CORPORATE SOCIAL AND ENVIRONMENTAL RESPONSIBILITIES AND SUSTAINABILITY IN SAUDI ARABIA

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ABSTRACT

This study examines the associations of corporate social and environmental responsibilities with corporate sustainability in Saudi Arabia for the period of 2007-2011. A pooled OLS regression analysis is used to estimate the associations proposed in the hypothesis. The final sample consists of 164 listed companies in Tadawul. The study finds that corporate social and environmental responsibilities is negatively associated with corporate sustainability. The study suggests that regulators, especially Saudi stock exchange, should mandate companies to disclose all relevant information related to corporate social and environmental responsibilities in a transparent and timely manner in order to assess the degree of these responsibilities incurred. For companies, this study proposes that they should emphasize more on enhancing the role and the quality of their social and environmental responsibilities as this enhancement may positively influence their sustainability.

KEYWORDS: CSR, CS, Saudi Arabia

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INTRODUCTION

Global changes and socioeconomic issues are threats that our planet faces in the recent time (Barrio, 2010). Based on the indicators, the fast increase of humanity's environmental footprint declines the ability of the earth to serve as reservoir of pollution and as a source of resources (Milton, 2010). This situation imposes into corporation leaders an obligation to involve themselves in corporate social responsibility and sustainable business practices (Promoni, 2009). CSR advocates believe that developing a better world is a cooperation of business, governments, and other stakeholders (Pava, 2008). In this regard, companies should address the impact of other activities beside their commercial ones and how all these activities impact the local community and society they work in (Kermani, 2006). Freeman and Hasnaoui (2011) indicate that CSR proponents make a call for business models with triple bottom lines that take into consideration the satisfaction of the shareholders" needs with the social and environmental needs of societal stakeholders. Companies incorporate corporate social and environmental responsibilities into their marketing strategies to sustain and grow competitive advantage. Consequently, they obtain greater levels of financial performance. CSR is considered an expensive investment through which organization can ensure a high intrinsic value and build a strong foundation within a community. As a result, they achieve a greater degree of financial performance and sustainability (Husted & Allen, 2007).

In general, justifying the expenditures, including the CSR activities, the incorporation of CSR activities into the existing business structures is considered as a concern for corporate leaders. This is because business executives are the agents of shareholders aiming at strengthen the financial and competitive positions of their firms (Yuan et al., 2011; Karnani, 2011).

Although much research, based on stakeholder theory, has been conducted on the topic of CSR documenting that there is a positive association between CSR level and firm performance, concerns still exist regarding how companies in Saudi Arabia sustain and grow competitive advantages in their businesses using corporate social and environmental responsibility activities. In a broad sense, the topic of CSR and CS is expected to influence the whole aspects of life in the country since there is a concern empirically evidenced that CSR does not necessarily contribute to the financial performance of the organizations or compromises return on investment (Husted & Allen, 2007). Furthermore and in particular, different industries may vary in their view of CSR because of different CSR requirements. This study is distinct from the previous studies in a manner that it examines the association of CRS and firm performance in petrochemical cement, retail, energy and utilities, agriculture and food, IT and telecommunications industries. These industries represent a prototype for studying the link between CSR and financial performance. The research problem involves identifying the significance of a relationship, or lack of significance of a relationship, of CSR and CS in these industries in Saudi Arabia based on stakeholder theory.

The rest of the paper continues as follows. The next section briefly discusses the literature review and the hypotheses development. The third section describes the research design and methodology. The empirical results and discussions of the study are reported in the fourth section while in the final section, conclusions and implications are drawn.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Although the majority of the studies examining the association of CSR and CS found a positive relationship (Pava & Krausz, 1996), still the extant scholarly researches remains mixed (Aras et al., 2010; Baird et al., 2012; Baron et al., 2011; Callado-Munos & UtreroGonzalez, 2011; Fu & Jia, 2012; Mishra & Suar, 2010; Robinson, Kleffner, & Bertels, 2011; Schreck, 2011; Surroca et al., 2010). It is worth to highpoint that the prior research on corporate sustainability has been examined in different regulatory business environments and audit markets with more focus on Anglo-Saxon countries, several methodological weaknesses such as omission of important variables, population definition; and sample size and type; weak empirical tests, different typical statistical analysis, and weak theoretical constructs. Particularly, the aforementioned reasons cause contradictory and limited results in the previous studies of CS. Although there is a growing trend in the research line of the association between CSR and firm performance, the results of these studies vary (De Bakker, Groenewegen, & Den Hond 2005). Importantly, there is a positive association between CSR and firm performance has been reported by several meta-analysis studies (Orlitky, Schmidt, & Rynes, 2003; Allouche & Laroche, 2005; Margolis, Elfenbein, & Walsh 2007).

