p- ISSN: 2708-2113 e-ISSN: 2708-3608 URL: http://dx.doi.org/10.31703/gesr.2022(VII-II).41
Vol. VII, No. II (Spring 2022) Pages: 440- 447 DOI: 10.31703/gesr.2022(VII-II).41

Global Educational Studies Review
GESR

Cite Us

The nexus of Corporate Social Responsibility and Corporate Financial Performance: Reality or Myth

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Abstract: *There has been a significant uptick in the number of global studies which analyze the empirical connection of CSR with CFP. This research will examine the correlation between CSR and CFP for cement firms trading on Stock Exchange of Pakistan (PSX). The correlation was investigated by regression analysis utilising statistics from the companies' annual reports. It was shown that CSR positively affects market-determined profitability and ratios. Additionally, prior research supported the study's conclusions. Companies in the cement industry are encouraged to participate in CSR projects in light of the findings so that they might improve their bottom lines.*

Key Words: Financial Performance, Corporate Social Responsibility, Profitability, Marketability

Introduction

There is no denying the importance of corporate social responsibility in the modern businesses around the world. It has grown in relevance throughout the past half-century and has become a hot topic for discussion (Carroll, 2016). There has been considerable research and analysis within the academic and practitioner communities concerning corporate social responsibility (Jo & Harjoto, 2011). There is no way for corporations to succeed if they do not consider the local society in which they operate. Corresponding to the European Commission (2001), CSR is "a voluntary approach to social and environmental concerns incorporated into a corporation's activities and connections with its stakeholders."

A key component of CSR is the integration of all institutional stakeholders involved in the firm's activities, which extends beyond investors' interests into society at large. According to (Carroll, 2016), there are five criteria necessary for a company to succeed: it must be economically successful, legally compliant, ethically responsible, and socially beneficial. Academic research has focused on CSR as a crucial component of enterprise management. CSR involves voluntarily interacting with stakeholders to contribute to sustainable development (Yuen & Lim, 2016). In today's world, organizations from large multinationals to small and medium-sized businesses communicate and report their CSR activities publicly to stakeholders within and across society by employing appropriate tools.

According to Barnett and Salomon (2006), companies that prioritise social responsibility often see a rise in their market share as a result. In the first place, it enhances the image and reputation of a company. Secondly, it can positively influence employee motivation,

Citation: Khan, F. U., Rehman, K., & Ali, A. (2022). The nexus of Corporate Social Responsibility and Corporate Financial Performance: Reality or Myth. *Global Educational Studies Review*, *VII*(II),440-447. https://doi.org/10.31703/gesr.2022(VII-II).41

retention, and recruitment. Moreover, it can be cost-effective because it increases revenue from higher sales and market share. In addition to the benefits above, the company can reap the benefits on a macro and micro level. According to Mohamed Essawy (2019), more socially responsible businesses are associated with economic growth. Economic growth at the national level is therefore strongly tied to CSR. Although CSR has been there for a long period of time, some discipline areas are still disputed and immature.

Much has been said in recent years about how CSR might improve a company's bottom line. Inconsistent results may be found in the intellectual writing when examining the theoretic connection of CSR with CFP inside a firm. The resulting corpus of knowledge in the field may be partitioned into three broad classes: CSR has been shown in certain research to boost profits for businesses (Bag & Omrane, 2022; Maqbool & Zameer, 2018; Famiyeh, 2017). There are others who believe CSR has a chilling effect on profits (Hirigoyen & Poulain-Rehm, 2014; Lin et al., 2019; Sekhon & Kathuria, 2019). Some people think CSR benefits company's success, whereas others say it has no effect (Chetty et al., 2015).

Problem Statement

In Pakistan, the CSR industry is in its infancy, requiring more rigorous efforts at the government level to mandate companies to expand their CSR activities to protect stakeholders' interests (Javed & Ahmad, 2020). Corporations may be encouraged to actively contribute to improving public life in developing countries by establishing corporate social responsibility rules. Recent studies have focused on CSR in Pakistan, an emerging market. However, CSR operations have a trivial effect on the bottom lines of corporations. In light of this, the intention of this research is to provide knowledge regarding association of CSR with CFP..

