

CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL PERFORMANCE OF THE NIGERIAN LISTED FIRMS

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Abstract

Corporate Social Responsibility (CSR) has received greater attention in the finance literature in the last few decades. Determining the direction of the relationship between CSR and financial performance has been a controversial issue among researchers, government agencies and policy makers. This paper examines the relationship between corporate social responsibility and firm financial performance of 36 Nigerian listed firms for the 10-year period, 2005-2014. Ordinary Least Squares regression analysis was used to determine the direction and strength of the relationship between CSR and firm performance. The result indicates a positive and significant relationship between CSR (measured by logarithm of corporate social responsibility expenditure) and firm financial performance (Return on Asset, and Profit Margin). The outcome of the study is consistent with some prior empirical studies and provides evidence in support of both social impact and positive synergy hypotheses. Management of firms are encouraged to put in place CSR policies that suit them and which are also beneficial to their host communities; since socially responsible firms are associated with some benefits which ultimately improve their financial performance.

Key words: Corporate social responsibility, Financial performance, Social contract, Social impact hypothesis, Positive synergy hypothesis.

Introduction

In the last two decades, the empirical literature on the study of corporate social responsibility (CSR) has increased tremendously, especially in the developed countries. In developing economies like Nigeria's, many companies, particularly the multi-nationals, have realized the importance of being socially responsible, hence the incorporation of CSR activities into their businesses. There is no universally acceptable definition of CSR, but the various definitions have one thing in common: companies giving back to their host communities (or other stakeholders) some basic things of life they lack. Frooman (1997) defines CSR as an action by a firm, which the firm chooses to take, that substantially affects an identifiable social stakeholder's welfare. The European Commission in 2001 viewed CSR as a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.

Companies differ in their approach to CSR. A company may choose to provide social infrastructure such as community hospital, schools, pipe-borne water, scholarship to locals,

pollution control or environmental remediation. Some others only believe in providing excellent working conditions for their employees, work safety, production of good products, etc. All these involve additional expenditure to the various companies that want to be socially responsible. The increased expenditure involved in being socially responsible will ultimately affect the financial performance of the company and wealth of the shareholders.

A question arises: should a company use its resources to provide for the community what the elected government should primarily do? There are two divergent views on this. One view is that governments should be held responsible for the provision of amenities to their communities since the primary function of a responsible government is to do just that. Proponents see a company as a profit-making venture with the aim of improving the wealth of its shareholders; they therefore hold that investing in corporate social activities impacts negatively on the profitability and wealth of the shareholders. The other view is that a company cannot ignore the problems of the environment in which it operates, and failure to address those issues might even consume the company. They also hold that the reputation of a socially responsible company will attract and retain employees, leading to reduced labour turnover, increased productivity and, ultimately, better financial performance. Hull and Tang (2012) argued that a consistent social performance presents a condition that under which firms can realize synergies and improve their performance. Furthermore, Jiraporn, Jiraporn, Boeprasert and Chang (2014) reported that credit agencies give higher ratings to firms with socially responsible acts.

On which side of the divide do Nigerian firms belong? The answer to this pertinent question is provided by the present study. Paucity of research materials in this area of study especially in Nigeria is the major source of motivation for the current work. Furthermore, this study tries to extend the work of Alshammari (2015), who due to lack of a suitable data set, failed to empirically test the relationship between CSR and firm performance. The use of Nigerian data set of 36 companies (covering 15 sectors of the economy) and for the period of 10 years (2005-2014) will address this gap. Specifically, the present study tries to answer the question: What relationship exists between CSR expenditure incurred by Nigerian firms and financial performance?

The rest of the paper is organized as follows. Section 2 presents the literature review. Section 3 discusses the methodology of the study. In section 4, the results are presented and discussed while section 5 concludes the study.

Literature Review

Theoretical framework

The concept of modern Corporate Social Responsibility (CSR) developed in 1950s through Bowen's seminal work "The Social Responsibilities of a Businessman" (cited in Uadiale and Fagbemi, 2012). Since then, efforts have been directed at the study of corporate social responsibility practices of firms to their host communities and the impact of such activities on their profitability. Regarding the direction of relationship between CSR measures and firm performance, the literature consists of three different results- positive; negative and no relationship. Preston and O'Bannon (1997) developed six causal and directional hypotheses to justify the three different opinions on the relationship between CSR and financial performance. These six hypotheses provide the theoretical framework of this study.

