Corporate social responsibility and organisational profitability management essay...

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Abstract

There are numerous factors affecting the organizational profitability; one of the important factors is corporate social responsibility. This paper tries to examine the relationship between Corporate Social Responsibility and organizational profitability. Many tools are used to measure the organizational profitability while those of the corporate social responsibility can sometimes be unreliable or insufficient. The tool chosen for measuring the Corporate Social Responsibility is Kinder, Lydenberg and Domini & Co. which is a database that is recently used as one of the most comprehensive source for Corporate Social Performance research.

This paper will mainly focus on Egyptian organizations and study their engagement in corporate social responsibility and compare the different result of profitability for a period of five years.

Keywords: Corporate Social Responsibility, Corporate Social Performance, Organizational profitability, Return on investment, Kinder, Lydenberg and Domini & Co.

Corporate social responsibility and Organizational Profitability

Researchers tried to define corporate social responsibility in such way that suits all theoretical and operational purposes, such as " Actions that appear to further some social good, beyond the interests of the firm and that which is required by law" (McWilliams & Siegel 2001, P. 117). CSR concerns everyone such as customers, employees, suppliers, community groups, governments, and even some stockholders as stated by McWilliams and Siegel (2001).

This paper will examine the relationship between corporate social responsibility and the profitability of Egyptian organizations. The purpose of this paper is to examine whether the corporate social responsibility will increase the profitability or not and to figure out the main benefits of being engaged in corporate social responsibility.

The paper is compromised of three main sections. The first section gives an overview on corporate social responsibility in general and how it is important for both organizations and community. The second section focuses on the concept of organizational profitability as it explains how it can be defined and how profit maximization can be measured. The third section is probably the most important section of the paper as it focuses on studying the relationship between the corporate social responsibility and the organizational profitability and the different consequences that may occur.

Literature Review

Corporate social responsibility (CSR) is a concept that is growing fast and more attention should be paid to the meaning behind its linguistic. (Amaeshi and Adin, 2007). The definition of Corporate Social Responsibility (CSR) can sometimes be ambiguous as stated by McWilliams and Siegel (2001).

Davis (1960) mentioned that CSR is considered as decisions or actions taken beyond the organization’s economic or technical self interest. Moreover Davis (1973) mentioned that CSR doesn’t only refer to the economic, technical or legal requirements of the firm, it goes beyond that and may affect all the firm’s actions. While Fitch (1976) described the CSR as the challenges taken by the corporation whether fully or partially to solve social problems. CSR should also have a suitable degree of how much it fits both the society’s expectations and business ethics. (Zenisek, 1979).

“ The notion that business organizations have societal obligations which transcend economic functions of producing and distributing scarce goods and services and generating a satisfactory level of profits for their shareholders” (Epstein, 1989, P. 585).

Moreover it was seen by Maclagan (1999) as a process that should express the moral values and interest of the individuals. McWilliams and Siegel (2001) added that CSR should go beyond the Legal interests of the firms. It should be actions that show some good to the society. While CSR as stated by Carroll (1991) is seen as a pyramid of Economic, legal, ethical and philanthropic as shown in Figure (1. 1). The pyramid of CSR was supported by Dusuki (2008) confirming that studies have observed people’s perception based on Carroll’s Pyramid of CSR.

CSR concerns everyone such as customers, employees, suppliers, community groups, governments, and even some stockholders as stated by McWilliams and Siegel (2001). They all form pressure on the company which can sometimes results in a great conflict on goals and objectives (McWilliams & Siegel, 2001).

As pointed above, CSR has numerous definitions and explanations. Moreover McWilliams, Siegel and Wright (2006) emphasized on how difficult it is, to make theoretical development or measurement since the definitions of CSR is either too many or not clear enough.

Approaches of Corporate Social Responsibility

According to Kramer and Porter (2006), four issues for organization to be engaged in CSR are: moral obligation, sustainability, license to operate, and reputation. Kramer and Porter (2006) described the Moral appeal as doing the right thing which appears more in the nonprofitable business. Sustainable Development is defined as " Meeting the needs of the present without compromising the ability of future generations to meet their own needs." (Kramer, Porter, 2006, P. 81) while the license to operate can be represented in the governments and the communities' regulations and other stakeholders to do business. Finally, reputation is used by many companies to improve a company's image, and gain customer's loyalty, build a strong brand and have a higher value of its stock (Kramer & Porter, 2006).

