

HOW ECONOMIC RECESSION EFFECT THE CORPORATE PHILANTHROPY? EVIDENCE FROM PAKISTANI CORPORATE SECTOR

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Abstract: *Corporate philanthropy is a significant indicator of firm's socially responsible behavior. Researchers and managers acknowledge the immense potential of corporate philanthropy for optimizing social and economic benefits. Aligned with this view corporate sector in Pakistan is engaged in philanthropic initiatives in some form or another. This paper aims to present the response of the Pakistani corporate sector to the corporate philanthropy at the time of global economic recession 2008-2009 by analyzing the sample of Public Listed Companies (PLCs). The analysis revealed that during the global financial crisis, the economic condition of Pakistan was worsened that was already in distress, but it hasn't strongly effected the corporate philanthropy as the data shows a slight decrease in the overall volume of corporate donations in 2007 and a slight decrease in the number of companies engaged in philanthropy during 2008. The finding of the study suggests that during the global economic downturn the PLCs in Pakistan continued to show commitment towards community through corporate donations.*

Keywords: *Corporate Philanthropy, Economic Recession, Inflation. Exports, GDP Growth (JEL code: B22)*

INTRODUCTION

Corporate philanthropy is significant for both business and society. The strategic perspective of corporate philanthropy is associated with numerous economic benefits such as alleviating corporate financial performance and corporate reputation (Porter and Kramer, 2002; Brammer and Millington, 2005). This growing importance of corporate philanthropy has led to increase in the volume of donations made by the companies all across the world. Despite this fact, corporate philanthropy remains controversial as in the view of many researchers such as Friedman "The business of the business is to do business."

In the recent times the global economic crisis of 2008-2009 which, according to many economists was the most serve after the great depression of the 1930s once again challenged the very notion of corporate philanthropy. The economic recession of 2008-2009 imposed immense financial pressures on the businesses as many underwent heavy financial losses and were forced to reduce the cost. In the struggle of restoring core operations many businesses were forced to drop non-essential activities. Among the list of non-essential activities, corporate philanthropy being the most discretionary element of corporate social responsibility became more susceptible

since on the activity list of the company's management it is "last in and first out" (Buchholtz, Amason, & Rutherford, 1999).

There were different studies that were conducted on the link between corporate philanthropy and economic recession but these studies were mostly conducted in the context of developed economies, however, very little is known about how the businesses in the emerging and developing economies responded to corporate philanthropy during the global economic crisis. The financial crisis that started from America spread worldwide and turned into global recession, but it had different implications for the developed and developing economies mainly due to the non-integration of financial systems of developed countries with the financial systems of under-developing countries. The financial systems in Asia were found to be stronger than the European and American financial systems, but still overall in Asian countries; unemployment increased and output decreased. So the current article is intended to present the case of developing economy of Pakistan by providing the overview of how the corporate sector in Pakistan responded to corporate philanthropy during the time of global economic recession 2008-2009 by analyzing the sample of Pakistani Public Listed Companies

(PLCs). The article consists of two sections. First section presents the review of literature on the link between corporate philanthropy and economic recession to serve the basis for further analysis. The second part presents the situation of corporate philanthropy during the global economic recession of 2008-2009 by analyzing the response of PLCs in Pakistan.

MATERIALS AND METHODS

The following section is intended to build the theoretical foundation for further analysis by explaining the concept of corporate philanthropy, economic recession and the link between the two in the light of pervious researches

Corporate Social Responsibility (CSR)

Figure 1 shows that the purpose of corporate social responsibility is to make firms sustainable in three aspects **i) Economic Aspect:** the firm’s operations have direct and indirect implications for all stakeholders. The better economic performance can lead to long term sustainability of operations and continuous payment of taxes that is in the interest of all stakeholders; **ii) Social Aspect:** consideration of firm’s actions that have impact on the welfare and interest of all stakeholders, including employees, customers and communities; **iii) Environmental Aspect:** reducing the negative impact of firm’s operations on the environment using less material and reducing or recycling the waste that can create win-win situation for all stakeholders (Uddin, Hassan, & Tarique, 2008).

