

CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL PERFORMANCE OF HOTELS IN ZANZIBAR

ABSTRACT

Corporate Social Responsibility is gaining more awareness in Zanzibar as the firms are recognizing the important role it plays on firm's performance. This research empirically examines the effect of corporate social responsibility and financial performance of hotels in Zanzibar. CSR is measured by cost paid for corporate social responsibility while financial performance is measured by using profitability measures such as ROA and ROE.

By utilizing panel data of 4 hotels for 7 years period from 2011-2017, the study uses ordinary least square method-random effect regression model. The study found CSR has significant positive effect on ROA and ROE of hotels in Zanzibar. The study also found that control variables (i.e leverage, R&D, size) have significant effect on ROA and ROE. The study recommends for more investment in CSR as a way of boosting hotels profitability.

Key words: Corporate social responsibility, financial performance, Hotel

1.0 INTRODUCTION

CSR into business activities have been realized as a very warming topic nowadays, for as customers, shareholders and other stakeholders show great importance in wanting this issue. CSR is a notion in which business organizations targets interest of society by taking actions on impact of their activities on suppliers, employees, customers, shareholders, communities and other stakeholders as well as their environment (Swanson,2005). CSR can involve a range of activities such as working in partnership with local communities, socially sensitive investment, developing relationships with employees and customers and involving in activities for environmental conservation and sustainability (Cornelius, Wallace &Tassabehji, 2007).

CSR as a concept has not taken roots in Tanzania, but as a corporate practice in the country it is a common phenomenon. There is an existence of unclear policies on CSR in Tanzania which cause companies rushing to claim CSR for their own advantage. Some companies use CSR as their strategies to gain public support in markets which help them sustain competitive advantage over others by using their social contributions to provide subconscious advertising (Gachanja et al. 2013).

At present, tourism and hospitality have interest in CSR. Some tourism experts believe that CSR activities affects public image of the companies as well as financial performance. Tourism is one of the fastest growing industries in an economy as a service sector, growing at an average rate of

34 4% per annum. Over the past fifteen years Zanzibar has been relying heavily on tourism in
35 generating revenue. This has been generating 25% of Gross Domestic Product and generating
36 about 80% of its foreign currency.

37 Hotel is a compliment service of tourism Through generating high revenue most hotels in
38 Zanzibar has been practicing CSR as it results in high impact in their financial performance so as
39 to enhance GDP. In Zanzibar, hotels that do practice CSR are very decisive in generating social
40 and business value simultaneously to be sustainable over time, as CSR has been considered as
41 more costly hence reduce profitability. Hotels that practices CSR needs to provide great efforts
42 in incorporate strategies to recognize that they have high profitability that add more cost.
43 Without a doubt, CSR is a factor that affects business in the future. Most of the studies focus on
44 the topic of CSR and Corporate financial performance on developed countries, thus current
45 research on developing countries is limited especially in Tanzania Zanzibar. Basing on economic
46 and environmental impact, hotel sector is one among the most important firms of applying CSR
47 activities. Hotel managers are becoming more aware of CSR activities, as they want to achieve
48 high growth and long term profitability (Erdogan and Baris, 2007). Therefore, this study focuses
49 on CSR and financial performance of listed 4 Nungwi hotels in Zanzibar. Specifically the study
50 examines the impact of CSR on return on asset (ROA) and return on equity (ROE) of the four
51 listed hotels at Nungwi in Zanzibar.

52 **2.0 LITERATURE REVIEW**

53

54 This part review theoretical and empirical literatures on the concept of corporate social
55 responsibility and its impact on financial performance (ROA and ROE). A concept of CSR refers
56 to firms responding to social and environmental concerns in business operations and interaction
57 with the stakeholders (Pe´rez & del Bosque, 2013). CSR includes social, environment and
58 economic responsibility, (Carroll, 1991; Elkington 1994; Adriana and Simon, 2017). Common
59 CSR practices in business involves a company doing a production in favor of society and
60 environment, eliminating waste, investing in infrastructure, developing for local to increase
61 profit (Wang & Bansal, 2012). CSR are more needed in emerging economies and developing
62 countries characterized by weak institutional environment (Jamali & Mirshak, 2007). Due to
63 absence of strong standard policies in developing countries firms must play a wider role in
64 society besides providing quality goods and services at reasonable prices and making returns for
65 the shareholders (Mishra & Suar, 2010). CSR affect financial performance. Stakeholder theory
66 explains on how organization builds its relationship with external environment for the purpose of
67 achieving organizational objectives (Hamidu et al., 2015). Stakeholders that exert much pressure
68 on companies as to achieve external performance are owners, employees, customers, suppliers,
69 investors, government, community, trade association (Sen & Cowley, 2013).

