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Original Article

The Relationship between Social Responsibility and Financial Performance in Companies Listed in the Tehran Stock Exchange

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ABSTRACT

The present article examines the relationship between corporate social responsibility and financial performance listed in the Tehran Stock exchange. In order to collect information pertaining to corporate social responsibility, a questionnaire was used containing questions on social responsibility regarding customers, employees, the environment and institutions within the society; corporate financial performance was measured using the Return on Assets (ROE). For this purpose 71 companies were examined in the time span from 2009 to 2013. To analyze the data, statistical regression was applied. Results of the research indicate the presence of a relationship between financial performance and the social responsibility towards customers and the environment, while no significant relationship was observed between the employees and social institutions. The present research shall assist managers in developing effective websites related to corporate social responsibility in order to achieve superior financial performance in the long term. It also provides a perspective, for companies, regarding the role of social responsibility in gaining future benefits.

Keywords: Social responsibility, Financial performance, Customers, Employees, Environment and Social institutions.

Introduction

Throughout recent years, the role of economic entities has been subject to change in the society; such that it is expected for them to not only attempt to increase their own profits but to be accountable to and be useful for the society they are interacting with. The society cannot exist without the entity while the entity cannot escape from the society. Thus, a two-way relationship exists between the business entity and the society. A theory has been introduced in recent years claiming that business entities can create wealth, employment and innovation, supply the market, strengthen their activities and promote competition, if the cooperate for the maintenance of the same society where they have played a major role in its initiation, the society can, on the other hand, provide them the proper foundations for the development and progress of the business entity by offering the necessary conditions for earning returns expected by investors and assuring the interested parties of the absence of unfair activities (Rahmavati et al, 2014).The responsibility of the company towards the society is useful for both the entity and the society and a better understanding of its potential benefits may result in large returns on investments for the company. The benefits include an increase in sales and customer loyalty. A number of researches point towards a large and growing market for products and services offered by companies with high levels of social responsibility (Rahmavati et al., 2014). Mehr and Webb (2005) proved that customers prefer to purchase their goods from companies that are aware of their social responsibility. Among other benefits of social responsibility, one can mention a boost in the potential for recruiting new while maintain experienced employees, companies progressing in the area of social responsibility realize that they can recruit new employees easier and maintain experienced staff for a period adequate for the entity to succeed in its objective (Turban, Groening, 1997). The support provided by the government is another benefit of the social responsibility, since philanthropic organizations, where in the level of social responsibility is higher, receive less regulatory claims from legislators such as the government or tax officials (Sandho, Kapoor, 2010).

Theoretical Framework of Research

Social Responsibility of the Entity

Social responsibility dates back to the times of Adam Smith towards the end of the eighteenth century. He discussed the issue of general welfare and believed that the efforts made by competing employers would be toward the maintenance of general welfare. In the 1890s, Andrew Carnegie, specified corporate social responsibility. Carnegie's approach was based on two principles, the benevolence and the patronage principle. The benevolence principle is considered a responsibility of the individuals and not the organization, while according to the patronage principle, organizations and wealthy individuals have to consider themselves the proprietors of the poor. Vis-à-vis this approach, a series of environmental issues in the 1970s and 80s, lead to the restatement of the issue of social responsibility. Milton Friedman, the famous economist is among the pioneers who believe it the responsibility of the economic entity to maximize profits within legal limits without any scheme or plot, he believes that social responsibilities should be delegated to individuals and public institutions, since responding to the needs and their levels is not within the authority of company managers and may affect company revenues, if enforced (Bratlow, 2007).Researchers have offered various definitions for social responsibility, a number of which have been mentioned below:

Holm and Watts (2000), have defined social responsibility as the business entity's "continuous obligation, to act ethically and to cooperate for purposes of economic progress, such as to promote the quality of life of the work force and their families as well as local and social institutions in a wider context". A brief glance at the definitions indicates the issue that the authors have yet to reach a unanimous definition, while similarities are observed among numerous definitions that have been provided; however, overall, it could be claimed that all definitions are based on the fact that social responsibility indicates the obligation of organizations towards all interested parties. Danco et al (2008), believe that the social responsibility of organizations involve economics, regulations, ethics, and philanthropic expectations of business entities, as provided to all interested parties. For purposes of this research, interested parties refer to any individual or group that may influence the activities, decisions, policies, processes or objectives of the organization.M.C. William and Seagull (2001) and Harjuto (2011) define corporate social responsibility as the activities that are performed for the progress of certain social objectives that have purposes beyond financial goals. Jones (1980) and Johnson et al (2010) have provided the following definition for corporate social responsibility: “corporate social responsibility means that companies have obligations towards constructional groups in the society, other than shareholders, and beyond what has been defined by union laws and regulations”.

