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CORPORATE SOCIAL RESPONSIBILITY PRACTICES AND FINANCIAL PERFORMANCE: EMPIRICAL EVIDENCE FROM PAKISTAN

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ABSTRACT

This study aims to investigate the relationship between CSR practices and financial performance. The study formulates one hypothesis about the effect of CSR practices on firms' financial performance. This study is based on data of 20 companies from the construction and chemical sectors from 2015 to 2019. The hypothesis was tested by using panel regression through using R software version 3.2. The results suggest that CSR practices has positive and significant effect on the financial performance of the firms in the study sample. The relationship between CSR practices and financial performance is inconclusive. There is a need to establish a general link between CSR practices and financial performance. The varying outcomes are primarily due to sample size, operationalization, and context, among other factors. Given the resource constraints, researchers suggest to conduct research on the association between CSR practices and financial performance in the context of developing countries. This study contributes to the literature on the effect of CSR practices on financial performance in the context of a developing country (Pakistan) and provides practical insights to corporate managers. Based on the results attained, it would be recommended that Pakistani corporate firms secure better financial performance by committing themselves in CSR activities.

INTRODUCTION

Social and environmental problems arise as results of business operations and manufacturing (Beamon, 1999; Elyateb et al., 2011). Given this, there is an increasing pressure on firms from internal and external stakeholders to implement environmental and social practices inside as well as in their supply chains. These challenges and pressures compel firms to adopt CSR practices while doing business. In effect, the integration of environmental and social practices in the business operations has become a competitive factor (Knopf et al., 2011).

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Consequently, companies are considering CSR as a major component of overall corporate activities and firms have increased their spending on CSR activities. Given this, companies are concerned about the effect of CSR practices as they incur costs while they implement the CSR practices. Commission of the European Communities (2001) defines CSR as a concept where companies integrate social and environmental concerns in their operations and interact with their stakeholders on a voluntary basis.

The question whether CSR practices contribute to a firm's financial performance has been addressed in several studies. The extant literature shows a mixed findings concerning the effect of CSR practices on financial performance. Some studies shows positive effect of CSR practices on performance (e.g., Shahid et al., 2016; Tanveer et al., 2017), some shows negative effect (e.g., Muzhar et al., 2013; Muhammad et al., 2015) while others come with even neutral results (e.g., Abbot and Monsen, 1979; Aupperle et al., 1985; McWilliams and Siegel, 2000). Differences in sample sizes, methodology and measurement (Quazi & Richardson, 2012; Tebini et al., 2015), and contextual factors (Tang et al., 2012) have been suggested to contribute to the variation in the relationship between CSR and financial performance. While methodological differences cannot be resolved in one paper, contextual differences are researchable. Therefore, rather than simply testing whether CSR practices affect financial performance, it is as important to know when and under which conditions this relationship occurs (Vishwanathan, 2010). Countries across the globe have different cultural, legal, educational, business, and economic environments. The essence of CSR might be global in nature, however, recent research shows that the pattern of CSR practices varies in different social, economic, cultural, legal, and political contexts (Matten & Moon, 2004). Midttun et al. (2006) show an association between the CSR practices pattern and national, political, and economic institutions. Thus, investigating the effect of CSR practices on performance in another context is needed. Pakistan is a developing country where CSR is a new phenomenon and most organizations are unaware about the concept, but still there are some organizations, which practice CSR. This study, explores the effect of CSR practices on financial performance in the context of Pakistan. Few studies have addressed the relationship between CSR practices and performance in developing countries compared to the developed world (Zhu *et al.*, 2005). Goyal *et al.* (2013) call for more studies in this context. This context is important because in developing countries given the resources constraints, managers only invest in CSR practices when it pays in terms of financial performance. The common perception is that CSR is a cost to the business and managers are unable to justify investment in CSR. In developing countries, this counts one of the main obstacles to implement CSR practices. This study will provide mangers an insight whether investing in CSR enhances the financial performance in firms from Pakistan. Information concerning whether CSR practices enhances financial performance will enable corporate managers to invest more in CSR practices, which will act as a self-motivating factor for the promotion of CSR practices. Thus, we posit the following research question:

RQ 1-Does CSR affect financial performance of the firms in Pakistan?

