MODERATING EFFECT OF CORPORATE GOVERNANCE ON THE RELATIONSHIP BETWEEN CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL PERFORMANCE

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ABSTRACT

Purpose-This paper studies the extent of CSR practices that would affect a firm's performance and if corporate governance could moderate the relationship between CSR activities and firm performance in order to facilitate the fulfillment of a better off needs among the stakeholders and company's ultimate objectives. This article addresses the foreign ownership, board Size, CEO duality, board independence, managerial ownership aspects of corporate governance.

Design/Methodology/Approach-A sample of listed entities in Sri Lanka by the end of 2016/17 financial year was selected for gathering the data and they were analyzed using moderator regression analysis.

Findings-Environmental and total CSR activities appeared to have a significant positive relationship on Return on Assets (ROA). Dividing the sample into manufacturing and non-manufacturing firms, it was found that the regression results of all environmental, social and total CSR are significantly positively related to ROA and Return on Sales (ROS) for manufacturing firms and was insignificant for non-manufacturing firms except for the relationship between environmental CSR activities and ROA. Moreover, corporate governance variables like board size, board independence and managerial ownership strengthen the positive relationship between CSR and firm performance for ROA, ROE and Tobin's Q. Furthermore, corporate governance has a stronger impact for manufacturing firms.

Keywords-Firm Performance, Corporate Social Responsibilities, Corporate Governance, Moderating Effects, Sri Lanka.

1. INTRODUCTION

At present, an increasing trend can be seen with regard to firms engaging in CSR activities. However, it is still questionable that the exact reason for the firms to engage in socially responsible activities. Further, the increase in corporate scandals throughout the world has resulted many interested parties to draw their attention towards the corporate governance mechanisms employed by the firms. With these implications, some countries have taken steps to impose rules and regulations regarding corporate social responsibilities as well as corporate governance (Kabir & Thai 2017)

Corporate social responsibility and financial performance have been popular research areas for many researchers. However, prior researches regarding these two variables involve mixed findings as per Lu et al. in 2014 (cited in Kabir & Thai 2017). That is whether the CSR is positively related, negatively related or no significant relationship with firm performance is still questionable. However prior researches support more on the finding that firm performance has a positive significant relationship with CSR (Mishra & Suar 2010). Anyhow, it is questionable whether the impact of various aspects of CSR, that is social, environmental perspectives, differently relates with the firm performance or not.

With the agency problem coming into light, the importance of corporate governance is becoming more and more significant. Corporate governance is simply defined as the system by which a firm is controlled and directed (The UK Corporate Governance Code, 2016). It is interesting to find out whether those governing systems have an influence or an impact over the relationship which subsists between CSR and firm performance. That is whether the different aspects of corporate governance when taken separately and when taken as a single variable supports or weaken the relationship between CSR and firm performance.

When looked into literature on CSR, firm performance and corporate governance, most of the studies have focused on the firms incorporated in developed countries like USA and European countries (Kabir & Thai 2017). This study has focused on Sri Lanka which is a developing country in South Asia. It was expected that it would be interesting to study how these three variables link in a developing country like Sri Lanka.

This study will contribute the existing knowledge mainly in two ways. One way is by finding the relationship between CSR and firm performance in Sri Lanka which is considered to be a developing country. Since the relationship with firm performance can differ based on the different aspects of CSR, both the social and environmental components of CSR will be considered separately (Kabir & Thai 2017). Secondly, by finding the impact of corporate

governance as a third variable, on the relationship between firm performance and CSR, by taking into consideration various aspects of corporate governance like board independence, CEO duality, board size and managerial ownership.

In the next sections of the paper further elaborations have been made on the prior researches that were referred, significance of the study that was carried out, research designs and methods used, findings and analysis, finally conclusion and limitations of the study.

2. LITERATURE REVIEW

This section focuses on reviewing local and international literature which are relevant to the study, also the gaps identified in the existing literature and the contribution of this study in reducing the identified gaps. Based on the literature survey mainly four types of relationships among CG CSR and firm performance relating to the selected research topic were identified.

2.1 Relationship between corporate social responsibility disclosures and corporate governance

Nowadays corporate governance concept has been widened and it has compassed some areas of CSR. According to Claessens (2003), corporate governance balances the trade-off between economic and social goals and the trade-off between individual and communal goals (Cited in Khan 2010). As per literature CG has considerable impact on CSR issues relating to employee conditions within the organizations (Deakin & Whittaker 2007, Cited in Khan 2010). Presence of non-executive directors can be seen as a main CG element and this ensures the interest of owners as well as the interest of other stake holders. Presence of diversified board can represent the interest of wider pool of stakeholders. These factors depict that CG elements has significant impact on CSR activities and thereby the CSR disclosures. Chan, Watson and Woodliff (2014) also have found a positive relationship between corporate governance and CSR disclosures in their study.

According to Khan, Muttakin and Siddiqui (2013) Managerial ownership has a negative relationship with CSR disclosure. However, it is positive in relation to export-oriented companies. Further they found that public ownership, foreign ownership, board independence and audit committee have positive impact on CSR disclosures. However this study has not found any significant relationship between CEO duality and CSR disclosures.

A study which was conducted by Cullinan, Mahoney and Roush in 2016 highlights a few main points, first that shareholders consider CSR performance when voting on corporate governance proposals, second is that when there are more CSR concerns regarding firm's

behaviour, shareholders tend to vote in favour of the corporate governance proposals. That means shareholder support for CG proposals is positively related with firm's CSR concerns.

As per the results of Said, Zainuddin and Haron (2009) government ownership and audit committee are positively and significantly correlated with the level of corporate social responsibility disclosure.

Khan (2010) found that non-executive directors and presence of foreign nationalities have a significant impact on the CSR reporting. However as per Khan (2010), there was no significant relationship between the women representation in the board and CSR reporting.