70

71 Firm's Financial Performance is an evaluation of how a firm (i.e management) can use its assets
72 to generate revenue. It also shows how well a firm can utilize its assets in a period of time to
73 show a firm's general financial health (Fauzi, 2007). Firms measure their success through long
74 term performance, which many firms now assess their success through CSR initiatives and
75 corporate performance. CSR when managed properly creates value to the company and society

76 (Nolan, et. al, 2009). Many studies have been conducted that shows various relationships
77 between corporate social and financial performance.

78 As known, company's primary objective is profit maximization in operating their business. In
79 studies conducted previously Berger and Drumwright (1999) found a positive relationship
80 between CSR and corporate social performance, with high trust from stakeholders, employees
81 and customers. Jenkins (2006) found that companies that practices CSR has positive brand image
82 than those that do not practice CSR. (Jones, 2005; McWilliams et al., 2006) shows that corporate
83 good image can be used as a tool to attract stakeholders in showing a positive corporate image,
84 which helps a company striving in a competitive market. Authors (Walsh et al., 2009) found that
85 firms that produce good quality products and services gains more trust from customers, grow
86 positive word of mouth, maximize profit, have high customer retention power and build
87 customer loyalty, from customers' perception. Sweeny, (2009) found a positive correlation
88 between CSR and firm's financial performance and this is because it affects the firm's
89 reputation, employee attraction and loyalty. (Mishra & Suar, 2010) have found a positive
90 relationship between CSR corporate financial performances. In employees' perception,
91 company's good image motivates employees in making more effort in their workplace and
92 becoming more productive, which leads to great performance in the company. This is because
93 good reputation leads to positive performance (Bergh & Ketchen, 2010).

94 Choi et al (2010) found a positive relation between CSR and CFP. The relation was due to the
95 positive correlation between stockholder-weighted CSR and Tobin's Q .Short term impact shows
96 financial performance measured by accounting-base measures such as ROA, ROE (Inoue & Lee,
97 2011). According to the studies, the effect on CSP measured by short term profitability is much
98 stronger than the effect resulted by long term profitability measured by market-based measure
99 (Inoue & Lee, 2011). In the study of Inoue & Lee (2011) found a positive relation between CSR
100 and CFP through the effect tested of five dimensions on CSR. Their result concluded that each
101 dimension of CSR has a different impact on the short-run and long-run financial impact but the
102 results obtained shows that CSR activities would improve firm's profitability. Wu & Shen (2013)
103 studies CSR in banking industry where the results showed the positive relation on CSR and
104 accounting-base financial measures (ROA, ROE, Net interest income) in the banking industry.
105 Ahamed, Almsafir & Al-Smadi (2014) used accounting based measure to measure financial
106 performance in Malaysia with control variables (firm's size and revenue) and resulted CSR is
107 positively related with ROA and ROE. Ming Wei Siw (2017) found that there is a positive and
108 significant relationship between CSR and CFP in that CSR one year lagged is followed by
109 improved CFP in the financial year. It is also found CFP one year prior, however, does not seem
110 to lead to decisions to engage in CSR.