Theoretical Background and Hypothesis Development

This study uses resource-based view to guide the relationship between CSR practices and financial performance. According to RBV, businesses can create certain assets and skills that they can employ to boost their performance and competitiveness (Halley & Beaulieu, 2009). The capacity to effectively leverage these resources is what creates a competitive advantage, according to RBV (Barney & Gryphon, 1992). Shang et al. (2010) highlighted the applicability of RBV in understanding the relationship between green supply chain management (GSCM) capability and organisational performance in the context of green practice implementation. Furthermore, Shi et al. (2012) stated that RBV theory was used in several studies to better understand the relationship between GSCM practices and organisational performance improvement.

Many studies have been conducted concerning the effect of CSR practices on financial performance. Majority of the studies have shown positive effect of CSR practices on financial performance. (e.g., Tsoutsoura et al., 2004; Tang et al., 2012; Kiran et al., 2015 Kakakhel et al., 2016; Shoukat et al., 2014; Wan et al., 2014; Murataza et al., 2014; Tanveer et al., 2017; Dakhli, 2022; Ang et al., 2022). For example, kakakhel et al. (2016) report the positive effect of CSR practices on financial performance in firms from cement industry, in banking sector (Shoukat et al., 2014; Tanveer et al., 2017), in the Oil and Gas industry in Pakistan (Kiran et al., 2015) and in the food industry of Pakistan (Murtaza et al., 2014). Similarly, Tsoutsoura et al. (2004) and Tang et al. (2012) also found positive association between CSR and financial performance in different sectors of the KLD listed firms. Wan et al. (2014) conducted a research study in Malaysia and show positive relationship between CSR practices and financial performance in Malaysia. Razaq et al. (2016) show positive relationship between CSR practices and financial performance in commercial banks in Nigeria. Dkhli (2022) shows the positive relationship between CSR and financial performance in terms of return on assets (ROA), return on equity (ROE), and Tobin Q (TQ) in French listed firms from 2007 to

2018 period. Ang et al. (2022) finds positive effect between CSR practices and financial performance in Chinese heavy polluted listed firms. Bag and Omrane (2022) demonstrate that CSR activities have a significant impact on financial performance; there is a moderate positive association between the concerned variables in that context.

Another group of studies shows negative effect of CSR practices on financial performance. For example, Mazhae et al. (2013) and Muhammad et al. (2015) found negative effect of CSR practices on financial performance in Pakistan. Shurti et al. (2014) found negative relationship between CSR and FP in the UK. Muturi et al. (2013) found negative effect in the context of Kenya. Rahmawati et al. (2014) and Hasan et al. (2007) found negative association between CSR and financial performance in Indonesia. Gerard et al. (2015) found negative association between CSR and financial performance in 329 companies from the US, Europe, and Asia Pacific. Nguyen et al. (2022) suggest that overall CSR disclosure has a negative impact on firm performance, but the perspectives provide a more complete view: environmental responsibility shows a clear negative influence, while social responsibility demonstrates a preferable but weak impact on financial performance. According Costa & Fonseca (2022) to Enrolling in CSR activities entails additional costs, which can undermine the company’s financial performance if not properly supported by public policies.

A third group of the studies found no link between CSR practices and financial performance. For instance, negative relationship between CSR practices and financial performance is reported in firms from cement, textile, fertilizer, and tobacco sectors (Iqbal at al., 2012) and pharmaceutical firms from Pakistan (Ayoub et al., 2007). Chutima (2013) found no relationship between CSR practices and in the hotel industry of Thailand. Hasan *et al.* (2007) found no link between CSR and FP in Indonesia. Rim et al. (2009) found no relationship between CSR and FP in Canadian firms. Maria has conducted a study on the Italian industry and found negative relationship. Similarly, Yousaf et al. (2015) and Naheem (2015) found no relationship in their research studies between CSR practices and financial performance.