2.2 Corporate governance and firm performance

This section focuses on the existing literature which has studied the relationship between corporate governance and firm performance. It shows that empirical findings are mixed, although the general argument is that good governance leads to better firm performance.

As an example according to Mashayekhi and Bazaz (2008), different attributes of corporate governance impact on firm performance differently. This study has found that board size has a negative and significant correlation with firm performance, board independence is positively related with firm performance, institutional director is not positively related with firm performance and CEO duality has no relationship with firm performance.

A recent study done by Outa and Waweru (2016) conclude that when a composite measure of corporate governance is used, it shows a positive relationship with firm performance, while it shows mixed results when CG attributes are taken separately.

Sami, Wang and Zhou (2011) found the quality of corporate governance has a positive significant relationship with firm performance and firm value. The study suggests that since the firms which have good governance tends to perform well; it will be a good implication for investors when taking crucial investment decisions. In addition, according to the study done by Shank, Hill and Stang (2013) the overall results give credence to the belief that superior corporate governance practices are a long-term value maximizing strategy.

2.3 CSR and firm performance

Relationship between corporate social responsibility and firm performance is a popular research area which many researchers have conducted their research on. Various research studies have identified different associations between these two factors. Some studies have identified that CSR impacts positively on firm performance (Graves and Waddock, 1994; Griffin and Mahon, 1997, Cited in Mishra & Suar 2010) while Bromiley and Marcus (1989)

and Wright and Ferris (1997) have identified a negative relationship between CSR and firm performance (Cited in Mishra & Suar 2010). On the other hand, some literatures show no relationship between these two factors (Aupperle et al, 1985; Teoh et al, 1999, Cited in Mishra & Suar 2010). However, as per Chappie and Moon (2005), CSR is highly practiced in developed countries as they have strong institutions, standards, and appeal system (Cited in Mishra & Suar 2010).

2.4 Moderating effect of corporate governance

All CSR activities necessarily have no positive impact on firm's performance. There is a possibility that the management of the organizations misuse the corporate resources by the name of CSR for their own interest. Corporate governance can be used as a mechanism to prevent those kinds of activities and thereby to facilitate the positive effect of CSR on financial performance.

The study carried out by Jiang and Zhang (2018) explained that a decrease in salary will dissatisfy the employee, and thereby, the performance of the employee may get affected. This article discusses about the role of corporate governance on mitigating the negative impacts. The article explained that the negative consequences can be minimized to a greater extent by having payments based on performance like in private institutions.

Kabir and Thai (2017) focused on the moderating effect of corporate governance on the relationship between corporate social responsibility and financial performance. Based on the findings of Kabir and Thai (2017) CSR activities have positive impact on firm performance. Some corporate governance characteristics such as foreign ownership, board size and board independence strengthen this positive relationship. However the moderating effect of state ownership is positive and significant for ROS (return on sales) only.

2.5 CSR in Sri Lanka

Disclosures of Corporate Social Responsibilities (CSR) are one of the ethical responsibilities of a corporate entity. Even though the Corporate Social Responsibility (CSR) is renowned and known concept in the world wide organizations, it is comparatively a new concept in Sri Lanka and research into this area relatively lower compared with other Asian developing countries like India, Pakistan, Bangladesh and Indonesia. Many companies are using the communication of CSR as a proxy for CSR activities. While voluntary disclosure of CSR activities by Sri Lankan organizations is common, it is not a mandatory requirement. Most of

the listed companies in Sri Lanka nowadays tend to disclose their CSR contributions and activities in separate sections of their annual reports according to GRI G4 guidelines.

2.6 Corporate governance in Sri Lanka

With the agency problem coming into light, the importance of corporate governance is becoming more and more significant.

The open economy policy introduced in 1977 and the privatization system incorporated lead to market oriented economy and impact on corporate governance mechanism.

The corporate governance initiatives are commenced in Sri Lanka in 1990's with the introduction of the voluntary code of best practices on matters relating to the financial aspect of corporate governance. The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and Securities and Exchange Commission (SEC) issued corporate governance code in the late 1990s. The rule on corporate governance, which is the first corporate governance regulation, was incorporated by as listing rules of CSE in 2008. The listing rules were further amended by the SEC in 2010 to address related party transactions and better prevent market shocks. The recent code of best practice on corporate governance was issued by CA Sri Lanka in 2017.

Corporate governance standard were made mandatory for all listed companies for the financial year commencing on or after 1st April 2008. The significant legislation enacted in Sri Lanka for corporate governance was the Companies Act No 7 of 2007, which replaced the 25 years old Companies Act No 17 of 1982.

2.7 Theoretical gap

Companies have to consume many valuable resources to execute CSR activities. Due to the agency problem, management of organizations may misuse those resources for their own benefit instead of maximizing the interests of stakeholders. Ultimate objective of an organization should be creating value for their stakeholders. Therefore, there is no point of doing CSR activities for the sake of doing. This is the point where corporate governance comes to the play to dilute the management misbehavior to accomplish firm's ultimate objectives. Hence, in this research explores how corporate governance moderates the relationship between CSR practices and firm performance. In addition as per the observations in section 2.1 to 2.4 there are mixed results and needs further examination. The practical importance of the study is enhanced because CSR is a trending business strategy used by the modern businesses in order to yield better benefits. Therefore, it is interesting to analyze how

the level of CSR and CG moderation impacts towards the progress of financial and non-financial performances.

3 RESEARCH METHODS

3.1 Research approach

A sample of listed entities was selected and data regarding the CSR activities, firms' performance and corporate governance were gathered. Then the data was analyzed using a moderator regression analysis to find out the relationship among the variables that we consider. The conclusions were to be arrived after comparing and evaluating against the hypotheses used.

