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

Management Arts

Elixir Mgmt. Arts 98 (2016) 42667-42671

ISSN: 2229-712X

The Role of Corporate Social Responsibility on Firms Financial Performance in Pakistan

Rida Waheed[1,*], Yulan Lv[1,*], Suleman Sarwar[1] and Haisam Sarwar[2]

[1]School of Economics, Shandong University, Jinan. PR China.

[2]University of Engineering and Technology, Lahore. Pakistan.

ARTICLE INFO

Article history:

Received: 21 July 2016;

Received in revised form: 11 September 2016;

Accepted: 21 September 2016;

Keywords

Corporate social responsibility,
Financial performance,
Pakistan.

ABSTRACT

The paper investigates the impact of corporate social responsibility on firms' financial performances in Pakistan. The data of 50 companies listed in Karachi stock exchange are used over the time 2005-2013. Return on equity, and return on asset is used as a proxy of company's financial performance. Whereas, community performance, environment management system and employee relations are taken as a proxy of corporate social responsibility. The data is collected from the annual financial statements published by the companies. The community performance, environment management system and employee relations confirm significant positive relationship with return on equity. The community performance confirms a significant positive relationship with return on asset; environment management system proves significant positive; on contrary, employee relation is insignificant and has no role in firms' financial performances. The results conclude the significant role of corporate social responsibility on the firms' financial performance in developing countries.

1. Introduction

Since the industrial revolution, the environmental has damaged continuously through the industrial wastes. Previously, the Government has presumed the sole responsibility for environmental protection and management. In 1987, the Brundtland Report attempted to focus the intention of business toward the environmental protection. As a result, companies realized their responsibility and performed their roles to make the environmental cleaning, and government also formed strict rules and regulation for the corporations to eliminate waste and emission. In case of emerging economies, the access to internet and media the companies role to protect the environment can be judged easily and such accessibility to companies force the companies to take CSR as a requirement instead of luxury. Dynamic impact of corporations in business administration is socially playing a very significant role in the markets (Fiori *et al.* 2007).

The performance of business organizations is based on the strategies they plan and the operations conducted by them in both the market and non-market environments. Hence, the extent to which company directors and managers must consider social and environmental factors in making their decisions is debatable. Moreover, Corporate Social Responsibility (CSR) is considered as an approach to make decisions which cover both social and environmental factors. Therefore it can be clearly assessed that CSR is a deliberate insertion of public interest into corporate decision controlling, thus honoring a triple bottom line which are People, Planet and Profit (Harpreet, 2009). CSR can be discussed in a variety of ways. Majority of these definitions assimilate the three elements: social, economic and environmental aspects, they together are known as the triple bottom line.

The triple bottom line clearly shows that the companies cannot follow a single objective; i.e. profitability, but they also need to consider the other factors also; such as, the objectives of adding social and environmental value to society (Mirfazli, 2008). Helg (2007) also describes CSR as certain concepts or a set of standards which are supported by a company that can help it to makes it stabilize its position in a society or in other words to create a crunch in the society. The practice of CSR can be observed when we look at the gas and oil multinationals. CSR helps them to rectify the effects of their extraction activities on the community that is living nearby. The companies initiate activities such as pipe-borne waters, schools and hospitals; but such kind of activities are not carried on for a long period of time (Amaeshi *et al.* 2006).

A wide range of definitions will also be viewed in the literature that will specify their role in the business community and in the society and the impact they have on social standards. Both accounting and market definitions have been used to study the relationship between corporate social responsibility and firm performance (Orlitzky *et al.* 2003). Researchers and scholars believe that cooperate social relationship among the community and the companies needs to be strengthen otherwise, it can have serious effects as it can create or destroy the shareholders' wealth and can also hamper his performance. Its performance in the terms of accounting also depends on CSR. The CSR activities help the companies to hold a firm position (Margolis & Walsh 2001).

The idea of CSR is different in the developed countries as compared to Pakistan. Here, developments were initiated actually by semi-government companies and international NGOs, whereas the concept of CSR in the west had developed in 1950's which contained the same aspects as contained recently in Pakistan.

