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The Nexus between Corporate Social Responsibility and Financial Performance in Nigeria

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Abstract

This paper investigates the effect of corporate social responsibility (CSR) on the financial performance of quoted firms in Nigeria. Three CSR constituents, Environmental protection, charitable contributions, and Training were assessed using multiple regressions to ascertain the extent to which they impact performance. Results show that environmental protection and charitable contributions had significant impact on financial performance while Training exhibited a neutral effect on the study's dependent variable. Firm size was also ascertained as a significant influence in the CSR- financial performance link. The study recommends that firms take advantage of the associated benefits concomitant with strategic social responsibility initiatives but however discharge such responsibilities in view of the company size.

Keywords: Social Responsibility, Financial Performance, Nigeria

1. Introduction

There is an understanding that Corporate Social Responsibility (CSR) has gone beyond being a business jargon to becoming a critical business function. This has been demonstrated vividly in academic circles, with a host of empirically-based investigations.

According to Waddock and Graves (1997), CSR is viewed as a comprehensive set of policies, practices, and programmes that are integrated into business operatives, supply chains, and decision-making processes throughout the company and usually include issues related to business ethics, community investment, environmental concerns, government, human rights, the market place as well as the work place.

Corporate Social Responsibility (CSR) entails the practice whereby corporate entities voluntarily integrate both social and environmental upliftment in their business philosophy and operations. The concept implies that companies voluntarily integrate social and environmental concerns in their operations and interaction with stakeholders (Manuel & Lucia, 2007).

A recent phenomenon along this line is the series of demands for corporate social responsibility institution by civil rights and environmental activity groups with legislations/ codes of conduct to ensure that businesses undertake social activities. These include codes of conduct and standards like the Global Reporting Initiative (GRI), Global Compact (2002) and Global Sullivan Principles (2009) among others. These are aimed at encouraging and streamlining firms' participation in socially responsible ventures. The performance of business organizations is known to be affected by their strategies and operations in market and non-market environments (Baron; 2000). There is currently a debate on the extent to which company managers should consider social and environmental factors in commercial decision making. A decision making mechanism that incorporates these factors may be described as corporate social responsibility.

The concept of CSR has evolved from being regarded as detrimental to a company's profitability, to being considered as somehow benefiting the company as a whole, at least in the long run. A view is emerging that CSR can contribute to the financial performance of a company. This approach which has been described as the 'enlightened shareholder approach' by Baron (2000) suggests that corporate decision- makers must consider a range of social and environmental matters if they are to maximize long-term financial returns.

There have been a number of studies in developed countries with an aim to testing the extent to which the economic drivers of corporate social responsibility deliver improved financial performance (Aupperle et al., 1991; Brine et al., 2006; Makni et al., 2009, etc). However such studies supporting the existence of a link between CSR and financial performance are relatively scanty in developing countries.

The CSR issue is a growing concern in corporate Nigeria today. This study is geared at unfolding the existing nexus between CSR and firm performance as it applies to developing economies with Nigeria as a focus.

2 .1 Measuring Corporate Social Responsibility and Financial Performance

2.1.1 Measuring Corporate Social Responsibility

Assessing how social and financial performances are linked is complicated by the lack of consensus of measurement methodology as it relates to corporate social performance. In many cases, subjective indicators are used, such as a survey of business students (Jackson, 2004), or business faculty members (Moskowitz, 1972), or even the Fortune rankings (McGuire, J.B., A. Sundgren, and T. Schneeweis 1988; Akathaporn and McInnes, 1993; Preston and O' Bannon, 1997). Significantly, it is unclear exactly what these indicators measure. In some studies, researchers utilize corporate disclosures on CSR. Regardless of the popularity of these approaches, there is no way to empirically ascertain whether the social performance data revealed by corporations are under-reported or over-reported. Thus, information about corporate social performance is open to questions about management and subjective bias. Still other studies use survey instruments (Aupperle, 1991) or behavioural and perception measures (McWilliams, A. and D. Siegel, 2000). Waddock and Graves (1997) drew upon the Kinder Lydenberg Domini (KLD) rating system, where each company in the S& P 500 is rated on multiple attributes considered relevant to Corporate Social Performance. KLD uses a combination of indicators: financial statements, articles on companies in the popular press, academic journals (especially law journals), and government reports in order to assess CSP along eleven dimensions. Based on this information, KLD constructed the Domini 400 Social Index (DSI 400), the functional equivalent of the Standard and Poor's 500 Index, for socially responsible firms.

