MODERATING EFFECT OF BOARD CHARACTERISTICS ON THE RELATIONSHIP BETWEEN CORPORATE SOCIAL RESPONSIBILITY PRACTICES AND FINANCIAL PERFORMANCE: EVIDENCE FROM NON-FINANCIAL COMPANIES LISTED IN THE COLOMBO STOCK EXCHANGE

R. R. D. S. Divyanjali[1,*], K. G. P. Senani[2] and J. S. Kumari[3]

[1, 2, 3] *Department of Accountancy and Finance, Faculty of Management Studies, Rajarata University of Sri Lanka, Mihintale, Sri Lanka*

*Corresponding author (email: Shehara0315@gmail.com)

INTRODUCTION

Most companies provide financial information to their stakeholders as a legal requirement, and there is a high tendency to report non-financial information as financial information itself could not satisfy all the stakeholders' information requirements. Thus, Corporate Social Responsibility (CSR) has been recognized as a good concept for presenting non-financial information to Stakeholders (Khan et al., 2012). CSR means measuring corporate performance through non-financial data and metrics to communicate ethical, behavioral, and motivational drivers (GRI). According to the extant literature, they could not lead to a definitive conclusion about the relationship or impact of CSR and a firm's financial performance, and inconclusive and mixed findings were noted. Rossi et al. (2021) mentioned that CSR practices affect the firm's financial performance significantly and positively. Nag and Bhattacharyya (2016) presented an opposing view and confirmed that engaging in CSR practices may not significantly impact a firm's financial performance.

Furthermore, in the Sri Lankan context, it wasn't easy to find studies that examine the moderating effect of board characteristics on the relationship between CSR and a firm's financial performance. As a result, these research findings are pivotal for shareholders and investors to make future economic decisions, managers to upgrade organizational strategies, employees to maintain job satisfaction, and policymakers to formulate effective policies for the country and economy. Furthermore, the findings of this study will be helpful to students and researchers for academic purposes and future research. Thus, the main objective of this study is to examine the moderating effect of board characteristics on the relationship between CSR practices and a firm's financial performance of non-financial companies listed on Colombo Stock Exchange.

METHODOLOGY

Most companies provide financial information to their stakeholders as a legal requirement, and there is a high tendency to report non-financial information as financial information could not satisfy all the stakeholders' information requirements. Thus, Corporate Social Responsibility (CSR) has been recognized as a good concept for presenting non-financial information to Stakeholders (Khan et al., 2012). CSR means measuring corporate performance through non-financial data and metrics to communicate ethical, behavioral, and motivational drivers (GRI). According to the extant literature, they could not lead to a definitive conclusion about the relationship or impact of CSR and a firm's financial performance, and inconclusive and mixed findings were noted. Rossi et al. (2021) mentioned that CSR practices affect the firm's financial performance significantly and positively. Nag and Bhattacharyya (2016) presented an opposing view and confirmed that engaging in CSR practices may not significantly impact a firm's financial performance. Furthermore, in the Sri Lankan context, it was not easy to find studies that examine the moderating effect of board characteristics on the relationship between CSR and a firm's financial performance. As a result, these research findings are pivotal for shareholders and investors to make future economic decisions, managers to upgrade organizational strategies, employees to maintain job satisfaction, and policymakers to formulate effective policies for the country and economy. Furthermore, the findings of this study will be helpful to students and researchers for academic purposes and future research. Thus, the main objective of this study is to examine the moderating effect of board characteristics on the relationship between CSR practices and a firm's financial performance of non-financial companies listed on the Colombo Stock Exchange.

H_1: There is a significant relationship between CSR and ROA of non-financial firms listed in CSE.
H_2: There is a significant relationship between CSR and ROE of non-financial firms listed in CSE.
H_3: The Board Characteristics significantly moderate the relationship between CSR and ROA of non-financial firms listed in CSE.
H_4: The Board Characteristics significantly moderate the relationship between CSR and ROE of non-financial firms listed in CSE.

RESULTS AND DISCUSSION

The researcher ensured that the data set had no missing values or outliers. After, the normality test was performed to measure whether the data sets were normally distributed or not.

Table 1 Descriptive Analysis

Variable	Mean	Min.	Max.	SD	Skewness	Kurtosis
ROA	0.053	-0.261	0.417	0.085	0.945	2.940
ROE	0.050	-0.578	0.594	0.153	-0.625	3.760
CSR	0.478	0.000	0.962	0.252	0.074	-0.811
BC	0.410	0.000	1.000	0.247	-0.050	-0.587
FS	22.100	16.420	25.770	1.350	-0.204	0.181
LEV	0.262	0.000	0.978	0.217	0.800	-0.042

According to Table 1, the CSR disclosure index also varied from 0% to 96.2%. However, 47.8% of the average disclosure index emphasizes that Sri Lankan companies' disclosure on CSR is at an average level. ROA and ROE of the firms are around 5%.