3.2 Research objectives

Primary objective of this research is to investigate the moderating effect of corporate governance on relationship between corporate social responsibility and firm performance of listed companies in Colombo Stock Exchange. It was expected to examine the association between corporate social responsibilities and firm performance and how the corporate governance variables such as board independence, CEO duality, board size and foreign ownership moderate that relationship. Moreover, this study aimed to identify the level of CSR disclosure of listed companies in Sri Lanka, how CSR impacts on firm performance and how corporate governance strengthens or weakens the relationship between CSR and firm performance.

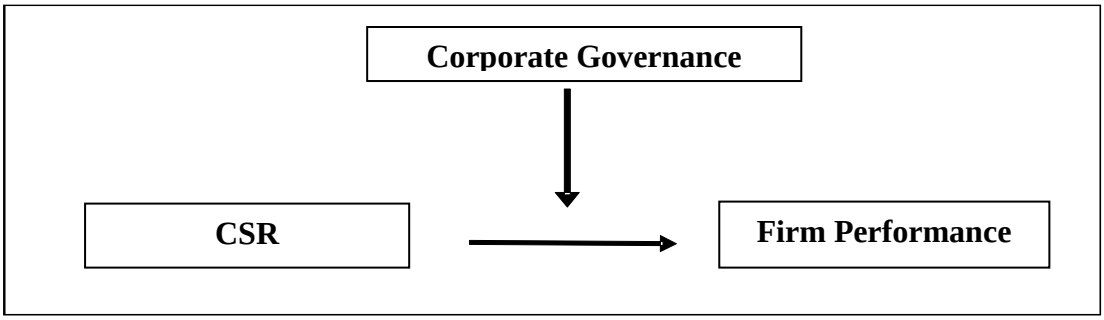
3.3 Population and sample

The sample consists of 50 listed companies which had the highest market capitalization with reference to the Colombo Stock Exchange as at the end of 2017/18 financial period. The rationale behind using the market capitalization as the selection basis was, it is believed that higher market capitalizations show the maturity and development stage of a firm. The more shares issued to the public and higher the stock prices traded, the company should have survived a long period in the society. Further, the companies with the highest market capitalization are expected to be within the biggest firms in Sri Lanka. Thus, these companies have much more potential, ability and resources to engage in CSR activities than smaller firms. However, the listed companies in Banking, Finance and Insurance sectors were omitted due to the deviation of the reporting periods between the stated sectors and other, which makes the comparisons less reliable, if not omitted. Dang and Li (2015) in their article

‘Measuring Firm Size in Empirical Corporate Finance’, had used the same basis to measure the firm size and filter prominent entities while Hickson and Turner (2005) had used market capitalization to analyze the market growth in Irish stock market. Chan, Watson and Woodliff (2014) had used firm size as a variable in the research article ‘Corporate Governance Quality and CSR Disclosures’ and market capitalization ranking from 1 (smallest) to 222 (biggest) was used to measure the variable : firm size. Shank, Hill and Stang (2013) in the article ‘Do investors benefit from good corporate governance?’, had used the market capitalization to measure the firm size and thereby arrive at the conclusions of the relationship between firm corporate governance and financial success. Mollah, Farooque and Karim (2012) had also used market capitalization as a variable to measure the firm performance as a market based measure.

It was intended that, in order to assess the effect of CSR activities on the firm’s performance, it is required to consider the impacts of CSR done in previous years since the impact of the CSR activities is expected to be displayed in the subsequent years’ performance. Based on that fact, the impact of CSR in 2013/14, 2014/15 and 2015/16 was evaluated against the financial performance of 2014/15, 2015/16 and 2016/17.

3.4 Conceptual diagram



3.5 Hypotheses development

3.5.1 Impact of CSR activities on firms’ financial performance

• As per the stakeholder theory, it explains how the entity should organise and manage the business ethics that address the morals and values of the stakeholders. By undertaking CSR activities, it could impact positively in various ways for the business, both income and cost aspects. (Freeman 1984, cited in Kabir &Thai 2017)

Companies get various financial benefits through CSR activities. Under income aspect, customers’ buying decisions have direct impact on firm’s financial performance. Increasing

tendency of customers' towards social and environmental issues can generate more income to an organization which emphasis on its social responsibility, in short term as well as in long term. (Servaes & Tamayo 2013, cited in Kabir &Thai 2017). Impact of firm's CSR activities on employee satisfaction, shareholders satisfaction, lenders satisfaction, government and community satisfaction can reduce organizations' overall cost and thereby increase the efficiency and effectiveness of the organization. Many researchers have found positive relationship between CSR practices and firm performance. Russo and Fouts (1997), Surrocaet al. (2010), and Tanget al. (2012) and Supriti and Damodar (2010) (Cited in Kabir &Thai 2017) found positive relationship and the meta-analysis of Orlitzk yetal. (2003) and Aguinis and Glavas (2012), (Cited in Kabir &Thai 2017) found a slightly positive impact of CSR on firm performance. Therefore, the first hypothesis is developed as follows,

H1.CSR practices have a positive relationship with firms' financial performance.

• To analyse the relationship between CSR and firm performance Kabir and Thai (2017) divided CSR activities in to two main components. They are environmental activities and social activities. These environmental activities create value addition by reducing wastage, pollution and it helps to increase the revenue which finally affects positively to the firm performance (Russo & Fouts 1997, cited in Kabir &Thai 2017). According to Porter and Linde 1995 (Cited in Kabir &Thai 2017), standard CSR practices can eliminate the non-compliance cost relating to environmental laws and regulations.

Endrikat et al. 2014 (Cited in Kabir &Thai 2017) have found a positive relationship between environmental CSR practices and firm performance. So the next hypothesis is,

H1a.Environmental activities have a positive relationship with financial performance.