Researches carried out previously have utilized ROE as an accounting-based performance which has centered on historical results, such as earnings, operating profits, and operating revenues. It is described as net income divided by the equity of the shareholder (Alzharani et al., 2011; Anderson & Reeb, 2003; Arslan, Karan & Eksi, 2010; Maury, 2006). This is an all-inclusive measure of performance, highlighting expropriation in the income statement as well as the balance sheet. The view is posed that accounting-based performance tool is more efficient than market-based ones (Sun & Tong, 2003). This is owing to the fact that, when the share market displayed a lack of efficiency, share prices are less likely to reflect all data available. On the other hand, however, the accounting-based performance measure is more keenly linked with financial survivability as opposed to share market value, thus enabling the performance assessment of publicly-traded organizations.

In the context of Saudi Arabia, issues of CSR and CS are unknown due to lack of studies in this discipline. In addition, Saudi setting of regulatory framework, audit market, and unique culture compared to those of the prior studies are different. Therefore, the hypothesis of this study is developed based on the suggestions of the stakeholder theory and the empirical studies' findings. In specific, Kanji and Chopra (2010) report that CSR failures cost firms too much of their resources. Examples of this failure is the case of Bhopal Gas Tragedy, General Electric failure to clean up Hudson River of organic pollutants, Exxon Valdez incident in Alaska, recall of millions of toys globally by toy giant Mattel for using lead poisoning paint, etc. Societies look at CSR as a strategy that have to be included into the corporate planning which thus influence the triple bottom line (3Ps): People (social bottom line), Planet (ecological bottom line), and Profit (economic bottom line). Importantly, CSR is seen as a direct and indirect contribution to business' bottom line and it can guarantee the long run sustainability (Bihari & Pradhan, 2011; Kanji & Chopra, 2010). They provide evidence that firms incorporating CSR activities in their business strategies live longer than those who do not. In the same vein, Raghubir et al. (2010) report that firms are continually explore the association between their CSR activities and sustainability. Kapoor and Sandhu (2010) document that CSR is a detrimental variable influencing the firm's performance. In addition, several studies find that there is a positive association between CSR and firm value (Sharma, 2011; Pava & Krausz, 1996; Preston & O'Bannon, 1997).

The foregoing arguments are summarized in expecting direct evidence on the association between CSR and CS. The testable hypothesis is stated in a direct form:

H_1: Ceteris paribus, there is a positive association between corporate social responsibility and corporate sustainability

RESEARCH DESIGN AND METHODOLOGY

Sample and Data

The data regarding the CSR and CS are hand-collected from the annual reports of the listed companies in Saudi Stock Exchange (Tadawul) for the period of 2007-2011. The sample of the corporate sustainability models comprises petrochemical cement, retail, energy and utilities, agriculture and food, IT and telecommunications companies. Samples selected for the five years are depicted in Table 1. For the other financial data, they are retrieved from annual reports and DATASTREAM. Excluding outliers and incomplete data, the sample size was reduced to 164 companies as a final sample eligible for inclusion in the analysis of corporate sustainability model.

Table 1: Sample Selection Procedure

Sample attributes	Number of observations
Total industrial firms in Saudi Arabia, from 2007 to 2011	243
Observations discarded	(79)
Final sample	164

Model Specification

The economic model is used to develop a model of CSR and CS. The variables proposed for inclusion in the model captures differences in the costs of agency relationships. Since the dependent variable is a continuous, metric scale measurement, to estimate this model, Multivariate Analysis is applied using pooled OLS regression. The functional equation of the pooled OLS regression model is utilized to determine the extent of the association of each of the independent variables on the CS.

$$CS = \beta 0 + \beta 1\ CSR + \text{Control Variables} + e \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots(1)$$

Where:

CS	=	Corporate Sustainability,
CSR	=	Corporate Social Responsibility,
Control Variables	=	Board of directors effectiveness, audit committee effectiveness, firm size, leverage, and firm age, and
e	=	error term.

Since the pooled OLS regression is used to test the hypothesis, outliers are detected and handled, assumptions of multicollinearity, normality, heteroscedasticity, linearity and autocorrelation are also evaluated.