Tele: +86 15634130973
E-mail address: Ridawaheed.sdu@gmail.com

NEEDS (National Economic Empowerment and Development Strategy) set the role of private sector stating that it needs to create productive jobs and enhancing productivity will help in improving the quality of life. In other words, corporate social responsibility can bring a change in the social development of the country, investing both in the corporate and social sector. A glance over the performance of companies that follow the CSR proves an improvement of relationship with investors and gain the employees loyalties. Limited research is to be found on CSR and financial performance of multinationals and foreign governments working in Pakistan.

This paper will let us know about the companies that are working there and what part do they play in the financial performance of Pakistan and to what extent are they useful in helping the community of Pakistan. The factual information will analyze and specify the performance of the companies listed at present. The work done through corporate social relationship and the performance of the companies in the social and economic sector is of great interest and will be covered in the paper. It will also display the data used to gather the factual information and the interpretation of results. The final section of the paper will brief the policy adopted for CSR in the light of the findings and observations.

2. Literature Review

The concept of Corporate Social Responsibility (CSR) actually originated in 1950, in the west with the writing of Bower, who wrote on "The Social Responsibilities of a Businessman (Carroll 1999). Apart from Bower, many other theories have also been formulated to understand the dominance of CSR. This literature is based on three principles strands; the positive relation of CSR, the weak relationship between the financial performance and CSR and lastly on the presence of the negative element between CSR and the financial outcome of results. Ullmann (1985) suggested that there is not enough facts presents, therefore no proper or solid connection between economic results and social information and performance. It can be predicted that the main reason for this is that the theory is thought to be inadequate and only very few studies have proved it to be or claimed it to belong to the three-dimensional theory. Some of the theories highlight the corporate social relationship and performance as a negative one. It might be possible that it has advantages and benefits but they are for a shorter period of time and do not lasts longer. Great returns as a result of the relationship between the two almost seem impossible so they share more of a negative relationship than a positive one. (Aupperle *et al.*1985). Another study investigates the relationship between some of the measures of corporate social performance (CSP) and financial performance in terms of a long-term relationship, by using accounting measures of profitability (Cochran & Wood 1984; Aupperle *et al*. 1985; Waddock *et al*. 1997). The results we get are mixed when the relationship between the two is measured intensively.

The notion presented by the second group of theorists is that there is no relationship between corporate social responsibility and corporate financial performance, at all. (McWilliams & Siegel 2000; Ullmann 1985; Aupperle *et al*. 1985; Waddock *et al.* 1997). Waddock *et al.* (1997) also suggested that the relationship shared is neutral between CSR and the corporate financial performance because many are coincidental connections. Findings have proved that the investment on the basis of CSR is productive in terms of certain images and overall financial results.

Many positive benefits exist; in fact, they are more than the cost that is invested. (Soloman & Hansen 1985; Pava & Krausz 1996; Preston & O'Bannon 1997; Griffin & Mahon 1997) claimed that the return of Corporate Social Responsibility is more than its investment and thus providing the companies with a handsome amount as the financial outcome. The benefits it provides are more than expected and it helps to build a good image. Literature unveils that many positive results are linked to CSR and its response is near to the stakeholders' requirements. Clarkson (1995) and Waddock and Graves (1997) reported that the shareholders, employees, suppliers, community and environment show satisfying results and since the companies are held accountable, the effect is positive on the firms. Positive reputations are experienced interlinked with positive financial returns that show the positive impact of CSR, Robert and Dowling (2002); Fombrun *et al*. (2000). Roberts & Dowling (2002); Fombrun *et al*. (2000); Porter & Van Der Linde (1995) and Spicer (1978), believed that the CSR can play a positive role in the development of a society, it can bring advantages and earn reputation. The organizations' financial performance is linked with new market opportunities and reaction of capital market.

