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THE EFFECT OF CORPORATE SOCIAL RESPONSIBILITY ON THE FIRM'S FINANCIAL PERFORMANCE

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─Abstract ─

The objective of this research is to investigate the relationship between the corporate social responsibility and the firm's financial performance. This relationship has been a very important issue and topic of great interest for researchers since from the origin of business entities. Therefore the aim of this study is to explore the nature of relationship between CSR and financial performance in the context of Egypt using a sample of 30 firms (firms listed on EGX 30) from 2007 to 2010. The sample was from a range of industrial sectors. We measured the corporate social responsibility by the S&P/EGX ESG Index, which is the only single source that offers published data regarding social corporate responsibility. The Corporate financial performance is measured by ROA and EPS. We find a positive and significant relation between corporate financial performance and the CSR. This result actually motivates organizations to think broadly about their obligations towards the society in which they operate rather than just maximizing their wealth.

Key Words: *CSR (Corporate Social Responsibility), FP (Financial Performance), S&P/EGX ESP*

JEL Classification: M14, G32, G10

1. INTRODUCTION

Corporate responsibility has become an important issue for many large companies today, and even smaller companies are beginning to seek ways of improving their public image through communicating their involvement in a variety of activities.

Companies become more responsible for their social and environmental impacts, increase the amount of resources allocated to activities generally labeled as CSR investments.

The term Corporate Social Responsibility (CSR) defines how a company conducts its business in a socially acceptable way and that it is accountable for its effects on all of its stakeholders, including the environment. Thus, CSR is a measure of the total impact of a business's activities on the lives of individuals within and without the company (European Commission 2001). Within the company, this includes human resources, health and safety, adaptation to change, management of environmental impacts and natural resources. Issues relating to the company's relationship with the outside world include local communities, business partners, suppliers and consumers, human rights, and global environmental concerns (European Commission 2001).

Beginning in the 1950s social responsibility of firms has been discussed not only in the boardrooms of large corporations but also in academia.

Since then, it has always been a very controversial topic and still nowadays is regarded as the only way to long-term prosperity by some and a terrible way to misspend money by others. Academics and finance professionals have been trying to resolve these conflicting theories and to find some form of common understanding in the last decades. However, there is still no definitive answer to the question: Is CSR favorable for a companies' financial performance?

This study was motivated by the lack of consistent evidence on the one hand and the relative lack of research in the Egyptian context on the other (there is a leading research concerning this issue in the Egyptian context which is Wahba H. (2007) that investigate the relationship between corporate environmental responsibility and profitability

2. What do the theory and the Literature tell us?

Although CSR is widely accepted as a concept; a major problem identified in CSR discourse is the lack of an agreed clarification of what is to count as 'CSR'.

So there are many attempts to map CSR theories in a specialized manner: Lantos made distinguishing between ethical, altruistic and strategic CSR (Lantos, 2001), Windsor identified ethical responsibility, economic responsibility and corporate citizenship (Windsor, 2006) and One of the most comprehensive classifications is that offered by Garriga and Mele in their essay on mapping out the territory of CSR theories, identifying four groups of CSR approaches: instrumental ,political, integrative and ethical (Garriga and Mele, 2004).

Garriga and Mele identify four main types of CSR theories with additional sub-groups. These include: Instrumental theories advancing economic objectives through social activities, Political theories advocating corporate power and its responsible use, Integrative theories expressing the necessity for corporations to integrate social demands and Ethical theories examining the morality and rightness of corporate social action.

And although researchers have applied different theoretical perspectives to illustrate the relationship between corporate social responsibility and the firm's financial performance, to date theories are inconclusive and the empirical evidence are mixed, have given a lot of different and heterogeneous results. In particular, it is possible to observe a great variety about the sign of the relationship studied positive, negative or neutral relationship.

The debate about the relationship between corporate social responsibility and the firm's financial performance has been lively started since Milton Friedman's (1962/1970) challenge that "a corporation's social responsibility is to make a profit." Friedman's comments added fire and intellectual challenge to the debate and triggered additional interest in either proving or disproving the relation between social performance and financial performance.

Also Freeman (1970) agreed with Friedman and opposed the idea of CSR by stating that corporations are neither meant for social activities nor they have expertise in this regime, therefore it is better that they produce quality products for consumer, obey legal rules and regulations and contribute in the economic development of country. Other researchers held this view point proposed that firms incur costs from social responsible actions that put them at an economic disadvantage compared to other, less responsible firms.(Aupperle, Carrol & Hatfield, 1985: Ullmann, 1985: Vance, 1975).

