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CSR Disclosure and Financial Performance in Listed Manufacturing Companies in Sri Lanka

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Abstract

The study was conducted to identify the Corporate Social Responsibility disclosure and financial performance in manufacturing sector in Sri Lanka. CSR disclosure is indicated as independent variable and it was measured by using CSR index. Financial performance identified as dependent variable which measured by using the Return on Equity (ROE) and Return on Assets (ROA). Data was obtained from annual reports websites publications and secondary data was collected from the year 2014 to 2019. The data was analysed using E-views and Pearson correlation. The study applied linear regression model to assess the impact of CSR disclosure and financial performance. Target population comprised of 38 listed companies of which, 30 companies were selected as sample. This data was collected for 5 years each firm giving 150 observations. In this study show that CSR disclosure and financial performance has a positive correlation at 5% significant level. The study concluded further that significant relationship existed between CSR disclosure and ROE. The study recommended that manufacturing firms should have much attention to the importance of CSR and need to pay more attention to increase financial performance.

Keywords: Corporate Social Responsibility (CSR) disclosure, Financial performance, Return on Equity (ROE), Return on Asset (ROA)

Introduction

Background of the study

CSR activities are one of the important activities of every organization at present. All the prominent organization presents CSR activities for the sake of society or as a part of responsibility. Organizations have embraced CSR without substantial increase in industries' performance; so the research sought to find out the effect of CSR on Firm's profitability (Resmi, Begum, & Hassan., 2018).

CSR disclosure is evaluating the performance of the company. A primary goal of CSR is to satisfy various stakeholders of the company. Most of entities perform CSR activities for its stakeholders than shareholders. CSR disclosure is used for achieving effective communication of a company's social and environmental responsibility activities to stakeholders.

CSR disclosure is a business organizations provide information to stakeholders for their corporate activities in the society. There are many empirical literatures about CSR disclosure (Alexander & Buchholz, 2016), (Oba, 2010) and (Olayinka & Temitope, 2012). There are no necessary requirements for disclosure in CSR in Sri Lanka. The companies are encouraged to present such disclosures practically, environment reporting (LKAS 3- Award for best disclosures). Most organizations bomb because of poor money management. Firms are required to measure their budget to plan their monetary prosperity over a given time period.

Financial performance is very broad management topic, which an association can be making benefits and behaving low degrees of liquidity. Subsequently, financial performance means to how well associations are overseen and fulfilling enthusiasm of their partners. It includes, deciding how successfully an association has connected its advantages for produce income in its business; it is important for firms to work with the restricted assets within company. The measures of financial performance are: return on equity and return on assets.

Financial performance shows investors about the general well-being of a firm. It's an icon of its economic health and management's task is doing. Financial statements used in evaluating overall financial performance include the balance sheet, the income statement, and the statement of cash flows. Financial performance indicators are quantifiable measures used to find that how well a company is doing. No single measure should be used to define the financial performance of a firm (Investopedia, 2021).

There is an availability of very limited research work in the context of CSR practices in context of developing countries like Sri Lanka. Therefore this study tries to investigate whether there is an impact of CSR disclosure on financial performance and support to understand is there any relationship between CSR disclosure and financial performance among manufacturing companies in Sri Lanka. It is expected that findings of the study would be great to use of planners, researchers and decision makers as well. Findings of this study will give deep knowledge about the CSR disclosure in manufacturing companies and how it affects to the financial performance.

Objectives

A majority of research to date on this theme has focused on the relationship between CSR and Financial Performance. Generally, these findings show this relationship to be positive;

however there exists a lack of homogeneity in the results. This study strives to fill this existing gap; and with this aim study sets two main objectives:

I. To examine the impact of corporate social responsibility disclosure on financial performance of listed manufacturing companies in Sri Lanka.

II. To examine the relationship between corporate social responsibility disclosure and financial performance of listed manufacturing companies in Sri Lanka.

Problem Statement

Previously studies have focused mainly on the developed countries and there is less work done on measuring the impact of CSR on Financial performance in developing countries like Sri Lanka and most of the firms are not yet quite familiar with the importance of CSR and thus don't pay much attention on that. (Resmi, Begum, & Hassan., 2018). Now a day's people have more knowledge about the organizations and the work they are doing for the welfare of the society. So the purpose of this study has addressed with relationship and impact, between and among CSR and profitability of firms in Sri Lanka.

