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The Effect of Profitability on Social Donations of Listed Nigerian Conglomerates

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Abstract

This study investigated the influence of Profitability on Corporate donations of Nigerian conglomerates for the period of 2009 to 2015. Panel regression was used to examine the effect of independent variable on the dependent variable. The study revealed that profitability measured by PAT_MARGIN and ROA are not significant drivers of conglomerate donation in Nigeria for the period under study. However, the study shows that firm size and cash holding are significant in driving corporate donations as large conglomerates and those with large cash in their balance sheet are more likely to make significant donations.
Keywords: *Corporate Donation, Profitability, Firm Size, Cash holding.*

Introduction

The dynamic and competitive business world today has created a challenging environment where businesses do not only have to take from the society but must continually give back to the society. The idea of Corporate Social Responsibility expects every reasonable business to make contribution towards the wellbeing of the society and its immediate environment in the form of corporate social responsibility donation or contributions.

In addition, a reasonable number of conglomerates in Nigeria and beyond have realized the importance of corporate social responsibility (CSR) practice and the benefit derived from such practice. Corporate social responsibility donations (CSRD) are an extension of the financial disclosure system and a good way to measure extent of economic participation, which reflects the wider anticipation of society concerning the role of the business community in the economy and how such business organizations impacted on their immediate environment by answering to some of the very needs in the locality, (Waller & Lanis, 2009), (Tilt, 2009).

However, despite the plausibility of corporate social responsibility in the forms of donations and other means, it must be noted that corporate social donation must hinge seriously on the profitability of the company involved because its only when a company has met and fulfilled its obligations to shareholders and other stake holders that it would seriously engage in social responsibility programmes. Campbell (2007) sees corporations' level of social responsibility as being influenced by factors such as financial conditions of the firm, health of the economy, corporate culture and well-enforced state regulations. Also, a lot of arguments have been put forward as to the rational for CSR. Some of it has been hinged on a moral argument, some rational argument, while others are on economic benefit such organizations are expected to derive by being in the good light of the community in particular and the economy at large (Werther & Chandler, 2006).

Business organizations in Nigeria including conglomerates are mainly responsible for creating wealth and driving progress which they are guided by governments and regulations, society pressure groups and customer's satisfaction. Meanwhile, the balance between societal needs and economic progress attracts the corporate attention to strategic and competitive role of environmental responsibility to corporate survival. Therefore, in the light of favourable performance by business organizations like conglomerates, we expect that corporate donations would be one of the beneficiaries of such favourable financial result. It can be argued that a company that puts parts of its financial resources back to the society stands a chance of performing better than other companies who don't since such act of benevolence would project the company favourably before the consuming public, hence, attracting more businesses (Shocker & Sethi, 1973).

The major motivation of this work is to see if Profitability of listed companies in Nigeria impacts their social responsibility programmes positively or otherwise. This paper is focused on finding out if the profitability of conglomerates is a significant driver of their donations. Works in this area most especially in developing economy like Nigeria are scanty with respect to how the profitability of conglomerates impacts their corporate donation programmes. This work would try to bridge this literature shortage and doing so with recent data from the Nigeria capital market.

Igalens and Gond, (2005) observed five major measurement approaches of corporate social performance and this include; measurements based on analysis of the contents of annual reports, pollution indices, perceptual measurements derived from questionnaire-based surveys, corporate reputation-indicators, and data produced by measurement organizations. These five approaches can also be used in the measurement of corporate social donations. In the first approach, corporate social donations are measured using annual report content. This method of measurement is focused on disclosures in the annual report. The work of Men (2013) has also provided a strong contribution to the measurement of social donations in Shanghai Stock Exchange (SSE). Using quantitative methods to measure CSR that is social contribution rate (CE), which is calculated by adding the responsibilities of the various stakeholders and then dividing by the owner's equity. The method of calculating social donation (SD) that would be adopted by this work would be to use the log of total amount of corporate social donations. This method of measurement would be applied using Panel Regression methodology to see how the Profitability of Nigerian conglomerates impact on their corporate social Donations for the period under study.

The basic research question and hypothesis of this work are: Does Profitability of listed conglomerates in Nigeria affects their corporate social Donation and is there any significant relationship between corporate social Donation and Profitability of conglomerates in Nigeria?

The World Business Council for Sustainable Development has discussed CSR with business and non-business stakeholders in a number of countries in the world with the objective of understanding local perspectives better and to get different perceptions of what CSR should mean from a number of different societies. Therefore the chosen priorities differed according to the perception of local needs.

