CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL PERFORMANCE: A STUDY OF THE TOURISM INDUSTRY IN SRI LANKA

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Abstract

Sri Lanka is under a myth that the fall of tourism is due to the Easter Sunday attack in 2019 followed by the COVID-19 pandemic in 2020. In contrast, this study argues the fall started even before those shocks incorporating corporate social responsibility (CSR) and financial performance (FP) in the tourism industry. A stratified random sample of 10 hotels was selected, and their annual reports were utilized in gathering data. An abductive approach was employed where content analysis was carried out to find out the CSR words, then thematic analysis was conducted to grasp the important themes of CSR, and then the Nila unit method was adopted in converting the themes to measurable CSR. After converting CSR measurable, the study continued with descriptive and correlation analysis. The study found a slight but incremental behaviour in CSR disclosure yet a significant slump in FP of hotels. The study is significant since it argues that the present economic crisis is not due to the Easter Sunday attack and COVID-19 pandemic, but it emerged even before the said shocks.

Keywords: Corporate Social Responsibility, Financial Performance, Tourism Industry, Nila Units, Sri Lanka

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1. INTRODUCTION

The tourism industry is a critical contributor to economic growth, and its activities are of high interest to the public. A clear link between the two (corporate social responsibility (CSR) and financial performance (FP)) would be of immense importance to decision-makers as social issues could lead to financial losses (Abeysinghe & Basnayake, 2015). CSR allows organizations to counteract the pressures from society to create a sustainable future and allows companies to enhance brand

image and reputation, consumer attraction, increase organizational commitment as well as create a satisfied community (Madurasinghe & Jahfer, 2016). CSR is a source of competitive advantage, that helps companies to compete with rivals while supporting human well-being (Inoue & Lee, 2011). Studies conducted to investigate the relationship between CSR and FP in different industries have shown positive, negative, and even neutral relationships between CSR disclosure and FP. However, studies focusing on CSR disclosure and FP of the tourism industry in Sri Lanka are hard to see.

Since the empirical investigations and findings are rare in the domain of CSR and FP in the tourism industry in Sri Lanka it had led to a myth, i.e., the economic crisis that prevails at present in Sri Lanka is due to the Easter Sunday attack and COVID-19 pandemic. As all know Sri Lanka declared bankruptcy in 2022. Most of the political actors in the Sri Lankan government interpreted the situation arose due to the Easter Sunday attack and the COVID-19 pandemic. Sri Lanka indeed lost tourists and income from tourism after 2018 (Nagendrakumar et al., 2021; Nagendrakumar et al., 2020). But the present study argues that the fall in the tourism industry originated well before those shocks. This study concentrates on that aspect and explores how FP behaves to CSR in the hotel sector of the tourism industry which has shown an upsurge after the end of the civil war in 2009 but a fall in FP in the hotel industry.

Madanaguli, Srivastava, Ferraris, and Dhir (2022) argue that CSR and tourism and their connection to research are well established and trending. Further, Okafor, Adeleye, and Adusei (2021) argues that investing in CSR activities would lead to the long-term growth of organizations. Besides, Wut, Xu, and Wong (2022) argues that academics concentrate on less explored contexts and topics and new analytical methods. Hence, the researchers were motivated to look at the performance of the hotel industry before 2018 in respect of CSR and FP and answer the myth. The researchers believe that the myth mentioned is one of the unanswered gaps in Sri Lanka and employs multi-method (content analysis, thematic analysis, Nila unit, descriptive analysis, and correlation analysis) in elevating the phenomenon under investigation.

The rest of the paper is organized as follows: Section 2 discusses the literature, Section 3 explains the method adopted, Section 4 discusses the findings, and then Section 5 presents the conclusion.

2. LITERATURE REVIEW

The literature reviews are organized in four different areas *viz.,* corporate social responsibility and financial performance, corporate social responsibility disclosure in Sri Lanka, measuring corporate social responsibility, and measuring financial performance.