Social impact hypothesis

This is based on Stakeholder theory which argues that a firm's boundary extends beyond the primary stakeholders to include any group that is affected by, or can affect the achievement of the firm's objectives (Freeman, 1984). Firms that pay close attention to their stakeholders and are consistent in sustaining their social performance as well as political performance will have improved reputation and financial performance (Hond, Rehbein, Baker & Lankveld, 2014). Thus, a firm is encouraged to contribute to the society part of what it derives from it and this is expected to improve the firm's reputation and performance. The social impact hypothesis posits a positive relationship between CSR cost and firm performance.

Slack resource hypothesis

This hypothesis predicts that better financial performance will result in the availability of slack resources that may increase a firm's ability to invest in corporate social responsibility activities. A positive relationship between firm performance and CSR cost is predicted by this hypothesis.

Trade-off hypothesis

The trade-off hypothesis, a neoclassical economist position posits that social responsibility activities involve huge costs that brings few benefits to the firm and these have a significant negative effect on the wealth of the shareholders. The proponents (such as Friedman, 1970, and Waddock & Graves, 1997) affirm that it is the duty of the government to provide all the needed infrastructure and amenities for the people while corporations should focus on improving the wealth of their shareholders. A negative relationship is expected between corporate social responsibility cost and firm performance.

Managerial opportunism hypothesis

According to this hypothesis, corporate managers may pursue their own selfish interests against the general interest of shareholders and other stakeholders. If the firm financial performance is strong, managers may reduce social responsibility costs in order to maximize their own short term gains. Relatedly, if financial performance is weak, corporate managers may engage in frivolous and unnecessary social programmes to offset their bad financial results.

Positive synergy hypothesis

This hypothesis opines that higher level of corporate social responsibility expenditure will lead to higher firm performance. The improved firm performance will offer the possibility of reinvestment in social responsibility activities and the cycle will go on and on.

Negative synergy hypothesis

According to this hypothesis, higher levels of CSR cost will lead to decreased firm performance, which in turn limits the social responsibility expenditure and the cycle will continue.

Related empirical studies on CSR and financial performance

Empirical studies conducted so far provide conflicting results on the relationship between CSR practices and firms' financial performance with some studies showing a positive relationship and others showing a negative relationship. In few other cases, no relationship was reported. However, the largest number of investigations found a positive relationship. Makni, Francoeur & Bellavance (2008) is an assessment of the causal relationship between corporate social performance and financial performance of 179 publicly held Canadian firms for 2004 and 2005 using Granger causality approach. No significant relationship was found between a composite measure of a firm's corporate social performance and financial performance, except for market returns. However, using individual measures of corporate social performance, the result provided a robust significant negative impact of the environmental dimension of corporate social performance and three measures of financial performance (return on assets, return on equity and market returns).

Also in North America, Fauzi (2009) reports an investigation of the relationship between CSR and financial performance of a sample of 101 companies listed on the New York Stock Exchange. Using a regression model, the study reveals no significant relationship between corporate social responsibility and firm performance. It also provides evidence of leverage (a control in the model) having a moderating effect on the interaction between corporate social responsibility and financial performance variables. Similarly, but using regression discontinuity approach, Flammer (2013) examined the effect of CSR on financial performance of listed firms in the USA. This involved analyzing the effect of corporate social responsibility-related shareholder proposals that passed or failed by a small margin of votes. The passage of such "close-call" proposals is akin to a random assignment of corporate social responsibility to companies and hence provides a clean causal estimate of the relationship between it and financial performance. The results showed that adopting corporate social responsibility-related proposals led to superior financial performance. In other words, there was a positive relationship.

