
Wijesinghe K.N.
Department of Accountancy
Faculty of Commerce and Management Studies
University of Kelaniya
nayomi@kln.ac.lk

Senaratne S.
Faculty of Management Studies and Commerce
University of Sri Jayewardenepura
samanthi.senaratne70@gmail.com

Abstract

Relationship between Corporate Social Responsibility (CSR) and Corporate Financial Performance (CFP) is a vexing problem faced by all business organizations. There are numerous studies supporting for different types of relationships ranging from positive to negative.

This study focused on Bank, Finance and Insurance (BFI) sector. In the study disclosure of CSR is considered. Disclosure of CSR was measured in terms of CSR disclosures quantified via GRI guidelines and financial performance as in terms of ROE and ROA.

Findings of the study revealed that the overall level of CSR disclosure is at a low level and there is a need of much improvement in Governance, economical, social and environmental disclosures which are the major components of sustainability. It is resulted a significant positive relationship between disclosure of CSR with ROE & ROA. It therefore claimed that the higher level of CSR disclosure yields the higher level of financial performance.

Key words: Bank Finance & Insurance sector, CFP, CSR, GRI guidelines
Introduction

Background of the study

Today’s competitive and dynamic market environment has created new set of challenges for any business which are not only related to economics. To survive and prosper, firms must bridge the gaps in economic as well as social systems. Maximizing shareholder’s wealth is an every time essential but fulfilling that condition alone is no more valid in measuring the financial prosperity.

McWilliams and Siegel (2001) said that the definition of CSR was not always clear and they define CSR as actions that appear to further some social good, beyond the interests of the firm and what is required by law. In Modern concept of CSR states that the business enterprises is in their usual process of business decision making should pay due attention to the social interests of the people in the community. A company is not only an economic entity but a social and political entity also. Most of the decisions taken by the companies not only affect the stockholders but also the stakeholders namely creditors, debtors, employees and the society at large in one way or the other. (Kapoor & Sandhu, 2010).

Problem Statement

Many managers have responded to heightened stakeholder interest in CSR in a very positive way, by devoting additional resources to promote CSR. A primary reason for positive responses is the recognition of the relevance of multiple stakeholders (Mitchell, Agle, &Wood, 1997). Other managers have a less progressive view of stakeholder relevance. They are reluctant to satisfy demand for CSR, because they believe that such efforts are inconsistent with profit maximization and the interests of shareholders, whom they perceive to be the most important stakeholder (McWilliams & Siegel, 2001).

This divergence in response has stimulated an important debate regarding the relationship between CSR and Corporate Financial Performance (CFP). Therefore many researchers dig into this matter in order to find any empirical relationship between CSR and CFP. Previous studies have identified different kinds of relationships (positive, negative, no relationship) between firm financial performance and firm social responsibility e.g. Aupperle, Carroll, & Hatfield, 1985; McGuire, Sundgren, & Schneeweis, 1988; Waddock & Graves, 1997) but to date there is no clear empirical relationship. It is clear that the relationship between CSR and CFP is still controversial and open area for further researches.
Therefore problem statement of the current study is what is the impact of disclosure of Corporate Social Responsibility on Corporate Financial Performance?

**Research Questions**

By researching into the matter of relationship between disclosure of CSR and CFP, following research questions to be answered.

1. What is the existing level of CSR disclosure of Bank Finance and Insurance sector in Sri Lanka?
2. What is the impact of disclosure of CSR on ROA?
3. What is the impact of disclosure of CSR on ROE?

**Objectives of the Study**

As mentioned earlier Since CSR is about satisfying current social expectations rather than traditional objective of satisfying narrower expectations of shareholders, still there are unsolved questions about how disclosure of CSR affect to CFP. There are three research objectives in the current study as shown below

1. To identify the existing level of CSR disclosure of bank, finance and insurance sector in Sri Lanka
2. To identify the impact of CSR disclosure on ROA
3. To identify the impact of CSR disclosure on ROE

**Significance of the Study**

Though there are numerous research literatures on the relationship between CSR and CFP, still the findings are controversial. Various arguments have been made regarding the relationship between firms' social responsibility and their financial performance. Therefore, this is an area which is still open for further research.