All the skewness values between -1 and 1 and standard deviation also behaved at a lower value. Correlation and regression analyses are focused on the primary investigation of variables in the following sections.

The relationship between CSR practices and Financial Performance

The following models were formulated to test the relationship between CSR practices and financial performance. As there are two dependent variables (ROA and ROE), two models were developed, as shown below;

$ROA_{it} = \beta_0 + \beta_1 CSR_{it} + \beta_2 FS_{it} + \beta_3 Lev_{it} + \varepsilon$ .... (1)

$ROE_{it} = \beta_0 + \beta_1 CSR_{it} + \beta_2 FS_{it} + \beta_3 Lev_{it} + \varepsilon$ … (2)

The significant result for the Hausman test directed to perform fixed effect panel regression to test the impact of CSR on ROA as per the suggested model 1. Even though a lower R^2 value appears, significant F-test results provide substantial evidence of the suitability of regression analysis to meet the study objective. The following Table depicts the results of the regression analysis.

Model 2 interprets the relationship between CSR_{it} and ROE_{it} with control variables. The below Table shows the results of Model 2 in random effect; the significant F-test results provide substantial evidence of the suitability of regression analysis to meet the study objective.

Table 2 Panel Regression Analysis

	Model 1 Dependent - ROA_{it}		Model 2 Dependent - ROE_{it}	
	Coeff.	Std. Error	Coeff.	Std. Error
CSR_{it}	0.077	0.082	-0.017	0.047
LEV_{it}	0.109**	0.041	-0.090**	0.041
FS_{it}	-0.017**	0.007	0.008	0.007
Constant	0.381**	0.162	-0.491**	0.190
Industry Dummy	Included		Included	
R-Squared		0.0089		0.1627
F		3.98***		48.73***
N		636		636
Hausman Test		17.77***		5.06

***Sig at 0.01 level **sig at 0.05 level

According to the results (Table 2), the Coefficient value between CSR_{it} and ROA_{it} was 0.07, but the significant value was 0.345. Therefore, the relationship between the variables is insignificant. Finally, this study identified that the relationship between CSR_{it} and the ROA_{it} of a firm is insignificant for non-financial companies listed in CSE. Accordingly, the first Hypothesis is not supported in our study.

According to regression analysis (Table 2), the Coefficient value between CSR_{it} and ROE_{it} was -0.017, but its significant value was 0.706. Therefore, the relationship between the variables is insignificant. Finally, this study identified that the relationship between *CSRit* and the ROE_{it} of a firm is insignificant for non-financial companies listed in CSE. This derives the overall understanding that CSR does not have a significant relationship with financial performance. Therefore, the hypothesis 1 is not supported.

The Moderation Effect of Board Characteristics on the relationship between CSR practices and ROA

The moderation effect of board characteristics on the relationship between CSR practices and financial performance is examined in the study, and accordingly, the following models 3 and 4 were developed.

$ROA_{it}= \beta_0+ \beta_1 CSR_{it} + \beta_2 BC_{it} + \beta_3 CSR_{it} \times BC_{it} + \beta_4 FS_{it} + \beta_3 Lev_{it} + \varepsilon$ ..(3)

$ROE_{it}= \beta_0+ \beta_1 CSR_{it} + \beta_2 BC_{it} + \beta_3 CSR_{it} \times BC_{it} + \beta_4 FS_{it} + \beta_3 Lev_{it} + \varepsilon$ ... (4)

This model 3 indicates the moderating effect of Board Characteristics on the relationship between CSR practices and ROA with control variables. The significant result for the Hausman test directed to perform fixed effect panel regression to test the impact of CSR on ROA with moderating effect of board characteristics as per the model 3, and also significant F-test results provide substantial evidence to the suitability of regression analysis to meet the study objective. The following Table depicts the results of the regression analysis.

This model 4 interprets the moderating effect of board characteristics on the relationship between CSR_{it} and ROE_{it} with control variables. The below Table shows the results of Model 4 in random effect; even though a lower R^2 value appears, significant F-test results provide substantial evidence of the suitability of regression analysis to meet the study objective. Table 3 below depicts the panel regression results for models 3 and 4.