Results from African data have also been interesting. Cheruiyot (2010) utilized data of 47 listed firms in Nairobi Stock Exchange to carry out a cross-sectional study on the relationship between CSR index and firm performance proxies (return on assets, return on equity and return on sales). The result revealed a statistically significant relationship between CSR and financial performance. A later study (Mwangi & Oyenje, 2013) investigated the relationship between CSR practices and financial performance of 10 firms in the manufacturing, construction and allied sector of the Nairobi Stock Exchange for the period 2007-2011. The results indicate an insignificant positive relationship between corporate social responsibility practice and financial performance. Using individual measures of corporate social responsibility practice, the study provides additional result of a significant and inverse relationship between financial performance and manufacturing efficiency.

In a Nigerian study, Uadiale and Fagbemi (2012) focused on forty listed companies to determine the impact of corporate social responsibility activities on financial performance (return on asset and return on equity). Their results showed that CSR had a positive and significant relationship with the financial performance measures. In a smaller study, Okafor and Oshodin (2012) examined the relationship between CSR and companies' performance for 20 Nigerian listed firms for three years: 2008 to 2010. The ordinary least squares method was used to estimate the coefficient of the independent variables. The results revealed a

positive and insignificant relationship between profitability and companies' contribution towards education and health; and negative but insignificant relationship between profitability and communities' development investment by companies. Babalola (2012) utilized a similar method to explore the relationship between CSR and the' profitability of 10 randomly selected listed firms in Nigeria for the period 1999-2008. Findings revealed that the firms invested less than 10% of their annual profit to social responsibility activities. However, a negative but insignificant relationship was found between corporate social responsibility and financial performance.

In a much larger investigation, Duke and Kankpang (2013) used an inferential research design to perform a cross-sectional study to test the effect of CSR measures (represented by waste management, pollution abatement, social action and fines and penalties) on financial performance of 275 Nigerian firms. These firms were selected from 883 firms (both listed and unlisted) who consistently rendered and filed annual returns with the Nigerian Corporate Affairs Commission over the preceding ten years. Findings revealed mixed results. While waste management and pollution abatement were found to be significantly and positively associated with firm performance, social action, fines and penalties were strongly but negatively related.

More recent studies include Mubeen & Arooj (2014), Alshammari (2015) and Samra, Shahid & Farzana (2015). Mubeen and Arooj (2014) studied the impact of CSR on shareholders' wealth and financial performance of 10 firms that are highly rated for CSR activities and 10 Non-CSR firms. Using accounting measures (ROE and ROA) as proxies for financial performance and earnings per share (EPS) and stock price and CSR measures, the authors found a significant positive relationship between CSR and shareholders wealth and financial performance. Alshammari (2015) used the propositions of institutional theory, stakeholder perspective and ownership framework on CSR to explore the relationship between firms' social performance and the financial performance of the firm. It explored the moderating effect of both corporate reputation as a proxy for firm social activities' publicly and the institutional investors in the firm. The study suggests that corporate ownership structure, as well as corporate consistent reputation will have influence on the extent to which a firm may benefit from its CSR activities and firm performance.

Samra, Shahid and Farzana (2015) investigated the impact of CSR practices on the financial performance of 10 Pakistani listed firms operating in the oil & gas sector for the period 2006-2013. The CSR spending of the companies were used as proxy for CSR while net profits, net profit margin and total assets were used as surrogates for financial performance. Correlation and regression results reveal a positive but insignificant relationship between CSR and all the performance measures.

Methodology

Source of data

Data for this study were derived from the annual published financial statements and reports of the firms for 10-year period, 2005-2014. Table 1 provides information on the companies selected for the study.

Table 1: Firms in the sample

Sector	Number
Agro/Agro-allied	2
Automobile and Tyre	1
Breweries	2
Healthcare	2
Industrial and Domestic Product	2
Building Materials	3
Chemical and Paints	3
Conglomerates	4
Construction	2
Printing and Publishing	2
Food/Beverages and Tobacco	3
Packaging	3
Petroleum (Marketing)	5
Textile	1
Commercial/Services	1
Total	36

Source: Researchers' selection from Nigerian Stock Exchange Fact Book (2015)

Population, sample and sampling technique

The population of the study consists of all the firms listed on the Nigerian Stock Exchange since inception of the Exchange in 1960. However, for the purpose of this study, 36 non-financial firms were selected. The sample was drawn using judgemental sampling and stratified sampling techniques. This is because the firms were firstly arranged based on their sectors before they were selected using researchers' judgement on those firms that provided the needed information required for this study. In all, the sample firms covered 15 out of 19 sectors of the non-financial segment of firms listed on the Nigerian Stock Exchange as at the beginning of 2005. Two reasons accounted for non-inclusion of financial firms in the study. Firstly, they provide services which do not have negative impact on the environment, and secondly, they operate in highly regulated business environment.

