

CORPORATE SOCIAL RESPONSIBILITY AND FIRM PROFITABILITY: A CASE OF OIL AND GAS SECTOR OF PAKISTAN

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ABSTRACT

The purpose of this study was to find the impact of Corporate Social Responsibility (CSR) practices on the financial performance of the Pakistani firms. The sample data includes 10 companies of Oil & Gas sector, listed on the Karachi stock exchange for the period 2006-13. The data was collected from annual reports of these companies. Variables include, CSR spending of the company, net profits, net profit margin and total assets. The correlation and regression tests were conducted in MS-Excel. The results suggest a positive correlation between CSR and net profit and net profit margin on the other hand negative correlation was found between CSR and total assets, but an insignificant impact of CSR activities on profitability of the firm. CSR is actually responsibility of business to play their part by sharing their profits with society as without them they could not survive.

Key Words: Corporate Social Responsibility, oil and gas sector and Karachi Stock Exchange (KSE).

INTRODUCTION

The concept of shared value or Corporate Social Responsibility (CSR) has exponentially attracted the attention of the business world as well as researchers. The overall performance of an organization is greatly dependent on the ethical business activities and activities related to social and environmental benefits. These activities will help an organization to sustain its reputation and goodwill. CSR is actually consists of all the practices of corporate governance which are related to policies, procedures, practices the focus of which is to improve social conditions, rights, protections, environmental protections and protection of the interest of all the stockholders of the business. It is the time not to confine business only for profitability of the firm but associate those with the social benefit as financial gain are actually associated with a social benefit of society. CSR is not just investment but a strong link between the firm and its stakeholders.

According to Ruben and Christopher (2009) CSR activities require a responsibility on the part of corporations toward its stakeholders specifically its customers, employees and community in addition to its profit maximization goals. These activities include donations or commitments regarding environment protection; social well being projects, and providing a healthy and safe working place for its employees.

Problem Statement

The concepts CSR its profitability are very important for its long term success and its goodwill. Problem statement of this study is to find the impact of CSR practices on the profitability and value of the firm in Oil and Gas sector of Pakistan.

Objectives of Study

This work tries to find the role of CSR activities of the firm on their financial performance in relation to profitability and its size. Pakistan is a developing country and the long history of unstable governments and unrealized plans. It is facing problems in the energy sector, very poor infrastructure, terrorism and poor government policies. These all situations have deprived the society and its wellbeing. In this situation business enterprise can play their CSR role not only to improve society welfare, but also to improve their reputation and overall long term financial gains.

LITERATURE REVIEW

The concept of CSR is not very difficult to understand, in simple it is related to activities which will consider itself a responsible entity of the society which not only fulfill its economic goals but also fulfills ethical and moral values of the society. The concept of CSR emerged in 1950 by Bowen, 1953. Carroll model (Carroll and Buchholtz, 2003) suggests that the first important goal of the organization is to fulfill its economic goals, after that its legal obligation, than ethical and philanthropic goals. McWilliams and Siegel (2001) states that practicing CSR by the business entity is doing social good not just obeying the rules of law, but working for the social welfare more than the law requires. Firms practicing true CSR activities increase their profitability by boosting their image and in the long run develop competitive advantage. As government is not able to solve each and every problem and social issues, business enterprises could play their part in solving many burning social issues. This could be done by developing public private partnership, improving value chain activities and concern for the environment and natural resources. All these activities lead to long term financial success. Despite the acceptance of CSR by corporate sector still many researchers have doubts about its validity in the competitive business environment. Milton Friedman, suggest that as the managers are agents of principle and if they try to spend more amounts on CSR activities they are actually utilizing somebody else money and in return, it will reduce profits paid to investors, wages to employees and more expensive products to customers. Therefore, he suggested that these spending should be done independently by employees and customers if they really want to. Friedman also suggested that companies should select those CSR activities which will provide long term benefit, e.g. they should provide donations to charitable organizations or indulge in community up building project, which will help them to save taxes and also provide than competitive advantage in the industry.