A second, contrasting viewpoint is that the explicit costs of corporate social responsibility are minimal and that firms may actually benefit from socially responsible actions in terms of employee morale and productivity (Moskowitz, 1972: Parket & Eibert, 1975; Soloman & Hansen, 1985). The other supporters of this view point concluded a positive relationship between the CSR anf the firm's financial performance(Waddock e Graves, (1997);Luce, Babe, Hillman,2001; Brammer, Brooks, Pavelin,2005; Wahba H,2007; Poodi L & Vergali,2008; Chin Huang Lin, 2008; Ehsan & Kaleem, 2012).

A third perspective is that there is a neutral relationship between firm's social and financial performance

So the study was motivated by the different results that are obtained depending on the different measures of CSR or the different ways of measuring the financial performance.

3. METHODOLOGY

3.1. The Research Hypotheses

The Hypotheses of the study are:

$H_{o:}$ There is no relationship between a firm's corporate social responsibility and its financial performance.

H_1: There is a positive relationship between a firm's corporate social responsibility and its financial performance.

3.2. The Empirical Analysis

The sample of this study was derived from the list of those Egyptian companies that are listed in the S&P/EGX ESG Index. This is the first index designed to track the performance of companies listed on the Egyptian Stock Exchange that demonstrate leadership on environmental, social and corporate governance ("ESG") issues.

This list was chosen as it is the only single source that offers published data regarding social corporate responsibility, as social responsibility among Egyptian companies is still in its infancy and social responsibility reporting or disclosure is still occasional and voluntary.

The researcher chose the period of the study to be four years from 2007 to 2010 as it is the only adequate period since the term CSR is not very well known before 2007 in the Egyptian markets and stopped at year 2010 to avoid the effect of the Egyptian revolution on the firms' financial performance that happened at the beginning of year 2011.

The initial sample is composed of all firms listed on EGX 30 for the four years from 2007 to 2010.The final sample consists of 38 companies, as some companies took a rank in the index and others lost its rank in the index.The companies in the sample covers 12 industrial sectors.

The independent variable is the corporate social responsibility which will be proxied by the rank of the firm in the S&P/EGX ESG Index and that because of the limited available social data on the Egyptian companies and as it is considered to be an aggregate measure that demonstrates leadership on environmental, social and corporate governance.

In literature CSR was also measured using a wide variety of proxies, demonstrating the wide remit of CSR such as the Fortune list which covers eight criteria (financial soundness, long-term investment value, use of corporate assets, quality of management, innovativeness, quality of products, use of corporate talent and community and environmental responsibility).

Other measures were specific to one attribute of CSR, e.g. the Toxic Release Inventory which addresses toxic emissions and pollution.

Both stock market and accounting based measures are used in the literature to determine firm financial performance. As noted by Prowse (1992), stock market returns are affected by differences between interests of managers and shareholders. Furthermore, Demsetz and Villalonga (2001) also note that accounting profit rates are not distorted by investor psychology and do not fail to provide insight to a certain extent into the future by including estimations on issues like goodwill and depreciation. Therefore, this analysis will employ return on assets (ROA) as the dependent variable to proxy for firm financial performance in line with many studies in literature , i.e. Aupperle, Carroll and Hatfield (1985), Belkaoui and Karpik (1989), Waddock and Graves (1997), Preston O' Bannon (1997), McWilliams and Siegel (2001) Luce, Barber and Hillman (2001).

To overcome model misspecification, the study also controls for several variables that previous work proved might confound the relationship between corporate social responsibility and financial performance. These variables employed help neutralize firm and industry specific differences in the sample that have the tendency to affect the dependent variables.

Firm size is used as small firms are less able than their large counterparts to communicate their CSR activities to external stakeholders. The log of fixed assets is utilized to control for firm size in this study.

Firm age is important to evaluate its influence on firm performance due to issues such as accumulation of experience and market share. Age is calculated as the number of years that passed since the establishment of the firm to the observation date

The debt level of a company has the potential to influence financial performance due to costs of finance and risk of default. It will be calculated as the ratio of long and short term debt to total assets.

The study employs the regression analysis to analyze the data of the study to estimate the impact of corporate social responsibility on firm financial performance. So the hypothesis will be tested by the following model:

$$ROA = \alpha + \beta 1\ CSR + \beta 2\ Age + \beta 3\ size + \beta 4\ DebR + e_{it}$$

ROA: return on assets; CSR: Corporate social responsibility; Age: Firm age; Size: Firm size ; DebR: debt ratio.

