

CORPORATE PHILANTHROPY IN THE PAKISTANI TEXTILE SECTOR: EVIDENCE ON SLACK RESOURCES, ADVERTISING INTENSITY AND PAST FINANCIAL PERFORMANCE

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Abstract

Literature provide various perspectives on corporate philanthropy but none the less there is general consensus on the fact that being discretionary in nature it requires discretionary resources of the firm that are labeled as slack resources. Several variables can affect the relationship between the organizational slack and corporate philanthropy such as the firms that are willing to spend more on advertising tend to be more generous in allocating organizational slack to philanthropic activities and similarly the firms with better past financial performance tend to direct more slack resources to social causes. This study is intended to examine the relationship between corporate philanthropy and slack resources and moreover it analyzes the role of advertising intensity and past financial performance in the respective relationship of slack resources and corporate philanthropy. The sample of the study consisted of 80 textile companies in Pakistan. The estimation method used for analysis was random effects model. The findings indicate that slack resources has a significant positive relationship with corporate philanthropy whereas advertising intensity and past financial performance doesn't moderates the relationship between slack resources and corporate philanthropy.

1. Introduction

Corporate philanthropy is form of corporate social behavior that is voluntary. It can be defined as cash and non-cash donations such as products, services and employee time given to charitable causes by the company or by company lead foundation. There is substantial debate in the literature about the economic benefits that corporate philanthropy can generate for the business such as increased profitability, tax advantage and improved social profile (Iatridis, 2015) However there is inconclusive evidence on how much companies should donate that will generate maximum economic benefits as the decision of how much to donate is relative and vary across firm attributes such as size, profitability, visibility, political connections and most importantly the resources available at its disposal (Amato and Amato, 2007). There is also a debate whether it should be done directly or through nonprofits, especially civic organizations (such as foundations). Some specialties of these organizations are discussed by researchers e.g. Bácsné (2012) has accessed the correlation between human background and social capital, Juhász-Vántus (2012) highlighted specialties of expectations regarding human resources, Pierog-Vörös-Dajnoki (2014) and Máté (2014) researched its labor marker natures, Wiwczaroski-Szabados-Pierog (2014) examined the international circumstances, conceptions, Gergely-Pierog (2016) in their latest article has focused on the role of motivation factors.

But focusing primarily on the relationship between slack resources and corporate philanthropy it can argued that slack resource hypothesis extended to corporate social

responsibility states that firms engage in corporate philanthropy only if the firm's slack resources permit. Corporate philanthropy is the most discretionary element of corporate social responsibility and is highly dependent on the availability of discretionary resources often termed as slack resources that exist both in the form of financial and non-financial resources (Seifert, Morris and Bartkus, 2004).

Although the slack resource theory view of corporate philanthropy is quiet compelling but companies always do not direct their excess resources to philanthropic initiatives because the relationship between the two is affected by several factors e.g. firm size, age, financial performance and willingness of the firm to spend on the advertising. This debate need to be extended further by testing the samples that are previously not being tested as most of the studies on this issue have been conducted in the western developed economies, little or no evidence is available from the developing economies as the financial pressures and growth patterns of the companies in under developing economies can be different.

The current study contributes by providing the perspective of developing economy (Pakistan) on the relationship between slack resources and corporate philanthropy and the role of other factors such as advertising intensity and past financial performance that affect the relationship between the two by analyzing the sample of companies from Pakistani textile sector. Textile companies can serve as an appropriate sample for the current study because they are significant component of Pakistan's corporate sector and often cited as the backbone of economy. It is the largest manufacturing and major employment generating industry in Pakistan and the major export of the country making it the eight largest exporter of textile goods in Asia.

The present article is structured in two parts: first part provide the overview of literature and second part presents the empirical findings of the study.

2. Literature Review

2.1. Slack Resources and Corporate Philanthropy

Corporate philanthropy is the most discretionary element on the company's to do list and because of its discretionary nature it requires discretionary resources that are often termed as slack resources. Organizational slack is defined as actual or potential resources which allow the organization to adapt successfully and make adjustments to pressures of internal or external environment and modify policies or initiate changes in strategy (Bourgeois, 1981). The field of corporate social responsibility, agency theory and behavioral theory offer three differing perspectives on the link between slack resources and corporate philanthropy but there is general consensus among the three on the fact that companies engage in corporate philanthropy only if the company has available slack resources.