Corporate Philanthropy

As mentioned above the social aspect of CSR highlights the impact of businesses on the community. The companies are expected to support the communities in which they operate. In this regard companies engage in different social causes such as funding different charities with cash or non-cash donations and this act is referred as corporate philanthropy. Furthermore Carroll’s (1991) model of corporate social responsibility can be used to explain corporate philanthropy. This model identify four types of responsibilities for business; i) Economic ii) Legal iii) Ethical and iv) philanthropy. In the order of priority first two responsibilities are the most important for business such as to generate profit and do business, according to law; third responsibility is expectation from the company that it will do business ethically, but the last responsibility is

neither mandatory nor expected but is deemed desirable. It is completely at the management’s discretion to decide to engage in philanthropic activities to support social causes and return something to the communities where they operate.

Recession

Lee and Shields (2011) defined recession as a period with decreased activity and economic difficulty for the majority of people. The profit of the business decreases as consumption falls, investment reduces and people start losing jobs. Due to increase in unemployment the income of household falls. The defining feature of rescission is that it affects the households and businesses by strongly affecting their decision making. According to some economist recession is unforeseen and unpredictable whereas others believe it is a predictable and inevitable result of many factors such as macroeconomics, lack of regulations for the financial systems, risky investments made by the banks or financial institutions and greed etc. (Roubini, 2011).

Economic Recession of 2008-2009

The financial crisis started in the mid of August 2007 in America and spread worldwide. The major cause of the crisis was the prime and subprime mortgages in America. The American government encouraged subprime mortgage after 2001 so that people can have ownership of their own homes (Poole, 2010). Subprime mortgage can be defined as lending money to the borrower with weak credit history or no history.

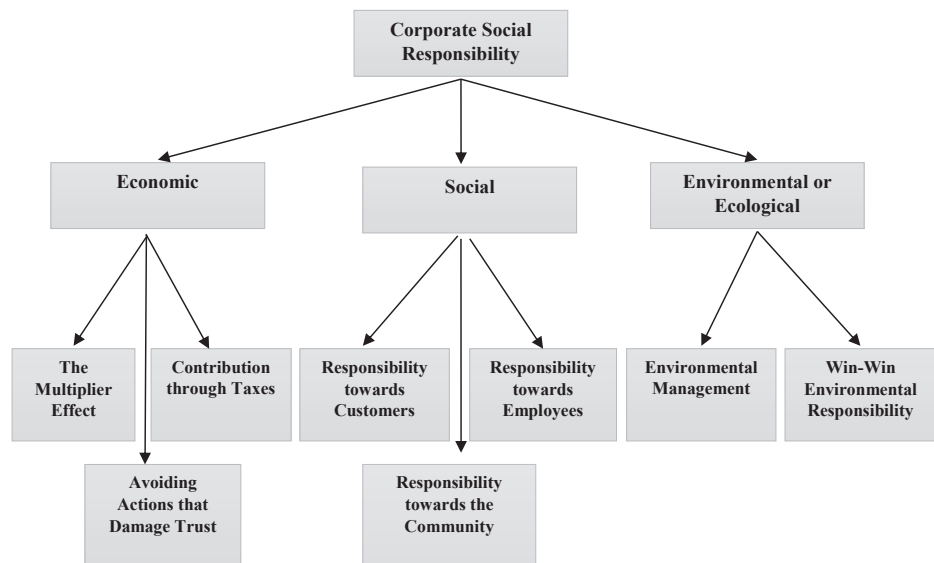


Figure 1: Three Dimensional Aspects of Corporate Social Responsibility
Source: (Uddin, Hassan, & Tarique, 2008)

This is done by providing loans for zero or minimum down payment with weak documentation and less credit checks to the borrowers. Initially the mortgage firms made millions and in some cases billions of dollars similarly the house

owners also made money as the interest rate remained low and prices of houses begin to rise. The mortgage backed securities allowed the immature investors to transfer the risk to others (Mah-Hui, 2008). As a result the subprime mortgage was considered a safe investment as the borrower in financial distress can sell the property or refinance it to pay back loans.

But the market participant's including private firms and the federal government failed to anticipate the falling prices of houses that later on, became the major cause of the financial crisis (Poole, 2010). The situation became worsened when the two main US mortgage funds run by Bear Stearns collapsed (Mah-Hui, 2008).