When consider the Sri Lankan context manufacturing companies are non-financial institutions that follow the CSR activities. Inhere, researcher focus on whether CSR disclosure impact on financial performance in manufacturing companies in Sri Lanka or not. There is a growing trend to report on listed companies in Sri Lanka on it.

Some researchers found there is an impact on CSR disclosure on financial performance with positive relationship (Kartadjumena, Hadi, & Budiana, 2011), (Alexander & Buchholz, 2016), and (Olayinka & Temitope, 2012), negative relationship (Auperle & Pham, 2011) and neutral association (Ullman, 2016) between CSR disclosure and corporate financial performance.

There are lack of research evidence about disclosure of CSR activities in manufacturing companies and its effect to the financial performance in Sri Lanka. So this area is still open for further research. The problem statement of the study is, "Is there any relationship between CSR disclosures with financial performance or impact among those variables". By researching about the problem findings should be answered these questions of "Is there any relationship between CSR disclosures with financial performance in manufacturing companies and "Is CSR disclosure affect to the financial performance in manufacturing companies in Sri Lanka?''

Research Questions

In shedding light on the key interplay between CSR and its profits, we expect the results of our work to go a long way toward convincing corporate boards that social policies must form an initial part of overall company strategy. To overcome the above two objectives, research questions to be answered as follows;

I. Is there any impact of CSR on financial performance of listed manufacturing firms in Sri Lanka?

II. Is there any relationship between CSR disclosure and financial performance of listed manufacturing firms in Sri Lanka?

Literature Review

Theoretical review

There has been a growing of concern for the environment and social issues. The public pays attention to the different social initiatives taken by companies. Here it is discussed about some theories related with CSR and financial performance.

Stakeholder theory

The stakeholder theory is one of the relatively new theories which the philosophy of its existence lays in corporate responsibility. This theory is often used to explain, why organizations disclosure CSR information by social and environmental accounting researchers. Stakeholder means "any group or individual who can affect or is affected by the achievement of the organization's objectives" (Freedman, 2006). It states that the organization should be thought itself of as grouping of stakeholders and to manage the interests, needs and viewpoints of stakeholders.

However, stakeholder theory, considers society, serves as a main tool for the study. Good CSR policy together with the appropriate behaviour of the board of directors will improve financial profitability, and favour shareholders, employees, customers, suppliers and all other agents likely to be affected by the decisions taken by the company (Fernandez, 2016).

The more critical the stakeholders' resources are linked to the continuied success and existance of the organization, the grater than stakeholders' expectation will be addressed (Islam & Deegan, 2008). Thus disclosure of particular type of CSR information can be used as a srategy to gain or maintain the support of powerful stakeolders.

Legitimacy theory

Legitimacy theory (Fernandez, 2016), (Kaufman & Englander., 2011) is based on the idea of a social contract between an organization and society, and try to report the CSR, so that they are approved by the community because organizations can continue their life until they are considered legitimate by the community (O' Donovan, 2002). Increase in social disclosure is a strategy by corporations to alter the perceptions about the legitimization of an organization in order to achieve the continuing mandate of the society (Deegan, 2002).

According to (Liu & Anbumozhi, 2009) previous studies on disclosure have used this to explain incentives for corporate voluntary disclosure for which CSR disclosure is an important component. In the legitimacy theory, CSR disclosure aims to legitimize a company's behavior by providing information intended to influence stakeholders' and eventually society's perceptions about the company (Hooghiemstra, 2000).

CSR disclosure is a critical way for firms to communicate with society, to convince the public that they are meeting their social expectations. According to (Akinpelu et al., 2013) the legitimacy theory argues for companies carry out their activities within the framework of the society they operate. They further argue that these bounds and norms are not fixed hence the need for organizations to watch out for changes and respond to them appropriately. It means of addressing exposure to public policy (Hassan, 2014).

Corporate social responsibility

CSR disclosure is as the process of communicating the social and environmental effects of organizations' actions such as economic, to relevant interest groups within society and society at large (Owen and Adams, 2017). (Williams & Siegel., 2001) It has noted that stakeholders such as employees, consumers, communities and environmental groups have exerted one form of pressure or other n business organization. Disclosure of CSR activities by business organizations is part of strategy to manage the pressures from the stakeholders.

