Corporate Social Responsibility and Financial Transparency: Evidence from Pakistan.

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CERTIFICATE

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Author's Declaration

I Shumail Tahir hereby state that my MPhil thesis titled Corporate Social Responsibility and Financial Transparency: Evidence from Pakistan is my own work and has not been submitted previously by me for taking any degree from this University PIDE (Pakistan Institute of Development Economics) or anywhere else in the country/world.

At any time if my statement is found to be incorrect even after my Graduation the university has the right to withdraw my MPhil degree.

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Dedication

I would like to whole heartedly dedicate this thesis to my parents for their continuous support in all facets of my life. I hope this achievement will complete the dream that you had for me all those many years ago when you chose to give me the best education you could.

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ABSTRACT

Corporate social responsibility disclosures are anticipated to promote financial accountability by providing transparent and improved financial statements. Various studies have analyzed the relationship with non-financial disclosures. This study investigates the association among corporate social responsibility and financial transparency. This research uses the data of top 100 non-financial firms listed on the Pakistan Stock Exchange for the year 2009-2019. Financial transparency is proxied by earnings aggressiveness and loss avoidance. CSR disclosure is measured by composing an index using 20 variables. The results depict that there exists a positive association among CSR and financial transparency. CSR promotes financial transparency and mitigates information asymmetry. It prevents the exploitation of outsiders by information advantage of insiders.

Keywords: Corporate social responsibility, Financial transparency, Earnings aggressiveness, Loss avoidance.

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Chapter 1.

This chapter provides an insight about the initiation and background of Corporate Social responsibility and financial transparency. How both of them are interlinked and what impact does CSR has on financial transparency of a firm. After that, research question and objective of the study are presented which describes the basic reason for the study. Following that significance of the study is mentioned which shows how this study can contribute to the financial scenario in Pakistan.

Introduction

1.1 Background of the study

The scope of corporate social responsibility (CSR), from the very start of the 21st century, has demonstrated a major progress all around the world. CSR disclosure is not only thought of as social and moral task but clear and precise rules and regulations have been issued in order to keep in view the morals, values, duties, administrative structure and the practices of the organizations, so that all the socially responsible concerns are foretold and are addressed and tackled in an appropriate manner (Shahin & Zairi, 2007).The basic notion of CSR is not to maximize profits but to incorporate a sense of responsibility among the organizations towards their stakeholders including all the shareholders, customer base, society, workforce and the surrounding where it is located. CSR disclosures has been the main topic of interest for researchers and its perception has not only expanded but has been widespread significantly (Laidroo & Sokolova, 2015). Out of all the reasons, financial transparency is the key factor for the firms to report and reveal their CSR reports (Ofori & Hinson, 2007). In order to provide more transparent disclosures and to fulfill the requirements of all the parties concerned, firms make efforts to reveal the relevant and important information. The management of the firm deliberately reveals various kinds of information in order to cut down the asymmetry of information among the managers and the stakeholders (Ho & Taylor, 2013).

Corporate social responsibility (CSR) describes the capacity of the firm held socially, economically and publically accountable for the evaluation, growth and development of the surrounding where it is located and in operation. It explains the facilities that a company provides to the society and economy as a whole voluntarily. This result in uplift in the purchasing conduct of the company and a good moral reputation of the company in the environment it precedes.

Whereas, financial transparency depicts a clear scenario of the economic conditions of a company by reporting the number of its earnings in its annual reports and financial statements. Companies are then held questionable for their disclosed information by different regulatory measures and accounting strategies. It is done to make sure that the rights of investors are being safe guarded. Chih et al. (2008) observe that all the stakeholders consider the financial transparency of the company equally important and it is not only confined to the shareholder only. This is due to the fact that the avoidance of asymmetry of information can provide safety to all the outsiders and avoid the misuse of them by the insiders that tend to have more information.

Now, the question arises that why CSR and financial transparency are being considered important? The answer is that by keeping in view the accusations of the accounting and management scam of Enron and some comparable accusations at Tyco, BMY, WorldCom and Xerox etc., it gives the impression to a lot that the inside members have gradually been misusing the opportunistic behaviors and their freedom of choice to exploit the external members by means of their opaque financial reports. An ample amount of comments have blamed such accounting and management scam of defaming the moralities of business (New York Times, 2002) or to collapsing of the corporate social responsibility. This clarifies that why the managers in communal view, and business, clients and stockholders are of the view that the sole purpose of an organization should not be just confined to accumulate profit at the cost of the needs of its stakeholders and the environment where it prevails. As a matter of fact, the financial transparency and responsibility, as important to the investors as they are to all of the other stakeholders, are the vital ethics of CSR which can help to reduce the exploitation of the outsiders from the insiders due to their advantage of being more informed.

Financial transparency emphasizes on using earnings of the firm to portray the true performance of the firms. So, earnings management is taken into consideration while discussing about financial transparency. As financial transparency and responsibility both are important for CSR, an essential need is to carry out a close inspection of problems regarding earnings management. Earnings management is basically the modifying of stated economic conduct of an organization by the inside members either to deceive some of its stakeholders or to affect predetermined conclusions (Healey & Wahlen, 1999). As an instance, the inside members can misuse their authority and overemphasize the actual earnings and underemphasize any genuine unpromising earnings in their financial reports which would provoke the external members to adopt measures to tackle them. In the presence of large scale earnings management the financial reporting of firm fails to address the true performance of firm and as a result impairs the capability of the outside members to actively partake in the governance of the firm (Leuz et al., 2003). Bhattacharya et al. (2003) figure out the three frequently used techniques that promote the earnings opacity which consequently lowers financial transparency. These three techniques are earnings aggressiveness, earnings smoothing and loss avoidance. All of them undoubtedly deteriorate the association among the accountability and genuine economic conduct of any organization or company.

Earnings aggressiveness tends to postpone the reporting of losses and to speed up the reporting of profits. Earnings smoothing basically shifts the benefits and costs across different reporting time periods with the intention of depicting a false image that the firm has stable earnings. Loss avoidance is an act to avoid the reporting of small losses.

In accordance with Qian et al. (2015), financial opacity is examined to be the inverse of financial transparency and all three aforementioned techniques of earnings management are the proxies of financial opacity. Hence, lesser degrees of earnings smoothing, earnings aggressiveness and the loss avoidance are anticipated to demonstrate a greater degree of the financial transparency.

Chih et al. (2008) propose that nature of relation among CSR and the earnings management is dependent upon the proxies being used. If earnings management is being proxied by earnings smoothing and loss avoidance, an increase in CSR decreases or moderates earnings smoothing and loss avoidance. In case of earnings management being proxied by earnings aggressiveness, increase in CSR may increase earnings aggressiveness.

There can be no relation at all among the CSR and earnings management in case of earnings management being carried out by institutional factors that are not related to CSR. The basic notion is that a corporation with a sound CSR makes no attempt to engage in earnings management, which provides an absolute indication of negative association among the both CSR and earnings management. The fundamental rationale is that a company perceives a sense of social responsibility and therefore makes no such attempt to conceal any undesirable earnings insights and hence does not partake in any earnings management activities. From this perspective, Shleifer (2004) infers that earnings management, which is found to be morally offensive and questionable, appears to be much less in the organizations that are highly engaged in their social responsibilities. Assuredly, CSR amplifies transparency and curtails the opportunistic behavior to control and alter the earnings. In the same way, Gelb and Strawser (2001) identify that a confined data sample of the firms of U.S. partaking in socially responsible endeavors deliver much more informational and detailed declarations in comparison to the firms that do not actively partake in social responsibilities. In similar manner, Shen and Chih (2005) figure out that improved transparency in the accountancy exposures in banking sector can lessen the possibilities of banks to alter their earnings. Those firms that are inclined toward CSR emphasize not just to boost the profits earning but in addition they also focus on improving upcoming relations with their stakeholders.

That is why it is anticipated that the companies which engage themselves in the practices regarding CSR will be likely to display transparency in their financial reports as an essential part of their moral code of conduct.

