 

# Impact of Corporate Social Responsibility on Firms Financial Performance and Shareholders wealth

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**Abstract**

Our research has the basic purpose of finding the impact of corporate social responsibility on shareholders wealth and firms financial performance. We have selected three variables consisting of independent variable (corporate social responsibility), and dependent variable (firms financial performance and shareholders wealth) to conduct our research to find out the impact of Corporate Social Responsibility on Shareholders wealth and Firms Financial Performance. We tried to examine the effect either it is positive or negative between social corporate responsibility and shareholders wealth, firms financial performance. We have selected the sample of 10 firms that are highly rated as corporate social responsibility firms and 10 Non corporate social responsibility firms and evaluate their financial performance measures in accounting terms like ROA and ROE and shareholders wealth measures like EPS and stock price and try to find out whether there is any difference present between financial performance and shareholders wealth in CSR and Non CSR firms and supports our results by doing previous literature survey about that topic. Our research result shows the significant positive relationship between Corporate Social Responsibility and firm's financial performance and shareholders wealth.

**Keywords:** Corporate Social Responsibility, Firms Financial Performance; Shareholders Wealth, Corporate Social Responsibility Firms, Non- Corporate Social Responsibility Firms.

## 1. Introduction

The concept of corporate social responsibility was first evolved in 1950's at that time it is known as Social responsibility. In 1953 the first publications about the Social corporate responsibility has been introduced in the market in the shape of book published by Howard Bowen. Before the emergence of corporate social responsibility concept the basic aim of the organizations was to earn maximum profit neglecting the fact that how adversely their operations affect the overall society.

Corporate Social Responsibility concept has given the much importance from past few years to analyze its effects on shareholders wealth and firms financial performance in academic research. By the help of these previous academic researches on that topic we tried to find out the effects of corporate social responsibility on shareholders wealth and firms financial performance in our research.

CSR is the basic part of every firm's corporate strategy in today's competitive environment between the successful firms. First, we have to understand the proper meaning of corporate social responsibility to analyze its effects on shareholders wealth and firms financial performance. Followings are the some of the general definitions of Corporate Social Responsibility elaborated by various researchers.

Corporate Social Responsibility concept is forced the firms to not just having their focus on the financial growth in terms of attaining higher profits but also take in consideration about the importance of working for the welfare of other societies and forcing the firms to take care of their employees and families as well.

According to Srivastava (2012) the basic focus of CSR concept is to provide prime benefits to employees, environment, customers, society and shareholders which are considered as stakeholders of the firm. The stakeholders are all the interested parties that have directly or indirectly affected by the overall organizations processes.

Fasanya & Onakoya (2013) revealed that the term CSR is a firm's responsibility towards its stakeholders and its commitments towards its overall firm's activities and processes.

## 2. Literature Review

CSR can be well-defined as the progressing organizational commitment to work for the betterment of the workforce of the organization to attain ethical values as well as to improve the overall performance of the organization that can also contribute to the economic development of that country. CSR is the responsibility taking by the organizations to design their activities in such a way that they can also facilitate the employees, customers, shareholders and stakeholders including the environment as well. CSR concept is the meaningful try by the organization to build an effective relationship between their business environment and the overall society that are affected by the organizational processes.

Corporate Social responsibility can be defined as the organizational responsibility to develop their processes in a way that taking into the account social, environmental, and social aspects in their strategies and focusing on fulfilling the other Stakeholders interests as well.

Now look at the some of the definitions of CSR proposed by some of the authors.

AGUILERA (2007) revealed that corporate social responsibility forces the firms to work under the concept of socially responsible firm wherever they operate their business, legitimately fulfill the needs and take extra care of the concerns of all the stakeholders. All the interested parties of the firm’s actions and performance that determine their future growth are called stakeholders of the firm.

As expressed by Bichta (2003) in countries that are the members of European state have to follow the prescribed regulations about environment safety, maintaining better relationship in between workforce and the firm, giving equal opportunities to all the workforce of the firm at workplace, providing better health and safety facilities to the workforce at workplace are some of the regulations that have developed by European member state in early 20th century. By looking at the above statement we can conclude that the Government can also influence the organizations to implement Corporate Social Responsibility as the part of their strategies for the betterment of the general society and environment of the specific country. But these kind of practices are more common in the European countries and if we talk about Asian countries they are not keen to follow the Corporate social responsibility concept and Government also do not play their role in forcing the organizations to not only involving in the activities to earn maximum profits but also take into the consideration of improving the social and environmental conditions which is the one of the implications of CSR in the developing Asian countries.