Research Question

There is still a lack of consensus in the academic literature over whether or not a company's commitment to social responsibility correlates with improved financial results. Study results on the correlation between CSR and CFP have been mixed. Therefore, the aim is to investigate nature, scope, and, development of CSR in Pakistan. CSR in Pakistan is still in its infancy.

Is there any significant relationship between CSR spending and financial performance? If any, then what is the direction (positive or negative) and strength (significant or not) of the relationship?

Research Objective

The primary purpose of present review is to inquire into CSR's connection to business success, and then to analyze that connection's intensity and trajectory.

Literature Review

Corporate social responsibility

Although CSR's constituent parts—its dimensions, structures, and concepts—have been the subject of study for quite some time, there is still no agreed-upon definition. CSR is defined and understood, in many ways contingent on the culture in which it is being applied, as was found by an analysis of 37 definitions (Dahlsrud, 2008). Stakeholders besides stockholders are specifically mentioned in the European Commission's (2001) definition of corporate social responsibility. Instead than prioritising the interests of shareholders, Becchetti and Trovato (2011) believe that managers should consider those of all stakeholders. Participating in CSR is advantageous for businesses in a number of ways, including attracting resources, increasing competitiveness, and opening up new prospects. Increases in CSR are associated with greater economic expansion, according to (Hirigoyen & Poulain-Rehm, 2014). Due to the ambiguity and complexity of the idea, CSR has been evaluated in a variety of ways. CSR is a multifaceted issue that may be evaluated using a variety of metrics.

Corporate Financial Performance (CFP)

The ultimate goal of any company's upper management should be to satisfy the needs of all of their stakeholders. Strategic plan, execution, and performance assessment or evaluation are the three main pillars around which organizational improvement processes are built. How effectively a firm does financially is a key indicator of financial risk management since it reflects the extent to which its financial goals are being met. Information gleaned from performance assessment systems may be used by managers in making strategic plans for the future and maintaining the organization's steady advancement. Financial ratios are used as a road map by managers and market specialists to chart the progress of a corporation's performance. Company profits are calculated by subtracting operating expenses from sales revenue. Liquidity ratios determine a business's capacity to repay its short term debts out of current assets. The greater a company's liquidity ratio, the more easily it can service its debt (Khushi et al., 2020). A company can benefit from activity ratios since they assist direct capital expenditures in the future. Income generated by an organization's assets is crucial to its continued existence. Managers are more likely to take risks on projects that will pay off in the long run. We only take chances on productive assets that yield high net invested asset sales. Leverage ratios are used to evaluate the balance between a company's debts and its shareholders' equity. Capital structure refers to the mix of debt and equity in a company and has a significant effect on how that company operates. As management take on additional debt to keep the business competitive and solvent, the company's leverage situation deteriorates as profits fall. Therefore, a rise in debit reduces the rate of a firm's equity (Bell et al., 2018).

Theoretical Linkage Between CSR and CFP

Contradictory results were obtained in studies examining the hypothesized correlation amongst CSR with CFP. Both proponents as well as detractors of CSR agree that it may have a positive or negative effect over firm's bottom line. Lastly, there are theories that argue CSR has no influence on a business's outcome at all. Researchers that find a correlation between CSR and profit assume that when a company does good deeds, its stakeholders think better of it, and the more satisfied the stakeholders are, the higher the company's profits will be (Esen, 2013; Famiyeh, 2017; Galant & Cadez, 2017). Others believe that a company's bottom line will improve if its leaders prioritise the needs of their stakeholders and hold themselves more accountable to them (Choongo, 2017; Wu et al., 2020). Orlitzky et al. (2003) used thirty years of data in meta-analyses, despite the fact that the empirical studies are contentious. There was a positive association of CSR with CFP. In addition, another meta-analysis by Van Beurden and Gössling (2008) found robust empirical evidence for a positive association between CSR and CFP. Instead, a positive correlation between CSR and CFP was discovered in a meta-analysis of 251 studies (Margolis et al., 2009). The research indicated that 63% of evaluations identified a favourable association between CSR and CFP, 15% found the negative, and 22% found a neutral or mixed relationship, according to a meta-analysis conducted by Peloza (2009) Peloza that comprised 159 reviews. CSR and CFP are equally acknowledged in the academic community, as seen by the previous discussion. The purpose of this research is to determine whether or not CSR and CFP are related in Pakistan. There is a dearth of research from poor countries like Pakistan in this area of research, which is dominated by reports from more developed nations.