Studies (Matten & Moon, 2008), (Musah, 2008) find that CSR has clearly addressed issues bothering on working hours and conditions, fair wages, health care, redundancy and protection against unfair dismissal. Customer pressures include the expectation that companies will produce safe products, quality and consumption impact on the environment, and provide more reliable consumer information. In addition, (Maignan, 2016) concludes that the better way to improve the treatment of the customers is to apply CSR disclosure as a marketing strategy.

Companies use CSR reporting as corporate communication and marketing instrument to be judged as legitimate by different stakeholders (Nielsen & Thomsen, 2007) and (Podnar & Golob, 2007). Stakeholders expect that firms will inform them about their activities, covering issues like labor management, human rights, society, environment and product responsibility. Accordingly, firms are required to report their social impact to stakeholders through their CSR reporting (Sutantoputra, 2009).

Environmental

Environmental responsibility is important; regarded as a necessary perquisite for the achievements of human beings. Actually, companies cannot ignore the problems of the environment in which they function. Environmental oriented CSR enhance firm performance in environmentally sensitive industries that are exposed to more environmental and social risks and greater public scrutiny. Industry concentration, industry growth, industry capital investment, industry size, industry advertising, industry minimum efficient scale, industry geographic dispersion, industry barriers to entry, and industry economies of scale all can play a role of increasing a company’s financial performance.

Community involvement

Community involvement is the power to bring positive, measurable change to both the communities in which you operate and to business. Community involvement examples include in kind and financial donations, employee volunteer days, enduring non-profit partnerships, and more.

Human Resource

Human resources oriented CSR refers to the efforts a company take to target CSR for the benefit of employees, who are viewed as a company’s value asset, by providing a safe and supportive working environment, fair pay, reasonable work hours, and work – life balance support, which enhance employee development, commitment and satisfaction.

Product and customer

Product and customer oriented CSR refers providing the explanation of major products to the customers, providing customer awards to the better customers and getting feedback from the customer.

CSR information is qualitative information. There is no any significant dimension to measure CSR activities in Sri Lanka. Therefore CSR disclosure is measured by using CSR index. Finally all data were analysed by using E-views.

Financial performance

Financial performance of a business can be assessed based on two crucial indicators. It indicates that profit should be measured from the perspective of shareholders' and firms' earnings. It indicates that profit should be measured from the perspective of shareholders' and firms' earnings. This study adopts two accounting based measures to examine the relationship with CSR disclosure. These two ratios are Return on Asset (ROA) and Return on Equity (ROE).

Return on Asset (ROA)

Basically, Return on Asset (ROA) is a fundamental profitability indicator that is employed to assess the efficiency of a business's assets. It indicates how much profit, a firm generates with its total assets. It implies how efficiently and effectively a business is receiving Earning advantage based on its assets. (Hossain, 2019). Return on assets (ROA) is an indicator of how profitable a company is relative to its total assets. ROA gives a manager, investor, or analyst an idea as to how efficient a company's management is at using its assets to generate earnings (Investopedia, 2021).

Many studies have employed ROA to discover the linkage between ROA and CSR disclosure (McWilliams, 2000), (Soana, 2011). The association between CSR and ROA has been seen to be positive (Ehsan & Kaleem, 2012). However some researchers (Hasan, 2013), (McWilliams, 2000) found there is no link between CSR and ROA.

$$ROA = \frac{Profit\ After\ Tax}{Total\ Assets} \qquad (1)$$

Return on Equity (ROE)

Return on Equity (ROE) is the amount of net income returned as percentage of shareholders' equity. Return on equity measures a company's profitability by revealing how much profit a company generates from the money shareholders have invested (Hossain, 2019).

ROE is expressed as a percentage and can be calculated for any company if net income and equity are both positive numbers. Net income is calculated before dividends paid to common shareholders and after dividends to preferred shareholders and interest to lenders. Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity. Because shareholders' equity is equal to a company's assets minus its debt, ROE is considered the return on net assets. ROE is considered a measure of a corporation's profitability in relation to stockholders' equity (Investopedia, 2021).

$$ROE = \frac{Net\ Income}{Share\ Holders\ Equity} \qquad (2)$$

Methodology

Data collection

Data were obtained by using annual reports of the listed manufacturing companies to gather the disclosed CSR activities for the research. Secondary data for the study relies over the period from 2015-2019. The sources of data include the yearly publications of the CSE, and the annual reports of the listed manufacturing companies.

Population and Sample

All 38 listed manufacturing companies in Sri Lanka are referred to population. From these, only 30 listed manufacturing companies have been selected using convenience sampling.