Description of Variables

Dependent variable (Financial Performance)

The study utilized two common accounting measurement variables (Return on Asset and Profit Margin) to proxy for financial performance, the dependent variable. The two variables were obtained from the financial reports of the selected firms and the Nigerian Stock Exchange Fact Book.

Independent variable (Corporate Social Responsibility Costs)

Unlike in some studies where individual units of CSR activities were studied and regressed against firm financial performance measures(see Babalola, 2012, Okafor & Oshodin, 2012, Uadiale & Fagbemi, 2012, Duke & Kankpang, 2013, and Nwangi & Oyenje, 2013), the present study used the composite approach. This involves the use of annual expenditure incurred on all the CSR activities by the selected firms as a single variable. This parameter is disclosed under donations and corporate social responsibility in the annual financial reports of the sampled firms. This approach is considered plausible because the sample firms belonged to different sectors and were involved in varying social responsibility activities (human resources, community involvement and environmental issues). Hence, in order to

avoid missing data during analysis stage, it becomes imperative for composite approach to be adopted.

Control variables

There are some variables that can also influence the dependent variable and inferences made may not be reliable if they are not captured in the model. For this study, three variables (firm size, leverage and asset tangibility) were used to serve as control variables. The measurement of the variables used in the study is as presented in Table 2.

Table 2: Measurement of variables

Variable	Abbreviation	Measurement
Return on Asset	ROA	Profit after tax/Total assets
Profit Margin	PRM	Profit after tax/Turnover
Corporate Social Responsibility Expenditure	CSR	Log of social responsibility costs
Firm size	SIZ	Log of total assets
Leverage	LEV	Total debts/Total assets
Asset tangibility	TAN	Non-current assets/Total assets

Source: Empirical literature with authors' modifications (2015)

Hypothesis

Following the research objective of this study, the general null hypothesis developed and tested is as shown in equation 3.1.

$$H_{01}: \text{There is no significant relationship between corporate social responsibility and firm's financial performance.} \quad (3.1)$$

Model specification

The study adopted a panel methodology (which combines simultaneously time series with cross-sectional data). Specifically, the model used in this study is as stated in 3.2a and 3.2b:

$$ROA_{it} = \beta_0 + \beta_1 CSR_{it} + \beta_2 SIZ_{it} + \beta_3 LEV_{it} + \beta_4 TAN_{it} + e_{it} \quad (3.2a)$$

$$PRM_{it} = \beta_0 + \beta_1 CSR_{it} + \beta_2 SIZ_{it} + \beta_3 LEV_{it} + \beta_4 TAN_{it} + e_{it} \quad (3.2b)$$

The coefficients of the explanatory (independent) variables were estimated with the use of simple pooled Ordinary Least Squares (OLS) method.

Validity and reliability of data

Data used for this study were obtained from reliable sources. The annual financial statements and reports of the sampled firms used were audited by reputable professional audit firms and approved by the regulatory agencies – the Nigerian Stock Exchange and the Securities and Exchange Commission for public consumption. Furthermore, data instruments employed for the study have been found in Financial Management and Financial Economics literature to be suitable for this type of study.

Results and Discussion

Descriptive statistics

Table 3 presents the descriptive statistics of the variables used in the study. It shows an average return on asset of the sampled firms during the period of study of about 4.72% and a

profit margin of 3.47%. The contribution of profit to total assets and turnover is very small. With average corporate social responsibility costs of *log inverse* 4.3807 (about N24,000 per annum) the amount spent by the selected firms to provide social amenities for their host communities is minor compared to revenue or profit generated during the period.

