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REVISITING THE ROLE OF CORPORATE GOVERNANCEON THE RELATIONSHIP BETWEEN CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL PERFORMANCE

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ABSTRACT

The notion that organizations have to serve the community to achieve sustainability have received opposing views of the role of firms in society and disagreements as to whether corporations should predominantly wealth maximize wealthation should be the sole goal of a corporation. The argument, however, remains significant. This paper takes into account the four dimensions of economic, legal, ethical, and philanthropic responsibility which represented a more nuanced approach to corporate social responsibility and that a firm has an economic obligation to operate efficiently and profitably while maximizing the stakeholders' values. The researchers explore the relationship between CSR disclosure and the financial performance of selected companies listed on the Saudi stock market and investigates the role of corporate governance in the relationship. Saudi Arabia remains a green site for research on the topic. The hypotheses consider the relationship of corporate social responsibility (CSR) and corporate financial performance (CFP), and how this relationship will get effecting through corporate governance. The authors propose a framework as well as a methodology for the study in which data from 10-year annual reports (2009-2019) of selected companies in Saudi Arabia service industry will be used for the analysis.

KEYWORDS: Corporate Social Responsibility, Sustainability, Governance, and Financial Performance.

1. INTRODUCTION

Many organizations believe that they have to serve or contribute to the community to achieve sustainability. Despite the continuous opposing views of the role of firms in society and disagreements as to whether wealth maximization should be the sole goal of a corporation to maintain their competitiveness in the international market (Durak et al., 2016), the notion that organizations should contribute to the community for sustainability remains essential. It is reflected in the work of (Ioannou and Serafeim, 2011) who found that high sustainability companies perform significantly better in terms of the stock market and accounting performance as compared to their competitors. Also, sustainable development will ensure that enterprises can lay the groundwork that will put them in the lead when the recession ends (Nidumolu et al., 2009). So, the continuous changes in the organizational environment present considerable challenges to organizations in achieving sustainability (Madorran and Garcia, 2016).

The critical questions of this paper is to explore corporate social responsibility (CSR) and determine the influence of corporate social responsibility (CSR) on corporate financial performance (CFP) if the firms applying governance. The paper is organized as follows: The next section discusses the evolution of CSR, followed by a discussion on the relationship between CSR and Financial Performance. Subsequently, the authors elaborate on the interplay of Corporate Governance in the relationship between CSR and FP before concluding with a proposed framework and methodology.

2. LITERATURE REVIEW

The field of Corporate Social Responsibility (CSR) is growing exponentially and has been the topic of intense debates over the past decade (Manokaran et al., 2018). Previous research on CSR saw social-cultural background factors influence people’s views on CSR and how the different issues within CSR are prioritized. The dynamics around the business environment allow the organization to build sustainable competitive advantages for the long-term through the integration between corporate social responsibility policies and the practices of those organizations. It is also well known that different cultures have different expectations of what corporations’ responsibilities towards society are (Burton et al., 2000).

The concepts of corporate social responsibility have evolved over several decades. The idea of corporate social behavior started from the United Nations Conference about the Human Environment, which was held in Stockholm in 1972 Polunin (1972). Despite the acknowledgment of its importance, CSR is still a voluntary act for firms in most parts of the world (Cheng and Courtenay, 2006). In the same vein, (Carroll, 1979) summarizes the history of CSR as early as the 1930s, for example, Wendell Wilkie "helped educate the businessman to a new sense of social responsibility." However, the initial concept of social responsibility may be marked by the book written by Bowen and Johnson 1953 entitled, “Social Responsibilities of the Businessman.” Based on the stakeholder theory, models that explicitly investigate the relationship between stakeholder management expressed as CSR activities, firm strategy and corporate financial performance will provide a performance to the organization (Theodoulidis et al., 2017). Many considered the book to be the first definitive publication on the topic. Subsequently, many other authors began to conceptualize the idea of social responsibility (Berle and Means, 1932; Cheit, 1964; Davis and Blomstrom, 1966; Greenwood, 1964; Mason, 1960; McGuire, 1963).

The discussions of the social responsibilities of businesses had become so prevalent in the mid-1950s that Peter Drucker chided businessmen, "You might wonder if you were a conscientious newspaper reader when the managers of American business had any time for business" (Drucker, 1954). The modern era of CSR can be attributed to the article “The social responsibility of business is to increase its profits" by Friedman (1970) (as mentioned in Blaga (2013). Friedman claims that CSR will enhance corporate governance, which will eventually lead to sustainability. On the other hand, The European Commission also argues that organizations "are increasingly aware that responsible behavior leads to sustainable business success" (Van de Ven, 2008).