The key CSR issues identified in the study were:

- Human rights
- Employee rights
- Environmental protection
- Community involvement
- Supplier relations

Literature Review

This section takes a look at past literatures that relates Profitability to social donations

Corporate Donation and Profitability

Organizations are subject to moral and sometimes legal obligations of accomplishing specific charitable purposes through donations according to Fremont-Smith (2004). Although these requirements suggest that companies are required to deploy their assets in the provision of a specific charitable output, these organizations are managed by individuals whose own best interests might not always align with this purpose. This suggests that might ensure some clash of interest among the stakeholders which might eventually result to Agency problem. In their seminar work, Jensen and Meckling (1976) describe the agency problem that comes with a separation of ownership from control, and Fama and Jensen (1983a, 1983b) extend this theory by noting the separation of decision rights by management and the bearing of risk by donors, grantors, and the state. Indeed, there is some empirical evidence that agency costs exist in every corporate setting; Core, Guay and Verdi (2006) finds that large endowments through better Profitability lead to higher possibility of spending in other activities such as donations and other charitable courses.

Also, research suggests that, in contrast to managers may choose to forego wealth utility in favour of the utility they gain from accomplishing a charitable mission, which might impact the use of

profit in generating future positive returns on investors' fund, (Roomkin & Weisbrod, 1999). Stewardship theory in the management literature pushes this idea further and allows for an alternative view of managerial behavior in that it "defines situations in which managers are not motivated by individual goals, but rather are stewards whose motives are aligned with the objectives of their principals" (Davis, 1997:21). To the extent that steward CEOs self-select into corporate donation derive significant utility from non-monetary rewards that such activities can provide. In order to align the interest of the stakeholders and mitigate the agency conflicts that might be present, it becomes important that the mangers of an organization must justify their interest to make charitable contributions by providing good profit and corporate performance, (Bansal, 2005).

Frumkin and Keating (2010) focus more narrowly on donation revenues and also examine pay-for-performance sensitivity to the administrative expense ratio, the ratio of administrative expenses to total expenses. They find that the level of compensation is negatively associated with the level of the administrative expense ratio, but is not associated with the change in donation revenues.

Some other studies are popular with the empirical evidence that exists between some good Profitability metrics and the ability of companies to give back in the form of corporate donations Baber, Daniel and Roberts (2002); Brickley and Van Horn (2002); Frumkin and Keating (2010); Aggarwal, Evans and Nanda (2012) examine metrics derived from total revenues, implicitly constraining the coefficient on the various revenue sources to be constant, while Frumkin and Keating (2010) focus narrowly on donations revenues. Baber, Daniel and Roberts (2002) and Aggarwal, Evans and Nanda (2012) document a positive association between compensatory donation changes and total revenue changes, Frumkin and Keating (2010) find no association between them.

Corporate Profitability is considered to be significant determinants of corporate social responsibility donations. The purpose of all profit-making organizations is to make and maximize profit and in turn minimize cost, through optimal utilization of available resources to achieve the best results they are capable through corporate social responsibility donations. Profitability is an important factor to all corporate donations not minding how it's interpreted using either the pro-profit argument or the profit cum social responsibility argument. This then means that only profitable companies can engage in meaningful corporate social responsibility while those who also seek improvement in their down line could also do same to boost their image and profit potentials (Mulyadi, 2010).

Posnikoff (1997) investigate the relationship between corporate donations and Profitability. The study revealed a positive relationship between Profitability in form of profitability and corporate donations. This signifies that improved corporate performance would significantly lead to increase in corporate donations by firms within their operating business environment as opined by Amason and Rutherford (1999). Also, Arora & Dharwadkar (2011) tried to find how profit impacts on corporate donation. The result obtained indicate that is a positive and statistically significant relationship between corporate donation and firms profit thereby Supporting the view that socially responsible corporate performance can be associated with a series of bottom-line benefits. Furthermore, the work of Uwalomwa, Egbide and Ayokunle (2011) opined that corporations with poor CSR practices may suffer the losses due to low sales or less investment as firms perceived to be socially responsible will have an added advantage in the market place in comparison to other competitors who don't since corporate donation activities will help enhance customers loyalty and increase firms sales. It then means that companies engaging in corporate donation from their bottom line results would result to improved bottom line result in the future.

The work of McWilliams, (2000) found a causal relationship between corporate donation and firm profitability. The work was based on Domini 400 Social Index. Then work Find positive correlation between CD, profit and R&D, and when it used as an independent variable, CD is shown to have neutral effect on firm profitability.

