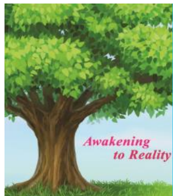

Available online at www.elixirpublishers.com (Elixir International Journal)

Organizational Behaviour

Elixir Org. Behaviour 101(2016) 43897-43902

Elixir
ISSN: 2229-712X

Corporate Social Responsibility as Precursors for Organization Performance; Insights from Literature

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ARTICLE INFO

Article history:
Received: 11 August 2016;
Received in revised form:
26 November 2016;
Accepted: 9 December 2016;

Keywords
Business Performance,
Corporate Social
Responsibility,
Community.

ABSTRACT

Businesses worldwide are faced with the challenge of responding to the needs of their external environment in a manner that adds value to their operations. It is imperative that businesses run their operations within the precepts of the law of the land in which they operate and other regulations prescribed by authorities like business associations and government agencies. The organization is also expected to treat their employees with dignity and within the existing labour laws. The customers expect organizations to produce quality goods and services while the shareholders expect a return on their investment. The communities' expectations conflict with the shareholders demands because in most cases community investments do not guarantee returns to the organizations. Nonetheless, organizations cannot afford to ignore the communities partly due to government regulations and also due to the long term benefits that accrue from such investments. The issue of organizations running operations in a responsible manner is no longer disputable due to the common understanding of the inherent benefits. Corporations possess power to control and influence the quality of employees, customers, shareholders, and residents of local communities in which they operate. Corporate Social Responsibility (CSR) focuses mostly on reputation and has only limited connection to the business, making them hard to justify and maintain over the long run.

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Introduction

CSR is an ethical theory that an entity has an obligation to act in a way that benefits the society. It is a duty that every individual has to perform so as to maintain a balance between the economy and the ecosystems. A trade-off always exists between economic development, in the material sense, and the welfare of the society and environment. Social responsibility means sustaining the equilibrium between the two. It pertains not only to business organizations but also to everyone whose action impacts the environment (Abiodum, 2012) CSR activities can be grouped into four main categories: economic, legal, ethical and philanthropic. Such classification assumes abiding by the CSR principles, where company's responsibility towards the society is based on normal profit maximization, following the legal rules, and moral responsibility as well as philanthropic activities. CSR as a concept is based on relationship between business world and society, and on behaviour of company's towards its main interest groups such as: employees, buyers, investors, suppliers, local community and special interest groups (Aburime, 2008).

In order for organization to be sustainable it must be financially secure, decrease its negative environmental impact and act in conformity with the expectations of society. Although the prime focus of business is generating profits, corporations can contribute to social and environmental goals by applying corporate social responsibility as a strategic line in their core business practices, corporate governance, and management instruments (Ominde, 2006). According to Prahalad, (2002), businesses encompass economic, legal, ethical and discretionary expectations that society has of organization at any given time. Businesses can use ethical decision making to secure their businesses by making decisions that allow for government agencies to minimize their involvement with the corporation. The best definition of CSR is that by Odhiambo, (2006) where corporate social responsibility is described as achieving commercial success in ways that honour ethical values and respect people, communities, and the natural environment.

Theoretical framework

Stakeholder Theory

In stakeholder theory, the purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services (Auka, 2005) or to serve as a vehicle for coordinating stakeholder interests (Boral, 2005). Stakeholder theory was first presented as managerial theory. Accordingly, the corporation ought to be managed for the benefit of its stakeholders: its customers, suppliers, owners, employees and local communities, and to maintaining the survival of the firm (Kamau, 2009). The decision making structure is based on the discretion of the top management and corporate governance, and frequently it is stated such governance should incorporate stakeholder representatives. Stakeholder theory of CSR is related to the belief that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law or union contact (Cassel, 2001). Thus, stakeholder theory takes into account individuals or groups with a stake in the company including shareholders, employees, customers, supplier and local community.

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According to Kipkemoi (2010) the stakeholder concept provides a new way of thinking about strategic management. By paying attention to strategic management, executives can begin to put a corporation back on the road to success. However, it is also a normative theory which requires management to have a moral duty in order to protect the corporation as a whole and, connected with this aim, the legitimate interests of all stakeholders (Friedman, 2010). Kamau, (2009) stated that management, especially top management, must look after the health of the corporation, which involves balancing the multiple claims of conflicting stakeholders. The term stakeholder was meant by Friedman (2010) to generalize the notion of stockholder as the only group to whom management need to be responsible. 'Stakeholder' can be taken in two senses. In a narrow sense, the term stockholder includes those groups who are vital to the survival and success of the corporation (Kweyu, 1993). In a wide sense, it includes any group or individual who can affect or is affected by the corporation (Abiodum, 2012).

