitalization also generally represents more confidence by investors and greater stability that may influence the firm's capacity to raise capital and implement corporate strategies.

Firm and Year Fixed Effects: To control for unobserved heterogeneity across firms and over time, the models introduce both firm fixed effects and year fixed effects. While the former takes care of time-invariant characteristics at the management level that might otherwise confound results such as management style, organizational culture, or baseline business model differences the latter adjusts for global shocks or macroeconomic conditions applicable to all firms each year. These fixed effects were executed via the Least Squares Dummy Variable (LSDV) method wherein dummy variables were formed for every firm and year with one reference category to preclude perfect multicollinearity some degree of omitted variable bias related either to firm-specific or time-specific factors in estimating CSR, political uncertainty, and their interaction effects on stock return volatility.

Including these several control variables makes it possible to attempt a more nuanced and accurate analysis of the relationship between our main variables of interest and firm performance. Corporate social responsibility and political risk effects can thus be extracted more cleanly since they lag all those firm-specific characteristics-perfect measures for use in that background, plus the researcher and policymaker and business leader stand to gain greatly from more qualified results.

5. Empirical Analysis and Results

The relationship between Corporate Social Responsibility, Political Uncertainty, and Stock Returns volatility shall be empirically tested. In order to account for the variation in CSR engagement among different firms, the data was later classified into four broad categories which considered: (i) all firms; (ii) firms with high CSR scores, where $CSR > 66$; (iii) firms with low CSR scores, where $0 < CSR \leq 66$; and (iv) firms with no CSR scores denoted as $CSR = 0$. The high CSR score and low CSR score standards are followed by Clément et al. (2025). A separate regression model for each category was run in addition to the firm-level control variables that incorporated both firm fixed effects and year fixed effects. This methodology thus fully captures how differences in types of firms undertaking CSR activities can mediate the role of political uncertainty in influencing firm-specific risk.

5.1 Descriptive Statistics

Descriptive statistics for the principal variables used in the empirical study are shown in Table 1, classified by levels of engagement in Corporate Social Responsibility (CSR) practices: All Firms, High CSR Firms ($CSR > 66$), Low CSR Firms ($0 < CSR \leq 66$), and Zero CSR Firms ($CSR = 0$). These data comprise central tendency and dispersion measures and show firm-level characteristics relevant to the study's hypotheses.

For the complete set of 4,341 firm-year observations in Model 1, the mean volatility registers at -1.42 with a standard deviation of 1.57. The average CSR score is 56.98 out of 100, implying that most firms undertake CSR-related activities to some extent. The adjusted Political Uncertainty Variable shows a mean of 100.45 which demonstrates different levels of political risk exposure among the firms.

The firms have reported an EPS of 2.64 and an ROA of 0.06; the leverage ratio which these firms maintained comes to 0.89, Market-to-book ratio average is at 3.56 and average market capitalization is 16.02 (on a logarithmic scale).

In Model 2 High CSR firms N 1234 firms demonstrate the lowest mean volatility 2.03 the highest average CSR score 76.18 and the lowest average political uncertainty 100.03 These firms also exhibit higher earnings EPS 3.17 and larger average market capitalization 16.44 thereby supporting the notion that CSR-intensive firms are generally more established and potentially more resilient

Model 3 (Low CSR firms, N = 2,983) shows a little more volatility 1.23, moderate CSR scores mean 51.41 and an average political uncertainty of 100.59. These firms show a bit lower financial performance compared to the high CSR group but better than the ones with no CSR engagement.

Model 4 (Zero CSR firms, N = 124) shows a stark contrast to the rest of the categories. These firms have a positive average volatility and give values like that for highest political uncertainty and the lowest EPS that is 0.72. They also report values for leverage and market capitalization that are significantly lower, while profitability metrics appear marginally weaker.

The figures of model 4 imply that firms not engaging in CSR are usually smaller, less profitable, and equally more politically risky. The descriptive statistics have shown evident trends: greater CSR engagement goes with reduced volatility and improved financial stability and the firms with no CSR initiatives tend to operate in more volatile and uncertain environments. These trends provide initial empirical backing for the study's hypotheses and justify segmenting the sample based on CSR intensity for a deeper analysis.

