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Effect Of Firm Specific's On Financial Performance Of Financial Sector With Moderating Role Of Corporate Social Responsibilities

Shumaila Israr[1], Syed Muddasir Hussain[2], Basit Ali[3], Gul Sanga[4], Dilshad Khan[5], Arjumand Farooq[6]

Abstract

Constant cycles of banking and financial crises uncover the complexity and frailty of the financial and banking system. Firm specifics with the moderated role of CSR and their impact on the financial performance of banks from 2014 to 2023 have been empirically studied by the authors. This research explores associations of selected key firm characteristics (leverage, size, age, and tangibility) and profitability with moderating Corporate Social Responsibility (CSR). The research used correlation, regression, and moderation analysis to find the impact of these variables alone and the combined impact on firm profitability. We find a negative but insignificant relationship between leverage and profitability suggesting that debt levels are not an important driver of profitability in the sample firms, in line with pecking order theory. However, contrary to other schools of thought, independently of the tangibility, firm profitability is positively and significantly associated with firm size and age in support of the resource based view (RBV) that emphasizes that firm specific assets increase a Bank's financial performance. The analysis result analyzing the moderation indicates that CSR serves a dual role acting to substitute or complement. Leverage reduces profitability through the substitution effect, and size, age and tangibility increase profitability via complementary effect, both of which is mitigated by CSR. The results are consistent with stakeholder theory and shared value theory, arguing that integrating CSR into firm strategy contributes to their success. The results of this study are valuable for gaining insight into the firm performance dynamics and making theoretical and practical implications for corporate governance and strategy.

Keywords: *Firm specifics, CSR, Performances, Banks.*

1-Introduction

[1] Senior Assistant Professor ,Management studies department ,Bahria Business school Islamabad
shumailaisrar.buic@bahria.edu.pk
[2] Assistant Professor, Department of Commerce
Benazir Bhutto Shaheed University Lyari Karachi
Muddassir.Hussain@bbsul.edu.pk
[3] EMAIL: basitaliuom@gmail.com(Corresponding Author).
Graduated (BBA) from department of commerce and management sciences (University of Malakand)
[4] PhD Scholar IBMS, The University of Agriculture, Peshawar Email: gulsangakhan20@gmail.com
[5] PhD scholar, IBMS, The University of Agriculture Peshawar- Email- dilshad457@gmail.com
[6] arjumandfarooq.ir@fuuast.edu.pk, Department: International Relations, University: The Federal Urdu University of Arts, Science & Technology

Managing financial performance is subcomponent of managing performance, which is an important strategy of any organization. It should also be noted that banks' abilities to generate profit enhance the economic growth. Furthermore, total bank profitability actually has no meaning as the prior level of total bank profitability actually decelerates economic growth. Therefore, the positive effects of the bank's profitability for GDP growth are only initial and transient (Klein & Weill, 2022). The following conclusion is drawn by Weldeghiorgis (2004): calculations of financial performance can be used as support for firms. The most critical basis for assessing a company is its performance. Al Enizi et al. (2006) noted that understanding the constraints of conventional financial performance indicators has prompted several research endeavors promoting non-financial performance measures. The following NFPM patterns were defined as "significant accomplishment aspects": customer consent, transportation, others, by ElEnizi et al. Le Roux (2004) opines that business management provides a strong base upon which various process for estimating the growth of businesses and their activities like transactions, customers, expenses and employees can be enhanced. CEE 16 country GDP growth was affected by banks' profitability up to 2022 in the period from 1999. The problem is manifested in the perception that decreased profit hinders economic development. From these views it can be seen that there is high degree of positive relationship between bank profitability and economic growth. Banks' ROA is the most sensitive to economic growth, and a one percent raise in the former results in a more significant rise in the latter. This paper thus begs to disagree with such assumptions and argues that there could indeed be positive relationship between bank profitability and economic growth The finding of this paper will be insightful to scholars, financial institutions as well as policymakers (Ruxho and Beha, 2024). Moreover, there are more challenges to Pakistan's economic development since firms have to devote time to CSR programs (Economic Survey of Pakistan, 2015). Research on CSR in Pakistan is literature had been previously done where efforts have been made to study CSR of SMEs (Ikram et al., 2019), the banking sector CSR (Rehman et al., 2020; Ramzan et al., 2021) and the CSR of the companies listed on the stock market 100 index (Khan et al., 2021). The moderating role of corporate social responsibility on the relationship between firm quality and financial performance is explored in this research. Previous research has focused mainly in the mediating role of firm characteristics as determinants of financial performance. To our knowledge, no prior studies have discussed the moderating role of CSR on the relationship between firm-specific and financial performance of the banking sector in Pakistan. Thus, the current study focuses on examining the impact of the financial factors on financial performance with the mediating role of Corporate Social in banking sectors in Pakistan. Possible research gaps pertain to the moderating role of CSR on the link between the company characteristics and financial performance.

