

Corporate Social Responsibility and Company Performance: Evidence from Sri Lanka

Tilakasiri, .K.K.

Faculty of Commerce and Management Studies, University of Kelaniya

Introduction

The CSR literature was divided into two areas: development studies, including definitions, theories, standards and frameworks, and relationship studies, including the relationships between CSR and company performance (CP), and CSR and share market performance. However, there are significant differences between the developed and developing countries in implementing CSR activities. Researchers have identified these differences—of culture, management perspectives, and geographical and natural business systems—and concluded that existing CSR in the developed world cannot be employed in developing countries.

However, developed countries have identified the benefits when implement the concept of CSR in their organisations. Then they have completed the various research such as relationship between CSR and CP, relationship between CSR and stock market performance, to endorse the benefits from this concept. Also, developing world still dearthof researchthen they have no chanced to recognise the benefits from this concept and no framework, indices and standards to perform CSR research are the limitations to CSR studies. Therefore, researchers are now turning their attention to investigating CSR from the point of view of developing countries. This research gap identified by the researchers and formed following research problems and objectives to continue the study.

Research Problem

The major research problem identified in the study as, Is corporate social responsibility performance related to CP in the Sri Lankan corporate sector? To explore possible answers to this question, three subsidiary questions were addressed:

- What does CSR mean in the Sri Lankan context?
- To what extent are Sri Lankan companies socially responsible?

- Is there a relationship between CSR and the CP of Sri Lankan companies listed on CSE?

Objectives of the Study

In developing countries, this issue is under-researched, even though some research has been conducted on the development of the CSR concept. Therefore, this study's main purpose was to explore the relationship between CSR and CP in a developing country—Sri Lanka.

More specifically, this study aimed to:

- develop a framework for identifying the CSR practices of companies operating in Sri Lanka
- develop an index for measuring the CSR performance of Sri Lankan companies listed on the CSE
- investigate the relationship between CSR and CP in Sri Lankan companies.

Theoretical Considerations and Empirical Evidence

CSR includes a number of theories and many studies have discussed agency, stakeholder and social contract that are behind the concept of CSR; these theories and CSR approaches under the themes of economics, politics, social integration and ethics (Parsons and Sociales 1961; Garriga and Melé 2004; Jamali and Mirshak 2007). Accordingly, the next section describes stakeholder and social contract theories in understanding the theoretical framework of the CSR concept. These two theories include strategies for achieving competitive advantages. Further, stakeholder theory is an important theory to discuss in this literature review section because the aim of this is to develop a CSR framework using stakeholders. The CSR in those developing countries directly relates with its stakeholders and therefore, it is needed to discuss more details to understanding the various scholars' descriptive ideas and real practices.

The results of empirical studies under the relation between CSR and CP have been mixed. For example, the long-term financial impacts showed a positive relationship with CSR in Waddock and Graves' (1997) study, no relationship in Aupperle et al.'s study (1985) and a negative relationship in the study by Waddock et al. (1998). Similarly, studies of the relationships

between CSP and CP have shown mixed results, with some short-term results being positive, others were mixed (Posnikoff 1997), or negative (Wright and Ferris 1997), while yet others found a neutral relationship (Teoh et al. 1999). A similar pattern emerged from studies of long-term CP. Some researchers identified a positive relationship (Cochran and Wood 1985; Waddock and Graves 1997; Stanwick and Stanwick 1998; Tsoutsoura 2004), some found a non-significant relationship (e.g., Aupperle 1985) and others contradicted showing a negative relationship (Waddock et al. 1998). The current study based on the context of developing countries CSR, the dearth of research has been done relating to this area. However, many researchers have encouraged to develop this area for the developing countries contexts.

Methodology

CSR Framework

To investigate the relationship on this study, a CSR framework was developed because there is currently no such framework in Sri Lanka to identify CSR practices in companies; this was one sub-aim of this study. In developing a CSR framework, the researcher made use of the iterative **Delphi method**, in the first round interviewing and in the second surveying expert and knowledgeable people about CSR practices. These qualitative data were then analysed using a content analysis research technique, which identified 28 activities for the potential CSR framework. Using this framework, six CSR constructs were identified in the pilot study of this research.

Develop an index

The major purpose for developing a CSR index was to measure the data using a quantitative method in order allow further analyses such as examining the relationships between CSR and CP. The CSR index was calculated based on the information disclosed by selected companies in their annual reports and their sustainability reports, and named the disclosure index which the literature has shown involves three steps. The first step is the selection of reliable items, relating to previous studies (Cooke 1989) and disclosures recommended by the accepted accounting standards body and legal requirements (Marston and Shrives 1991). The second step is weighting items as they arise in the index. The final step involves calculating the index scores.

Identify the relationship between the CSR and CP

The third sub-aim of the study was to examine the long-term relationship between CSR and CP according to the above framework. Fifty companies listed in the Colombo Stock Exchange in Sri Lanka were selected for the study and all these companies disclosed their CSR practices and CP data in either their annual reports, sustainability reports or on their company website. The period of the study has been the past five years - from 2004 to 2009. From 2004 CSR data were identified; company financial data were identified using a lag time of one year (2005).