Table 1

Descriptive statistics

Model 1 All firms						
	Mean	Median	Min	Max	Std. dev.	Obs.
Volatility	-1.42	-1.27	-11.76	3.36	1.57	4341
CSR	56.98	56.90	0.00	100.00	17.15	4341
Political Uncertainty	100.45	102.31	0.00	110.88	7.94	4341
EPS	2.64	1.22	-84.65	99.94	7.01	4341
LEVERAGE	0.89	0.64	-46.32	74.09	2.12	4341
MKT CAP	16.02	15.92	10.75	19.72	1.19	4341
MKT to BOOK	3.56	2.44	-14.65	74.74	4.55	4341
ROA	0.06	0.05	-0.78	1.95	0.09	4341
Model 2 High CSR firms						
Volatility	-2.03	-1.80	-11.42	2.32	1.79	1234
CSR	76.18	74.00	66.10	100.00	8.17	1234
Political Uncertainty	100.03	102.29	24.95	110.89	9.03	1234
EPS	3.17	1.48	-52.45	94.01	7.72	1234
LEVERAGE	0.92	0.70	-9.20	8.00	0.89	1234
MKT CAP	16.44	16.35	13.23	19.50	1.02	1234
MKT to BOOK	3.13	2.27	-14.65	37.54	3.26	1234
ROA	0.05	0.05	-0.24	0.36	0.06	1234
Model 3 Low CSR firms						
Volatility	-1.23	-1.12	-11.76	3.36	1.38	2983
CSR	51.41	52.10	18.80	66.00	9.04	2983
Political Uncertainty	100.59	102.31	0.00	110.89	7.48	2983
EPS	2.50	1.16	-84.65	99.94	6.73	2983
LEVERAGE	0.91	0.62	-38.22	74.09	2.31	2983
MKT CAP	15.92	15.76	12.33	19.72	1.16	2983
MKT to BOOK	3.77	2.51	-14.12	74.74	5.02	2983

ROA	0.06	0.05	-0.78	1.95	0.10	2983
Model 4 No CSR						
Volatility	0.21	0.22	-2.37	2.60	1.04	124
Political Uncertainty	101.47	102.85	59.65	110.89	6.95	124
EPS	0.72	0.84	-26.52	24.70	5.46	124
LEVERAGE	0.38	0.47	-46.32	11.99	4.63	124
MKT CAP	14.08	14.13	10.75	16.93	0.95	124
MKT to BOOK	2.78	2.17	-12.49	19.32	3.21	124
ROA	0.05	0.05	-0.46	0.54	0.12	124

The table represents summary statistics for all key variables containing the mean, median, minimum, maximum, standard deviation and count of observations. These stats are shown for the following variables: Stock return volatility (Volatility), Corporate Social Responsibility (CSR), Political Uncertainty, Earnings Per Share (EPS), Leverage ratio (LEVERAGE) Market capitalization (MKT CAP), Market-to-book ratio (MKT to BOOK) and Return on assets (ROA).

5.2 Correlation Analysis

Table 2 gives the correlation matrix of the key variables used in the regression analysis. This output provides preliminary perceptions of the associations between corporate social responsibility, political uncertainty, and volatility in stock returns along with some firm-level control variables. The dependent variable, return volatility of stocks, shows a negative correlation with CSR ($r = -0.348$), meaning that firms with higher CSR activities tend to have lower return volatility. This result holds Hypothesis 1 and has backing from literature too (e.g., Lins et al., 2017; Flammer, 2015); it is believed that CSR increases financial stability by increasing trust among stakeholders and capitalizing on reputation.