Methodology

Research Design

The authors of this study apply the notion of stakeholder management to the connection between CSR and financial success. To investigate the connection, a correlative methodology is used. In order to explore and quantify this relationship, statistical analysis is required. Studies dealing with numerical numbers often use quantitative research methods (Bell et al., 2018). In quantitative research, numbers and statistics are frequently referred to as a means of describing, characterizing, investigating, and illustrating relationships between variables (Saunders et al., 2009). Additionally, it uses statistical and quantified outcomes derived from reality to produce generalizable data.

Variables in the Study

The study mainly focused on two primary variables: CSR and CFP. In this case, CFP serve as the dependent variable, whereas CSR is the independent one. Stakeholder management theory, which predicts that CSR initiatives will boost profits, informed our choice of indicators.

Research Variables Measurement

Measurement of CSR

Due to its multifaceted nature, CSR cannot be evaluated using a single metric. There are two main challenges in trying to quantify it. The theoretical definition is contested (Dahlsrud, 2008). Second, there are many different kinds of dimensions in this idea (Carroll, 1979). Due to the lack of consensus and complexity of the concept, numerous alternative methodologies have been utilised in the literature to quantify CSR. Notable metrics include reputation indices, content analyses, questionnaire-based surveys, and uni-dimensional measurements (Galant & Cadez, 2017). There are benefits and drawbacks to every possible solution. In this study, CSR will be measured using a Unidimensional approach. As a result of this approach, CSR is measured on a single dimension. According to the Uni-dimension approach, CSR is measured by the formula used by Khan, Malik, Saghira, Rasheedc, and Husnaind (2021), Ehsan et al. (2018), and Pyo & Lee (2013). Ratio of CSR expenditures to total earnings or profits of a firm is calculated as Total Spending on CSR

Measurement of Financial Performance

Among researchers, there is no consensus on which parameters to consider as indicators of financial performance (Hirigoyen & Poulain-Rehm, 2014). Generally, researchers evaluate financial performance using three types of methods. Financial performance can be quantified by using accounting variables, such as income, costs, and profits (Hagberg, Johansson, & Karlsson, 2015; Moon, Bae, & Jeong, 2014; Tang, Hull, & Rothenberg, 2012), or by combining accounting variables (Cavaco & Crifo, 2014; Saeidi, Sofian, Saeidi, Saeidi, & Saaeidi, 2015); or by a combination of accounting variables. Combining accounting-based and market-based measures is the third approach (Mishra & Suar, 2010). In this analysis, we use both market-based and accounting-based metrics to evaluate financial performance.

Strategy for Research

This study used a longitudinal research design to analyse the connection between CSR and the financial success of firms in the cement sector from 2015 through 2019. Analyzing data over time allows researchers to gauge trends and, in some cases, to draw causal conclusions. The longitudinal method involves choosing a sample and then surveying it at least once more.

Sources and Methods of Data Collection

Primary and secondary data are the two categories that are recognised by Saunders et al. (2009). All information utilised in this analysis will come from secondary resources. This study uses secondary data techniques to obtain the data on the variables from the companies' annual reports that were randomly selected for the study. It saves time and money to work with an existing database, allowing researchers to focus on data interpretation and analysis instead of data collection (Bell et al., 2018). It is also advantageous to use secondary data for longitudinal studies due to its longitudinal nature.

The Empirical Model

The correlation between CSR and CFP was analysed with the use of a pooled linear regression model. Accounting and marketoriented measures were used to express CFP while the ratio of spending on CSR to income after taxes was employed as proxy to measure CSR. The empirical models to express the relationship are as follows:

$$CFP_{i,t} = \beta_0 + \beta_1 CSR_{i,t} + \varepsilon_{i,t} \dots\dots\dots\dots\dots\dots.(1)$$

Where $CFP_{i,t}$ is the corporate financial performance for company "i" at the period "t." Similarly, $CSR_{i,t}$ is corporate social responsibility for company "i" at period "t" respectively. Moreover, β_0 is the y-intercept, while β_1 is regression coefficients of CSR. The dummy variable for CSR is coded as "1" if a firm is involved in CSR activities otherwise, coded as "0". The term $\varepsilon_{i,t}$ is referred to as error term.