• For the purpose of in-depth analysis, Kabir and Thai (2017), measured firms' social performance under three main categories namely philanthropy, employee related and product related CSR activities. Community related activities (philanthropy) help to enhance customer satisfaction (Luo & Bhattacharya 2006, Lev et al. 2010, cited in Kabir &Thai 2017), while employee related activities help to attract and retain new employees and enhance employee loyalty (Greening & Turban, 2000, Backhaus et al.2002, cited in Kabir &Thai 2017). Product related social activities also have positive impact on customers' buying decisions, customers'

retention ratio and customers' attitude. Therefore, ultimately all these social activities impact positively on firm performance. Therefore, the next hypothesis was developed as shown below.

H1b.Social activities have a positive relationship with financial performance.

3.5.2 Moderating effect of corporate governance on relationship between CSR and firm performance

• Independent directors improve the monitoring quality of the board. When comparing to non-independent directors, independent directors have less financial interest (Coffey & Wang 1998, cited in Kabir & Thai 2017) and more concern on long term benefits and sustainable development (Johnson & Greening 1999, cited in Kabir & Thai 2017). As per Wang and Dewhirst (1992) (cited in Kabir & Thai 2017), independent directors have more stakeholder orientation. Proper balancing ability of independent directors, between short and long term goals and among stakeholder demands, create positive moderating effect on the relationship between CSR and firm financial performance (Liao et al. 2015, cited in Kabir & Thai 2017). Findings of Kabir and Thai (2017) also prove that the board independence strengthen the positive relationship between CSR and financial performance.

H2: Independent board strengthens the positive relationship between CSR and firm performance.

• The Board of Directors play a significant role in the corporate level decision making and planning and thereby directing the entity to the desired objectives. When the board size becomes larger, monitoring of managers can be done easily by dividing workload. Moreover, it can be collected more resources from external findings (Kabir, & Thai 2017). In addition, larger board can represent diversified view of wider group of stakeholders and this lead to better corporate decisions. Based on the results of the study done by Kabir and Thai (2017), the next hypothesis is,

H3.Larger board strengthens the positive relationship between CSR and firm performance.

• CEO and board chairman role being held by the same person is known as CEO duality. This may create leadership and governance issues. Both jobs are demanding roles. Chairman has

the board level authority and the CEO carries the delegated authority by the board. Therefore, if one person has both roles, he has unfettered power. Typically, chairman represents the interest of shareholders and CEO promotes the management view. When this two positions being held by two persons, CEO has less power in influencing independent directors, as independent directors are not employees of the organization (Core et al.1999, cited in Kabir & Thai 2017). Hence the next hypothesis is,

H4. Companies which having CEO Duality weaken the positive relationship between CSR and firm performance.

• CSR is a concept that was grown from the western world and speeded in the whole business world. Moreover, the developed western communities are more caring about the social aspects than the third world countries and developing economies. Launching CSR activities will draw the attention of foreign investors, and in order to do so, businesses have to engage in CSR activities. CSR disclosures reduce information asymmetry. Reduction of information asymmetry reduces the risk of foreign investment. Therefore, to attract more foreign investors, firms will undertake more CSR activities (Siegel & Vitaliano 2007, cited in Kabir &Thai 2017). Management of organizations may misuse limited resources for their own benefit instead of maximising the interests of stakeholders. However, the pressure from foreign investors in decision making process can legitimate these managerial decisions (Oh et al.2011 cited in Kabir &Thai 2017). Typically, foreign ownership is not limited to financial investments. It has direct impact on decision making process of the organization and direction of the organization through their managerial involvement. (Kabir & Thai 2017). According to Douma et al. (2006), Chen and Liao, (2011) (cited in Kabir &Thai 2017) foreign ownership has a positive impact on financial performance. In addition, as per the findings of Kabir and Thai (2017), foreign ownership strengthens the positive relationship between CSR and financial performance. Therefore the next hypothesis is as follows,

H5.Higher the proportion of equity owned by foreign Investors strengthens the positive relationship between CSR and firm performance.

• As per the agency theory, less managerial ownership is one reason for principal agent problem. According to Jensen and Meckling (1976) (cited in Said, Zainuddin & Haron 2009) this lead to managers (or directors) opportunistic behaviour. Study done by Nasir and

Abdullah (2004) (Cited in Said, Zainuddin &Haron 2009) found a positive relationship between management, shareholding and the level of voluntary disclosures among the Malaysian financially distressed firms. Coffey and Wang (1998) (Cited in Said, Zainuddin &Haron 2009) found that managerial control (percentage of stock owned by insiders) has a positive influence on charitable donations. Therefore, based on these prior studies, following hypothesis was constructed,

H6.Higher the managerial ownership strengthens the positive relationship between CSR and firm performance.

3.6 Operationalization: Variables and measurement of variables

The table given below shows the operationalization of the variables which are considered in our study.