Table 3 Panel Regression Analysis- Model 3 and 4

	Model 3 Dependent - ROA_{it}		Model 4 Dependent - ROE_{it}	
	Coeff.	Std. Error	Coeff.	Std. Error
CSR_{it}	0.145	0.101	-0.078	0.078
$CSR_{it} \times BC_{it}$	-0.136	0.131	0.138	0.137
LEV_{it}	0.114**	0.041	-0.088	0.041**
FS_{it}	-0.017**	0.007	0.007	0.007
Constant	0.328**	0.165	-0.475	0.192**
Industry Dummy	Included		Included	
R^2		0.0094		0.1641
F-stat		2.99**		50.56***
Hausman Test		20.63***		5.98

***Sig at 0.01 level **sig at 0.05 level

According to Table 3 results, the significant value was 0.299. It means BC_{it} negatively moderates the relationship between CSR_{it} and ROA_{it}. Therefore, this study identified the board characteristics insignificantly moderate the relationship between CSR_{it} and ROA_{it} of non-financial companies listed in CSE. These findings do not support Hypothesis 3. These results further indicate BC_{it} negatively moderates the relationship between ROE_{it} *and* CSR_{it}. Because its significant value was 0.315, this study identified that the *BCit* insignificantly moderates the relationship between ROE_{it} *and* CSR_{it} of non-financial companies listed in CSE. Accordingly, the hypothesis 4 of the study is not supported.

When considering the empirical results, Nag and Bhattacharyya (2016) confirmed the results of this study that CSR_{it} reporting may not have any significant impact on accounting and market performance. However, some other findings have argued the results derived from our study. Ben et al. (2021) revealed that CSR positively impacts firm financial performance proxy with ROA_{it}, ROE_{it}, and Tobin's Q. However, contextual differences between our study and current studies study might be the reasons to have these challenging findings.

CONCLUSIONS AND IMPLICATIONS

This research aims to examine the moderating effect of board characteristics on the relationship between CSR practices and firm financial performance in non-financial companies listed on the CSE. STATA and annual report data were used to obtain a more reliable estimate of the quality of the results. The study made strides toward closing the research gap by investigating board characteristics' theoretical and empirical role in the logically plausible link between CSR practices and firm financial performance. Therefore, this research undoubtedly helps all parties looking for new dimensions in the business world. This study's findings indicate no significant relationship between CSR practices and ROA and ROE of non-financial companies. Based on this result, the managers can make the decisions and upgrade the organization's strategies. Furthermore, as there has been a tendency to pay more attention to non-financial factors such as CSR among potential investors in recent times, the findings will benefit them. Few pieces of research examined the relationship between *CSR* practices and a firm's financial performance using board characteristics as a moderating variable. Therefore, the results of this research provided further support and added value to the existing literature. The scope of this study is non-financial companies listed on the Colombo Stock Exchange. Therefore, the researcher has not used financial companies in the research. This was due to the difference in the financial companies' operations and procedures. Furthermore, the scope of this study has been narrowed down to Sri Lanka because of the data availability. The researcher has restrictions on gathering international data and information. However, future researchers can consider international companies and their information.

Keywords: Board characteristics, corporate social responsibility, return on assets, return on equity

REFERENCE

Ben Saad, S., & Belkacem, L. (2021). Does board gender diversity affect capital structure decisions?. *Corporate Governance: The International Journal of Business In Society*, *22*(5), 922-946. https://doi.org/10.1108/cg-12-2020-0575

Kabir, R., & Thai, H. (2017). Does corporate governance shape the relationship between corporate social responsibility and financial performance?. *Pacific Accounting Review*, *29*(2), 227-258. https://doi.org/10.1108/par-10-2016-0091

Khan, A., Muttakin, M., & Siddiqui, J. (2012). Corporate governance and corporate social responsibility disclosures: Evidence from an emerging economy. *SSRN Electronic Journal*. https://doi.org/10.2139/ssrn.2050630

Maqbool, S., & Hurrah, S. (2020). Exploring the Bi-directional relationship between corporate social responsibility and financial performance in Indian context. *Social Responsibility Journal*, *17*(8), 1062-1078. https://doi.org/10.1108/srj-05-2019-0177

Nag, T., & Bhattacharyya, A. (2016). Corporate social responsibility reporting in India: Exploring linkages with firm performance. *Global Business Review*, *17*(6), 1427-1440. https://doi.org/10.1177/0972150916653032

Rossi, M., Chouaibi, J., Chouaibi, S., Jilani, W., & Chouaibi, Y. (2021). Does a board characteristic moderate the relationship between CSR practices and financial performance? evidence from European ESG Firms. *Journal of Risk And Financial Management*, *14*(8), 354. https://doi.org/10.3390/jrfm14080354