Given the above discussion, there are three major paradigms associated to CSR activities and their effect on financial performance. Studies with positive effect of CSR practices on financial performance base their argument on the grounds that firms that practice CSR activities create good image in the society, help in promoting marketing of the firm, fulfill the government environmental protection laws, which ultimately does not only recover the CSR expenditures but increase profit (Kabir & Chowdhury, 2022). Studies with no association show no effect of CSR practices arguing that investment in CSR practices neither improve nor decrease financial performance (Kahloul et al., 2022). Finally, studies with negative effect are of the opinion that implementing CSR practices incurs costs, which lower the firm financial performance (ibid). Overall, the relationship between CSR practices and financial performance is mixed resulting from different context, sample size, and industries. Among them, context could lead to varied results. Most studies address the association in developed countries, and many researcher call for studies on the effect of CSR practices in developing countries (Haleem et al., 2021). This study addresses the association between CSR practices and financial performance in Pakistan to demonstrate whether CSR practices affect financial performance or not. Moreover, previous studies have tested the relation between CSR and financial performance in on cement, food, banking, fertilizer, and pharmaceutical companies, while firms from construction and chemical sector are mainly under researched in Pakistan. This study aims to test the relationship between CSR practices and financial performance in firms from construction and chemical sectors. We posit the following hypothesis:

H1: *There is positive and significant relationship between a firm CSR practices and financial performance.*

The Pakistani context

This study is based on data collected from manufacturing industries in Pakistan, a growing Asian country. CSR is a new phenomenon, and very few companies are aware of it or practice it (e.g., Pakistan State Oil, Unilever). External pressure on Asian manufacturers to adopt environmentally and socially responsible practices is well documented in the literature (e.g. Eltayeb et al., 2011; Tsoi, 2010; Zhu & Sarkis, 2007; Adebanjo et al., 2017). In such countries, the cost of implementing such practices has been cited as a major impediment (Gulger & Shi, 2009; Lund-Thomsen &Nadvi, 2010). If there are evident connection between the adoption of environmental and social practices on the financial performance, the urge to adopt such practices may become self-sustaining. Therefore, addressing the relationship between CSR practices and financial performance is important in the context of Pakistan.

Methodology

Data Source and sampling

There are 557 firms listed on Pakistan Stock Exchange (PSE), which are further categorized in thirty-five different sectors. This study is based on firms from chemicals and construction sector, which include more than sixty five companies. All Chemical and construction companies listed on the Pakistan Stock Exchange (PSE) counts the population of this study. Out of them, we selected 20 companies and studied their annual reports given the criteria that the annual reports of these firms contains information regarding investment in CSR. The annual reports of the concerned companies were studied and finally 20 companies were selected that practice CSR and on the other hand we also selected those 20 firms which did not practice in corporate social responsibility. Data was collected mainly from financial statements and audit reports of these firms from 2007 to 2017.

Operationalization

CSR, which is the independent variable, can be measured in several ways. We measured CSR via the total amount of donations at a given period of time (Kiran et al., 2015; Javed et al., 2017). Financial performance is dependent variable, which is measured by Return on Asset (ROA) and net profit margin (NPM) (Tanveer & Bagh, 2017; Shoukat &Nadim, 2014). We controlled for size measured by taking the natural log of the firm total assets (Tsoutsoura et al., 2004).

Model of the Study

The aim of this study is to test the effect of CSR practices on financial performance. CSR practices is independent variable while financial performance is dependent variable. For realizing the aim of this study, we used panel data and run the following regression analysis.

$$(ROA)_{it} = \beta_0 + \beta_1 CSR(D_{it}) + \beta_2(Size_{it}) + \varepsilon_{it}$$

Where β represents the intercept from a regression line. β1 represents the coefficient of the CSR. β2 shows the slope of the controlling variable (size). β1 represents the coefficient of the CSR. ε is called the epsilon, which is the error term. We collected data of all variables for each firm i at time t. For robustness analysis, we include another measure of financial performance in the above equation as below.

$$(NI)_{it} = \beta_0 + \beta_1 CSR(D_{it}) + \beta_2(Size_{it}) + \varepsilon_{it}$$

Where NI presents net income, β_0 represents the intercept from a regression line. β1 is the slope of the regression line and it represents the coefficient of the independent variable CSR practices. β2 shows the slope of the controlling variable (size). The epsilon is the error term.

