CAN SOCIAL RESPONSIBILITY OF CITIZEN FIRM BE CONDITIONED FINANCIAL PROSPERITY?

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ABSTRACT: *Based on a specific sample, which is sustainable citizen companies along the period 2002-2007, we examine - in pool and descriptive studies - financial, and social characteristics of these firms. Our findings identify several important facts. This causal analysis has allowed us, in a great measure, to conclude that these corporate citizens appear to use diverse strategies and synergies to meet social demands in order to improve financial performance through instrumental commitment. The reward of social investment is made in the long term, whereas if the company is prosperous and if managers are ready to meet social demands then it will be immediately recognized by rating agencies in their evaluation process. Also there is no a unanimous conclusion about the relationship between the social and the financial.*

KEYWORDS: *sustainable citizenship, social performance, financial performance earning management, positive synergy, negative synergy.*

INTRODUCTION AND HYPOTHESIS DEVELOPMENT

We focus, in this work, on the idea of creation of the value through a social commitment to the diverse stakeholders of the firm (customers, employees, community, society. government, environment.... all the partners of the firm) and to demonstrate that this goal can be realized only if **the financial performance of the firm is good** and also if the manager has a positive initiative and intention to serve the interests of all stakeholders of the firm.

It is important to clarify that we adopt a critical view against the unanimous relationship between the social and the financial, and we expect a complex and a controversial relationship. So we intended to show that no consistent correlations may exist.

This relationship may be relevant only in the long term through an instrumentalist approach. Means these firms having good financial performance may be a long term condition to reply the different social demands

Through the seminal investigation of Waddock and Graves 1997, we can guess that there are synergetic relationships and strategic arrangements between social performance and financial performance and vice versa. This prompted us to understand these directions of causality, more clearly, in the regressions that aim to verify the following assumptions:

H1: An earlier positive reputation through good social performance can influence financial performance.

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H2: Good present or past level of financial performance may encourage companies to engage in social investment.
In this research, we focus on detecting if the financial performance can engage social commitment and if a good social performance can improve the financial performance.

Sample and Data Collection

To validate these assumptions, we rely on a sample of firms that have remained classified, during the six years of study on the social list of most admired firms from 2002 till 2007as described in table 1.

Table 1: list of sustainable citizens firms

Sustainable citizens firms
AUTODESK
NORTHWEST NGCO
ECOLAB
PITNEY
CISCO SYSTEM
STARBUCKS
SOUTHWEST AIRLINES CO
TIMBERLAND
INTEL
HERMANMILLER
CUMMINS

The data are taken from different documents: proxies' statement and financial reports published on Fortune500, sec.gov, Edgarscan, YahooFinance, firms' websites.

Econometric Approach

To verify the causal direction between financial performance and social performance, we relied on the work of Waddock and Graves (1997) and Berman & al (1999).
In fact, we tried to test the effect of social performance on financial performance - and vice versa - using a one-year delay between social performance and financial performance.
Testing models take the following forms:
PSti = f (PF (t-1) i + control variables), where PS: social performance and PF: financial performance.
PFti = f (PS(t- 1) + control variables)
To calculate the scores of the 100 Best Corporate Citizens, "Business Ethic" Socrates uses the online database of environmental research, social and government, created by KLD[1] . In the KLD database, firm actions toward each of the five stakeholder groups are measured on five-point Likert-type scales; -2 suggest negative actions toward that stakeholder group, and +2 suggests positive actions undertaken by the firm toward the group. Analysts at Kinder, Lydenberg, Domini, and Company establish these ratings

[1] www.kld.com

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by using both primary and secondary data on approximately 650 firms operating in the United States. To determine areas of strength and concern for each company in the database, KLD relies on public records of notable socially responsible activities (such as sponsoring local educational initiatives or recycling programs) and signs of disregard for particular stakeholders (such as violations of environmental regulations or payment of civil damages for product safety). The KLD ratings are also heavily influenced by qualitative data, such as evaluations of corporate advertising and charitable giving programs. Additionally, since the primary mission of the Domini Social Equity Fund is to provide financial returns to investors by taking equity positions in socially responsible firms, analysts from KLD frequently visit corporate sites to directly observe and appraise the actions of particular firms.

Our variables are defined in table 2.