Economic Recession and Corporate Philanthropy

In difficult economic times, businesses respond to CSR usually in two ways, either it is considered as an economic burden or it is used as a differentiation tool. Consistent with the first view of CSR, it can be argued that companies during the difficult financial times should reduce spending on CSR in order to save resources and should focus only on the survival of business by maximizing profit which is its primary responsibility and compromise all other social responsibilities that are not mandatory. Second view presents the other side of the coin by arguing that CSR can be used to acquire a competitive advantage to strengthen the brand name by differentiating business from its competitors and gain economic benefits. CSR can help companies survive difficult times as it can provide businesses with financial and non-financial benefits in the form of increased trust and improved corporate reputation and support from the communities where these companies operate (Branca, Pina & Catalão-Lopes, 2012; Pereira, Sousa, Maia, 2015).

The studies conducted in the context of economic recession 2008-2009 and its impact on CSR show that there was a noticeable reduction in the CSR spending of the businesses. Moreover businesses were handling CSR more strategically during the financial crisis as the companies only invested in the projects that were aligned with their core business objectives and had any future prospects for bringing financial returns. The environmental aspect of the CSR was least affected mainly due to strict legislations followed by the economic aspect, but as expected the social aspect was the most affected aspect of CSR as companies downsized dozens of employees and considerably reduced community investments such as corporate philanthropy (Klára, 2011).

Literature identify numerous factors that can affect corporate philanthropy during the economic recession, most noticeable e.g. are strategic alignment of the philanthropic activities with the company's core business, industry type and the size of the company.

Strategic Alignment: Businesses have different motivations to engage in corporate philanthropy and, most commonly cited motives are altruistic and strategic. Increasingly the businesses are becoming more strategic in corporate giving and most influential work in this regard is of Porter and

Kramer (2002) who argued that if the company has a strategic orientation towards its philanthropic activities it can improve its competitive context. If the company's donations are unfocused; simply to generate goodwill without well planned business and social objectives it can add little value to the long-term business goals. The social and economic objectives of the organization are diverse but not conflicting and philanthropy can be used to converge both to improve long-term standing of the business. So the companies should identify the social causes that are aligned with the business expertise in order to create synergy between economic and social goals (Cochran, 2007).

In this regard, Klára (2011) surveyed three companies and found that in the time of economic downturn, companies were having more strategic orientation towards their CSR activities and were seeking financial returns from the CSR investments instead of just improved corporate reputation. There was a significant decrease in the spending of companies in socially desirable activities. The companies were only investing in the projects that were related to their core business. Taking a strategic perspective to corporate philanthropy; companies focused mainly on building the genuine relationship with the stakeholders based on trust rather just developing the cosmetic image of generous donors.

This strategic alignment of corporate philanthropy with the core business of the company can be mutually beneficial for both society and business during the unfavorable economic conditions. Many charities are dependent on the corporate donations and cut off in such donations can be significant as in the difficult economic times companies need strong financial reasons to support such charities. Corporate philanthropy's link with corporate reputation and eventually the firm's bottom line are attractive reasons to continue supporting such social causes in difficult economic time (McCarthy, Contardo & Eckert, 2010).

Industry type: Lee, Singal & Kang (2013) categorized CSR into two parts, OR-CSR (Operations Related CSR) that include activities such as employee relations and product quality controls and Non-OR CSR (Non-Operations Related CSR) activities related to community and environment. They argued that investment in Non-OR-CSR activities such as philanthropy can be harmful to the firm's value in the time of recession. But on the other hand Osili, Ackerman and Li (2014) linked overall corporate philanthropy with macroeconomic context, they analyzed key macroeconomic indicators such as Gross Domestic Product (GDP), unemployment rate, personal consumption, S&P 500 index and recession but found no significant relationship between these indicators and corporate philanthropy. Their finding were supportive of the hypothesis that corporate contributions are counter cyclical (Levy & Shatto, 1978) which means the contributions increase in the unfavorable economic conditions. They concluded that corporate philanthropy is more sensitive to market structures, specific industry and societal needs rather than overall economic conditions.

Industry type can affect the spending on corporate philanthropy during the recession. For example Lee et al

(2013) argued that industry such as restaurants are at the risk of getting more affected by the economic downturn. Because financial performance of restaurants can be lower as the expenditure made by the customers in restaurants is discretionary in nature and can be cut off easily. In such situation the expenditure of firms on activities that are not instrumental in the firm's survival such as philanthropy can be affected.