Corporate Social Responsibility Aspects

In most researches, various aspects such as employees, customers, the environment, health and hygiene, education, rural development and social institutions, have been considered in the ethical context for purposes of determining the levels of corporate social responsibility (e.g. Zaman Khan, 2010; Hwang, 2010; Sandho & Kapoor, 2010). In the present research, as in the study performed by Abbott and Mensen (1979), Zaman Khan (2010), Sanho and Kapoor (2010), four aspects have been considered for social responsibility including customers, employees, the environment, and social institutions, each of which shall be briefly discussed in the following sections.Corporate social responsibility towards customers includes activities performed by the company in order to gain customer satisfaction, just as the customer orientation and continual improvement principles attempt to accomplish under quality management principles. The customer orientation principle claims that companies depend on their customers and should thus understand their present and future needs and aim for providing more than the expectations of their customers and other interested parties (ISO Standard 26000, 2010).The second aspect of social responsibility refers to human resources as a significant portion of the society and no company can succeed without the emotional support provided from its employees. Overall, working conditions influence the quality of work provided by employees and their economic and social progress, since social and financial expenses resulting from diseases, casualties and death occurring in the workplace, are heavy. Moreover, unexpected and extreme pollution and other workplace dangers are probable and may affect the society and environment as well. Fulfilling social responsibilities in contexts such as safety and health may reduce expenses, boost employee welfare and morale and increase production (ISO standard 26000, 2010).

The third aspect of social responsibility relates to environmental responsibility which is quite significant in its role and provides the necessary conditions for the existence and success of human beings. Social issues maintain a close link with human rights, social development and contribution and other core issues of social responsibility. A company cannot ignore the environmental issues relating to it. They can act responsibly by taking measures to protect and recover their natural environment, such as planting trees and maintaining fields, farms, forests and their ecosystems. Companies can also promote environmental performance by preventing pollution from spreading through the air and water, abstaining from the production of solid and liquid waste, preventing the pollution of soil, refraining from using dangerous and poisonous chemicals and other pollutions resulting from activities, products and organizational services (ISO standard 26000, 2010). The fourth aspect of social responsibility is feeling responsible towards social institutions. Nowadays, it has been accepted that companies are related to the society and institutions that they interact with and their continuity and survival depends on the health, permanence and success of these institutions. Thus, a company is responsible for the welfare and development of the institutions surrounding it. Among responsibilities of the entity towards its society, one can mention the allocation of a portion of its profits for educational and cultural facilities, health and hygiene, etc…, since education can be regarded as a social foundation and identity. The promotion of education and culture positively affects development and social correlation (ISO standard 26000, 2010).

Social Responsibility and Financial Performance

Corporate social responsibility has been the focus of economic entities throughout the last two decades. Corporate social responsibility highlights significant issues such as ethics, the environment, safety, education, human rights and…. Although carrying out corporate social responsibility imposes primary expenses on the company, yet ultimately due to its influence on company reputation, expenses are reduced in the long term and demands increase resulting in a rise in sales levels and promotion of company performance, in the long term (Poody and Vergali, 2009).The tendency and insistence of the economic entity in performing its social obligations in all aspects would have a significant impact on financial performance. In fact its tendency towards social responsibility encourages the entity to exert its efforts towards improvement of the environment, lower intake of energy and materials, management of waste and etc (Sandho, Kapoor, 2010). Hence, economic entities can maximize their long term returns, arbitrary, through the reduction of their negative impacts on the society. The mentality that seems to be forming among economic entities is that long term success can be achieved through the management of company operations aside from ensuring environmental support and the progress of corporate social responsibility (Sammy et al, 2008). Thus, carrying out social responsibilities of the company leads to success within companies in the long term and ultimately, promotes economic growth, increase in the corporate competitive ability and financial performance (Sanchez et al, 2010).According to research, three types of relationships, namely positive, negative and neutral (with no impact) have been observed among social responsibility and financial performance (Lin, Yang and Liu, 2009). Among the main reasons for these limitations and contrary results, is the absence of a theoretical foundation and methodology problems (Eschuletnes, 2008).