Many studies on CSR and FP had been conducted around the globe. All of them have arrived at different conclusions as to the sort of relationship that exists between CSR and FP. This ambiguity might be due to methodological artefacts and also because of the unavailability of a proper

theoretical foundation (Theodoulidis, Diaz, Crotto, & Rancati, 2017).

Gaio and Henriques (2020) argue that companies pursuing CSR policies financially outperform their peers, and these results are supported even during the financial crisis period. With a few exceptions, Moneva, Bonilla-Priego, and Ortas (2020) disclose a neutral impact of corporate environmental, social, and governance performance on firms' financial success. A study in Libya concluded that a positive relationship exists between CSR disclosure and a firm's performance in terms of FP and company reputation (Bayoud, Kavanagh, & Slaughter, 2012). They further investigated the link between CSR and employee commitment, but no significant relationship between the two was discovered. A study by Isanzu and Fengju (2016) concluded that there is a significant and favourable difference in FP of Tanzanian firms engaging in CSR than the ones that do not. A study in Croatia stated that, though no apparent relationship exists between the two some reports could reveal a low level of correlation between the two when tested thoroughly (Fabac, Calopa, & Sestanj-Peric, 2016). Moenna (2014) adopted both market-based and accounting-based measurements to study the relationship between two of the top fifty companies in the EU. Findings showed that, though there is a significant association between CSR and accounting-based FP, no such association is found between CSR and market-based FP. Another study in Bangladesh concluded that, though there is a significant impact from CSR on return on equity (ROE) and net profit, no such impact exists on indices such as EPS and return on assets (ROA) (Resmi, Begum, & Hassan, 2018). This study further argues that the impact of CSR on different FP indices such as ROA and ROE can differ even if they are related to the same measurement base. A study by Al-Malkawi and Javaid (2018) also employed these two measurement bases in their study and found that there is a positive relationship between CSR and FP of non-financial firms in the Saudi Arabia stock market.

A study by Inoue and Lee (2011) concludes that though CSR is having a positive effect on the overall FP of firms, individual dimensions have varying degrees of effects on FP. Sheham and Jahfer (2011) also support these findings by stating that while CSR dimensions such as employee and customer supply relations show a significant positive correlation with FP, no such relationship could be seen between the community and environment dimensions and financial indices.

Very few studies have been carried out in Sri Lanka on CSR and FP. They were also mainly focused on the banking sector and not much focus was given to the tourism industry, despite being a field studied well in other countries (Ghaderi, Mirzapour, Henderson, & Richardson, 2019; Inoue & Lee, 2011; Yoon & Chung, 2018).

According to Damayanthi and Rajapakse (2011), there is a growing trend in listed corporations reporting CSR activities. Studies have shown an increased competition among many Sri Lankan organizations to prove how they are performing in different aspects of CSR (Beddewela & Herzig, 2013). According to Damayanthi and Rajapakse (2011), there are two reasons for companies to disclose their CSR activities. One is to

increase the company's reputation and the second is to maintain competitiveness in the market. A study by Abeysekera (2008) argues that disclosure of human capital is done to reduce the pressure between organizations and their constituents as well as to increase capital accumulation.

A study by Wijesinghe (2012) argues that, though there is a positive increment in the trend of CSR disclosure, Sri Lanka's actual disclosure level of CSR activities is at a lower level compared to other countries. The researcher further states that disclosure of social, economic, and environmental variables is at an unacceptable level. According to Wijesinghe (2012), several reasons could underlie the low level of CSR disclosure in Sri Lanka such as focusing primarily on maximizing shareholder's wealth instead of focusing on stakeholders, measuring and disclosing CSR being a costly task, less pressure from authorities, and unavailability of proper guidance. Rajapaksha (as cited in Beddewela & Herzig, 2013), says that out of 238 companies listed on Colombo Stock Exchange (CSE), only 120 companies have disclosed CSR-related information, while only 85 have disclosed such CSR activities under a separate section.

