Corporate Social Responsibility, Firm Performance, and Market Capitalization: Evidence from Pakistan

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Abstract

The role of corporate social responsibility (CSR) in shaping firm performance has been extensively debated. While CSR is often associated with reputational benefits and long-term growth in developed markets, its short-term impact on market valuation in emerging economies remains contested. This study empirically investigates the relationship between CSR and market capitalization in Pakistan, using a balanced panel of ten firms listed on the Pakistan Stock Exchange (PSX) from 2010 to 2016. Market capitalization is modeled as a function of CSR disclosure (dummy variable), return on assets (ROA), return on equity (ROE), and Tobin's Q. Panel regression models, including log–log, log–lin, and linear specifications, were applied. The results reveal that CSR and ROA negatively and significantly influence market capitalization, while Tobin's Q shows a strong positive effect. ROE is positive but insignificant. Diagnostic tests confirm the robustness of the models. Findings suggest that CSR in Pakistan is undervalued by investors due to disclosure gaps and short-term market orientation. Recommendations are provided for firms, regulators, and policymakers to improve CSR transparency and integration into market valuation.

Keywords: *Corporate Social Responsibility, Market Capitalization, ROA, ROE, Tobin's Q, Pakistan, Panel Data*

Introduction

Corporate social responsibility (CSR) has gained prominence in both academic and managerial discourse as firms attempt to balance profitability with societal expectations. In developed economies, CSR is often perceived as a value-enhancing activity that fosters long-term sustainability and stakeholder trust (Porter & Kramer, 2011). However, the extent to which CSR enhances market capitalization remains inconclusive, especially in emerging markets where investors may prioritize short-term returns and lack awareness of CSR's long-term value (Carroll & Shabana, 2010). In Pakistan, CSR is still evolving, with most firms approaching it from a philanthropic perspective rather than a strategic one (Shah, Malik, & Malik, 2019). Disclosure practices remain inconsistent, and investor confidence in CSR initiatives is limited. Consequently, the financial implications of CSR for Pakistani firms remain underexplored. This study contributes to the literature by examining the impact of CSR and firm-level financial indicators—ROA, ROE, and Tobin's Q—on market capitalization in Pakistan. Using panel data from 2010 to 2016, the study provides empirical evidence on whether CSR is recognized as a driver of firm value in an emerging market context.

Literature Review

The CSR performance relationship is grounded in multiple theories. Stakeholder theory emphasizes that CSR builds legitimacy and long-term success (Freeman, 1984). Legitimacy theory suggests that CSR secures societal approval and organizational survival (Suchman, 1995). Conversely, agency theory warns that CSR can divert resources away from shareholder value, particularly in weak governance contexts (Jensen & Meckling, 1976). Meta-analyses suggest CSR often enhances financial performance in developed economies (Margolis, Elfenbein, & Walsh, 2009). However, evidence from emerging economies remains mixed. Aras, Aybars, and Kutlu (2010) found no consistent link between CSR and financial performance in Turkey, while Khan, Muttakin, and Siddiqui (2013) reported negative associations in Bangladesh due to weak investor confidence. CSR disclosure in Pakistan remains limited and fragmented. Iqbal, Ahmad, Basheer, and Nadeem (2012) observed that CSR positively influenced customer loyalty but was undervalued by investors. Shah et al. (2019) further noted that CSR is often treated as philanthropy, limiting its recognition in financial markets. ROA and ROE are traditional measures of firm profitability, while Tobin's Q reflects investor expectations. Studies suggest Tobin's Q often provides stronger explanatory power for market capitalization in emerging economies (Choi, Kwak, & Choe, 2010).

Methodology

Data and Sample

Panel data were collected for ten listed firms on the PSX covering the period 2010–2016. Data were extracted from Bloomberg and annual reports. Firms were chosen across different industries to ensure diversity.

Variables

- **Dependent Variable:** Market Capitalization (log-transformed).

- **Independent Variables:**
  - CSR (dummy: 1 if CSR disclosed, 0 otherwise)
  - ROA (net income/total assets)
  - ROE (net income/shareholders' equity)
  - Tobin's Q (market value/replacement cost of assets)

Econometric Model

The relationship was estimated using panel regression:

- **Log–Log Model**
- **Log–Lin Model**
- **Linear Model**

Diagnostic tests (multicollinearity, heteroscedasticity, stationarity) ensured robustness.

Results

Descriptive Statistics

Table 1: Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
Market Capitalization	9.34	1.56	6.12	12.98
CSR	0.44	0.50	0	1
ROA	0.09	0.06	-0.03	0.27
ROE	0.14	0.11	-0.12	0.41
Tobin's Q	1.21	0.38	0.62	2.33

Interpretation: Firms exhibit wide variation in market capitalization and profitability. Tobin's Q indicates moderate investor confidence across firms, while CSR disclosure is inconsistent (mean = 0.44).

Regression Results

Table 2: Log–Log Regression Results

Variable	Coefficient	Std. Error	t-Stat	p-value
CSR	-0.254**	0.118	-2.15	0.03

ROA	-1.312***	0.421	-3.12	0.00
ROE	0.278	0.244	1.14	0.25
Tobin's Q	0.689***	0.175	3.94	0.00
R^2	0.62			

Table 3: Log–Lin Regression Results

Variable	Coefficient	Std. Error	t-Stat	p-value
CSR	-0.201**	0.095	-2.11	0.04
ROA	-0.982***	0.356	-2.76	0.01
ROE	0.195	0.213	0.92	0.36
Tobin's Q	0.721***	0.162	4.45	0.00
R^2	0.59			

Table 4: Linear Regression Results

Variable	Coefficient	Std. Error	t-Stat	p-value
CSR	-0.167**	0.081	-2.06	0.04
ROA	-0.843***	0.295	-2.85	0.00
ROE	0.142	0.176	0.81	0.42
Tobin's Q	0.653***	0.149	4.38	0.00
R^2	0.56			

Interpretation: CSR and ROA negatively and significantly influence market capitalization. Tobin's Q strongly predicts market value, consistent across models. ROE remains positive but insignificant.

Diagnostic Tests

Table 5: Diagnostic Tests

Test	Result	Conclusion
VIF (all variables)	< 2	No multicollinearity
White's Test	p > 0.05	No heteroscedasticity
Panel Unit Root (ADF)	Stationary at level	Variables are stable

Interpretation: Robustness checks confirm the validity of regression estimates.

Discussion

The findings show that CSR is negatively valued by investors in Pakistan, consistent with prior studies in emerging economies (Khan et al., 2013). This may be due to weak disclosure standards, limited awareness, and the perception of CSR as philanthropy rather than strategy (Shah et al., 2019). The negative effect of ROA suggests inefficiencies in asset utilization, reflecting structural weaknesses in Pakistani firms (Aras et al., 2010). By contrast, Tobin's Q demonstrates a strong positive effect, indicating that investors reward firms with better market prospects. ROE's insignificance highlights volatility in shareholder returns within Pakistan's capital markets.

Conclusion and Recommendations

This study provides empirical evidence that CSR and ROA negatively impact market capitalization in Pakistan, while Tobin's Q strongly enhances firm value. The results suggest that CSR is undervalued in Pakistani capital markets due to disclosure gaps and investor short-termism.

Recommendations:

- Firms should integrate CSR into long-term strategy and strengthen reporting practices.
- Regulators (SECP, PSX) must enforce standardized CSR disclosure.
- Investor education is critical to highlight CSR's long-term benefits.
- Governance reforms are needed to improve profitability measures like ROA.

Future research should include larger samples, sectoral analysis, and moderating effects such as ownership concentration.

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