Various approaches exist on the positive relationship between social responsibilities and financial performance. The first approach states that a relationship is present between quantitative expenses in companies, such as the payment of interest to bond holders, and the qualitative expenses such as the quality of production or safety expenses. Efforts made by the company for incurrence of lower qualitative expenses through social activities results in higher financial performance. Moreover, the "social impact hypothesis" has been presented as the basis of positive relationships between corporate social performance and financial performance. In fact, the hypothesis suggests that providing all needs of non-owner parties would have a positive impact on corporate financial performance. The second approach states that financially successful companies utilize fewer resources to achieve a higher financial performance and can thus devote a significant portion of their resources to social performance. The third approach suggests that companies with a heavier social responsibility are less exposed to risk of negative incidents as the probability of incurring heavy fines for pollution (of the environment) is low; similarly heavy financial lawsuits are quite improbable, or rather they are quite unlikely to perform negative social activities that would mar their reputation, which ultimately leave a positive impact on corporate financial performance. Overall, if two companies would be similar in all aspects and their only difference would be the acceptance of a wide range of social responsibilities by one and the avoidance by another, it could be expected that the first company would display less negative risk and face fewer loss inducing incidents (Eschuletnes, 2008).The negative relationship between corporate social responsibility and financial performance conforms to the mentality resented by Friedman and the neoclassical economists. They claim that social responsibility directs companies towards the incurrence of expenses that would ultimately lead to a drop in income and shareholder wealth. "Management Opportunism Hypothesis" refers to a foundation and basis for the negative relationship between the social responsibility of a corporate and financial performance. The hypothesis states that when financial performance is strong, managers tend to reduce expenses linked to social responsibility in order to increase short term profitability and accordingly their personal incentives, which are related to short term profitability. On the other hand, when financial performance is weak, managers focus on increasing expenses related to prominent social programming (Ehsan, Calm and Gabin, 2012).The neutral relationship (absence of a relationship) between the two variables has been proven through numerous researches. Accordingly, since the general status of the corporate and society is quite complex, therefore no direct relationship exists between corporate social responsibility and financial performance (Sismon, Koher, 2002).

History of Research

Tissot Sura (2004) examines the relationship between corporate social responsibility and their financial performance, results of which indicates a positive significant relationship between financial and social performance.Neling and Webb (2008) study the relationship between financial performance and social responsibility. Findings suggested that a negative weak relationship has been observed among financial performance and social performance.In a similar research, titled "Corporate Financial and Social Performance" Vanderlan et al (2008), have studied the relationship between corporate financial and social performance, results of which indicate the presence of a relationship between the two.Scott et al (2010) have also performed a similar study titled "Corporate Social responsibility and Financial Performance" to research the relationship between financial and social performance, results of which indicate a positive relationship between the two. To evaluate financial performance they applied criteria such as the ROA and Tobin's Q, and concluded that a significant negative relationship exists between financial performance and social responsibility. Rahmavati et al (2014) studied the relationship between corporate financial performance and social responsibility in a research titled "the impact of corporate social responsibility on financial performance and actual manipulation as an adjusting variable". Findings suggested that actual manipulation in cash flows leaves a negative impact on the relationship between corporate social responsibility and financial performance.Poor Ali and Hojami (2013) studied the "impact of environmental performance on financial performance in companies through determining the role of social responsibility as intervening variables". Results indicate that environmental performance does not directly impact financial performance of companies; rather it is when environmental performance is joined with disclosures made on social responsibility that an increase in corporate financial performance is observed.

Research Hypothesis

According to the theoretical basis presented, the hypotheses of the present research have been formulated as follows:First Hypothesis: A significant relationship is present between corporate financial performance and social responsibility, towards customers. Second Hypothesis: A significant relationship is present between corporate financial performance and social responsibility, towards employees. Third Hypothesis: A significant relationship is present between corporate financial performance and social responsibility, towards the environment. Furth Hypothesis: A significant relationship is present between corporate financial performance and social responsibility, towards social institutions.