However when it is considered the global trend it can be concluded that the disclosure of CSR is no more a voluntarily activity. It is also a part and partial of annual reports as in conjunction with the financial statements of a company. Reporting on CSR is inevitable since the significance of such reporting has been weighted highly in the international context. Most countries are now concerning more on adhering to GRI guidelines, sustainability reporting, green accounting…etc. In such a situation this study would assist to identify where we are in this dynamic contest. Hence, the results of the study would enhance the knowledge and improve management practices. On the other hand there is lack of research evidence in this regard specially in Sri Lankan context. This research would fill so identified research gap.
Furthermore, in Sri Lanka it has no valid index to measure CSR activities and disclosures and this study emphasis the need of such index. Finally findings of this study would encourage companies and authorities to sense in depth about CSR and step up into new reporting areas of sustainability, to be in line with the international standards and equalize the quality of reporting to cutting edge globally accepted norms.

Scope of the Study
In the current study, researcher identified the impact of disclosure of CSR on CFP in BFI sector. In the case of quantification of CSR, whole GRI index was used. In this index 121 sub variables categorized into 7 main variables. When it comes to the CFP, among number of financial performance measures profitability is considered. In order to measure the profitability ROE and ROA used. Sample of the study is 27 companies of BFI sector and data collected for five consecutive years, begins from 2005/2006. In order to test the hypothesis regression analysis was used.

Limitation of the Study
Measurements of CSR were based on annual reports which were self-reported disclosures by the firms. The CSR activities reported by companies might be overstated or understated. Over-reporting or under-reporting may produced biased results. CSR data based on regular surveys of business people, business writers, business schools and the people at large might have produced more reliable results. Finally the limitation regarding the use of financial performance measurements was considered as one of the notable limitation of the study. Researcher used accounting based measures of the firm’s financial performance; however, the use of market- based measures might have produced more reliable results. Moreover CFP is measured by using only two profitability measures. When calculating ROA and ROE, data relating to the end of the year were only considered.

Literature Review/Theory and Hypotheses
What is the relationship between CFP and CSR?
Based on different research criticisms mainly three views could be identified on the relationship between CSR and CFP. Firstly the view that firms facing a trade-off between social responsibility and financial performance. Secondly, contrasting viewpoint of that the explicit costs of corporate social responsibility are minimal and those firms may actually benefit from socially responsible actions in terms of employee morale and productivity and
third perspective is that the costs of socially responsible actions are significant but are offset by a reduction in other firm costs. (Beurden & Gossling, 2008; McGuire, Sundgren, & Schneeweis, 1988)

**Negative Relationship**
Those who have concluded that there is a negative relationship between social responsibility and financial performance also have argued that high responsibility results in additional costs that put a firm at an economic disadvantage compared to other, less socially responsible firms (Bragdon & Marlin, 1972; Vance, 1975). These findings added that costs may result from actions like making extensive charitable contributions, promoting community development plans, maintaining plants in economically depressed locations, and establishing environmental protection procedures. In addition, concern for social responsibility may limit a firm's strategic alternatives. For example, a firm may forgo certain product lines, such as weapons or pesticides, and avoid plant relocations and investment opportunities in certain locations (McGuire, Sundgren, & Schneeweis, 1988).

**Positive Relationship**
In contrast, other scholars investigated on corporate social responsibility and performance has argued for a positive association. Several authors have cited improved employee and customer goodwill as an important outcome of social responsibility (Davis, 1973; Ruf et al., 2001). For example, a firm perceived as high in social responsibility may face relatively few labor problems, and customers may be favorably disposed to its products. Socially responsible activities may also improve a firm's standing with such important constituencies as bankers, investors, and government officials. Improved relationships with these constituencies may bring economic benefits (Moussavi & Evans, 1986). Indeed, banks and other institutional investors have reported social considerations to be a factor in their investment decisions (Spicer, 1978). High corporate social responsibility may therefore improve a firm's access to sources of capital. Avoiding social responsibility by business may provoke additional legislation leading to higher cost of compliance that can never be recovered by businesses (Russo & Fouts, 1997).

**No significant relationship**
Under this situation researcher has accepted that additional cost of the CSR is set off by the benefits of the CSR. Therefore, there is no relationship. Cornell and Shapiro (1987)
**CSR in Sri Lanka**

There is lack of research evidences about CSR in Sri Lanka. In the research article of Fernando (2007), he has mentioned the results of a survey which is conducted by an International NGO, International alert on CSR perceptions and attitudes of the Sri Lankan public and business organizations in 2004. According to the results, in the business community, most respondents feel that they have a strong role to play in addressing social needs but, while there is a long history of charitable giving in Sri Lanka, few companies have a strategy or policy for doing so. They do not have a clear direction on how and what to contribute to society, and the benefits from doing so. Only 17% companies had formal, written CSR policy. Only 59.8% of companies have been actively involved for more than six years. Seven organizations have had CSR policies running for more than 30 years and one has been involved in the concept for 65 years. According to him there is improvement in CSR engagement after Tsunami.

