IMPACT OF CORPORATE SOCIAL RESPONSIBILITY ON THE FINANCIAL PERFORMANCE: EVIDENCE FROM LISTED MANUFACTURING COMPANIES IN SRI LANKA

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ABSTRACT

Corporate Social Responsibility (CSR) is getting wider attention in the present competitive business environment. However, the relationship between Corporate Social Responsibility and financial performance is still an ambiguous problem for many business organizations. Though several studies are available on CSR and financial performance, the conclusions are vague. Therefore, the objective of this research is to assess the impact of corporate social responsibility on the financial performance of listed manufacturing companies in Sri Lanka. Corporate social responsibility indicated through the aspects of community, customer, employee and environment is taken as the independent variable, while financial performance measured through the return on assets is considered the dependent variable. This study is based on the voluntary disclosures made in the annual reports regarding 25 manufacturing companies registered in Colombo Stock Exchange. The data cover a period of 5 years (2016-2020) to give enough information for the study. Correlation analysis indicates that all the independent variables positively correlate with ROA. According to the regression outcome, CSR activities towards the community and customers have a significant positive impact on financial performance. It indicates that when firms attend to more CSR activities towards the community and customers, it will lead to an increase in the profitability of firms. This may be due to the good image and trust built among the community and customers. However, it is surprising to see a significant negative effect of CSR activities related to employees on the financial performance of listed manufacturing companies. Furthermore, Contribution to the environment with CSR activities has an insignificant impact on the firm's financial performance. In conclusion, CSR activities significantly affect the financial performance of listed manufacturing companies on the Colombo Stock Exchange. Findings are useful for managers to identify the level of resources to be invested in CSR activities to maximize the firm performance. Furthermore, CSR activities of firms signal investors to show that it is highly profitable to invest in a firm that engages in CSR activities.

Keywords: Corporate Social Responsibility, Colombo Stock Exchange, Firm Performance, Profitability, Return on Asset

1. INTRODUCTION

Background of the Study

Corporate social responsibility (CSR) is one of the most popular topics in the present business world. With the introduction of globalization, businesses began to change rapidly, and they looked for a newer concept. When the market becomes competitive, these competitive firms try to engage more unique features to build differentiated, unique innovations to build barriers to new entrants and capture a bigger market share than the current business. The trend of engaging in activities of corporate social responsibility has grown rapidly in the last few years. Because of the Covid-19 situation in Sri Lanka, all the business firms are highly concerned about Corporate Social Responsibility. They follow the government rules, regulations and instructions regarding social well-being and healthiness.

In the past, a company's ultimate objective was to achieve profits, and the shareholders were the only party towards which the company had responsibilities. Therefore, the ultimate objective of financial management was to maximize shareholder wealth (Tilakasiri, 2012). The contemporary business world is moving towards expanding and fulfilling the objectives of all stakeholders. They not only focus on profit but gradually adapt to the different types of new trends in the market. As such, the ultimate purpose of companies is to focus more on satisfying the needs of all stakeholders while reaching satisfactory levels of profit. Therefore, business companies attempt to play a new role to be able to take care of both social and environmental aspects while gaining an adequate level of profit. For that reason, corporate social responsibility is becoming an emerging area within the scope of accounting.

Regarding society, employees and the situation since their prospects are wider than the profits. CSR is normally interrelated with other terms, such as corporate citizenship and the triple-bottom-line concept theory. CSR is described as actions that appear to further some social good beyond the interest of the firm and that which is required by law (McWilliams & Siegel, 2001). Many companies are accountable for using CSR issues because shareholders, analysts, regulators, activists, labour, unions, employees, community organizations and the general public always ask whether they are adopting those issues (Tsoutsoura, 2004).