2.1.1 Corporate Social Responsibility: According to the most cited Carroll's model of corporate social responsibility there is a hierarchy of four different types of responsibilities economic, legal, social and philanthropic. Philanthropy is not obligatory in fact it's optional and highly dependent on the management's discretion (Carroll, 1991). Corporate social responsibility paradigm considers corporate philanthropy highly desirable and associate with various social and economic benefits. More recently the notion of strategic corporate philanthropy link corporate philanthropy with the strategic goals of the company and argue that it is connected with improved corporate financial

performance and corporate reputation. Despite the considerable debate in the literature about the economic benefits of the company past studies show significant variation in the amount of corporate donations made by the companies as there are numerous firm related factors that affect this decision and one significant factor is an excess cash resource. CSR theorists agree on the fact that companies engage in corporate philanthropy only if the company's resources permit (Seifert, Morris and Bartkus, 2003). On the management's to do list corporate philanthropy is last in and first out since it is not mandatory so it is not only dependent on the profitability of the firm but also on its ability to convert earned profits in to slack resources. Although the greater profits can lead to the greater availability of slack resources but if the firm is investing profits in to its production function or other core activities then the availability of slack resources for the discretionary activities decreases (Chiu and Sharfman, 2009). In this regard if the firm has strategic orientation about its philanthropic initiatives it will consider corporate philanthropy as core activity and will more likely to direct its slack resources to the charitable causes that are tied with the business goals.

2.1.2 Agency Theory Perspective: The concept of corporate philanthropy is not without its critiques, the opponents of corporate philanthropy use agency theory perspective and belief that it is highly undesirable. Their criticism is mainly inspired by the views of famous economist Milton Friedman who argued that corporate philanthropy can be cause of agency problem (Choi and Wang, 2007). According to agency theorists the prime responsibility of managers as agents is to maximize the economic benefits for shareholders, the needs of other stakeholders are deemed important only if such needs contribute to the maximization of the shareholders wealth. In this regard if the company has excess cash, it should be used for the economic growth by investing in high return projects and if this option is not feasible then the excess cash should be returned to its owners. Otherwise the availability of slack resources can be cause of agency problem as managers have more autonomy over free cash flows so while allocating slack resources they might tend to behave opportunistically and direct donations to social causes that will give them political benefits and prestige in community. Thus it can be argued if the availability of slack resources increases then agency problem should also increase such that more the slack resources, more the managers will tend to direct slack resources to corporate philanthropy (Seifert, Morris and Bartkus, 2003; Iatridis, 2015).

2.1.3 Behavioral Theory Perspective: The most common use of *Behavioral Theory of the Firm* is in the field of slack resources. There is considerable evidence in the literature that organization initiate corporate social strategy only when slack resources permit (Bowen, 2007). According to the behavioral theory perspective managers are not following economic and social goals separately in fact they try to optimize both simultaneously as going beyond the legal requirements and designing and implementing corporate social strategy without economic benefits doesn't sound rational. So companies engage in social activities that have maximum economic benefits such as corporate philanthropy improving corporate reputation. However when the managers decide to invest slack resources it can cause conflicting situation which charitable cause will get the donation because besides having economic goals they also have personal goals (Bowen, 2007).

2.2. Factors Affecting the Link between Slack Resources and Corporate Philanthropy

The relationship between slack resources and corporate philanthropy is not that simple it is affected by various factors such as number of board of director's independence, investment fund ownership, CEO stock ownership, corporate financial performance and advertising intensity (Fox, Faff, Navissi, 2011; Jeffrey, Harrison & Coombs, 2012; Waddock and Graves, 1997). For the current study two variables are considered that can affect the relationship between slack resources and corporate philanthropy one past corporate financial performance and other is advertising intensity.

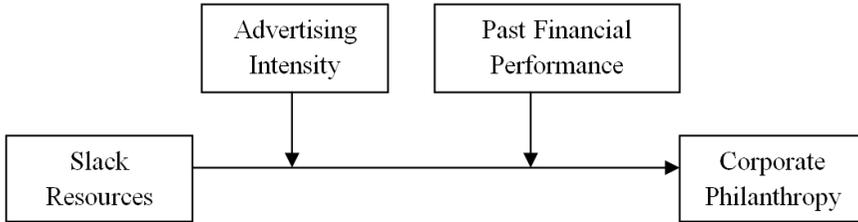
2.2.1 Corporate Financial Performance: Better corporate financial performance leads to better corporate social performance because the companies with healthy financial performance have more resources available at their disposal to invest in social activities (Soana, 2011). Similarly the often cited work of Waddock and Graves (1997) in this regard suggest that firm's improved financial performance leads to greater availability of slack resources enabling the firm to invest more in philanthropic programs and increase its social performance which in return enhances its financial performance; they termed this phenomenon as virtuous cycle. Another possible explanation about corporate financial performance affecting the link between slack resources and corporate philanthropy comes from agency theory according to which Board of Directors (BOD) as agents of shareholders face continuous pressures to improve firm's performance. The decisions to direct slack resources towards corporate philanthropy are tied to the firm's performance. When the firm's performance is good and shareholders are satisfied; directors are more likely to use slack resources for social causes but weak financial performance of the firm compels BOD to find cost cutting strategies in every aspect including corporate philanthropy (Arora and Dharwadkar, 2011). So it can be said that the better financial performance will strengthen the relationship between slack resources and corporate philanthropy and vice versa.