**Regression Model**

In order to test the hypothesis, researcher has identified a suitable model from previous studies (Waddock & Graves, 1997). In current study’s econometric model (except the INDi) is developed based on the model identified by Waddock and Graves (1997). The details of which are as follows.

\[
\text{PERFi} = f(\text{CSPi}, \text{SIZEi}, \text{RISKi}, \text{INDi})
\]

Where

\[
\text{PERFi} = \text{long-run economic or financial performance of firm i (measures of accounting profits)}
\]

\[
\text{CSPi} = \text{a proxy for corporate social responsibility of firm i (based on an index of social performance)}
\]

\[
\text{SIZEi} = \text{a proxy for the size of firm i}
\]

\[
\text{RISKi} = \text{a proxy for the "risk" of firm i (debt/asset ratio)}
\]

\[
\text{INDi} = \text{industry of firm i (4 digit SIC code)}
\]

**Methodology**

**Measuring Corporate Financial Performance (Profitability)**

**Return on Assets**

In many research studies ROA used as a measurement to determine the profitability status (Aupperle, Carroll, & Hatfield, 1985; Heinz, 1976; McGuire, Sundgren, & Schneeweis,
1988). ROA measures operating performance of how well assets have been employed by a firm. The assets of the company are funded by both debt and equity. It measures the companies’ ability to generate profits with its own assets, rather than by using shareholders’ equity or other liabilities. Therefore, ROA figures out the idea of how effectively the company is converting its money into net income. This signals the investor on the return they would gain if invested in that entity. The standard formula for ROA is as follows.

\[
\text{ROA} = \frac{\text{Profit after tax (Net income after tax)}}{\text{Total assets}}
\]

**Return on Equity**
This identifies as the profitability from the point of view of investors. It measures a firm's efficiency at generating profits from every unit of shareholders' equity. Bragdon and Martin, 1972; Kapoor and Sandhu, 2010, have used this ratio to measure profitability in their studies. The standard formula for ROE is as follows.

\[
\text{ROE}=\frac{\text{Profit after Tax (Net income after tax)}}{\text{Shareholder’s equity}}
\]

CFP therefore measured through content analysis. Data needed to calculate ROA and ROE had been collected directly referring annual reports of selected companies. i.e. each companies five years performance figures of profit after tax(PAT), total assets(TA) and shareholders’ fund (SF) were gathered.

**Measuring Corporate Social Responsibility**
As discussed in the previous chapter CSR can be quantified mainly by using measurements based on analysis of the contents of annual reports, pollution indices, perceptual measurements derived from questionnaire based surveys, corporate reputation indicators and data produced by measurement organizations. Because of the unavailability of data for other methods researcher decided to follow the content analysis method. Content analysis has been done based on the GRI guidelines.

**Control Variables**

**Firm Size**
Size of entity is an important control variable, since larger firms experience better financial performance rather than small firms. Firm size is measured by book to value ratio and shown as follows

\[
\text{Book to value ratio} = \frac{\text{Market price at the end of the year} \times \text{Number of shares}}{\text{Total assets}}
\]
Risk
The systematic risk of a stock, which cannot be captured under accounting base risk measures, can be obtained by rearranging the above equation and solving for β. Therefore equation for β would be:

$$\beta_i = \frac{\text{Cov}(R_i, R_m)}{\text{Var}(R_m)}$$

Population and Sample
There are 33 listed companies in BFI sector. Sample of the study is 27 companies.

Conceptual Model
Figure 1
Conceptual Model

Building Hypothesis
Hypotheses were formulated based on the nature of the relationship to be prevailed between CSR and CFP. There could be positive, negative or neutral relationships between the variables which would be testing in the study. The weight of the arguments about potential positive relationship between CSP and financial performance is high. Hence in the current study it hypothesizes that the impact of disclosure of CSR on CFP is to be positive.
Hypothesis 1: There is a positive impact on disclosure of CSR on ROE
Hypothesis 2: There is a positive impact on disclosure of CSR on ROA

Results and Discussion
Level of CSR disclosure
Researcher found the overall level of disclosure based on the whole GRI index and the prepared index (after excluding all non-disclosed variables). When considering the level of disclosures, overall average level of disclosure was at a low level. With regard to the whole GRI index, the average level disclosure is only 21% and in the case of prepared index it is only 28% which is unsatisfactory.
Table 1 Descriptive statistics