Furthermore, Companies provide highly transparent financial information because they think that it is their social responsibility to provide these to its stakeholders. They have a sense of social responsibility to spend their time, efforts and capital resources to select and exercise the CSR guidelines to fulfill the moral values and hopes of the stakeholders, general public and the surroundings in which these firms are located and are less probable to disclose the information which is not financially and economically transparent and fails to address the accurate economic conduct of the firm. Gelb and Strawser (2001) debate that firms are encouraged to take part in stakeholder managing activities by carrying out the activities of their social responsibilities and disclosing the detailed and informative report is one of such activities. Now the question arises that why do the companies reveal their information to the outsiders? Or why is that possible that some of the companies prefer to reveal more detailed reports as compared to other companies? Some of the studies debate that in case of revealing more informational disclosures; the firms can reduce their cost of capital by increasing their demand for the equity and debt issued. A wide range of scholars have acknowledged this understanding. For instance, the Special Committee on Financial Reporting of the American Institute of Certified Public Accountants (1994) affirms that firms can get an easy access to the capital and they can reduce cost of capital by enhancing their financial disclosure quality.

1.2 Research Question

The association among corporate social responsibility (CSR) and the financial conduct of the firms remains to be at contrasting positions. Several studies indicate a positive association among both the CSR and financial performance of the companies (Waddock & Graves, 1997) whereas some studies indicate the existence of a negative association among the two (Cordeiro & Sarkis, 1997). In addition to that, various studies show that there exists no association among CSR disclosures and the financial conduct of firms (McWilliams & Siegel, 2000). This contradictory phenomenon has become the motivating factor for the study. The main notion of the study is to examine:

- Does CSR influence financial transparency?

1.3 Objective of the study

The relationship among CSR and the financial transparency of a firm continues to be a highly practical question. This is why the main purpose of this study is:

- To provide insight about the association among corporate social responsibility and financial transparency.

1.4 Significance of the study

The findings of this study may contribute tremendously to the benefit of CSR and Financial reporting standard setters, corporate governance law makers and ultimately the public at large. This study provides insight not only to transparency policy setters but also foster further development of CSR. The public at large will be aware of which companies are socially responsible and would prefer to make transactions or otherwise would like to be associated with that name. If we look from the governmental point of view transparency is closely linked with CSR. The organizations that are transparent disclose their information in a manner that allows all the stakeholders to have a deep insight regarding all the matters relevant to (Kaptein, 2003). Financial transparency is deemed as an important ingredient for CSR.

So the main aim of the research is to find out if there exists a direct positive correlation between CSR and financial transparency. With the passage of time CSR strategy of any company is only valued if it is properly disclosed and reported. Same is the case with the financial side of things where proper disclosures and audited statements boost shareholder and investor confidence in a company. It has been seen that as long as the company makes information available and accessible, disclosure and reporting of information are in fact inevitably linked to transparency (Dubbink et al., 2008).

Chapter 2.

This chapter discusses the theoretical linkages between the corporate social responsibility and the financial transparency and further discusses the contradictory phenomenon and different aspects of the association between both. It sheds light upon the relationship of CSR in context of different theoretical approaches. It also includes the empirical literature carried out regarding the association between CSR and financial transparency. This chapter is concluded by mentioning the literature gap and the problem statement.

Literature Review

A major part of the literature has paid attention to the quality of and the reasons for corporate social responsibility. Undeniably, with an increase in the attention to the social responsibility of firm, the scholars have also started to pay much heed on this phenomenon. The prevalent approach toward the CSR has theatrically changed in the time span of a last few decades. The market collapse on Wall Street in 1929 resulted in the emersion of the notion of corporate social responsibility (CSR). In year 2000, the United Nations set up the Global compact which since its commencement has devised 10 rules and regulations to safeguard and encourage the rights of humans, labor force, the surrounding environment and combating corruption. In the development stages of international accountancy, Carnegie and Napier (2002) put forward seven ways from a relative view about the treatment of CSR and financial disclosures in various finance marketplaces. During the World Summit in 2005, the environmental, social, and the economical elements were reconfirmed as competent and effectual in regard to the financial and accounting policy making process of a firm.

2.1 Theoretical Literature

In the beginning, the idea of an organization partaking in expensive social activities, if not being subject to direct criticism, was interrogated. In the present day, the CSR practices, sometimes categorized by the name of stakeholder management (Freeman, 1984) or corporate citizenship (Maignan et al., 1999) is being regarded as an authentic and a serious effort.

In the developing nations like Pakistan, the idea of CSR is new and it is still in its inception stages. Merely a few companies have a CSR reporting of their own and these are particularly the multinational companies that have their own guidelines of CSR reporting. Organizations and the overall community are not much mindful of their human and constitutional moralities and duties. They do not consider CSR as a foundation of success and development in the long run and it is mostly taken for granted. In the case of Pakistan, much of the efforts put in CSR are mainly because people think of it as an act of altruism. The donations provided by the organizations are also considered as a significantly important proxy for CSR reporting. (Makki & Lodhi, 2008).

In order to enlighten a particular phenomenon, the responsibility of looking for a suitable theory is not easier to undertake (Tilling, 2001). In accordance with this purpose, some academic scholars use different theoretical structures to explore the quality and accountability of the society and environment disclosures (Islam & Deegan, 2010). Numerous theoretical structures are used to analyze CSR. Friedman (1970) states that carrying out CSR activities is representative of agency problem or it is a matter of dispute among the benefits of managers and stakeholders. He claims that the managers or insiders utilize CSR in order to achieve their own social or political gains at the costs of its stakeholders. In accordance with this view, capital funds invested in CSR would be spent more efficiently, keeping in view social ethics and will increase the efficiency of the firm.

Moreover, as Hill and Jones (1992) debate, there exists a similarity among the general class of stakeholder-agent relationships and the principal-agent relationships considered by agency theory. According to the stakeholder-agent theory (Hill & Jones, 1992), the firms are motivated to invest in CSR activities as it could be helpful to reduce the monitoring costs that are related with the information asymmetry rooted in the relationship of stakeholder and agency. Considering that it is quite a difficult task for the stakeholders to detect whether the management is working in favor of them or not, stakeholders require more information of the management activities of the firm. As indulging in CSR reports the quality of work the management is doing, the stakeholders do not feel the need to gather more information. Hence the monitoring dost is also reduced.

Another theory namely, the legitimacy theory (LT) has been vastly recognized theory to describe the CSR disclosure of a company (Murthy & Abeysekera, 2008). According to this theoretical approach, firms are recognized as a part of a greater social system. According to this opinion, some of the scholars discover that companies are influenced by the surrounding where they are working. That's why LT focuses on the possibilities for the management of the companies that will contribute towards the expectations of the surrounding community (Deegan, Rankin & Tobin, 2002). Organizations usually reveal their positive CSR behavior and by means of CSR activities they try to express their legitimization actions. To improve the legitimacy of a firm, the firm abstains from revealing negative information and increase good CSR reporting which in turn results in an increase in financial transparency.

For a better understanding of CSR disclosure, another theory used is the Social and political cost theory. Political costs are affected by numerous different reasons and are increased which in turn affect the company's administration decisions about what accounting tools should be used (Watts & Zimmerman, 1978). Larger organizations are more prominent to the general public and are more vulnerable to the political decisions. This point of view is monitored by the top administration of larger organizations. The top administrator members may reveal CSR concerns as an integral portion of their annual reports in order to curtail the political costs.

Two more theories that provide a better understanding of link between corporate social responsibility and the financial conduct of a company are theory of social exchange (Cropanzano & Mitchell, 2005) the theory of stakeholders (Kumar & Tiwari, 2011) also known as the theory of instrumental stakeholders (Gherghina, Vintilă & Dobrescu 2015). The theory of Stakeholders creates a link among all the suitable stakeholders and the wealth maximization of the shareholders. It shows the relation between a company and all of its stakeholders. The company is bound to meet the needs of its different stakeholders instead of only the important shareholders. That's why this theory focuses on the accountability of a company to its stakeholders and to carry out the accountability, the disclosure of information plays a vital role. The society has the freedom to know about some aspects of the operations of the company. CSR, thus, provides the society as a whole about the degree to which the company has been meeting the obligations assigned to them.

Gherghina et al. (2015) distinguished that the value of stockholders will expand if the resources of stockholders are used efficiently for CSR disclosures. The act of a company to partake in the CSR activities may give a good impact to the general public with regard to the company's status and repute which in turn can have an impact on return on capital. The stakeholder theory hence provides an association between the society and the stakeholders to achieve corporate performance. The social exchange theory illustrates that there exists a two way relation between the firms and the general public. As the general public increases the sales of a firm by purchasing their products, the firms also contribute to the general public by partaking in the CSR activities. For that reason, the theory of stakeholders defines that CSR, return on capital employed (ROCE) and market book value (MBV) are all associated whereas the theory of social exchange ultimately provides an association among the size of firm and CSR.