Results

First, we calculated descriptive statistics to describe the general characteristics of the data (see table 1). For testing the multiple regression, it is important to normalize the data. We normalized the data by calculating descriptive statistics including skewness and kurtosis, which shows that the data is normal. Further, we also removed the outliers, which cause biasness in the results. Table 1 shows descriptive statistics:

Table 1: General characteristics of the data

Variable	Mean	Med	St Dev	Kurt	Skew	Min	Max
Panel A: Firms that are actively engaged in CSR activities							
ROA	0.07	0.04	0.09	1.61	0.89	(0.18)	0.43
Net Profit Margin	0.11	0.07	0.17	5.61	0.97	(0.69)	23.37
Size of the Firm	9.04	9.31	1.39	(0.56)	(0.64)	5.60	10.95
Panel B: Firms that are not actively engaged in CSR activities							
ROA	(0.00)	0.01	0.07	1.04	(0.45)	(0.24)	0.21
Net Profit Margin	(0.53)	0.01	1.77	14.74	(3.58)	(11.09)	2.40
Size of the Firm	7.45	7.71	1.64	(0.95)	(0.14)	4.03	10.14

Table 1, shows the descriptive statistic of the dependent variable (ROA). The mean value of ROA is higher than median value. The data set also shows higher deviation with respect to mean value. Which tells us the data set is not normally distributed. Further, the same row also illustrates the measure of shape of data set as skewness and kurtosis. We can observed from the values that our sample data set has lighter kurtosis, which indicates a lighter tail of the distribution. The sample data set reports a higher value than a normal distribution, which indicates that data set produce positively skewed asymmetric distribution. Contrast to normal distribution where the mean values closed to 0 for skewness and close to 3 in case of kurtosis. The higher value of mean with respect of median is also a good explanation of the positively skewed distribution of the sample data set.

Descriptive statistics of the dependent variable, Net Profit Margin (NPM) is shown in Table 1. The mean value of considered variable is higher than median value. The data set also shows higher deviation with respect to mean value, which shows that data set, is not normally distributed. Further, the same row also illustrates the measure of shape of data set as skewness and kurtosis. It can be seen from the values that our sample data set has heaver kurtosis, which indicates it has much data in tails than peaks. The sample data set reports a higher mean than median contrast to a normal distribution, which indicates that data set produce positively skewed asymmetric distribution. Contrast to normal distribution where the mean values closed to 0 for skewness and close to 3 in case of kurtosis. The higher value of mean with respect of median is also a good explanation of the positively skewed distribution of the sample data set. The descriptive statistics of the control variable i.e. size of the firm is shown Table 1. The mean and median value has approximately the same values. This shows that data set is normally distributed. In addition, the same row also illustrates the measure of shape of data set as skewness and kurtosis. The table shows that our sample data set has "light tailed kurtosis", which indicates it has less data in tails than peaks. The sample data set reports a negative but close to 0 skewness which indicates that data set produce a comparatively symmetric distribution.

Table 1 shows the descriptive statistic of ROA. This shows that ROA has a negative meanwhile close to zero value form median. Further, the same row also illustrates the measure of shape of data set as skewness and kurtosis. It can be seen from the values that our sample data set has lighter kurtosis, which indicates a light tailed kurtosis because the value is less than 3. The sample data set reports a negative value of skewness, which indicates that data set produce negatively skewed asymmetric distribution. Contrast to normal distribution where the mean values closed to 0 for skewness and close to 3 in case of kurtosis. The lower value of mean than median in our sample data set is also a good explanation of the negatively skewed distribution. The dependent variable, NPM has a negative meanwhile close to zero value form median. Further, the same row also illustrates the measure of shape of data set as skewness and kurtosis. We can observed from the values that our sample data set has high-tailed kurtosis, which indicates many values lie in peak than tail. The sample data set reports a significant negative value of skewness, which indicates that data set produce negatively skewed asymmetric distribution. The lower value of mean than median in our sample data set is also a good explanation of the negatively skewed distribution. Size of the firm is one of the control variable of the study, in order to analyze the descriptive statistic of the variable under consideration for the firms those not actively involved in CSR. We can see that mean and median value has approximately the same values. In addition, data set shows significant lower deviation with respect to mean. Which tells us the data set is normally distributed. In addition, the same row also illustrates the measure of shape of data set as skewness and kurtosis. It is clear from the values that our sample data set has "light tailed kurtosis", which indicates it has less data in tails than peaks. The sample data set reports a negative but close to 0 skewness, which indicates that data set produce a comparatively symmetric distribution.

