IS DISCLOSURE OF CORPORATE SOCIAL RESPONSIBILITY ASSOCIATED WITH FIRM PERFORMANCE?

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ABSTRACT

The relevance of ethics to the management of modern companies has gradually increased. In recent years, economic, environmental and social information has become a key issue in the strategic agenda of competitive companies. This study investigates the relationship between the disclosure of corporate social responsibility (CSR) reporting and firms' performance. We use a sample of 51 firms belonging to the World Business Council for Sustainable Development in Portugal. We construct an index of CSR based on the content analysis of the companies' sustainability reports. Contrary to previous literature, we did not find a relationship between corporate social responsibility disclosure in Portuguese firms and their financial performance. However, additional results demonstrated that social responsibility disclosure in larger firms is associated with a higher level of performance.

Keywords: Corporate Social Responsibility; Disclosure; Firms; Performance; Portugal.

1 Introduction

In recent years, the business world has been encouraged to work actively towards Corporate Social Responsibility (CSR) because, in addition to providing a business opportunity in today's world, it frequently reflects the expectations of firms' customers, human resources, society, and stakeholders (Mark-Herbert & Von Schantz, 2007). Corporate social responsibility focuses on long-term shareholder value by incorporating the best practices in the following areas: ethics, governance, transparency, business relationships, financial return, product value, employment practice and environmental protection (Epstein, 2008).

Investors are given an indication of the social reputation vis-à-vis that of competing companies when they look at a company´s stock, its products and strategies, both in relation to past events and future prospects (Lu et al., 2017).

The importance of information in financial reports for stakeholders is well established in the literature (Hope & Thomas, 2008; Lambert, 2001). However, the role played by the disclosure of corporate social sustainability information in the increase in transparency resulting from the availability of additional information on firm performance (Margolis et al., 2008) is an understudied topic. The primary goal of a business is to maximize shareholder value. From a business perspective, CSR initiatives can be viewed as methods of achieving significant competitive advantages. Assessing the link between CSR and firm performance is essential, as it can enhance a firm's sustainability.

This study is motivated by the importance of CSR reporting and the lack of research on the disclosure of non-financial informaton and firm performance; the main objective is to examine the relationship between corporate social responsibility disclosure and firms' performance.

We use the data of the thirty companies published in the list of the Business Council for Sustainable Development (BCSD), together with additional information from the Amadeus database and from each company's website to obtain specific corporate governance and firm characteristics.

Contrary to what is reported in previous literature, we find that the disclosure of corporate social responsibility in Portuguese firms is not associated with performance. However, additional results demonstrated that social responsibility disclosure in larger firms is associated with a higher level of performance. Our results suggested that additional information in firms´ CSR reports can be used by managers to conceal actual financial performance from investors, and it therefore decreases transparency. We also find that corporate social responsibility disclosure is associated with a higher level of performance in larger sized firms. This suggests that larger firms presented high-quality non-financial disclosure information as they are more concerned about maintaining their visibility and reputation.

The remainder of the paper is organized as follows: Section 2 reviews the relevant literature and develops our hypothesis. Section 3 describes the research design, sample and data. Section 4 sets out our main empirical results. Finally, section 5 concludes.

2 Literature review and hypothesis

2.1. Corporate Social Responsibility

CSR is broadly understood to be an enterprise´s responsibility for its effect on society. To discharge their social responsibilities, enterprises must encompass CSR initiatives, incorporating social, environmental, ethical, human rights and consumer concerns, in their strategic plans (European Commission, 2011).There is no common definition of CSR. The European Commission (2011, 4) defines CSR as "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis". Davis (1973, 312) defines CSR as "the firm's considerations of, and response to, issues beyond the narrow economic, technical, and legal requirements of the firm to accomplish social benefits along with the traditional economic gains which the firm seeks".

The concept of sustainability has been operationalized through environmental, social, and financial performance dimensions, summarized through the triple bottom line (Elkington, 1994). Furthermore, research has systematically confirmed the interrelationship between social, environmental, and financial performance.