With the aim of explaining the relationship between CSR and Earnings management, prior literature has advocated two different perspectives. The first prospect, managerial opportunism prospect states that firms who engage themselves in earnings management might deliberately use CSR to cover up their opportunistic behavior. The managers that partake in earnings management may make use of CSR to tackle the surveillance and stakeholder activism (Prior et al. 2008). As CSR is concerned with ethical and moral issues, taking part in socially responsible programs and activities will not only put a good impression on stakeholders but will also positively affect the company's reputation. This positive impression of the firms will help them build good ties with the community and also to gather support from different groups of stakeholders. This implies that some firms that tend to engage in earnings management carry out the CSR activities in order to conceal their opportunistic behavior. In accordance with this stance, Choi et al. (2013) debates that firms who engage in opportunistic behaviors for their own personal benefits tend to disguise their actions by partaking in socially responsible activities. Furthermore, Choi et al. (2013) concludes that those firms that belong to rich countries and carry out CSR activities engage more in earnings management in contrast to those firms that do not carry out CSR activities. They do so for the sole purpose of hiding their opportunistic behavior of engaging in earnings management.

On the other hand, firms that are strongly committed to CSR and are more socially responsible, do not engage themselves in opportunistic behaviors and hence, do not partake in earnings (Chih et al. 2008). Kim et al. (2012) finds that CSR is negatively related to earnings management implying that the firms that are strongly committed to CSR do not partake in opportunistic behaviors like earnings management. It is likely to be possible that the management of the firm might get involved in some activities that could pose a threat to the company and stakeholders except the managers. Since managers are more concerned about their own job security, profits, and maximizing their own benefits, the parting of management and ownership of the firm could cause some serious issues along with the existence of conflicts and asymmetry of information. This motivates us to investigate the relationship between earnings management and CSR in the light of agency theory. Agency conflict arises in the scenario when managers work for their own benefits instead of maximizing the value of the firm from stakeholder point of view. It causes the asymmetry of information as managers have more superior information as compared to the owners. Managers can engage in opportunistic behaviors such as earnings management to attain their objectives, which as a result can increase the agency cost of the firm. Since it can cause serious problems to the firm and causes information asymmetry, an ideal solution needs to be discovered to tackle such problems. For that, Watts and Zimmerman (1986) debate that a sound accountability and transparency system can be one of the solutions to tackle the agency conflicts. Provided that financial transparency and accountability are important to CSR, a detailed analysis of CSR and earnings management is required in context of agency conflict Chih et al. (2008). Jo and Kim (2007) debate that firms that reveal detailed information about their social and moral activities are less likely to engage in earnings management due to the fact that information is more transparent which reduces the asymmetry of information between the management and the stakeholders. It will help the stakeholders to identify earnings management.

In the similar way, Eisenhardt (1989) implies that as the information methods give information to the principal regarding the activities of agent, they are less likely to engage in opportunistic behaviors because they will have the fear of being caught. Likewise, Shleifer (2004) debates alterations of earnings is less likely to occur in firms that are strongly committed to CSR. Moreover, Chih et al. (2008) imply that firms that have a strong dedication to CSR activities prevent themselves by partaking in opportunistic behaviors regarding earnings.

Eventually, in context of signaling theory Hughes (1986) illustrates that reliability of information disclosed by the corporation plays a vital role in lowering the degree of information asymmetry. Provided that earnings management occurs more often when there is asymmetry of information, signaling theory presumes that CSR activities are used as a medium to lessen the extent information asymmetry i.e. agency conflict between firms and their stakeholders. Henceforth, on the basis of the notion that CSR disclosure is a useful medium to reduce the asymmetry of information, previous studies anticipated a negative association between CSR and information asymmetry (Brown et al. 2004; Coller and Yohn 1997; Heflin et al. 2005; Welker 1995) which as a result indicates a negative association among CSR and earnings management.

By adopting CSR practices, the firms send positive signals to their stakeholders that the firms have a better ability to fulfill the administrative voids. Now the question arises that how so firms give signal to their stakeholders. Most of the studies imply that firms that carry out socially responsible activities can decrease the extent of information asymmetry among the firm's management and the relevant stakeholders which improves financial performance.

On the basis of signaling theory, carrying out CSR activities is one of the ways for the firms to transmit information regarding their abilities. According to signaling perspective, firms that are more invalid in CSR practices tend to perform better and have more capabilities in comparison to those that are not much involved. Investors are more likely to invest in those firms that perform socially responsible activities (Spence 1973).

2.2 Empirical Literature

Friedman (1962, 1970) is commonly known to advocate the traditionalist opinion of the organization and its performance in the society it prevails. In accordance with the Friedman view, an organization is solely answerable to its shareholders and the only aim of the organization is to maximize its value. Following this notion of the role of an organization, an ample amount of literature has paid attention to the relationship among apparent CSR and the estimators of financial performance of the firms postulating that higher degree of CSR would in turn lessen the financial reporting of a firm. Opposing this view, Pava and Krausz (1996) carried out an extensive examination of this idea which the name the paradox of social cost. This states that those firms which partake in social responsibilities tend to outperform than those firms which do not take part in social responsibilities. Pava and Krauz provided an assessment of 21 studies that inspected the association among the CSR and the financial conduct of the firms. They wrapped up with the conclusion that there is slight indication that conduct of those firms that carry out CSR is comparatively weak as compared to other firms that do not partake in CSR activities. In fact, they discovered that the opposite of this notion to be accurate, the experimental outcomes recommend that firms that carry out social responsibilities tend to perform better than their corresponding firms. The CSR disclosure has now been acknowledged as a legal and vital trait of any organization. Therefore, companies will put in more efforts and resources in order to choose the accurate criteria and implement the CSR activities. Pava and Krausz (1997) specify that the trait that determines a CSR practice to be more legal is its close association of conduct to the actions of firm. Presenting the high degree of financial reports undoubtedly fulfills this requirement. Moreover, the provision of high levels of disclosures is also known to fulfill the requirements of various stakeholders.

Financial accountability and transparency is not essential just for the understanding of shareholders but it is as much important to other stakeholders as well. They are considered to be the principles that define the how socially responsible a firm is. The CSR policies of a company have direct influence on the administration's choices regarding the reporting of financial statements because it influences the company's incentive upon transparency (Kim et al., 2012).

Being transparent is considered an instrument for accountability as it allows the stakeholders to withstand the company and stand together against it if it deems necessary (Dingwerth & Eichinger, 2010). As the information provided by the company is anticipated to facilitate all the stakeholders to take sound decisions, they can also mutually take decision to stand against the company's policies if considered necessary.

Likewise, in accordance with the myopia avoidance hypothesis, firms that are involved in CSR activities are not as likely to engage in earnings management because they are essentially more dedicated to their organizational policies and to make policies regarding transparent financials (Chih et al., 2008).

The basic debate is that CSR disclosures encourage financial transparency and decreases the probability to partake in earnings management activities. There are practical findings in support to the view and document a negative association among CSR and earnings management.

In context to CSR and financial transparency, Adeneye and Ahmed (2015) inspect what effect does corporate social responsibility (CSR) has on the financial conduct of company on behalf of 500UK firms. By using a descriptive research design CSR is calculated using CSR index. Performance of the company is estimated by means of market to book value (MBV), company size (Size) also return on capital employed (ROCE). The outcomes portray that the MBV and ROCE are positively associated with CSR but no symbolic link is seen among CSR and size. The paper recommends that in order for companies to have better financial performance, more hard work should be put into CSR reporting which in turn can lead to be more competitiveness of a firm.

Cormier, Ledoux, Magnan and Aerts (2009), examine in what way a firm exercises its authority to bridge the gap of information asymmetry between its stakeholders in Canada. Information asymmetry is estimated by any of the two: share price volatility or Tobin's Q. The outcomes reveal that the magnitude concerning corporate administration disclosure, size of board and audit committee lessens the asymmetry of information. It puts forward that administration disclosure maybe used to mimic the technique of administration of a firm in lowering the stock market asymmetry. This is particularly in countries that provide a greater level of legal protection to investors. In addition, Cormier et al., (2009) discover that administrators also take into consideration the costs and benefits analysis of stakeholders while providing the degree of their administration disclosure.