111 On the other hand Vance (1975) provided evidence that there was a negative relation between
112 CSR and CFP measured by stock market returns in UK. Jensen, 2001 stated that the aim of the
113 company is to maximize profit and not the well being of the society, the study also states that
114 social activity affects CFP negatively. Sundaram & Inkpen, 2004 imposed that corporate social
115 responsible activities puts pressure on the company's profit as it has no relation with economic
116 role of firms. There is also a study done by Brammer, Brooks & Pavelin (2006) which shows a
117 negative relation between corporate social responsibility and financial performance in UK listed
118 firms. Lopez, Garcia, & Rodriguez (2007) showed how CSR activities impact the business
119 performance. The researchers selected 55 European firms, in which one group practiced social

120 responsibility and the other did not. This resulted to a group with CSR activities having a
121 negative impact on business performance Lopez et. al.,(2007). Chen et al., 2015 observed that
122 companies spend much time, effort and resources on cooperating CSR activities thus becomes
123 costly and decrease in company's profit. In having a decrease in financial performance,
124 managers can reduce investing in CSR activities to bring about improved financial performance.

125 Some scholar observed no relationship between CSR and Financial performance. Ulman, 1985;
126 McWilliams & Siegel, 2001 found that the relation between CSR and CFP does not exist and
127 that is due to many variables that impact the business. Even with the same accounting-based
128 measure some researchers get different findings in the research. There are some researchers who
129 find that CSR has no impact on CFP to measure financial performance when using accounting-
130 based measures. Surroca et al (2010) studied that there is no relationship between CSR and CFP.

131 Based on the researchers' knowledge, most of the above literatures shows influence of CSR and
132 CFP in financial institutions but there is no study that measured CSR by CSR costs over sales
133 based on the hotels specifically in developing countries. Therefore this study examines the
134 impact of CSR on return on asset (ROA) and return on equity (ROE) of listed hotels in Zanzibar.

135 **3.0 RESEARCH METHODOLOGY**

136

137 This part presents method used for analysis. This study utilize OLS random effect model to
138 determine the relationship between CSP and CFP. The total sample consists of 4 selected hotels
139 at Nungwi in Zanzibar with years of observation over the period of 2013-2017. These hotels are
140 selected as the data source because willing to report their social behavior and as hotel industry
141 plays a very important part in contributing to the GDP of the country. The sample consists of 4
142 listed hotels in Zanzibar which are located at Nungwi for the years 2011-2017. This research
143 focuses on Nungwi because Nungwi hotels have been publicly reporting their CSR information.

144 **3.1. Model Presentation**

145 This study utilizes OLS random effect regression model is as follow in showing the effect of
146 CSP on CFP. This regards the unobservable firm characteristics. Random effect model consider
147 changeability of all variable that affects the corporate financial performance (CFP) (Barnett &
148 Salomon, 2012). This is the best method because hotels are operated due to change environment
149 Random effect regression model of showing impact of CSP on CFP is as follows;

$$150 \text{CFP}_{it} = \alpha_0 + \alpha_1 \text{CSR}_{it-1} + \alpha_2 \text{Size}_{it} + \alpha_3 \text{Lev}_{it} + \alpha_4 \text{R\&D}_{it} + \varepsilon_{it} \quad (1)$$

151

152 Where, *CFP* is the corporate financial performance; *CSP* is corporate social responsibility;
153 *Size* is size of the hotel; *Lev* is *Leverage*; *R&D* is research and development, ε is error
154 component; α_0 is constant and $\alpha_1, \alpha_2, \alpha_3$ and α_4 are coefficients.

155 **Measures of Variables**

156 **Corporate Financial Performance** is a dependent variable. It is measured by using profitability
 157 (i.e, ROA and ROE) (Barnett & Solomon, 2012; Ahamed et al, 2014). ROA measure ability on
 158 the management to utilize assets of the hotels while ROE is a net profit a firm earns through a
 159 percentage of shareholder’s equity that measures how managers efficiently manage the capital
 160 invested by shareholders (Inoue & Lee, 2011). It is influenced by corporate social responsibility.

161 **Corporate Social Responsibility** is an independent variable. It measures by Ln of previous year
 162 total cost paid for social responsibility divide by sales. It is expected to have positive effect on
 163 financial performance because increasing amount paid for social responsibility increase
 164 organization image that increase profitability (Ahamed, Almsafir & Al-Smadi, 2014).