Nowadays, firms are being encouraged to change their business conduct so as to address sustainability issues and, as a result, the accounting community has been discussing the relationship between accounting and sustainability and trying to understand how accounting can respond to this challenge (Passetti, Cinquini, Marelli & Tenucci, 2014; Burritt, 2012).

The purpose of this study is to analyze whether firms with a higher performance opted in favor of complying with a sustainability report. Cormier and Gordon (2001) suggest that corporate ownership, firm size, and the risks faced in capital markets affect a firm's reporting strategies. Gamerschlag et al. (2011) found that the probability of a firm opting in favor of a sustainability report increases when the firm has greater visibility. In Portugal, there is no evidence of the rationale behind the firms' voluntary choice of creating a stand-alone sustainability report. Consequently, attention in this research was paid to the report choice and the characteristics of firms choosing the sustainability report.

Empirical studies have demonstrated that there is no universal and cohesive method to measure sustainability and they have drawn attention to the problem of multiple and contrasting goals (Gallardo-Vázquez & Sanchez-Hernandez, 2014; Montiel, 2008; Saeidi, Sofian, Saeidi, Saeidi, & Saaeidi, 2015), the influence of internal and external factors

(Christ & Burritt, 2013), and specifically industrial contexts (Azapagic, 2004; Nordheim & Barrasso, 2007).

Some studies developed models to measure CSR in specific contexts. Veleva and Ellenbecker (2001) presented a tool to foster business sustainability based on indicators of sustainable production for the industry sector. In the same line, Azapagic (2004) developed sustainability indicators as a tool for performance assessment and improvements in the metallic, construction and industrial minerals sectors.

2.2. Theoretical perspective

2.2.1 Agency theory

Agency theory is a principal theory used to explain CSR. It was first applied to CSR disclosure by Belkaoui and Karpik (1989). Two features of private firms can determine the extent of CSR, type I and type II agency problems: ownership concentration and the opportunity of executive entrenchment. Type I agency problem consists of the separation between ownership and control, which leads to a divergence between management and owner interests (Jensen & Meckling, 1976). These agency problems arise when asymmetric information coexists with divergent objectives between managers and shareholders. Managers with little ownership may have incentives to manage accounting figures so as to increase earnings-based compensation, relax contractual constraints, or avoid debt covenants (Healy, 1985; Holthausen et al., 1995), thus originating high agency costs for owners. The type II agency problem arises from conflicts between controlling and non controlling shareholders, which can result in executive entrenchment and large incentives to report a weak financial position (Fama & Jensen, 1983).

However, social performance expenditures reduce net income. Therefore, firms that prefer leading social performance and disclose it are more likely to have lower contracting and monitoring costs, and to have high political costs. Belkaoui and Karpik (1989) suggested that the decision to disclose social performance is positively correlated with social performance, economic performance and political visibility, and is negatively correlated with contracting and monitoring costs.

2.2.2 Stakeholder theory

Stakeholder can be defined as any group or individual who can affect or is affected by the achievement of the organization's objectives. The general idea of the stakeholder concept is that it redefines the organization in terms of what the organization should be and how it should be conceptualized. Friedman and Miles (2001) state that the organization itself should be thought of as a group of stakeholders and the purpose of the organization should be to manage their interests, needs and viewpoints.

The managers of a firm are thought to undertake stakeholder management. Unlike agency theory, in which the managers are working for and serving the stakeholders, stakeholder theorists suggest that managers in organizations have a network of relationships to serve - this includes the suppliers, employees and business partners. On the one hand, managers should manage the corporation for the benefit of its stakeholders in order to ensure their rights and participation in decision making and, on the other hand, the management must act as the stakeholders' agent to ensure the survival of the firm so as to safeguard the long term stakes of each group.

More recently, CSR has involved more parties. Therefore, the CSR model now encompasses both internal and external stakeholders. Internal stakeholders usually comprise employees and suppliers, while external stakeholders can include communities and the public.