2.2.2 Advertising Intensity: Corporate philanthropy is found to be associated with improved brand reputation and customer loyalty whereas from the marketing perspective the advertisements also serve the same purpose i.e. developing strong and long-term relationship with customers. The corporate social responsibility is used as a differentiation strategy by many companies to differentiate from competitors and establish a unique competitive advantage. In the advertisement intensive industries firm in the quest of differentiating itself from competitors are more likely to engage in philanthropic initiatives (Zhang, Zhu, Yue & Zhu, 2010).

Fox, Faff, Navissi (2011) conducted the study on corporate donations by analyzing chinese equity market after the Wenchuan earthquake in 2008 and found that the companies that directly donated products and services to the consumer earned higher stock returns. The associated cause of the abnormal returns were the marketing effect of corporate donations that lead to enhanced brand image and awareness. Similarly Chiu and Sharfman (2009) explained that the firms with greater visibility seek greater legitimacy from various stakeholders such as communities. Such firms use corporate philanthropy as a tool to invest in social causes to meet the expectations of communities in which they exist. The firms that spend more on advertising tend to be more generous in corporate giving. So it can be argued that the advertising intensity will influence the relationship between slack resources and corporate philanthropy in a way that companies that are more willing to spend on the advertisement will tend to direct more slack resources towards corporate philanthropy and vice versa.

- H1: There is positive relationship between slack resource and corporate philanthropy.*
- H2: The advertising intensity moderates the relationship between slack resources and corporate philanthropy.*
- H3: The past financial performance moderates the relationship between slack resources and corporate philanthropy.*

Figure 1:



Source: Author's Proposed Theoretical Framework

3. Methodology

3.1. Data and Sample

The data for the study was secondary in nature and was collected from the annual reports of the textile companies listed at Pakistani Stock Exchange (PSE) and from the annual financial analysis of non-financial sector conducted by the State Bank of Pakistan (SBP). There are 154 textile companies listed at PSE under three different categories i.e. textile composite, textile spinning and textile weaving. The 80 companies were included in the final sample. Other companies were dropped from the analysis for two reasons: first because of unavailability of financial information or incomplete financial information and second because the non-engagement of companies in corporate philanthropy.

The time period for the analysis of data was six years from 2009 till 2014. The nature of data was panel because the data was the combination of both cross-sectional and time series as each textile company was analyzed for six years.

3.2. Measurement

Following measurements are used for the variables of the study.

3.2.1 Corporate Philanthropy: Corporate philanthropy was measured using the total amount of annual donations reported in the annual reports of the companies.

3.2.2 Slack Resources: Cash flow ratio (current assets divided by current liabilities) is used to measure the available slack resources for the companies (Wang, Choi & Li, 2008).

3.2.3 Advertising Intensity: The advertising intensity was measured using the ratio of selling, general and administrative expenses to sales (Wang & Qian, 2011).

3.2.4 Past Financial Performance: The past financial performance was measured by using the return on assets (ROA) lagged by one year.

3.2.5 Control Variables: There are two control variables used in the study size and debt to equity ratio. Size of the company is measured using the natural log of company's total assets (sum of current and non-current assets). To measure the financial leverage of the company debt to equity ratio and is measured by dividing the total liabilities by shareholder's equity.

3.3. Econometric Model:

Following models are developed for the current study:

$$CP = \beta_0 + \beta_1 TA + \beta_2 D/E + \beta_3 SR + \varepsilon$$

$$CP = \beta_0 + \beta_1 TA + \beta_2 D/E + \beta_3 SR + \beta_4 AI + \beta_5 AI * SR + \varepsilon$$

$$CP = \beta_0 + \beta_1 TA_{it} + \beta_2 D/E_{it} + \beta_3 SR_{it} + \beta_4 ROA_{it-1} + \beta_5 SR_{it} * ROA_{it-1} + \varepsilon$$

Whereas:

i represents cross section

t represents time series

CP is dependent variable corporate philanthropy and SR is independent variable slack resources. Total assets (TA) and debt to equity ratio (D/E) are control variables. The moderating variables in equation are advertising intensity represented by IA and return on assets is represented by ROA_{it-1} . To test the moderation hypothesis interaction term is created by multiplying independent variable slack resources (SR) with both moderators advertising intensity ($AI * SR$) and past financial performance ($SR_{it} * ROA_{it-1}$).

