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Evaluating the Impact of Corporate Social Responsibility, Financial Distress, and Firm Performance in an Emerging Market

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ABSTRACT

The study explores the impact of Corporate Social Responsibility (CSR), Financial Distress (FD), and the Firm Performance (FP) in Pakistani, listed, non-financial corporations. This study uses data from year 2006 to 2023, collected from annual reports. To ensure a robust analysis, study undertakes Generalized Method of Moments (GMM), Fixed Effect (FE) and Random Effects (RE) techniques. The findings imply that resource allocation for CSR not only achieves social duty but also maximizes value of shareholder value by enhancing FP. Alternatively, results show a significant and negative effect of FD on ROA. Which indicates that those corporations that are undergoing FD may face a downfall in their profits, reviling negative consequences of financial challenges. The study will help to investors, managers, and policymakers on how CSR boost the profitability of these corporations and uncovers the adverse effects of FD. The study also serves as a guide for policymakers and investors, informing them of the implications of FD on FP.

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1. Introduction

Corporate social responsibility (CSR) has evolved over time, from early charitable and philanthropic activities to a more comprehensive framework that now encompasses environmental, social, and ethical considerations in corporate strategies (Dzage & Szabados, 2024). Howard Bowen's 1953 book "*Social Responsibilities of the Businessman*" served as the catalyst for the contemporary notion of CSR. In the book, Bowen made a groundbreaking argument: he stated that organizational leaders are morally bound to act and make consistent decisions that are not only aligned with organizational goals of maximizing profits but also with society's goals and values. Corporate philanthropy and employee volunteer initiatives are just two examples of the many diverse ways CSR can manifest. CSR initiatives can directly influence a business's environmental strategy, sourcing (i.e., upstream supply chain management), goal-setting (using performance metrics, for example), and operational decision-making (Aguinis, Rupp, & Glavas, 2024). CSR has not received considerable attention in developing nations until recent times, when debates began exploring and linking it with multifaceted advantages, ranging from social impacts to profit maximization for companies themselves (Jamali, 2007). CSR is one method by which businesses participate in initiatives intended to benefit stakeholders and improve their interactions with them (Dzage & Szabados, 2024). CSR refers to an organization's ethical behavior and transparency in its attempt to make responsible decisions. Institutional, financial, and moral factors are essential for CSR (Li et al., 2024).

There have been many studies on the link of CSR and FP (Anderson, Hyun, & Warsame, 2024; Khan, Ali Malik, & Saghir, 2020; Li, Esfahbodi, & Zhang, 2024). There have been intense debates on the link of CSR and FP over time, as literature reports both pros and cons of CSR in relation to FP (Margolis, Elfenbein, & Walsh, 2009). If significant investment in CSR does not generate economic returns for a company, it may be considered an inefficient allocation of resources (Wang, O, & Claiborne, 2008). The discussion of the CSR-FP link still needs widespread attention (Khan, Ali Malik, & Saghir, 2020; Leal-Millán, Leal-Rodríguez, & Albort-Morant, 2017). CSR is a waste of resources (Becchetti, Ciciretti, & Hasan, 2015; Preston & O'Bannon, 1997). Moreover, through CSR initiatives, managers gain personal benefits (Barnea & Rubin, 2010). Some researchers believe that investing in CSR may increase a company's goodwill (Cheung et al., 2013; Wang & Berens, 2015). Companies are always searching for methods to increase their profitability, and CSR serves as a tool to help achieve this objective by improving the company's image (Jizi, Nehme, & Melhem, 2022). Choi and Yu (2014) show a significant link of CSR and FP. Several studies have also reported an insignificant association of CSR-FP (Soana, 2011; Surroca, Tribó, & Waddock, 2010). Stakeholder theory (Freeman, 2010) posits that social consumption help improve stakeholder relations and ultimately increase FP (Barnea & Rubin, 2010). Similarly, signaling theory states that involvement in CSR helps improve reputation and enhance competitiveness (Connelly et al., 2011) and also helps increase FP (Uyar, Karaman, & Kilic, 2020). When a business fulfills its social obligations, it could incur agency costs. As a result, the emphasis on CSR could negatively impact FP (Nguyen, Agbola, & Choi, 2019).