Table 2

Correlations

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) Volatility							
(2) CSR	-0.348	1					
(3) Political Risk	0.659	-0.029	1				
(4) EPS	0.023	0.068	-0.044	1			
(5) LEVERAGE	-0.046	0.019	0.071	-0.031	1		
(6) MKT to BOOK	0.013	-0.03	-0.033	0.049	0.197	1	
(7) ROA	0.029	-0.004	-0.054	0.191	-0.042	0.419	1

This table shows the Pearson correlation coefficients for the key variables Stock return volatility (Volatility), Corporate Social Responsibility (CSR), Political Uncertainty, Earnings Per Share (EPS), Leverage ratio (LEVERAGE) Market capitalization (MKT CAP), Market-to-book ratio (MKT to BOOK) and Return on assets (ROA). These correlations are derived from the full sample. No serious issues of multicollinearity were seen since the correlations between explaining variables stayed under 0.8.

Notably, after reversing the direction of the political uncertainty variable so that higher values correspond to greater uncertainty, a substantial positive correlation between political uncertainty and volatility of stock returns is seen ($r = 0.659$). This aligns with both theoretical expectations and empirical evidence that more market-based risk and price volatility occur in times of heightened political uncertainty. The negative correlation between CSR and political uncertainty ($r = -0.029$) though weak, suggests firms with higher CSR engagements may be marginally more likely to operate in politically stable environments, or they are less susceptible to reputational regulatory shocks driven by political factors.

Among the control variables, none show high correlations with the principal explanatory variables, thus reducing multicollinearity concern. EPS, leverage, market-to-book ratio and ROA show low to moderate correlation with CSR, political uncertainty, and volatility. All correlation coefficients are far below the generally accepted 0.80 multicollinearity

threshold: hence the inclusion of these control variables in the multivariate regression models.

To sum up, the correlation study gives early evidence for the suggested links and shows that multicollinearity will not likely skew the regression results. The positive link between political uncertainty and volatility, most notably, highlights the need to check CSR's moderating role in later regression tests.

5.3 CSR and Stock Return Volatility

Hypothesis 1 (H1) states that engagement in corporate social responsibility (CSR) results in stock return volatility being lowered. This is based on the belief that CSR activities enhance stakeholder confidence, improve a firm's reputation, and create goodwill among investors, customers, and society at large. In turn, through such channels, engagement in CSR will probably reduce the adverse effects that surprises happen to hold about events regarding changes in regulation and reputation on financial stability. Companies involved in CSR tend to be perceived as more responsible and ethical; hence capable of reducing investor doubt therefore building confidence especially during economic or political crises. Such activities address issues related to social welfare, environment protection, and governance; thus, they minimize both firm-specific crises and regulatory penalties. An alternative implication inferred from this is that firms with high levels of CSR engagement were predicted to have less stock return volatility compared to their less engaged counterparts.

Table 3 gives the regression outputs that use both firm and year fixed effects, which means controlling for unobservable heterogeneities that are firm-specific and time-specific, respectively. If not controlled for, these heterogeneities could lead to spurious relations in the estimates. In this model, it is assumed that CSR effects shall not be confounded by any time-invariant characteristics of firms, like industry affiliation or corporate culture; nor by macroeconomic shocks or political events that change over time. The coefficient on CSR for the full sample (All Firms) reported here confirms the

hypothesized relationship—it is negative and statistically significant at very high levels ($\beta = -0.0184$, $t = 5.48$, $p < 0.01$).

Table 3

CSR, Political Uncertainty and Volatility

	(1)	(2)	(3)	(4)
<u>Main Variables</u>				
	-0.0184***	-0.0113	-0.0127*	0
CSR	(-5.48)	(-0.89)	(-1.68)	(-0.30)
	0.0001	0.0068*	0.0015	0.0047
Political Uncertainty	(-0.13)	(-1.78)	(-0.95)	(-1.53)
	-0.0002***	-0.0001**	-0.0002***	0
CSR × Political Uncertainty	(-15.91)	(-2.32)	(-8.03)	(-0.32)
<u>Control Variables</u>				
	-0.0025***	-0.0038**	-0.0031***	-0.002
EPS	(-2.99)	(-2.12)	(-2.64)	(-1.38)
	0.0002*	0.0005	0.0001	0.0003
LEVERAGE	(-1.54)	(-1.29)	(-0.88)	(-1.02)
	0.0001*	0.0002**	0.0002**	0.0001
MKT to BOOK	(-1.86)	(-1.98)	(-2.1)	(-1.34)
	-0.7603***	-0.6842***	-0.8027***	-0.6321
ROA	(-4.15)	(-2.89)	(-3.57)	(-1.62)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	4341	1197	2637	507
Adj. R-squared	0.462	0.481	0.453	0.128