Majeed, Aziz and Saleem (2015) explore the possible impacts of the features of corporate governance (CG) on corporate social responsibility (CSR) disclosure. Main features of CG that are taken into consideration are size of board, independent directors, women directors as well as foreign nationals. Multiple regression analysis is performed and the outcomes depict that the comprehensive CSR statements by Pakistani firms are somewhat adequate but the selections of CSR components are in fact very profound. The results portray that group of variables consisting size of board, institutional ownership, concentration of ownership and the size of firms have a positive association with degree of CSR disclosure. Board size and institutional ownership stand out to be the most influential of all variables. Bigger the size of board directors, the larger will be the degree of CSR disclosure.

As earnings management is taken into consideration in the discussion about CSR and financial transparency, Chih, Shen and Kang (2008) study whether any association among corporate social responsibility (CSR) and Earnings management (EM) crosswise 1,653 companies in 46 countries is seen. The study focuses on the idea that a company which intends to report CSR does not try to use smoothing techniques for its earnings. Moreover such firms also show a little to no concern in escaping earning losses and downfalls. This may lead to earnings aggressiveness but tough legal actions can be used for prevention. In order to inspect the association among CSR and EM, four hypotheses namely myopia avoidance hypothesis, multiple objective hypothesis, institutional hypothesis and predictable earning hypothesis are formulated. The first hypothesis states that there exists a negative association among CSR and EM. The second and forth one respectively state that there is a positive association. On the contrary, the third states that there is no association at all.

Barnea and Rubin (2005) study the association amongst a firms' CSR rankings and the capital and ownership structure of the firm. The study uses a distinctive set of data that classifies the major 3,000 US organizations on the basis that whether they are socially responsible or socially irresponsible. The paper provides a strong indication that the CSR spending is a reason of dispute among owners. The main reason for such conflict is that the senior officers gain more benefits as they have the major segment of the firms. The results depict that the social rating of firms have a negative association between the senior officers' ownership and leverage, whereas no correlation is found with the institutional ownership.

Benlemlih and Bitar (2016) examine the link among Corporate Social Responsibility (CSR) and efficiency of investment by employing 21,030 US firm-year sample for almost 3000 firms over the year 1998 to 2012. The study provides powerful indication that greater levels of CSR reporting accelerate investment efficiency. This is due to the fact that firms with greater CSR disclosures are more transparent. Furthermore, it concludes that impact of CSR on investment efficiency is more noticeable in the time of the subprime mortgage crisis.

Yunis, Durrani and Khan (2017) provide an updated scenario of empirical as well as theoretical literature in context of CSR in case of Pakistan. The study evaluates a number of different methods that can be used for future research, particularly in the case of Pakistan. Furthermore the center of attention is the issue of Child labor and textile and leather industry. The results state that in the present scenario, the methodological tools that researchers use is whether at a micro-level study approach or at a macro-level exploratory approach.

Cai, Jo and Pan (2011) practically investigate the consequences of corporate social responsibility (CSR) and CEO advantage considering a big section of US firms for the time span of 1996 to 2010. Two hypotheses are formulated. The overinvestment hypothesis is established on the agency theory. The conflict–resolution hypothesis is established on the stakeholder theory. The results show that CSR lag has a poor impact on the total and cash compensation after being controlled for different aspects of firm and board features. There also exists a negative relationship among lagged employee relations and CEO compensation. This negative relationship among CSR and CEO compensation relates with the conflict–resolution hypothesis on the basis of stakeholder theory.

Zhao and Xiao (2018) explore how the stages of life cycle of firm contribute in association of corporate social responsibility (CSR) with financial constraints by means of a sample of Chinese A-share public companies for the time duration of 2010–2016. The firms are being categorized into different stages of their life cycle. The study provides evidence that the firms in their growing, settled, and deteriorating stages of the life cycle have a negative correlation of CSR engagement with financial constraints. Nevertheless, those firms who are in their early growth stages have no prominent impact of CSR on financial limitations.

Cho, Lee and Pfeiffer Jr (2012) explore if information asymmetry is affected by CSR performance of the firms. The study uses KLD social performance rating scores as an estimate of CSR conduct with sample being used of 51,086 firm-year observations, for the time span 2003 to 2009. The results provide the evidence that positive and negative CSR reporting helps lowering the information asymmetry. Furthermore, the impact of negative CSR reporting is much more influential in lowering the information asymmetry as compared to the positive CSR reporting. The impact of informed investors shows that here exists a negative link among the CSR performance and bid-ask spread. This occurs due to the fact that the knowledgeable investor can possibly misuse their CSR information advantage.

Gao, Dong, Chenkai Ni and Renhui Fu (2016) examine the determining factors and economic concerns of non-financial disclosure. They are estimated on the behalf of ratings of corporate social responsibility (CSR) disclosure. The study finds that CSR exposure value is linked to the fundamental CSR conduct of the firm, financing prerequisites and to the corporate administration of the firm. Furthermore it explains that why do firms diverge prominently in their reporting of CSR events. The stronger the CSR conduct of a firm, the better is the firm's financial reporting quality. Advanced valued CSR disclosures are transformed in improved pricing and provide economic benefits.

Nair, Muttakin, Khana, Subramaniama and Somanath (2019) inspect the performance of the CSR reporting making impact on the financial transparency in case of India. The study recommends that CSR reporting magnifies the financial conduct and transparency where the government has made it mandatory to disclosure information. Moreover, they wrap up that this association among CSR reporting and the financial transparency is strengthened by proprietorship by the market investors.

Sierra-Garcia, Garcia-Benau and Bollas-Araya (2018) examine a study on Spain and discover that the 97.1% of companies listed on IBEX-35 publish the non-financial data in a distinct report whereas the percentage decreased to 80% in 2017. The results disclose that a corporate sector where a company functions is a defining element in level of governing consent. Certainly, complex sector such as the oil and the gas that discharge a large number of gases and air pollutants are those which deliver additional evidence.

Dhaliwal, Radhakrishnan, Tsang and Yang (2012) study association among exposure of non-financial evidence and the analyst estimate precision. The firm level data consisting 31 countries is used. They provide evidence that the connection is well built in the nations which are more stakeholders based and the CSR performance is also expected to have an impact on firm financial conduct. The association is likewise powerful for those companies and economies that have dense financial disclosure.

Hirshleifer and Teoh, (2003) describe that due to restraints such as inadequate investors' devotion and information handling capability, CSR disclosure value can possible have a weak or no impact on capital market, since they are not as much captivating in the case of attraction seeking actions for example the initiation of CSR report.

Byard, Li, and Yu (2011) explain the acceptance of International Financial Reporting Standards (IFRS). They documented that the advantages of adopting International Financial Reporting Standards (IFRS) are applicable to those firms who are more transparent and provide a high quality CSR disclosure. Moreover, they study finds that forecast errors and diffusion decline more for firms with higher disclosures and transparency.

Deng, Kang, and Low (2013) examine that high CSR acquirers gather greater merger benefits and higher returns on value weighted portfolio. It is more beneficial in post-merger long-standing operational conduct in comparison to small CSR claimants. Furthermore, it shows that mergers by larger CSR claimants are less expected to face failure and are completed in a shorter span of time in comparison to low CSR acquirers.

Rezaee and Tuo (2017) study the advantages that the organization gets from non-financial disclosures and if these disclosures are linked with company's' environmental, social, and governance (ESG) stability conduct. They take into account earnings quality due to the fact of it being abundant evident element to affect progressive non-financial disclosures and trademarked cost as it is a much prominent element in affecting chronological nonfinancial disclosures. The results depict that those companies with improved incomes quality and lesser trademarked rate announce additional non-financial exposures.

In context to Pakistan, following studies have been carried out whose findings are stated below:

Lone, Ali and Khan (2016) examine if, after the provision of corporate social responsibility (CSR) guidelines by the Securities and Exchange Commission of Pakistan (SECP) in 2013, any change exists in the CSR reporting structure. The consequences of corporate governance (CG) on CSR exposure is also taken into consideration. The study investigates if the provision of voluntary guidelines showed any development in the CSR exposure. Paired-samples of t-test are used and the outcomes depict that the degree of the general CSR disclosure has shown a symbolic expansion from 58.9 to 62.7 per cent after the provision of SECP guidelines. The degree of CSR disclosure varies from sector to sector. On average, amongst all the sectors, the CSR disclosure is maximum for the oil sector and gas sector (0.72) and is minimum for Textile (0.51). Moreover board size, number of independent directors also women directors have significantly positive influence on CSR exposure.