3.3. Estimation Method

The balance panel data was used for the current study because the data consisted of both cross section and time series as each textile company was analyzed for the time period of six years that constituted the balance panel data. Hussmann test was used to choose the appropriate estimation method. For all three econometric models the value of Hussmann test was insignificant that shows that the random effects model is the appropriate estimation method to test the three models.

4. Results

Following section show the empirical results of the study:

Table 1: The Random Effects Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.423798	0.323214	13.68690	0.0000
TA	1.80E-08	2.57E-08	0.700285	0.4842
D/E Ratio	0.002379	0.005077	0.468625	0.6396
Slack	0.858269	0.235120	3.650343	0.0003

Source: Author's calculations based on the data reported in the annual reports of the companies

The results in table 1 show that the coefficient of slack resources is positive and moreover significant ($\beta = 0.85$, $p < .05$) which shows that slack resources are significant predictor of corporate philanthropy leading to the acceptance of hypothesis 1. The R square value is .61 indicating that independent variables cause 61% variance in corporate philanthropy with $F = 7.62$ $p < .05$.

Table 2: The Random Effects Model with Advertising Intensity as Moderator

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.446496	0.343608	12.94059	0.0000
TA	1.73E-08	2.58E-08	0.668259	0.5044
D/E Ratio	0.001900	0.005643	0.336659	0.7366
Slack	0.834703	0.264467	3.156168	0.0017
AI	0.008719	1.463946	0.005956	0.9953
Slack*IA	0.195362	1.539891	0.126867	0.8991

Source: Author's calculations based on the data reported in the annual reports of the companies

The results in Table 2 show that advertising intensity doesn't moderate the relationship between slack resources and corporate philanthropy as the coefficient of interaction term between slack resources and advertising intensity is insignificant ($\beta = 0.19$, $p > .05$) which means the hypothesis 2 of the study is rejected. Moreover the advertising intensity alone has insignificant effect on the corporate philanthropy ($\beta = 0.08$, $p > .05$). After the inclusion of moderator and interaction term the R square value is .61 indicating that independent variables cause 61% variance in corporate philanthropy with $F = 7.40$ $p < .05$.

Table 3: The Random Effects Model with Past Financial Performance as Moderator

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.631911	0.321072	14.42641	0.0000
TA	1.12E-08	2.52E-08	0.444142	0.6572
D/E Ratio	0.002663	0.004973	0.535548	0.5926
Slack	0.572237	0.240809	2.376311	0.0180
Past FP	0.048123	0.011048	4.355909	0.0000
Slack*Past FP	-0.000813	0.001140	-0.713234	0.4761

Source: Author's calculations based on the data reported in the annual reports of the companies

The results in table 3 show that the past financial performance does not moderate the relationship between slack resources and corporate philanthropy as the coefficient of interaction term between slack resources and past financial performance is insignificant ($\beta = -.0008$, $p > .05$) leading to the rejection of hypothesis 3. However the past financial performance has positive value of coefficient showing that it has significant positive effect on the corporate philanthropy ($\beta = 0.04$, $p < .05$) better the corporate financial performance more will be the corporate donations. After the inclusion of moderator and interaction term the R square value is .63 indicating that independent variables cause 63% variance in corporate philanthropy with $F = 7.99$ $p < .05$.

5. Discussion and Conclusion

The study confirms significant positive relationship between organizational slack and corporate philanthropy however advertising intensity and past financial performance doesn't moderate the relationship between slack resources and corporate philanthropy. The results are consistent with the findings of previous studies that companies having greater availability of slack resources donate more (Seifert et al., 2003, Waddock and Graves, 1997) and the amount of corporate donations fall and rise with the amount of available discretionary resources. The failure of the study to find significant moderation effect of advertising intensity support the view that companies with high visibility and operating in advertisement intensive industry tend to donate more. The sample of the

study consisted of textile companies that are not having intense advertisement needs as the customers of these companies are not general public but the foreign buyers who place export orders. It can be concluded that for these companies advertisement expenditure will not affect the company's decision of allocating slack resources to corporate philanthropy. Similarly past financial performance don't moderate the relationship between slack resources and corporate philanthropy although the past financial performance has a significant positive relationship with corporate philanthropy. These findings suggest that sound financial performance increase the corporate donations but doesn't affect the company's decision to direct available resources to corporate donations.

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