3.3. Estimation Results

Table 1 presents the results of the regression analysis using CSR as the dependent variable and financial performance as the independent variable, controlling for age, size, and debt.

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Median regression                                    Number of obs =       109
  Raw sum of deviations   661.54 (about 6.52)
  Min sum of deviations 425.7913                     Pseudo R2     =    0.3564
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roa	Coef.	Std. Err.	T	P>|t|	[95% Conf.	Interval]
csr	.0965162	.0135475	7.12	0.000	.0696135	.1234189
sizas	.1431276	.0676461	2.12	0.037	.0087959	.2774593
debt	-.0198244	.0023354	-8.49	0.000	-.024462	-.0151867
age	-.0198455	.0061965	-3.20	0.002	-.0321504	-.0075406
_Isic_2	-1.25225	.5805416	-2.16	0.034	-2.40509	-.0994093
_Isic_3	-1.438808	.5960104	-2.41	0.018	-2.622367	-.2552498
_Isic_4	.1806074	.5951448	0.30	0.762	-1.001232	1.362447
_Isic_5	20.48086	.6497182	31.52	0.000	19.19065	21.77107
_Isic_6	-5.272135	.5452084	-9.67	0.000	-6.354811	-4.189459
_Isic_7	-.7738066	.5894256	-1.31	0.192	-1.944289	.3966757
_Isic_8	19.65499	.7273752	27.02	0.000	18.21057	21.09941

_Isic_9	-2.598925	.5837395	-4.45	0.000	-3.758116	-1.439734
_Isic_10	7.812354	.6337004	12.33	0.000	6.553951	9.070757
_Isic_11	-3.630503	.7316479	-4.96	0.000	-5.083411	-2.177596
_Isic_12	.6039546	.5932725	1.02	0.311	-.5741669	1.782076
_cons	4.123477	1.658099	2.49	0.015	.8308218	7.416132
F(11, 93) =	518.60		Prob > F =	0.0000		

Table 3: Regression analysis for the relationship between the CSR and financial performance measured by ROA

As can be seen the coefficients for csr, size, debt, age and all industries except for industry 4,7 and 12 are significantly different because their p-values are smaller than 0.05.

According to the previous model that used ROA as a profitability measure, the results indicated that there is a significant positive relationship between return on assets and corporate social responsibility. This finding is consistent with the results that found an association between the constructs (McGuire etal., 1988; McGuire et al., 1990; Simpson & Kohers, 2002; Waddock & Graves, 1997a; Wokutch & Spencer, 1987; Preston, O'bannon,1997).

Also this relationship is consistent with the researches that took certain dimensions of CSR such as the environmental dimension as in (Wahba,H 2007) which exerted a positive and significant coefficient on the firm market value. Or the R & D expenditures dimension as in (Chin and others, 2008)

This finding is inconsistent with some research results (Alexander & Buchholz, 1978; Aupperle et al., 1985; Cochran & Wood, 1984; Shane & Spicer, 1983; Ullman,1985).

It is shown from the results that the size is positively correlated with the earning per share and the corporate social responsibility. Waddock and Graves, (1997) proposed that smaller companies did less CSR related activities than larger companies.

Larger companies are more mature and attract the attention of the public more easily, and thus, they should respond more to the needs of public interest stakeholders. Small firms are less able than their large counterparts to communicate their CSR activities to external stakeholders.

3. CONCLUSION

The research main finding is that there is a positive and significant association between corporate financial performance and the CSR measure.

These results are consistent with the researcher expectations as the market rewards those firms with a high intensity of environmental and social activities compared with other firms within the industry.

Secondly, the results show that the 'superior investor' viewpoint and the institutional investors pay attention to the way firms manage their social issues.

It is important for a firm to realize which aspect of its social responsibility is more important to its primary stakeholders and that a firm's social initiatives, when properly directed, tend to improve its bottom line in Egypt.

Finally the positive relationship between CSR and FP reveals positive social behavior of Egyptian firms. Egyptian firms are contributing in the social wellbeing of society, improving the living standards by promoting education and better health facilities, protecting environment. They are also taking good care of their employees in order to build their trust and confidence. In turn these social expenditures not only facilitate the firms to attain the continuous and long term sustainable development but also help them to achieve financial benefits as well.

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