# AN EMPIRICAL STUDY OF CORPORATE SOCIAL RESPONSIBILITY AND CORPORATE FINANCIAL PERFORMANCE

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## INTRODUCTION

In the last decade, the trend of participating in Corporate Social Responsibility (CSR) initiatives has exploded, a vital aspect of today's corporate world. The concept of CSR has been debated for more than decades (Tilt, 2016). Primarily, business entities are concerned with profit-maximizing and their obligations towards shareholders and creditors. The business entities' goals are now to be broadened, and they must meet the demands of all stakeholders while conducting commercial operations, considering the social and environmental implications. Herein, the global upswing of interest in triple-bottom-line (Profit, Planet, and People) implications prompted the creation of the CSR framework.

CSR refers to how a company conducts itself to be economically viable, law-abiding, ethical, and socially beneficial (Carroll, 1983). Porter and Kramer (2006) asserted that CSR involves obtaining business triumph through acts that embrace ethical values and respect people, communities, and the natural environment. According to Carroll (1991), CSR encompasses four social commitments: economic, legal, ethical, and philanthropic responsibilities. Thus, CSR is a commonly acknowledged method for a corporation to achieve a balance or integration of economic, environmental, and social concerns while also meeting stakeholder expectations (Hewage et al., 2016)

Both society and business are interdependent, whereas job opportunities, goods and services, and taxes are provided by the business, while the society provides the employees, consumers, and policies. Because neither can thrive without the other, it makes more sense for businesses and society to collaborate for the common good rather than remain in conflict. For this to happen, business decisions and social policies must be in sync (Porter & Kramer, 2006). Herein, companies execute CSR differently depending on the firm size, industrialization-infused corporate culture, and stakeholder demands (Niresh & Silva, 2018). In the context of Sri Lanka, CSR is still regarded as philanthropic and charitable actions solely as CSR, and some companies view CSR as an investment. In contrast, others regard it as a waste of money (Hewage et al., 2016).

CSR is a primarily unregulated and voluntary endeavour focusing on the economic, environmental, and social implications of organizations' daily activities and the links between firm ideals and philanthropic engagement (Hollerer, 2012). As a result, it is puzzling why a company would want to report on its CSR efforts. Furthermore, the study difficulty has been aggravated by the intangibility and long-term nature of the advantages, as well as the problems in quantifying how the benefits outweigh the cost of such voluntary effort (Gallardo-Vazquez et al., 2019; Aslaksen et al., 2021). As a result, to better understand the issue mentioned above, the study investigates the link between CSR and corporate performance.

**LITERATURE REVIEW**

CSR is primarily a notion whereby firms opt freely to contribute to a better society and cleaner environment. Firms accomplish this predominantly voluntarily by incorporating social and environmental concerns into their business operations and interactions with their stakeholders (Commission of the European Communities, 2001). Furthermore, CSR meets not only legal requirements but also advances human capital, the environment, and stakeholder satisfaction (Commission of the European Communities, 2001). Carroll (1991) proposed a pyramid of CSR that "encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time" (Carroll, 1979, p. 500). Economic responsibility is the most fundamental, which underpins all other corporate obligations and requires enterprises to maintain economic stability. Then there is legal accountability, where corporations are required to follow regulations. Ethical duty refers to the rules, norms, or expectations in place to preserve stakeholders' moral rights. Philanthropy responsibility refers to firms' voluntary efforts in light of society's expectations as good corporate citizens (Baden, 2016).

Because of the qualitative nature of corporate responsibility and the difficulty of quantifying it properly, measuring it is difficult. CSR completeness has been measured in a variety of ways, including investment in CSR initiatives, donations to education, health, and welfare, environmental commitment, environmental, social, and governance ratings, employee participation in CSR projects, and the implementation of transparency rules (Bagh et al., 2017; Usman & Amran, 2015). Accordingly, the multidisciplinary nature of the approach and diverse behaviours displayed in measuring cooperate responsibility performance will provide a much clearer understanding of the multidimensional viewpoint.

This study subscribes to a multitudinal stakeholder approach, which underpins that CSR covers all activities of a firm that contribute to the wellbeing of society by supporting and safeguarding the interests of its many stakeholders who impact it (Parmar et al., 2010). As a result, the study looks at CSR to employees (salaries), CSR to shareholders (dividend per share), CSR to investors (Interest Coverage Ratio), CSR to customers (Cost Ratio), CSR to the government (Tax Expenses), and CSR to suppliers/ creditors (Assets/ Liability Ratio) as proxies for CSR environment (Iqbal et al., 2012; Tyagi et al., 2013; Khurshid et al., 2018).