Table 1: Operationalization of variables

Variable and denotation	Measurements	Related studies
Independent variable		
1. CSR disclosure *($CSR_{i,t}$)*	CSR index (containing 29 items) for firm *i* and period *t*.	Khan, Muttakin and Siddiqui (2013)
Dependent variables- Firm performance		
1. Return on Equity *($ROE_{i,t}$)*	Calculated as: $\frac{Net\ Income_{i,t}}{Shareholders'\ Equity_{i,t}}$	Kabir and Thai (2017)
2. Return on Assets *($ROA_{i,t}$)*	Calculated as: $\frac{Operating\ Profit_{i,t}}{Total\ Assets_{i,t}}$	Kabir and Thai (2017)
3. Return on Sales *($ROS_{i,t}$)*	Calculated as: $\frac{Operating\ Profit_{i,t}}{Sales_{i,t}}$	Kabir and Thai (2017)
4. Tobin's Q ratio *($Q_{i,t}$)*	Calculated as: $\frac{Equity\ Market\ Value_{i,t}}{Equity\ Book\ Value_{i,t}}$	Kabir and Thai (2017)
5. Stock Return *($SRTN_{i,t}$)*	Calculated as: $(Stock\ Price\ Difference_{i,t} + Dividend_{i,t}) / Stock\ Price_{i,t-1}$	Kabir and Thai (2017)

Moderator variables- Corporate Governance		
1. Foreign Ownership *($FOR_{i,t}$)*	Proportion of foreign shareholders to the total shareholders for firm *i* and period *t.*	Kabir and Thai (2017)
2. Board Size *($BOS_{i,t}$)*	Natural logarithm of number of directors on the board for firm *i* and period *t.*	Kabir and Thai (2017)
3. CEO Duality *($CEOD_{i,t}$)*	Coded as '1', if CEO and chairman roles are separated, and '0' otherwise, for firm *i* and period *t.*	Kabir and Thai (2017)
4. Board Independence *($BOI_{i,t}$)*	Proportion of independent non-executive directors on the board, for firm *i* and period *t.*	Kabir and Thai (2017)
5. Mangerial Ownership *($MGO_{i,t}$)*	Proportion of ordinary shares held by directors, for firm *i* and period *t.*	Khan, Muttakin and Siddiqui (2013)
Control variables		
1. Firm Size *($FSZ_{i,t}$)*	Natural logarithm of book value of total assets as at year end for firm *i* and period *t.*	Mashayekhi and Bazazb (2008)
2. Leverage *($LEV_{i,t}$)*	Calculated as: $\frac{Total\ Debt_{i,t}}{Total\ Assets_{i,t}}$	Mashayekhi and Bazazb (2008)
3. Firm Age *($AGE_{i,t}$)*	Natural logarithm of the number of years from the date of incorporation for firm *i* and period *t.*	Isidro and Sobral (2014)

3.7 Analytical strategies

Quantitative data analysis strategies are used more prominently in this research. Based on prior researches done, which have been summarized in review of literature, it was noted that they had also used the same approach.

To conduct the analysis, OLS regression is used. Kabir and Thai (2017) mentioned that Russo and Fouts, (1997) Servaes and Tamayo (2013) and Harjoto et al. (2015) also used similar method for analysing purpose of CSR and firm performance.

Therefore, in order to test the hypothesis relating to CSR and firm performance, the following model is used.

$$PERF_{it} = a_0 + a_1 CSR_{it-1} + a_x Controls_{it} + \varepsilon_{it}$$

$PERF_{it}$ = Firm performance in year t

CSR_{it-1} = Corporate social responsibility measure in year t-1

$Controls_{it}$ = Size, Leverage, Firm age, in year t

ε_{it} = Firm-specific error

To test the moderating effect of corporate governance factors, OLS regression model used by Kabir and Thai (2017) was adopted. As per Kabir and Thai, Matta and Beamish (2008), Peng and Yang (2014), they have used the similar model for this purpose.

$$PERF_{it} = a_0 + a_1 CSR_{it-1} + a_2 CG_{it-1} + a_3 CSR_{it-1}\, CG_{it-1} + a_x Controls_{it} + \varepsilon_{it}$$

$PERF_{it}$ = Firm performance in year t

CSR_{it-1} = Corporate social responsibility measure in year t-1

CG_{it-1} = Corporate governance variables in year t-1

$Controls_{it}$ = Size, Leverage, Firm age, in year t

ε_{it} = Firm-specific error

4 FINDINGS AND DISCUSSION

4.1 Descriptive statistics

Descriptive statistics of the variables are given in the Table 2. It was observed that the average CSR index score from 2014-2016 is 20 while the highest being 101. When considered environmental CSR index score separately, its average from 2014-2016 is 7 and the maximum score is 28, regarding social CSR index, the average score in the considered period is 14 and the highest score is 89. However when the mean CSR index score is considered separately from 2014 to 2016, an increment can be seen from 19 (2014) to 24 (2016). This trend is visible in social and environmental indices when taken separately as well. That is average score of environment CSR index has increased from 6 (2014) to 8 (2016) and average score of social CSR index from 13 (2014) to 16 (2016).

In analyzing firm performance, it is visible that average ROE among the companies included in the selected sample is 0.11, ROS is 0.24 and ROA is 0.09. Average value of Q is 2.69 and stock return is 0.11 from 2015 to 2017 with regard to the sample of companies under consideration. When consider the value readings of control variables, it depicts that the average total assets of the sample is Rs. 34 billion, leverage is averaging around 24 percent and the average age is 52 years.

It is observable in relation to corporate governance variables that the average foreign ownership is 18 percent and managerial ownership is 11 percent for the sample. Board size averages around 8 and the average proportion of independent directors in the board is 0.39.

Table 2: Descriptive statistics

Variable[a]	*N*	Mean	SD	Minimum	p25	p50	p75	Maximum
Financial Performance Variables								
ROE	150	0.11	0.13	-0.37	0.05	0.12	0.16	0.90
ROA	150	0.09	0.06	-0.10	0.04	0.08	0.12	0.30
ROS	150	0.24	0.68	-0.10	0.08	0.11	0.18	0.80
Q	150	2.69	3.51	0.15	0.72	1.23	2.83	16.39
SRTN	150	0.11	0.32	-0.48	-0.12	0.04	0.28	1.19
CSR Variables								
CSR	150	21.87	20.31	0.00	7.75	17.00	30.25	101
CSR_E	150	7.14	6.78	0.00	1.00	5.00	11.25	28.00
CSR_S	150	14.73	14.48	0.00	5.75	11.00	18.00	89.00
Corporate Governance Variables								
Ownership Variables								
FOR	150	0.18	0.24	0.00	0.01	0.06	0.23	0.98
MGO	150	0.11	0.21	0.00	0.00	0.00	0.08	0.80
Board Variables								
BOS	150	8.68	2.04	5.00	7.00	8.50	10.00	15.00
BOI	150	0.39	0.13	0.13	0.29	0.36	0.50	0.72
Control Variables								
FSZ (billion LKR)	150	34.57	45.54	2.24	8.99	19.81	36.25	277.27
LEV	150	0.24	0.17	0.00	0.09	0.22	0.36	0.70
AGE	150	52.74	35.21	8.00	24.75	40.50	71.25	151.00

[a] Definitions of these variables are indicated in Table 1.