Followings are the responsibilities of Organizations that underlines in the concept of Corporate Social Responsibility.

### *2.1 Responsibility towards Organization itself*

The responsibility of an organization is to work for the improvement in their overall processes to earn maximum profit which is the basic objective of an organization.

### *2.2 Responsibility towards Employees*

Since employees are the integral part of an organizations they have to work for the betterment of their employees by giving them suitable environment, giving them timely payments, look for their health improvement, work for the betterment of their family and finally encouraging them to take part in the organizational decision making.

Brine (n.d) explored that the firms which facilitates their workforce by providing them better working conditions to taking their interests in considerations will results in better quality of their products and experienced higher level of growth in their profits. Companies that work for their employees under the lightening concept of corporate social responsibility are often faced less employee turnover and retain their employees at the maximum rate as their employees are fully satisfied with their working condition and all the other facilities provided by the organizations.

### *2.3 Responsibility towards Shareholders*

As shareholders are the owners of the organizations it is the responsibility of the organizations to secure their investments and put all the possible efforts to provide them a maximum return on their investments.

When organization are meeting their responsibilities of securing shareholders’ investment and gave them maximum returns it results in adding in the value of the organization and goodwill of the organizations in the market and more investors are attracted towards that organization and make their investment in terms of purchasing shares of that organization.

### *2.4 Responsibility towards customers*

It is the utmost responsibility of the organizations to provide the customers the better products meeting all the quality standards having low price. As customers are the main sources of an organization to earn maximum profit making them responsibility results in earning higher profits as the organizations built the ability of satisfying their customers and making them loyal customer? Albuquerque (2013) expressed that CSR can be used to maximize firms value by minimizing the systematic risk and can considered as the investment in maintaining customer loyalty. As mentioned earlier that investing in Corporate social responsibility to provide better products to the customers results in achieving customer loyalty to increase the firms value supported by the earlier mentioned research as well.

*2.5 Responsibility towards Environment*

It is the responsibility of the organization to design their processes that are environmental friendly and work for the betterment of environment in a way that there should be proper process of managing the industrial waste that should not harm the environment.

There is an criticism on Corporate social responsibility as well like it was said by the some authors that it work against the agency theory that tells us that the managers are working in the organizations as the agent and their basic goal is involving in the activities that maximizing the profits of the organizations rather than take in consideration of other factors like work for the betterment of employees, customers, stakeholders and the environment. This criticism can be neglected in a way that if you work for the employees than they are more engaged to the organizations and effectively doing their tasks that adds value in the organizational overall performance. According to Rangan (2012) most of the firms in today's era are implementing some practices of CSR in their operations regardless of the ongoing criticism on CSR.

According to Foote (2010) the importance of CSR concept to improve the firms performance is mostly discussed around the results inference by various researchers as CSR can negatively, neutrally and positively affects the firm's financial performance.

The effects of implementing the CSR on firm's performance are very vast.

Poddi & Vergalli (2009) implies that the honorable firms that implement the CSR idea results in better long term performance. These firms are subjected to some early costs that results in achieving higher profits by the increase in their sales due to the fact that they maximize their social responsibility and minimize their long term costs that will increase their goodwill.

The above mentioned research shows that there is a positive relationship between CSR and firms performance as organizations that involves in the Corporate social responsibility have better long run performance as they develop a goodwill and effective reputation in the business environment for their organizations by taking into account the society betterment in their processes and decisions and design their processes that are environmental friendly which remove the harm of environment in which the societies are lived.

Fasanya & Onakoya (2013) revealed that CSR is the basic tool to the financial development of the firm in terms of attaining higher profits by adopting the process of taking community and society welfare in considerations by the firm. Most of the studies conducted on evaluating the effect of corporate social responsibility on firm's financial performance show the positive relationship in between them.