2.3. CSR and firm performance

There is ample empirical evidence of the relationship between sustainability and firms' performance (e.g. Alafi & Hasoneh, 2012; Galbreath & Shum, 2012; Lin, Yang, & Liou, 2009; Margolis et al., 2008; Orlitzky et al., 2003; Shen & Chang, 2008; Van Beurden & Gössling, 2008). While some positive relationships are found, namely in attracting investment (Smith, 2005), improving financial performance (Barnett & Salomon, 2006), financial returns (Barnett, 2007), decision to disclosure (Dhaliwal et al. (2011), others are negative or neutral (Galbreath & Shum, 2012; Lys et al., 2015).

Deng et al. (2013) suggest a positive relationship between corporate social responsibility performance and a firm's future performance. The impact of CSR on firm performance was examined in Taiwanese firms and a positive association was identified between CSR and monetary performance (Lin et al., 2009). Moreover, Galbreath (2008) found strong positive links between CSR and organizational benefits in Australian firms. Despite the heterogeneity of results and conclusions to be found in the literature, they all indicate that firms undertaking CSR activities clearly perform better. A review paper by Van Beurden and Gossling (2008) found that 68% of studies demonstrated a positive association between CSR and firm performance. These findings were supported by Alafi and Hasoneh (2012).

The more a company's economic performance improves, the more it will undertake and disclose social responsibility activities (Roberts, 1992). Profitable companies tend to be more interested in explaining CSR activities and managing the costs of disclosures (Gamerschlag et al., 2011).

Global companies are more likely to emphasize product safety as part of their CSR, and are more likely to implement it through company policies and partnerships with government. Latemann et al. (2009) use data from 68 multinational firms in China and India to investigate the level of CSR communication. They note that Indian firms communicate more CSR information, as the Indian business environment is more rule-based, which they contrast with the more relation-based environment in China. Their results confirm that firm size and governance structure have a significant influence on CSR communication.

When economic performance is high, the firm faces less pressing demands from its financial stakeholders and so has the financial capacity to invest in programs with social, environmental and economic merit. High levels of profitability allow the firm to meet shareholders' expectations and still retain the ability to invest in CSR. By contrast, during times of low profitability, the pressure will be on management to reduce costs and maximize economic returns to stakeholders. Thus, we expect that:

H1: Financial performance and corporate social responsibility are positively related.

3 Method

3.1. Sample and Data

The empirical study investigates the disclosure of corporate social responsibility and performance in medium-sized enterprises operating in Portugal. We use the data of the companies enrolled in the Business Council for Sustainable Development (BCSD), together with additional information from the Amadeus database and from each company's website to obtain specific corporate governance and firm characteristics. The final sample comprised 51 firms in 2016.

3.2. Analysis of Data

A set of CSR indices was developed by the researchers to score CSR disclosure in the sample. We build a CSR index based on the content analysis of corporate social sustainability reports, assigning scores to the companies' disclosure of CSR activities. Previous empirical studies have demonstrated that there is no universal and cohesive method to measure the disclosure of corporate social responsibility and they draw attention to the problem of multiple and contrasting goals (Gallardo-Vázquez & Sanchez-Hernandez, 2014; Montiel, 2008), the influence of internal and external factors (Christ & Burritt, 2013), and specifically industrial contexts (Azapagic, 2004).

We applied the Global Reporting Initiative (2006) methodology to construct a CSR index on a sample of 51 firms belonging to the World Business Council for Sustainable Development in Portugal.

The GRI indicators (economic, social and environmental) are associated with the importance given by each entity through a classification between 0 and 4 that will reflect the degree of importance given by the company to the factors under analysis, as visualized in Table 1.

Table 1: Scale of scoring used in the evaluation of companies

Scale	Classification
0	The company does not refer to the indicator although it may be important for its activity.
1	The company refers to the indicator as "not applicable" to its activity.
2	The company refers to the indicator but does not comply with it; does not consider it relevant to its activity or the value is null.
3	The company refers to the indicator but its implementation is not fully verified; has the intention to verify or is in compliance.
4	The company refers to and complies with the indicator; there is a concise report and compliance with the company's activity.

Source: Authors

CSR is measured from 0 to 4 for each firms. Annex 1 presents the essential classification of each indicator according to the GRI guidelines. The index is composed of three dimensions: economic, environmental and social. The social dimension is subdivided into the following parts: i) labor practices and conditions; ii) human rights; iii) society; and iv) product liability.