Content analysis and the use of reputation indices are considered acceptable methods for the measurement of CSR (Cochran & Wood, 1984). Riff, Lacy, and Fico (2005) argue that content analysis is a codifying text method used to gather items from a written document for categorization. These data can be used for qualitative discussions, or the counting of derived items could provide data for quantitative research purposes (Nuzula & Kato, 2010) which is called the Nila unit. They further argue that subjectivity in selecting items is a disadvantage of content analysis. Though, a disadvantage exists, in literature, content analysis is a method commonly used by scholars in measuring CSR disclosure.

According to Unerman (2000), units of measurement, such as several documents, words, pages, sentences, and paragraphs, are used under the method of content analysis. As stated by Milne and Adler (1999), though individual words have no apparent meaning, unlike sentences, the use of words as a unit of measurement can lead to extra precision than sentences. According to Unerman (2000), when sentences are being used as the unit of measurement, the possibility arises of different writers stating the same meaning, using a similar amount of words and space leading researchers to use misleading data in their studies. Krippendorff (2004) denoted that the repetition of particular words could indicate the importance given by the writer on a particular subject. In this study, repetition of words could indicate the importance given by the selected firms on a particular CSR dimension. Word count can also aid in maintaining consistency and reliability, as the same keywords are applied to all documents (Nuzula & Kato, 2010). Biasness in interpreting sentences can be avoided by using word count as a means of measuring.

Different studies have adopted different indices for measuring CSR. According to the literature, the most commonly employed method of measuring CSR disclosure is the use of reputation indices such as MSCI KLD 400, Vigeo Index, and Dow Jones Sustainability Index (Galant & Cadez, 2017). In a study by Inoue and Lee (2011), the KLD rating system is used to measure CSR. KLD ratings are derived from the KLD social rating database, which provides a summary of a firm's corporate social performance across time (Ahmadi, 2014). The same article, referring to the works of Hillman and Keim (2001), states that a major limitation in KLD is the unavailability of measurement for activities relevant to suppliers. Cochran and Wood (1984), who were the first authors to study the relationship between CSR and FP, used the Moskowitz reputation index to measure CSR. This index consists of three categories being socially responsible, which include, 'best', 'honourable mention', and 'worst' reputation. López, Garcia, and Rodriguez (2007) adopted the Dow Jones Sustainability Index for measuring CSR. Dow Jones Sustainability Index uses the top 2500 firms listed on the Dow Jones Industrial Average to evaluate sustainable performance (Ahmadi, 2014).

The possibility of measuring CSR has allowed researchers to link measurement to FP of organizations. FP measuring methods can be divided into accounting-based measures and market-based measures (Inoue & Lee, 2011). This multidimensionality of FP can also be challenging. As indicated by McGuire, Sundgren, and Schneeweis (as cited in Inoue & Lee, 2011), the degree of linkage between the two can differ based on the FP dimension considered. It is because, these two measurement bases relate to different financial aspects of the organization (Ahmadi, 2014). Calculations of indices have allowed scholars to examine links between CSR and FP in different industries. Most scholars have used ROA, ROE, and return on sales (ROS) as financial indices to link CSR and FP (Kang, Lee, & Huh, 2010; Lee & Park, 2009, 2010). Some studies have employed Tobin's Q and earnings per share (EPS) for measuring FP as well (Inoue & Lee, 2011; Lee, Seo, & Sharma, 2013; Kim & Kim, 2014). Indices such as ROE and ROA are considered accounting-based indices that represent a firm's short-term profitability. Tobin's Q and EPS, on the other hand, are market-based indices that help investors to measure a firm's ability to gain future profits (Inoue & Lee, 2011).

Previous studies were meant to discover the relationship between these two measurement bases. Accounting-based measurements reflect short-term FP, while market-based measurements reflect long-term FP (Ahmadi, 2014). Shen, Gentry, and Tosi (2010) conclude that there is a positive correlation between the two measurements but with a covariance of less than 10 per cent. Venkatraman and Ramanujam (1986) state that two measurements are to be non-related as short-term and long-term goals of a firm that differ from each other. Moreover, Thaler and Benartzi (2004) argue that a firm's market performance shows how much investors are likely to invest in the firm and not its actual financial value.