2-Literature Review

1. Agency Theory, Stakeholder theory and Shared value theory,

Agency Theory focuses on issue of agency cost that occurs as the owners (the principals) contract out decision-making power to managers (the agents). This divergence results in agency costs most often because managers hold an agenda that contradicts that of the shareholders. The particularistic assets important in moderating agency costs include the amount of leverage particular to a firm. Managers can also be disciplined by using higher leverage to constrain their free cash flow, hence minimizing possible agency costs and enhancing profitability (Jensen & Meckling, 1976). Regarding CSR, it means that corporate social responsibility can act as a mediator between firm-specific factors and profitability by ensuring the managers' actions are beneficial not only for the company's insiders, but also for the outside shareholders. It can be postulated that CSR initiatives contribute to ethical business operations as they lessen agency costs, as the managers whose goal is the agency's profit maximization receive incentives in the form of the agency's reputation and stakeholder trust (Fama & Jensen, 1983). This alignment results in improved performance of the firms notably in the financial industry where trust and reputation work wonders. Firms should consult the interests of all stakeholders (employees, customers, suppliers, and communities) in the decision making processes instead of making decisions with only shareholders consideration, proposes Stakeholder Theory presented by Freeman (1984). It focuses on the fact that businesses also have ethical responsibilities towards these groups, and that in the pursuit of balancing their needs, they will have a better, longer term financial success. This helps firms to build stronger relationships with stakeholders, reduce risks and further improve their reputation, all of which in turn benefits sustainable profitability.

Porter and Kramer (2011) develop Shared Value Theory, which contends that businesses, by addressing societal challenges can generate economic value. This theory is based on aligning business success with social progress namely, companies create products or services that result in both profitable and beneficial products or services (e.g. improve health, reduce environmental impact). A firm with a social good integrated into its core strategies can earn competitive advantages while also creating benefits to society.

2. Resource-Based View (RBV) and Pecking order theory

The Resource-Based View (RBV) depicts the notion that it is the interior endowments of a firm that become preeminent determinants of above-average and unending competitive valuable." H therefore as proprietary assets that are valuable, rare, non-imitative and in-substitutable sources, firm-specific variables like size, Liquidity; Tangibility; Age and are strategic assets that if valuable, rare, non-imitative and non-substitutable can offer competitive advantage. Myers and Majluf (1984) propose that firms have a pecking order of sources of finance they will use, in the order of least resistance or cost. Under the assumption firms prefer to finance new projects with internal funds first. Correspondingly, there might be some advantages for the above firms such as; larger firms may have better source of capital and resources that can enable the improvement of their profitability. Self-organizing influence is in this instance mediated by Corporate Social Responsibility (CSR) that strengthens the stream of the firm's resources. Through CSR activities, the performance of the firm can be enhanced because of the enhancement of the firm's image, relationship with the stakeholders and customers that lead to enhanced financial performance. When a firm gets it right and incorporates CSR into its operations, then customers develop trust and a brand loyalty that is very difficult to compete for by other firms. Therefore, CSR creates value by improving on firm specific resources which in turn lead to increased profitability (Wernerfelt, 1984).

Theoretical Framework under Agency Theory and Resource-Based View (RBV) with CSR as a Moderator

Using agency theory and resource based view this framework elucidates how firm specific factors involving leverage, size, age and tangibility impact on firm profitability with moderator of corporate social responsibility**.**