Table 2 Correlation matrix

Penal A. Firms which practice CSR

	Don	*ROA*	*NPM*	*Size*
CSR(Don)	1			
ROA	0.25	1		
NPM	0.29	0.58	1	
Size	0.39	0.02	0.31	1

NI mean Net Income. TS represent total Sale. ROA mean Return on assets. Don shows Donation, NPM means Net Profit Margin and Size show, size of the firm

Penal B. Firms which do not practice CSR.

	ROA	*NPM*	*Size*
ROA	1		
NPM	0.56	1	
Size	0.01	(0.04)	1

The correlation between ROA and CSR (Don) is 0.25, NPM and Don is 0.29, and size and Don is 0.39. Correlation between ROA and NPM is 0.56, between size and ROA is 0.01and between NPM and size is 0.04.

Is there any relationship exist between CSR practices and firm financial performance?

Table 4(a) shows the explanatory power of the model. The R square value is 0.19. Overall, 19% explanatory power subject to one independent variable is encouraging.

Table 4(a): Explanatory power of the model

R	*R square*	*Adjusted R Square*	*Standard error*	*Observations (n)*
0.44	0.19	0.19	0.08	440

Table 4 (b) highlight the model fitness. We can see in the last column of Table 4 (b) that the F statistics value is greater than 2 while its respective probability value is less than 0.05. These statistics provide enough evidence for the appropriate fit of our model.

Table 4(b): Model fitness

ANOVA

	Df	*SS*	*MS*	*F*	*Significance F*
Regression	3.00	0.72	0.24	34.58	0.00
Residual	436.00	3.02	0.01		
Total	439.00	3.74			

Table 4 (c): The effect of CSR activities on the firm financial performance

	Coefficients	t	P-value
Intercept	0.013	0.614	0.540
CSR	0.032	4.182	0.000
Size	(0.002)	(0.813)	0.417
Interactive dummy	0.064	6.928	0.000

The effect of CSR on return on asset is positive and significant (β = 0.032; P = 0.000). After including the interactive dummy (which is the multiplication of the CSR and the variable where 1 = firms that do not practice CSR and 0 = firms that practice CSR). The effect of the interactive dummy is positive and significant (β = 0.064; P = 0.000), which shows that firms that practice CSR practices compare to those that do not have higher return on asset. Thus, further confirm the positive and significant effect of CSR practices on return on asset, which is one measure of financial performance. Size has positive and insignificant effect on return on asset (β = 0.002; P = 0.417).

Robustness Tests

We run the main model again but this time with a different proxy for financial performance, NPM. The outcomes are summarized in Table 5.

Table 5: Robustness analysis with alternative measure of firms' financial performance (NPM).
Table 5(a):

Multiple R	R Square	Adj. R Square	Std. Error	Observations
0.115	0.013	0.011	1.286	440

Table 5(a) shows the explanatory power of the model. The R square value is 0.013, which means that the model has explained 1.3% variation. We accept that the explanatory power of the model is not above average but this is because we are using only two variables for the prediction of the financial performance of the firms. There can be number of other variables, which has possible effect on financial performance. However, they are out of the scope of this study.

Table 5(b): Model Fitness.
ANOVA

	Df	*SS*	*MS*	*F*	*Significance F*
Regression	1	9.718638	9.718638	5.873398	0.015776
Residual	438	724.7531	1.654688		
Total	439	734.4718			

Table 5(b) highlights the fitness of the model. For this purpose, we study the value of the F statistics. As in last column of Table 5 (b) the F statistics value is greater than 2 while its respective probability value is 0.001 and less than 0.05. These statistics provide enough evidence to conclude that the model we used in this study is fit and significant.