Husted and Salazar (2006) were also in agreement with Friedman and suggest that businesses should indulge in strategic CSR which will help them to enhance their goodwill by not compromising their profits. Siegel and Vitaliano (2007) examined a large sample of public limited companies in the US and suggests that firms should be firm CSR activities should be strategically selected I order to enjoy its profit maximization benefits

According to Maignan, Ferrell and Hult (1999) majority of customers prefer to buy products of socially responsible firms and also about 76 percent are willing to switch their brands from those firms who are not practicing CSR activities to the ones who are actually practicing these activities. In a survey of 1000 consumers in the USA, Hess, et al (2002) found that almost 43% customers were very impressed by firms who actually donated for social welfare and development.

Much work has been done for finding CSR activities and its relation with the profitability of the firm and the results are mixed. According to Waddock and Graves (1997) financial performance is greatly flounced by firms CSR activities. Neihsel (1994), found a positive and significant effect of firm's donations and its profitability. Seifert et al. (2003) found a weak but positive correlation between available cash and firm's CSR activities. Bashir, Hassan and Cheema (2012) concluded that CSR activities of an organization positively impact employee satisfaction which in results increase the productivity and profitability. Conifer, Nazari, Emami and Soltaniet al. (2012) worked in restaurants and airline industry found a mixed relation of CSR activities and financial performance. Javed, Saeed, Lodhi and Malik (2013) used Caroll model of CSR on KSE 30 index companies of Pakistan and suggest that there is a positive relationship between firms, financial performance, economic and legal responsibilities and negative relationship in the case of ethical and discretionary responsibilities. They also conclude that CSR by corporate sector provides a healthy environment for the country and promotes a culture in which laws are abided willingly. Domenico (2014) used samples from Italian firms and suggest a weak positive association between corporate social performance and financial performance.

Canada, Erhemjamtsa, Tehranianb (2012) worked in the banking sector and found that in financial crises different sizes of banks showed different behavior. Small banks show a significant relationship between different bank characteristics and profitability, but large bank which are more involved in CSR activities shows a positive and significant impact on their financial performance. Singh and Pachar (2012) used empirical measures to identify the impact of CSR activities on the financial performance of the firm and they found a positive and significant relationship between these two variables Ehsan, Kaleem and Jabeen (2012) suggests that there is a two way relationship between firm CSR activities and its financial performance. They worked on panel data and run random effect model, there results suggests a positive relationship between these two variables. Cochran and Wood (1984) found that the average age of company is highly correlated with its ranking in regards its social responsibility, therefore they control this

variable still they found a significant correlation between firm profitability and CSR. Nazir, Iftikhar and Aiza (2010) worked on tobacco industry of Pakistan and Suggest that CSR concept is very new in Pakistani context so very little has been found in this regard in the tobacco industry. They found two companies in this sector, namely- Pakistan Tobacco Company and Lakson tobacco Pakistan, as tobacco in its self is very dangerous for the health but still these companies are playing their part in different CSR activities in order to create goodwill in the minds of their customers. Kanwal, Khanam, Nasreen and Hameed (2013) also try to find relationship between firm performance and CSR in different KSE listed companies of Pakistan and found a positive correlation between these two variables. They suggest that CSR activities give dual benefits to the firm. At one end they enhance a positive image in the minds of their stakeholders on the other hand improve their financial position. Vintila (2013) found a positive relationship between firm size and profitability to its CSR activities in the case of Romanian companies. Uwalomwa (2011) found a positive relationship between firm size and CSR. They suggest that larger companies are more capable of exercising CSR practices because they more capable of sparing money for these types of activities. Bronco and Rodrigues (2008) suggests that stakeholders expect more socially responsible behavior from large corporations therefore large corporate exercise more CSR practices as compared to small size companies. Kedia and Kuntz (1981) found a negative correlation between firm CSR activities and asset size as a percent of net income in different banks of Texas banks.