This also follows the thinking of Toutsoura (2004) who concluded a positive and statistical significant relationship between CD and firm profit as profitable companies are predisposed to do more in the areas of community and societal involvement.

Choi (2010) studies empirical relation between CSR and corporate profit in Korea during 2002-2008. The work measured corporate Profitability with ROE, ROA, and Tobin's Q. ROE and ROA could be used as a profitability indicator, while Tobin's Q is often used as measurement of firm value. Work revealed positive and significant impact between corporate Profitability and stakeholder-weighted CSR index. That goes ahead to suggest that firm performance measures and the firm value as indicated by the performance of Tobin Q are significant in determining the value of corporate social responsibility. Also, Ngwakwe (2009) studied Nigerian firms using both primary and secondary data. Their chi square test and content analysis of questionnaire revealed a positive relation between corporate donation and profitability. Other works such as Weshah (2012), Jones (2005), Sun, (2012), Servaes & Tamayo (2013) which investigated the relationship between corporate donation and Profitability found a positive and significant association between them.

However other works such as Welch and Wazzan (1999) found that companies with good financial results measured are negatively related to corporate social responsibility donations. This therefore suggests that increase in firm profitability would bring about a decrease in corporate social responsibility donations as it's most likely that these conglomerates would prefer to channel their profits to other areas they might see as more relevant. This notion is also supported by Singh and Kansal (2011) and Lucyanda (2012) who examined the influence of firm characteristics toward Corporate Social Responsibility disclosure with selected samples from Indonesia stock exchange in 2007-2008. The findings and conclusion of the work was similar to Mulyadi (2010) studies in Indonesia in 2010 which revealed no significant relationship between Corporate Donations and firm performance.

In the case of Nigeria, Abiodun (2012) shows in his studies that the relationship between corporate donation and firm performance is negative. He concludes that profitable organizations in Nigeria do not invest much in CSR activities. Hoppe & Lehmann-Grube, (2001), Lioui and Sharma, (2012) are also in agreement to these findings.

Leverage

Leverage is the amount of debt used to finance a firm's assets. A firm with significantly more debt than equity is considered to be highly leveraged. But if the firm has too much borrowing, it may not be able to pay back all of its debts and have the free cash flow that can enable it effectively engage in other reasonable activities such as CD. Belkaoui and Karpik (1989) examine the association between the decision of firm's to disclose social responsibility information with respect to donations and conglomerate leverage. They found that corporate social responsibility donations are correlated with firms perceived to be responsive socially, firms that have low leverage. Hence, they propose that a positive relationship between corporate donation and low corporate leverage as on only a company low on leverage can effectively engage in corporate donations. The work of Farouk & Usman (2013) conducted in Nigeria and found that leverage had a significant positive impact on corporate social donations (CSRD). Aras and Aybars (2010) and Barbosa & Louri (2015) also supported this finding and concluded that there is a significant relationship between CSR activities of companies and leverage and asserted that good returns may favourably allow conglomerates and other socially responsible companies to embark on CSRD.

Size

Stanny and Ely (2008) they also pointed out that large companies also have greater impact on their community and therefore receive more attention from lenders about their CSR practices which in turn affects their cost of borrowings and corporate donation expenditures positively. They specifically concluded that large firms have greater incentives in this direction as they are able to disclose CSR information in their annual reports in order to enhance their reputation and public image, as well

as reduce government intervention and agency costs. This therefore entails that conglomerates would need good debt equity mix to be able and strong enough to support socially activities more effectively through donations. This work would see the behavior of this supporting variable in explaining how conglomerates Profitability would impact on their donation behaviour. Cowen, Linda and Scott (1987) in their work was one of the early studies conducted to find the impact of size tend to have on corporate donations. The work supported the idea that size has a significant impact in determining the extent of corporate social involvement of companies. This therefore means that increase in firm size significantly lead to increase in corporate donations.

Cash Flow

The Free Cash Flow Theory by (Jensen, 1986) stresses that managers have an incentive to hoard cash to increase the amount of assets under their control and to gain discretionary power over the firm investment decision. Free cash flow in hand enables management to find ways to spend, and hence chooses corporate social responsibility donations when good projects are not available (Opler, Pinkowitz, Stulz & Williamson, 1999)

In relation to the **pecking order theory**, Myers (1984) opines that firms finance investments firstly with retaining earnings, then with safe debt and risky debt, and finally with equity. When current operational cash flows are sufficient enough to finance new investments and also on social donations, firms repay debt and accumulate cash. When retained earnings are not enough to finance current investments, firms use the accumulated cash holdings and, if needed, issue debt in place of operating cash flow. In addition, cash holding generates costs and benefits and it constitutes a safety buffer which permits firms to avoid the costs of raising external funds or liquidating existing assets and which allows firms to finance their growth opportunities. Insufficient cash forces firms to forgo profitable investment projects or to support abnormally high costs of financing.