Research Problem

The concept of Corporate Social Responsibility has been developed in Western countries since the 1950s. Various CSR frameworks, standards and principles have grown significantly as researchers expand the concept in the business world. However, the relationship between CSR and financial performance is still a cryptic problem for many business organizations. In Sri Lanka, this issue is under-researched as a developing country (Tilakasiri, 2012). There are some studies relevant to CSR but the findings are indefinite (McWilliams and Siegel, 2001). While some researchers find a positive and negative relationship, others find no/neutral relationship between CSR and financial performance (Classon and Dahlstrom, 2006). The firms do not address the needs of other stakeholders. As they wish to increase the shareholders' wealth, they always try to increase the performance and through it, they wish to retain enough retained earnings and return on assets to strength the future operations of the company. Therefore, they do not like to block those earnings on implementing CSR activities which do not receive short-term benefits. Those CSR activities are not attached to monetary terms. By applying CSR practices, firms' can enhance their popularity (Barnett and Salomon, 2006).

But when concerned about the market situation, to survive in the market in the long run, a firm should attain a satisfactory level of profit which can satisfy the stockholders, needs while satisfying the needs of other stakeholders. Therefore, firms should pay special attention to satisfying the needs of stakeholders. The problem of the study is to identify the significant association and the relationship between Corporate Social Responsibility (CSR) and financial performance (Tilakasiri, 2012).

Research Objectives

The objective of corporate social responsibility is to satisfy the current social expectations rather than satisfy the expectations of the shareholders. So, there is a matter of whether this affects the financial performance of an entity. Otherwise, the cost of corporate social responsibility might be in vain. Financial performance would be measured using return on assets (ROA) as the dependent variable. Under this research, corporate social responsibility disclosure is measured by identifying different corporate social responsibility activities performed by the manufacturing companies based on the community, customer, employee and environment as independent variables.

The ultimate objectives of this research are,

- To evaluates the relationship between corporate social responsibility and financial performance.
- To assess the impact of corporate social responsibility on the financial performance of listed manufacturing companies in Sri Lanka.

Significance of the Research

This study illustrates how companies manage the business process to produce an overall positive impact on society. It is essential for management to manage their overall strategies in the business profitably. This study facilitates filling the research gap regarding Corporate Social Responsibility and Financial Performance in the Sri Lankan context.

It can be summarised the following benefits for a company of being socially responsible: (1) it is easier to attract resources; (2) it can obtain quality employees; (3) it is easier to market products and services; (4) it can create unforeseen opportunities; and (5) it can be an important source of competitive advantage (Barnett and Salomon, 2006).

The CSR policies address more and more non-monetary benefits. Firms are ignoring the adoption of those activities because the benefits of CSR are not visible, and it cannot measure in monetary terms, and basically, it is affected the long run of the firm. Because of that, the firms are not concerned about those and close their eyes. Therefore, this research is based on filling the knowledge gap in the Sri Lankan context. The findings of the present study are useful to the managers to identify the level of resources to be invested in those kinds of activities to get the maximum level of performance. For investors, they can identify the industry in which they should invest the money.

2. LITERATURE REVIEW

Corporate Social Responsibility

CSR is a concept that encourages social responsibilities on a voluntary basis. Although such social activities are not directly related to business, there is an indirect positive impact on the business undertaking them. For example, as a result, the public may have a positive image of the business company, and employee morale may be boosted, which in turn may have a positive effect on the productivity of the company (Ariyabandu and Hulangamuwa, 2002).

According to Classon and Dahlstrom (2006), CSR is the way for a company to get the responsibility of all the stakeholders. As stated by Sims in 2003, CSR requires "the continuing commitment by business to behaving ethically and contributing to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large." And also he stated that every organization has a responsibility to take care of society and enrol on activities which are contributing to the welfare of society. In the contemporary business world, businesses target not only maximizing profit but also operating the business in a socially responsible manner (McWilliams and Siegel, 2001).