This analysis made show the measurements of abnormal terms in the short time span (Wright & Ferris 1997), where as if we look into the benefits we can gain in the long term, we will come across a negative relationship between the CSR and the market profits. The profits are very few which generates an idea that the relationship shared is rather negative than positive as there are several drawbacks that are linked together promoting the notion that it is an inversely portioned relationship .We can use the event study methodology to make out what can be the result of the relationship between CSR and the financial performance in terms of short-run financial impact (abnormal returns) when companies are involved in either socially responsible or irresponsible acts (Wright *et al.* 1997; Posnikoff 1997; McWilliams *et al.* (1997). Hypothesis made with respect to the observational facts show the relationship of CSR and the financial performance as negative or near to negative. Preston *et al.* (1997) concluded that manager can lower down investments which will affect the profits in the short term or their personal compensation. (Barnea & Rubin 2006) Waddock *et al.* (1997) suggested that responsible companies have a competitive drawback since they have unnecessary cost and so they will be lessen the profit shared by the shareholders assumed that companies with responsible behavior may have a competitive disadvantage, since they have unnecessary costs.

Researchers have mostly used market measures (Alexander & Buchholz 1978; Vance 1975), others have used accounting measures (Waddock *et al*. 1997; Cochran *et al.* 1984) and some have adopted both of these (McGuire *et al*. 1988). Both of these two measures represent different point of views of in evaluating a firm's financial performance, having theoretical implications that vary (Hillman & Keim 2001) and they are noted to be biased (McGuire *et al.* 1988).Using various measures, makes the result complex especially when we need to compare different results. (Tsoutsoura, 2004, Brammer *et al*. 2006; Fiori *et al.* 2007), adopted the study that reported the three measures of social performance, (health and safety, training and development, equal opportunsities policies, equal opportunity systems, employee relations, systems for job creation and job security) and environmental performance (policies, management systems, and reporting)and the social measures. Margolis *et al*. (2001)

concluded that 95 empirical studies between 1972-2001, which showed that if we treat CSR as an independent variable then the performance judged shows a fairly positive relationship . The measurements in financial performance in 42 studies came out to be 53%, no relationship was found in 19 studies and the percentage recorded was 24%, a negative relationship in 4 studies with a percentage 5% was recorded, and a mixed relationship was found in 15 studies, showing a percentage of19%.

Kanwal, Khanam, Nasreen and Hameed (2013) also try to find relationship between firm performance and CSR in different KSE listed companies of Pakistan and found a positive correlation between these two variables. They suggest that CSR activities give dual benefits to the firm. At one end they enhance a positive image in the minds of their stakeholders on the other hand improve their financial position. Javed, Saeed, Lodhi and Malik (2013) used Caroll model of CSR on KSE-30 index companies of Pakistan and suggested that there is a positive relationship between firms, financial performance, economic and legal responsibilities and negative relationship in the case of ethical and discretionary responsibilities. They also concluded that CSR by corporate sector provides a healthy environment in country and promotes a culture in which laws are abided willingly. Bashir, Hassan and Cheema (2012) concluded that CSR activities of an organization have positive impact on employee's satisfactions which in results increase the productivity and profitability. Khanifar, Nazari, Emami and Soltaniet al. (2012) worked in restaurants and airline industry and found a mixed relationship between CSR activities and financial performance. Ehsan, Kaleem and Jabeen (2012) suggested that there is a two way relationship between firm CSR activities and its financial performance. They worked on panel data and run random effect model, there results suggests a positive relationship between these two variables. Nazir, Iftikhar and Aiza (2010) worked on tobacco industry of Pakistan and Suggest that CSR concept is very new in Pakistani context so very little has been found in this regard in the tobacco industry. They found two companies in this sector, namely-Pakistan Tobacco Company and Lakson tobacco Pakistan, as tobacco in its self is very dangerous for the health but still these companies are playing their part in different CSR activities in order to create goodwill in the minds of their customers.

If we will assess the relationship generally keeping all the evidences as a record, we will see that is a mixed one. It is not an easy job to measure the measurements of CSR as a little consensus is present as to which instrument can be applied to judge. In most of the cases, the indicators used are subjective rather than objective. Similarly the consensus about the use of the measuring instrument for financial performance is little and therefore it makes the measurement difficult to record.