Method of Research

The research is a descriptive study with applicable objectives. For purposes of testing the hypotheses, the regression model was applied and pre-determined tests included the Durbin-Watson test and the normality of errors test, were used to ensure the reliability of results (Faal Ghayumi and Momeni, 2010). The SPSS software was used to prepare information collected from excel software and to test the hypotheses. The research literature was extracted from library resources and texts while a questionnaire was used for the collection of information on the corporate social responsibility index. The questionnaire is composed of four sections, each containing a series of questions, with "yes-no" responses, on social activities of the company with customers, employees, the environment and social institutions. In order to ensure the validity (content credibility) of the questionnaire, a series of questions were formulated according to the ISO 26000 international standards. A number of the questionnaires were distributed within a limited group in order to be able to identify and eliminate its defects and shortcomings. The Cronbach's Alpha coefficient was used to examine the reliability of the questionnaire. Accordingly a preliminary test was performed in which 20 questionnaires were distributed among the chief executive officers of several companies and the results were scrutinized using the SPSS software. Based on findings from the preliminary sample, reliability of the questions for each section of the questionnaire is acceptable. It is presumed that an Alpha coefficient of higher than 0.7 indicates acceptable levels of reliability (Faal Ghayumi, Momeni, 2007).

Variables and Methods of Calculating the Variables

Independent Variables

For purposes of measuring the financial performance as the independent variable of research, the return on equity has been used as a criterion; for measurement purposes, income before interest and tax on equity is considered. The criterion has been calculated for five years from 2009 to 2013. Information on ROE calculation has been collected through reports that have been issued by the Tehran Stock Exchange and information banks such as Tadbir-Pardaz.

Independent Variables

In the present research, to measure social reliability, as the dependent variable of research, a questionnaire was used containing 53 “yes-no” questions. The general format of the questions was designed based on the ISO 26000 standard, Corporate Social Responsibility, issued in 2010. Other standards such as the ISO 9000 and 14000 were also applied for this purpose; corporate social responsibility reports that are prepared in various other countries based on related standards, were utilized for the formulation of other questions as well. The questionnaire is composed of the following four sections:

Corporate social responsibility towards customers, as presented in questions 1 to 10, for testing the first hypothesis.

Corporate social responsibility towards employees, as presented in questions 11 to 23, for testing the second hypothesis.

Corporate social responsibility towards the environment, as presented in questions 24 to 33, for testing the third hypothesis.

Corporate social responsibility towards social institutions interacting with the corporation, as presented in questions 33 to 53, for testing the fourth hypothesis.

Similar to researches by Zaman Khan (2010), Sandho and Kapoor (2010) and Hwang (2010), a score of one has been given to positive responses and a score of zero to negative ones. Total scores in each section are divided to total number of questions in the same section, in order to measure corporate social responsibility towards customers, employees, the environment and social institutions.

To test the hypotheses, the following regression models have been used:

Model (1) $CSRCU = \propto_i + \propto_1 ROE_i + \varepsilon_i$

Model (2) $CSRWO = \propto_i + \propto_1 ROE_i + \varepsilon_i$

Model (3) $CSREN = \propto_i + \propto_1 ROE_i + \varepsilon_i$

Model (4) $CSRCO = \propto_i + \propto_1 ROE_i + \varepsilon_i$

Where,

ROE: Income before interest and tax divided by equity

CSRCU: Corporate social responsibility towards customers

CSRWO: Corporate social responsibility towards employees

CSREN: Corporate social responsibility towards the environment

CSRCO: Corporate social responsibility towards employees

Statistical Population and the Sample

The statistical population of research includes all companies listed in the Tehran Stock Exchange, with the following traits:

Have become members in the Stock Exchange Market prior to the start of the fiscal year 2009.