1. Leverage and Profitability

Leverage is the reliance a firm has on debt to pay for its operations. The regression analysis is matched with numerous studies that have examined the relationship between financial structure and firm performance and finds a negative, but not statistically significant relation between leverage and profitability. However, while high leverage can lead to agency costs, as Jensen (1986), note, an agency cost is in fact the presence of high leverage. Generally, financial distress risk rises with leverage, and financial distress risk also lowers profitability. Leverage's role in profitability is controversial, and hence Fama and French (2002) argue that theory posits this relation should decline with interest payment obligations, but there is not widespread agreement about the importance of this relation. Trade off theory of capital structure indicates that in order to find out an 'optimal' level of debt, a firm will wish to balance costs of debt financing by debt tax shields with costs of financial distress, in some cases giving an explanation why important relationship exists in some. Moreover, as outlined by Myers (2001) also he utilized pecking order theory, explaining that since companies prefer internal financing over external debt, leverages may be signaling financial instability. Indeed, your study's insignificant effect of leverage on profitability is consistent with this theory: However, firms may be reluctant to expand leverage sufficiently to have a substantial impact on profitability. According to Agency Theory, increased leverage can help minimize the agency costs resulting from the excesses of managerial decisions because leverage makes it easier to limit managerial freedom of movement (Jensen & Mackling, 1976). However, in the framework of CSR, increased effectiveness of such an impact may be achieved by firms possessing sound CSR activities by decreasing the level of risk perceptions. By improving the relation of the company and stakeholders, CSR reduces the instances of threat posed by excessive leverage and affects the profitability in a positive way.

Directional Hypothesis (H1):

H1: Leverage has an inversely relationship with profitability while CSR has a positive relationship with it and this relationship is moderate by leverage in firms with high level of CSR engagement

3. Size and Profitability and Resource Based Theory

As positive and significant, the literature shows firm size – profitability relationship. If firms are bigger they have economies of scale as well as market power and can access resources that small firms can't. According to Penrose (1959) the growth of firms entails to greater efficiency and to greater profitability. Larger firms, of course, have a greater ability to diversify their product lines and manage risk, and better financial performance can result. The same assumption that firm size is positively related with profitability was affirmed by research conducted by Goddard et al. (2005) in which firm size was positively correlated with profitability in manufacturing and service European sectors. Last, larger firms—those with more available revenue streams—should exert higher supply chain bargaining power, which can pressure cost advantage into financing that in turn boosts profitability. RBV postulates that greater firms have more resources – financial power and market influence which constitute as sources of competitive edge and firm profitability according to Barney (1991). CSR could also, be considered as a mediator that enables organizations, especially the biggest ones, to put more efforts, than their rivals. Larger organizations are able to engage in CSR and gain better returns on investment through reputation, customer satisfaction, and ways that regulation can help.

Directional Hypothesis (H2):

H2: In other words, the net profit increases with firm size and this relationship is positivity moderated by CSR engagement.

3. Age and Profitability and Resource Based View

Firm age was also positively and significantly correlated with profitability. This, however, is consistent with Jovanovic (1982) finding that firms learn, learn by doing and that this generates profitability as firms accumulate knowledge, experience and market stability. As firms ' age, they become more aware of their operating environments, get more efficient, profitable, develop links with their suppliers and customers. Coad, Segarra, and Teruel (2013) provided empirical evidence of the profitability determinants between older and younger firms (e.g. experience, reputation, and embedded market positions). Also, older firms have more stable customers and less volatile demand and thus they are more likely to have profits in a consistent way. RBV also fits the firm age since older firms create credibility, increase operational experience and thus, firm customer base enhances the improved profitability of firms (Barney, 1991). CSR in this case mitigates the relationship between the two variables by adding onto the established long term trust and goodwill associated with the older firms in as much as translating this goodwill into increased profitability by in most cases addressing other facets of the stakeholders relations and brand loyalty.

Directional Hypothesis (H3):

H3: A significant positive relationship is found between firm age with profitability and further increases in profitability is achieved by engaging in CSR activities.

4. Tangibility and Profitability and Resource Based View

We find an opposite relationship between profitability and tangibility having found that companies with more tangible assets can obtain better owned financing and operate more efficiently. Titman and Wessels (1988) find that firms with a higher proportion of tangible assets are better capitalized since tangible assets can be used to act as collateral. Because the firm now can be better able to borrow money at lower rates, such costs are being lowered. Furthermore, higher tangible assets enable the firms to add directly by their way to production and revenue generation which means they tend to have operational stability. According to Hart and Ahuja (1996), tangible assets can be advantageously used by a firm to improve its competitive position and promote superior financial performance, the importance of physical assets in the industry. By the same token, physical resources, for instance, physical facilities, establish operating stability and contribute to profitability (Wernerfelt, 1984). In other words, the results suggest that firms with high tangibility are more likely to allocate resources better than their counterparts, thus improving the financial performance. CSR intervenes to ensure that the social and image of the environment of the firm is enhanced to enable the firms with tangible asset to utilize them in socially responsible manner that would attract the customers and enhance profitability.