Several studies finds a positive and significant link of CSR-FP (Waddock & Graves, 1997). The global link of CSR-CFP is filled with confusion and disagreement (Scholtens, 2008). Companies must allocate their scarce resources to socially responsible activities to increase corporate performance (Duque-Grisales & Aguilera-Caracuel, 2021). CSR may help firms enhance their social reputation (Villamor & Wallace, 2024), build better relations with investors, and, eventually, improve their FP (Ghanbarpour et al., 2024). Responsible managers understand the value of CSR and leverage it. CSR also helps managers resolve conflicts among stakeholders and maximize shareholder interests (Harjoto & Jo, 2011). The problem of FD has provoked significant discussion, particularly in relation to CSR initiatives. When a firm is in financial crisis, its primary focus is usually to ameliorate the situation and protect the interests of its shareholders, rather than prioritizing social advantages (Aguilera et al., 2007). If FD is not addressed promptly, investors may lose confidence in the firm and show less interest in making investments, which could lead to further financial issues for the company (Stepani & Nugroho, 2023). Three financial situations, low or stagnant sales growth, excessive interest costs, and insufficient capital can lead to a firm going bankrupt. Thus, the interdependence of these three factors is essential to reducing the likelihood that the business will encounter financial difficulties (Nurcahyono et al., 2023). Literature on FD indicates that experienced managers help companies avoid FD, and low-risk companies tend to perform better than high-risk companies (Alqahtani & Mayes, 2018). The CSR-FP link remains a topic of debate (Cui, Liang, & Lu, 2015; Sardana et al., 2020). Especially in developing economies (Pereira, 2017). Further elucidation of this link is required in developed regions of the world (Cui, Liang, & Lu, 2015; Han, Mittal, & Zhang, 2017). Numerous studies examine the linkage of CSR and CFP; however, the findings are inconsistent (Tsatsaronis et al., 2024; Wu et al., 2020). In recent decades, extensive studies has found contradictory, weak, or even negative associations (Hakimi, Boussaada, & Karmani, 2025; Lu et al., 2014).

1.1. Problem Statement

The link of CSR and FP has been a focus of much academic discussion, especially in developed nations. Findings remain unclear, making it an area of interest for more investigation (Frynas & Stephens, 2015). There are only a few articles of research in the literature concentrating on this relationship within less developed economies (Blasi, Caporin, & Fontini, 2018; Khan et al., 2021). Persistent contention with regard to this relationship is what motivates scholars to keep arguing over it (Hakimi, Boussaada, & Karmani, 2025; Xie et al., 2017). Literature shows that only 10% of studies are coming from developing countries on CSR-FP link (Pisani et al., 2017). The attention on this link from developing countries is high on some other important issues (Idemudia, 2011; John et al., 2019). Studies reported positive, negative and neutral results on the link of CSR-FP (Orlitzky, 2013; Turban & Greening, 1997; Waddock & Graves, 1997). The consensus on this relationship is yet awaited (Aftab et al., 2024). Which opens up the avenue of research for future to explore this link (Hakimi, Boussaada, & Karmani, 2025; Xie et al., 2017). Research in the area of CSR and FD comprise major avenues of study; yet, these constructs are generally investigated in isolation, needing more exploration within an integrated analytical framework to fully comprehend their linked dynamics (Deegan, 2002). Firms effectively use CSR as a strategic risk management strategy, thereby improving their reputational integrity. This proactive application of CSR serves as a shield against varied risks, including political, regulatory, and societal consequences, strengthening organizational resilience and navigational efficacy in the face of multidimensional problems (Godfrey, 2005; Minor & Morgan, 2011). Drawing from the aforementioned empirical evidence, discourse, and identified research gaps, it is clear that there exists a compelling imperative to examine the interplay of CSR, FP, and FD within the realm of Pakistani listed companies.