Financial Performance

Financial performance is defined as a measure of make income of the business (Damodaran, 2005). Financial performance has been the measurement of success in many entities in the world (Thrun, 2003). The ROA measures not only the profit aspect but also that associated with assets employed to get the profit in the business. If the ROA is broken down, there will be two important measures: profitability ratio (profit margin) and asset turnover ratio. According to Alexander and Buchholz (1978), the key measure is the use of financial ratios in measuring the financial performance of the firm. Firm performance definition focuses on how socially responsible activities effect on firm's market value. Market value is the price of a firm's equity multiplied by the total number of shares (Copeland et al., 1994; Friedman, 1962).

How to measure Corporate Social Responsibility and performance

The importance of measurement is highlighted by Harrington (1987), who notes that "if you can't measure something, you can't understand it; if you can't understand it, you can't control it; if you can't control it, and you can't improve it" (Harrington, 1987). Carroll (2000) stated the question if it's possible to create valid and reliable measures. In addition, it was pointed out how difficult it is to introduce performance measures focused on the corporate outcomes of a company. However, the performance measures cannot be related to output because social concerns cannot be fully controlled by companies; thus, the company should not be considered a less responsible company (Graafland et al., 2003). An important topic of CSR measurement is the sort of CSR measures; the primary sort of CSR measures concerns general things that do not consider the direct and indirect effects of its sector in society (Graafland et al., 2003; Hino, 2001; Turker, 2009), while the second one proposes both general and sector-specific indicators (Azapagic, 2004; Azapagic and Perdan, 2000).

According to McGuire, Sungren and Schneeweis (1988), accounting measures such as return on assets, return on equity and return on sales gives various information regarding the company. Because of that, return on assets is used as the measurement to measure the financial performance of manufacturing companies. As an accounting measure, ROA provides a better forecast regarding CSR than market measures. The net profit percentage is the ratio after-tax to net sales. It reveals the remaining profit after all production, administration, and financing costs have been deducted from sales and income taxes recognized. As such, it is one of the best measures of the overall results of a firm, especially when combined with an evaluation of how well it is used its working capital. The measure is commonly reported on a trend line to judge performance over time. It is also used to compare the results of a business organization with its competitors.

Relationship between Corporate Social Responsibility and Financial Performance

According to Tsoutsoura (2004), there is a positive relationship between CSR and profitability, and it makes a greater contribution to strengthening the past opinion. And he has found that the firm with frozen financial performance has several resources to invest in CSR activities. They are employee relations, environmental concerns and community relations. The firms that are financially fixed can allocate more resources for CSR activities, which helps to improve the brand image and automatically, it is more beneficiary in the long term. Profitability or financial performance directly influences CSR. It is proved that the financial variable is most strongly correlated with CSR within industry groups. And there is a positive correlation between social involvement and profitability (Selvarajh et al., 2011).

3. METHODOLOGY

This study examines the effect of corporate social responsibility on firm performance using a quantitative research approach. Accordingly, the researcher collects numerical data and analyses using mathematical and statistical methods. The conceptual framework was developed based on the predictions made during the hypothesis's development process. Accordingly, this model identifies corporate social responsibility as the independent variable and financial performance as the dependent variable. Hypotheses and Conceptual Framework can be shown as below;

H0: There is no relationship between CSR (community, customer, employee and environment) and the financial performance of a company.

H1: There is a relationship between CSR (community, customer, employee and environment) and the financial performance of a company.