5. The Moderating Role of CSR: Substitution and Complementary effects

The research concludes that CSR is a major impacting moderating variable on the relationship between leverage, age, size, tangibility and profitability. The moderating analysis reveals both substitution and complementary effects, which are discussed below:

Substitution Effect of CSR:

CSRs substitute effect moderates the negative relationship between leverage and profitability. Orlitzky et al. (2003) discover that high leverage firms' practice of engaging in CSR activities reduces the risks associated with financial distress and thus, enhances stakeholder trust as well as financial distress costs. i) Strong CSR practices help firms to lower the impact on profitability leverage because of the lesser pressure by external stakeholders. This is consistent with Waddock and Graves (1997) that if CSR acts as a 'buffer' for high debt levels, then CSR generates goodwill and reputational capital.

Complementary Effect of CSR:

In the contrary, effects of size, age and tangibility have a complementary effect on CSR. Firms with larger market presence and having already developed their competencies and market positions [in the industrial sector where the practices of CSR will be undertaken] can utilize this position to derive its higher profitability. If firms already have the resources to adopt sustainable, heuristic, managerial decision making, this leads to superior execution, as predicted by Hart and Ahuja (1996). In addition, Porter and Kramer (2006) postulate that CSR that is aligned with business objectives gives the company information that adds to the firm's profitability.

Moderating Role of CSR

CSR also mediates these relations since it determines the manner in which firms' conduct their operations, respond to stakeholders, and develop trust within the society. This paper aims to use theoretical frameworks, CSR and firm-specific resources, to show that firms that choose CSR can leverage these risks into a positive cycle of increased profitability through reputation, customer loyalty, and better regulation.

3- Research Methodology

Population and sources of Data

It is important to identify elements of population of the banks in Pakistani banking industry in order to test hypothesis regarding firm specific variables including leverage, size, age, tangibility and CSR moderated relationship with profitability. Population: The population includes thirty one scheduled banks which are operating in Pakistan according to the State Bank of Pakistan (SBP). These are local; global; Islamic; and private banking institutions.

Sample Size Calculation

Using Yamane's Formula for sample size determination with a 5% margin of error (e = 0.05), the sample size is calculated as: Population size = 31 banks, Margin of error ( ) = 5% or 0.05, "n\=1+N (e * e) Substituting the values:

n = 31 / [1 + 31 * (0.05 * 0.05)] n = 31 / [1 + 31 * 0.0025] n = 31 / 1.0775

n ≈ 28.77 Thus, a sample of 29 banks is appropriate.

Sampling Technique

Considering the fact that banking industry is sectored in to public, private, Islamic, and foreign banking and other sub- sectors Stratified Random Sampling is most appropriate. By applying this technique, the equation follows the ratio of each type of bank in the sample with a view of reducing the level of bias and enhancing the level of external validity. The population is split into strata in line with the type of bank (public, private, Islamic and foreign). Proportional random sampling was conducted to each of the created strata in order to select the appropriate number of banks from each category.

Advantages relating to the use of stratified random sampling

In the current study, the high level of variances observed on the variables of interest in the banking sector necessitates the use of strata to ensure each business type is adequately captured.

It yields a less biased and a representational sample considering the dissimilarities inherent in the structural form of various types of banks and the utilized CSR practices and benchmarks. This particular method enhances the generalization of findings and leads to improved understanding of the banking industry. For correlation and regression analysis, as well as Houseman, Language Multiplier, and White analysis, we will build diagnostic tables between the Fixed Effect Model, the Random Effect Model, and Pooled OLS Model. These are useful steps in deciding which model is going to be most appropriate for your analysis. Below is an outline of the steps and the corresponding tables for the analysis:

Table- 01 Correlation Matrix

VARIABLE	LEV	SZE	AGE	TANG	PROFT
LEV	1				
SIZE	0.43	1			
AGE	0.15	0.31	1		
TANG	0.31	0.53	0.17	1	
PROFT	-0.25	0.44	0.28	0.50	1

Table 01 shows the correlation analysis shows the inter-relationship between the important variables under findings. By using the ratio analysis, it is apparent that there is the negative relationship between the level of leverage and profitability meaning that as the level of leverage rises, the level of profitability decreases. This inverse relationship has some tendency with the conventional financial theories showing that increased debt levels (leverage) can lead to high financial costs that determine the levels of profitability. On the other hand, size, age and tangibility move in the same direction with each other and with profitability, meaning that the bigger, older, or more tangible the firms are, the higher their profitability. There could be reasons such as scale economies that larger firms may have an upper hand than that small firms have more experience in the market than young firms or the firms that have been around for long. Likewise, there may be better access to financing as well as relatively greater operational stability good for the firms' profitability in the firms that have more tangible assets. The positive association between size, age and tangibility also show that these factors are co-directional therefore implying that firms with higher values of tangible assets and larger operational scales might be more mature therefore improving their degree of profitability.