2. Literature Review

The studies on the link of CSR-FP are inconclusive (Li, Esfahbodi, & Zhang, 2024; Scholtens, 2008). The studies show mixed findings regarding this link (Waddock & Graves, 1997). Companies must allocate their scarce resources to CSR activities (Duque-Grisales & Aguilera-Caracuel, 2021). As reported by Licandro et al. (2024), there is an association of CSR-FP, implying that there is a mediated link of this link and stakeholder satisfaction levels. In instances of stakeholder disputes, managers effectively use CSR strategies to resolve conflicts amicably and optimize shareholder interests, thereby highlighting the advantageous role of CSR in enhancing FP (Harjoto & Jo, 2011). Both developed and emerging countries currently doing CSR. The link of CSR-FP continues to provoke debate and lacks definitive conclusions, with ongoing research producing inconclusive findings (Blasi, Caporin, & Fontini, 2018; Khan et al., 2021). Malik and Nadeem (2014) highlighted that there is limited research on CSR and FP in Pakistan. Consequently, the link of CSR and FP is an area that warrants further investigation. Ahamed, Almsafir and Al-Smadi (2014) argued that CSR has gained significant attention from researchers in emerging countries. Some major shareholders and internal managers of the company may engage in CSR primarily for their personal benefits and reputation (Barnea & Rubin, 2010). A significant body of scholarly research supports a positive link of CSR and FP, although findings remain inconclusive (Hakimi, Boussaada, & Karmani, 2025; He et al., 2020; Kakakhel et al., 2015; Kiran, Kakakhel, & Shaheen, 2015; Long et al., 2020; Szegedi, Khan, & Lentner, 2020; Wu et al., 2020). High leverage often leads firms to incur agency costs, prompting managers to make high-risk decisions (Jensen & Meckling, 1976).

Iqbal, Ahmad and Kanwal (2013) reported that CSR practices are at a low standard in Pakistan. Olaniyan, Efuntade and Efuntade (2021) concluded that CSR and FP are significantly related. Babajee et al. (2021) reported that CSR is a key to increase organizational efficiency. Kurt et al. (2021) reported that implementation of CSR can help to gain confidence of investor, and trust of stakeholders, as well as to promote economic development. Al-Hadi et al. (2019) argued that CSR and FD both are explored in isolation. Zheng, Wang and Jiang (2019) looked at the benefits of engagement in CSR activities, study also explored CSR engagement and its impact on FD. Results show that CSR reduces FD risks through strengthening stakeholder relations inside businesses, which adds to our knowledge of the stakeholder perspective on CSR through a longitudinal approach and company context analysis. Mangalagiri and Bhasa (2022) reported that market attitudes show that mandatory CSR expenditures do not receive adequate acknowledgment. Further, Setiawan et al. (2022) show that involvement in CSR initiatives clearly improves performance, with firms that priorities such activities continuously. This highlights the importance of CSR programs in promoting both societal benefits and concrete business outcomes. Based on the literature covered above, these are the hypotheses:

H1: CSR is positively related to financial performance (ROA).
H2: FD is negatively related to financial performance (ROA).