Table 3: Descriptive Statistics

	Mean	Minimum	Maximum	Standard deviation	Skewness	Kurtosis
ROA	0.0472	-3.0259	0.5080	0.1900	-12.097	192.060
PMG	0.0347	-1.8712	0.3808	0.1667	-6.230	57.155
CSR	4.3807	0.0000	8.3180	2.9603	-0.685	-1.280
SIZ	9.8107	8.0200	11.4990	0.7582	-0.328	-0.620
LEV	0.2102	0.0000	3.0908	0.2729	4.946	42.228
TAN	0.3770	0.0000	0.8228	0.1836	0.473	-0.394

Source: Authors' computation with the use of E- Views 7.0

Although social responsibility cost incurred differs between firms, it is still small if one considers the maximum value of *log inverse* 8.3180 (about N205 million). The firm size average *log inverse* 9.8107; while the leverage is 0.21. It shows that the proportion of debt to total asset is about 21%, while about 79% is due to equity financing. The average value of asset tangibility of 0.377 depicts that the percentage of non-current assets to total assets of the sample firm is about 38%.

Multicollinearity test

In order to make correct inferences from the econometric analysis conducted, there is need for the test of multicollinearity among the variables. Three different methods were employed to achieve this. Gujarati (2003) and Rumsey (2007) submit that coefficient value of 0.8 and above for an explanatory (independent) variable indicates the existence of high multicollinearity problem between it and other variables. Furthermore, Gujarati (2003) posits that Variance Inflation Factor (VIF) and Tolerance value can also be used to test multicollinearity problem. A variable with VIF of above 10 or Tolerance value of less than 0.1 shows existence of high multicollinearity between it and other variables.

Table 4 presents the result of the multicollinearity test among the variables used in the study. From Table 4, none of the variables have VIF of above 10 or Tolerance value of less than 0.1. As seen in Table 5, none of the variables have co-efficient (or sig) value of 0.80 and above. These results, thus, indicate that the model does not have a high multicollinearity problem.

Table 4: Multicollinearity test

Variable	VIF	Tolerance value
CSR	1.222	0.818
SIZ	1.226	0.816
LEV	1.065	0.939
TAN	1.027	0.704

Source: Authors' computation with the use of E- Views 7.0

4.3 Correlation

Table 5 presents the correlation matrix of the variables used in the study. From it, the performance proxies (ROA and Profit Margin) have a positive and significant association

with CSR, at 1% level. This indicates that the higher the profit, the higher will be the amount spent on corporate social responsibility activities.

Table 5: Correlation matrix

	ROA	PRM	CSR	SIZ	LEV	TAN
ROA	1.000					
PRM	0.653*** (0.000)	1.000				
CSR	0.217*** (0.000)	0.226*** (0.000)	1.000			
SIZ	0.071 (0.177)	0.143*** (0.006)	0.373*** (0.000)	1.000		
LEV	-0.522*** (0.000)	-0.370*** (0.000)	-0.168*** (0.001)	0.104** (0.049)	1.000	
TAN	-0.085 (0.108)	-0.106** (0.044)	0.056 (0.286)	0.160*** (0.002)	0.043 (0.417)	1.000

* **, *** indicate significant at 10%, 5% and 1% levels, respectively
Sig-values are shown in parentheses

Source: Authors' computation with the use of E- Views 7.0

The table further shows a negative and significant association between the two performance proxies with leverage at 1% level. This is consistent with the prediction of the pecking order theory. However, the association between ROA and firm size and tangibility is not significant, but significant with Profit Margin as performance proxy (positive with firm size at 1% level and negative with tangibility at 5% level). It is worthwhile to note that correlation alone cannot be used to make correct inferences because it shows the direction but not the strength of the relationship. To mitigate this limitation of correlation, a simple pooled Ordinary Least Squares (OLS) was conducted.

4.4 Regression result

Table 6 presents the regression results using simple pooled Ordinary Least Squares for the two models.