Thus, stakeholders are identified by their interests in the affairs of the corporation and it is assumed that the interests of all stakeholders have intrinsic value (Aburime, 2008). The base legitimacy of the stakeholder theory is on two ethical principles; principle of corporate rights and principle of corporate effects (Awuor, 2010). Both principles take into account the Kant's dictum respect for persons. The former establishes that the corporation and its managers may not violate the legitimate rights of others to determine their future. The latter focused on the responsibility for consequences by stating that the corporation and its managers are responsible for the effects of their actions on others. There is the problem of solving conflicting interests between stakeholders. Several authors, accepting the basic stakeholder framework, have used different ethical theories to elaborate different approaches to the stakeholder theory, and specifically to solve conflicting stakeholder demands. It has been proposed, among others, the following theories: Feminist Ethics (Berhut, 2002), the Common Good Theory (Beck and Fuchs, 2004), the Integrative Social Contracts Theory (Ominde, 2006) and the Doctrine of the fair Contracts (Mutuku, 2004). Freeman accepted these pluralistic ethical approaches by presenting stakeholder model as a metaphor where different ethical theories find room.

Empirical Evidence

The study by Mutuku, (2004) investigated whether US commercial banks in aggregate were taking substantive steps at being socially responsible, if their socially responsible activities had changed since the financial crisis, and whether they were being rewarded for their actions. The study used publicly available data on CSR to analyze CSR strengths and CSR concerns. It found out that the largest banks consistently had higher CSR strengths and CSR concerns during the sample period. Further, this group saw a steep increase in CSR strengths and a steep drop in CSR concerns as the worst of the financial crisis passed. The study also found that more profitable banks, banks with higher capital ratios, and banks that charged lower fees on deposits had significantly higher CSR strengths. The researchers found out that banks with more females and minorities on the board of directors had significantly higher CSR strengths. Examining the relation between CSR and bank performance, the researchers realized that the largest banks appeared to be rewarded for being socially responsible as both size adjusted ROA and ROE were positively and significantly related to CSR scores. Thus, after the financial crisis, the biggest banks that had been accused of putting their own interests ahead of their customers and the financial system as a whole worked to repair their reputations by turning to more socially responsible activities. For these banks, the increased participation in socially responsible activities was related to improved financial performance.

Kipkemoi (2010) studied the relationship between CSR and financial performance using structural equation modeling. His findings were that; all respondents had knowledge of the term CSR, however, not all respondents used the term CSR and others such as "corporate citizenship" and "corporate responsibility and sustainability" were offered as alternatives. It was noted that some SMEs felt the word "Corporate" alienates small firms and implies CSR is more complicated than it is in reality, while some large firm respondents felt the word "Social" confined their CSR activities to those of a social nature. With regard to the management of CSR, all large firms interviewed had devoted persons or departments to CSR, while no SME had a separate CSR department, the management of CSR was assumed by senior management, in most cases the CEO. It was also noted that CSR was more formal, strategic and integrated into all aspects of the business in large firms than in SMEs. While definitions of CSR differed from firm to firm, Lorraine (2009) realized that a commonality among them was that CSR was generally defined by reference to stakeholder theory in that a firm was socially responsible if it took into account the interests and needs of its group of stakeholders. CSR activities are positively correlated with firm size.

Petrick and Quinn (2011) aimed at analyzing the effect exerted by CSR on short-term and long-term corporate financial performance of European companies listed in the Stoxx Europe 600 index and Stoxx Europe Sustainability index from 2007 to 2010. Results revealed that the implementation of a CSR strategy, the level of economic development of the country and firm size determine the ROE of the firm. The CSP variable is positively and significantly related to the ROE of companies. Thus, companies with more socially responsible activities improve the shareholders' return by realizing higher CFP. Thus, firms in more developed countries obtain significantly better financial performance than other companies situated in less developed countries. In contrast, there was a negative and significant relation between firm's volume of total assets and ROE which could be due to larger firms having a more complex organizational structure that is more formal and centralized than those of smaller firms. The results for ROA showed that the estimators obtained using the different models also presented differences in terms of size and level of significance, as was the case for the ROE specification. The study found a positive and significant relationship between the ROA variable and CSP and the classification of the country in which the company's headquarters were situated, while the relationship between ROA and firm size was negatively significant. The results showed a positive and significant relationship between CSR, CSP and the level of development of the country where their headquarters were located.