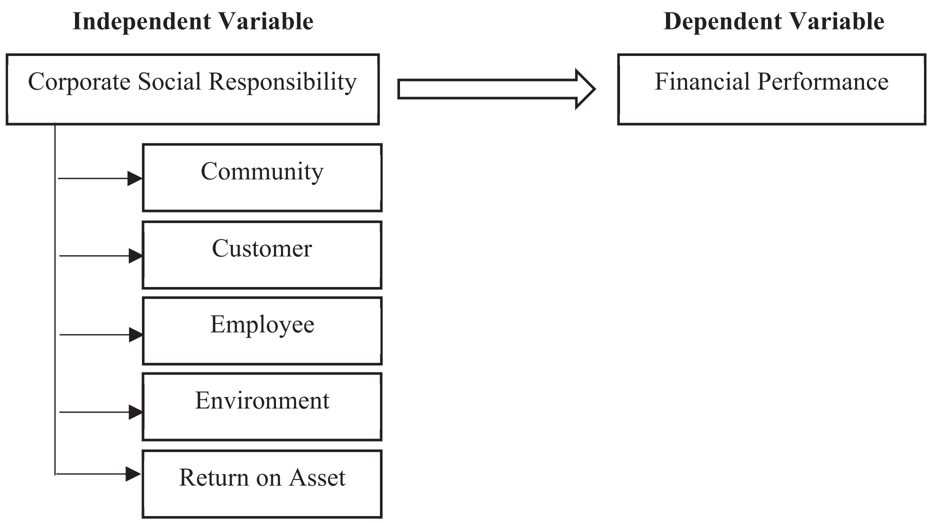

Figure 5 Conceptual diagram

Accordingly, this model identifies corporate social responsibility as the independent variable and financial performance as the dependent variable. Corporate social responsibility is measured by the CSR activities of the company, which includes Community, Customer, Employee and Environment. The financial performance of the company is measured by Return on Assets (ROA).

Research Design

This study has a positivist research philosophy. This quantitative research is conducted based on the secondary data and is highly objective. The secondary data approach facilitates to study of a large data set. These secondary data disclosed from annual reports are more relevant than primary data. The researcher is independent.

And follows the deductive approach. The research study is based on the Explanatory purpose related to hypothesis testing.

Operationalization of Variables

Table 17. Operationalization Table

Variables	Measure	Source
Community Customer Employee Environment	Total score of the dimensions/ Maximum possible score obtainable * 100	(Tilakasiri, 2012)
ROA	Net Profit/Total Asset*100	(McGuire, 1988)

Sample Selection

The study collects information from manufacturing companies listed on Colombo Stock Exchange (CSE). Those selected manufacturing companies are currently applying CSR practices. That is the reason for selecting the listed manufacturing companies as the sample. Out of the 20 industries in CSE, there are 45 manufacturing companies in the manufacturing sector. So, the population is 45 listed manufacturing companies.

The governance rules and regulations to practice corporate social responsibility are lacking in Sri Lanka (Tilakasiri, 2012). This study is based on the voluntary disclosures made in the annual reports regarding the sample of 25 manufacturing companies. The data cover a period of 5 years (2016-2020) in order to give enough information for the study. Sample selection is made by using the random sampling technique in order to reduce the biases of the study. This selection was based on the following criteria. Firms must be listed in CSE before 2016, and the selection of the companies mainly considers the availability of data related to corporate social responsibility and financial performance.

Data Collection

According to the conceptual framework, the independent variable is Corporate Social Responsibility, and the dependent variable is firm performance. The secondary data method is used because the researcher may have fewer resource requirements, such as time and money. The secondary data approach facilitates to study of large data sets. Not only may that, using secondary data results in new, unexpected discoveries (Lanis, 2011).

Data were collected from the audited annual reports and websites of respective firms. The study uses the total asset and net income to compute the return on assets. ROA is used to measure the financial performance of the companies. CSR information was obtained from the sustainability report and corporate social responsibility, which were available on company websites and annual reports. The study focuses on community, customer, employee and environment to measure the CSR activities of the company. Since this study is based on data obtained from annual reports published by companies, the reliability of the data is high.

Data Analysis Techniques

The study applies more statistical measurements to address the research questions and test the hypotheses developed earlier. Mean values were used to identify the adoption of CSR in the selected industry. The correlation method was used to identify the significance of the association between CSR and financial performance. The regression analysis is used to examine the impact of CSR towards financial performance. Multiple linear regression method was applied to investigate the causal relationship between CSR and Firm performance. The multiple regression equation of the study is developed as follows,

$$ROA = \beta 0 + \beta 1 Community + \beta 2 Customer + \beta 3 Employee + \beta 4 Environemnt + \varepsilon$$

4. FINDINGS AND DISCUSSION

Descriptive Statistics

The descriptive statistics of the variables used in the regression with minimum, maximum, mean and standard deviation values for the period of 2016 to 2020 of the selected sample.