This table gives the results of fixed effects regression models in a rundown on how CSR, Political Uncertainty, and their interaction impact the volatility of stock returns. The sub-samples in columns (1) to (4) are All Firms, High CSR Firms, Low CSR Firms, and Zero CSR Firms. Firm-year combinations are used for all regressions. Standard errors are reported below the coefficients and t-statistics in parentheses. Significance levels: *10%, **5%, ***1%.

This empirical evidence bolsters the assertion that higher engagement in CSR activities relates to lower volatility in stock returns. The finding further supports the argument that CSR functions as an effective tool in managing risks since it reduces a firm's external shock exposure besides fostering stronger stakeholder relations. Market uncertainty can take a toll on a firm's resilience, but corporate social responsibility (CSR) can help build reputational capital and institutional legitimacy. Investors perceive firms with high CSR engagement as less risky, which drives down required returns and lowers stock price volatility. In addition, proactive CSR firms might be able to avoid lawsuits, regulatory sanctions, and damage to reputation—all ESG-related incidents—that further enhance financial performance stability. Results show that the symbolic effect of the CSR coefficient is material in its implications for finance; it is said to reduce volatility in financial markets as per prior theoretical and empirical studies. The evidence in Table 3 above strongly backs Hypothesis 1 and shows that CSR engagement does much in the firm performance stability cycle, especially in markets that are dynamic and often unpredictable.

When the sample is divided according to CSR engagement intensity, additional granularity emerges that underscores key differences in how CSR affects stock return volatility. For firms with Low CSR (CSR scores between 0 and 66), the coefficient on CSR remains negative and statistically significant at the 10% level. This finding indicates that even small amounts of CSR contribute significantly to the reduction of volatility, hence reinforcing the notion that CSR serves as an important risk mitigation mechanism at even low levels. It particularly highlights the strategic value of such engagement for firms at early or moderate stages in their adoption of CSR, where incremental investments in CSR may have large financial returns.

The empirical evidence suggests that in such firms with limited investment in CSR, the returns from investment in terms of risk are very high. From a signaling view, early CSR efforts can greatly change stakeholder views, improving firm reputation and credibility which in turn can lower market scepticism and volatility. Also, small CSR practices can

lead to better deals with regulators, stable supply chains, and customer loyalty; all these helps keep financial performance steady and lower sensitivity to outside shocks. The importance of the CSR coefficient among low CSR firms shows that initial CSR investments are likely to be more seen and more effective than extra CSR activities in already highly active firms. In markets where CSR expectations are growing, firms at the bottom of the CSR scale can get edges just by taking on simple responsible actions. It can be concluded that, in general, the results have shown some very strong evidence that the engagement in CSR, even at levels which may be considered moderate, is fundamentally important when it comes to reducing stock return volatility as well as increasing firm resilience; this is especially true for those firms which have not historically engaged very much in CSR activities.

The High CSR firms (CSR scores above 66) the coefficient on CSR remains negative though statistically insignificant. It does not seem to be the case that there are high marginal benefits of CSR at such levels of adoption. Firms deeply embedded in CSR probably have already reaped most of the stabilizing benefits associated with it, like enhanced reputation capital, stakeholder trust, and regulatory goodwill. Thus, further incremental CSR would turn out to be fairly marginal or even trivial regarding its direct impact on stock return volatility. This theoretical proposition has been empirical evidence that after a certain threshold level of financial risk mitigation through CSR, its role becomes less utility-increasing.

In the case of Zero CSR firms, the CSR coefficient is statistically insignificant and virtually nil. It brands the result as implying no meaningful relationship between engagement in CSR activities and the volatility of stock returns for firms that do not engage in these activities. It thus underscores the major role played by the adoption of at least minimal levels of CSR, in fact, for the realization of risk mitigation benefits. Firms totally disengaged from CSR practices seem unable to tap into protective effects related to stakeholder support and reputational insulation, hence they appear more vulnerable to external uncertainties.