The independent variable was the disclosed CSR data, which were qualitative. In addition, CP, a dependent variable, was measured by using three accounting indicators: ROS, ROE and ROA. Consequently, these quantitative data were employed in the panel data regression model using E-Views software to scientifically analyse the data to identify the significant relationship between these two variables.

Statistical Analysis

Recently Mahoney and Roberts (2007) and Saleh et al. (2008), used panel data analysis for their CSR relationship studies. Panel data is the combination of cross-sectional and time-series data used in economics to provide substantial information about economies. This model is the most appropriate methodology for the present study because it uses both cross-sectional and time-series data for the five years between 2005–2009. Several terms have been used to describe panel data including pooled and longitudinal data, event study and cohort analysis (Gujarati 2003). Several researchers have used time-series and cross-sectional data to examine issues that could not be studied in either time-series or cross-sectional settings alone (Greene 2007).

The model

Three accounting variables were utilised to represent CP: the dependent variables ROE, ROS and ROS. The panel data equation for this study as follows:

$$Y_{it} = \alpha_i + \beta_1 X_{1it} + \beta_2 X_{2it} + \varepsilon_{it}$$

Therefore, the three equations explaining the direct relationship between ROE, ROA and ROS can be expressed as:

$$ROE_{it} = \alpha_i + \beta_1 Com_{1it} + \beta_2 Hlth_{2it} + \beta_3 Env_{3it} + \beta_4 Emp_{4it} + \beta_5 Edu_{5it} + \beta_6 Cus_{6it} + \varepsilon_{it}$$

In addition, ROA is expressed as:

$$ROA_{it} = \alpha_i + \beta_1 Com_{1it} + \beta_2 Hlth_{2it} + \beta_3 Env_{3it} + \beta_4 Emp_{4it} + \beta_5 Edu_{5it} + \beta_6 Cus_{6it} + \varepsilon_{it}$$

while ROS is expressed as:

$$ROS_{it} = \alpha_i + \beta_1 Com_{1it} + \beta_2 Hlth_{2it} + \beta_3 Env_{3it} + \beta_4 Emp_{4it} + \beta_5 Edu_{5it} + \beta_6 Cus_{6it} + \varepsilon_{it}$$

Where ROE = Return on Equity; ROS = Return on Sales; ROA = Return on Assets; Com = Community; Hlth = Health; Env = Environment; Emp = Employees; Edu = Education; Cus = Customers.

The indirect relationship of the panel data model is shown below. The differences mentioned between the direct models in this study include control variables such as company size:

$$ROE_{it} = \alpha_i + \beta_1 Com_{1it} + \beta_2 Hlth_{2it} + \beta_3 Env_{3it} + \beta_4 Emp_{4it} + \beta_5 Edu_{5it} + \beta_6 Cus_{6it} + \beta_7 eFirmSiz_{7it} + \varepsilon_{it}$$

In addition, ROA is expressed as:

$$ROA_{it} = \alpha_i + \beta_1 Com_{1it} + \beta_2 Hlth_{2it} + \beta_3 Env_{3it} + \beta_4 Emp_{4it} + \beta_5 Edu_{5it} + \beta_6 Cus_{6it} + \beta_7 eFirmSiz_{7it} + \varepsilon_{it}$$

While ROS is expressed as:

$$ROS_{it} = \alpha_i + \beta_1 Com_{1it} + \beta_2 Hlth_{2it} + \beta_3 Env_{3it} + \beta_4 Emp_{4it} + \beta_5 Edu_{5it} + \beta_6 Cus_{6it} + \varepsilon_{it}$$

$$ROS_{it} = \alpha_i + \beta_1 Com_{1it} + \beta_2 Hlth_{2it} + \\ + \beta_7 eFirm Siz_{7it} + \varepsilon_{it}$$

Where ROE = Return on Equity; ROS = Return on Sales; ROA = Return on Assets; Com = Community; Hlth = Health; Env = Environment; Emp = Employees; Edu = Education; Cus = Customer; Company size: total sales/total assets.

Key Findings

The findings of this study are in agreement with the literature identified from different countries. This study related to the developing countries of Sri Lanka. The present study developed a CSR index because existing indices cannot be adopted to Sri Lankan companies because their formal CSR practices have not been implemented in this country.

The main objective of the study was to identify the relationship between CSR and CP in the listed companies in Sri Lanka. The results showed that there is a significant relationship between CSR and CP. To understand these results, the findings revealed that community-related activities showed a positive relationship with CP, while health-related activities showed a negative relationship. The above discussion of the limitations of this study and the possibilities for future research conclude this thesis.

Conclusion

The literature has revealed the benefits to be gained from effective CSR practices. CSR acts as a very important role in attracting stakeholders and stakeholder confidence to companies. The study supported the argument that there is a positive relationship between CSR and the performance of Sri Lankan companies. In addition, the data collection technique, method of analysis and development of a new CSR index were new in the area of CSR in Sri Lanka.