Table 2: Descriptive Statistics

	ROA	Community	Customer	Employee	Environment
Mean	7.824	46.720	72.960	78.880	75.520
Median	6.450	40.000	80.000	80.000	80.000
Maximum	49.390	100.000	100.000	100.000	100.000
Minimum	-18.910	0.000	20.000	40.000	20.000
Std. Dev.	9.752	27.231	17.275	15.304	17.013
Skewness	1.468	0.184	-0.764	-0.230	-1.135
Kurtosis	8.130	2.122	3.149	2.484	5.455
Jarque-Bera	182.032	4.719	12.296	2.497	58.236
Probability	0.000	0.094	0.002	0.286	0.000
Sum	978.090	5840.000	9120.000	9860.000	9440.000
Sum Sq. Dev.	11792.97	91955.20	37004.80	29043.20	35891.20
Observations	125	125	125	125	125

The average or mean value of the Return on Assets (ROA) is 7.824. The company investment increases by 6.45 on average to the maximum of 49.39. The minimum value of ROA is -18.91 shows a decrease in ROA for companies listed in Colombo Stock Exchange. Other than that, minimum and maximum values are 49.39 and -18. 91 respectively. The value of the standard deviation is 9.752.

Community, Customer, Employee and Environment are independent variables. The average value of the CSR level of the Community is 40 from the range of 0 to 100. The median value of the CSR level of the Customer is 80 from the range of 0 to 100.

The CSR level of Employee is with an average value of 80 from the range of 0 to 100. From the range of 0 to 100, the CSR level of the average environment value is 80. The maximum and the minimum values are varied from 0 to 100 of the independent variables. The Mean value of all dependent (ROA) and independent variables (Community, Customer, Employee and Environment) is 7.82, 46.72, 72.96, 78.8 and 75.52 out of 100, respectively. The standard deviation values of ROA, community, customer, employee and environment are reported as 9.75, 27.23, 17.27, 15.30 and 17.01, respectively.

Correlation Analysis

Table 18: Correlation Matrix

Variable	ROA	Community	Customer	Employee	Environment
ROA	1.000				
Community	0.363	1.000			
	0.000				
Customer	0.411	0.314	1.000		
	0.000	0.000	-----		
Employee	0.244	0.289	0.812	1.000	
	0.006	0.001	0.000	-----	
Environment	0.173	0.538	0.177	0.191	1.000
	0.052	0.000	0.048	0.033	-----

According to Table 3, all independent variables positively correlate with ROA in the listed Manufacturing firms. All the correlation values of the table are in plus values. All these correlation values are positive as well as these values are more than zero and near zero. That means there is a weak and positive relationship between the dependent and independent variables. These p values are less than 0.05 (5%) and 0.1 (10%) significant levels. It indicates a positive and significant relationship between the independent and dependent variables of this study.

Regression Analysis

Table 4. Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.5064	5.0438	-0.8934	0.3734
Community	0.1017	0.0346	2.9369	0.0040
Customer	0.3165	0.0767	4.1219	0.0001
Employee	-0.1836	0.0860	-2.1348	0.0348
Environment	-0.0135	0.0535	-0.2530	0.8006
R-squared	0.2595	Mean dependent var		7.8247
Adjusted R-squared	0.2348	S.D. dependent var		9.7521
S.E. of regression	8.5304	Akaike info criterion		7.1643
Sum squared resid	8732.171	Schwarz criterion		7.2774
Log likelihood	-442.770	Hannan-Quinn criter.		7.2102
F-statistic	10.5156	Durbin-Watson stat		0.7880
Prob(F-statistic)	0.0000			

In this study, the model is estimated, and hypotheses are tested by regression analysis (multiple linear regression). The regression method is applied to investigate the causal relationship between corporate social responsibility and financial performance. Table 4 shows the regression results based on ordinary least squares (OLS) regression by using Pooled OLS method.