So, these findings really back up Hypothesis 1, showing that generally, CSR activities help firms keep their stock return volatility low. The link is strongest in firms with moderate to low levels of CSR activities; it seems like the first or extra investments in CSR give the largest direct benefits in lowering volatility. This finding makes a strong case for the strategic importance of early CSR adoption since companies can use reputation gains, stakeholder support, and better operational stability to mitigate financial risks. In addition, the findings fit well with earlier thinking that sees CSR as a type of "insurance-like protection" against not just internal shocks but also a wider range of external uncertainties. After all, their CSR actions could help lower the reputational, regulatory, and operational risks these firms bear in such an erratic environment. All this evidence points to one thing: if there is any role for CSR in enhancing resilience at corporate and financial levels, it surely is substantive and far from symbolic.

5.4 Interaction Between CSR and Political Uncertainty

Hypothesis 2 (H2) posits that the interaction between corporate social responsibility and political uncertainty goes a long way in stock return volatility moderation. This latter hypothesis seeks to argue that firms with stronger CSR engagement would likely absorb external political shocks better, turning them up while politically risky situations do not affect their financial performance. It is suggested that CSR initiatives help build goodwill reservoirs among stakeholders, which include investors, customers, regulators, and the community; these may be drawn upon in times of instability. Investments into socially responsible practices enhances firm legitimacy and credibility which also dampens direct negative reputational and operational impacts on firms when there is political uncertainty.

In addition, engagement in CSR leads to superior risk management systems, operational flexibility, and governance which could help firms operate well under complicated regulatory and political environments. Companies with a shown dedication to CSR are also probable to have less volatility in investor mood and way of getting capital during

times of political turmoil, which further stabilizes their financial results. So, H2 states that CSR not just has inner ethical and social worth but also acts as a tactical tool that lessens the effect of outside uncertainties, helping in the general decrease of specific firm financial risk.

Table 3 shows regression results that strongly support the hypothesis, using both firm and year fixed effects. For the full sample of firms (All Firms), the coefficient on the interaction term between CSR and Political Uncertainty comes out negative and highly statistically significant ($\beta = -0.0002$, $t = -15.91$, $p < 0.01$). It implies that CSR engagement strengthens firms' resilience to political uncertainty, thereby reducing stock return volatility sensitivity to external political risk factors. The magnitude as well as significance of this interaction term highlight the strategic role that CSR could play as an asset in managing exogenous threats which are not under a firm's immediate control. These results mean that firms with higher CSR engagement can sustain investor confidence and operational stability more effectively during periods of political turbulence. Firms orienting towards CSR can reduce the adverse impacts of changes in regulations, policy instability, and political turmoil by relationing with stakeholders and embedding socially responsible practices into core operations. The credibility of the conclusion that engaged CSR serves as a moderating factor against political uncertainty is further enhanced by the robustness of these findings across different model specifications. In other words, the evidence herein has dynamically and strategically validated Hypothesis 2, highlighting the risk management value of CSR activities.

Subsample analysis also brings out vital variations in levels of CSR engagement. For High CSR firms (CSR scores above 66), the interaction coefficient between CSR and Political Uncertainty retains its negativity and 5% level of statistical significance ($\beta = -0.0001$, $t = -2.32$, $p < 0.05$), though the magnitude of the coefficient does by a fraction less than that in the full sample. The above result implies firms with deeply embedded CSR practices continue to enjoy protective effects against political uncertainty; this reinforces an argument above that CSR provides a stabilizing function in environments that are volatile.

However, the slightly lower magnitude implies a case of diminishing marginal returns to CSR at higher engagement levels: once a firm has reached substantial integration with regard to its CSR activities, additional volatility reduction might confer smaller incremental benefits.