Multiple regression analysis was used to examine the determinants of CSR disclosure. Our main dependent variable is performance, measured by net income divided by total assets (ROA). Ordinary least squares analysis was used to examine the performance and CSR disclosure practices. There are different ideas about the effect of a firm's size, age and revenue on the relationship between CSR and firm performance (see, Galbreath & Shum, 2012; Lee, Faff, & Langfield-Smith, 2009; Orlitzky et al., 2011). Therefore, this study considers firm size, sales growth, age of firm, dimension of corporate board and industry as control variables.

We consider firm size because large firms have strong management and are concerned about their reputation and visibility. Environmental performance indicators are used for waste management, natural resources, air emission and cost reduction in gas and water use. The study of Perrini, Russo, and Tencati (2007) has demonstrated that large firms invest in sustainability management and external reporting to increase visibility and to inform stakeholders. SIZE is the natural logarithm of a firm's total assets at the end of year.

Firms with high growth opportunities have greater investment opportunities, but financing future investment implies a higher cost of capital. Therefore, growth firms may reduce their sustainability to avoid raising the cost of capital or to maintain access to capital. While extant empirical studies found a positive relationship between growth and sustainability (Maigan, Ferrell, & Ferrell, 2005; Maron, 2006), others found a negative or neutral relationship (Teoh, Welch, & Wazzan, 1999). GROWTH is the change in a firm's total sales at the end of year between 2015 and 2016.

Brammer and Pavelin (2006) indicate that when a company's ownership is dispersed, its stockholders have less ability to directly exercise their authority over managers and therefore only monitor them. Hence, the control of power of ownership concentration in medium firms could reduce interest in business conduct that addresses sustainability. We consider OWNERSHIP as a control variable, that is the percentage of shares held by the group of owners.

Firms with a longer life expectation have countless reasons to foster socially responsible actions. They have high ethical standards, positive commercial values, their actual name may be the bearer of both reputation and a sense of responsibility and therefore help maintain their business sustainability. Empirical studies found that CSR disclosure is positively associated with firm age (Roberts, 1992). AGE is the number of years since the founding of firm or the oldest of its predecessor firms.

Legal compliance and proactive management of any environmental issues influence the use of environmental performance indicators. Specifically, the size of the board of directors can play a significant role in developing the sustainability policy. Adams and McNicholas (2007) found that the elaboration and presentation of a sustainability report increase the analysis of environmental and social issues and, consequently, firms give greater value to environmental performance and strive to improve their business actions. GOVERNANCE is the number of directors on the board of the firm at the end of year.

The regression model is detailed below.

$$CSR_{i,t} = ROA_{i,t} + Ownership_{i,t} + Size_{i,t} + Growth_{i,t} + Age_{i,t} + Governance_{i,t} + Industry_{i,t} + \varepsilon$$

Where:

t	The current accounting year for firm i
CSR	The number of CSR disclosure items.
ROA	Net income divided by total assets.
OWNERSHIP	The percentage of shares held by the group of owners.
SIZE	The natural logarithm of a firm's total assets at the end of year.
GROWTH	Change in a firm's total sales at the end of year between 2015 and 2016.
AGE	The number of years since the founding of firm or the oldest of its predecessor firms.
GOVERNANCE	The number of directors on the board of the firm at the end of year.
INDUSTRY	Industry dummy variables.
ε	The regression residual.

4 Results

This section details the research results and discussion. Table 2 provides descriptive statistics of the variables.

Table 2: Descriptive Statistic

Variable	Mean	Standard Deviation	5%	Median	95%
CSR	3.93	0.19	3.67	3.80	4.49
ROA	1.00	51.79	-116.75	2.00	108.05
Ownership	94.57	16.69	42.45	100	100
Size	10.81	2.78	5.96	11.19	14.68
Growth	-8.37	26.71	-84.35	0.00	30.70
Age	42.83	30.82	7.40	39.5	117.35
Governance	1.93	0.58	1.00	2.00	3.00

The mean value of CSR is 3.93. The high level of ownership concentration in Portugal in comparison to other countries is reflected in the average value of 94.57%, which is also higher than the values reported in studies such as Morck et al. (1988). The average firm size is 10.81. Firms have an average of 2 directors. The overall experience of the firms is 43 years. Table 3 shows Pearson's correlations for all variables.