Kakakhel, Ilyas, Iqbal and Afeef (2015) show what effect does corporate social responsibility (CSR) has on the financial conduct of cement producing listed firms of Karachi

Stock Exchange (Pakistan) during the time span of 2008-2014. The results depict that here exists a significantly positive linkage between CSR and the financial conduct. Outcomes also provide the theoretical view of link among CSR financial conduct.

Sharif and Rashid (2013) analyze corporate social responsibility (CSR) of listed commercial banks of Pakistan together with possible impacts of various corporate governance (CG) features on CSR disclosures. The outcomes of this study affirm that apart from the fact that the CSR is voluntarily conducted in Pakistan whereas the partaking of commercial banks of Pakistan in numerous CSR movements has been quite satisfactory. Moreover the degree of CSR reporting is really notable. The consequences portray that non-executive directors influence CSR positively.

Saeed and Hashmi (2019) investigate what effect does family ownership has on the relation between corporate social responsibility and earnings management in Pakistani firms. The study employs the data for the years 2009-2017 of the public listed non-financial firms of Pakistan stock exchange. Pooled OLS regression model is used to analyze the relationship among CSR and earnings management. The findings of the study show that CSR is negatively related to earnings management. Moreover, the family ownership plays a vital role to moderate the association among CSR and earnings management. It supports the socio-emotional wealth theory. The family owned firms that are involved in CSR activities indulge less often in earnings management in contrast to the firms that are not family owned.

2.3 Literature Gap

Like all other developing countries, in Pakistan, the CSR activities are eminently affected by many outside forces and dominant stakeholders for instance the international buying community, international investors and their media houses and the foreign governance authorities. Furthermore, contrary to the developed economies, the developing economies face much lesser burden from general public in the case of CSR reporting. The link between CSR reporting and the financial transparency of a firm are confined to a few empirical documentations. In Pakistan, CSR activities are carried out voluntarily by a company or firm and most of it is being carried out on charitable and humanitarian basis. In the context of financial disclosures and transparency, not much research has been carried out in nonfinancial sector to the best of my knowledge. The reason for sluggish speed of research in this area is because the issues are complex and to find relationship and linkages between financial transparency and CSR is not that straightforward. The aim of study is to bridge the gap, in case of emerging economy of Pakistan, of the relationship among CSR and financial transparency. This detailed analysis will help the Pakistani Companies understand that the stakeholders value the CSR activities and thus will encourage them to be involved in CSR activities and give detailed disclosure of the CSR activities carried out for the perusal of the stakeholders so as to create value for the Company in the longer run. Companies will be guided on the activities that will result in greater value creation and the benefits of which will outdo the cost incurred on them.

This study will be an addition to the few such literatures available for our country in this facet of study. In the context of CSR and financial transparency, there is hardly any study carried out in Pakistan, to the best of my knowledge. The study will provide a detailed analysis based on most recent data of the most prominent Companies to provide evidence that whether or not there exists a relation between the CSR and financial performance of the companies. Moreover, a recent study in the case of Pakistan of Saeed and Hashmi (2019) has explored the relationship among CSR and earnings management by using family ownership as moderator. This study is different from the aforementioned study on the following basis: First of all, this study forms an association among CSR and financial transparency and conduct of the firms. It shows how CSR activities along with corporate governance practices promote financial transparency. Secondly, the proxies of earnings management used for financial transparency are earnings aggressiveness and loss avoidance which differ from the aforementioned study that has used real earnings management and accrual-based earnings management.

2.4 Summary of literature

On the whole, prior studies show that firms that carry out CSR activities are not much likely to involve in earnings management. Nevertheless, apart from taking decision to manipulate earnings, companies also make decisions on the ways to manipulate their stated performance. Put differently, some firms face dilemma regarding involvement in earnings management games and to what degree it should be utilized (Roy chowdhury, 2006).

The relation among corporate social responsibility (CSR) and financial conduct of the firms remain to be at a conflicting position. Several studies indicate a positive association among both the CSR and financial performance of the companies (Waddock & Graves, 1997) whereas some studies indicate the existence of a negative association among the two (Cordeiro & Sarkis, 1997). In addition to that, various studies show that there exists no association among CSR disclosures and the financial conduct of firms (McWilliams & Siegel, 2000). This contradictory phenomenon has become the motivating factor for the study.

2.5 Problem Statement

CSR disclosures are expected to foster the economic growth and promote financial stability and accountability by providing more transparent and improved financial statements. In Pakistan, the CSR activities are eminently affected by many outside forces and dominant stakeholders for instance the international buying community, international investors and their media houses and the foreign governance authorities. Furthermore, contrary to the developed economies, the developing economies face much lesser burden from general public in the case of CSR reporting. In Pakistan, CSR activities are carried out voluntarily by a company or firm and most of it is being carried out on charitable and humanitarian basis. The reason for sluggish speed of research in this area is because the issues are complex and to find relationship and linkages between financial transparency and CSR is not that straightforward. That is why the basic aim of study is to provide an insight about the association among CSR and financial transparency. Since, CSR promotes financial transparency and mitigates information asymmetry and also prevents the exploitation of outsiders by information advantage of insiders. This detailed analysis will help the Pakistani Companies understand that the stakeholders value the CSR activities and thus will encourage them to be involved in CSR activities and give detailed disclosure of the CSR activities. Companies will be provided guidelines on the activities which may result in greater value creation and the benefits that will outdo the cost incurred on them.

Chapter 3.

This chapter discusses the data, the variables and the sources from where they have been collected and the methodology that has been used to check the association among the CSR and financial transparency.

Data and Methodology

3.1 Data Sources and Variables

The sample of data used is comprised of top 100 non-financial companies listed on Pakistan Stock Exchange covering all the major sectors, subject to the availability of data. The reason behind the sample chosen is that all the companies taken into consideration are audited by the top auditors or affiliate and are historically reputable. Moreover, they follow the codes of corporate governance.

The data used is collected from Thomson Reuters and the annual reports of companies for eleven years (2009-2019). All the reports are downloaded from PSX data portal and the official websites of the companies. The data is secondary and panel in nature.

The time period starts from 2009 due to the reason that the Securities and Exchange Commission of Pakistan (SECP) published a Corporate Social Responsibility (CSR) Ordinance in 2009. The mentioned order was applied to all the public listed companies and demanded CSR reporting in the annual reports, if any, carried out by the companies in every financial year, both in monetary and descriptive terms.

TABLE 3.1-1 DATA AND VARIABLE DESCRIPTION

Variables	Notation	Description	Data Source
Earnings Aggressiveness	EA	Derived Variable.	Thomson Reuters, annual reports
Loss Avoidance	LA	Dummy variable which equals 1 if profitability lies between 0-2% and 0 otherwise.	Thomson Reuters, annual reports
Corporate Social Responsibility disclosure	CSRD	An index consisted of 20 variables.	Thomson Reuters, annual reports
Board Independence	BIND	Percentage of independent members of board.	Thomson Reuters, annual reports
Size	SIZE	Natural log of total assets of firm.	Thomson Reuters, annual reports
Leverage	LEV	Debt to assets ratio of firms.	Thomson Reuters, annual reports
Market to Book Ratio	MTB	Market value of equity scaled through book value of equity.	Thomson Reuters, annual reports

Dependent variables:

Financial transparency being the dependent variable is estimated by using the earnings management techniques i.e. earnings aggressiveness (EA) and loss avoidance (LA) as proxies. Even though a lot of previous studies have proxied financial transparency by using abnormal accruals, but they are identified to be not suitable and noisy proxy (Menon & Williams, 2004). So in consistence with the earlier research of Nair et al. (2019), the financial transparency is now being proxied by earnings management techniques. In accordance with Qian et al. (2015), financial opacity is examined to be the inverse of financial transparency and all three aforementioned techniques of earnings management are the proxies of financial opacity. Hence, lesser degrees of earnings aggressiveness and the loss avoidance are anticipated to demonstrate a greater degree of the financial transparency.

In accordance with Qian et al. (2015), following formula to estimate earnings aggressiveness (EA) is used.

$$EA = (\Delta TA - \Delta CL - \Delta CASH + \Delta STD - DEP + TP) / LTA$$

Here EA represents the earnings aggressiveness. ΔTA represents the change in the total assets. ΔCL represents the change in the total current liability. ΔSTD represents the change in short term debt. DEP represents the depreciation expenditure. TP represents tax payable and LTA represents the lagged total assets.

The second proxy to estimate financial transparency is loss avoidance (LA). Following the earlier study, Loss avoidance (LA) is taken as a dummy variable that is equal to 1 in case of profitability lying between 0 and 2% and considered 0 alternatively (Carey & Simnett, 2006; Menon & Williams, 2004). Return on assets is used to measure the profitability of the firm.