Peloza (2009) expressed in his research paper that 159 studies conducted including academic and practitioner resources, negative relationship between CSR and firms performance have been reported by 15% studies, 22% studies revealed that there is a neutral relationship between CSR and Firms performance but most of the studies (63%) showed the positive relationship between CSR and firms performance. The above given statistics revealed that the investment in the Corporate social responsibility penetrate the firms overall financial performance.

Kercher (2006) revealed that the first we have to examine that whether CSR have the main focus on taking in considerations all the stakeholders of the firm or only to increase the value of the shareholders wealth in firms decision making process which is mostly discussed about CSR. Some of the followers of shareholders theory argued that the elementary aim of the organizations is to increase the shareholders wealth and some of the followers of stakeholder's theory concept argued that the organizations should take into account all the interested parties of the firm like customers, employees and the environment as well.

The earlier debate about Corporate Social Responsibility is that either the organizations should work for the betterment of shareholders or stakeholders but in the current era of Corporate Social Responsibility the organizations need to focus on the both aspects. The arguments of Shareholders theory proponents can be satisfied in a way that the firms implementing Corporate social responsibility concept work for the stakeholders like customers, employees and the environment in which they operate that contribute in the long-term success and profitability because the customers are the basic source of firms which they earn profit through effectively work done from their employees as they are the basic resources of an organization. We can say that if the organization work for their customers and employees that help in attaining maximum profits and long-run success, it also affects the shareholders wealth in a positive way as they are concerned with the profitability of the firm from which they can earn their maximum returns.

Iwu-Egwuonwu (n.d) expressed that CSR can be considered as the practice that evolved from the previous tested notation that profits can be increased by the firms that maintain their better relationships with their stockholders by taking best care of their interests, and taking in considerations about the social empire. Most of the studies result revealed that relationship between CSR and firm's financial performance is positively related. We can inference the results from the above stated research that there is a positive relationship between the CSR and the firm's performance and if the organizations work for the stakeholders interest it ultimately affects the shareholders wealth in a positive way as well and maximize the shareholders wealth.

Different researchers conclude that shareholders theory may results in decreasing organizational performance in the current business setting.

According to Servaes & Tamayo (2012) firms that have high customer responsiveness, CSR have positive effect on firm's value. Customer awareness is very important variable that also contribute its importance in developing the positive relationship between the CSR and firm value. Taking in consideration the interest of customers of organizations adds the value in firms performance in terms of profitability of the firm which in turns the maximization of shareholders wealth.

Problem Statement

- Definition of Corporate Social Responsibility is different in different countries. You have to understand the perspective of each country about the Corporate Social Responsibility concept.
- There is criticism about the Corporate Social responsibility that it violates the concept of Agency theory.
- In Asian countries the concepts of Corporate Social Responsibility have not been given the desired importance as compared to the Developed European countries. In Asian countries they are more concerned with the just profit maximization.

## 3. Methodology

### *3.1 Sample*

To define our sample we have to consider the problem to evaluate the firms which are considered as Social Corporate Responsibility firms that should include in our sample. For this purpose we have followed the following steps.

- We have selected the firms that are listed in stock exchanges that follow the concept of CSR to check its effects on the firm's performance and shareholders wealth.
- In second step we selected the groups of Non Corporate social Responsibility firms and the firms that implement the Corporate Social Responsibility to analyze some of the differences in their financial performance for the particular time period.
- Finally, we selected our sample size of the firms that implement corporate social Responsibility concept.

We have selected 10 firms from different sectors that are considered as Corporate Social Responsibility firms and 10 firms that are Non Corporate Social Responsibility firms. We analyze the financial data of year 2011 for these firms and try to examine the impact of CSR on firm's financial performance and shareholders wealth.

**Exhibit-1- CSR and Non CSR firms included in our sample**

| CSR Firms | Non CSR Firms |
|---|---|
| 1-Nestle Pak Ltd | 1-Murree Brewery Company Ltd. |
| 2-Unilever Pak Ltd | 2-Clover Pak Ltd |
| 3-Bata Pak Ltd | 3-Dost Steel Ltd |
| 4-D.G Khan Cement Ltd | 4-Lucky Cement Ltd |
| 5-Shezan International Ltd | 5-National Foods Ltd |
| 6-Colgate-palmolive Pak Ltd | 6-Data Agro Ltd |
| 7-Fauiji Fertilizer Company Pak Ltd | 7-Descon Chemicals Ltd. |
| 8-ICI Pak Ltd | 8-Leiner Pak Gelatine Ltd. |
| 9-Nishat mills Ltd | 9-Masood Textile mills Ltd |
| 10-Kohinoor mills Ltd | 10-Mukhtar Textile mills Ltd |

3.2 *Basic Methodology*

We have selected the mixed Methodology in which we try to analyses the effects of CSR on Firms performance and Shareholders wealth.