Fiscal year end in the company is on 20 March of each calendar year.
The company has not changed its fiscal year throughout the period 2009 to 2013.
Management information on the companies (especially notes to the financial statements) be readily available.
Not be included among investment, leasing, financial and credit institutions and not be a bank; it should be a production company.
Based on the limitations above, 145 companies were selected for whom questionnaires where designed and distributed. The questionnaires were distributed through fax, e-mails and in person, and in one month, only 71 questionnaires were filled and returned to the researcher on which analysis was performed. Information used for this research pertains to a five year period from 2009 to 2013.

Research Findings

As mentioned, a questionnaire has been used to measure corporate social responsibility containing 53 "yes-no" questions. Positive responses to each questions earns a score of one for social responsibility of the company. Thus, the maximum score that a company earns would be 53 (100 percent) as sample size is 71 companies, the maximum total score for all sample companies would be 3763. The total score earned by the companies is 2524. Accordingly, the average score for sample companies in all sections of the questionnaire is 67 percent. The 67 percent representing a company's fulfillment of social responsibilities is comprised of 17 percent relating to customers, 19 percent to employees, 18 percent to the environment and 13 percent to each company in each individual section and in total. Table (1) presents the average scores earned by sample companies for each section and in total.

Table 1. Scores Earned by Companies

Sections	Number of Questions	Company Score	Average Score in all Sections	Average per Section
Social Responsibility towards Customers	710	635	0.17	0.89
Social Responsibility towards Employees	923	717	0.19	0.78
Social Responsibility towards the Environment	710	675	0.18	0.95
Social Responsibility towards Social Institutions	1420	497	0.13	0.35
Total	3763	2524	0.67	

As can be observed from table (1), sample companies have earned the lowest scores in the section relating to corporate social responsibilities towards institutions as compared to other sections; this represents the weakening of social responsibilities that a company has towards other institutions within a society.

Scores earned in the other three sections are quite similar however the average score earned in the section relating to employees has been the highest.

Mean, standard deviation and maximum and minimum values for the independent variable for all 71 companies has been presented below.

Table 2. Mean, Standard Deviation, Maximum and Minimum Values for the Independent Variable

Independent Variable	Sample Size	Average	Standard Deviation	Maximum	Minimum
ROE	71	0.25	0.12	0.71	0.02

Testing the Hypotheses

In the first hypothesis, the issue questioned was whether or not a relationship exists between corporate financial performance and social responsibilities towards customers. To ensure the presence or absence of a relationship, regression analysis was used. Regression methods involve the testing of the overall significance of the regression model which shall be done using the ANOVA table, subsequently the coefficient significance of the independent variable is tested using the table of coefficients from SPSS (Faal Ghayumi and Momeni, 2010). Results of statistical analysis performed on the first hypothesis have been summarized in Table (3):

Table 3. Results of Regression Analysis on the First Hypothesis

Dependent Variable	Independent Variable	Coefficient of Determination	Durbin-Watson	F-Statistics	Significance Interval	Error Interval	Result
ROE	Social Responsibility towards Customers	-0.427	1.815	6.852	0.025	0.157	Approved

As can be observed in Table (3), the significance interval of the test is 0.025 which is lower than the error interval determined for the research (5 percent). This finding indicates that the regression model is significant and based on the significance interval in table (3) one can learn that regression coefficients are significant as well, thus the first hypothesis can be approved. It can be concluded that corporate financial performance is significantly related to corporate social responsibility towards customers. In the present research, for purposes of applying regression models, assumptions relating to regressions were also tested. The Durbin-Watson test has been thus used to examine error independence and normality. The Durbin-Watson statistics for the first hypothesis have been presented in table (3) and as the value falls between 1.5 and 2.5, it can be concluded that the errors are independent and that regression models can be used to test the hypotheses (Faal Ghayumi and Momeni, 1989). Tests on normality of errors indicates that errors relating to the first model and the first hypothesis display normal distribution since mean values are small figures close to zero and standard deviation values are close to one and equal to 0.994. The second hypothesis evaluates the issue of whether or not corporate financial performance is related to social responsibility towards employees. Findings of statistical analysis of the second hypothesis are illustrated in table (4):

Table 4. Results of Regression Analysis for the Second Hypothesis

Dependent Variable	Independent Variable	Coefficient of Determination	Durbin-Watson	F-Statistics	Significance Interval	Error Interval	Result
ROE	Social Responsibility towards Employees	0.404	2.152	2.45	0.119	0.199	disapproved

