

# **The Inter Linkage of Corporate Reputation between Corporate Social Responsibility and Financial Performance**

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## **Abstract**

Many researchers confirm that corporate social responsibility (CSR) has a direct and indirect influence on financial performance. This study examines the mediating effect of corporate reputation between the relationship of corporate social responsibility and financial performance in Pakistan's banking sector. Structural equation modeling has been applied to explore this relationship and the primary data are collected using developed scale. The findings are based on 405 responses from bank employees and the results show that corporate social responsibility significantly influencing financial performance and this relation is partially mediated by customer satisfaction, corporate reputation, and competitive advantage. These results also suggest an increment in CSR activities that enhance financial performance by indirectly targeting the aforementioned intangible assets.

**Keywords:** corporate social responsibility (CSR), financial performance, customer satisfaction, corporate reputation, competitive advantage.

## **1. Introduction**

Corporate social responsibility has been considered a fundamental fragment of management sciences literature for the last few years (Pino et al., 2016; Zhu and Zhang, 2015). Organizations are gradually accepting their operating responsibilities that influence the society and natural environment in the form of development for employees, community, and societies (Aguilera-Caracuel et al., 2015). CSR is the method by which business adds to that stability rather than taking away from it. Generally, CSR appears as a hopeful driver for development in emerging countries (Yusoff and Admamu, 2016). Corporations could prove beneficial in many ways by cooperating in society than just focusing on short term organizational profits. These corporations can establish a corporate agenda that clearly indicates their social responsibility by providing employees with training and development, technological advancement, community social and health programs and commitment to human rights, which revealing the corporation as a good citizen and reproducing an environmental friendly livelihood (Wang et al., 2015).

Corporate socially responsible activities motivate the organizations to do more social activities which are required by legislation (Yu & Choi, 2014). Generally, CSR has turned into an inexorably important subject among researchers of social sciences (Godfrey et al., 2009). Practically speaking, many organizations are likewise effectively occupied with CSR exercises (Liu et al., 2011). Historical studies have been conducted in the identification of a direct relationship between CSR on financial performance (Kakakhel et al., 2015), brand performance (Lai et al., 2010) customer satisfaction (Saeidi et al., 2015), and corporate political activities (Hond et al., 2014). Finally, it could be inferred that the connection between CSR and company performance is more conspiratorial than the consequences of numerous previous research studies have shown. Similarly, this study went on to expand previous studies on the connection between CSR and financial performance. In doing so, another question to be asked in this study is: "Is corporate reputation the mediator in the connection between CSR and financial performance"?

This research contends that the connection between CSR and company performance is more complicated than prior research has revealed. As a result, reputation in the final research study of (Awang and Jusoff, 2009) has been omitted and the author of that study believed there could be another mediating variable between these relationships. Similarly, this study explored a greater mind boggling connection amongst CSR and company performance, which includes corporate reputation as a mediating variable. The mediation of this factor coordinates future looks away from a weak direct connection amongst CSR and company performance relation. Historically, customer satisfaction (Salmones, Pérez & Bosque, 2009), corporate reputation (Mulki & Jaramillo, 2011) and competitive advantage (Walsh & Beatty, 2007) are findings of corporate social responsibility. These factors as well influence the financial performance significantly and positively (Li et al., 2006). Furthermore, customer satisfaction is also interconnected with corporate reputation, and competitive advantage (Walsh, Dinnie & Wiedmann, 2006). So; it is important to incorporate customer satisfaction, corporate reputation and competitive advantage simultaneously with the interconnection of CSR and performance.

## **2. Literature Review**

The literature review contains the theoretical and empirical concepts and ideas relating to corporate social responsibility and its different dimensions, including non-financial aspects of performance with measuring factors. Different aspects of CSR with existing and historical relationships present between these predicting, predictors, and mediating dynamics. Numerous years have been passed researching CSR, and multiple experts, analysts and researchers have defined CSR in their own ways (Nejati & Ghasemi, 2012; McWilliams et al. 2006). In today's scenario, demands for environmental compassion products and services are increasing, leading to higher CSR (Gauthier, 2005; Van Beurden & Gössling, 2008). Even after numerous investigations, there is still a lack of a general and concise definition of CSR. Therefore, CSR will be different and challenging for each stakeholder (Van Marrewijk, 2003) to conceptualize. The definition of Carroll (1979) is the clearest conceptualization of CSR and considers the financial, legal, ethical and philanthropic measures of CSR. CSR also has been considered a key figure in the achievement of monetary objectives (Garriga & Mele, 2004).