Table 2: List of variables

ROA	Return on assets
ROE	Return on equity
Discrestional Accrual (AD)	Level of earning management[2]
Size (SIZE)	Log of total employees
R&D (RD)	Research and developement expenditures
Debtes (D)	Debt Ratio
FCF	free cash flow
Sales	Sales level
EFF	Efficiency costs
Mar	Advertizing costs
SC	Measured as the average of scores The citizenship score is the average of the different criteria variables: The relationship with shareholders ; - The relationship with the community; - Diversity; -The relationship with employees; - The environment; - Governance; - And the product or the relationship with customers.

Descriptive Analysis

We illustrate the descriptive statistics in the following two tables' statistics. In table 3, we present the overall average values , whereas in table 4, we present these averages by company.

[2] This variable was calculated basing on estimation of Dechow and al 1995 model.

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Table 3: Mean values of variables

	FCF ?	RD?	ROA?	ROE?	SIZE?	D?	SC?	MAR?	EFF?
Mean	0.15	0.05	0.13	0.21	10.31	0.50	0.87	0.26	0.49

Where R & D: Research and development spending;Mar: marketing effort and EFF: efficiency cost; ? a pool symbol used by the Eviews software.

Table 4: average values by company

	FCF	RD	ROA	ROE	SIZE	D	SC	MAR	C
AUTOD	0.262	0.212	0.181	0.294	9.352	0.410	0.663	0.482	0.
NORTH	0.071	0.013	0.071	0.085	9.143	0.564	0.688	0.182	0.
ECOLAB	0.152	0.092	0.120	0.175	10.494	0.575	0.809	0.303	0.
PITNEY	0.063	0.017	0.083	0.383	11.321	0.860	0.780	0.306	0.
CISCO	0.149	0.078	0.150	0.166	10.526	0.331	0.916	0.257	0.
STARB	0.237	0.004	0.183	0.199	10.425	0.369	0.888	0.326	0.
SOTHW	0.121	0.000	0.053	0.075	10.427	0.524	0.843	0.231	0.
TIMB	0.203	0.024	0.237	0.233	9.575	0.321	0.922	0.306	0.
INTEL	0.246	0.102	0.164	0.162	11.451	0.219	1.184	0.150	0.
HERMR	0.160	0.059	0.126	0.346	9.538	0.744	0.924	0.229	0.
CUM	0.081	0.040	0.087	0.195	11.200	0.660	0.983	0.229	0.

- It seems that the company "Autodesk" has the lowest social score compared to other companies. However, the company has significant amounts of free cash flow, advertising expenditures, research and development. In addition, it seems to be more efficient. This may suggest that the company has failed social score.
- The company "Intel" has the largest size compared to other companies. In addition, it has the highest social score. This implies that the size is a key determinant of social performance. We think there is a positive affinity between the size and the social score**.** The company is also the least indebted and having committed the lowest amount in advertising campaigns. It is interesting also to reveal that the company Intel has the highest amount of discretional accrual[3]
- Therefore, we believe that earnings management can be a second important determinant of sustainability on the list of 100 Best Corporate Citizens, during the six years of study.

At best, the social status of the company was unable to prevent accounting manipulation. At worst, it was the catalyst to become more involved in such discretionary strategies.

- The company “Pitney" seems to be the most effective for shareholders at the expense of its social performance and is the most indebted: **Contradiction between financial and social objectives.**
- We note that “Timberland " is the most financially successful in the short term. The company which is financially the least efficient is the "Northwest gaz natural firm." Moreover, this poor performance is associated with a low level of social score.

A good social score can be explained by good financial performance and vice versa (positive synergy / negative synergy).

[3]See Appendix 1

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It is interesting to note that the financial performance of all of these companies is positive.
It appears that every company has its strategic program, conditioned by its specific characteristics.

Effect of Financial Performance (Delayed One Year) On Social Performance

In this research framework and in order to validate our assumptions, we have integrated delayed effects in the equations to estimate the nature of the relationship.
Please see the results as summarized in table 5.

Table 5: Estimation results of the regressions of financial performance on the level of social score

DependentVariables	coefficients	DependentVariables	coefficients
ROE?(-1)	-0.349669*	ROA?(-1)	-1.232849***
FCF?	-1.585630***	FCF?	-1.527599***
RD?	-0.705312	RD?	-0.276599
SIZE?	0.021197**	T?	0.026548***
D?	0.095022	D?	0.148313
MAR?	0.142916***	MAR?	0.141731***
EFF?	-0.196056***	CEFF?	-0.171781***
R-squared	0.980366	**R-squared**	0.975238
D-W	2.829578	**D-W**	2.583272
F-Stat	307.9109	**F-Stat**	221.7776
PF-Stat	0.000000	**PF-Stat**	0.000000

* , **, *** : Thresholds risk level of 1% , 5% and 10% , respectively.