These past pieces of literature support the multidimensional nature of FP. Which measurement base to be used for the calculation of a firm's performance is still not clearly defined. For this research, ROE, an accounting-based measure, would be employed in assessing the firm's FP.

3. RESEARCH METHODOLOGY

The study adopted an abductive approach and employed a stratified random sample of ten listed hotels. The data was gathered from annual reports of the hotels between 2013–2014 and 2017–2018. CSR-related information disclosed in annual reports was initially analysed through a content analysis method. Accordingly, a checklist of 190 CSR-related keywords was developed based on literature (Hackston & Milne, 1996; Inoue & Lee, 2011; Maqbool & Zameer, 2018). This checklist contained keywords related to five CSR dimensions *viz. community, employee relations, environment, product quality,* and *diversity.* Both singular and plural forms of keywords were used to identify CSR-related information in annual reports. As argued by Milne and Adler (1999), extra precision can be gained by using words than sentences as a unit of measurement when conducting a content analysis. Using words also aided in maintaining consistency and reliability, as the same list of words is used in analysing all selected documents (Nuzula & Kato, 2010).

The mere use of keywords to identify CSR-related information did not serve the purpose of the study. Different firms had adopted different writing styles and reporting patterns in disclosing information. For example, words such as "talent" may fail to identify CSR initiatives relating to employee relations when they are described in unique Sinhala words such as "*Prathiba*". Therefore, theoretical thematic analysis by Braun and Clarke (2006) was utilized to deepen the analysis. Under theoretical thematic analysis, CSR activities disclosed in annual reports were grouped into 62 CSR sub-themes. These sub-themes were also based on a previously developed CSR checklist. To ensure that all annual reports are treated equally, a set of decision rules was also adopted (Hackston & Milne, 1996). Finally, the repetition of both keywords and sub-themes was counted and converted into Nila units[1] (Nuzula & Kato, 2010) to measure the CSR performance of each firm.

$$Nila\ Unit = \\ = \frac{Number\ of\ CSRness\ Words}{Total\ Number\ of\ Words\ in\ one\ Document} \times 100 \quad (1)$$

Keywords and sub-themes identified were counted using Adobe Acrobat Reader DC version 19. AnyCount 3D software version 9 was used to count the number of words in the selected annual reports. average Nila unit percentages (ANUP) for each year were then calculated.

The present study utilized ROE to evaluate the FP of the hotel sector. ROE is one of the most commonly utilized ratios in literature to evaluate FP (Griffin & Mahon, 1997). Though calculated ROE values were present in some annual reports, to maintain consistency, the present study utilized the following formula to calculate the said ratio manually. In calculating ROE, average shareholder equity was considered as the value of shareholders. Furthermore, when the company is considered

instead of the company's group, minority/non-controlling interest was excluded from the ratio.

$$Return\ on\ Equity = \frac{Profit\ before\ Interest\ and\ Tax}{Value\ of\ Shareholder} \times 100 \quad (2)$$

Average return on equity (AROE) was then calculated for each year to arrive at comparable values. Finally, Pearson correlation analysis was carried out to check the association between the two variables.

4. RESULTS AND DISCUSSION

Data for the study was gathered from 50 annual reports of ten firms over five years. Table 1 illustrates descriptive statistics of the CSR and ROE measurements of the ten firms for five years.

Table 1. Descriptive statistics of ROE and Nila units

Description		Nila unit	ROE
N	Valid	50	50
	Missing	0	0
Mean		0.67015	4.53698
Median		0.49230	4.83250
Mode		0.223	-14.467[a]
Std. deviation		0.466162	7.307782
Variance		0.217	53.404
Range		1.526	42.999
Minimum		0.104	-14.467
Maximum		1.630	28.532

Note: a. Multiple modes exist. The smallest value is shown.