4.2 Relationship among CSR, firm performance and corporate governance

Correlation analysis

Table 3 depicts the correlation among the dependent, independent, moderator and control variables. All performance variables are significantly positively correlated with ROE. Correlations among other performance variables are not consistent with ROE. Stock return is significantly negatively correlated with ROA. Environmental CSR and social CSR are significantly positively correlated with overall CSR. Overall CSR index and environmental CSR index are significantly correlated with ROA. Firm size which is a control variable significantly correlated with performance variables except for ROE. Leverage is significantly

negatively correlated with ROE and ROS. Firm age is significantly negatively correlated with ROE and ROA. In relation to the corporate governance variables, managerial ownership and board size are significantly and positively correlated with CSR variables.

Table 3: Correlation matrix

Variables[a]	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
(1)ROE	1															
(2)ROA	0.59**	1														
(3)ROS	0.39**	-0.04	1													
(4)Q	0.18*	-0.06	-0.06	1												
(5)SRTN	0.32*	-0.41**	0.06	0.09	1											
(6)CSR	0.05	0.18*	-0.15	-0.12	-0.03	1										
(7)CSR_E	0.10	0.22**	-0.15	-0.09	-0.02	0.90**	1									
(8)CSR_S	0.02	0.16	-0.14	-0.13	-0.03	0.98**	0.80**	1								
(9)FOR	-0.04	-0.09	0.02	-0.11	-0.06	0.00	-0.04	0.02	1							
(10)MGO	-0.09	-0.00	-0.08	-0.13	-0.03	0.23**	0.21**	0.22**	-0.27**	1						
(11)BOS	0.08	-0.19*	-0.09	0.14	-0.01	0.19*	0.23**	0.16*	-0.15*	0.15	1					
(12)BOI	-0.03	0.07	-0.06	-0.25**	0.12	0.04	-0.05	0.07	-0.15	-0.11	-0.1	1				
(13)CEOD	-0.18*	-0.22**	-0.03	-0.20*	-0.16	0.13	0.14	0.11	0.19*	0.06	-0.09	0.08	1			
(14)FSZ	-0.19	-0.26**	-0.21**	-0.29**	-0.14**	0.27**	0.31**	0.23**	0.08	0.08	0.30**	-0.10	0.13	1		
(15)LEV	-0.17*	0.01	-0.23**	-0.09	0.02	0.07	0.02	0.09	-0.12	0.06	0.32**	0.01	-0.22**	0.37**	1	
(16)AGE	-0.19*	-0.33**	0.15	-0.05	-0.05	-0.31*	-0.30**	-0.28**	0.06	-0.08	-0.08	-0.00	-0.12	0.27**	-0.02	1

[a] Definitions of these variables are indicated in Table 1.

*p<0.05; **$p<0.01$

Moderator regression analysis

4.3 CSR and firm performance

In table 4, a positive and significant p-value on environmental activities shown only in ROA as a measure of firm performance. All other measures of firm performance have the expected signs: environmental activities are positively related with ROE, ROS, Tobin's Q and stock return, but are not significantly associated. Hence, the findings in Table 4 does not provide convincing support for the Hypothesis, H1a: Environmental activities have a positive relationship with financial performance. This result was fairly improved when the sample was segregated into manufacturing and non-manufacturing companies: environmental activities are significantly related with ROS in addition to ROA in manufacturing companies (Table 8). There is no significant relationship between social activities and any of the measures of firm performance, under the regression for non-segregated sample of companies according to the results of Table 5. Under the regression for segregated sample of companies, the result was quite changed as for the manufacturing companies, social activities and ROA,

and ROS are significantly related (Table 9). Hence, the findings in Table 9 provide more convincing support for the Hypothesis, H1b: Social activities have a positive relationship with financial performance of the manufacturing companies. Total CSR is significantly associated only with ROA, when the sample of companies were not segregated (Table 6). When the sample of companies were segregated, total CSR is significantly related to ROS in addition to ROA for the manufacturing companies (Table 10). Hence, the findings provide more convincing support for the Hypothesis, H1: CSR practices have a positive relationship with firms' financial performance of the manufacturing firms. These results further emphasize that the positive relationship between CSR practices and firm performance is not significant as in almost all the measures of firm performance, the p-value on CSR activities is not less than 0.05 significance level. The results regarding the relationship between CSR activities and firm performance is similar to the one found by Matin, Thaghafian, Esapour, Alavi and Farhoodi (2011) which emphasized that there is no significant relationship between CSR activities and firm performance. Moreover, the results of the study indicate that the estimated regression coefficient is significantly positive for manufacturing firms and is insignificant for non-manufacturing firms, which was also found in Kabir and Thai (2017).