As a result, many types of research have focused on finding a worldwide connection between CSR and performance. Research studies have concluded positive associations amongst the relation of CSR and performance (Alafi & Hasoneh, 2012; Galbreath & Shum,

2012). Orlitzky et al., (2005) for example, extended the prospect of (Garriga & Mele, 2004) and conducted studies using 52 previous surveys on the CSR and performance relationship. They proposed that socially responsible organizations are performing better than irresponsible organizations. Moreover, research studies have examined the better relationship of socially responsible organizations with determinants of performance (Rettab et al., 2009). The first hypothesis is proposed upon the basis of a direct relationship (Baron & Kenny, 1986) between CSR and financial performance.

- **H<sub>1</sub>:** There is significant impact of corporate social responsibility on financial performance

Margolis & Walsh (2003) argued that numerous research studies have concentrated only on examining the immediate connection amongst CSR and performance, while a few researchers (Alafi & Hasonah, 2012; Galbreath & Shum, 2012) asserted that examining the immediate connection amongst CSR and performance just aids ambiguous numerous compelling variables in the above-mentioned relation, which ultimately leads to inconsistent outcomes. Therefore, to achieve concrete results, the ignored factors to be considered and should be checked and experimentally tested. Three interrelated factors, namely customer satisfaction, corporate reputation and competitive advantage, must be included in the application to get a solid result. Current research studies have indicated that customer satisfaction (Flatt & Kowalczyk, 2011), reputation (Roberts & Dowling, 2002), and competitive advantage (Sabate & Puente, 2003) positively contribute to financial performance. CSR provides financial and non-financial benefits to organizations.

Organizations should be less risky, have a good corporate reputation and take advantage of financial benefits (Helm, 2007). Companies take advantage of better sales growth and greater profitability in the context of financial benefits with increased corporate reputation (Kotha et al., 2001; Roberts & Dowling, 2002). Firms make efforts to maintain their long-term corporate reputation, which improves customer satisfaction (Anderson & Sullivan, 1993). Galbreath and Shum (2012) suggested that they agree that corporate reputation is the result of better customer satisfaction. Customer satisfaction indicates that customers are satisfied with the products and services offered by the company (Ahmed & Amir, 2011). Satisfied customers also will make repeated purchases, which is an indication of improvement in the organization's profitability (Matzler & Hinterhuber, 1998). Finally, one could demonstrate that the best results are influenced by greater customer satisfaction.

Anderson, Fornell, and Rust (1997) demonstrated that customer satisfaction drives the improvement of profitability. Galbreath and Shum (2012) proposed that there are fewer opportunities for a direct relationship between customer satisfaction and performance that is undermined by corporate reputation. Reichheld and Sasser (1989), in their comprehensive study, noted that customer satisfaction influences organizational performance. They justified that satisfied customers will lead to repeat purchases, which is indicative of financial benefits and creates long-term loyalty with the products offered and the services of the organization. These findings support the indirect relationship between CSR and organizational performance by interacting with customer satisfaction and corporate reputation (Arikan et al., 2016).

Therefore, finally, it is proposed that corporate reputation also mediates more than just customer satisfaction. Customer satisfaction and corporate reputation are key segments of competitive advantage (Gupta, 2002) and could be affected by customer satisfaction

(Awang & Jusoff, 2009). In addition, corporate reputation also predicts the competitive advantage that differentiates organizations from their competitors (Gupta, 2002). Hence, the hypothesis could be drawn from the studies mentioned above that competitive advantage could also be a mediating factor between CSR and financial performance (Jain et al., 2017). Research has indicated that CSR, customer satisfaction, corporate reputation and competitive advantage have a positive impact on financial performance.