Maignan and Ralston (2002) conceptualized Corporate Social Responsibility CSR as motivating principles that are driven with values, stakeholders, performance; and the processes of programs and activities aimed at implementing corporate social responsibility principles. According to Gaio and Territories (2010), the relationship between the integration of stakeholders and the place brand and image feeling reinforcing emphasizing the statement that the more the stakeholders feel involved in the creation of the place brand process, the more likely they tend to assume responsibility that places with a more collaborative posture in the branding process are the ones that tend to have with more positive self and public images.

The programs and activities may also address issues of stakeholder, including philanthropic, sponsorships, volunteer, code of ethics, quality, health and safety, and managing environmental impacts; as well as other issues such as community, customer, employee, shareholders, and suppliers. On the other hand, the European Commission defines CSR as "a concept whereby companies integrate social and environmental concerns in their business operations and their interaction with their stakeholders voluntarily" (Van de Ven, 2008).

Purcell et al. (1974) stated that CSR is a willingness of the corporate manager implicating his or her firm actively and with moral concern to confront some social issues he or she deems urgent and to bend the influence of the company in solving those problems within the ability of the firm. Thus, the manager must balance the needs of various groups affected by the firm's decisions to achieve both profit and common good without pressures by any factor. Nonetheless, Hay and Gray (1974) believe that the managers must look at social responsibility beyond the traditional wealth maximization or at least attempt to balance the competing demands of the various pressure groups.

Carroll (1979) pointed out that corporate executives have argued with the issue of the organization's responsibility to its society. Early on, it was struggled by some that the corporation's sole responsibility was to provide a maximum financial return for shareholders. Moreover, Carroll's taxonomy of four dimensions of economic, legal, ethical, and philanthropic responsibility represented a more nuanced approach. According to this set, a firm has an economic obligation to operate efficiently and profitably while maximizing the stakeholders' values.

Usually, the concept of CSR is related to Philanthropic and this is popular in the Middle East countries, which is making the companies not considering valuable contributions for solving critical

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and social issues because communities are expecting from the organizations more than what is planned for them. This following model based on Carroll (1979)'s work is cited by most of the CSR scholars.

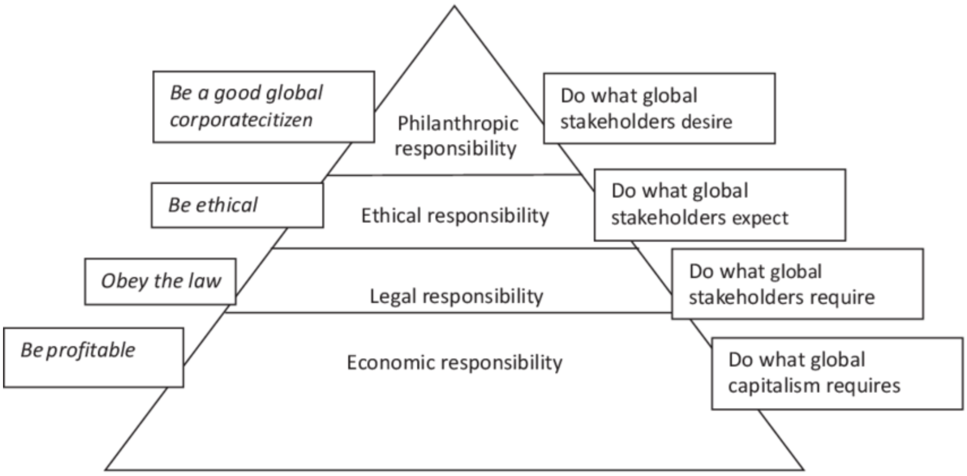

Figure 1: The CSR Pyramid Source: own work based on Carroll, 1979, 1991, 2004. (Raczkowski et al., 2016)

Figure 1 above presents the pyramid of four-level of corporate social responsibility (CSR). The first level from the bottom of the pyramid has started with economic responsibility as a critical base of implementation of other corporate social responsibilities and fundamental responsibility of the organizations to provide such economic requirements in the market. The second responsibility in the perspective is legal responsibility which says that organizations have to follow the rules and laws including regulations of corporate to maintain social fair. For example, public listed companies in Saudi must be registered with the Saudi Stock Exchange (Tadawul) to ensure that they conform to the regulations set by the authority. Further, the third responsibility is ethical responsibility where the organization accepts to consider and concern the principles of business ethics and manners in order to maintain the social part as a requirement of sustainability. Organizations, especially in Saudi Arabia, are beginning to pay more attention to business ethics for long-term sustainability. Finally, the last responsibility of the Carroll perspective or the top level of the pyramid is philanthropic responsibility or that can be known also as human responsibility, as well as, Carroll has considered philanthropy as corporate actions that are in response to society's expectation and requirements.