2.1.2 Measuring Financial Performance

Financial performance measurement has been a much easier task; nevertheless, it also has its complications. There is the huge divide between market and accounting measures. Many researchers use market measures (Alexander and Buchholz, 1978; Vance, S. C., 1975), others put forth accounting measures (Waddock and Graves 1997; Cochran and Wood 1984) and some adopt both of these (McGuire, J. B., Sundgren, A., Schneeweis, T., 1988). The two measures, which reflect different perspectives of how to assess a firm's financial performance, have different theoretical implications (Hillman and Keim, 2001) as well as biases (McGuire, Schneesweis, & Hill, 1988). Comparison of results could become complex with the use of different measures.

Accounting measures capture only historical aspects of firm performance (McGuire, Schneeweis, 1988). However, they are subject to bias from managerial manipulation and differences in accounting procedures (Branch, 1983). Market measures are future oriented and focus on market performance. They are less vulnerable to different accounting procedures and represent the investor's evaluation of the ability of a firm to generate future economic earnings (McGuire, Sundgren, and Schneeweis 1988). However the use of market measures suggests that an investor's valuation of firm's performance measure is a proper performance measure (McGuire et al., 1988).

2.2 Prior Literature and Hypotheses Development

The attempt to establish or prove a general cause-effect relationship between CSR and a firm's financial performance is the fastest growing and most significant area of CSR research today (Phillips and Claus, 2002). This focus is not new, as far back as the 1970s; scholars were interested also in the question of whether socially responsible firms were also profitable firms (Mc Williams and Siegel, 2001). In the late 1980s, the view became common that CSR initiatives might bring long run economic gain. However while this underlying assumption may have thrived, today's researchers are demanding more hard, quantitative evidence (Phillips and Claus, 2002). According to Margolis and Walsh (2002), one hundred and twenty two published studies between 1971 and 2001 empirically examined the relationship between CSR and financial performance. Waddock and Graves (1997) find significant positive relationship between an index of CSR as measured by the Kinder Lydenberg and Domini database and performance measures such as ROA (return on assets) in the following year. McGuire et al (1988) find that prior year's stock returns and accounting based performance measures are related to current measures of CSR, but that a past record of good social performance does not affect the current financial performance of a firm. This sounds ridiculous but finds defense and support in the works of Cho and Pucik (2005) that use ratings of CSR from fortune magazine with a one year lag and as such rendered the reverse-causality bias no longer a concern. Brine et al (2006) examine the relationship between financial performance and CSR across the top 300 AS listed companies for the 2005 financial year. CSR was captured as a dummy with a value of one (1) where separate sustainability disclosures are made by the firm and a value of zero if otherwise. While financial performance was captured along accounting measures- return on assets, return on sales and return on equity. They find no statistical significant relationship between the adoption of CSR and a firm's financial performance. Oba (2011) disaggregates CSR into four constituents- charitable contributions, human resource management, environmental management and community corporate social responsibility. The study examined the isolated and aggregate impact of these constituents on market value as measured by Tobin's equity Q. Results showed an insignificant link between community social responsibility, human resource management and market value while a negative impact of charitable contributions on market value was documented. Based on the foregoing, we propose the following null hypotheses:-

1) There is no significant impact of environmental protection on financial performance
2) There is no significant impact of charitable contributions on financial performance
3) There is no significant impact of training on financial performance
4) Firm size has no significant impact on the CSR –financial performance relationship.