As can be observed in Table (4), the significance interval of the test is 0.119 which is higher than the error interval determined for the research (5 percent). This finding indicates that the regression model is not significant and that the second hypothesis is disapproved. It can be concluded that corporate financial performance has no significantly relationship with corporate social responsibility towards employees. Moreover, the Durbin-Watson statistics for the second hypothesis as presented in table (4) indicate error independence. Error normality tests for this hypothesis indicate that errors display a normal distribution. The third hypothesis examines the issue of whether or not corporate financial performance is related to social performance towards the environment. Findings of statistical analysis of the third hypothesis are illustrated in table (5):

Table 5. Results of Regression Analysis for the Third Hypothesis

Dependent Variable	Independent Variable	Coefficient of Determination	Durbin-Watson	F-Statistics	Significance Interval	Error Interval	Result
ROE	Social Responsibility towards the Environment	0.428	1.976	4.095	0.015	0.174	Approved

As can be observed in Table (5), the significance interval of the test is 0.015 which is lower than the error interval determined for the research (5 percent). This finding indicates that the regression model is significant and that the third hypothesis can be approved. It can be concluded that corporate financial performance has a significant relationship with corporate social performance towards the environment. Moreover, the Durbin-Watson statistics presented in table (5) indicate error independence in this hypothesis. Errors in the third model relating to the third hypothesis display normal distribution indicated by error normality tests performed.The fourth hypothesis examines the issue of whether or not corporate financial performance is related to social performance towards the institutions. Findings of statistical analysis of the fourth hypothesis are illustrated in table (6):

Table 6. Results of Regression Analysis for the Fourth Hypothesis

Dependent Variable	Independent Variable	Coefficient of Determination	Durbin-Watson	F-Statistics	Significance Interval	Error Interval	Result
ROE	Social Responsibility towards Social Institutions	0.275	2.155	1.027	0.825	0.203	disapproved

As can be observed in Table (6), the significance interval of the test is 0.825 which is higher than the error interval determined for the research (5 percent). This finding indicates that the regression model is not significant and that the fourth hypothesis has also been disapproved. It can be concluded that corporate financial performance has no significantly relationship with corporate social responsibility towards social institutions. Similar to previous results, the Durbin-Watson statistics for the fourth hypothesis indicate error independence. Errors in the fourth model relating to the fourth hypothesis display normal distribution. Based on the approval of the first and third hypotheses, it could be claimed that a significant relationship is present between corporate financial performance and social responsibilities towards customers and the environment.

Discussion and Conclusion

The relationship between corporate social responsibility and financial performance has been examined in this research. Findings indicate that the financial performance of companies listed in the Tehran Stock Exchange is related to corporate social responsibility towards customers and the environment. Thus the first and third hypotheses have been strongly supported while other hypotheses were not approved. The present research is similar in findings to those performed by Sismon and Koher (2002), Tissot Sora (2004), and Scott et al (2010). In fact, this research has approved the presence of a relationship between corporate social responsibility and financial performance, similar to the studies mentioned above. Based on the presence of a relationship between financial performance and social responsibility towards customers and the environment, it is suggested that managers make all efforts to strengthen theses aspects within the company as promotion of social performance leads to higher financial performance. Moreover, managers are encouraged to strengthen other social aspects within the company as well. This research is among a series of studies carried out in the economic atmosphere of Iran, on the relationship between corporate financial performance and social responsibility. It can be used as a model for future research. For instance other criteria for financial performance can be used in future studies, to examine the presence of a relationship between each criterion and social responsibility. Moreover, the relationship between financial performance and other aspects of social responsibility as presented in other researches and as mentioned in the ISO 26000 international standards can be examined.

Research Limitations

Since a number of data used in this study have been collected based on the questionnaires distributed among various companies, numerous complexities and problems have occurred such as a lack of cooperation by some companies in filling out and presenting the questionnaires, which has resulted in a reduction in sample size for analytical purposes. Another limitation is in the responses offered by certain companies with the objective of reflecting a positive picture in the area of social responsibilities, which influences the results to a great extent.

Limitations

1) The difficulty of access to information resources
2) People unfamiliar with electronic insurance

3) Failure to provide information to customers by Insurance

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