Data collection is restricted to only five year period (2015- 2019) & 30 companies. Considered years CSR may be fluctuating within whole years in case of different factors, unavailability of the data and lack of disclosure of selected variables, so these research findings are depends on the disclosure of annual reports.

Conceptual framework

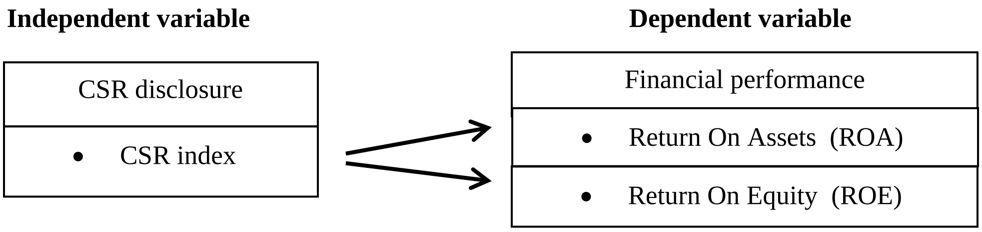

Figure I: Conceptual Framework

Operationalization

Table I: Operationalization

Concept	Variable	Indicators	Measurement
CSR disclosure	CSR Index	01.Environment i. Environmental awards ii. Environmental Policies iii. Pollution control iv. Industrial process 02.Community Involvement i. Social welfare ii. Donation to the charity iii. Seminars & conferences 03.Human resources i. HR development ii. Health and safety arrangement iii. Policies for company's remuneration package 04.Products & customer i. Providing information on the safety of company's product ii. Consumer awards	$\sum_{j=1} rj \div n$ rj = 1 (if the j item is disclosed) rj = 0 (if the item is not disclosed) n= No of items (Mohammed, Zakaree, & Oladele, 2016)

Financial performance	Return On Assets	It indicates how much profit a firm generates with its total assets.	$\text{ROA} = \frac{\text{Profit After Tax}}{\text{Total Assets}}$ (Sadeghi, Arabsalehi, & Hamavandi, 2016)
	Return On Equity	It indicates how much profit a company generates with the money shareholders have invested.	$ROE = \frac{\text{Net Income}}{\text{Shareholders Equiy}}$ (Sadeghi, Arabsalehi, & Hamavandi, 2016)

Hypothesis development

Following are the hypotheses developed by the researcher on relationship and impact of the variables.

H1 = There is a significant impact of CSR disclosure on financial performance.

- H1a = There is a significant impact of CSR disclosure on ROA.
- H1b = There is a significant impact of CSR disclosure on ROE.

H2 =There is a significant relationship between CSR disclosure and financial performance.

- H2a = There is a significant relationship between CSR disclosure and ROA.
- H2b = There is a significant relationship between CSR disclosure and ROE.

Mode of analysis

In this study it is used simple regression analysis, because there are only two variables, dependent variable and independent variable. The regression models utilized to test the CSR disclosure and financial performance is given below.

So it can be as following,

$$y = \beta 0 + \beta x \qquad (3)$$

Where,

- '**y'** is the financial performance
- '$\boldsymbol{\beta 0}$' represent the intercept coefficient
- '$\boldsymbol{\beta x}$' is the CSRD

This is the basic regression equation that used to build following models

Model 1 $\longrightarrow \boldsymbol{ROA = \beta 0 + \beta 1 CSRD} + \mathcal{E}$

Model 2 $\longrightarrow \boldsymbol{ROE = \beta 0 + \beta 1 CSRD} + \mathcal{E}$

Where, $\beta 0$ = constant

Ɛ = Error

Findings of the study

Descriptive statistics

Table II: Descriptive statistics

	CSR disclosure	ROA	ROE
Mean	0.391	0.095	0.137
Median	0.416	0.068	0.115
Maximum	0.833	0.493	0.640
Minimum	0.016	-0.074	-0.192
Std. Deviation	0.152	0.09	0.125

Event source: E-views

By using E-views 8, Descriptive Statistic of the CSR disclosure (Independent Variable) and ROE, ROA (Dependent variables) was computed and it included mean, maximum, minimum and standard deviation.