3. Research Methodology

3.1 Population of the Study

The universal population of this study is one hundred and sixty four (164) quoted companies in Nigeria as at 31st

December, 2011 covering thirty four (34) sub-sectors. However, banks, insurance companies and other financial institutions whose financial statements are generally known to have different financial presentation as a result of their regulation by the Bank and Other Financial Institution Act (BOFIA) 2004 and Insurance Act 2004 (Ngwakwe, 2009) are excluded leaving the total population to one hundred and three (103) covering twenty nine (29) sub-sectors.

3.2 Sample

Since the study intends to examine CSR in quantitative perspective, the need to identify quoted companies that gives quantitative reports on their CSR activities and initiatives become imperative, hence the use of judgmental sampling method of non-probability sampling as used in some previous study of this kind (Siegel, 2002; Waddock and Graves, 1997). Apart from banks, insurance companies and other financial institutions' exclusion for the above stated reason, this study employs a filter - quoted companies in Nigeria that did not consistently present quantitative information in annual reports on their CSR activities during the last ten years (2001-2010) were also excluded in this study leaving the researcher with ten (10) companies in five sub-sectors which are used in this study. (See Appendix)

3.3 Sources and Methods of Data Collection

The sources of the data used are annual reports of these companies for the past ten years starting from 2001 to 2010. The period was chosen primarily due to the outcry for social responsibility issues during this period and also the time scope which gives room for trend analysis.

3.4 Model Specification

To investigate the effects of corporate social responsibility on the financial performance of quoted companies in Nigeria, the study employs the multiple regression technique of data analysis. Particularly, multiple regressions were employed using SPSS to analyze the relationship that exists between the variables being considered.

For the purpose of this study, variables of performance shall be Return on Sales (ROS) and Return on Equity (ROE). Consequently, the following models are postulated:

$$ROS = \beta_0 + \beta_1 EPN + \beta_{2Log}Cc + \beta_3 TRN + \beta_{4Log}Fs + e_{it} \ldots \quad (i)$$

$$ROE = \beta_0 + \beta_1 EPN + \beta_{2Log}Cc + \beta_3 TRN + \beta_{4Log}Fs + e_{it} \ldots \quad (ii)$$

Where:

ROS = Return on Sales

ROE = Return on Equity

EPN = Environmental Protection

TRN = Training

Cc = Charitable Contributions

Fs = Firm Size (as represented by Total Assets)

3.5 Measurement of Variables

Two of the independent variables – Environmental Protection (EPN) and Training (TRN) are non-metric variables. They are both limited to the extent of their being reported in the financial statements. Training carries one (1) where there is an indication in the financial statements that the company is engaged in employee training and development programmes for its staff and carries zero (0) when such is not disclosed in the financial statements.

Environmental Protection was measured along four indicators: Environmental Policy, Environmental impacts, Environmental Management System, and Environmental Performance Disclosure. When a company reports on any of these, it carries one (1) otherwise zero (0).

The third variable is charitable contributions represented by the total amount of money spent by the firm as philanthropic costs or donations while firm size being a control variable is denoted by total assets. Due to the widely spread value nature of the metric variables (Cc and Fs), we find their natural logarithm as employed in the work of Matthew & Rebecca (2008).

The dependent variable is financial performance represented by Return on Sales and Return on Equity. Return on sales is computed as net income before interest and tax divided by sales while return on equity is computed as a percentage and calculated as:

Return on Equity = Net Income/Shareholder's Equity

Net income is for the full fiscal year (before dividends paid to common stock holders but after dividends to preferred stock.) Shareholder's equity does not include preferred shares.

For the purpose of the first model, performance was represented by Return on Sales (ROS) while in the second model; performance was represented by Return on Equity (ROE) as calculated using disclosed companies annual reports for the years under review. In both models, Firm Size as represented by total asset was introduced as a control variable to test its effect on the model.