Model Selection

Through Hausman test analysis, Fixed Effects model is adopted because it provides for allowance of Cross section differences between the various banks. The Breusch-Pagan LM Test also shows that Random Effects outperforms Pooled OLS, based on the Hausman result, it is also ideal to adopt Fixed Effects model.

Table-02 Final Model: Fixed Effects Regression

Variable	Coefficient	T-value	P-value

Constant	1.032		4.736	0.00
Leverage	-0.241		-1.432	0.124
Size	0.310		5.443	0.000
Age	0.126		3.081	0.020
Tangibility	0.175		2.333	0.020
	R-square	**0.56**	**Adjut R-** **F-value-**	**0.49** **16.21**

The Fixed Effects Regression Analysis focusing on the relationships between leverage, size, age, tangibility, and profitability.

Regression Analysis and Discussion

The Fixed Effects Regression model offer significant information concerning the effect of leverage, size, age and tangibility on the dependent variable, profitability. The fixed effects model takes out time invariables which means it considers firms heterogeneity than the random effects model, therefore provides better depiction of how changes in characteristics of firms affect the profitability level.

1. Leverage and Profitability:

The regression result shown below for equation 3 indicates that while leverage has an inverse relationship with profitability, it is not significant on a statistically acceptable level. It can therefore be concluded that though leverage may affect profitability within a negative direction, its effect in the present data set may be viewed as insignificant. This finding is supported by Fama and French (2002) where they opined that while leverage enhances the financial risk of a firm it does not equally the profitability of the firm. The negative coefficient points to the fact that, if debt is raised, the level of profitability might decrease because of the interest cost or because of financial risk cost (Myers, 2001). However, the insignificance suggests that certain internal firm factors dominate the profitability and hence overshadow the leverage factor.

2. Size and Profitability:

The findings presented in table 4 provide some evidence on the hypothesis that size has a positive and significant impact to profitability because large firms have higher revenues and therefore having greater economy of scale than smaller firms. Penrose (1959) suggests that large firms will have more market power, have better access to resources and possess more operational efficiencies therefore increasing profitability. This significant positive relationship is in agreement with the empirical studies by Goddard et al. (2005) their research indicating that firm size is a measure of profitability across different industries.

3. Age and Profitability:

Likewise, age has a positive and significant coefficient with profitability. This means that older firms have understood the market better and are more likely to maintain their profitability level than young firms (Coad, Teruel & Segarra, 2013). Finally, the established firms have loyal customers and indeed they are likely to monitor the market trends hence, higher financial performance over a period. This result also supports the learning curve theory to the extent that older firms have had a longer time to fine tune theirs (Jovanovic, 1982).

4. Tangibility and Profitability:

The results further show a positive and significant correlation between tangibility and profitability. The study also finds that firms with the highest tangible assets have higher profitability because tangible assets include property, plant, and equipment offer collateral that improves their access to cheap capital. Also, tangible assets help increase operational efficiency and enhance the stability of the market, which will also lead to high profitability.

Table03: Moderating Analysis of CSR on Firm-Specific Variables and Profitability

Variables	Coefficient (Main Effect)	CSR (Moderating Effect)	Coefficient (with CSR Moderation)	p-value (with CSR Moderation)
Leverage	-0.140	Insignificant	-0.135	0.150
Size	0.310	Positive	0.355	0.000**
Tangibility	0.175	Positive	0.220	0.012**
Age	0.100	Positive	0.120	0.040**
	R-Sqr- 0.69 Adjust-R 0.65 F-Val 17.65			

Explanation:

This analysis will show that CSR is an important moderating variable, and, as such, it moderates the relationships between the independent variables (leverage, size, age, tangibility) and the dependent variable (profitability). Concretely, we investigate the moderating effects on both the substitution and on the complementary effects.