The findings highlighted that Corporate Social Responsibility (Community, customer, employee and environment) affected a company's financial performance (Return on asset). According to the results of this research study, the independent variables of community, customer and employee are significant $p < 0.05$. But the independent variable of the environment is insignificant, which $p > 0.05$. According to the previous scholar findings, the relationship between the CSR level of the environment and ROA was negative and insignificant (Tilakasiri, 2012).

However, in this study F = 0.0000 n <0.05. It shows that the overall combined effect of the model is good. So, the model is significant and efficient for taking decisions. In this model, alternative hypotheses (H1) can accept without any issues (the overall model is good). According to t-statistics, all three out of four independent variables are significant to the model. According to this model, there is a relationship between corporate social responsibility and financial performance. However, 25% of the dependent variable is explained by independent variables. After removing the autocorrelation from the model, the Durbin Watson Stat value is 1.87, which is greater than 1.5 acceptable level and within the standard range. Corporate social responsibility activities do necessarily have a profit-increasing performance-enhancing ability in manufacturing firms in Sri Lanka.

Hypotheses Testing

Table 19: Summary of Hypotheses Testing

Variable	Hypotheses	Relationship	Significant	Accepted/ Rejected
Community	H1	Positive	Significance	Accepted
Customer	H1	Positive	Significance	Accepted
Employee	H1	Negative	Significance	Accepted
Environment	H1	Negative	Insignificance	Rejected

5. CONCLUSION

According to the results obtained from regression analysis, there is a statistical relationship between corporate social responsibility and financial performance during the period considered in the study. In section 4, the research results were presented, analysed, and discussed descriptive statistics, correlation analysis and regression analysis. To assess whether the model is efficient, three assumption tests were followed. They are the Serial correlation test (Breusch-Godfrey Serial Correlation LM Test), Multicollinearity test and Heteroskedasticity Test. The findings highlighted that Corporate Social Responsibility (Community, customer, employee and environment) affect the financial performance (Return on asset) of manufacturing companies in Sri Lanka.

According to the results, there is a relationship between corporate social responsibility (community, customer, employee and environment) and financial performance (return on asset) of manufacturing firms in Sri Lanka.

The most important topic in the present business environment, corporate social responsibility, refers specifically to relationships with stakeholders such as the community, customers, employees and environment. This study provides commentary to the company that these stakeholder activities benefit them. The result is useful for identifying the activities to improve the profitability level. They encourage in involving in corporate social responsibility activities. It is useful to whole parties of society. And this is useful for investors to identify the industry in which they should invest their money. That is useful to improve the market value of the business. That acts as a signal for investors to show that it is most profitable to invest their money in that company (Tilakasiri, 2012).

At present also, Sri Lankan corporate social responsibility data is a voluntary disclosure. Because of that, the companies disclose the financial information regarding corporate social responsibility in order to increase companies' willingness to report. On the other hand, financial data cannot exactly reveal the real state of corporate social responsibility towards its shareholders. This is the main limitation of the study.

The adoption of corporate social responsibility activities differs from industry to industry. This result can be varied for other sectors of the companies, such as the service sector. There is a space available for future researchers to research by comparing industry-wise information. It will be useful to its potential users. Not only that, anyone can conduct research on this topic by selecting a wider sample than this. This study is based on corporate social responsibility and firm financial performance. Financial performance is not the only concept linked with corporate social responsibility. There are so many concepts which are useful to identify the relationship with corporate social responsibility. It is useful for decision-makers to identify that relationship for their decision-making. It is a new opportunity to conduct another research to identify that kind of relationship.

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