4. Results and Discussions

The tables below show the regression results obtained using EViews

Table 1 Descriptive Statistics

	N	Range	Minimum	Maximum	Mean		Std Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic	Std Error	Statistic
ROS	100	.28	.06	.34	.2216	.00813	.08129
EPN	100	1.00	.00	1.00	.4500	.05000	.050000
log CC	100	7.88	.00	7.88	6.2840	.11709	1.17094
TRAINING	100	1.00	.00	1.00	.7100	.04560	.45605
Log _ FS	100	2.13	5.90	8.02	6.8893	.55777	.55774
Valid N (listwise)							

Table 2 Regression

Dependent Variable: ROS

Method: Least Squares

Date: 09/16/12 Time: 19:30

Sample: 1 100

Included Observations: 100

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EPN	0.026324	0.013146	2.002475	0.0481
LOG CC	0.025280	0.006506	3.885849	0.0002
TRN	-0.009348	0.014267	0.655236	0.5139
LOG FS	0.048388	0.013162	3.676480	0.0004
C	-0.275778	0.077786	-3.545329	0.0006

R- squared	0.408906	Mean dependent var	0.221647
Adjusted R- squared	0.384018	S.D. dependent var	0.081292
S.E. of regression	0.063802	Akaike info criterion	-2.617373
Sum squared resid	0.386710	Schwarz criterion	-2.487115
Log likelihood	135.8687	F-statistic	16.42973
Durbin-Watson stat	2.226858	Prob(F-statistic)	0.000000

The descriptive statistic in table 1 show that for every N1 on sales, sample firms had return of N0.22. That is 22 kobo was the average return on sales. Forty five percent of the sampled firms disclosed information on environment protection while seventy one (71%) showed participation in staff training to the extent of such being disclosed in the annual reports. The average log of charitable contributions stood at 6.2840 while average log of firm size stood at 6. 8893.

From the results on table 2, Environmental Protection (EPN), Charitable Contributions (CC) and Firm size (Fs) have been identified as significant explanatory variables in predicting return on sales. However, the training (TRN) variable was not significant in predicting return on sales

Adjusted R^2 in this study equals 38% (0. 386). That is, 38% of the variation in Y is explained by the regressors. This is quite a reasonable fit since there will certainly be other variables that explain return on sales apart from CSR variables.

The P-value of the F statistics at 0.0000 certifies the overall significance of the model.

Table 3 Regression

Dependent Variable: ROE

Method: Least Squares

Date: 09/06/09 Time: 22:32

Sample: 1 100

Included observation: 100

Variable	Coefficient	Std. Error	t-Statistic	Prob
EPN	0.109110	0.016076	6.787362	0.0000
LOGCC	0.081409	0.007955	10.23317	0.0000
TRN	0.051691	0.017446	2.962884	0.0039
LOGFS	0.084876	0.016095	5.273598	0.0000
C	-0.831661	0.095121	-8.743179	0.0000

R-squared	0.779310	Mean dependent var	0.350448
Adjusted R-squared	0.770018	S.D. dependent var	0.162689
S.E. of regression	0.078020	Akaike info criterion	-2.215005
Sum squared resid	0.386710	Schwarz criterion	-2.487115
Log likelihood	135.8687	F-statistic	16.42973
Durbin –Watson stat	2. 226858	Prob (F-statistic)	0.000000

Going by the regression results on table 3, all independent variables employed to forecast return on equity were found to be statistically relevant.

The Adjusted R square stood at 0.7700, that is, 77% of the changes in the dependent, can be explained by the regressors after considering the effect of adding more regressors to the model. This is still a weighty goodness of fit. The F statistic with a probability value of 0.0000 confirms the overall significance of the model. This goes to say that the covariates have an aggregate significant impact on return on equity.

Summarily, two functions have been structured for the purpose of this study. The first function shows the impact of four independent variable (Environmental protection, charitable contributions training and firm size) on return on sales. Results from the investigating revealed that environmental protection charitable contributions and firm size had a positive significant impact on return on order on sales while training was documented to have a neutral effect on the dependent variable.

Firm size as denoted by the natural logarithm of total assets has been found to be positively significant in predicting return on sales. This result offers support to the works of Cho and Pucik (2005) that the size of a firm influences the relationship between CSR and financial performance. It also lends support to the findings of Oba (2011) that firm size moderates the nexus between social responsibility and firm value.