3. Data and Methodology

The study consists the sample of 50 listed companies of Karachi stock exchange, Pakistan by using the time period 2005 to 2013. For the data collection purpose, the study uses annual reports published by the listed companies. The dataset of financial companies are excluded from the sample because they do not directly impact the environment. Return on equity (ROE) and return on asset (ROA) is used as a proxy of company's financial performance. Whereas, community performance (CP), environment management system (EMS) and employee relations (ER) are taken as a proxy of corporate social responsibility. The studied equations are as follows:

$$ROE_{it} = \beta_0 + \beta_1 CP_{it} + \beta_2 EMS_{it} + \beta_3 ER_{it} + \varepsilon_{it} \quad (1)$$

$$ROA_{it} = \beta_0 + \beta_1 CP_{it} + \beta_2 EMS_{it} + \beta_3 ER_{it} + \varepsilon_{it} \quad (2)$$

4. Data Analysis and Presentation of Results

This section of the study presents results of the analysis performed on the data collected to test the propositions made in the study and answer the questions of the research. A Pearson correlation analysis was used to find a significant relationship between CSR and financial performance. Table 1 shows the results of correlation; ROE is significantly correlated with community performance (CP), environmental management system (EMS) and employees' relationship (ER). The finding of ROE confirms a significant positive relationship between CSR and financial performance. Table 1 also presents the Pearson correlation results for ROA, which confirms CSR is significantly correlate with firms' financial performance in Pakistan.

Table 1. Pearson correlation

	ROE	**CP**	**EMS**	**ER**
ROE	1	0.491*	0.225*	0.351*
CP		1	0.389	0.275
EMS			1	0.118
ER				1
	ROA	**CP**	**EMS**	**ER**
ROA	1	0.172*	0.263*	0.092
CP		1	0.562	0.153
EMS			1	0.328
ER				1

Table 2 shows the results of summary of regression model for return on equity (ROE). The value of R indicates the correlation between corporate social responsibility (CSR) and the firms performance variables, while, R2 represents the explanatory power of the CSR variables. The values of R and R-Sq are 0.416 and 0.274, respectively, which signify the 27.4% variation in firms financial performance is due to the corporate social responsibility. The R-sq value also indicates that remaining 72.6% variation in firms' financial performance is unexplained by the given model. Andy (2000) explained that a good model should contain high F-ratio, the F-ratio is 6.482 that confirm the validity of given model; ROE is significantly affected by the CSR variables. The community performance (CP) confirms a significant positive relationship with return on equity (ROE) coefficient 0.385; environment management system (EMS) proves significant positive with coefficient 0.183; employee relations (ER) also verifies significant positive relationship with ROE.

Table 2. Regression analysis return on equity (ROE).

Model Summary				
R	0.416		*R-Sq*	0.274
Adj R-Sq	0.219		*S.E*	3.193
Summary of ANOVA				
	Sum of Squares	***mean square***	***f***	***sig***
Regression	92.453	42.591	6.482	0.001
Residual	241.849	4.986		
Total	334.302			
Regression				
	Cofficient	***p-value***		
CP	0.385	0.001		
EMS	0.183	0.000		
ER	0.416	0.000		
Const	-0.152	0.364		

Table 3 displays the results of model summery, ANOVA and regression estimation for ROA model. The R value is 0.349 and R-Sq is 0.318, the R-Sq depicts the power of CSR variables that is 31.8%; the firm financial performance (FP) varies 31.8% due to the change in corporate social responsibility (CSR) variables, while the remaining 69.2% variation in firms' financial performance (FP) is unexplained in the given model of ROA. The F-statistics of ROA model is 4.189; this indicates the fitness of the model and proves the role of at least one CSR variable in firms' performances. The community performance (CP) confirms a significant positive relationship with return on asset (ROA) with coefficient 0.284; environment management system (EMS) proves significant positive with coefficient 0.263. On contrary, employee relation (ER) is insignificant and has no role in firms financial performances

Table 3. Regression analysis return on asset (ROA).

Model Summary				
R	0.349		R-Sq	0.318
Adj R-Sq	0.173		S.E	2.752
Summary of ANOVA				
	Sum of Squares	**mean square**	**f**	**sig**
Regression	89.652	39.437	4.189	0.000
Residual	201.039	3.581		
Total	290.691			
Regression				
	Cofficient	**p-value**		
CP	0.284	0.000		
EMS	0.263	0.004		
ER	0.142	0.271		
Const	-0.382	0.364		

5. Conclusion

The purpose of this study was to investigate the factors involved which promote corporate social responsibility in the society and the contribution of Pakistani listed companies in Karachi stock exchange. Return on equity (ROE) and return on asset (ROA) are used as a proxy of firms' financial performance while community performance (CP), environment management system (EMS) and employee relations (ER) are taken as a proxy of corporate social responsibility. The study analyzes the data of fifty listed companies and the data of studied variables are collected from the firm's financial reports over the period 2005-2013.