<table>
<thead>
<tr>
<th></th>
<th>Whole GRI index</th>
<th>Prepared index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>21</td>
<td>28</td>
</tr>
<tr>
<td>Minimum</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>Maximum</td>
<td>64</td>
<td>85</td>
</tr>
</tbody>
</table>

For this low level of disclosure followings may be the possible reasons. Being an Asian country, (Chambers, Chapple, Moon, & Sullivan, 2003; Mohan, 2001; Welford, 2004), primary objective even now is to maximize shareholders, high cost involved in measuring and disclosing, no much intensive by authorities, accounting frame work of Sri Lanka is not in line with the latest global dynamics.

Although the overall level of disclosure is at a low level, it also observed a positive increment in trend of such disclosures over the five years. Finding can be shown in a table and as a graph as follows

Table 2 Descriptive statistics (Yearly)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Average level</td>
<td>23.8</td>
<td>24.2</td>
<td>25.1</td>
<td>30.3</td>
<td>37.3</td>
</tr>
<tr>
<td>Maximum level</td>
<td>34.7</td>
<td>35.7</td>
<td>45.2</td>
<td>58.9</td>
<td>85.2</td>
</tr>
<tr>
<td>Minimum level</td>
<td>15.7</td>
<td>10.5</td>
<td>16.1</td>
<td>15.1</td>
<td>20.8</td>
</tr>
</tbody>
</table>

Figure 2 Average, maximum and minimum levels of CSR disclosure (prepared index)
Positive incremental trend may be due to recently experienced corporate scandals such as Golden key, Ceylinco etc, improved awareness of stakeholders on global trends, introduction of awards, introduction of Code of Best practices by ICASL and listing requirements by the CSE.

By analyzing the cumulative frequencies of the CSR disclosure level, reporting practices of companies can be identified. It is revealed that majority of companies are at a below 50% level of CSR disclosure. Only few companies are doing extensive CSR reporting.

<table>
<thead>
<tr>
<th>Table 3 Reporting practices of companies (Cumulative frequencies)</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of companies</td>
</tr>
<tr>
<td>CSR disclosure level  Prepared Index  Whole index</td>
</tr>
<tr>
<td>Less than 50%        96                99</td>
</tr>
<tr>
<td>More than 50%       4                  1</td>
</tr>
</tbody>
</table>

Even though the average level of disclosure is low, disclosure level of some variables were at a satisfactory level. Variables like strategy and analysis, organization profile, and reporting parameters, are at a satisfactory level. Most of this information is traditional. Therefore it can be assumed that still Sri Lankan companies are stick into a traditional way of reporting by giving more priority for financial statements. It can be assumed that corporate information they providing are not from a CSR perspective, but just because those are mandatory and they used to provide.

It is observed that the trend of these variables is stagnant. However there is a satisfactory increasing trend in the variables like governance, social, economic and environmental.
Figure 3 Trend in average level of disclosure (variable vise)
Towards sustainability through CSR

According to the Triple Bottom Line (TBL) for sustainability every organization must ensure its reporting corporate performance against economic, social, and environmental parameters. These three parameters are included in GRI guidelines. Are Sri Lankan companies moving towards sustainability? When observe CSR data, it is clear that there is huge gap between expected and actual level of disclosures with regard to the economical, environmental and social variables. However attractive growth reported in the level of disclosure for 5 years of period in social and environmental parameters, except economic factors. Therefore it can be identified that there is a trend towards sustainability but insufficient.

Table 4 Growth Rate of TBL Disclosures

<table>
<thead>
<tr>
<th>Variable</th>
<th>Level of Disclosure</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic</td>
<td>31</td>
<td>41</td>
</tr>
<tr>
<td>Environment</td>
<td>0.9</td>
<td>12</td>
</tr>
<tr>
<td>Social</td>
<td>4.7</td>
<td>16</td>
</tr>
</tbody>
</table>
Figure 4 Difference between expected and actual levels of disclosure
(Governance, economic, environmental and social)
Relationship between disclosure of CSR and financial performance

In the current study impact of CSR disclosure on CFP is identified by using two regression models, with the ROE and ROA as the dependent variable respectively. Both models significant positive relationship was evidenced. In the case of the first model (ROA is the dependent variable) there is a significant positive relationship at 5% level of significance. In the second model (ROE is the dependent variable) also significant positive relationship at 5% level of significance is resulted. However, in both the models it has recorded very low extent of explaining the change in performance by disclosure of CSR (ROE-$R^2=0.24$, ROA-$R^2=0.26$).