The minimum for the variable of CSR disclosure was 0.016, the maximum was 0.833 and with 0.416 of median. Standard deviation says that CSR disclosure differ from the mean in range of 0.152. For last five years, the minimum value for ROA was – 0.074 and maximum value was 0.493 with the mean value 0.095 and standard deviation 0.09. Minimum ROE is -0.192 and maximum was 0.64 with 0.173 mean and 0.125 of standard deviation. The descriptive statistics indicate high dispersion of data for every variable in this study.

Regression analysis

Table III: Regression model 1

	ROA
Observation	150
R- Squared	0.0094
Adjusted R- squared	0.0019
Probability(F- statistic)	0.2626

Event source: E-views

According to that regression coefficient CSR disclosure, R – squared value is 0.0094, means that 0.94% of the variation in ROA is explained by variation in CSR disclosure. Further, this model reveals that the coefficient for CSR and ROA is insignificant at 0.05 level (P=0.2626) which is indicate CSR disclosure has no significant impact on ROA (Abeysinghe & Basnayake, 2017).

However according to this observation there is insignificant impact of CSR disclosure on ROA in manufacturing companies in Sri Lanka.

Table IV: Coefficient Model 1

Variable	Coefficient	Probability
C	0.072	0.001
CSR disclosure	0.057	0.262

Event source: E-views

Value of the CSR disclosure is more than significant level (0.262> 0.05) therefore coefficient of 0.057 is insignificant. And also there have been insignificant impact of CSR disclosure on ROA.

Table V: Regression Model 2

	ROE
Observation	150
R- Squared	0.034
Adjusted R- squared	0.027
Probability(F- statistic)	0.031

Event source: E-views

CSR disclosure is significant impact on ROE as shows by probability 0.031. According to that regression coefficient CSR disclosure is show significant impact on ROE (P<0.05). R – Squared value is 0.034. It means that 3.4% of the variation in ROE is explained by variation in CSR disclosure. Further, this model reveals that the coefficient for CSR and ROA is significant at 0.05 level (P=0.031) which is indicate CSR disclosure has significant impact on ROE.

Table VI: Coefficient Model 2

Variable	Coefficient	Probability
C	0.077	0.009
CSR disclosure	0.153	0.031

Event source: E-views

Value of the CSR disclosure is less than significant level (0.031< 0.05) therefore coefficient of 0.153 is significant. And also there have been significant impact of CSR disclosure on ROA.

Hypothesis Testing

H_1 = There is significant impact of CSR disclosure on financial performance.

H1a = There is impact of CSR disclosure on ROA.

According to regression analysis there is a positive insignificant impact of CSR disclosure on ROA at 5% significant level. Its P value is 0.262 which is more than 0.05 significant levels. Hence the researcher rejects the H1a and accepts the null hypothesis.

H_{1b} = There is impact of CSR disclosure on ROE

According to regression analysis there is a positive significant impact of CSR disclosure on ROE at 5% significant level. Its P value is 0.031.It is less than 0.05 .Hence the researcher rejects H_{1b} and accepts the null hypothesis.

H_2 = There is a significant relationship between CSR disclosure and financial performance.

H_{2a} = There is a significant relationship between CSR disclosure and ROA.

According to the result of correlation analysis, there is a positive weak relationship between CSR disclosure and ROA at 5% significant level (0.097). Its p value (0.262) is more than 0.05. Hence the researcher accepts the null hypothesis and rejects H_{2a}.

H_{2b} = There is a significant relationship between CSR disclosure and ROE.

According to the result of correlation analysis, there is a positive weak relationship between CSR disclosure and ROE at 5% significant level. Its p value (0.0.031) is less than 0.05. Hence the researcher rejects the null hypothesis and accepts H_{2b}.

Finally the find of study revaluated that there is a positive significant relationship between CSR disclosure and financial performance of Listed Manufacturing companies in Sri Lanka and there is a significant impact of CSR disclosure and financial performance according to the data analysed.

Discussion and recommendation

Results discussion

The aim of the study was establish the relationship between CSR disclosure and financial performance of manufacturing companies in Sri Lanka. Data was analysed using data from 2015 to 2019 annual reports in Colombo stock exchange. In Sri Lanka, there are 38 listed manufacturing companies. The study is based on 30 manufacturing companies. CSR disclosure is measured by using the CSR index. Financial performance measured by using ROA and ROE

Findings of the study suggested that there exists a significant relationship between CSR disclosure and firm performances (ROE) among manufacturing companies in Sri Lanka. According to the results, many CSR factors affect firms' performance measured by ROA & ROE. According to the regression model this study found there is a positive significant impact on ROE which means companies can increase financial performance (ROE) by increasing CSR disclosure and there is a positive insignificant impact on ROA, which is study findings are consistent with those of previous studies (Nyeadi, 2018), (Walker, Zhang, & Yu, 2015), (Dergisi, 2012), (Olayinka & Temitope, 2012).