- **H<sub>2</sub>:**Customer satisfaction mediates between the relationship of corporate social responsibilities and financial performance
- **H<sub>3</sub>:**Corporate reputation mediates between the relationship of corporate social responsibilities and financial performance
- **H<sub>4</sub>:**Competitive advantage mediates between the relationship of corporate social responsibilities and financial performance

The motivation behind this study is to investigate the degree to which an organization can improve their performance by implementing CSR and its strategies. There are many ideas and theories that support the argument that CSR establishes competitive advantage and improves the organizational performance (Porter & Kramar, 2002). CSR is a theory of business ethics and contains a bundle of four dimensions and responsibilities, namely economic, legal, ethical and philanthropic. Corporate ethics built on stakeholder theory seek to involve all those affected by the organization in its decision-making process. Stakeholder theory supports the idea that stakeholders or individuals influence or are influenced by the corporate strategies or practices rather than by the social responsibility principle. Emshoff and Freeman, (1978) proposed an idea that there must be similarities between the objectives of the stakeholder group and the organizational goals. If an organization is supporting all its stakeholders, then it will build a decent reputation among those stakeholders and with society, which prompts its enhanced performance.

### 3. Conceptual Framework

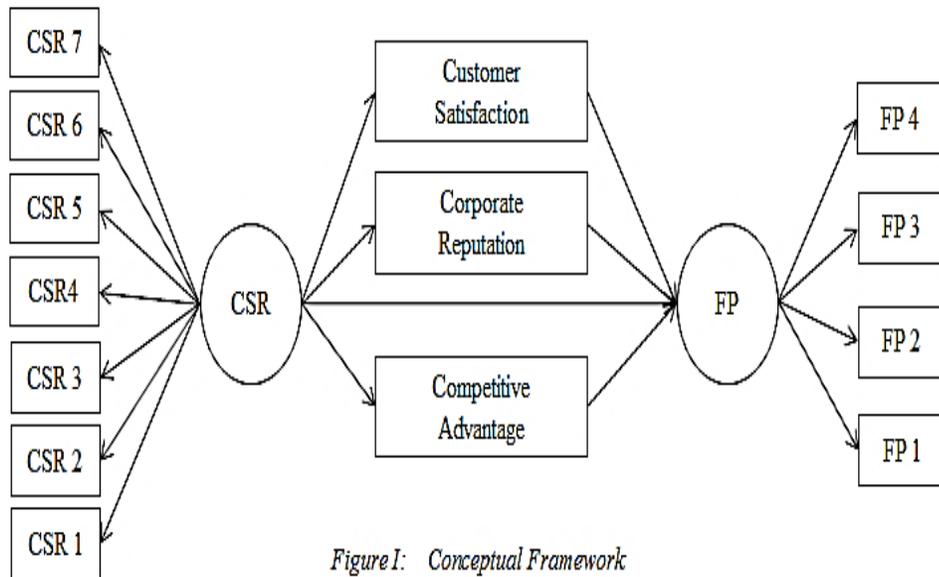


Figure 1: Conceptual Framework

Above framework shows the way how three intangible assets as mediators would be tested between CSR and financial performance relationship. Where CSR has been measured through 7 variables and financial performance has been proxied by 4 manifest variables.

#### **4. Methodology**

This study is going to examine the inter linkages of corporate reputation between CSR and financial performance of Pakistani banks. Primary data collected from distributing pre-designed and verified structured questionnaires among focal persons of organizations. Actually, this research based on such kind of substances which can be measured and known, so quantitative strategy is utilized to investigate the truth. So we can state that this research study depends on positivism paradigm. This study focused on casual research because in this study we want to examine the impact of corporate social responsibility and financial performance. So, this study is going to incorporate the casual research because it will use the cause and effect of CSR and financial performance under mediating variables. SPSS and AMOS software has used for data analysis.

There are different ways of the survey which used for data collection in historical researches but in these research five point Likert scales is used because these are respondent friendly and provides reliable data. In this study, actually working on the trends of CSR to financial performance, so main concern will be toward the individuals who are working in the organizations. The population of this research based Pakistani banking sector. There are more than 50 banks working in Pakistan with numerous branches. The respondents taken for this study were the branch managers, operation managers, and other focal persons of banking sectors working in Pakistan. For this research, questionnaires are distributed among the focal persons according to a number of banks working.