While Brammer, Millington and Rayton (2007) stated that Employees' training can be seen as an activity of social responsible and should be used to increase the employees' commitment to the organization, they also mentioned that the fair treatment of employees which is a approach of social corporate responsibility increase commitment to the organization.

Effect of Corporate Social Responsibility

As mentioned by Cacioppe, Forster and Fox (2007) a lot of studies focusing on how important the companies' reputation and whether it is engaged in a social responsibility for both customers and investors or not, while other researches focused on how the attitude and behavior of the managers and professionals can be affected by their perception about the company’s ethical and social responsibility.

Effect of Corporate Social Responsibility on the Community.

Kramer and Porter (2006) added that CSR can provide a wealthy economy and society by having different forms of cooperation such as investing capital, doing business, purchasing goods, and providing jobs. Moreover, Evans, Foote and Gaffney (2010) added that companies could be disciplined by their customers when they don’t meet the society expectation or the expectation of the customers by decreasing the demand of their products. Mathis (2007) mentioned that CSR can change companies to be more pro-active and accordingly they will have a high influence on the policy making process and a better position within their sectors than their competitors.

Effect of Corporate Social Responsibility on Organizations.

It is important to analyze the effect of CSR on organizations and to determine whether CSR can have an impact on the organizational performance or not. Evans, Foote and Gaffney (2010) stated that CSR has important and clear influence on achieving performance excellence. According to Cacioppe, Forster and Fox (2008) some studies showed that CSR can have a potential influence on the employees’ and leaders’ behavior, while organizational success is impacted by the ethical sense of customers and investors. Jaramillo, Mulki and Valenzuela (2010) viewed CSR as a way to gain customers’ retention and loyalty, on their article they analyzed how ethical firms can not only attract more customers but also build a long term strong relationship.

While Singh (2006) explained why many researchers focused on how to achieve the customers’ needs and wants, since customer satisfaction has a positive influence on the organizational profitability. Cacioppe, Forster and Fox (2008) studied that CSR leads to both the retention of both employees and customers with the trusted brand image and the good quality of workforce. Mathis (2007) looked at the CSR as a way to provide sustainability to organizations. Moreover Cacioppe, Forster and Fox (2008) added that investors take in their consideration companies’ management before investing in it. Evans, Foote and Gaffney (2010) stated that the least benefit companies can get from taking CSR as one of its business strategy is on the public relations level.

Organizational Profitability

Profit is the end result of deducting total costs (TC) from total revenues (TR) as stated by Primeaux (1997). Therefore, profit maximization is producing the right quantity of goods or services given the suitable amount of resources (Primeaux, 1997). From a behavioral perception, Profit maximization can also be obtained from producing the correct quantity with an acceptable quality of goods or services to the customers and as the legal and ethical standards of the society (Primeaux & Stieber, 1994).

The performance measurement that will be used to evaluate and compare the efficiency of different investments will be the return on investment (ROI). To calculate ROI, the benefit of an investment, it is divided by the cost of the investment; the result is a percentage or a ratio (http://www. investopedia. com/terms/r/returnoninvestment. asp)

The return on investment formula:

In the above formula " gains from investment", refers to the profits gained from spending the investment of interest. Return on investment is a very common measurement because of its adaptability and simplicity. That is, if an investment does not have a positive ROI, or if there are other opportunities with a higher ROI, then the investment should be not be undertaken. (http://www. investopedia. com/terms/r/returnoninvestment. asp)

Impact of Corporate Social Responsibility on Organizational Profitability

Kolstad (2007) has shown in his paper that the relationship between CSR and profit are a controversial issue. Kramer and Porter (2006) added that corporations can think of CSR as a constraint or an additional cost, although it may be an opportunity for them to innovate and gain a competitive advantage. Friedman (as cited by Foote, Gaffney and Evans, 2010) was criticizing the money spend on CSR stating that the major responsibility of the managers is to maximize the profit of the organization as they contracted with the owners of the firm.