Concerning control variables, all have the expected signs: Firm size (Log (assets)) is positively related to the measures of firm performance, as it gets more comfortable to accomplish higher financial performance for larger firms, Leverage is positively related to the measures of firm performance, as leverage usage could provide tax shield for profitable firms, which results in improved firm value, and Firm age also is positively associated to the measures of firm performance. Kabir and Thai (2017) also found the same expected sign for these control variables in almost all regressions. In this study, Firm size is significantly associated with almost all the measures of firm performance under the regressions for non-segregated sample of companies. Matin, Thaghafian, Esapour, Alavi and Farhoodi (2011) also found that there is a significant positive relationship between firm size and firm financial performance. Firm age is significantly associated with ROA and ROS under the regressions for non-segregated sample of companies and is significantly associated with ROE and ROA of the manufacturing companies. The relationship between leverage and all the measures of firm performance are insignificant in almost all the regressions.

Variable	ROE			ROA			ROS			Tobin's Q			Stock return		
	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig
Env. Activities	+	0.112	0.232	+	0.275	0.002	+	-0.032	0.732	+	0.020	0.831	+	0.098	0.300
Firm Size		-0.154	0.127		-0.347	0.000		-0.198	0.047		-0.308	0.003		-0.337	0.001
Leverage		-0.125	0.156		0.129	0.117		-0.157	0.071		0.015	0.866		0.143	0.107
Firm age		-0.125	0.178		-0.151	0.084		0.192	0.038		0.042	0.649		0.071	0.447

Table 4: OLS regressions of Environmental activities on Financial performance and control variables (for all the manufacturing and non-manufacturing companies as a whole)
*p<0.05

Variable	ROE			ROA			ROS			Tobin's Q			Stock return		
	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig
Social Activities	+	0.002	0.986	+	0.148	0.081	+	-0.026	0.761	+	-0.069	0.436	+	0.048	0.589
Firm Size		-0.100	0.295		-0.266	0.004		-0.204	0.030	+	-0.274	0.004		-0.310	0.002
Leverage		-0.144	0.099		0.09	0.278		-0.153	0.074		0.008	0.928		0.128	0.142
Firm age		-0.173	0.056		-0.213	0.014		0.195	0.029		0.007	0.937		0.047	0.605

Table 5: OLS regressions of Social activities on Financial performance and control variables (for all the manufacturing and non-manufacturing companies as a whole)
*p<0.05

Variable	ROE			ROA			ROS			Tobin's Q			Stock return		
	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig
Total CSR	+	0.036	0.689	+	0.198	0.023	+	-0.03	0.739	+	-0.046	0.616	+	0.067	0.464
Firm Size		-0.114	0.241		-0.295	0.002		-0.201	0.037		-0.28	0.005		-0.320	0.001
Leverage		-0.140	0.108		0.101	0.222		-0.154	0.073		0.007	0.935		0.132	0.131
Firm age		-0.159	0.086		-0.187	0.033		0.193	0.034		0.014	0.875		0.057	0.540

Table 6: OLS regressions of Total CSR activities on Financial performance and control variables (for all the manufacturing and non-manufacturing companies as a whole)
*p<0.05

	ROE		ROA		ROS		Tobin's Q		Stock return	
	Adjusted R^2	sig	Adjusted R2	sig	Adjusted R2	sig	Adjusted R2	sig	Adjusted R2	sig
Env. Activities	0.064	0.009	0.177	0.000	0.088	0.002	0.058	0.013	0.051	0.021
Social Activities	0.054	0.016	0.139	0.062	0.088	0.002	0.061	0.010	0.046	0.029
Total CSR	0.055	0.015	0.152	0.00	0.088	0.002	0.059	0.012	0.047	0.026

Table 7 : ANOVA of CSR activities on Financial performance (for all the manufacturing and non-manufacturing companies as a whole)
*p<0.05

Variable	ROE			ROA			ROS			Tobin's Q			Stock return		
	Predicted Sign	Beta	sig	Predicted Sign	b	sig	Predicted Sign	b	sig	Predicted Sign	b	sig	Predicted Sign	b	sig
Environmental Activities	+	-0.024	0.909	+	0.446	0.018	+	0.481	0.026	+	-0.311	0.157	+	-0.131	0.563
Firm Size		-0.015	0.953		-0.336	0.124		-0.053	0.829		0.075	0.770		-0.146	0.587
Leverage		0.134	0.589		0.472	0.035		0.283	0.258		-0.392	0.136		0.443	0.110
Firm age		-0.579	0.017		-0.349	0.091		-0.041	0.859		-0.140	0.562		-0.348	0.176

Table 8: OLS regressions of Environmental activities on Financial performance and control variables (for manufacturing companies)
*p<0.05

Variable	ROE			ROA			ROS			Tobin's Q			Stock return		
	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig
Social Activities	+	-0.047	0.783	+	0.487	0.001	+	0.508	0.004	+	-0.33	0.068	+	-0.215	0.251
Firm Size		-0.013	0.957		-0.277	0.148		0.015	0.945		0.031	0.897		-0.147	0.563
Leverage		0.134	0.586		0.448	0.029		0.257	0.272		-0.375	0.142		0.448	0.099
Firm age		-0.579	0.006		-0.476	0.005		-0.184	0.326		-0.048	0.811		-0.334	0.125

Table 9: OLS regressions of Social activities on Financial performance and control variables (for manufacturing companies)
*p<0.05

Variable	ROE			ROA			ROS			Tobin's Q			Stock return		
	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig	Predicted Sign	Beta	sig
Total CSR	+	-0.042	0.819	+	0.497	0.002	+	0.524	0.005	+	-0.34	0.078	+	-0.198	0.322
Firm Size		-0.011	0.964		-0.317	0.110		-0.029	0.898		0.060	0.807		-0.135	0.601
Leverage		0.133	0.589		0.460	0.028		0.270	0.254		-0.384	0.135		0.443	0.105
Firm age		-0.584	0.009		-0.399	0.024		-0.101	0.610		-0.102	0.634		-0.358	0.121

Table 10: OLS regressions of Total CSR activities on Financial performance and control variables (for manufacturing companies)
*p<0.05

4.4 Moderating effect of corporate governance variables

Next the moderating impact of corporate governance variables over the relationship between the level of corporate social responsibility disclosures and firm performance was considered. Results of moderating impact are depicted from table 11.