The study (Abeysinghe & Basnayake, 2017) found there is an insignificant impact of CSR on firm performance (ROA) in Listed Commercial Banks in Sri Lanka. The researcher identified financial performance will not be totally depended on CSR disclosure. It means there is insignificant impact of CSR disclosure on financial performance (ROE) in Domestic Banking industry in Sri Lanka.

The results of the study have revealed that companies have a tendency to focus on some areas of community development, including the environment, product and customer, as these are the serious challenges faced by Sri Lankan communities.

Conclusion

Researcher proposed to provide several implications or outcome. This ultimate outcome is to find, is there any affect CSR disclosure to manufacturing companies' financial performance. CSR disclosure is not a mandatory in Sri Lanka as in many other countries. Therefore, it is not captured within the general framework on financial reporting which is heavily focused on the financial statement and the related disclosures. Hence, CSR disclosures are provided in the annual reports of companies as voluntary disclosures. Better CSR leads the firm towards to achieve better performance therefore CSR adds values to the company.

According to the collected data related for last five years, it is revealed that the CSR disclosure in manufacturing companies in Sri Lanka is at moderate level. When considering level of CSR disclosure trend for last five years there is positive incremental trend. According those things it can be concluded that there is an attractive growth in adopting for CSR activities by considering level of CSR Sri Lanka does not have standard framework to disclosure of CSR activities as it is voluntary activity.

Correlations between CSR and the financial performance reflect that there is a relationship. As well as all regression output emphasize that there is a positive relationship between corporate social responsibility disclosure and financial performance (ROE).

By considering all above factors finally it can be concluded that there is a positive impact of CSR disclosure on financial performance in manufacturing companies in Sri Lanka, As well as though it is still voluntary activities in Sri Lanka, there is a positive incremental trend for last five years it might be due to the positive relationship of CSR disclosure impact to financial performance. Therefore it can be suggested that companies have to take much attention to the importance of CSR and need to pay more attention about CSR disclosure. A conducive and friendly social and business environment will enable corporations to achieve their main objective of profit and shareholders 'wealth maximization.

As per the results, companies should spend more on CSR activities generally and on employee benefits expense in particular, as CSR expense leads to higher profitability and better performance. CSR should be spent on employee benefits expense because employee benefits can impact their motivation, which results in higher productivity and performance. Furthermore, the emotional bond of an employee with their organizations can reduce absenteeism and turnover and improves productivity. Lack of implementation of CSR is due to poor monitoring, unclear policies, bureaucracy and complicated tax systems. Organizations should focus on a wider role in society beyond focusing on quality products at reasonable rates. Therefore, it was concluded that CSR has a positive impact on the financial performance of Sri Lankan manufacturing firms.

Limitations and Recommendations

There are some limitations of the study. Such as, using secondary data and results are depended on that. This study is only considering manufacturing companies in Sri Lanka. To overcome these limitations, following things can be recommended. Those are use of primary data which obtain from primary sources, use of other factors as dependent variable such as reputation, employee morale, Firm value, etc. Study has considered the evaluation for only five years these findings should be interpreted base on that period. Future research in this area should consider it necessary to extend the number of periods studied to evaluate data. The large sample size should be used to interpret the end result instead manufacturing companies. This finding would increase the awareness among manufacturing firms which do not adopt a long-term CSR policy due to a provable link with profitability. The present findings should encourage Sri Lankan companies to engage in CSR activities.

Directions for future research

While this mayn't be large enough, not all the sectors, another sector firms were covered for some of them lacked the data. Thus, the study is limited by the number of observations. The period could potentially be too short for further analysis and therefore capable of yielding biased results. The researcher should expand sample period. A similar study can be conducted using different measurements when examine the CSR disclosures other than CSR index. Future researcher can add control variable to measure impact of CSR disclosure on firm performance. The current study was conducted in manufacturing firms; however, future studies should focus on other non-manufacturing firms in a wide range of sectors. The study did not account for the specific sectors, but future studies can perhaps look into this perspective within the manufacturing sector.

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