Table 6: Pooled Ordinary Least Squares (OLS) Regression Results

Variable	ROA			PMG		
	Co-efficient	t-stat	prob	Co-efficient	t-stat	prob
Constant	-0.122	-1.068	0.286		-2.298**	0.022
CSR	0.006	2.003**	0.046		2.145**	0.033
SIZ	0.025	2.067**	0.039		3.011***	0.003
LEV	-0.356	-11.198***	0.000		-7.385***	0.000
TAN	-0.088	-1.883*	0.061		-2.539**	0.012
R ²	0.755			0.644		
Adjusted R ²	0.630			0.596		
F-Stat	38.545*** (0.000)			21.583*** (0.000)		
Durbin-Watson	1.992			1.901		
No. of observations	360			360		

* **, *** indicate significant at 10%, 5% and 1% levels, respectively.

Source: Authors' computation with the use of E- Views 7.0

From Table 6, the F-stat of the two models are 38.545 and 21.583; both being significant at 1% level. It shows that the models as a whole are fit. Durbin- Watson values of 1.992 and 1.901 indicate less autocorrelation in the two models.

In Table 6, the relationship between the two financial performance proxies (ROA and Profit Margin) and corporate social responsibility proxy (CSR) is positive and significant at 5% level. This finding is supported by Waddock & Graves (1997), Hillman & Kein (2001), Orliczky, Schmidt & Rynes (2003), Tsoutsoura (2004), Allouche & Lavoche (2005), Wu (2006), Donker, Poff & Zahir (2008), Uadiale & Fagbemi (2012), Okafor & Oshodin (2012), Samina (2012), Amole, Adebisi & Awolaja (2012), Akinpelu, Ogunbi, Olaniran & Ogunseye (2013), Flammer (2013), Nadeem, Vaveed & Naqvi (2014) and Mubeen & Arooj (2014). The outcome of this study provides evidence in support of both the Social Impact and Positive Synergy Hypotheses of Preston and O'Bannon (1997). The null hypothesis is hereby rejected and the alternative hypothesis is accepted. Thus, there is a significant relationship between corporate social responsibility and a firm's financial performance.

For the control variables, Table 6 further reveals consistent results from the two models. It shows a positive and significant relationship between the two performance variables (ROA and PRM) and firm size at 5% level in model 1 and 1% in model 2. Also, there is a negative and significant relationship between the two financial performance variables and leverage (at 1% level). This is consistent with the prediction of Pecking Order Theory of Myers and Majluf (1984) and a branch of Jensen and Meckling (1976)'s Agency Theory. The relationship between the financial performance proxies and tangibility is also negative and significant at 10% and 5% levels for models 1 and 2, respectively.

Conclusion and Recommendations

Conclusion

The study empirically tested the relationship between corporate social responsibility and firm's financial performance of 36 Nigerian listed non-financial companies for the ten-year period, 2005-2014. With the use of simple pooled OLS, results indicate a positive and significant relationship between the two financial performance proxies (ROA and Profit Margin) and corporate social responsibility activities (measured by logarithm of CSR expenditure). The outcome of the study suggests that the higher the firm investment in social activities, the higher the financial performance of such an organisation will be. This study extends the work of Alshammari (2015), who due to lack of suitable data set, failed to empirically test the relationship between the CSR and financial performance.

Recommendations

It is hereby recommended that firms should put in place robust CSR policies that will be beneficial to their host communities and at the same time not injurious to their operation's finance. Organizations that are socially responsible have been shown to enjoy some benefits, which ultimately affect their financial performance positively.

The regulatory agencies should also develop a framework that will enable companies to fully disclose all the social responsibility activities undertaken by them in their annual reports. This will to certain extent help researchers and the general reading public to appreciate the contributions of these companies to their immediate environment.

Suggestion for further studies

Paucity of relevant data, different methodologies adopted by researchers and lack of acceptable definitions of relevant variables are the major limitations to the study. Efforts

should be made by financial economists and policy makers to come up with suitable variables that can be used to measure accurately the variable, CSR.

For future research, a larger sample size and a longer study period should be considered. A similar study may also be undertaken for other sectors (banking, insurance, aviation, etc.) of the economy.

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