Data Analysis and Results

This data analysis was done to look at the connection between corporate social responsibility (CSR) and the financial success of businesses. CSR was used independent variable and was measured by spendings on CSR activities by the sampled firms. The firms, having spent money on CSR related activities are coded as "1" and those who do not spend money on CSR related activities are coded as "0". This categorization was made to see whether companies spending on CSR have positive impact or not compared to companies are not in CSR related activities. The financial performance was used dependent variable and was measured by accounting measures divided into profitability ratios and market ratios. Net profit margin (NPM), assets turnover (AT), return on assets (ROA), financial leverage (FL), return on equity (ROE), and gross profit margin (GPM) are among the profitability ratios. Additionally, to market indicators such market price per share (MPS), earnings per share (EPS), price-earnings ratio, and dividend payout ratio (DPO).

Table 1. Regression Results: The impact of CSR on Profitability ratios

	(1)	(2)	(3)	(4)	(5)	(6)
	NPM	AT	ROA	FL	ROE	GPM
CSR	7.394***	.204***	5.605***	.325	12.386***	11.684***
	(1.795)	(.054)	(1.258)	(.282)	(3.406)	(2.844)
_cons	9.737***	.436***	5.52***	1.434***	5.779**	17.216***
	(1.491)	(.044)	(1.045)	(.235)	(2.83)	(2.362)
Obs.	100	100	100	100	100	100
R-squared	.148	.129	.168	.013	.119	.147

*Standard errors are in parentheses: *** 1%, ** 5%, *10%*

The table 1 provides the results of pooled linear regression model for the accounting ratios of profitability used dependent variables and CSR as independent variables. Six linear regression models were run for each profitability ratios given in column 1 to 6. According to the findings, CSR positively and significantly affects NPM, AT, ROA, ROE, and GPM while having a negligible positive influence on FL. The positive coefficients suggest that businesses investing in CSR-related activities are more lucrative than those that aren't. The most significant effect of CSR on profitability was observed for ROE, followed by GPM, NPM, ROA, and AT, in that order.

Table 2. Regression Results: The influence of CSR on Market ratios

	(1)	(2)	(3)	(4)
	MPS	EPS	PE	DPO
CSR	85.25***	9.021***	2.502	.217***
	(28.883)	(2.434)	(1.903)	(.048)
_cons	33.504	4.018**	6.384***	.107***

	(1)	(2)	(3)	(4)
	MPS	EPS	PE	DPO
	(23.992)	(2.022)	(1.581)	(.039)
Observations	100	100	100	100
R-squared	.082	.123	.017	.175

*Standard errors are in parentheses: *** 1%, ** 5%, *10%*

The findings of a linear regression using market metrics (MPS, EPS, PE, and DPO) as the dependent variable and CSR as the independent variable are shown in Table 2. The results show that CSR has positive relationship with all market ratios and found to be statistically significant except PE ratio. It is evident that CSR has highest impact on market price per share of firms doing CSR compared to firms that do not. It indicates that involvement in CSR by firms inflates the MPS, EPS, and DPO by 85, 9, and .21 units more compared to firms with no indolent in CSR. These results imply that firms engaging themselves in CSR related activities positively and significantly improve the reputation and thereby increase their market value and share.

Discussion and Conclusion

This study looked at the financial performance of Pakistan's cement sector in relation to corporate social responsibility. There is empirical evidence that CSR may impact the financial success of firms. CSR was quantified as an independent variable by enterprises' engagement and CSR spending. Profitability and market ratios were used to calculate CFP. CSR was discovered to have a favourable impact on profitability and market-driven ratios. Bag and Omrane (2022), Famiyeh (2017), and Maqbool and Zameer (2018) all confirm these conclusions. As a result, CSR should be seen as a corporate policy rather than an optional component. CSR as one of the fundamental company operations may increase business performance. CSR strategies may assist a company in meeting both its long-term financial and social objectives. Managers and entrepreneurs must consequently participate in a variety of social responsibility projects and activities. By meeting stakeholder expectations and generating significant financial results, such CSR activities enable companies to gain a competitive advantage and build a strong business image. Because the findings of this study may be limited to Pakistan's cement industry, it may have limitations. This study's research period has been restricted to the years 2015 to 2019. As a result, comparable longitudinal study including a larger number of non-financial and financial sector organisations might be beneficial in gaining a comprehensive knowledge of how CSR and CFP are associated.

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