Charitable contributions have been identified to also show a positive significant impact on return on sales. This result contradicts the works of Friedman (1970) and Oba (2011). They demonstrate in their respective studies that philanthropic costs (charitable contribution) have a negative impact on the financial performance of a firm since the firm has fewer funds to invest into profitable ventures. However, the results lend support to the study's hypothesis that charitable contribution would significantly impact on financial performance.

Environmental protection was similarly an explanatory variable having a positive significant impact on return on sales. This goes to show that the bottom line is improved when environmental concerns are identified as a priority. It goes to offer confirmation to the findings of Ngwakwe (2009) that waste management as a social responsibility improves financial performance as measured by return on total assets. This demonstrates that such environmental friendly practice (environmental protection) possibly improves corporate image and then consequently financial performance. Training as a variable of corporate social responsibility had no impact on return on sales. This demonstrates that effort by management at improving the skills and technical know-how of their employees does not have a consequent effect on the profit per sales.

The second function demonstrates similar results to the first except that training in the second function has a positive significant effect on return on equity.

This seems to offer an argument of the possible difference in the interaction of the CSR explanatory variables on various kinds of performance measures. Return on equity measures how well a company uses reinvested earnings to generate additional earnings, giving a general indication of the company's efficiency while return on sales is equal to a firm pre-tax income divided by total assets, measuring a firm's profit per naira of sales, (Bodie, Kane and Marcus, 2002).

In this study, the return on equity model was found to be highly significant than the return on sales. The explanatory variables seemed to be more portent and efficient in predicting Return on equity than sales. Nevertheless CSR variables were significant in predicting the two measures of financial performance.

5. Conclusion

First the study has provided statistical evidence on the use of four independent variables- environmental protection, charitable contributions, training and size in explaining and predicting financial performance of the sampled firms. The results show that the four variables have a significant aggregate impact (at 5% level of significant) on Return on sales and Return of Equity of sample firms. This study demonstrates that CSR directed at environment protection and charitable giving have ripple effects on the bottom line. These findings are robust to the two measures of financial performance (Return on equity and Return on sales).

The study also demonstrates that firm size has a role to play in the link that abounds between CSR and financial performance that is, the larger the size of a company, the more likely it is willing to invest in more social and environment issues which have a ripple effect on financial performance.

Finally, this research work demonstrates that the virtue of CSR in improving financial performance is a reality even in developing countries like Nigeria. The concept CSR is unavoidable because of the ever growing expectations of societies, investors, and the changing world. More so, with the emerging trend of social criteria being employed as filter for making investment decisions by institution and individuals; the CSR issue remains a burning issue and critical consideration for obtaining a competitive advantage in the modern business world

This study observes that businesses cannot operate optimally in a society which they ignore. As such, this study recommends that managers consider CSR initiatives in the light of the firm's corporate abilities. CSR initiatives should be strategic; and as such, businesses must identify standards of behaviour expected of them and adhere to that. Management should give attention to issues of environmental concerns, strategic philanthropy, and training; as these have been ascertained to positively impact financial performance

Future Research might have to engage in extensive studies to explore other casual mechanisms linking CSR and performance and to determine whether or not those relationships hold consistently overtime. It would be worthwhile to investigate how long it takes for the potential impact of CSR on financial performance to be revealed. It may also be useful to use a year lag between the measurement of financial performance and the corporate social responsibility measure do as to determine whether there is an associated log between the implementation of CSR and improved financial performance. Alternatively, a lag could be used to examine if improved financial performance leads to an increase in the level of social responsibility for firms.

The findings of this study leaves much room for finer refinements and applications further, the empirical results of the study are certainly not conclusive, but rather open the door, hopefully, for much- needed further research on this important phenomenon.

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Appendix 1 Sample Firms

1. A.G Leventis plc
2. Unilever plc
3. Chellarams Plc
4. Nigeria Bottling Company Plc
5. Nestle Nigeria Plc
6. Flour Mills of Nigeria Plc
7. Mobil Nigeria Plc
8. Neimeth International Pharmaceuticals Plc
9. Chemicals and Allied Products
10. Berger Paints Plc