For firms with Low CSR (CSR scores between 0 and 66), the interaction term between CSR and Political Uncertainty is negative and statistically significant at the 1% level ($\beta = -0.0002$, $t = -8.03$, $p < 0.01$). Here, though, the magnitude of the interaction effect is larger for low CSR firms compared to high CSR firms; thus, incremental CSR initiatives act to provide especially strong protective benefits for firms that initially have lower levels of engagement in CSR. This finding means that marginal investments in CSR by firms with limited prior commitments can yield disproportionately high-risk mitigation benefits, particularly under conditions of political volatility.

From a theoretical perspective, increased responsiveness among low CSR firms may manifest as a signaling effect whereby the initiation or increase of CSR activities rapidly enhances reputation, stakeholder support, and perceived legitimacy. Where there is minimal baseline CSR engagement, even small steps will likely be very noticeable to external stakeholders and investors, thus boosting confidence and lowering market-based risk premiums. Also, this shows that CSR uptake is good not just for companies with established CSR strategies but for companies in the initial phase of adopting socially responsible practices. All in all, these findings further strengthen the strategic value of CSR as a changing tool for managing exposure to political risk.

The results give strong support to Hypothesis 2. It shows that besides reducing baseline stock return volatility, CSR engagement helps moderate the negative effects of external political uncertainty on firm-specific risk exposures. The interaction effect between CSR and Political Uncertainty is negative and statistically significant in all model specifications and subsamples, thus reinforcing the perspective that CSR serves as a dynamic mechanism for risk mitigation. This result aligns with theoretical arguments since it

implies that CSR activities increase firms' flexibility to adapt to changes and their ability to sustain trust among stakeholders when external shocks occur. By internalizing socially responsible practices, firms could manage periods of increased political stability, regulatory change, or even broader forms of institutional instability better. Enhanced goodwill from undertaking CSR can translate into investor confidence, customer loyalty, and supportive regulation—financial resilience translates from these. The actual proof also hints that taking part in CSR is not just a show or tool for fame but has real important value in strategy when it comes to handling risk that comes from politics. So, CSR acts as a key part of today's plans for managing risks in a company, especially when the political settings are very tense and unpredictable.

6. Discussion

6.1 Summary of Key Findings

The empirical findings provide substantial support for the hypotheses. In line with Hypothesis 1 (H1), elevated levels of Corporate Social Responsibility (CSR) engagement reduce the future volatility of stock returns. The findings support that CSR functions like an ordinary mechanism of risk management. In alignment with Hypothesis 2 (H2), interaction between CSR and political uncertainty return stability. The result indicates that CSR stabilizes volatility directly and firms enhance resilience against external political disturbances. The above has also demonstrated robustness in several subsamples and model specifications to the extent of reinforcing the reliability of results.

6.2 Interpretations of Results

Results highlight the strategic role that corporate social responsibility can play in sustaining financial performance. The loss-reducing effects of CSR are primarily observed for firms with low to moderate CSR activities. This setting implies that the initial or incremental investments in CSR have high marginal losses reduction benefits as the stakeholders start reacting positively to the signals of commitment towards social and ethical responsibilities. These firms are likely to see huge gains in investor confidence, reputation, and operational credibility from just a little investment in CSR practices. On the other hand, for firms with high CSR engagement, the incremental gains seem to dwindle; this means that there exists a level beyond which increasing CSR does not bring additional benefits in terms of risk mitigation. Stakeholders perceive such diminishing returns of investments into CSR; they see no further change in their perception regarding stability or ethicality of the firm after a certain point of investment. The results for zero CSR firms further confirmed the critical importance of CSR engagement. Firms that do not participate at all in CSR leave themselves completely exposed to political risks and financial volatility since they lack the reputational insurance and stakeholder goodwill enjoyed by CSR-oriented firms. This vulnerability proves the necessity of strategic positioning for CSR, not as optional or symbolic, but as essential within modern

environments characterized by high volatility. Furthermore, the significant interaction between CSR and political uncertainty reinforces the view that CSR is not merely a reputational signal but an organizational capability of substance that genuinely enhances firm resilience. It goes with an emerging intellectual trend that holds there is enhancement in stakeholders' confidence due to effective CSR, increased operational flexibility, and strengthened internal governance when undertaken properly. Integrating CSR into their strategic plans puts them in a better position to absorb shocks from outside, preserve running continuity, and maintain financial performance during periods politically and economically high unstable.