We also control for the effect of five agency-related variables found by related literature for their potential confounding effect on the CS. It is expected that CS to be positively associated with board of directors effectiveness *BDE_SCORE*, audit committee effectiveness *ACE_SCORE*, firm size *LASSET*, firm leverage *LEV*, and the firm age *FIRM_AGE*. As for the board of directors effectiveness, previous studies in the firm performance discipline have examined board of directors' characteristics as individual determinants associated with firm performance. For example Alexander et al. (1993); Birnbaum (1984); Cicero et al. (2010); Goodstein et al. (1994); Pfeifer (1972, 1973) found a positive link between firm performance and board size. With regard to audit committee effectiveness, according to agency theory, the role of the audit committee is assumed to be centered on supervising and monitoring financial reporting integrity, which enhances the overall value of the firm. The studies carried out thus far in the field of audit committees have provided a link between audit committee characteristics and the performance of the firm through individual tests. For example, Raghunandan and Rama (2007) found a positive link between firm performance and audit committee size. Concerning firm size, in the empirical literature of CG, firm size has been adopted as a control variable impacting the performance of the firm (Aljifri & Moustafa, 2007; Alzharani et al., 2011). Ghosh (2001) suggests that larger firms perform better than smaller ones owing to their capacity to achieve risk diversification. In this same regard, it is held by Helmich (1977) and Kumar (2004) that larger entities are more effective than smaller ones due to skills of staff, economies of scale, and market power. Regarding firm leverage, debt or leverage is the utilization of borrowed funds in an attempt to enhance firm performance. This could decrease agency costs by lessening the cash flows available for the expropriation of negative net present value projects and opening the business to greater supervision by the market. This could increase management pressure in terms of enhancing firm performance as it decreases the moral risk through lessening free cash flow at the disposal of management (Alzharani et al., 2011; Jensen, 1986; Harris & Raviv, 1991; Myers, 1990). For instance, Grossman and Hart (1982) detailed the fact that debt financing means management is more aware of consuming fewer perks, and ultimately become more effective in circumventing bankruptcy, and thus the loss of reputation and control. As for the firm age, the age of the firm is a critical factor in firm development, firm dissolution likelihood, and the variability of business growth (Evans, 1987a). The link between firm performance and firm age has been detailed well, with some research utilizing age as a proxy for the experience a firm has gained through its business (Geroski, 1995). With the increase of firm age, management garners much more insight into their abilities and skills over time (Stinchcombe, 1965; Evans, 1987b). Younger firms are more vulnerable with firm age expected to last only between five and 10 years, as noted by Ward and Mendoza (1996).

As for the measurements of the variables, Table 2 exhibits the dependent, test and control variables measurements**.**

Table 2: Summary of the Operationalization and the Expected Sign of the Research Variables

Variables	**Acronym**	**Operationalization**	**Coefficient Predictions**
			Pooled OLS
Dependent Variable			
Corporate Sustainability	*ROE*	net income divided by shareholders' equity	d.v
Test Variable			
Corporate Social and Environmental Responsibilities	*CSR*	An index score	+
Control Variables			
Board of Directors' Effectiveness Score	*BDE_SCORE*	Proportion of board of directors effectiveness,	
Audit committee's effectiveness score	*ACE_SCORE*	Proportion of audit committee effectiveness,	
Firm Size	LASSET	$\log_{10}$ of total assets	
Firm Leverage	LEV	long term debt-to-total asset ratio	
Firm Age	AGE	the number of years since the company was established	
Note: d.v – dependent variable			

As for the CSR index score, Table 3 shows how CSR is measured

Table 3: *CSR Index*

	Items	1 if yes, 0 if no
	NAME OF COMPANY: …………………………………………… INDUSTRY: ………………………………………………………..	
	COMMUNITY INVOLVEMENT	
1	General philanthropy	
2	Participation in government social campaigns	
3	Community programs (health & education)	
	ENVIRONMENT	
1	Environmental policies	
2	Raw materials conservation & recycling	
3	Environmental protection program	
4	Awards for environmental protection	
5	Support for public/private action designed to protect the environment	
	EMPLOYEE INFORMATION	
1	Employees appreciation	
2	Recruitment problems	
3	Discussion of ways to overcome recruitment problems	
4	Picture of employees welfare	
5	Discussion of employees' welfare	
	PRODUCT OR SERVICE INFROMATION	
1	Discussion of major types of products	
2	Pictures of major types of products	
3	Improvement in product quality	
4	Improvement in customer services	
5	Customer awards/ratings received	
	Value-added information	
1	Value-added statement	
2	Qualitative value-added statement	
3	Value-added data/ratios	
	Total index score	

EMPIRICAL RESULTS AND DISCUSSIONS

Table 4 depicts the mean, standard deviation, minimum and maximum of each variable in the sample data set.