Ominde, (2006), while studying economic perspectives on CSR, realized that individual preferences were the ultimate driving force behind any form of CSR. In the presence of social stakeholder preferences, firms may use strategic CSR to maximize profits, while not-for-profit may use CSR to satisfy shareholders' social ambitions. Only if managers take CSR beyond strategic levels or shareholder preferences does CSR

constitute moral hazard. The study revealed that when people make donations or privately provide public goods, such as charity, there may be many factors influencing their decision other than altruism. Social pressure, guilt, sympathy or simply a desire for a "warm glow" may all be important. Within this framework two opposing perspectives on CSR can be taken. First, CSR may constitute a special form of investment into innovation that may result in negative costs (net benefits) over time. Secondly, shareholder value maximization in general, as well as profit maximization in particular, can motivate CSR. Stakeholders may be endowed with respective social, environmental or ethical preferences. CSR treats the existence of social or environmental preferences as exogenously given and focuses on the interactions between firms and stakeholders. The study considered such impure altruism formally and developed a wide set of implications. In particular, the study discussed the invariance proposition of public goods, the sufficient conditions for neutrality to hold, the optimal tax treatment of charitable giving and calibrates the model based on econometric studies in order to consider policy experiments.

Cassel, (2001), while carrying out a meta-analysis of the results from 167 studies, found that 27% of the analyses showed a positive relationship, 58% showed a non-significant relationship, and 2% showed a negative relationship between CSR and CFP. Building up on the view of CSR as a resource, the CSR-CFP relationship is influenced by both the company's social performance and institutional norms of CSR in the firm's industry. In support of the view that CSR is a valuable resource for firms, they found that CSR-related shareholder proposals that were adopted led to superior financial performance as compared to firms whose CSR-related shareholder proposals were rejected. The researchers realized that adopting the proposal led to an increase in ROA by 0.7% to 0.8%, and an increase in NPM by 1.1% to 1.2% in the two fiscal years following the adoption of CSR. They also found that the stock market reacted positively to the passage of close-call CSR proposals in the two-day event window following the announcement of the vote. A CSR proposal that passed yielded a positive cumulative abnormal return of 1.9% compared to a proposal that failed.

A study by Ngakwe, (2009) revealed that disclosure of the CSR activities by organizations was used as a measurement tool of performance in the sense that the investment in CSR activities was an indication of the level of resources available and more especially the value that the organization had ascribed to the beneficiaries of the programs. Though CSR was considered part of the operations of an organization, its impact on the organization's financial performance was slightly different from that of other functions such as production, finance, selling and distribution. Therefore, if it would not be possible to establish a clear relationship between CSR and corporate performance, the social and environmental responsibility of the organization was likely to remain at the level of empty mission statements and isolated add-on activities which in turn would affect the performance of the organization. The study revealed that CSR practices were aligned with the strategic intent and that generally the CSR programs met the expectations of employees, investors and local communities.

Odhiambo, (2006) investigated the relationship between CSR and market share of supermarkets in Kisumu City for the period 2006 to 2010. He sought to determine the factors that motivated the practice of CSR amongst supermarkets in Kisumu City. The findings revealed that there was a strong relationship between CSR and market share. Institutions that had invested more on CSR had high sales revenue. The researcher also realized that there was a positive correlation coefficient between market share index and CSR. Larger supermarkets preferred education, water and sanitation while the other supermarkets preferred to support to the less fortunate in society as their CSR activities.

Ponu and Okoth, (2013) tested the relationship between investment in CSR and sustained growth of commercial banks in Nairobi County. The researchers sought to establish the relationship between banks sustained growth and CSR. The findings revealed an increasing positive attitude towards CSR in terms of investment. There was a general agreement that CSR was essential for the success of the firm. Since commercial institutions work to generate profits by offering the best services to customers, they would provide proper care to retain its customers. The researchers found out that investment in CSR activities had a positive effect on a banks' sustained growth. The findings indicate that there was a weak positive relationship between the variables and that only 11% of bank sustained growth could be explained by investing in CSR activities.