3.2.1 Financial Analysis

In first step we analysed the financial data of the selected CSR firms by looking at their ROE and ROA ratios to check the effects of implementing CSR in the firms on Firms financial performance in terms of its profitability.

For the purpose of analyzing the effects of CSR on Shareholders wealth we analyzed the stock prices of the firms and EPS implementing Corporate Social Responsibility and compared these stock prices with Non- Corporate Social Responsibility firms to check its impact on Shareholders wealth.

3.2.2 Literature Survey

We try to analyze the effects of CSR on Firms performance and Shareholders wealth by looking at the previous literature of different authors about that concept and try to evaluate the impact of CSR on Firms Financial and Non-financial performance and on shareholders wealth.

## 4. Hypothesis

We are trying to evaluate our hypothesis using above mentioned methodology. Followings are our Hypothesis.

H1- Corporate Social Responsibility has the significant positive impact on Shareholders wealth.

H1a- Corporate Social Responsibility has the significant negative impact on the Shareholders wealth.

H2- Corporate Social Responsibility has the significant positive impact on firm’s financial performance.

H2a-Corporate Social Responsibility has the significant negative impact on firm’s financial performance.

We trying to inference our results of above mentioned Hypothesis about the Corporate Social Responsibility by using the above mentioned methodology in which Corporate social responsibility is Independent variable and firms performance and Shareholders wealth are dependent variable.

## 5. Findings and Discussion

By looking at the ROA and ROE ratios of CSR firms as compared to Non CSR firms we can evidently say that there is a significant positive impact of CSR on Firms Financial performance because the ROA and ROE ratios are high in Corporate Social Responsibility firms as compared to Non CSR firms. Nestle Pak Ltd which is considered as the highly rated Corporate Social responsibility firm outperforms Non Corporate Social Responsibility firm Clover Pak Ltd in terms of ROA and ROE ratio as Nestle Pak Ltd reports ROA of year 2011 22.37% as compared to Clover Pak Ltd which is 8.05% and ROE ratio of Nestle Pak Ltd in same year is 98.57% as compared to 16.56% of Clover Pak Ltd. Approximately all the Corporate Social Responsibility firms that are included in our sample outperform the Non Corporate Social Responsibility firms in terms of their financial performance that is measured with the help of ROA and ROE ratios. By looking at the above given statistics we accept the H1 hypothesis that say that there is a significant positive impact of CSR and CSP.

We analyzed the EPS and price of the stock of CSR firms and Non CSR to evaluate the relationship of CSR and

Shareholders wealth. The EPS of highly rated CSR firm Unilever Pak Ltd of year 2011 is 307.11 as compared to Non CSR firm Murree Brewery Co. Ltd that reports the low EPS of 30.02. The Stock price of Unilever Pak Ltd is 317.15 in year 2011 as compared to stock price of 244.41 Murree Brewery Co. Ltd. The CSR firms and Non CSR firms that are included in our sample shows the same results as well. By looking at the above given statistics we can generalize our findings that there is a significant positive impact of CSR on shareholders wealth and hence accepts the H2 hypothesis. (Exhibit-1 includes the CSR and Non CSR firms that are included in our research)

Look at the some of the others researches that tried to check the impact of CSR on CP and Shareholders wealth and analyses the results in support of our findings.

Tsoutsoura (2004) expressed that socially responsible firms can gain lots underpinned benefits supporting this view by the results that tells us that there is a significant positive effects of CSR on firm's financial performance.

According to Brine (n.d.) most of the researches shows that there is possible relationship between CSR and firms financial performance after taking in to considerations about CSR by the firms.