The community performance (CP), environment management system (EMS) and employee relations (ER) confirm significant positive relationship with ROE. The community performance (CP) confirms a significant positive relationship with return on asset (ROA) with coefficient 0.284; environment management system (EMS) proves significant positive; on contrary, employee relation (ER) is insignificant and has no role in firms' financial performances These variables confirm the relationship between CSR and the financial performance in developing countries.

Accumulating different observational facts, we came across the result that companies should invest in corporate social responsibility (CSR) activities, which help to raise the living standards of the community; additionally, it improves the firms' financial position. It also boosts up the image of the companies and helps them to boost the sales and earn a good revenue and reputation. Therefore, corporate social responsibility is now an investment instead of expenditure. It also contributes in making the society of Pakistan a better living place. It is therefore justified that corporate social responsibility in Pakistan plays a significant part in getting increased returns and unlike the west; it has a positive impact of CSR in the society.

References

Alexander, G. J. & Buchholz, R.A. (1978), "Corporate social performance and stock market performance", Academy of Management Journal 21(3), 479–486.

Amaeshi, K.. Adi, B. Ogbechie, C. & Amao, O. (2006), "Corporate Social Responsibility in Nigeria: Western Mimicry or Indigenous Influences?" No. 39-2006, ICCSR Research Paper Series – ISSN 1479-5124, The University of Nottingham, pp. 1- 44.

Andy, F. (2000): Discovering Statistics: using SPSS for Windows, London: Sage Publication.

Aupperle, K. E. Caroll, A.B. & Hatfield, J. B. (1985), "An empirical examination of the relationship between corporate social responsibility and profitability", Academy of Management Journal 28(2), 446- 463.

Barnea, A. & Rubin, A. (2006), "Corporate social responsibility as a conflict between shareholders",Working paper, University of Texas.

Bashir Rizwana, Hassan Atif and Cheema Farooq-e-Azam (2012) Impact of corporate social responsibility activities over the employees of the organizations: an exploratory study journal of management and social sciences Vol. 8, no. 2,12.

Brammer, S. Brooks, C. & Pavelin, S. (2006), "Corporate social performance and stocks returns: UK evidence from disaggregate measures", Financial Management 35(3), 97-116.

Carroll A. B. (1999), "A Corporate Social Responsibility: Evolution of a Definitional Construct", Business and Society 38(3), 268-295.

Clarkson, M.B. (1995), "A stakeholder framework for analyzing and evaluating corporate social Performance", Academy of Management Review 20(1), 92-117.

Cochran, P.L. & Wood, R.A. (1984), "Corporate social responsibility and financial performance, Academy of Management Journal 27(1), 42-56.

Ehsan, S., Kaleem, A., & Jabeen, S. (2012). Exploring the interaction between Financial Performance and Corporate Social Responsibility in Pakistani Firms. J. Basic. Appl. Sci., Vol 2(10), 10431-10439.

Fiori, G. Donato, F. & Izzo, M. F. (2007), "Corporate Social Responsibility and Firms Performance. An Analysis on Italian Listed Companies", http://ssrn.com/abstract=1032851 [accessed 26 June 2010].

Fombrun, C. J. Gardberg, N. A. & Barnett M. L. (2000), "Opportunity platforms and safety nets: corporate citizenship and reputational risk", Business and Society Review 105(1), 85–106.

Griffin, J. J. & Mahon J. F. (1997), "The corporate social performance and corporate financial performance debate: twenty-five years of incomparable research", Business and Society 36(1), 5–31.

Harpreet, S.B. (2009), "Financial Performance and Social Responsibility: Indian Scenerio", http://ssrn.com/abstract=1496291 [accessed 20 July 2010].

Helg, S. (2007), "Corporate Social Responsibility from a Nigerian perspective", Masters Thesis No 591013, Handelshogsklan Vid Doteborgs Universitet, pp. 1-101.