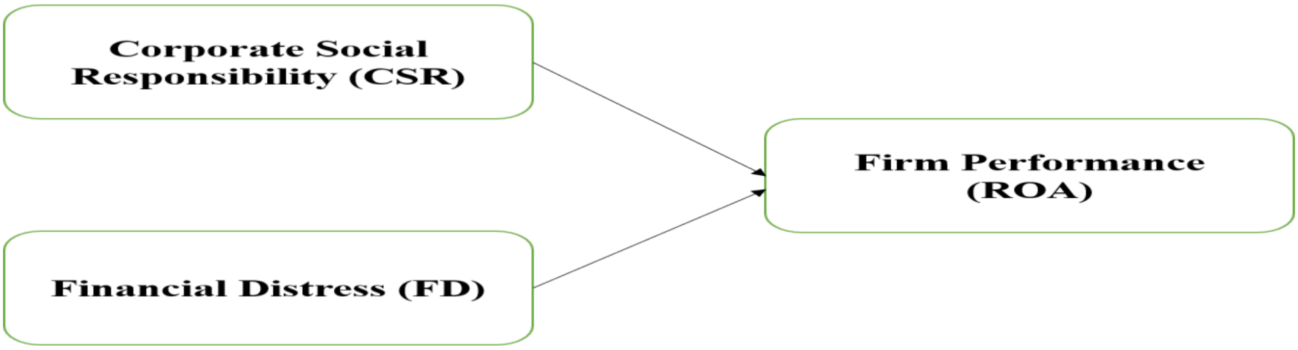
3. Research Methodology

The study's population comprises all PSX-listed companies. The sample includes non-financial sector listed companies; the financial sector is excluded due to distinct financial disparities. The data for the research is derived from company annual reports and balance sheet analysis (BSA). The study employs the fixed effect, random effect, and GMM techniques. This study uses the GMM technique as it has many advantages over traditional methods. This technique can handle issues of endogeneity with instrumental variables in the study and reduces bias that results from the of error term and explanatory variables (Wooldridge, 2010). For consistent estimation and more accurate results of panel data, the GMM technique is specifically suitable as it can handle unobserved heterogeneity along with dynamic endogeneity (Arellano & Bond, 1991).

3.1. Framework of the Study

Figure 1 depicts the framework for this study. The model illustrates the linkages of CSR, FD, and ROA.

Figure 1: Framework of the Study



3.2. Econometric Model

The equation-1 given below presents the model of the study:

$$ROAi,t = \beta 0 + \beta 1CSRi,t + \beta 2FDi,t + \beta 3SIZEi,t + \beta 4AGEi,t + \beta 5LEVi,t + \varepsilon i,t \quad (1)$$

3.3. Operationalization of Variables

This section delineates the variables and proxies employed within the study framework. The dependent variable is FP, measured through ROA. The independent variables encompass CSR, quantified by the monetary spending ratio, and FD, evaluated using the Altman Z Score model. The study also incorporates control variables such as firm size, age, and leverage to mitigate potential confounding factors. Table 1 displays a list of variables, proxies and respective measurements.

Table 1: Measurement of Variables

Variables Name	Definition/Measurement	Reference
Corporate Social Responsibility (CSR)	"CSR monetary spending ratio = total CSR expenditures ÷ earnings after-tax"	Ehsan et al. (2018)
Financial Distress (FD)	"(1.2*working capital /total assets+1.4*Retained earnings/total assets +3.3*earnings before interest and taxes /total assets+0.6*Market value of equity /book value of total liabilities +0.99*sales /Total assets)"	(Altman, 1968)
Firm Performance (ROA)	Net Income ÷ Total Assets	M Shoukat Malik and Nadeem (2014)
Size	Log of TA	Yang and Baasandorj (2017)
Age	Age of firm (In years)	
Leverage	TL÷TA	

4. Results and Discussions

This section outlines the results of descriptive, correlation and regression analysis.

4.1. Descriptive Statistics

As seen in Table 2, the descriptive statistics give an overview of every variable in the data set, which enables to identify the existing differences. This helps to see the level of dispersion in the data, and understand the salient features of the data.

Table 2: Descriptive Statistics

	Mean	Median	Max	Min	Std. Dev.
CSR	0.013	0.004	0.528	-0.378	0.051
FD	0.327	0.000	1.000	0.000	0.469
ROA	0.049	0.043	0.513	-0.866	0.098
SIZE	15.552	15.373	20.256	10.893	1.517
AGE	3.482	3.496	5.056	0.693	0.525
LEV	0.164	0.138	0.709	0.000	0.136

4.2. Correlation Matrix

Table 3 shows the correlation matrix for all the variables we looked at in this study. It highlights how these variables relate to one another, with relationships ranging from positive to negative or even no association at all. Our analysis indicates that there aren't any multicollinearity issues among the variables we studied. The correlation values fall within acceptable limits, confirming that the data is free from multicollinearity problems.