Table 3: Pearson's correlations

	CSR	ROA	Ownership	Size	Growth	Age	Governance
CSR	1.000						
ROA	-0.106	1.000					
Ownership	-0.275	-0.053	1.000				
Size	0.081	-0.307	-0.176	1.000			
Growth	-0.063	0.322	-0.223	-0.080	1.000		
Age	0.083	0.197	-0.017	0.244	0.036	1.000	
Governance	-0.026	0.013	0.013	0.193	-0.046	-0.093	1.000

The number of CSR disclosures correlated positively with firm performance (ROA), firm size (SIZE), and age (AGE). These correlations are in the direction of the hypothesis.

Table 4 reports the Ordinary Least Squares (OLS) regression for sustainability determinants, estimated for the total firms under analysis. Three OLS estimations are presented: column C1 includes all variables and industry dummies of the regression of the research model; column C2 includes all variables to test hypothesis 1; column C3 includes the interaction of the ROA and firm size variables. The main findings are similar in the two first estimated regression models.

Surprisingly, the performance (ROA) is negative and not statistically significant in our study. Our main findings indicate that the disclosure of corporate social responsibility in Portuguese firms is associated with a low level of performance.

In line with our expectation, sustainability is positively and significantly related with firm size. This is consistent with previous literature and confirms that large firms invest in sustainability accounting and external reporting to increase visibility and to inform stakeholders (Perrini et al. 2007). This demonstrates that larger-sized firms with corporate social responsibility disclosure are associated with a higher level of performance. Our results support the view that CSR is a useful business strategy in the large Portuguese firms.

Moreover, we find that sustainability is negatively and significantly related with ownership concentration and sales growth. This demonstrates that the control of power in medium-sized firms could lead to less interest in business conduct addressing sustainability (Passetti et al., 2014). Our results demonstrate that growth firms must support more costs, and this reduces their commitment to sustainability.

Table 4: Regression estimates of sustainability

Variable	C1 (t-stat)	C2 (t-stat)	C3 (t-stat)
ROA*SIZE	-	-	0.034*** (0.367)
ROA	0.000 (-0.137)	0.000 (0.049)	0.000 (0.038)
Ownership	-0.000*** (-3.752)	-0.000*** (-3.378)	-0.000*** (-3.375)
Size	0.112** (2.117)	0.0005** (2.015)	0.117** (2.045)
Growth	-0.005*** (-2.709)	-0.006*** (-2.572)	-0.006*** (-2.635)
Age	0.000 (0.137)	0.000 (0.141)	0.000 (0.136)
Governance	-0.141 (-0.552)	-0.076 (-0.517)	-0.067 (-0.618)
Industry dummies	Yes	Not	Yes
Adj. R^2	0.149	0.103	0.167
F-Stat (p-value)	0.002	0.002	0.003

*, ** &*** indicates significance at the 1%, 5% and 10% levels, respectively

In addition, the corporate governance determinants of sustainability, such as number of directors and experience, are not statistically significant in our study. This may demonstrate that corporate governance characteristics are not determinant for business conduct addressing sustainability issues. According to Rachman et al. (2011), firm age was not statistically associated with CSR disclosure.

The model with interaction variables is presented in column C3. The results demonstrated that ROA in the largest firms is positively and significantly associated with corporate social responsibility disclosure. According to Cowen et al. (1987), the larger companies tend to receive more attention from the public, and they are therefore under pressure to exhibit social responsibility.

5 Conclusions

This study investigates the relationship of voluntary CSR disclosure and firms' performance. Our results indicate that firm size is strongly associated with high levels of CSR. Contrary to our expectations, we did not find that the corporate social responsibility disclosure in Portuguese firms is associated to financial performance.