Firm's Size: Size of the firm is another important factor that can affect corporate philanthropy during the recession. In the difficult economic times CSR of small and medium size enterprises (SMEs) is at risk of potential cut off, especially the corporate philanthropic dimension; because the CSR of SMEs is usually not fully integrated into the business processes and is carried out at the time when the business environment is comfortable (Sima & Gheorghe, 2011). Bansal, Jiang, Jung (2015), differentiated CSR into two categories i) strategic CSR and ii) tactical CSR. The tactical CSR is the social activities of the firm that are for the short term and require fewer resources and the strategic CSR is for the long term and require more resources and changes in the organizational structure. In the recessionary time the larger companies with strong financial performance continue to invest in strategic CSR as they have the ability to commit resources for long term and wait for the CSR to materialize and this is not usual for the SMEs.

RESULTS AND DISCUSSION

Pakistan's economy is mainly composed of three main sectors: agriculture, industry and services. The corporate sector is an integral component of Pakistan's economy and in corporate sector Public Listed Companies (PLCs) are fundamental constituent. There are 583 public listed companies listed on a Pakistan stock exchange (formally three stock exchanges Karachi, Lahore and Islamabad merged to form a Pakistan stock exchange in 2016). PLCs can be broadly categorized into two main sectors 1) financial and 2) non-financial. The major economic groups in the financial sector include commercial banks, investment banks, insurance companies, leasing companies and mutual funds etc. The non-financial sector comprises of textile, sugar, cement, chemicals, fuel and energy etc.

Consistent with the world view of corporate philanthropy; that it is a significant indicator of firm's socially responsible behavior and having immense potential for optimizing social and economic benefits, corporate sector in Pakistan is also engaged in philanthropic initiatives in some form or another. The donations made by PLCS range from a few thousand to millions of Pakistani rupees. During the global economic recession of 2008-2009 the corporate sector in Pakistan was also affected and this situation challenged companies to continue their support for social sustainability commitments. Before discussing the response of PLCs towards corporate philanthropy during difficult economic times it is important to shortly view that how the Pakistan's economy and its corporate sector was affected by the global recession.

Pakistan is a developing economy and the global economic

crisis affected economies of developing countries, mainly in the area of trade, capital inflows and investment (Ahmed and Donoghue, 2010). The Table 1 shows the snapshot of key macroeconomic indicators of Pakistan's economy for last ten years from 2005 to 2014 including the years of economic recession 2008-2010.

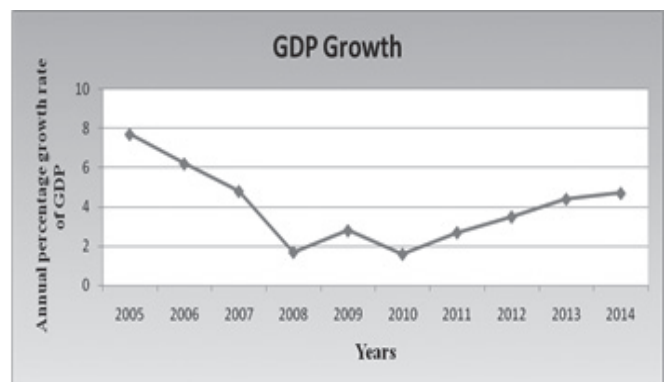
Table 1: Key Macroeconomic Indicators of Pakistan for Ten Years (2005-2014)

| Year | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|----------------------------------|------|------|------|------|------|------|------|------|------|------|
| GDP growth rate | 7.7 | 6.2 | 4.8 | 1.7 | 2.8 | 1.6 | 2.7 | 3.5 | 4.4 | 4.7 |
| Inflation | 9.1 | 7.9 | 7.6 | 20.3 | 13.6 | 13.9 | 11.9 | 9.7 | 7.7 | 7.2 |
| Exports (% of GDP) | 15.7 | 14.1 | 13.2 | 12.4 | 12.4 | 13.5 | 14.0 | 12.4 | 13.3 | 12.3 |
| Imports (% of GDP) | 19.6 | 21.5 | 19.8 | 23.2 | 19.7 | 19.4 | 19.0 | 20.4 | 20.1 | 18.7 |
| Cash Deficit/ Surplus (% of GDP) | -3.2 | -3.9 | -3.9 | -7.2 | -4.6 | -5.0 | -6.4 | -8.0 | -5.2 | - |

Source: The World Bank (2015)

Pakistani economy was already in turmoil with weak macroeconomic indicators such as high inflation, unemployment, poverty, trade deficit and negative balance of payments (Khilji, Farrukh, Iqbal & Hameed, 2010).