On the other hand, financial performance is the financial results of the interplay between an organization's traits, activities, and environment (Combs et al., 2005). The extant studies that have focused on the relationship between CSR and performance revealed a favorable solid relationship between the two variables (Bagh et al., 2017; Weber, 2008; Saeidi et al., 2015); a negative relationship (Mentor, 2016; Usman & Amran, 2015); no relationship exists (Lee et al., 2013; Tyagi et al., 2013).

In essence, the literature depicts variant results between CSR and financial performance. Therefore, it is critical to comprehend the true financial impact of CSR initiatives and regulations.

## METHODOLOGY

The study is dedicated to the following quantitative secondary data analysis research design. Accordingly, after employing a judgmental sampling technique, the study chose ten companies from the Food, Beverage, and Tobacco Sector listed on the Colombo Stock Exchange (CSE), considering their market capitalization as of 31st March 2021 from a total of 47 companies. The study follows longitudinal analysis by collecting data for five years, from 2017 to 2021. Variables were measured by collecting secondary data from the annual reports filed with the CSE.

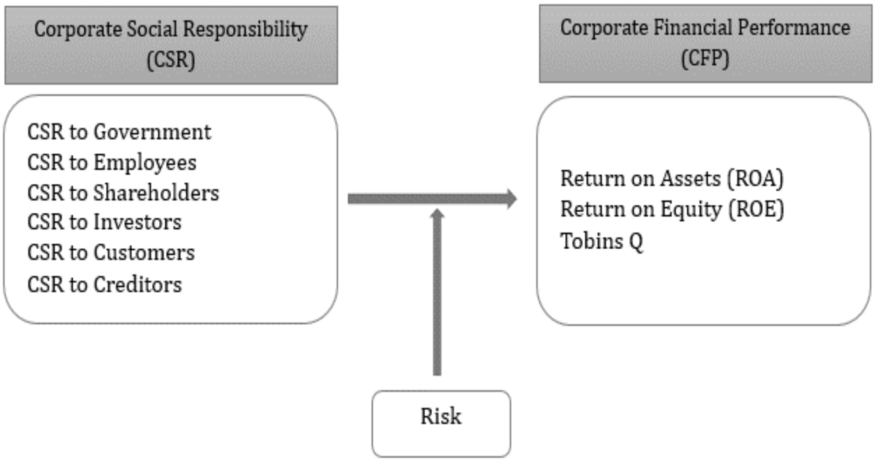


Figure 1 Conceptual Framework

The study model is presented in Figure 1, and the independent variable is determined as follows; Tax expenses serve as a proxy for CSR to the government (CSRG), which is then quantified by the income tax's share of operating income; Salaries serve as a proxy for CSR to Employees (CSRE), which is measured as the percentage of operating income that is distributed to staff in the form of wages and benefits; CSR to Investors (CSRI) is indicated by Interest Coverage ratio (ICR) and calculated by dividing the earnings before taxes expense and interest expense by the interest expense incurred by the company for the one year; CSR to Customers (CSRC) is indicated by Cost Rate (CR) and assessed by dividing the company's operational costs by the shareholder's equity or common stock. CSR to Creditors is calculated by dividing the company's total assets by its liabilities.The pooled most minor square regression analysis as the predictive modeling technique was used to investigate the relationship between the variables. The study used E-Views data analysis software to perform panel data regression to determine the causal link between the variables. Panel data analysis is a statistical method for analyzing two-dimensional data such as cross-sectional and time-series data frequently used in social science, epidemiology, and econometrics. The analysis is categorized as pooled panels, random effect models, and fixed-effect models. The study emphasized the econometric applicability of the fixed-effect and random-effect models. Then, performing the Hausman test, the study determined which model was appropriate for this analysis (Medyawati & Yunanto, 2017). To execute the regression analysis, the model must meet the basic requirements of regression analysis to be satisfied.

## DATA ANALYSIS

The following data processing stage included the classical assumption test as a prerequisite for using panel data regression. Based on the normality tests, it was possible to determine that the data met the normalcy assumption. The multicollinearity test came next. All variables had Variance Inflation Factor (VIF) greater than 0.10 and less than 10, avoiding concerns with multicollinearity issues in the regression model. The presence of heteroscedasticity is a serious concern in regression analysis and analysis of variance because it nullifies statistical tests of significance that presume all modeling mistakes have the same variance. The presence of heteroscedasticity was suspected if there were patterns on a scatterplot. Because there was no discernible pattern, points on the Y-axis were scattered above and below zero, and the analysis proved that there was no heteroscedasticity. The autocorrelation value for Durbin Watson (DW) was 1.437. The DW value should be between -2 and +2, indicating that there is no autocorrelation for satisfactory results.