The research instruments are used in this study has been adapted according to multiple dimensions of CSR (Maignan & Ferrel, 2000), financial performance (Mishra and Saur, 2010), customer satisfaction (Wallin Andreassen & Lindestad (1998), corporate reputation (Weiss, Anderson, & MacInnis, 1999) and competitive advantage (Dunk, 2007; Flynn et al., 1995). This analysis includes cross sectional data and it was collected from multiple respondents' belonging to managerial posts of Pakistani public and private banks. Structural equation modeling was used for checking normality, correlation, regression, and confirmatory factor analysis of corporate social responsibility and financial performance with mediating factors.

#### **5. Empirical Findings**

##### *5.1 Measurement Models*

The measurement model is the first stage which explains the fitness of each item of scale which could be included in the model and confirmatory factor analysis is used to analyze the observed variables and their goodness, fitness, reliability, and validity. Goodness and fitness of measurement model could be verified using chi-square and normed chi-square because the values should be in between the defined ranges (Schumacker & Lomax, 2004). RMR and RMSEA values should be less than 0.08 (Steiger, 2000) and 0.10 (Browne & Cudeck, 1989) respectively which have noticed that values are in between cut off ranges. CFI (Tabachnick and Fidell, 2006), GFI and NFI (Shevlin and Miles, 1998) values should not less than 0.90 which clearly denoted that all measurement models are good and fit for the structural model.

**Table 1: Comparative Fitness Levels of Measurement Model**

Index	Cut Off Level	CSR	CS	CR	CA	FP
		Fitness	Fitness	Fitness	Fitness	Fitness
$\chi^2$	<b>Low Preferred</b>	101	2.68	16.0	1.74	3.21
$\chi^2/df$	$\leq 5.0$	5.00	2.68	8.00	1.74	3.21
RMR	$\leq .08$	0.04	0.01	0.04	0.01	0.01
CFI	$\geq .90$	0.86	0.99	0.92	0.99	0.99
GFI	$\geq .90$	0.94	0.99	0.98	0.99	0.99
NFI	$\geq .90$	0.83	0.99	0.92	0.99	0.99
RMSEA	$\leq .10$	0.10	0.06	0.13	0.04	0.07

*5.2 Descriptive Statistics and Normality*

Descriptive statistics typically indicate mean, median, minimum and maximum values. Moreover, these statistics indicate the normality of data using Skewness, kurtosis, and Jarque bera. This research included a total of 405 respondents after removing inadequate and inappropriate questionnaires. Mean and median indicated that the trend in the data was towards strongly agreed as per average of the results. Minimum and maximum values explained both extremes in the data. Skewness is a measure of symmetry, or more unequivocally, the absence of symmetry. Skewness infers about a positive or negative spread of data and in this study the spread of data was gone toward the negative. Kurtosis deals about the flatness of data.

**Table 2: Descriptive Statistics and Correlation Matrix**

	Mean	$\sigma$	1	2	3	4	5
CSR	3.731	0.443	1.00				
FP	3.882	0.688	.416**	1.00			
CS	3.823	0.502	.299**	.306**	1.00		
CR	3.738	0.618	.323**	.264**	.269**	1.00	
CA	3.670	0.638	.502**	.356**	.173**	.390**	1.00
** Significant at 5% Level							

Normality is considered as one of important assumptions which are necessary for development and processing of statistical tools. Normality tests are included Cronbach alpha, descriptive statistics, P-P Plot and Histogram etc. These different tests are used for recognizing non-normality in specific circumstances (Thode, 2002). Linearity indicates the linear relation between endogenous and exogenous variables. Multiple regressions assume that the variables are normally distributed. Moreover it is assumed that the predicting factors are not strongly correlated with each other. The values of Cronbach are more than the threshold level of 0.70 which indicated that reliability status of sample data. Multicollinearity can also be verified by using Variance Inflation Factor (VIF) test and its value should not exceed by 10 (Coenders & Saez, 2000). Secondly, tolerance could also be measure of data multicollinearity as it indicates relationship between predicting variables.

Tolerance level should be less than 0.2 which indicates there is no issue of multicollinearity in sample data (Coenders & Saez, 2000).