References

- Aupperle, KE, Carroll, AB & Hatfield, JD 1985, An empirical examination of the relationship between corporate social responsibility and profitability', *Academy of Management Journal*, vol. 28, no. 2, pp. 446–63.
- Cochran, P & Wood, R 1985, Corporate social responsibility and financial performance', *Academy of Management Review*, vol. 4, pp. 758–69.

- Cooke, TE 1989, Disclosure in the corporate annual reports of Swedish companies', *Accounting and Business Research*, vol. 19, no. 74, pp. 113–24.
- Garriga, E & Melé, D 2004, Corporate social responsibility theories: mapping the territory', *Journal of Business Ethics*, vol. 53, no. 1, pp. 51–71.
- Greene, WH 2007, *Econometric Analysis (7 th)*, Upper Saddle River, NJ: Prentice Hall.
- Gujarati, D 2003, *Basic Econometrics*, Boston: McGraw Hill.
- Jamali, D & Mirshak, R 2007, Corporate social responsibility (CSR): theory and practice in a developing country context', *Journal of Business Ethics*, vol. 72 no. 3, pp. 243–62.
- Mahoney, L & Roberts, RW 2007, Corporate social performance, financial performance and institutional ownership in Canadian firms', in vol. 31, pp. 233–53.
- Marston, CL & Shrides, PJ 1991, 'The use of disclosure indices in accounting research: a review article', *The British Accounting Review*, vol. 23, no. 3, pp. 195–210.
- Parsons, T 1961, *An outline of the social system*, University of Puerto Rico, Dept. of Social Sciences.
- Posnikoff, J 1997, Disinvestment from South Africa: They did well by doing good', *Contemporary Economic Policy*, vol. 15, no. 1, pp. 76–86.
- Saleh, M, Zulkifli, N & Muhamad, R 2008, An empirical examination of the relationship between corporate social responsibility disclosure and financial performance in an emerging market, *International Journal of Productivity and Performance Management*, Vol. 59, No. 3, p.229 – 254. .
- Stanwick, PA & Stanwick, SD 1998, The relationship between corporate social performance, and organizational size, financial performance, an environmental performance: An empirical examination', *Journal of business ethics*, vol. 17, no. 2, pp. 195– 204.
- Teoh, SH, Welch, I & Wazzan, CP 1999, The effect of socially activist investment policies on the financial markets: Evidence from the South African boycott', *Journal of Business*, pp. 35–89.

Tsoutsoura, M 2004a, *Corporate social responsibility and financial performance*, University of California, Berkeley

Waddock, SA & Graves, SB 1997, The corporate social performance-financial performance link', *Strategic Management Journal*, vol. 18, no. 4, pp. 303-19.

Waddock, S, Graves, S & Gorski, R 1998, Social and Traditional Investment: Stakeholder and Performance Characteristics', *The Investment Research Guide to Socially Responsible Investing*.

Wright, P & Ferris, S 1997, Agency conflict and corporate strategy: The effect of divestment on corporate value', *Strategic Management Journal*, vol. 18, no. 1, pp. 77-83.

Community Relations
1.Organising video/audio programmes and short films for understanding safety: road rules, healthy foods, first aids, preventing deceases, respect to each other etc. And organising first aid programmes; safety programmes
2.Building up houses for homeless people: tsunami affected people
3.Organising sports activities
4.Supporting services for elders, children and disabled person
5. Organising mental relief activities: musical shows, exhibitions etc
6.Maintaining parks and towns
Health Relations
7.Organising Dengue, HIV And Rebels Preventing Programmes
8.Supporting Services To Government Hospitals. Donating Beds, Equipment, Theatres And Additional Buildings
9.Providing Scholarships For Medical Students, Doctors For Further Education
Employee Relations
10.Training and development
11.Health and Safety programme
12.Equal and impartial employment policy, Grievances handling, Prevention child labour, Labour discrimination (Women)
13.Trade Union development
14.Welfare facilities: transport; insurance; sports; organising functions, Organising day care centres and pre-schools children
15.Formal recruiting, promotion and firing system
16.Formal leaves system and Financial benefits
Education Relations

17.Organising education seminars for students and teachers for updating syllabuses and preparing for the exams
18.Donations books, uniforms and foods and building up libraries in school level
19.Organising English language support programme: organising for rural areas student
20.Organising disability support activities for disabled children (Braille keyboards, text to speech programmes, learning aids for slow learners)
21.Organising skill development programme for undergraduates and school leavers
22.Organising day care centres and pre-schools children
Customers Relations
23.Offers quality products and services
24.Provides information that is truthful and useful
25.Respects the rights of consumers.
Environmental Relation
26.Organising programmes for caring the environment, saving the environment- _save our environment‘, cleaning the environment
27.Applicable environmental rules: building plans, waste water arrangement cleaning the garden, permission for land development
28.Planting trees: herbal and avoiding soil erosion

Appendix

Sources: Analysed data based on the descriptive statistics