ArinËœo, Canela and Garcia-Castro (2010) mentioned that CSR is not always providing a positive impact on the financial performance, some cases showed that it could have a negative impact as well. While McWilliams and Siegel (2000) added that a lot of empirical studies, showed that CSR and profitability can be engaged in a positive, negative or even neutral relationship. kolstad (2007) stated that CSR can be seen as a way to reach the final goal of the organization which is increasing the shareholder returns but can’t be considered as a goal itself. Companies should balance scarifying some financial profit and between satisfying its stakeholders at least on the short term. (ArinËœo, Canela & Garcia-Castro, 2010). Kolstad (2007) added that executives used to care only about the profits and the benefits of the shareholders, while nowadays companies may have to widen their goals to include the CSR.

Friedman (as cited in Kolstad, 2007) presented the idea that maximizing the profit is the only essential moral aspect that can be offered by the executive to the corporation and that idea was supported by four arguments. First, he mentioned that managers should follow the interest of the shareholders according to the legal contract they have. Second it will be illegal for managers not to follow the interest of the shareholders since this will be considered as taxation to the shareholders. (Kolstad, 2007).

Third, he advised the corporations to focus more on its core operations to be more efficient. Fourth, since not all the corporations is engaged on CSR, then CSR can be an added cost to corporations that cares about society leading to unfair competition between companies Friedman (as cited in Kolstad, 2007). Kolstad (2007) strongly criticized the overstated idea presented by Friedman, saying that responsibility of business should be seen in a wider view and should take in consideration other agents and shouldn’t only consider the shareholders’ interest and that the provided idea will need more examination and analysis.

While Peloza (2006) mentioned that due to many criticisms of CSR by whom, managers tried to ensure that CSR will deliver a financial income to the firm by developing different strategic forms for CSR. While Demacarty (2009) pointed out that the CSR doesn’t necessarily provide a stronger financial return nor does it produce weaker return, it depends on the techniques that are used to increase the financial.

Waddock and Graves (1997) studied the linkage between corporate social performance (CSP) and financial performance using CSP as the variable for CSR and return on investment (ROI), return on equity (ROE) and return on assets (ROA) as the variables used to measure the profitability or the firm’s financial performance. They hypothesized a positive relationship between financial performance and CSR; the study reported that the improved financial performance leads to increase in the CSP. Moreover, financial performance can be increased when firms are engaged in CSP since their ability to invest socially indicate a good managerial performance that could supply the firm with funds that can be used for other investments (Waddock and Graves, 1997).

Orlitzky, Schmidt and Rynes (2003) also reported the same analysis. They used meta-analysis to find a positive relationship between CSP and financial performance.

Research Gap

While going through the literatures that studied Corporate Social Responsibility, a lot has been found on understanding the Corporate Social

Responsibility either in its definition, approaches or even in how to measure it.

One can find some limitations and gaps since Corporate Social Responsibility can have many aims, some of its definition was very narrow while others were very broad, involving almost everyone’s concern. The problem with the confliction on aims and means is that it is not clear whether Corporate Social Responsibility should be applied by organizations or not. Some results showed that Corporate Social Responsibility is a must for organizations and societies to grow while others concerned it as an overhead.

Another Gap is that the relationship between Corporate Social Responsibility and profitability. A lot of researchers analyzed whether Corporate Social Responsibility is profitable or not, but limited researches studies the impact of Corporate Social Responsibility on a certain companies or for a certain country and noticed its effect on profitability.

The purpose of this proposal is to examine the effect of CSR on organization’s profitability. The research question is: What is the effect of CSR on the profitability of Egyptian Organizations?

Hypothesis

Organizations that are engaged in CSR will have high CSP.

Organizations that are engaged in CSR will have higher financial performance.

The relationship between CSR and Organizational profitability is strongly positive with a higher corporate social performance and financial performance.

Implications

Organizations are usually committed to their employees, customers, and their society. Organizations that experience high levels of commitment to the well being of society will have a better image and therefore gain more loyalty of employees, customers and may gain higher profit. Further, organizations may view ethical and social judgment as one of their effectiveness and success.

A reasonable measurement of CSR is critical for studying its effect, Kinder, Lydenberg and Domini & Co. (KLD) tool will provide a full report of organization's CSR indicating to what extend the organization is involved in social activities.

Then different results of CSR measurements will be compared to the annual profit of organizations. A focus on these two variables may improve the overall performance of organizations and bring more satisfaction to the whole society.

Method

Subjects or Participants

The study will focus on the effect of CSR and organizational profit on Egyptian organizations, the population will be 100 Egyptian organizations and accordingly the sampling size will be 80 organizations. The sampling design will be the simple random sampling so that each company will have an equal chance of being chosen as the subject.