Methodology

This work used a total of all active quoted conglomerates in Nigeria stock market for the period of 2009 to 2015 which comprise of Scoa Nigeria PLC, Chellarams PLC, A.G. Leventis, Chariot Group, Promasidor Nigeria Ltd, UAC Nigeria PLC, Transnational Corporation Nigeria PLC, West African Cotton Company Ltd. The data was sourced secondarily from **MachameRATIOS®** company econometric database and only conglomerates who have consistently published their accounts for the period under study were selected. This means inactive, delisted and acquired conglomerates were excluded from the study.

The major objective of this work is to see how the profitability (ROA and PATM) of conglomerates impacts their corporate donations (CD) within the period of study. The major variable of impact in this work is the Profitability Variables of the companies after controlling for size (SIZE), leverage (LEV) and cash holding (CASH) effects of the respective companies.

The major hypothesis of this paper is:

HO: There is no significant relationship between Profitability and corporate Donations

The panel regression methodology would be employed in this study to examine the impact of Profitability on corporate Donations after controlling for three other variables in order to achieve predictive robustness. The below is a brief empirical link between corporate social donations and our selected control variables.

The following regression models were used in this study:

MODEL 1:

$$CD_{it} = \alpha_{it0} + \beta_1 ROA_{it} + \beta_{it2} LEV + \beta_{it3} SIZE + \beta_{it4} CASH + \varepsilon_{it}$$

MODEL 2:

$$CD_{it} = \alpha_{it0} + \beta_1 PATM_{it} + \beta_{it2} LEV + \beta_{it3} SIZE + \beta_{it4} CASH + \varepsilon_{it}$$

Where;

CD= corporate Donation measured by log of cash donations

ROA= return on Asset measured by PAT/Total Asset

PATM=PAT Margin measured by ΔPAT

LEV=Leverage measured by Total Leverage/Total Asset

SIZE=Firm Size measured by log of Total Asset

CASH= Cash/Total Asset

Results and Discussion of Findings

The table below explains some basic features of our variables of study. These include the correlation metrics, the descriptive statistics and the main results which help us form conclusion on our study. Table 1 below reveals the direction of association of the variables of study

TABLE 1: Correlation Matrix

	LOGDON	PAT_MAGIN	ROA	CAS_TA	TL_TA	SIZE
LOGDON	1					
PAT_MAGIN	0.06	1				
ROA	0.16	-0.17	1			
CAS_TA	0.06	0.58	0.01	1		
TL_TA	-0.15	0.04	0.15	0.03	1	
SIZE	0.22	-0.36	0.22	-0.46	0.14	1

Source: Authors computation (2016)

The dependent variable which is proxy by log of Cash Donations made by Nigerian conglomerates in our sample of study reveals a positive association with Profit after Tax Margin(PAT_M=0.06) and Return on Asset(ROA=0.16). This supports the idea that improvement in the Profitability of companies increases their chances of making donations. It can also be observed that other control variables exhibit a positive relationship with donations with the exception of Leverage (TL_TA). This shows that highly leveraged conglomerates might not have the financial strength to engage in Social responsibility programmes that involves cash spending as they would be more interested in balancing their liquidity condition and paying the accruing interests to their lenders. Also, not having any serious correlation among the variables is suggestive of absence of multicollinearity.

TABLE 2: Descriptive Statistics

The Table below shows the descriptive statistics of the conglomerates that make up our sample of study.

	LOGDON	PAT_MAGIN	ROA	CAS_TA	TL_TA	SIZE
Mean	5.371	0.07	1.73	1765541	84.05	8.83
Median	5.135	0.05	1.8	3903.67	85.55	8.73
Maximum	7.5	0.421655	4.6	17058917	96.03	9.46
Minimum	0.1	-0.263779	-1.6	0	71.4	8.38
Jarque-Bera	64.47	5.39	1.04	81.79	1.63	1.74
Probability	0	0.06	0.09	0	0.04	0.01
Observations	30	30	30	30	30	30

Source: Authors computation (2016)

The mean Donation of the sampled companies had a log value of 5.37. The mean PAT_M was 0.07 while ROA was 1.73. Size and Leverage showed average values of 84.05 and 8.83 respectively.