Figure 2: GDP growth of Pakistan 2005-2014



After the crisis overall macro-economic situation was worsened with low GDP, high inflation rate, low exports and fiscal deficit. GDP growth rate sharply fall from the highest 7.7 in 2005 to 1.7 in 2008 and the lowest in 1.6 in 2010.

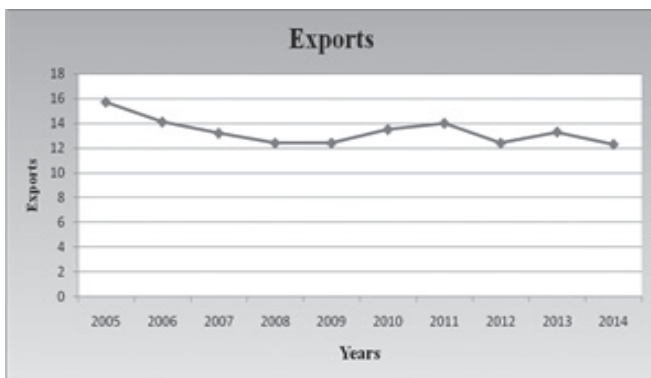
Similarly the figure 3 shows the highest inflation in 2008 i.e. is 20.3. The prices of import significantly increased as Pakistan's major import is oil and due to economic downturn the prices of commodities were increased globally and the oil prices were no different that reached the highest.

Figure 3: Inflation in Pakistan (2005-2014)



The sky high prices of oil lead to decline in exports as shown in the figure 4 because the cost of production of the manufacturing sector increased tremendously as the major source of power generation in Pakistan is furnace oil.

Figure 4: Exports (% of GDP) of Pakistan (2005-2014)



The major impact of the crisis was on the non-financial sector in Pakistan in comparison to the non-financial sector. The manufacturing sector faced heavy loses especially the textile sector. The energy shortfall caused companies to operate below the optimum level. Beside the increase in consumption other major reason of the energy shortfall was the increased oil prices as mentioned above. Another reason for the difficulty of textile sector was the export orders. Pakistan is the major exporter of textile products in United States of America and European countries that were severely affected by the economic crisis the reduced demand lead to the decline in export orders (Khawaja, Mahmood & Qadir, 2010).

Contrary to non-financial sector the financial sector in Pakistan survived the global financial crisis with mild shock. The financial systems of US and European countries were severely affected by the crisis, but the financial systems of emerging and developing economies (EDE) such as China, India and Pakistan were not that adversely affected as that of developed economies (Husain, 2011). In case of Pakistan the policy and regulatory reforms in the 1990s, such as minimum paid up capital required and more equity in the bank served as the major shock absorber. Another reason for the survival of the financial sector of Pakistan was its non-integration

with the international financial sector (Khawaja et al., 2010).

Table 2 shows the overall volume of donations made by Public Listed Companies in Pakistan for last ten years from 2005 to 2014. The data are collected from the survey reports of corporate philanthropy conducted by Pakistan Center of Philanthropy (PCP). PCP is a nonprofit organization and conducts this survey and publishes results annually.

Table 2: Total Volume of Corporate Donations in Billions (Pakistani Rupee PKR)

| Year | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|-----------|------|------|------|------|------|------|------|------|------|------|
| Donations | 1.61 | 2.3 | 1.85 | 2.23 | 2.4 | 3.3 | 3.8 | 4.1 | 4.8 | 5.9 |