Table 5(c)

	Coefficients	*t Stat*	*P-value*
Intercept	(0.265)	(4.058)	0.000
CSR	0.011	2.424	0.016
Size	0.021	0.613	0.321
Interactive dummy	0.052	6.231	0.000

Table 5 (c) shows the positive and significant effect of CSR on net profit margin (β = 0.011; P = 0.016). Size has positive and non-significant effect (β = 0.011; P = 0.016), while interactive dummy has positive and significant effect (β = 0.052; P = 0.000) on net profit margin. Thus, the effect of CSR on both measures of financial performance (ROA, NPM) is positive and significant, which provide enough evidence to conclude that CSR activities have positive and significant effect on firm financial performance. Also, firms who practice CSR perform better in terms of financial performance than firms that do not practice CSR. This support hypothesis H1.

Discussion

The relation between CSR practices and financial performance is mixed. Therefore, establishing a general link between CSR and financial performance of the firms is important. Many researchers call for investigating the link between CSR practices and financial performance of the firms in developing countries (Goyal et al., 2013). Based on the resource base view, this study address whether investing in CSR practices enhances the financial performance of the firms? The results support hypothesis H1: There is positive and significant relationship between a firm CSR activities and its financial performance. According to Welford (2005), developing countries are still lagging behind developed countries, due to lack of resources, weak institutions, standards and appeal systems and poor implementation (Kemp, 2001; Arevalo & Arvind, 2011). For these reasons there is a common perception among investors that CSR practices does not pay off in term of financial performance (Roberston, 2009). Investors in developing countries can get returns in emerging markets anyway, so they do not take CSR practices in their operations (Aras & Crowther, 2009). However, the present study shows that if firms from developing countries invest in CSR, it will pay off in term of financial performance. This result is very promising, as this will encourage corporate managers in Pakistan to invest more in CSR practices as investment in CSR practices pay in terms of financial performance. This will also help in the promotion of CSR practices as the benefits from CSR will act as self-motivating factor for the adoption of CSR practices in the absence of the strong regulations about CSR in Pakistan. The findings of the study are in line with studies including Tsoutsoura and Haas, 2004; Tang *et al.*, 2012; Murtaza et al., 2014; Mujahid & Abdullah , 2014; Wan et al., 2014; Kiran et al., 2015; Kakakhel et al., 2016; Abdulrazaq &Abdu, 2016; Tanveer et al., 2017; Dkhli, 2022; Ang et al., 2022), who argue that spending on CSR improve the financial per formance of the firm. Our study findings is in constrast to those who report either the neutral (e.g., Rim *et al.*, 2009; Chutima, 2013; Yousaf *et al.*, 2015; Naheem, 2015) or negative effect of CSR practices (e.g., Rahmawati *et al.*, 2014; Mazhae *et al.*, 2013; Muhammad *et al.*, 2015; Costa & Fonseca, 2022; Nguyen et al., 2022) on financial performance.

Conclusion

Contribution to theory

The relationship between CSR practices and financial performance is inconclusive. There are few studies on the effect of CSR practices on financial performance in developing countries and many researchers suggests conducting research in this regard. Also, there is a need to establish a direct link between CSR practices and financial performance. This study contribute to the existing literature on the association between CSR practices and financial performance given the resource based view from the context of Pakistan, which is a developing country. The results show positive relationship between CSR practices and financial performance.

Contribution to practices

This study has several practical implications. First, the positive effect of CSR practices on the firm's financial performance will encourage corporate managers from the construction and chemical sectors to invest more in CSR practices as it pays in terms of financial performance. Second, this finding will help in the internal promotion of CSR practices, as regulations concerning CSR is weak in Pakistan and are unable to force companies to adopt the CSR practices.

Limitations and further research

This study suffers from several limitations. First, CSR was measured in monitory terms like spending in the form of donation to health, charities and education. However, there are various CSR dimensions in which firms can invest. Further studies can address more dimensions of CSR and test the hypothesized relationship of this study. Second, this study investigated the effect of CSR on financial performance of firms from chemical and consturction industry in Pakistan. The researcher suggests that the possible effect of CSR on financial performance be extended to other industries. Further reseach can be conducted to determine if CSR has any effect on the financial performance of service oriented firms such as telecommunication industry, private hospitals, insurance companies, non bank financial intermediaries, and micro finance institutions.

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