Additional results demonstrated that social responsibility disclosure in larger firms is associated with a higher level of performance. The implications of our study are summarized as follows. First, CSR leaders are most likely to be the largest firms in each industry. Large firms are more visible, thereby drawing the attention of a wider range of external stakeholders. Large firms are also better placed to realize economies of scale in the implementation of sustainability programs.

The findings of this study are important to the ongoing debate about the benefits of disclosure of information in corporate sustainability reporting. Much of this debate has focused on the financial consequences on investment in sustainability activities. By contrast, the current study centred on the incentives for managers to obtain high levels of CSR by examining the factors associated with leading CSR firms. Additionally, our findings are relevant to standard setters and regulators who underscore the importance of CSR reporting.

Our study also adds to the recent evidence that non-financial disclosures provide incremental information to investors. By revealing that CSR disclosures is associated with low performance, we extend the literature addressing the relevance of CSR disclosures.

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ANNEX 1

GRI indicators of CSR

Corporate Social Responsibility indicators
ECONOMIC
Economic value
Identification of financial implications and other risks and opportunities for the organization's activities due to climate change
Coverage of the defined benefit pension plan obligations that the organization offers
Reference to significant financial assistance received from government
Procedures for local hiring and proportion of senior management recruited from the local community
Development and impact of investments in infrastructure and services offered, mainly for public benefit, through commercial commitment
Identification and description of significant indirect economic impacts, including extent of impacts
ENVIRONMENTAL
Identification of the type of materials used by weight or volume
Indication of the percentage of materials used from recycling
Indication of direct energy consumption by primary sources
Indication of indirect energy consumption by primary sources
Identification of energy saved due to conservation and efficiency improvements
Reference to initiatives to provide products and services based on energy efficiency and renewable energy, and reductions in consumption as a result of these initiatives
Description of the main impacts on biodiversity in terrestrial, water or marine environments
Presentation of habitats protected or restored by the company
Presentation of strategies, measures in force and future plans for managing impacts on biodiversity
Indication of total weight of waste, by type and method of disposal
Identification of no significant spillage
Presentation of initiatives to mitigate the environmental impacts of products and services and the extension of the reduction of these impacts
Total expenditures and investments in environmental protection, by type
SOCIAL
LABOR PRACTICES
Indication of total workers by type of employment, employment contract and region
Presentation of the total number and turnover rate of employees, by age group, gender and region
Description of corporate governance group and description of employees by category, gender, age, minorities
Indication of the proportion of basic salary between men and women by functional category
HUMAN RIGHTS
Indication of the percentage of significant investment contracts that include clauses referring to human rights policies
Indication of the percentage of suppliers submitted to human rights assessments and measures taken
Description of the freedom of association policy and its degree of application
Exposure of policies excluding child labor
Description of policies to prevent forced labor and slavery

Corporate Social Responsibility indicators
Indication of the percentage of security personnel trained in human rights policies
Indication of the total number of cases of violation of indigenous peoples' rights and policies taken
SOCIETY
Presentation of the nature and effectiveness of programs that evaluate operations in the community
Indication of percentage and total number of business units submitted to risk assessments related to corruption
Indication of the percentage of employees trained in anti-corruption policies and procedures
Identification of non-existence of corruption cases and prevention measures
Identification of the position regarding public policies and participation in the elaboration of public policies and lobbies
Identification of non-financial and in-kind contributions to political parties and similar institutions
Indication of non-existence of lawsuits for unfair competition, trust and monopoly practices and their results
Indication of non-existence of significant fines and total number of non-monetary sanctions resulting from non-compliance with laws and regulations
PRODUCT LIABILITY
Representation of the life cycle phases of products/services in which health and safety impacts are evaluated with a view to improvement
Indication of non-existence of cases of non-compliance with regulations related to the impacts caused by the products/services
Presentation of the type of product / service information required on the labels and percentage of products / services that require such labeling
Indication of non-existence of cases of non-compliance with label regulations
Identification of practices related to consumer satisfaction, including results of research or studies
Presentation of programs for adherence to laws, standards and voluntary codes related to communication and marketing
Indication of non-existence of non-compliance with advertising and marketing regulations