Table 3: Correlation Matrix

	CSR	FD	ROA	SIZE	AGE	LEV
CSR	1					
FD	-0.084	1				
ROA	0.041	-0.529	1			
SIZE	-0.047	-0.044	0.180	1		
AGE	-0.010	-0.146	0.023	0.107	1	
LEV	-0.013	0.469	-0.327	0.071	-0.190	1

4.3. Regression Analysis

In Table 4, you can see the results regarding how CSR and FD influence FP. We looked at the data through a few different models, including Fixed Effect, Random Effect, and GMM. The Fixed Effect model shows a positive link of CSR and ROA, which suggests that investing in CSR could be beneficial for FP. This is in line with what earlier studies have found (Khan, Ali Malik, & Saghir, 2020; Kiran, Kakakhel, & Shaheen, 2015; Szegedi, Khan, & Lentner, 2020). On the other side, the effect of FD on ROA is significant but negative, meaning that companies facing FD usually report lower ROA. The Random Effect model indicates there's a positive link of CSR and ROA. This means that companies can enhance their performance—as reflected by ROA—by investing wisely in CSR efforts. Conversely, when it comes to FD and its impact on ROA, the relationship is significant but negative, suggesting that businesses facing financial troubles usually see lower ROA. The GMM analysis revealed a clear positive link of CSR and ROA, suggesting that putting money into CSR initiatives can actually boost a FP as reflected in ROA. On the other side, the study also found that FD negatively affects ROA, indicating that companies facing financial issues might see a drop in their ROA. Generally, as a business grows, its ROA tends to improve. There's a clear link of a company's age and its ROA. That said, if a company relies heavily on debt to run its operations, it can negatively impact its financial health, which ultimately leads to a drop in ROA and lower returns overall.

Table 4: Regression Results

	Fixed Effect Model			Random Effect Model			GMM Model		
	Return on Assets			*Return on Assets*			*Return on Assets*		
Variables	*Coef*	*t-stat*	*Prob*	*Coef*	*t-stat*	*Prob*	*Coef*	*t-stat*	*Prob*
CSR	0.085	3.769	0.000	0.012	5.645	0.000	0.008	4.666	0.000
FD	-0.070	-9.697	0.000	-0.079	-13.433	0.000	-0.070	-14.782	0.000
Size	0.006	0.831	0.405	0.012	2.939	0.003	0.003	1.496	0.135
Age	0.015	2.164	0.030	-0.016	-2.647	0.008	-0.007	-1.938	0.053
Lev	-0.080	-2.399	0.016	-0.091	-3.610	0.000	-0.204	-8.775	0.000
Adj R^2	0.563			0.0201			0.160		
J-Stat							2.126		
J-Stat (P)							0.145		
F-Stat	10.738			100.40					
F-Stat (P)	0.000			0.000					

5. Conclusion

The link of CSR, FD, and FP is really important in fields like finance, economics, accounting, and management. While a lot of studies have looked into how CSR connects with

FP, not much has been said about how FD relates to FP, especially in developing countries. This research aims to fill that gap by examining the effects of CSR and FD on FP. It uses data from non-financial companies listed on the PSX from 2006 to 2023 and employs various statistical methods, including fixed effect, random effect, and GMM. The GMM analysis revealed a strong and positive link of CSR and ROA, which means that investing in CSR could actually boost FP, as shown by ROA (Naseem et al., 2020; Szegedi, Khan, & Lentner, 2020). On the other side, the impact of FD on ROA was statistically significant and negative, indicating that companies with financial difficulties tend to see their ROA decline (Al-Hadi et al., 2019). These findings have serious implications for regulators, stakeholders, and corporate managers. The study emphasizes the need for regulatory reforms that encourage CSR practices in Pakistan and other emerging economies, pointing out the positive effects of expanding CSR initiatives on knowledge transparency in capital markets. The evidence suggests that engaging in CSR should be viewed as a strategic move that could help lower financing costs for businesses by enhancing their information environment. Future studies should consider including more developing countries to make the results more generalizable. The research sample is confined to one country. For more diverse and globally relevant results, future research should involve additional developing countries.

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