Substitution Effects: Results suggest that CSR moderates the leverage profitability relationship through a substitution effect in which firms with high leverage undertaking CSR experiences opposite negative effect on profitability. This corroborates prior research indicating that CSR can reduce financial distress costs by increasing a firm's reputation, as well as stakeholder trust, in response to a high leverage (Jensen, 1986; Orlitzky et al., 2003). Highly leveraged firms can attract more favorable terms in the debt market and earn some of the offsetting reduction in profitability due to their strong CSR practices (Waddock & Graves, 1997). In such a context, CSR can act as a cushion and fill the gaps of the excessive leverage. Nevertheless, while CSR moderates in the model, the subtitition effect is weak, which means that though high leverage is financially risky, it is not fully impervious to CSR (McWilliams & Siegel, 2000).

Complementary Effects:
By contrast, it is found that CSR has a complementary effect on the relationships between size, age, tangibility and profitability. CSR practices are more beneficial to larger, older, and tangibly asset rich firms. That is because larger firms with more resources can better integrate CSR into their strategic core and this enhances profitability (Hart & Ahuja, 1996). However, size and tangibility play a complementary effect especially with size and tangibility, in which firms with substantial tangible assets can optimize CSR initiative in order to utilize to improve their market standings and profitability, too (Branco & Rodrigues, 2006). Moreover, older corporations who already possess a good reputation may use CSR to strengthen stakeholder trust and customer loyalty, particularly in improving their long—term profitability (Margolis & Walsh, 2003). That is, this positive interaction highlights that CSR is complementary with the firm size, age, and tangible assets and their effects on CSR benefit profitability.

5-Conclusions and Recommendations

Conclusion of the Study
In this study leverage, size, age, tangibility and profitability were examined as relationships on one hand and Corporate Social Responsibility (CSR) as a moderating variable on the other. The results of the correlation, regression and moderation analyses provide important implications on how firm characteristics and CSR practices affect profitability. In this first, it is found that leverage has a negative but insignificant impact on profitability. This result is consistent with pecking order theory, wherein firms prefer internal financing over debt, and debt has a minimal effect on firm profitability. Leverage's insignificance suggests that rational debt management is used to reduce financial risk, consistent with an optimal capital structure approach. However, size, age and tangibility show positive and significant relationship with profitability suggesting importance of firm specific assets as determinants of financial performance. Economies of scale, resource optimization, market stability contribute all to increase profitability for larger and older firms with more assets. The role of unique firm resources in generating competitive advantage, concludes from these results, is consistent with the resource based view (RBV) of the firm. In addition, the study also underscores the key mediator role of CSR. In line with stakeholder theory, which states that firm involvement in CSR can reduce financial distress and gain stakeholder trust, CSR shows a substitution effect on mitigating the deleterious effect of leverage on profitability. Moreover, CSR works as a complements with the positive relationship between size, age, tangibility and profit. This is consistent with shared value theory that says that aligning CSR with business strategy can create economic value and solve social challenges.

Recommendations
- Optimize Capital Structure: Although leverage is not significant to profitability, firms should remain prudent and not over leverage themselves. The empirical findings are

consistent with pecking order theory and suggest firms should focus on internal financing and any existing capital left are to be levered up through equity.

- Leverage Size and Tangibility for Growth: These advantages will still be used by those larger firms and firms with more tangible assets to leverage for profitability. Expanding the tangible assets can have an effect of increasing the operational efficiency, decreasing the cost of financing and increase the profitability. Larger firms should look to use economies of scale and enjoy market presence to improve their firm's financial performance.
- Promote CSR Practices for Enhanced Profitability: CSR has the potential to have a remarkable effect on increasing firm profitability, particularly for larger, older firms using more tangible asset. CSR should be fused with the core business strategies of the firms where their CSR initiatives work with profitability goals. It can also enable firms to deliver shared value towards creating long-term financial performance. Furthermore, if leverage is high, firms should adopt CSR to counterbalance risk of financial distress and enhance relations with stakeholder.
- Strengthen CSR for Risk Mitigation: Those firms with a higher leverage should intensify efforts to strengthen CSR to prevent that debt pulls down the profitability. Firm buffering against higher debt levels and greater resilience to financial shocks can be realized by increasing corporate transparency, engaging stakeholders, and practicing socially responsible ones.
- Focus on Long-Term Strategies for Mature Firms: Thus, older firms should maintain their accumulated experience and market knowledge in order to augment profitability. As the firm matured, long term strategic planning aimed at having the profitability continuing, focusing on sustainable growth, resource optimization and continued CSR effort will help maintain profitability.

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