The number of valid items in the table represents ten hotel firms for the period between 2013–2014 and 2017–2018. Nila unit values of the data set are in between the range of 0.104–1.630. The ROE values have ranged from -14.467–28.532. Nila units and ROE values of the data set have recorded a mean of value 0.670 and 4.537, respectively. The standard deviation of Nila units is 0.466, illustrating a low dispersion from its mean value. The ROE values of the data set illustrate a much higher dispersion from its mean value, with a standard deviation of 7.308. It denotes that a considerable difference can be seen among individual ROE values of the hotels in Sri Lanka.

Figure 1 graphically depicts the behaviour of CSR disclosure level of the selected firms during the considered period. A slight but growing behaviour in CSR disclosure is evident based on the findings of the study. During the period between 2013–2014 and 2017–2018, ANUP has depicted a growth of 24.1 per cent, with an average annual growth rate (AAGR) of 5.5 per cent. Though an overall increment of 24.1 per cent may seem to be attractive at first glance, a low AAGR of 5.5 per cent illustrates a slow growth in CSR disclosure during the period. Annual growth rates of ANUP have varied between 13.8 per cent and 1.4 per cent. It depicts an inconsistency in growth during the considered period. Even if a continuous increment in CSR disclosure is evident during the period, this inconsistent growth rate questions whether this trend would continue in consecutive years.

Only six organizations out of ten selected had dedicated a separate section in their annual reports to discuss CSR and sustainability-related matters.

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[1] The origin of the Nila unit was Japan. Nila Firdausi Nuzula and Masanori Kato develop this formula to numerically represent CSR and test the correlation between CSR and share prices.

Annual financial reports contained only information relating to the financial aspect of firms, and hardly any CSR-related information was disclosed. Wijesinghe (2012) made a similar argument stating that most firms disclose information relating to their firm and financial performances to satisfy shareholders' needs only. Wijesinghe (2012) further states that it is still the primary aim of Sri Lanka organizations to maximize shareholder wealth instead of satisfying the needs of all stakeholders.

**Figure 1.** Trend in CSR
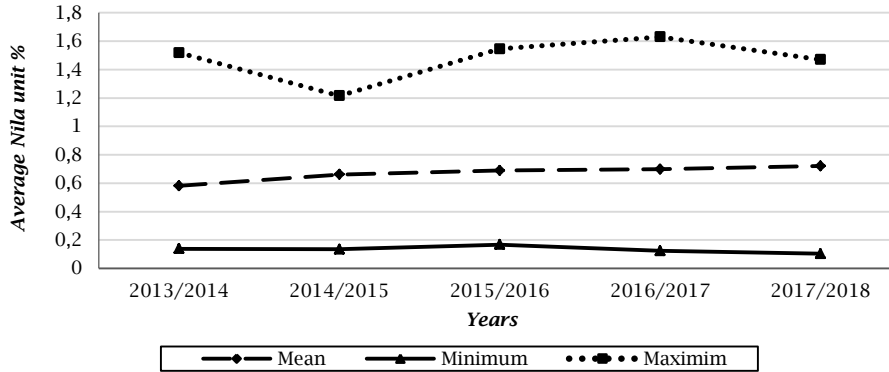
The level of importance given by these firms to different dimensions of CSR is graphically illustrated in Figure 2. In terms of dimensions of CSR, the highest weight is given to "employee relation" and "community" when disclosing CSR-related information throughout the five years under review. During this period, an average weight of 37 per cent was given to "employee relations" when disclosing information. Tourism is a high labour-intensive sector and having high customer interactions daily might have led these hotel firms to give such prominent focus on their labour. Such a high emphasis on human capital in annual reports could also be due to the intention of creating confidence among the firm's current and potential shareholders.

The higher emphasis when disclosing the information is also given to dimensions such as "community" and "environment". A significant effort by firms on reducing the adverse effects of their operations on nature and the community was observed during the analysis. It is still questionable whether these efforts are strategically placed to benefit the firm itself instead of the community.