Hypothesis

- H1: CSR has a significant positive relationship with net profits.*
H2: CSR has a significant positive relationship with total assets.
H3: CSR has a significant positive relationship with net profit margin

METHODOLOGY

Sample and Sample Measures

Secondary data was collected from annual reports of 10 Pakistani listed companies of Oil and Gas sector had selected from 2006-13. All these companies are listed KSE, Pakistan. The data is cross section as well as time series The correlation test was applied in MS-Excel.

Research Instrument:

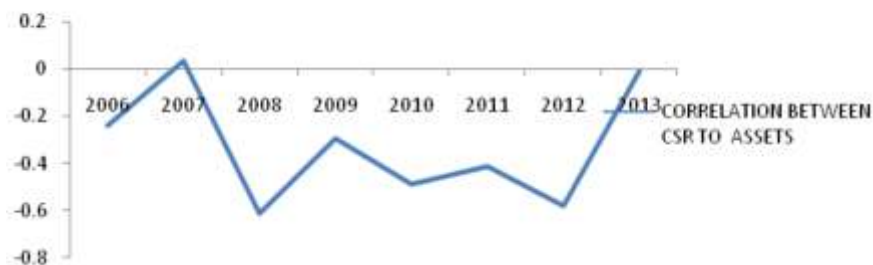
The correlation and regression methods were used to find the association between profitability and CSR activities. Variables used in the study were CSR amount, profit after taxation, net profit margin to sales and the amount of total assets. Results are generated in MS Excel. Variables included are total assets, net profits, net profit margin

and CSR. Total assets were measured by taking the log of total assets, net profits include profits after taxation, Net profit margin was measured by dividing net profits with net sales and CSR includes sum of donations and salaries, wages and benefits contributed by the company.

RESULTS

Years	Correlation between assets and CSR	Correlation between net profits and CSR	Correlation between net profit margin and CSR
2006	-0.241246232	0.569566428	0.740726332
2007	0.036416939	0.32992483	0.666824285
2008	-0.612157675	0.10072714	0.364893001
2009	-0.293336507	0.10072714	0.585121709
2010	-0.488472594	0.139892366	0.391076541
2011	-0.411268754	0.923689621	0.432468701
2012	-0.579652432	0.187701962	0.2605154
2013	-0.009339194	0.223177998	0.291591824

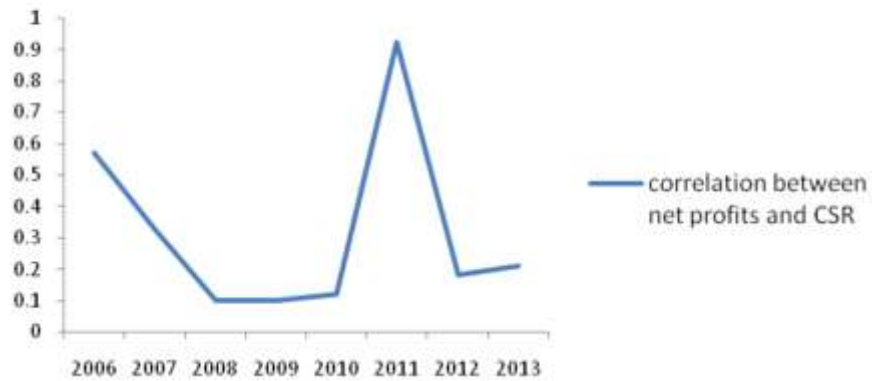
CORRELATION BETWEEN CSR TO ASSETS



Graph 1: Correlation between total assets and CSR

The correlation between the CSR and was weakly negative in 2006 and 2006 but was highly negative in the years 2008 and 2012 but in 2013 there almost zero correlation between these two variables.