A survey by Anyona, (2004) on CSR practice by Kenyan companies sought to identify social responsibility practices by firms listed in the NSE and the factors that explain the kind of CSR practices adopted by these firms. The study found out that all the companies practiced long term planning and had strategies or social responsibility in place. It was observed that majority of these firms focused on health and education in their practice and were responsible to their employees by offering them medical, housing and pension schemes. It was also observed that water conservation and management was poorly addressed with most of the respondents focusing on internal implications or their activities rather than the water situation as a whole on factors that drive companies to adopt CSR. The recognition of CSR as a core value was the most cited explanation. Other factors include: giving back to the community as a way of meeting government requirement on degradation and as a medium of advertisement.

Okoth (2012) found out that CSR was good for the financial performance of large and medium size banks and had no effect on the ROA of small banks. The researcher realized that CSR had a positive and significant effect on ROA and ROE for all commercial banks when aggregated. However, when classified on the basis of market size, the study revealed that CSR improved financial performance of large and medium size banks while the effect on ROA of small banks was insignificant. This study concluded that CSR had a positive effect on financial performance of large and medium size banks and no significant effect on the financial performance of small banks. The researcher concluded that it was not in the interest of shareholders for small banks to engage in CSR activities as doing so could only drain their wealth without any return.

Abiodun (2012) carried out a study to determine the effect of CSR on firms‟ profitability in Nigeria. In this study, secondary data was collected from ten profitable firms randomly selected on the Nigeria Stock Exchange. Using regression analysis, the study found a negative relationship between firms‟ CSR performance measure with profit after tax and investment in CSR.

Christensen and Overdorf, (2000) carried out a study to determine the relationship between CSR, firm policies and

performance in US. The study used a sample of 3,268 companies using KLD data. Using regression analysis, they found a positive relationship between CSR and firm's investment policies, organizational strategy and performance.

Ngwakwe (2009) carried out a study to determine the relationship between environmental responsibility and firm performance in Nigeria. He used a sample of 60 manufacturing companies. Using regression analysis, he found that sustainable practices of the „responsible" firms are significantly related with firm performance.

Hasan et al (2011) carried out a study to determine CSR and financial performance linkage in Bangladesh. In this study, financial performance of 5 socially responsible banks was compared with the financial performance of 12 none socially responsible banks. The study found that socially responsible banks had a better financial performance though the difference was not statistically significant.

Tsoutsoura (2004) carried out a study to determine the relationship between CSR and financial performance in California using a sample of 422 firms and collected data covering a period of 5 years. He found a positive and significant relationship between CSR and financial performance. Locally, many studies that have been carried out on CSR do not necessarily relate it to financial performance of firms. However, most studies tend to show that CSR is used as a strategic tool towards enhancing financial performance of firms.

Studies by Ponnu and Okoth (2009) to determine the corporate social responsibility disclosure in Kenya using a sample of all the 54 listed companies at the NSE found preliminary evidence of the possibility that CSR disclosures in Kenya represent attempts by companies to improve their corporate image and to be seen as responsible corporate citizens.

Kipkemoi (2010) carried out a study to determine the relationship between CSR and financial performance at the NSE using a sample of 36 firms listed at the NSE. Using regression analysis, he found that there was a significant positive relationship between CSR and ROA and a significant negative relationship between CSR and GIS. The study also found no significant relationship between CSR and ROE .In the commercial sector, the study yielded a significant positive relationship between CSR and ROA and a negative relationship with both ROE and GIS. In this study, CRS index of each firm was obtained by scoring each dimension of CSR. This study however cannot be argued to provide conclusive knowledge on the relationship between CSR and financial performance of commercial banks considering that it only sampled listed banks and therefore the sample used was not an adequate representation of commercial banks in Kenya.
A study by Anyona (2005) CSR and performance of commercial banks in Kenya, majority of respondents agreed that CSR is in the long term interest of firms. Interestingly, majority disagreed that business can forgore profitability for social good. This implies that firms would not engage in social responsibility if its involvement increase costs by more than increase in revenue. Somehow, this reaction of respondents emphasizes the view of instrumental theories that CSR is in fact used by firms as a means to profits. In this study, a census survey on all the 30 banking institutions was conducted. The attitude of respondents was captured on a five-point likert scale interpreted as; strongly agree, Agree, Disagree and don't know.