165

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Table. 1: Variable Definitions

Variables	Definition	Expected sign
CFP		
ROA	EAITDA divided by book value of total assets	
ROE	EAITDA divided by book value of total equity	
CSR	Ln of previous year total cost paid for corporate social responsibility/ Total sales	+
Control Variables		
Size	Ln of Book value of total assets	+
Lev	The ratio of long-term debt to total assets	=
R&D	The ratio of R&D expenses to total sales	+

167

168 There are many control variables used in this researches such as size, leverage; and research and
 169 development.

170 Size is one among the important control variable in considering CSR in firms that stress
 171 corporate financial performance (Barnett & Salomon, 2012). The effect of Hotel size is
 172 calculated by including the logarithm of total assets (Ln(A)) of a hotel, (Yudistira, 2004). It is
 173 expected to have positive impact on financial performance (Gamerschlag et al., 2011). Positive
 174 relationship between size of the hotels and financial performance arises due to the fact that large
 175 hotels enjoy operating benefits by employing few professional managers and high technology
 176 and reduces other costs such as cost of information that increase profitability. Size of the hotels
 177 is included because normally the expansion of hotels leads to the increases job specialisation,
 178 and enjoyment of economies of scale that increase profitability.

179 Leverage is another important control variable. It is measured as a ratio of long-term debt to total
 180 assets. Leverage shows how hotels operate in high and low debt. High leverage ratio makes a
 181 hotels’s profit to be influenced in a negative way because of large amount of interest that hotels

182 is supposed to pay (Inour & Lee, 2011). Thus reduces profitability. Firms with low leverage are
183 more likely to engage in CSR activities than firms with high leverage ratio.

184 R&D is expected to have positive impact on financial performance (Lin et al., 2009). Research
185 and development leads to correct investments and efficient employees that leads to more profit in
186 the hotels.

187 **4.0 Analysis**

188 This part shows analysis of the results on the impact of corporate social responsibility on
189 financial performance of Nungwi hotels in Zanzibar where size, leverage and research and
190 development are used as control variables. Before presenting main results of random effect
191 model; descriptive statistic, correlation analysis and houseman test are presented.

192 **4.1 Descriptive Statistics**

193 Table 2.1 shows the descriptive statistics for all variables used in this research. This panel data
194 includes 4 hotels over the period of 2011 to 2017 for the Nungwi hotel firms in Zanzibar. This
195 analysis gives an overview of the number of observations, mean, median, standard deviation,
196 minimum and maximum.

197

Table 2.1: Descriptive Statistics

Variables	N	Mean	Median	Std Dev	Minimum	Maximum
CSP	140	0.004633	0.00443	0.004055	0.004055	0.005504
ROA	140	0.003219	0.022128	0.030555	0.087193	0.029252
ROE	140	0.009256	0.059287	0.0049792	0.247881	0.087451
R&D	140	0.003823	0.003654	0.000494	0.003264	0.004576
Leverage	140	0.655827	0.665483	0.026083	0.613732	0.693003
Size(mil)	140	0.833703	0.856488	0.053417	0.756923	0.909972

198

199 The descriptive statistic shows that at least every hotel in the sample discloses some information.
200 The mean value of independent variable (CSR) is 0.0046; this means the selected hotels
201 published 5 CSR keywords per 1000 words in the annual report. The CSP variable resulting to a
202 positive mean value shows the sample hotels in this research are actively incorporating CSR
203 activities.

204 The average ROA for the sample hotels is 0.0032. This is the lowest mean value. The leverage
205 have highest mean value. When mean values are compared by variance of all variables, results
206 confirm all variables meet the required standard.

207 **4.2 Correlation Analysis**

208 This analysis shows the correlation of all for the sample firms (hotels) in this study. The research
 209 looked on the correlation level between independent variables. Table 2.2 represents the
 210 correlation of independents variables used in this study to establish the existence correlation
 211 between variables.

212

213

Table 2.2: Correlation Matrix

Correlation				
Probability	CSR	LEVERAGE	R_D	SIZE
CSR	1.000000			

LEVERAGE	-0.391665	1.000000		
	0.0000	-----		
R_D	0.598982	-0.390817	1.000000	
	0.0000	0.0000	-----	
SIZE	-0.135495	-0.213602	-0.125877	1.000000
	0.1004	0.0113	0.1084	-----

214 *.** Correlation is significant at the 0.01 and 0.05 level, respectively.