Table 5 Regression output (Dependent variable ROA)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>-.030</td>
<td>.028</td>
<td>-1.075</td>
<td>.284</td>
</tr>
<tr>
<td>CSR</td>
<td>.002</td>
<td>.001</td>
<td>2.081</td>
<td>.039</td>
</tr>
<tr>
<td>BETA</td>
<td>-.021</td>
<td>.014</td>
<td>-1.475</td>
<td>.143</td>
</tr>
<tr>
<td>SIZE</td>
<td>.096</td>
<td>.015</td>
<td>6.376</td>
<td>.000</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.265</td>
<td>Durbin-Watson stat 1.445</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted</td>
<td>R-squared</td>
<td>0.248</td>
<td>F-statistic</td>
<td>15.721</td>
</tr>
<tr>
<td>S.E. of regression</td>
<td>.103</td>
<td>Prob (F-statistic)</td>
<td>0.000</td>
<td></td>
</tr>
</tbody>
</table>

Table 6 Regression output (Dependent variable ROE)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>-.149</td>
<td>.182</td>
<td>-.822</td>
<td>.413</td>
</tr>
<tr>
<td>CSR</td>
<td>.013</td>
<td>.005</td>
<td>2.362</td>
<td>.020</td>
</tr>
<tr>
<td>BETA</td>
<td>-.075</td>
<td>.091</td>
<td>-.828</td>
<td>.409</td>
</tr>
<tr>
<td>SIZE</td>
<td>.148</td>
<td>.098</td>
<td>1.516</td>
<td>.132</td>
</tr>
<tr>
<td>R-squared</td>
<td>.244</td>
<td>Durbin-Watson stat 1.714</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted</td>
<td>R-squared</td>
<td>.060</td>
<td>F-statistic</td>
<td>2.774</td>
</tr>
<tr>
<td>S.E. of regression</td>
<td>.670</td>
<td>Prob (F-statistic)</td>
<td>0.044</td>
<td></td>
</tr>
</tbody>
</table>
This indicates that there is a positive impact of disclosure of CSR on both ROE, ROA and hence the overall on financial performance. What can be these financial benefits derived by CSR. Many researchers have identified the benefits of CSR which are ultimately resulted better financial performance. Some of them are reduction in cost of capital (Baiman & Verrecchia, 1996; Diamond & Verrecchia, 1991) increase in corporate identity, image and reputation (Simoes & Dibb, 2008), Investor preference in CSR (Waddock and Graves, 1994), reduce level of Risk (Bowman, 1980; Clarkson 1995)

Based on the above factors performance of the firm may increased and it will lead to a better financial performance. When looking at these factors it is clear that CSR is a mean of satisfying all stakeholders’ needs.

Conclusions

According to the CSR data collected revealed that the overall level of disclosure in the actual scenario is at a very low level in comparison with the global standard of such disclosures. However, disclosure level relating strategy and analysis, organization profile, reporting parameters are at a satisfactory level since considerable amount of companies disclosed the information relating to such areas in their annual reports. Huge gap between the expected and actual levels of disclosure in the social, economical, governance and environmental variables was observed in the study. Moreover it has been revealed that most of the CSR information even the companies provided so far in their annual reports is mandated by authorities. Hence that addresses only the minimum requirement. Further it can be elaborated that majority of companies still give more priority for figures appears in the financial statements and therefore the general perception is that annual report means financial statements.

This finding has backed the conclusion arrived that most of companies are still stick to the traditional way of reporting despite the current global changes in reporting. However slight growth in the level of disclosure was observed throughout the period of 5 years, but this growth is needed to improve by making awareness of both companies and public about the importance of CSR and convincing them the advantages of such reporting.

With the regression results it can be concluded that there is a positive impact of disclosure of CSR on financial performance. Though the explanatory power of CSR on variation in ROA and ROE is low, it has a positive impact on both. Therefore it can be concluded that companies have taken in to consideration the importance of CSR. When it comes to sustainability, adhering GRI guidelines is an indicator of moving towards sustainability.
Therefore it can be concluded that we need to pay more attention and put more effort in order to achieving sustainability.

Globalization has dissolved all boundaries among nations. Therefore harmonization has become a decision factor in this context. Organizations concerning much on their reputation and profits now must in line with the globally accepted social responsibility norms. By considering all the factors discussed above it has been identified the need of creating CSR boom in Sri Lanka

References


Routledge, New York, NY.