Independent Variables:

Corporate social responsibility disclosure mentioned as (CSRD) is the independent variable. CSR index is used to measure CSR performance of the firms in consistent with the study of Saeed and Hashmi (2019) (mentioned in the appendix). CSR index is formed by taking into consideration the following categories: Community Involvement, Environmental, Employee Information, and Product and Service Information. Firstly an unweighted scoring method is used to count the number of components included in the index. After that, a dichotomous method is applied. The number 1 is assigned to the item if it is present in the report and 0 otherwise. Then, a score of each item is added and the total score of a firm is divided by total number of items included in index. In this index, a firm can achieve maximum score of 1 (or 100%) and a minimum of 0. The higher the value of index, the greater is the degree of disclosure.

Control Variables:

The size of firm (SIZE), in consistent with the study of Qian et al. (2015), is identified as the natural log of the firm's total assets. As bigger firms are more prominent and are also anticipated to be the center of great attention, that's why they make more efforts to be perceived as more transparent in their financial affairs and involve less in the earnings management techniques

The leverage variable depicted as (LEV) is described as the ratio of the book value of firm's debts to the book value of the firm's total assets (Muttakin & Subramaniam, 2015). Larger amount of debt is able to encourage greater degree of financial transparency because of the involvement of valuable and eminent stakeholders.

The Market to book variable depicted as (MTB) ratio is defined as firm's market value of equity being scaled through its book value of equity (Qian et al., 2015). It is anticipated that a negative association exists between the coefficient of MTB and the proxies used to measure the financial accountability and transparency.

The Board independence variable depicted as (BIND) is defined as percentage of the independent members of board from outside (Qian et al., 2015). In consistence with the findings of Klein (2002), it is anticipated that there seems to be a negative relation of financial opaqueness with the companies that have a major portion of independent board of directors.

3.2 Methodology

The data is panel in nature that is why we apply the panel data analysis. Panel data analysis investigates individual (specific to the company) effects over the time with a purpose of dealing with the heterogeneity or specific effect of individuals that may several times be left unnoticeable. To find the association among corporate social responsibility and financial transparency, we adopt three panel data models namely the Pooled OLS method, the fixed effect model and the Random effect model.

In the pooled OLS model, we assume that no such difference exists among the cross-sectional data. There is common intercept and slope for all the firms. All the individual entities have no specific trait within the measurement set.

The regression model used for the analysis of data is as follows:

$$FNTPY_{it} = \beta + \beta_1 CSRD_{it} + \beta_2 BIND_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 MTB_{it} + \varepsilon \qquad \textbf{(1)}$$

Cross-sectional (i) = 1, 2 … 100

Time period (t) = 1, 2, 3. . . 11

FNTPY is financial transparency

CSRD is the corporate social responsibility disclosure index

BIND is the board of independent directors

SIZE is firm size

LEV is leverage

MTB is market to book ratio of firm

ε is error term

In the case of variation in data, the intercepts of some individual groups might be different in term of different cross sectional units. In such scenario, the results are likely to be biased. This issue is tackled by making use of fixed effect model. In fixed effect model, we have a separate intercept for all the firms in order to check and capture the uniquely specific traits of all the firms. The fixed effect model generates individual company specified dummies for data, that assumes a different intercept for each of the cross sectional unit. This is why it is also called the least square dummy variable (LSDV) estimator.

$$FNTPY_{it} = \beta_o + \beta_1 CSRD_{it} + \beta_2 BIND_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 MTB_{it} + \varepsilon_{it} \qquad \textbf{(2)}$$

A different case would exist, where each individual company may differ in terms of their error terms. In presence of such scenarios, random effect model is used. In random effect model, the value of constant is not the same for every entity rather it is a random parameter.

$$\beta = \beta_i + v_i$$

v_i = zero mean standard random variable.

For random effect model, the equation (1) becomes:

$$FNTPY_{it} = (\beta_i + \nu_i) + \beta_1 CSRD_{it} + \beta_2 BIND_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 MTB_{it} + \varepsilon_{it} \quad \textbf{(3)}$$

$$FNTPY_{it} = \beta_i + \beta_1 CSRD_{it} + \beta_2 BIND_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 MTB_{it} + (\varepsilon_{it} + \nu_i) \quad \textbf{(4)}$$

Firstly, we need to run test to verify whether the correct estimator is used. For this purpose, we apply the Bruesch-Pagan langrage multiplier test. It is used to check random effect model against pooled OLS model.

H_o: Pooled OLS model is an appropriate fit

H_1: Random Effect model is an appropriate fit

If the p-value is significant, i.e. $p < 0.05$, the null hypothesis is rejected. In this case we use the alternative model i.e. the random effect model.

Now the question arises that which of the two models i.e. the random effect model and the fixed effect model is more appropriate to use? A test designed by the Hausman can be applied to address this question. The null hypothesis of the Hausman test states that fixed effects model and random effects model do not differ significantly. It follows a chi-square distribution and the usual criteria that if the computed vale of chi-square exceeds its critical value for the given level of significance and degree of freedom, then random effects model is not suitable. It means that the random error terms are most probably correlated with one or more than one regressors. In such scenario, fixed effects model is more appropriate and should be used. (Gujrati, 2011)

H_o: Random effect model is an appropriate fit

H_1: Fixed Effect model is an appropriate fit

In terms of p-value, if the p-value is significant i.e. $p < 0.05$, the null hypothesis is rejected. In this case we use the alternative model i.e. the fixed effect model.

We also run the basic tests to check for heteroscedasticity and autocorrelation in the data.

For heteroscedasticity we use, Breusch-Pagan / Cook-Weisberg test.

The null hypothesis states that there is homoscedasticity whereas the alternate hypothesis states that heteroscedasticity exists.

H_o: There is Homoscedasticity

H_1: There is no homoscedasticity i.e. Heteroscedasticity

If the p-value is significant i.e. $p < 0.05$, we reject our null hypothesis and conclude that heteroscedasticity exists.

In presence of heteroscedasticity, we use robust panel regression model. The robust panel regression model solves the issue of heteroscedasticity by the use of robust standard errors.

For Autocorrelation, we use Wooldridge test.

The null hypothesis states that there is no 1st order autocorrelation whereas the alternate hypothesis states that 1st order autocorrelation exists.

H_o: There is No 1st order Autocorrelation

H_1: There is 1st order Autocorrelation

If the p-value is significant i.e. $p < 0.05$, we reject our null hypothesis and conclude that there exists 1st order autocorrelation.

Chapter 4.

This chapter of the study is comprised of all the results and discussions about the findings of the study. It discusses in detail the relationship of different variables, their descriptive statistics, the correlation matrix and all the tests that have been carried out.

Results and Discussions

4.1 Descriptive Statistics & Correlation Matrix

4.1.1 Descriptive Statistics

TABLE 4.1-1 DESCRIPTIVE STATISTICS

Variable	Obs	Mean	Std.dev	Min	Max
EA	997	0.0575	0.5009	-0.8686	0.9502
CSRD	1,097	0.4914	0.2094	0.05	0.9851
BIND	1,097	0.6272	0.2524	0	1.0000
SIZE	1,097	8.7743	1.7582	3.5997	15.3322
MTB	1,097	1.6879	1.3237	0.5984	4.8647
LEV	1,097	0.5591	0.2072	0.2452	0.8877

The basic notion of descriptive analysis is to statistically demonstrate the overall characteristics of the data being used to estimate the models. The table 4.1-1 shows the descriptive statistics of the model that we are going to estimate. It reports the observations mean, standard deviation, minimum and maximum value for all variables of study. All the data collected is Rupees in Millions. The table shows that earnings aggressiveness lies in the range of -0.86 to 0.95. While the mean value and standard deviation of earnings aggressiveness is 0.05 and 0.50 respectively. The corporate social responsibility disclosure lies in a range of 0.05-0.98 whereas the mean value and standard deviation of corporate social responsibility disclosure is 0.49 and 0.20 respectively. It shows that the companies are involved in carrying out CSR activities to a moderate extent. The average percent of independent board members in the firm is approximately 62%. The size of the firm ranges between 3.59 to 15.33. Meanwhile, the average size and standard deviation of firm is 8.77 and 1.75 respectively. The market to book ratio is reported to lie in the range of 0.59 to 4.86. While the average and standard deviation of market to book ratio is 3.29 and 1.32 respectively. The leverage lies between a range of 0.24 to 0.88 whereas the average leverage ratio and standard deviation is 0.55 and 0.20 respectively. The mean value of leverage shows that 55% of a firm is financed by debt.