215 Based on the above results all independent variables are not correlated. Therefore all independent
 216 variables can be used in the regression model.

217

218 **4.3 Regression Results**

219 This part analyses results of random effect model regression on the effect of corporate social
 220 responsibility on financial performance (i.e ROA and ROE) of the hotels. Table 2.3 shows effect
 221 of corporate social responsibility on ROA and ROE.

222 The results show positively significant influence of CSP on ROA and ROE. The study comply
 223 with Wu & Shen (2013) study and against Chen et al., 2015. This shows that improving in
 224 corporate social responsibility leads to increase the corporate financial profit hence increase
 225 performance. By increasing corporate social responsibility, profit increase due to increasing
 226 image of hotels to the public and effort of employees on improving productivity.

227 ;

228

229

Table 2.3: Results of CSR on ROA and ROE

	ROA	ROE
CSP	3.114	8.75
	(7.48)	(7.54)
Size(mil)	0.35	1.02
	(8.28)	(8.58)
Leverage	0.53	1.65
	(5.76)	(6.41)
R&D	-671.6	-1882.4
	(6.93)	(-6.95)
Constant	15.57	43.63
	(7.14)	(7.16)
No. of observations	140	140
Adj-R sq	0.585	0.601
F-value	49.89	53.24
F-statistic	49.89611	53.24349
Prob(F-statistic)	0.000000	0.000000

231

232 The size of the firm is significant positive influence both ROA and ROE. This shows when the
 233 size of the hotel increase, Hotels enjoys economic of scale and admitting many tourists. A hotel
 234 enjoy operating benefits by increases job specialisation, employing few professional managers,
 235 high technology and reduces other costs such as cost of information. Thus increase sales volume
 236 that raise profit hence increase profitability

237 The study also found positive significant influence of leverage on ROA and ROE of the hotels.
 238 High leverage ratio makes hotels to earn more profit. This shows hotels do not pay much amount
 239 as interest and use debt efficiently as capital invested. Thus increase profitability.

240 R&D shows negative results and significantly impacts both ROA and ROE. This shows R&D
 241 increase unnecessary costs of the hotels and it does not leads to correct investments and efficient
 242 employment of the resources that leads to low profit in the hotels hence low profitability.

243

244 The Hausman test was performed before conducting random effect regression. The hypothesis is,
 245 if Hausman Chi-square statistics is greater than the probability random effect model is favored
 246 and if the Hausman Chi-square is less than the probability, random effect model is favored. This
 247 shows that probability is greater than the Hausman Chi-square, thus, the random effect model
 248 can be used in this panel. Based on rule of thumb general model is good because F statistic value
 249 is greater than 10 and p values shows significant.

250 5.0 CONCLUSION

251 This study shows high insight concerning the relationship between CSR and corporate financial
252 performance in the form of ROA and ROE. This study used panel data of 4 Nungwi hotels
253 covered a period of 2011-2017 to work with OLS random effect model. ROA and ROE were
254 used as dependent variables, CSR as main independent variable of the hotels. The study adds
255 control variables such as leverage, R&D and size.

256 The study found that corporate social responsibility (CSR) has positive and significant relation
257 with hotel's financial performance in Zanzibar and all control variables are significance positive
258 impact of ROA and ROE except R&D has significant negative impact. This is due to competitive
259 advantage achieved by CSR activities which resulted to customer loyalty which in turn increased
260 hotels turnover.

261 The study recommends firms to be socially responsible so as to see the value of the firm for the
262 shareholders. The hotel managers should allocate many resources in different forms of CSR
263 activities but it should make sure recourses are efficiently allocated by reducing cost through
264 bargaining and improving quality to increase customer loyalty and growth. This is due to the fact
265 that CSR activities enhance hotels performance in financial perspective.

266 It is also the government should encourage hotels to practice corporate social responsibility by
267 reducing tax to their operation. Tax reduction will automatically makes hotels to invest in CSR
268 that increase profitability and hence economic growth and development because this sector
269 contribute much in country's economy.

270

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