6.3 Comparison with Previous Literature

The outcomes of the study are in line with that of earlier studies which conceptualized CSR as some form of insurance protection (Lins et al., 2017). Thus, the present study has also provided empirical evidence that CSR engagement can serve as a mitigating factor for firm-specific financial volatility in times of high political uncertainty. Just as Chatjuthamard et al. (2021) found that CSR reduces firm sensitivity to political risk, this study adds further empirical evidence to the argument that CSR engagement makes organizations resilient external shock factors. The significant interaction between CSR and political uncertainty stress CSR's strategic value beyond reputational leverage, reinforcing it as a means to strengthen stakeholder relationships, enhance operational flexibility, and improve firms' adaptability.

The observed phenomenon that low CSR firms derive more marginal value from CSR engagement has already been noted by Flammer (2015) who in fact argued that even initial investments in CSR go a long way in enhancing firm value and stability. The incremental initiatives are thus interpreted as highly salient to the stakeholders and serve to build trust and legitimacy rapidly in a firm with a historically low engagement in CSR activities. However, the dynamics with high-CSR firms introduced are those of diminishing returns to CSR. It appears that once firms cross a certain threshold of engagement in CSR, added on the ground yield lower marginal benefits for volatility

reduction. It may be that there is an effect of saturation as stakeholder groups have already fully integrated an image of corporate social responsibility by the firm, thus making further improvement less effective both in altering investor perception and risk reduction. This adds to the increasing body of work on CSR and corporate risk management by underscoring the protective effects of CSR are conditional in nature; it indicates that the strategic value of CSR may vary, depending on a firm's baseline level engagement and the political environment.

6.4 Theoretical Implications

This study adds significantly to the literature on corporate social responsibility (CSR) by reinforcing the view of CSR as a dynamic, ethereal obligation mechanism through which firms manage risks in an ongoing fashion, rather than just a tool for enhancing reputation or ethical commitment. Findings from this study empirically prove that CSR engagement generates direct financial implications and incentives for firms by reducing their stock return volatility and moderating the adverse impacts of political uncertainty on their operations. The paper extends stakeholder theory by providing empirical evidence that tangible stakeholder goodwill is fostered through CSR activities, hence strengthening firm resilience and financial stability in times of external disruptions. Companies undertaking meaningful CSR will sustain investor confidence as well as customer and regulator trust, which are critical elements in sustaining financial stability amidst uncertainties.

The results further deepen the knowledge on political risk management by situating corporate social responsibility (CSR) within the context of a strategic framework of proactive organizational reactions to macro-level uncertainties. Firms that undertake CSR initiatives create in advance protective buffers against regulatory changes, reputational risks, and institutional instability rather than passively facing political volatility. Companies can reduce their vulnerability to external impacts and keep running continuously amid rising political and economic disturbance by integrating CSR into holistic risk management plans.

6.5 Practical Implications

The findings of this study hold crucial implications for corporate managers and policymakers. For corporate decision-makers, the results indicate that investments in CSR are socially desirable and strategically essential in ensuring financial stability and risk mitigation. More precisely, evidence suggests firms with low to moderate levels of CSR activities will significantly benefit marginally regarding stock return volatility as well as resilience against external political and regulatory shocks. Therefore, it can be recommended that managers reformulate CSR to be part of the overall risk management framework of their firm rather than an additional discretionary corporate philanthropy activity. Embedding CSR into core operations and governance frameworks will enable organizations to develop better relationships with stakeholders, improve investor confidence, and enhance organizational adaptability during periods of heightened uncertainty.

For policymakers, the findings highlight CSR promotion as a potential driver of wider financial market stability and sustainability among companies. This may create strong firms that, in turn, positively impact the economy during periods of political instability. If positioned by the policymakers in their guidelines as a means of systemic risk reduction rather than purely an avenue for corporate ethics, they would be able to align corporate incentives more effectively with societal goals. Therefore, this study has formulated a significant strategic and policy relevance for CSR in an environment characterized by heightened volatility both politically and economically.