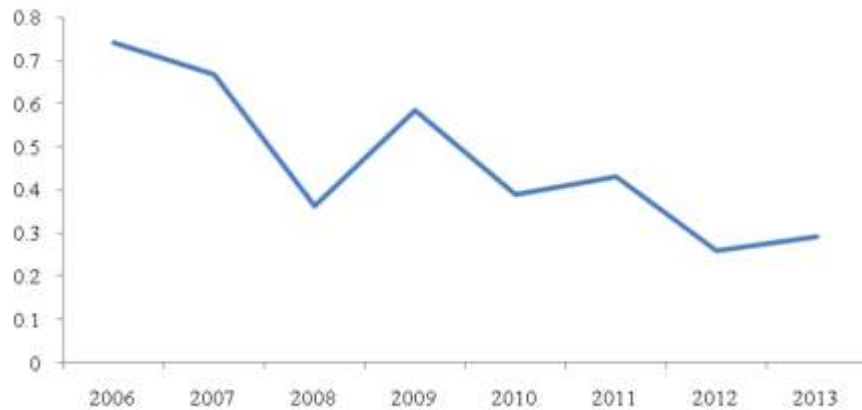
CORRELATION BETWEEN NET PROFITS AND CSR



Graph 2: Correlation between net profits and CSR

The correlation between the CSR and net profits are positive. In 2011 it shows a very high correlation of about 90%.

NET PROFIT MARGIN



Graph 3: Correlation between Net profit margin and CSR

The correlation between net profit margin and CSR activities is positive it was very high in 2006 but in 2013 it shows weak positive correlation of almost 29%.

Table 1.2				
Regression results				
Dependent variable: Assets				
variables	beta	Standard deviation	t-value	p-value
CSR	13.2093	37.5456	0.352	0.74273
R-squared = 0.96 Adjusted R-squared = 0.851 F- statistic: 0.4508 with p-value = 0.770339				

Regression results in Table 1.2 does not suggest any significant Impact of assets on CSR activities. This is due to lower value of t-statistic. Overall model is also not significant due to the value of f- statistics

Table 1.3				
Regression results				
Dependent variable: Net Profit Margin				
variables	beta	Standard deviation	t-value	p-value
CSR	2.92545E-08	6.96062E-08	0.420	0.69587
R-squared = 0.371928 Adjusted R-squared = 0.413163 F-statistic: 0.515311 P- value = 0.731714				

Regression results in Table 1.3 does not suggest any significant impact of Net Profit Margin on CSR activities. This is due to lower value of t-statistic. Overall model is also not significant due to the value of f- statistics

Table 1.4				
Regression results				
Dependent variable: Profit				
variables	beta	Standard deviation	t-value	p-value
CSR	2.07658	7.79875	0.266	0.80319
R-squared =0.406025 Adjusted R-squared = 0.336443 F-statistic:0.5 P- value = 0.68				

Regression results in Table 1.4 does not suggest any significant impact of assets on CSR activities. This is due to lower value of t-statistic. Overall model is also not significant due to the value of f- statistics

ANALYSIS

The results show a positive association of CSR and net profits and net profit margin, which suggest a positive relationship between CSR activities and profitability of the firm. These results support the results of Vintila (2013), Cornetta, et al. (2012) and Kanwal, et.al (2013) therefore first hypotheses was accepted. On the other hand correlation between total assets and CSR was found negative therefore second hypothesis was rejected. This result contradicts the results of Uwalomwa (2011), Branco and Rodrigues (2008) and Cornetta, et al (2012) and supports the findings of Kedia and Kuntz (1981) who found a negative correlation between firm CSR activities and asset size. Regression results suggests that insignificant impact CSR activities on assets, net profit margin and profits.

CONCLUSION

In order to find the impact of CSR activities on the profitability and its value data of 10 companies of oil and Gas sector which were listed on KSE was collected. The data were extracted from annual reports of these companies. In order to find the relationship of sea with the profitability correlation and regression test was conducted. The result shows a positive relationship between CSR and net profit and net profit margin. Whereas negative relationship between total assets and CSR. Regression results suggests an insignificant impact of CSR activities on profitability. This work is subject to certain limitation as it has taken data of only one sector and time frame of 8 years, further research can be done by using data from different other sectors. As the awareness of the importance of CSR practices is increasing globally, it is important for Pakistani business sector to feel their responsibility and play their part in solving many social problems of the country. The current study will help the corporate managers to incorporate social concern in their corporate vision and strategy development.

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