We note that the financial performance lagged one year seems to have a negative and significant effect on the level of future social score. Indeed, the financial performance of the previous year was low; this could be valued in the evaluation process, in the following year, assuming that these firms were oriented macro and not only to the interests of shareholders.
However, we recorded a significant positive effect of advertising expenditures on the level of social scores. The size appears to have a significant positive effect on social performance. Similarly, a high level of cash flow can be devalued in the evaluation process and have therefore a low score, as the company is not able to operate its business effectively
It appears that the social levers are: the ratio of advertising, cost efficiency, size and cash flows and the financial performance of the previous year.

Effect of Social Performance on Financial Performance

We present in table 6, the results of these estimations:

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Table 6: Estimations results of the effect of social performance, lagged one year, on financial performance

	Coefficients(ROE :Independent variable)	**Coefficients (ROA : Independentvariable)**
SC?(-1)	0.011006	0.025252
FCF?	0.995533***	0.625263***
RD?	0.228222*	0.066325*
SIZE?	0.002247	-0.002643**
D?	0.272248***	0.077610***
MAR?	0.020668**	0.005825
EFF?	0.017167**	0.015293
R-squared	0.961588	0.958030
D-W	1.693466	1.779372
F-Stat	154.3722	140.7650
PF-Stat	0.000000	0.000000

*, **, *** : Thresholds risk level of 1% , 5% and 10% , respectively.

It is interesting to note that there is a positive relationship between corporate social performance lagged one year and the financial performance of the following year; this implies the existence of a positive, but not significant, synergy between these two variables.
In addition, social scores are not significant but their significance probabilities are very close to the level of confidence, suggesting a delayed effect more than one year of social variable. This seems reasonable because the process of influence of social engagements may take time to improve financial performance. This prompted us to look for the significance of this effect delayed for two years.
Kindly, see the results of this new estimation in table 7:

Table 7: Results of the effect of social performance (delayed two years) on financial performance

	Coefficients(ROE)	**Coefficients(ROA)**
SC?(-2)	0.011376**	0.012268
FCF?	1.188462***	0.534673***
RD?	-0.123120***	0.013148
T?	0.001318**	-0.003471***
D?	0.321131***	0.086935***
MAR?	0.015097	-0.026903
EFF?	0.045417	0.004309
R-squared	0.988419	0.972938
D-W	2.078999	2.121330
F-Stat	369.8312	155.7944
PF-Stat	0.000000	0.000000

*, **, *** : Thresholds risk level of 1% , 5% and 10% , respectively.

At the first glance it appeared a positive effect of PS, delayed two years, highly significant on PF. **Indeed, a positive synergy can be achieved in the long term**

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(Wadock and Graves, 1997). In other words, a social engagement relieves fruit in the long term. In addition, the goodness of fit is improved compared to the first two regressions considered previously, suggesting the plausibility of this latter specification showing a significant instrumental commitment.

DISCUSSION AND CONCLUSION

This causal analysis has allowed us, in a great measure, to conclude that these corporate citizens appear to use diverse strategies and synergies to meet social demands in order to improve financial performance through instrumental commitment.
The reward of social investment is made in the long term, whereas if the company is prosperous and if managers are ready to meet social demands then it will be immediately recognized by rating agencies in their evaluation process in order to be classified as citizen firm.
Our results confirm that the engagement in social responsibility depend not only on the prosperity of the firm but also and especially on the willingness of the managers and their discretionary strategies.

And it is evident, even through this short investigation, that we cannot affirm a positive or a negative relationship between the financial and the social, therefore we cannot reach a consensus about this strategic effect. It is clear that there is a synergetic relationship that depend specially on the degree of the prosperity of the firms and on others immeasurable variables like the managerial discretion and the effect of synergetic relationship that depend specially on the degree of the prosperity of the firms and on others immeasurable variables like the managerial discretion and the effect of their entrenchment towards social responsibility commitment.

FUTURE IMPLICATIONS

So Future studies can investigate whatever corporate governance in these firms may assign a real social engagement. And we can do also researches on the relationship between the managerial discretion and his entrenchment on social performance.

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pg. 303

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Appendix 1

Mean values of discretional accruals

	AUT[4]	NOR	EC	PIT	CI	STA	SOt	Tim	INTL	HERM	CUM
Mean	0.0582	-0.0003	-0.0076	0.0014	0.0586	-0.0124	-0.0130	0.0097	0.0758	0.0033	-0.0063

[4]Abbreviations of the Americans firms 'names

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