Table 1 Diagnostic Test- Hausman Test

| | ROA | ROE | Tobin's Q |
|---|---|---|---|
| Probability | 0.0000** | 0.1750** | 0.0000** |
| Model | Fixed Effect Model | Random Effect Model | Fixed Effect Model |

The Hausman test determines which model is appropriate for the investigation. The following hypotheses were addressed in this test: $H_0$: Random effect model is appropriate for the analysis, and $H_1$: Fixed effect model. Accordingly, if the P-value is less than 0.05, the fixed-effect model is appropriate, and if P-value is more significant than 0.05, the random effect model is appropriate.

Table 2 Fixed and Random Effect Model

| | Fixed Effect Model: ROA | | | | Random Effect Model: ROE | | | | Fixed Effect Model: Tobin's Q | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Variable | Coefficient | Std. Error | t-Statistic | Prob | Coefficient | Std. Error | t-Statistic | Prob | Coefficient | Std. Error | t-Statistic | Prob |
| C | 1.8441 | 0.5140 | 3.6492 | 0.0009 | -0.1199 | 0.1634 | -0.8369 | 0.4019 | 1.9441 | 0.6140 | 3.7492 | 0.0029 |
| TAX | 1.6170 | 0.7045 | 2.3239 | 0.0270 | 0.0342 | 0.1697 | 0.1614 | 0.8804 | 1.7170 | 0.8045 | 2.4239 | 0.0390 |
| SAL | -0.0278 | 0.0404 | -1.2315 | 0.2232 | -0.0088 | 0.0186 | -2.1710 | 0.0348 | 0.0722 | 0.1404 | -1.1315 | 0.2252 |
| DPS | -0.0782 | 0.0353 | -3.4788 | 0.0014 | 0.0198 | 0.0161 | 1.6249 | 0.1138 | 0.0218 | 0.1353 | -3.3788 | 0.0034 |
| ICR | 0.0100 | 0.0100 | -3.9383 | 0.0004 | 0.0100 | 0.0100 | 3.7305 | 0.0006 | 0.1100 | 0.1100 | -3.8383 | 0.0024 |
| CR | 0.3978 | 0.4060 | 0.9893 | 0.3346 | 0.0967 | 0.1305 | 0.7300 | 0.4755 | 0.4978 | 0.5060 | 1.0893 | 0.3366 |
| ALR | -0.2912 | 0.1328 | -2.4429 | 0.0196 | 0.0640 | 0.0428 | 1.6570 | 0.1070 | -0.1912 | 0.2328 | -2.3429 | 0.0216 |
| DER | -0.8236 | 0.3158 | -2.7160 | 0.0102 | 0.1584 | 0.1037 | 1.5936 | 0.1208 | -0.7236 | 0.4158 | -2.6160 | 0.0122 |

According to the Panel regression analysis corporate social responsibilities (CSR) and ROA presented a significant positive relationship ($R^2 =0.885$, $f$= 0.000); Also corporate social responsibilities (CSR) and ROE presented a positive relationship ($R^2 =0.623$, $f$= 0.000); then, corporate social responsibilities (CSR) and Tobin's Q presented positive relationship ($R^2 =0.713$, $f$= 0.000). Furthermore, the relationships were measured by conspiring the impact of the controlling variable (risk).

## CONCLUSIONS AND IMPLICATIONS

The study considered CSR for a broad range of stakeholders as following CSR to employees (salaries), CSR to shareholders (dividend per share), CSR to investors (Interest Coverage Ratio), CSR to customers (Cost Ratio), CSR to the government (Tax Expenses), and CSR to suppliers/ creditors (Assets/ Liability Ratio) under a risk centered environment (Khurshid et al., 2017; Iqbal et al., 2014; Tyagi & Sharma, 2013). After that, a relational model between CSR and financial indicators is constructed to solve the long-standing puzzle of why corporations report on CSR due to its long-term nature and the intangibility of the benefits connected with such an effort. The study ascertained the positive relationship between CSR, ROA, ROE, and Tobin's Q. Therefore; the study findings are aligned with the studies of (Bagh et al., 2017; Weber, 2008; Saeidi et al., 2015). According to the findings of this study, firms can utilize CSR with stakeholders to improve manufacturing organizations' financial performance. More robust CSR policies foster a healthier environment, eliminating externalities and damaging stakeholders' interests/benefits. This study's findings significantly contribute to the body of knowledge and have important implications for policymakers and industrial sector governance.

***Keywords:*** Corporate social responsibility, financial performance, stakeholder perspective

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