Mutuku (2004) in a study to determine the relationship between CSR and financial performance of publicly quoted companies listed in Kenya carried out a census survey on all the 32 companies listed at the NSE. The firms were grouped as low, medium and high CSR performers based on their CSR score. Using regression analysis, he found that there was no relationship between CSR and financial performance for all the companies listed at the Nairobi stock exchange. One clear limitation of this study however is the methodology used. The study only measured CSR index for the year 2004 and ignored CSR scores for the previous years. It is possible that the economic condition was not favorable and firms registered poor financial results despite their involvement in CSR activities.

A study by Ominde (2004) to determine the link between corporate CSR and Corporate Strategy among firms listed at the NSE found that firms incorporate CSR in all their corporate strategies. In this study, census survey design was used. Respondents were asked to indicate the extent to which their firms incorporated the stated CSR activities in the various corporate strategies listed. Descriptive statistics was used to determine the proportion of linkage between CSR and corporate strategy. This study however does not show the effect that this linkage had on the financial performance of these companies.

In a study to determine the factors influencing the practice of CSR of financial institutions in Kenya, Auka (2006) collected data from all the 48 banking institutions listed at the NSE. Using descriptive statistics to analyze the data, he found that corporate image was the main factor that influenced the practice of CSR among financial institutions. It is much more likely that a firm would be interested in building its image so as to expand its customer base and grow its revenues and profits. There is therefore need to determine whether the corporate image built out of CSR activities effect on the profits of commercial banks.

Odhiambo (2006) carried out a study on CSR as a strategic tool for stakeholder management in large scale enterprises in Kenya. In this study, a sample of 103 large scale enterprises was drawn using systematic stratified sampling method. A standard questionnaire was used to collect data and descriptive statistics used to analyze the data. The study found that CSR is perceived to have a huge positive effect on the publicity of the organization.

Kweyu (1993) carried out a study to determine managerial attitude toward business Social responsibility using the case of bank managers in Nairobi. Using a sample of ten banks randomly sampled, and with the help of a questionnaire, data was collected from all managers in the ten sampled banks. The study found that 76% of managers agreed that it is in the long run interest of business to get directly involved in social issues. 67% of managers agreed that a business that wishes to capture favorable public image will have to show that it is socially responsible.

Discussion

Empirical literature argues that firms can improve their financial performance by engaging in socially responsible behaviour. Studies by Abiodun (2012) found a negative relationship between CSR and profits after tax for firms listed at the stock exchange in Nigeria. Ngwakwe (2009) found a positive relationship between CSR and financial performance. Locally, most studies focused on the strategic aspects of CSR. Ponnu and Okoth (2009) found preliminary evidence that firms engage in CSR activities to improve their corporate

image from which they expect to grow their sales and profits. Similar findings were obtained in the banking sector by Auka (2006), Anyona (2005), Ominde (2004) Odhiambo (2006) and Kweyu (1993). Despite the vast empirical evidence that firms use CSR as a strategic tool to grow their financial performance, there is not much research that has been done to establish the effect of CSR on financial performance in the banking sector. Mutuku (2004) found no relationship between CSR and financial performance of firms listed at the NSE. Kipkemoi (2004) found a positive relationship between CSR and ROA and a significant negative relationship between CSR and GIS. Clearly, studies by Mutuku and Kipkemoi are not only few, but also yielded mixed and contradictory results. One fundamental limitation of these studies is that they used listed companies.

Conclusion

Studies that have been conducted are based on the belief that a responsible institution is rewarded for its good reputation and have failed to arrive at the same conclusion. Some of these studies show a positive correlation, others a negative correlation while others have shown no correlation at all. A closer examination of these studies reveals variations on data sources, measures used on both dependent and independent variables and control variables. The researchers have not been conclusive as to what is the relationship between corporate social responsibility and financial performance.

The aforementioned empirical studies have demonstrated that there is a link between CSR and financial performance. Most of the early studies attempting to identify the relationship between CSR and financial performance have focused on subjective techniques to measure CSR. These studies have not, however, demonstrated how a firm's financial performance would be affected by investing in CSR activities. The studies have not explained the motive for commercial institutions to aggressively invest in CSR activities despite the fact that there is no requirement for them to do so. This constitutes a research gap which this study is seeking to breach.

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