The correlation explained 41% significant relationship between corporate social responsibility as an independent variable and financial performance as a dependent variable. The initial result is relevant with few researchers (Alafi & Hasoneh, 2012; Galbreath & Shum, 2012) who have identified a positive relationship between CSR and financial performance. In addition, there is a significant and positive relationship between customer satisfaction, corporate reputation and competitive advantage, which is 29%, 30% and 50%, respectively. These mediating factors are also showing a significant relationship to financial performance and to each other.

5.3 Hypothesis Testing

The structural equations modeling has been applied to test the hypothesis and the first-order confirmatory factor analysis indicated that out of eighteen items of corporate social responsibility, only seven items will be in the best fit category and should be processed for further analysis. The direct relationship indicated that there is a significant and positive relationship between CSR and financial performance. This finding was supported by multiple studies, as they already tested the significant and positive relationship between these two factors (Miller, 2016; Jain et al., 2016; Ahamed et al., 2014). This finding provided a platform for corporate and management staff to enhance corporate social responsibility activities that lead to improved financial performance in the banking sector. In addition, the findings confirm the concepts of stakeholder theory which grounds that organizations must provide benefits to their stakeholders that ultimately are beneficial to the organizations themselves.

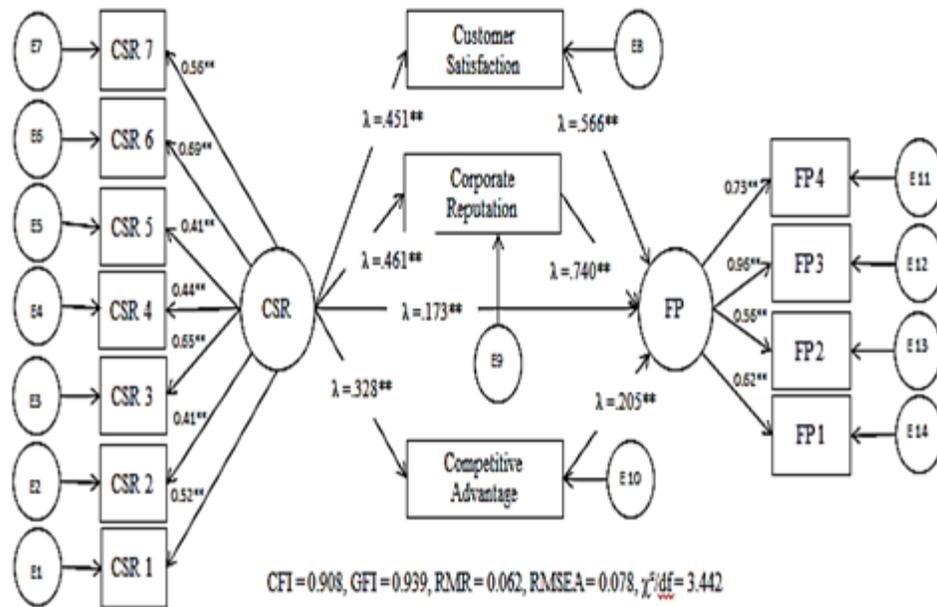


Figure 2: SEM Output

Iacobucci et al. (2007) demonstrated that structural equation modeling could be additional predominant in identifying a mediating relation than regression analysis. Baron and Kenny

(1986) procedure is used to test hypotheses and figure II clearly demonstrated the analysis. They suggested four steps to mediate the analysis and first it is examined that CSR is contributing positively to the financial performance with goodness and fitness of the model. The standardized regression coefficient is 0.173 at a significance level of 5%. The values of CFI, GFI and RMR are among the desired ranges that clearly demonstrate the goodness and fitness of the model. The first hypothesis is accepted.