The aforesaid has led the hotels to consider their performance rather than concentrating on the overall macro-economic indicators of Sri Lanka. The phenomenon is peculiar. That is, from the end of the civil war (from 2009) the tourist arrival showed an increasing trend (Nagendrakumar et al., 2021), but the hotels FP showed a declining trend. However, the hoteliers observed only an increase in tourist arrival and believed the FP would also show the same positive trend, but it was not so. The above myth led the government also to believe the downturn in the tourism industry was due to the Easter Sunday attack and COVID-19 pandemic. This was another piece of evidence which shows Sri Lanka's want for continuous empirical research in this domain.

Figure 2. Dimensions-wise importance in disclosure
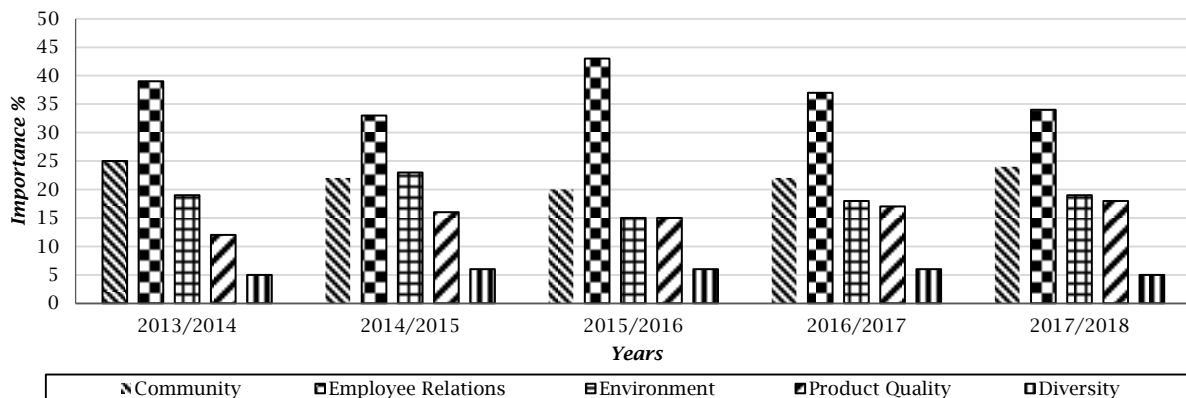
Most initiatives taken under the theme of the environment can also be linked with reducing energy consumption to reduce costs and counteracting law and order pressure. Some community initiatives are undertaken to maintain strategic and harmonious relationships with local groups to hinder volatile situations from arising, which could lead to negative goodwill on the firm. From the findings, diversity is the least emphasized dimension, with an average weight of disclosure of only 6 per cent. Though firms have continuously discussed their policies to maintain equality among different gender, ethnicity, and racial groups, hardly any weight is given to factors such as employment

of differently abled and special interest groups, which includes ex-drug addicts and ex-convicts.

Figure 3 graphically illustrates how FP behaved during the period. The overall AROE between 2014–2018 has declined by -36.9 per cent, with an average annual decline of -10.9 per cent. When

considering annual growth ratios, 2014–2015 and 2015–2016 recorded a decline of -11.2 per cent and -14.5 per cent, respectively. From 2015–2016 to 2016–2017, this negative growth rate has reduced to -6.1 per cent but again increased to -11.4 per cent in 2018.