Organizations need to achieve all the four levels of the Carroll perspective as the responsibilities of the social corporate. As mentioned above, in the Saudi Arabia context, CSR has gained much attention from organizations as many have embarked on numerous CSR activities. Despite this phenomenon, the extent of the practices is still in its early stage of growth as the awareness of CSR among managers is still low (Azhar, 2016). The government has been promoting CSR directly and indirectly, mainly through the religious authorities on doing good and preserving the environment since the early 1960s (Ali et al., 2013) but the results remain vague.

3. Corporate Social Responsibility and Financial Performance

The studies on the relationship between corporate social responsibility and financial performance has started since the 1970s(Bragdon and Marlin, 1972; Meiselman et al., 1972), continuing until today. While there is a plethora of research that has attempted to investigate the relationship between CSR and financial performance in conventional financial institutions, there are numerous definitions of financial performance.

Alreshidi (2018) defines financial performance as a measurement of economic performance in the following definition, the ability of the city to achieve business growth that supporting the financial viability of the business in terms of economic development (e.g., financial performance, job creation, and Human Resources Development). On the other hand, Griffin and Mahon(1997) asserted that literature provides approximately 80 performance measures on corporate social responsibility and financial performance relationships. Financial performance has been broadly measured using market-based, accounting-based and perception-based measures (Orlitzky et al., 2003) although most of the literature considers the financial performance not as a determinant of the research variable but as a measurement tool...

Commonly used financial performance measures are firm size, asset age, return on equity capital (ROE), return on assets (ROA) return on sales, operating profits (Return on capital employed (ROCE)), accounting profits (Net Profit (NP)) and market measures (Price to Book ratio (P/B)) (Pradhan, 2016). In this regard, the authors concur with the definition by Mynhardt et al.(2017) who looked at financial performance as a measurement for evaluating the financial performance of the firm's through return on equity (ROE), return on assets (ROA), share price and market capitalization, its incorporation and place in an appropriate market index, including (stock market index).

Though the public generally believes that organizations must help solve social issues through CSR practices, there exist misconceptions whether CSR affects organizational financial performance. Most of the literature that looked at the relationship between financial performance and corporate social responsibility found that it is significant and mostly positive. Orlitzky et al.(2003) conducted a meta-analysis of 52 studies yielding a total sample size of 33,878 observations. The meta-analytic findings suggest a positive link between CSR and increased profits. In their study, CSR (which they termed as corporate social performance CFP) appears to be more highly correlated with accounting-based measures than with market-based indicators of financial performance. Also, the reputation indices correlated highly with FP compared to other indicators of CSR. This meta-analysis establishes a stronger link between CSR and FP.

A positive relation to CSR and corporate financial performance relation cannot be generalized. Negative results between CSR and FP were revealed by Wright and Ferris (1997) and Paten et al.(2005) while other studies found inconclusive results (McWilliams and Siegel, 2001). There are results pointed to a neutral CSR and corporate financial performance (CFP) both have relation both in general and specific terms, with a few exceptions. CSR is assessed for the stakeholder groups in aggregate and for each stakeholder group in segregate. Findings at the research of Mishra and Suar (2010) suggest that responsible business practices towards primary stakeholders can be profitable and beneficial. There is no generalization of a positive relation to CSR and corporate financial performance relation, whereas the CSR and return on assets (ROS) relation has shown to correlate positively in specific contexts. Client-ROA, community ROA and environment-ROA relations remained neutral (Silva et al., 2018).

4. The Role of Corporate Governance in the Relationship between CSR and CFP

It has been acknowledged that one of the factors that could impact the relationship between corporate social responsibility and financial performance is corporate governance (Platonova et al., 2018). Incorporate social responsibility discourse; the success of corporate social responsibility initiatives is often connected to the engagement of governance practices. These relations use the engagements and also assist firms to gain legitimacy among business practitioners and society in general (Schrempf-Stirling et al., 2016).

Different academic literature suggests a plethora of definitions for corporate governance. Sarkar et al.(2012) iterated that the state of corporate governance of companies is difficult to quantify due to the encompassing nature of its definition. Of these, perhaps the ones that most adequately capture the overarching reach of corporate governance is contained in the following definitions: It is "the whole set of legal, cultural, and institutional arrangements that determine what public corporations can do, controls, how that control is exercised, and how the risks and return from the activities they undertake are allocated", and It is the system that directs and controls business corporations. For example, the corporate governance structure specifies the distribution of rights and responsibilities among the board, managers, shareholders and other stakeholders, and define the rules and procedures for making decisions on corporate affairs. Thus, corporate governance provides the structure through which the company can set its goals and the means of attaining those goals and monitor performance (OECD, 1999).