Hillman, A. J. & Keim, G. D. (2001), "Shareholder value, stakeholder management, and social issues: What's the bottom line?", Strategic Management Journal 22(2), 125-139.

Javed Muzhar, Saeed Rashid, Lodhi Rab Nawaz, Malik Qamar Uz Zaman (2013) The Relationship between Corporate Social Responsibility and Firm Financial Performance: A Case of Pakistan. Journal of Basic and Applied. 3(11)34-45.

Kanwal Munaza, Khanam Farida, Nasreen Shagufta and Hameed Shahid (2013). Impact of corporate social responsibility on the firm's financial performance. IOSR Journal of Business and Management. Vol:14, Issue 5 pp.67-74

Khanifar Hossein ,Nazari Kamran, Emami Mostafa and Soltani Hossein Ali (2012), Impacts corporate social responsibility activities on company financial performance Interdisciplinary Journal of Contemporary Research in Business. Vol 3, no 9.

Margolis, J. D. & Walsh, J. P. (2001), "People and profits? The search for a link between a company's social and financial performance", Mahwah, N J: Lawrence Erlbaum Associates.

McGuire, J. Sundgren, A. & Schneeweis, T. (1988), "Corporate social responsibility and firm financial Performance", The Academy of Management Journal 31(4), 854-72.

McWilliams, A. & Siegel, D. (2000), "Corporate social responsibility and financial performance: Correlation or misspecification?" Strategic Management Journal 21(5), 603–609.

Mirfazli, E. (2008), "Corporate social responsibility (CSR) information disclosure by annual reports of public companies listed at Indonesia Stock Exchange (IDX)", International Journal of Islamic and Middle Eastern Finance and Management 1(4), 275 – 284.

Nazir, Mian Sajid and Iftikhar, Mehnoor and Rana, Aiza ussain (2010). Reviewing Corporate Social Responsibility Initiatives of Tobacco Industry in Pakistan. Interdisciplinary Journal Of Contemporary Research In Business. 2(1). 105-117.

Orlitzky, M. Schmidt, F. L. & Rynes, S. L. (2003), "Corporate Social and Financial Performance: A Meta- Analysis", Organization Studies 24(3), 403–441.

Pava, L. & Krausz, J. (1996), "The association between corporate social responsibility and financial performance: The paradox for social cost", Journal of Business Ethics 15(3), 21-357.

Porter M.E. & Van Der Linde, C. (1995), "Green and Competitive. Ending the Stalemate", Harvard Business Review 73(5), 121-134.

Posnikoff, J. F. (1997), "Disinvestment from South Africa: They did well by doing good", Contemporary Economic Policy 15(1), 76-86.

Preston, L. E. & O'Bannon, D. P. (1997), "The corporate social-financial performance relationship: a typology and analysis", Business and Society 36(4), 419-429.

Roberts, P. & Dowling, G. (2002), "Corporate Reputation And Sustained Superior Financial Performance", Strategic Management Journal 23(12), 1077-1093.

Singh, M. & Davidson, W. N. (2003), "Agency Costs, Ownership Structure and Corporate Governance Mechanism", Journal of Banking and Finance 27(5), 793-816.

Soloman, R. & Hansen, K.. (1985), 'It' s Good Business', Atheneum, New York Spicer, B. H. (1978), "Investors, corporate social performance and information disclosure: An empirical study", Accounting Review 53, 94–110.

Tsoutoura, M. (2004), "Corporate Social Responsibility and Financial Performance", Working Paper Series, Center for Responsible Business, UC Berkeley.

Ullmann, A. (1985), "Data in search of a theory: a critical examination of the relationship among social performance, social disclosure, and economic performance of US firms", Academy of Management Review 10(3), 540–577.

Waddock, S. & Graves, S. (1997), "The Corporate Social Performance-Financial Performance Link", Strategic Management Journal 18(4), 303-319.

Wright, P. & Ferris, S. P. (1997), "Agency conflict and corporate strategy: The effect of divestment on corporate value", Strategic Management Journal 18(1), 77–83.

Vance, S. (1975), "Are socially responsible firms good investment risks?", Management Review 64, 18–24.