When considering the moderating impact of foreign ownership, it was found that higher the proportion of foreign ownership does not strengthen the positive relationship between CSR and firm performance. Therefore, *H5* is not supported.

It was found that the higher the board size strengthens the positive relationship between exists between CSR and firm performance (ROE, ROA and Tobin's Q). Moreover, regression results show that the positive relationship between CSR and firm performance (ROA, Tobin's Q, Stock return) is strengthened by the board independence. Accordingly, *H2* and *H3* are supported. However, managerial ownership strengthens this positive relationship only for ROA and Tobin's Q.

Variables	ROE		ROA		ROS		Tobin's Q		Stock return	
	R^2	Sig	R^2	Sig	R^2	Sig	R^2	Sig	R^2	Sig
TCSR X BOI	0.044	0.052	0.157	0.000	0.088	0.004	0.099	0.002	0.053	0.03
TCSR X FOR	0.043	0.054	0.144	0.000	0.076	0.008	0.055	0.028	0.035	0.083
TCSR X BOS	0.074	0.009	0.203	0.000	0.077	0.007	0.112	0.001	0.036	0.081
TCSR X CEOD	0.099	0.002	0.215	0.000	0.098	0.002	0.075	0.008	0.045	0.05
TCSR X MGO	0.051	0.035	0.167	0.000	0.079	0.006	0.095	0.002	0.035	0.085

Table 11: OLS regressions of financial performance on CSR Total score (TCSR) and corporate governance moderating effects (BOI- Board Independence, FOR- Foreign ownership, BOS- Board size, CEOD- CEO duality, MGO- Managerial ownership)

Another test was performed for the two sub samples (manufacturing industry sub sample and non-manufacturing industry sub sample) to see the moderating effect of corporate governance on the relationship between CSR and firms financial performance. Similar kind of robustness test was performed by Rezaul Kabir and Hanh MinhThai (2017) in their research to test the moderating effect of corporate governance.

According to the findings in the manufacturing industry sub sample, the coefficient of moderating effect of foreign ownership is positive. Kabir and Thai (2017) also found a positive joint effect of CSR and foreign ownership. According to their findings, joint effect of (coefficients) board size and board independence also positive.

The regression results of manufacturing industry sub sample shows that board size, foreign ownership and board independence strengthen the relationship between CSR and firm

financial performance (ROA, ROS). As per research done by Kabir and Thai (2017) similar results were found and this research's findings also provide evidence that corporate governance has a stronger impact for manufacturing firms.

OLS regressions of financial performance on CSR (TCSR) and corporate governance moderating effects – Manufacturing industry sub sample.

Variables	ROA		ROS	
	B	sig	B	sig
Total CSR	0.176	0.332	0.238	0.284
Foreign ownership	-1.521	0.012	-1.280	0.073
TOCSRX FOR	1.276	0.023	0.921	0.165
Firm Size	-0.129	0.568	0.253	0.361
Leverage	0.110	0.652	-0.136	0.646
Firm age	-0.474	0.007	-0.214	0.292

Table 12: OLS regressions of financial performance on CSR total score (TCSR) and foreign ownership (FOR) moderating effects

Table 13

	ROA		ROS	
	R^2	Sig	R^2	Sig
TCSR X BOI	0.547	0.000	0.627	0.000
TOCSRX FOR	0.539	0.000	0.313	0.013
TOCSR X BOS	0.480	0.001	0.341	0.008
TOCSRX CEOD	0.419	0.002	0.222	0.047
TCSR X MGO	0.423	0.002	0.201	0.0708

OLS regressions of financial performance on CSR (TCSR) and corporate governance moderating effects – Non Manufacturing industry sub sample

Table 14

	ROA		ROS	
	R^2	Sig	R^2	Sig
TCSR X BOI	0.100	0.007	0.12	0.002
TOCSRX FOR	0.105	0.005	0.104	0.006
TOCSR X BOS	0.172	0.000	0.103	0.006
TOCSRX CEOD	0.160	0.000	0.151	0.000
TCSR X MGO	0.113	0.040	0.107	0.005

5. CONCLUSION

This study examines the impact of CSR activities on a firm's performance and the moderating effect of corporate governance on that relationship. This paper focused on a developing country, Sri Lanka, which in recent years had increased its focus on CSR

activities and Sustainability reporting. Regression analyzes were carried for the selected sample of fifty stock exchange listed firms and results were compared with hypotheses.

Environmental and total CSR activities appeared to have a significant positive relationship on ROA, while all the other relationships had no significant relationship. Dividing the sample into manufacturing and non-manufacturing firms, it was found that the regression results of all environmental, social and total CSR are significantly positively related to ROA and ROS for manufacturing firms and was insignificant for non-manufacturing firms except for the relationship between environmental CSR activities and ROA. Thus the insignificant relationship between CSR activities and ROS when considered all the firms had mostly resulted from the impact of non-manufacturing firms.

When considering the moderating impact of corporate governance variables it was found that higher the proportion of foreign ownership does not strengthen the positive relationship between CSR and firm performance while higher the board size , board independence and managerial ownership indicated positive relationships between exists between CSR and firm performance . In the analysis of the moderating effect further, the regression results of manufacturing industry sub sample showed that board size, foreign ownership and board independence strengthen the relationship between CSR and firm financial performance (ROA, ROS) and it evidenced that the corporate governance has a stronger impact for manufacturing firms.

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