According to Sanchis et al.(2019), some organizations in the business environment take on sustainability environmental, social, and governance (ESG) practices as a mediator between sustainable supply chain management (SSCM) controversies and market value to examine whether SSCM controversies with organizational's stakeholders lead to improvements in the ESG dimensions of organizational sustainability. The results of this study confirm substantiate both the positive relationships of SSCM controversies to the ESG dimensions two years later and a positive relationship of the dimension of governance to Tobin's Q. It also confirms a significant negative relationship of a social dimension to Tobin's Q and a non-significant relationship of environmental dimension to Tobin's Q.

Independent outside directors in the organization have the most significant impact on the corporate social performance of the corporation staff, customer, supplier, community and society dimensions. Corporate Government shareholders extremely increase corporate the social performance extraordinarily because government shareholders will be more likely to request that companies fulfill their social responsibilities. Furthermore, f Foreign institutional stockholders, on the other hand, help to increase worker and supplier performance through enhanced by paying more attention to employee policy relationships. Independent outside directors, foreign institutional stockholders, and domestic financial institutional stockholders are shown to improve financial performance (Huang, 2010).The authors propose the following framework and hypotheses for the study.

As previously argued that corporate social responsibility is culture-specific, the same applies to corporate governance. Different cultures may pose different business practices, and it will be interesting to see how the selected variables interact in the context of Saudi Arabia. The authors propose the following framework and hypotheses for the study.

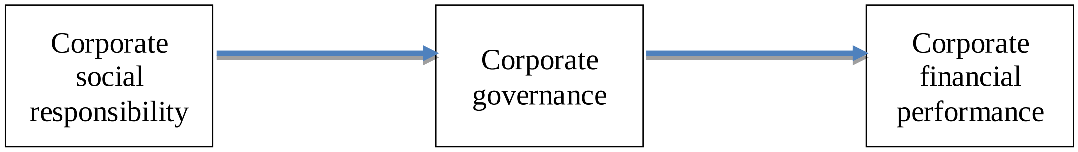

Figure 2: The Research Framework

As previously argued, CSR is culture-specific. The same applies to corporate governance. Different cultures may pose different business practices and it will be interesting to see how the selected variables interact in the context of Saudi Arabia.

The hypotheses of this research will consider the relationship of corporate social responsibility

(CSR) and corporate financial performance (CFP), and how this relationship is mediated by corporate governance.

H1: CSR has a positive influence on corporate financial performance.
H2: Corporate governance mediates the relationship between CSR and corporate financial performance.

5. PROPOSED METHODOLOGY

Research approach can be divided into three types, which are the deductive, inductive, and abductive approach. Deductive and inductive approaches are different in terms of the relevance of hypotheses to the study. The former approach tests the validity of hypotheses in hand, while the latter one is used to emerge new theories and generalizations. Besides, abductive research is processed to explain surprising facts or puzzles. The authors believe that the deductive approach will be the most appropriate for this study.

As has been mentioned, this paper aims at exploring the relationship between CSR and financial performance with particular reference to Saudi Arabia context. It also looks at the role of corporate governance in the relationship. This study will be within the context of CSR practices in Saudi Arabia. Studies by scholars on culture such as Hofstede have shown significant differences between the business culture of Saudis and other nationalities. The authors can further add the uniqueness of the context to the body of knowledge regarding CSR. This study will also investigate the role of corporate governance in the relationship between CSR and FP. It is suggested that data is based on information from selected companies listed on the Saudi stock market. The Saudi stock market mainly can be grouped into manufacturing and non-manufacturing.

Although the economy of Saudi is dominated by upstream and downstream petrochemicals industry, the authors suggest that the service sector would provide valuable findings because of its growing contribution to the Saudi economy. The Gulf Business (2018) report shows that six out of ten top listed companies with the highest market capitalizations are service companies. Therefore, the choice of service companies would be appropriate. The selected companies' annual reports of 10 years (between 2009 until 2019) will be used for the analysis. Subsequently, the data collected from financial statements and reports will be evaluated and analyzed to gain useful information for the study. The data will be used to test the hypotheses developed in the study which are either confirmed or rejected. Based on the findings later, a conclusion of the study will be made and suggestions for future prospects by enhancing the evidence will be proposed.

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