Source: Pakistan Center of Philanthropy

Figure 5: Corporate Donations of PLCS in PKR

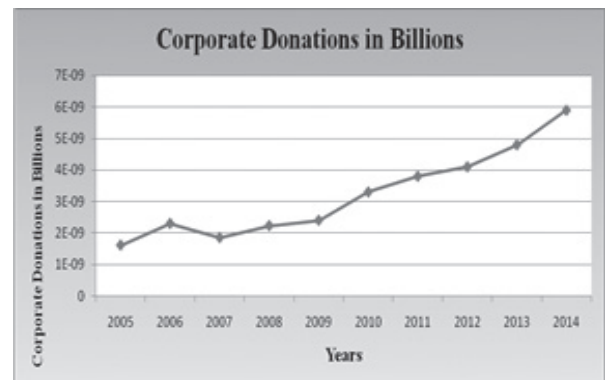


Table 3 shows the number of companies engaged in philanthropy with respective amount range from less than 1 million to more than 5 million. The participation of public listed companies in corporate philanthropy shows the lowest percentage in 2008 is 51% which is least in the last ten years i.e. 227 companies. However the total volume of donations increased in 2008. During the time of global economic crisis 2008-2009 the total volume of corporate donations shows that the number of donor companies decreased in 2008. In Pakistan the donations made by PLCS among many factors largely depend on the size of the company usually the bigger companies donate more as compared to smaller companies. In Pakistan the bigger companies contribute more generously and contribute around 80% to the overall donation volume and in 2008-2009 were no different more than 80% of the philanthropic donations in 2008 were made by the large companies. As discussed earlier firm size is an important factor that affect corporate philanthropy during difficult economic times. Large companies have more resources available at their disposal and are in a position to continue their commitment to society.

Table 3: Number of Public Listed Companies by Volume of Donations (Pakistani Rupee) from 2010 – 2014

| Size of Donations | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|--|------|------|------|------|------|------|------|------|------|------|
| Donations > 5 m | 63 | 71 | 48 | 47 | 65 | 59 | 76 | 71 | 80 | 85 |
| 4m<Donations<5m | 11 | 8 | 11 | 6 | 9 | 10 | 10 | 5 | 12 | 8 |
| 3m<Donations<4m | 14 | 12 | 11 | 9 | 11 | 18 | 13 | 18 | 14 | 11 |
| 2m<Donations<3m | 14 | 16 | 17 | 16 | 22 | 21 | 28 | 22 | 20 | 23 |
| 1m<Donations<2m | 21 | 35 | 29 | 31 | 40 | 32 | 34 | 30 | 37 | 30 |
| <1m | 175 | 187 | 174 | 168 | 160 | 136 | 124 | 126 | 105 | 103 |
| Total | 298 | 329 | 290 | 227 | 307 | 276 | 285 | 272 | 268 | 260 |
| Total sample | 551 | 546 | 535 | 548 | 542 | 532 | 490 | 478 | 488 | 580 |
| The total % of companies engaged in CP | 54% | 60% | 54% | 51% | 57% | 52% | 58% | 57% | 55% | 56% |

Source: Pakistan center of corporate philanthropy

In 2008 the number of donor companies was decreased, the decrease was evident for the PLCs that donate less than one million and mostly these companies are smaller in size. Another reason in the increase in donation volume in 2008 was the companies from the financial sector, especially the commercial banks that were among the top donors. The Commercial Banking sector, which accounts for less than 5% of the public listed companies, was responsible for 10% of the total philanthropic donations generated in 2008 (Pakistan center of Philanthropy, 2008).

Figure 6: Percentage of PLCs Engaged in CP



The financial sector of Pakistan was affected mildly by the global economic recession and didn't go through financial losses as such. Corporate financial performance of firm is an important determinant of firm's corporate financial performance (Waddock and Graves, 1997). The firms with better financial performance tend to donate more so PLCs from financial sector were having better financial performance and continued supporting social commitments.

So it can be concluded that the global recession of 2008-2009 affected companies in almost all spheres, but the most susceptible sphere was the corporate philanthropy. The ever-growing financial pressure on businesses to curtail costs and increase profits was considered a threat for future of CSR. Corporate philanthropy as most discretionary element of corporate social responsibility was feared to be the first to go on the list of non-essential activities. The study was conducted

to present the case of developing economy of Pakistan to explain that how corporate sector in Pakistan responded to corporate philanthropy during the global economic recession of 2008-2009. The study shows that the global recession had an adverse impact on the Pakistan's economy. But overall the PLCs that are integral part of Pakistan's economy continued to show commitment towards community through corporate donations with a slight decrease in the number of companies engaged in corporate philanthropy and followed by slight decrease in the overall volume of donations made by the companies during the recessionary years.

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