Hayne (2010) stated that the results of their meta-analysis show that there is a positive effect of corporate social performance on corporate financial performance. According to Afiff & Anantadjaya (2013) the results show that CSR employee, CSR community, firm's size, profitability and leverage have significant effect toward firm's stock price.

Ming Shiu & Lin Yang (n.d.) revealed that the firms bond and stock prices can produce insurance like effects by engaging their activities in accordance with the CSR concept and these effects are also remains for longer terms. Bayoud (n.d.) expressed that in order to improve the firm's financial performance; the firms are increasing their focus on corporate social responsibility development in their annual reports.

Firms focus on the employee confession, environmental disclosure, customer disclosure and society disclosure to increase firm's financial performance.

## 6. Conclusion

We can conclude that CSR concept is very important for the firms to attain maximum Financial Performance in today's competitive environment. Our results shows that there is a significant positive impact of CSR and firms financial performance and shareholders wealth by analyzing their accounting measures like ROE, ROA, EPS and price of the stock of particular CSR firms and compare these results to the Non CSR. We analyzed that these accounting measures of CSR firms are higher than Non CSR firms which concludes our discussion as CSR has positive impact on the Firms Financial Performance and Shareholders Wealth.

We also include previous literature survey on that topic to give evidences of the results that have been concluded by other authors after their research on that topic in support of our results.

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**Annexure-1**

**<u>Corporate Social Responsibility Firms</u>**

| **Company Name** | ROE | | ROA | | EPS | | SP |
|---|---|---|---|---|---|---|---|
| 1-Nestle Pak Ltd | 98.57% | | 22.37% | | 121.11 | | 167.86 |
| 2-Unilever Pak Ltd | 151.02% | | 40.16% | | 307.11 | | 317.15 |
| 3-Bata Pak Ltd | 34.06% | | 23.29% | | 102.1 | | 433.57 |
| 4-D.G Khan Cement Ltd | 2.37% | | 1.37% | | 1.09 | | 69.98 |
| 5-Shezan International Ltd | 23.29% | | 11.81% | | 24.09 | | 158.84 |
| 6-Colgate-palmolive Pak Ltd | 44.88% | | 31.81% | | 41.51 | | 138.45 |
| 7-Fauiji Fertilizer Company Pak Ltd | 160.58% | | 23.13% | | 33.4 | | 38.26 |
| 8-ICI Pak Ltd | 20.25% | | 13.92% | | 14.76 | | 115.52 |
| 9-Nishat mills Ltd | 16.21% | | 10.79% | | 13.78 | | 100.67 |
| 10-Kohinoor mills Ltd | 9.12% | | 4.13% | | 2.27 | | 32.88 |

**Source: State Bank of Pakistan (Financial Statements analysis of Companies listed in Karachi Stock Exchange of year 2006-2011)**

**Annexure-2**

**<u>Non Corporate Social Responsibility Firms</u>**

| **Company Name** | **ROE** | | **ROA** | | **EPS** | | **SP** |
|---|---|---|---|---|---|---|---|
| 1-Clover Pak Ltd | 16.56% | | 8.05% | | 4.23 | | 41.93 |
| 2-Murree Brewery Company Ltd. | 19.57% | | 16.66% | | 30.02 | | 244.41 |
| 3-Leiner Pak Gelatine Ltd. | 0.47% | | 0.26% | | -0.46 | | 28.5 |
| 4-Dost Steel Ltd | -1.73% | | -0.52% | | -0.16 | | 8.9 |
| 5-Lucky Cement Ltd | 16.34% | | 10.87% | | 12.56 | | 85.88 |
| 6-National Foods Ltd | 43.46% | | 13.09% | | 5.72 | | 22.27 |
| 7-Data Agro Ltd | -1.62% | | -0.76% | | -0.38 | | 12.72 |
| 8-Descon Chemicals Ltd. | 0.25% | | 0.06% | | -0.12 | | 2.43 |
| 9-Masood Textile mills Ltd | 24.10% | | 6.93% | | 6.79 | | 77 |
| 10-Mukhtar Textile mills Ltd | -11.24% | | -7.52% | | -0.37 | | 3.14 |

**Source: State Bank of Pakistan (Financial Statements analysis of Companies listed in Karachi Stock Exchange of year 2006-2011)**