Instrument

Evans, Foote and Gaffney (2010) stated that there should be a reliable way to measure the relationship between organizational profitability and CSP and those researches have been deeply involved in how to measure the CSP of organizations. They also added that past measurement was not accurately measuring the outcomes of CSR since they were based on reputational surveys, government pollution indices, financial reports, and CSR orientation studies.

The research tool will be developed by Kinder, Lydenberg and Domini & Co. (KLD) which is a social choice investment advisory firm. Their tool is a social performance database. Waddock (2003) mentioned that KLD is currently the most commonly used database and is considered a comprehensive source for CSP research.

KLD publishes the CSP ratings and the data cover areas of environmental performance, social contribution, corporate governance, and controversial business involvement. KLD require sources include direct communication with the company managers, public documents, and governmental data (http://www. kld. com). Figure (1. 2) illustrates the structure of the KLD database.

Chen and Delmas (2010) described KLD's three main categories which are environmental performance, social ratings, and governance ratings. They described how each of these categories are divided into levels for example the environmental performance includes climate change and operations and management, while social ratings includes human rights and the employees' relation while governance rating includes the structure and reporting methods.

Design

Dependent variable is the organizational profitability, in order to measure our hypothesis; I am using the following measure of profitability: Return on investment (ROI) was among the measures of performance, ROI is the most used.

The independent variable will be the CSR. The control variables are factors such as firm's size, industry and other risks (Waddock & Graves, 1997). Kinder, Lydenberg,

Domini (KLD) is used as a measure of how well companies perform socially, KLD measures have been used in previous research to study the SP in premier management journals (Agle et al., 1999; Coombs and Gilley, 2005; Hillman and Keim, 2001; McWilliams and Siegel, 2000). The KLD have several advances, as it represents a multi-dimensional measure of SP, consistently measured by a group of professionals with and where different information sources are combined to find out the final score for each firm (Waddock and Graves, 1997).

Procedure

KLD researches the social, environmental, and governance performance of corporations. KLD research relies on five different data sources to obtain the ratings and analysis of each company. Data are collected in a closely controlled process from each company, government, non-government organization and media sources. KLD tracks each company through more than 14, 000 global media sources daily. (http://www. kld. com). Figure (1. 3) illustrates the KLD research process they are using.

A quantitative technique will be needed to measures the effect of CSR on profitability, a valuable data should be provided to KLD. To obtain such information required, both documents and Surveys will be used.

Documents of the companies' CSR behavior in the community will be examined and a comparison will be made between them. Published documents about the companies and how they are engaged in CSR practices will be used to get a broad idea about the subject at hand. For example, National newspapers and articles can be investigated to know what activities each company is sponsoring or to gain an idea about educational simulations moreover, accounting books can be investigated to get an idea of the profitability development at times when CSR activities are applied, such documents may include financial statements, balance sheets and cash flow. Figures in accounting books should be analyzed to measure profitability.

Surveys will be conducted to the top management and corporate social responsibility manager to understand their perceptions of CSR and to determine whether CSR is considered one of the decisions made by top management and to determine the extent by which the CSR activities affects the financial value and profitability.

Concerning the profit, the analysis will check financial performance through financial documents including (ROI) will be used as the variable to measure the profitability or the firm's financial performance and compare it with different CSR measurements reported from the KLD.

The research is planned to analyze data within five years period for each of the companies and, the period can be considered long to be able to analysis the effect of CSR and compare it the profit of the organization.

Concerning the Time plan, data will be collected for the companies in the first period. The 80 companies will be contacted and debriefed about the purpose of the research. Tasks should be scheduled early to guarantee that there will be sufficient time and that the last period will be left for entering the data using the KLD tool and analyze the reports the final results of the research.

Limitations

The most important limitation is that the results of case studies cannot be generalized as it studies very specific companies and it only seeks in-depth understanding of some elements.

Also there could be information unavailability, where the required information could be unavailable or unattainable. It could sometimes be difficult to be able to get accurate and precise information. Another limitation is that the measurement of the organizational long term profitability and its estimate may be affected by other unexpected factors such as financial crisis, inflation in the market.

Yet, the research can give an indicator to organizations on whether the CSR has an impact of their profitability or not and according to the research they can decide to what extent they would like to be involved in CSR.