In Observing the highest and lowest values show that the conglomerate companies sampled differ in many respects. For example, while some companies are donating more, some are donating much less. Also, while some of the companies are profitable and having large cash in their balance sheet, others are not. This shows that our samples were not skewed to any particular direction. Also, the JB Probability shows that all the variables are normally distributed at 1% level of significance.

Hence, any recommendations made to a very large extent would represent the characteristics of the true population of study.

TABLE 3: Regression Results

Table 3 below shows the variables of our study with their coefficient and P_values with Log of Donation being the Dependent variable.

VARIABLES	*SIGN*	*COEFFICIENTS ROA MODEL*	*COEFFICIENTS PAT-M MODEL*
C		7.88(0.71)	12.10(0.59)
PAT-M		-	1.31(0.69)
ROA	+	0.11(0.70)	-
CAS-TA	+	0.00(0.89)	0.00(0.01)*
SIZE	+	1.98(0.38)	2.36(0.02)
TL-TA	+	-0.00(0.95)	-0.04(0.43)
R-Squared	+	0.19	0.30
Adj-R-Squared	+	0.17	0.20
F-Statistic		10.48(0.06)*	12.48(0.00)*
Observation		30	30

Source: Authors computation (2016), **Note:** * is 1% level of significance. Values in () are the P_values

From table 3, it can be observed that the R_Squared of the two models is 0.19 and 0.30 Respectively with F.Statistics that is significant at 1% level of significance. The result shows that the ROA variables predict about 19% of the dependent variable while the PAT_M model predicts to the extent of 30%. This makes the variables in the model reliable to some extent in predicting the dependent variable. However, given to the poor nature of the R_Squared, there should more variable inclusion in the models so as to improve their predictive ability.

From the table above, our major variables which measure Profitability of the sampled conglomerates in Nigeria from 2009 to 2015 ***[ROA=0.11(0.70)], [PAT_M=0.31(0.69)],*** shows that there is no significant relationship between Profitability of sampled conglomerates in Nigeria and the log of their Financial donations for the period under study. This means that how well or otherwise conglomerates perform might not have a significant influence on the donations they would make. Other factors are then expected to be responsible in driving the donation behavior in the Nigeria conglomerate sector based on our sample and time of study. This is in line with Abiodun (2012). Hoppe & Lehmann-Grube, (2001), Lioui and Sharma, (2012) who believe that improvements in companies profitability does not make them donate more. Lioui and Sharma, (2012) are also in agreement to these findings in their studies.

The variable for cash holding ***[CAS_TA=0.00(0.89), 0.00(0.01)]*** is a significant driver of corporate donation in the Nigeria conglomerate sector when such donation is logged. It then means companies with more free cash in their balance sheet are better positioned to engage significantly in corporate social responsibility programmes through donations. This is in line with the views of (Opler, Pinkowitz, Stulz& Williamson, 1999) who believe that companies would always opt for corporate donations with their available cash.

Our result shows that leverage is inversely and insignificantly related to log of corporate donation ***[TL_TA= -0.00(0.95), -0.04(0.43)].*** This means that highly levered companies are more likely to be less involved in corporate donation activities as they would be more concerned with interest payment and debt settlement.

However, size proved to be a significant driver of donation as shown in our second model *[Size=1.98(0.38), 2.36(0.00)]*. At 1% level of significance, size proved to be a significant driver of corporate donations of Nigerian in some instance. This suggests that big conglomerates have more reputation to protect so would deem it fit to give back to the society in a significant way. This finding supports the views of Parsa and Deng (2008).

Conclusion

This work tried to investigate the influence of Profitability of conglomerates on their corporate donations. Donation was measured using the log of Cash donations made by the sampled companies while profitability was measured using Return on Asset (ROA) and Profit After Tax Margin (PAT_M). The work revealed that profitability measured by Profit after Tax Margin and Return on Asset does not have any significant effect on corporate donation measured as the log of Cash Donations of sampled conglomerates. However, in one of the models, it was found that size and cash holdings are positive and significant in driving donation in the conglomerate companies in Nigeria. Conclusively, companies with large cash in their balance sheets are more likely to be involved in corporate social responsibility programmes and support such with significant cash donations. Also, big companies are also more likely to donate significantly more than smaller companies. Further studies can be extended to other sectors of Nigerian economy. Also, interaction effect can be introduced in future studies to know for example what would be the interaction effect of profitability and size, age etc. on corporate donations. There should also be more variable inclusion to improve the predictive power of the model.

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