**Table 3: Standardized Regression Weight**

			Std. Estimates	S.E	C.R	P-Value
CSR	————>	FP	0.173	0.129	2.323	0.020*
CSR	————>	CS	0.451	0.115	2.516	0.012*
CS	————>	FP	0.566	0.666	2.293	0.022*
CSR	————>	CR	0.461	0.115	2.515	0.013*
CR	————>	FP	0.740	0.563	2.247	0.025*
CSR	————>	CA	0.328	0.075	3.737	0.000*
CA	————>	FP	0.205	0.100	2.248	0.025*
*Significant at 0.05 Level						

Their suggested second step to involve the mediator factor and it is examined that CSR is contributing positively to customer satisfaction with the goodness and fitness of the model. The standardized regression coefficient is 0.451 at a significance level of 5%. The third step to examine the relationship between customer satisfaction and financial performance that customer satisfaction is positively contributing to financial performance with the goodness and fitness of the model (Xie et al., 2017). The standardized regression coefficient is 0.566 at a significance level of 5%. It should be noted that (Baron & Kenny, 1986) the assumption is fulfilled. In the case of the second mediating factor, CSR is contributing positively to corporate reputation (Lee et al., 2017) and the standardized regression coefficient is 0.461 at a significance level of 5%. On the other hand, corporate reputation is contributing positively to financial performance. The values of CFI, GFI and RMR are among the desired ranges that clearly demonstrate the goodness and fitness of the model.

In the case of the third mediating factor, CSR is contributing positively to the competitive advantage and the standardized regression coefficient is 0.328 at a significance level of 5%. In addition, the competitive advantage is contributing positively to the financial performance (Jain et al., 2017). The values of CFI, GFI and RMR are among the desired ranges that clearly demonstrate the goodness and fitness of the model. In addition, the Sobel test (Sobel, 1982) is incorporated to verify, which clearly demonstrated that there is a partial mediation that exists between CSR and financial performance in all three cases of mediation.

**6. Discussion and Conclusion**

CSR is considered an imperative part of management science literature in recent years (Pino et al., 2016, Zhu and Zhang, 2015). There are multiple studies that directly identified the relationship between CSR and performance (Jain et al., 2016, Yusoff & Admamu, 2016, Maignan, Ferrell, & Ferrell, 2005). (Teoh, Welch, & Wazzan, 1999, Wright & Ferris, 1997) examined significant negative relationships and (Madorran & Garcia, 2016, Gbadamosi, 2016; Nakamura, 2015) did not identify any consistent relationship. The

extension of above-mentioned studies mentioned and claimed that there is the omission of moderating and mediating variables for availing real effects of CSR and financial performance relationship.

Therefore after identification of logical and rational research gap, three associated mediating factors customer satisfaction, corporate reputation, and the competitive advantage is considered to enhance the relationship. The concluding remarks demonstrated that customer satisfaction, corporate reputation, and competitive advantage (Jain et al., 2017) are mediating the relationship to corporate social responsibility and financial performance. Consequently, it was assumed in this study that commitment in CSR incorporated all three mediators positively. In fact, the findings support the three hypotheses of this research. Thus: (1) CSR is associated with company performance; (2) the association between CSR and financial performance is partly mediated by customer satisfaction (Galbreath & Shum, 2012), corporate reputation (Luo & Bhattacharya, 2006) and competitive advantage (Majeed, 2011) in the relationship between CSR and financial performance.

There are many evidence that CSR is improving financial performance in developed and developing economies, but stakeholders still expect much more CSR practices than those actually doing in organizations (Salehi & Azary, 2009). This study is contributing to existing CSR literature in multiple ways. This study contributed methodologically to linking CSR with financial performance using mediating factors. In a practical perspective, managers must improve their values and perceptions to show the organizational response to stakeholder concerns. Therefore, it is proposed that customer satisfaction, corporate reputation, and competitive advantage are intangible assets for organizations in a globally competitive environment. These results also suggest an improvement in CSR activities that improve organizational performance by indirectly targeting the aforementioned intangible assets.

### **7. Limitations and Future Direction**

This study is conducted in the Pakistani context, which is limited to generalize globally. Future studies could also conduct in other developing economies, emerging and Asia Pacific countries to generalize. In addition, it is suggested to incorporate stakeholder pressure as a moderator and firm reputation (Agyemang, & Ansong, 2017) as mediator between the relationship of corporate social responsibility and financial performance. This study considered four dimensions of corporate social responsibility (Maignan & Ferrel, 2000) and future studies could possibly be conducted using more and latest dimensions which could increase the generalizability.

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