6.6 Limitations and Future Research Directions

This study has taken the liberty to make valuable contributions but sits within a context of several limitations that must be acknowledged. First, the sample comes from a particular dataset, which may limit the generalization of findings across different regional, institutional, and market contexts. CSR practices and the type of political risk can vary widely between countries and industries due to variations in their regulatory

systems, cultural expectations, and economic development levels (Henisz & Zelner, 2010).

Second, CSR participation was evaluated at the total company level, without breaking down specific aspects of CSR like environmental care social efforts or governance policies. Since different aspects of CSR can have different impacts on firm risk using a general CSR score might mask important differences in how particular CSR actions relate to political uncertainty and influence stock return volatility future studies should use detailed CSR measures to explore whether some facets of CSR are better than others in reducing firm risk.

This study looks at the direct and moderating effects of CSR and not its possible mediating effects like change in investor outlook, capital access or firm operational strategy adjustments. Looking into these paths could provide better understanding of how CSR impacts financial stability (Flammer, 2015). Further studies can also advance this analysis using data from several countries, which will allow a comparative look at the institutional settings or examining sector-specific dynamics to find out if industry traits alter the CSR-risk link.

As noted, the above limitations must be addressed to bring the role of CSR in modern risk management Strategy to the better understanding that it should have and thus make the viewing more nuanced and comprehensive.

7 Conclusions

This study tries to see how effective Corporate Social Responsibility (CSR) is as a mechanism in reducing political risk by looking at its influence on the volatility of stock returns in European firms. Based on stakeholder theory and seeing CSR as a flexible tool for managing risks, the analysis uses a broad panel dataset of 419 non-financial companies listed in the STOXX 600 index from 2010 to 2022. By including both company-specific and time-specific fixed effects, this study gives strong empirical evidence that engaging in CSR not only directly reduces return volatility but also significantly changes how political uncertainty impacts negatively.

The results support two main hypotheses. First, in line with prior literature (e.g., Flammer, 2015; Albuquerque et al., 2019), stock return volatility is negatively related to CSR engagement, particularly for firms with low to moderate CSR activities. This implies that the financial stability returns from initial or added CSR efforts are significant. Second and more importantly, the interaction of CSR with political uncertainty goes a long way in mitigating volatility; it underlines that CSR serves as an organizational strategic buffer when there is political turbulence (Chatjuthamard et al., 2021; Andriosopoulos & Deepty, 2022). This hold across most subsamples; however, diminishing marginal returns seemed to apply for firms with very high CSR scores and no risk-reducing effects for firms with zero CSR engagement.

This study theoretically advances stakeholder theory by showing how CSR creates stakeholder goodwill and legitimacy in the eyes of institutions, which then convert into real resilience against external shocks. It also adds to political risk literature by positioning CSR within the firm's risk management frameworks, not just as a mechanism for enhancing reputation.

From a practical viewpoint, the study has great relevance for corporate managers and policymakers. Managers should perceive investments in CSR as a twin objective strategy— one, to improve the company's ethical image and the other, to strengthen its

operational and financial resilience. In turn, policymakers could see the encouragement of CSR as part of an overarching endeavour to promote economic stability, especially in countries prone to political disturbances.

The study is insightful, though it acknowledges some limitations in using aggregate Environmental, Social, and Governance (ESG) scores as a proxy for CSR and considering only publicly listed European firms. Future research could investigate the disaggregated dimensions of CSR (environmental, social, governance) or take other geographical and institutional contexts to validate and fine-tune the mechanisms through which CSR moderates political risk.

To conclude, this study has produced profound evidence to the effect that CSR is not merely a symbolic endeavour but rather a strategic asset in managing political uncertainty. The integration of CSR into the operational and governance programs of firms will make them more resilient, reduce their financial risk, and contribute to general economic stability. Political landscapes will continue to evolve; thus, under such conditions, CSR is deemed to be one of the flagship pillars of sustainable and adaptable corporate strategy.

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