The difference in the observations of the first variable i.e. the earnings aggressiveness is due to the formula being used to construct the variable. The original data contains same number of observations for all the variables. For EA, first lag is used due to the requirement of variable construction.

4.1.2 Correlation Matrix

TABLE 4.1-2 CORRELATION MATRIX

	EA	LA	CSRD	BIND	SIZE	LEV	MTB
EA	1.0000						
LA	-0.0293	1.0000					
CSRD	-0.022	-0.093	1.0000				
BIND	-0.1018	-0.0154	0.0844	1.0000			
SIZE	-0.2128	-0.0298	0.4237	-0.0728	1.0000		
LEV	-0.0149	0.147	-0.1701	0.0632	-0.0767	1.0000	
MTB	-0.1715	-0.0235	0.0865	0.2226	-0.3205	-0.0325	1.0000

The basic objective of the correlation matrix is to know that whether or not there is any correlation among all the variables. It shows the nature of association among the variables. It allows us for a comparison of correlation values with the coefficients of our model.

Table 4.1-2 shows the correlation matrix of all the variables of the model and shows the association among them. The value of CSRD is negatively correlated with the earnings aggressiveness and loss avoidance. It shows that those firms that are involved in CSR activities do not engage themselves in earnings management techniques and hence are more transparent. The board of independent members seems to have a negative association with both of the measures of financial transparency. It means that companies that have more concentration of independent board members do not promote financial opaqueness. The do not partake in earnings management techniques and hence provide more transparent financial reports. The size of firms has a negative relation with both earnings aggressiveness and loss avoidance. It asserts that the firms that are larger in size are much less likely to engage in earning management techniques. They do not promote financial opaqueness and hence provide more transparent financial reports. The variable leverage is negatively associated with earnings aggressiveness but it has a positive association with loss avoidance. The market to book ratio is negatively associated to both proxies of financial transparency.

4.2 Interpretation of results

We have run all the three panel regression models i.e. the pooled OLS model, the fixed effect model and the random effect model.

To test the presence of autocorrelation, we use Wooldridge test for autocorrelation in panel data. The null hypothesis states that there is no 1st order autocorrelation whereas the alternate hypothesis states that 1st order autocorrelation exists.

H_o: no first-order autocorrelation

F (1, 99) = 2.175

Prob > F = 0.1435

Since the p-value is greater than 0.05 and it is insignificant, we do not reject our null hypothesis and conclude that there is no 1st order correlation in our panel data.

To test the presence of heteroscedasticity, we use Breusch-Pagan / Cook-Weisberg test. The null hypothesis states that there is homoscedasticity whereas the alternate hypothesis states that heteroscedasticity exists.

H_0: Constant variance

chi2 (1) = 70.91

Prob > chi2 = 0.0000

Since the p-value is significant, we reject our null hypothesis and conclude that there exists heteroscedasticity.

In such scenario where there exists the issue of heteroscedasticity, we make use of the robust standard errors. So, to tackle this issue, we use robust panel regression model.

4.2.1 Model 1: Earnings Aggressiveness as a proxy of financial transparency

For our first model, we have run all the three panel regression models i.e. the pooled OLS model, the fixed effect model and the random effect model. The random effect model is our main model while the other two models are for comparison. The random effect model is chosen on the basis of comparison tests. We have applied the Breusch-Pagan langrange multiplier test to choose among the pooled OLS model and random effect model. The null hypothesis states pooled OLS model is a better fit. The alternative hypothesis is that random effect model is more appropriate. If the p-value is significant, we reject the null and choose the alternative model. The p-value is 0.0041 which is significant as it is less than 0.05. We reject our null hypothesis and conclude that random effect model is more appropriate.

Hausman test is performed to decide between the fixed effect model and the random effect model. The null hypothesis states that random effect model is a better fit. The alternative hypothesis states that fixed effect model is more appropriate. If the p-value is significant, we reject the null and choose the alternative model. The p-value is 0.9935 which is insignificant as it is more than 0.05. So, we do not reject our null hypothesis and conclude that random effect model is more appropriate.

TABLE 4.2-1 EARNINGS AGGRESSIVENESS REM

Variable	Coefficient	Robust Std. Error	Z-Statistic	P>|Z|
CSRD	-0.1918	0.0963	-1.99	0.047**
BIND	-0.1015	0.0934	-1.09	0.277
SIZE	-0.0648	0.0119	-5.44	0.000***
MTB	-0.0374	0.0141	-2.64	0.008***
LEV	-0.0201	0.0808	-0.25	0.803
CONS	-0.4645	0.1573	-2.95	0.003***

(*, **, *** represent level of significance at 10%, 5%, 1% respectively.)

In our first model, financial transparency is proxied by earnings aggressiveness. The CSR disclosure indicates a negative and statistically significant relationship with earnings aggressiveness at a significance level of 5%.

This is consistent with the findings of Qian et al. (2015) that found same relationship among various proxies of financial transparency and corporate social responsibility. As a matter of fact, those companies which partake actively in socially responsible activities tend to be more generous towards all the stakeholders, rather than only considering the major shareholders.

Moreover, such firms are very less inclined towards earnings management techniques and refrain from providing opaque financial reports.

The firms that are strongly committed to socially responsible activities do not manipulate their earnings because they do not conceal any unpromising earnings and, thereby, do not partake in earnings management (Chih et al., 2008). Given the fact that earnings management is considered to be an immoral act in relation to CSR, the firms that are more involved in carrying out CSR practices behave in a more socially responsible manner when it comes to their financial reports (Choi et al., 2013). Similarly, Kim et al. (2012) mention that firms that invest their hard work and provide funds to carry out CSR activities are more likely to follow trustworthy and transparent disclosure of their financial reports and hence less presumably engage in earnings management.

In accordance with signaling theory, firms that reveal more transparent information to lessen the asymmetry of information and to send signals to their investors are considered to have better performance than their competitors (Álvarez et al., 2008; Miller 2002). Despite that, Hughes (1986) affirms that reliability of the disclosed information plays a vital role in mitigating the asymmetry of information. Given the fact that earnings management is highly possible to occur when the extent of information asymmetry is high, the signaling theory presumes that information regarding CSR activities is utilized as a medium to remove the information asymmetry (agency conflict) between firms and their stakeholders. Thus, on the basis of the concept that CSR disclosure is an effective instrument to lessen the information asymmetry, previous studies have indicated a negative relation among CSR disclosures and information asymmetry (Heflin et al., 2005). This indicates that CSR and earnings aggressiveness are negatively related.

SIZE of the firm which is measured by the natural log of firm's total assets also indicates a negative and statistically significant relationship with earnings aggressiveness at probability level of 1%. . In consistent with finding of Lee and Choi (2002), it shows that bigger firms disclose more transparent information, and so, they size are much less likely to engage in earning management techniques. They do not promote financial opaqueness and hence provide more transparent financial reports.

Larger firms are less likely to manipulate their earnings because the firm's size is linked to its internal monitoring system. Larger the size of the firm, more advanced its internal monitoring system is. Moreover, they have more proficient auditing companies which make sure of the fact that the firm is performing in an effective and transparent manner. This lessens or removes the extent of involvement in earnings management and provides more transparent financials (Beasley et al., 2000).

The market to book ratio of firms which is calculated by dividing the market value to the book value of total equity also indicates a negative and statistically significant relationship with earnings aggressiveness at 1% level of significance. This suggests that the MTB ratio affects the firm's decision to engage in earnings management techniques. The firms that are big and have high MTB ratio have a lesser tendency to partake in earnings aggressiveness.

This indicates that such firms are more socially responsible and do not engage themselves in opportunistic behaviors. This in turn results in more transparent financial reports. It mitigates the information asymmetry and prevents the exploitation of the outsiders by the information advantage of insiders.

In consistence with study of Klein (2002), the variable, independent directors of board, (BIND) has a negative association with earnings aggressiveness but it is statistically insignificant. It implies that in relation to earnings aggressiveness, the independent board members are not much sensitive to it.

Leverage (LEV) also has a negative insignificant relation with earnings aggressiveness. Despite the fact that its impact is insignificant, the negative sign of coefficient implies that high leveraged firms tend to avoid manipulating their earnings and hence do not partake in opportunistic behaviors.