Figure 3. Trend in FP
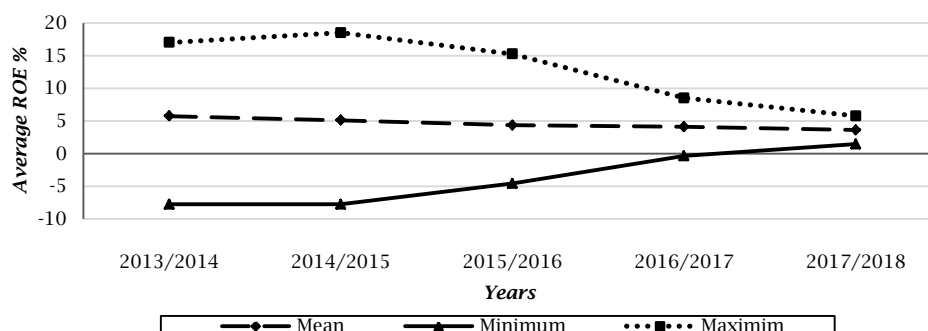
When investigating the reasons for this fall in AROE, it is clear, that it was due to the development of the informal sector including budget hotels, homestay providers, villas, and others. The informal sector was performing well not only within the Colombo area but also in locations available to the public. This development was mainly due to the existence of the global trend of experiential tourism which refers to the preference among tourists. This attribute was successfully done by the informal sector in the tourism industry. The regulatory framework followed by these informal sectors is different from that of the formal sector hotels. Most villas offered by the informal sector are exempted from taxes, which enables them to provide services to guests for competitive prices.

Another issue in the annual reports was the economic risk. The depreciation of Sri Lankan currency over US dollars had resulted in decreased revenue earning to the hotels. This depreciation of the currency has added even more pressure to luxury and five-star hotels. This is because, with the increasing cost-driven rates, price-conscious travellers tend to prefer the informal sector over well-established luxury hotels.

The highest tourist arrivals were Chinese and Indians. The tourists from western countries were much more beneficial as the average expenditure they were higher than that of Chinese and Indians. Eastern Europe was also considered one of the main markets of Sri Lanka tourism. However, the political instability in East Europe had impacted adversely on tourist arrival. The withdrawal of direct flights from Sri Lankan Airlines to European destinations had also been a critical reason for Sri Lanka to have fewer tourist arrivals from Europe. Other reasons in the annual reports for the decline in ROE values include adverse weather conditions and the dengue epidemic caused for mass hysteria in the community.

Pearson correlation analysis was carried out to identify the relationship between CSR and FP. Accordingly, a negative but strong correlation of -0.959 with a P-value of 0.010 was found between CSR and FP. As depicted in Table 2, five cases are included in the data set, representing data related to the selected firms. A significance level of less than

0.05 is required to consider a relationship to be statistically significant. Hence, the study establishes a robust negative relationship between CSR and FP in the tourism industry of Sri Lanka.

Table 2. Correlation between CSR and FP

Description		Mean_ROE	Mean_CSR
Mean_ROE	Pearson correlation	1	-0.959**
	Sig. (2-tailed)		0.010
	N	5	5
Mean_CSR	Pearson correlation	-0.959**	1
	Sig. (2-tailed)	0.010	
	N	5	5

*Note: ** significant at 5%.*

5. CONCLUSION

A slight but incremental behaviour in the trend of CSR disclosure is evident in Sri Lanka during the period. Yet, though a positive increment is observed in the level of CSR disclosure in the period, its annual growth is low. Hence, it is concluded that hoteliers in Sri Lanka did not concentrate on CSR activities before 2018. Further, the study concludes that overall FP had been declining by 36 per cent during the period before 2018 causing the formal tourism industry to a drastic fall. The decline of FP in the formal sector was due to the growth of the informal sector in Sri Lanka.

When disclosing CSR, the highest emphasis was given to employee relations, community, and environment but diversity was given the least importance. The study provides another piece of evidence for the existence of a strong negative, statistically significant relationship between CSR and FP in the tourism industry. Accordingly, most of the hoteliers in Sri Lanka hesitate to invest in CSR activities since it leads to a drop in FP.

The study by incorporating the abductive method has very clearly set the light on the downturn of the tourism industry before 2018. Hence, it is concluded that the claim by the Sri Lankan government that the fall was caused by the Easter Sunday attack and COVID-19 pandemic is a myth, and the slump was evident even before those shocks.

The subjectivity element in the coding methods applied under the two approaches of content and thematic analysis is the limitation of this study. However, the study proved that the researchers-maintained objectivity since the Nila unit recorded the standard deviation of is 0.466, indicating a low dispersion from its mean value.

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