4.2.2 Model 2: Loss Avoidance as a proxy of financial transparency

For the second model, Hausman test is performed to decide between the fixed effect logit model and the random effect logit model. The null hypothesis states that random effect logit model is a better fit. The alternative hypothesis states that fixed effect logit model is more appropriate. If the p-value is significant, we reject the null and choose the alternative model. The p-value is 0.6128 which is insignificant as it is more than 0.05. So, we do not reject our null hypothesis and conclude that random effect logit model is more appropriate.

TABLE 4.2-2 LOSS AVOIDANCE REM LOGIT MODEL

Variable	Coefficient	Robust Std. Error	Z-Statistic	P>|Z|
CSRD	-1.3650	0.6633	-2.06	0.040**
BIND	-1.6954	0.7496	-2.26	0.024**
SIZE	0.0216	0.0741	0.29	0.771
MTB	0.0078	0.0151	0.52	0.605
LEV	2.1700	0.8254	2.63	0.009***
CONS	-0.3491	0.0846	-4.12	0.000***

(*, **, *** represent level of significance at 10%, 5%, 1% respectively.)

In the second model, we have used loss avoidance as a proxy for financial transparency. The corporate social responsibility disclosure (CSRD) shows a negative and statistically significant relationship with loss avoidance at 5% level of significance. This is also consistent with the study of Qian et al. (2015) which found identical relation in several proxies of earnings management and corporate social responsibility. This shows that the firms that are more inclined towards carrying out social activities are less likely to engage in opportunistic behaviors. The firms that are more socially responsible do not try to avoid the reporting of small losses. They provide more transparent financials which in turns reduces information asymmetry. This prevents the exploitation of outsiders by the information advantages of insiders.

In consistence with findings of Chih et al. (2008), it implies that more a firm is involved in CSR activities, the lesser it is likely to engage in earnings management. This is due to the fact that firms which are more socially responsible are not likely to engage in loss avoidance. Likewise, Shleifer (2004) illustrates that manipulation of earnings, that is considered morally questionable, rarely exists in companies that are strongly committed to CSR.

Firms that are more socially responsible keep in view the longer term relations with their stakeholders instead of focusing on shorter term profit maximization. From this perspective, delivering improved quality of financial statements and earnings is thoroughly linked to CSR activities (Orlitzky et al., 2003; Brammer et al., 2007).

The variable board of independence (BIND) is calculated as the ratio of independent directors of board out of the total number of board of directors. It is disclosed in the annual report of each firm in the code of compliance. It also depicts a negative and statistically significant relation with loss avoidance. It means that higher concentration of independent board members might enhance that management practices. They are more beneficial to company by keeping a check on the earnings management of the firms (Beasley, 1996; Klein, 2002). when the directors have an easy access to information, the participate less in opportunistic behaviors. This in turn lowers the degree of earnings management. It promotes the transparency and removes information asymmetry (Beasley, 1996; Klein, 2002).

It is also likely to be possible that the independent board members would mitigate the organizational disputes among the owners and management by encouraging the managers to reveal for CSR activities. In this way the firms are less likely to engage in earning management techniques and provide more transparent financials. This conclusion is also in persistence with the outcomes of the studies conducted in more developed countries (Brammer & Pavelin, 2008).

The leverage of the firm (LEV) shows a positive and statistically significant relationship with loss avoidance at a 1% significance level. It is also in consistence with the earlier studies (Leuz et al., 2003; Chih et al., 2008). It may signify that the high leveraged firms might involve themselves in loss avoidance practices to alter their earnings. The firms that are high leveraged and have more cash flow variability will probably be more inclined to engage in earnings management.

The market to book ratio (MTB) has a negative but statistically insignificant relation with loss avoidance which is also in persistence with the study of Klein (2002). Moreover, the size of firm (SIZE) also does not show any significant relation with loss avoidance. It means that the size of the firm is not much sensitive about engaging in loss avoidance.

Chapter 5.

The last chapter of the thesis concludes all the findings of the study with reference to the previous findings and provides some policy recommendations that are needed to be kept in mind in order to have a better understanding and implementation of the CSR practices and how it can contribute to the economy.

Conclusion and Policy recommendations

5.1 Conclusion

Financial transparency, defined in a lot of various manners, focuses on the precision and accuracy of the information disclosed by a firm through its earnings and financial reports. In the presence of opportunistic behaviors and earnings management techniques such as earnings aggressiveness and loss avoidance, firms fail to depict a clear picture of their financial and economic conditions ((Leuz et al., 2003; Chih et al., 2008). This study analyzes the effect of corporate social responsibility disclosures of the firms on their financial transparency. It broadens the already existing researches on CSR in Pakistan by utilizing the data from top 100 non-financial firms listed on the Pakistan stock exchange (subject to the availability of data).

Based on the empirical findings, this study concludes that corporate social responsibility has a significantly negative relation with earnings aggressiveness and loss avoidance. It means that CSR has a negative association with financial opaqueness. As financial opaqueness is inversely related to financial transparency, the results imply that corporate social responsibility is positively associated with financial transparency. It is in consistence with the findings of Qian et al., 2015. The findings of this study propose that the firms that are socially responsible and engage themselves in CSR activities are more likely to be concerned of their behavior towards the general stakeholders. They are less likely to be involved in the earnings management activities and therefore, provide more transparent financial reports. This also helps to remove the asymmetry of information and safeguards the rights of outsiders that can be exploited by the information advantage of the insiders.

Moreover, the outcomes of this study recommend that engagement of firms in socially responsible activities can turn out to be very beneficial in controlling the earnings management techniques. The CSR disclosures may also be used as a medium to gain the trust of shareholders as it provides more transparency and less information asymmetry. Higher CSR disclosures can also help the firms to enhance their reputation in the society.

5.2 Policy Recommendations

CSR operations and activities do not just include expenditures but they are the investment and governance policies that aim to improve value and performance of the firm. CSR not only has beneficial impact on the shorter term performance, it also affects the long-term value of the firm. CSR helps to ease a number of possible conflicts between different stakeholders. This in turn enhances the reputation of the firm.

It is known worldwide that CSR begins where legal obligations end. Therefore, the public policies regarding CSR may be specified as a collection of soft government actions with the point of view to promote CSR on voluntary basis. As CSR is voluntary the authorities should incentivize CSR by the following to promote its adoption by the corporations:

1- Publicize voluntary policies or mandatory requirements which help as a guide to the firms in implementation of socially responsible activities.

2- Run different campaigns to increase awareness regarding CSR concerns and its importance for the long term value creation for the corporation.

3- Offer tax breaks for CSR-related activities.

4- In order to make it beneficial for firms to carry out CSR activities, the general public must be concerned and fully aware of the CSR projects undertaken by the firms. They should be educated enough to know about the loss that is done by their own living and buying habits and as an individual, their own social responsibilities.

5- Remove/ minimize red tape and avoidance of strict rules and regulation regarding CSR programs as it becomes very laborious and restrictive for many firms to benefit from.

6- Provision of funds to organizations that are community based and is located in remote areas.

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Appendix

Formation of CSR index:

CSR index is used to measure CSR performance of the firms. In consistence with the study of Saeed and Hashmi (2019), the study utilizes a modified version of index that incorporates the components in relevance to the firms of Pakistan. CSR index is formed by taking into consideration the following categories: Community Involvement, Environmental, Employee Information, and Product and Service Information. Firstly an unweighted scoring method is used to count the number of components included in the index. After that, a dichotomous method is applied. The number 1 is assigned to the item if it is present in the report and 0 otherwise. Then, a score of each item is added and the total score of a firm is divided by the total number of items included in the index. In this index, a firm can achieve a maximum score of 1 (or 100%) and a minimum score 0. The higher the value of index, the greater is the degree of disclosure.

Table A1:

	Items included in CSR index
A.	**Community Participation**
1.	Charity & donations
2.	Housing support
3.	Community-based schemes
B.	**Environment Based**
1.	Environmental guidelines
2.	Recyclability
3.	Pollution control
C.	**Information of employees**

1. No. of workers
2. Employee’s share in profits
3. Sound retirement advantages
4. Worker’s safety & health at workplace
5. Worker’s training programs
6. Worker’s well-being
7. Staff Relations
8. Policies related to Child labour

D. Goods and Services Info

1. Quality & safety assurance
2. Customer reward
3. Products related R&D
4. Kinds of disclosed products
5. Emphasis on customer’s service & satisfaction
6. Value-added report