Table 4: Descriptive statistics (N = 164)

Variables	Mean	Minimum	Maximum	Std.Deviation
ROE	12.56	-31.97	41.09	13.07
CSR	0.36	0.05	0.67	0.17
Control variables				
BDE_SCORE	0.52	0.00	1.00	0.26
ACE_SCORE	0.58	0.00	1.00	0.26
LASSET	23018687.03659	65319.00	332783648.00	56485091.838744
LEV	22.45	0.00	69.170	19.34
FIRM_AGE (years)	23.69	0.80	56.99	14.77

This table shows the descriptive statistics of the variables

Table 4 displays that there is a significant range of variation among the considered sample of this study. It is shown that the range of ROE is 12.56 with a maximum of 41.09 and a minimum of -31.97 and a standard deviation of 13.07. As the for hypothesized variable, Table 4.1 illustrates that the mean of CSR is 0.36 with a maximum of .67 and a minimum of 0.05 and a standard deviation of 0.17. With respect to the control variables, the range of BDE_SCORE is from 0.00 to 1.00 with an average of 0.52 and a standard deviation of 0.26. The mean of ACE_SCORE is 0.58 with a maximum of 0.00 and a minimum of 1.00 and a standard deviation of 0.26. The mean of LASSET is S.R 23018687.03659 with a maximum of S.R 332783648.00 and a minimum of S.R 65319.00 and a standard deviation of S.R 56485091.838744.. The LEV ranges from 0.000 to 69.170 with an average of 22.45 and a standard deviation of 19.34. The range of FIRM_AGE is from 0.80 to 56.99 with a mean of 23.69 and standard deviation of 14.77.

Table 5: Correlation matrix of independent variables (N = 164)

	C	BDE	ACE	L	L	FIR
CSR	1					
BDE	-	1				
ACE	-	.065	1			
LAS	.2	.012	.112	1		
LEV	.3	-	-	.23	1	
FIR	-	.247	.111	-	-	1

As shown by Table 5, the correlation matrixes verify that no multicollinearity exists among the variables, as none of the variables correlates above 0.90. All the variables have a correlation of equal to or less than .416.

Table 6 shows the pooled OLS regression used to evaluate the level of association of the hypothesized variable on the corporate sustainability Tables 4.3 report the estimated model coefficients, the associated significant test results, the adjusted R^2 and the *F*-values for the corporate sustainability model. The F-value is a statistically significant at the 1% level, indicating that the overall model can be interpreted. The adjusted R^2 is 20.30%. The statistics show that the ROE model has explained 20.30% of the total variance in the corporate sustainability. This indicates a moderately good fit corporate sustainability model.

Table 6: Pooled OLS Analysis Results–ROE Model

Variables	Expected Sign	Coef.	*t*	*P*> |t|
Hypothesized Variables				
CSR	+	-0.114	-1.408	**0.161**
BDE_SCORE	+	0.044	0.560	0.576
ACE_SCORE	+	-0.101	-1.421	0.157
Control Variables				
LASSET		.394	3.915	**0.000**
LEV		-0.189	-1.810	**0.072**
FIRM_AGE		0.408	4.741	**0.000**
Adjusted R^2			20.30	
Model *F*-stat.			7.90	
P-value			0.000	
No. of Observations			164	

Bold = significance at 1%, 5% and 10%

Table 6 exhibits an inconsistent with expectations, CSR is negatively related to CS in a form of ROE (p-value = 0.081, one-tailed significance). Thus, hypothesis H_1 is rejected. This implies that corporate social responsibility has a negative impact on the degree of corporate sustainability in Saudi setting. Although this result is inconsistent with stakeholder theory, several previous empirical studies have supported these findings (Pava & Krausz, 1996; Iskyan, 2010; Brammer, Brooks, and Pavelin, 2006; Makni, Francoeur, and Bellavance; Cardebat and Sirven, 2009; Bello, 2005; Nelling and Webb, 2009; Demacarty, 2009; Chih et al., 2010; López, Garcia, and Rodiquez). For instance, Iskyan (2010) indicated that companies that always concern about social and environmental issues would find it difficult to grow up and achieve financial performance. By the same token, Moore (2001) argued that future financial performance could be distracted as companies focus social performance. Moreover, López, Garcia, and Rodiquez (2007) found that CSR expenses incurred by responsible organizations put them at a short-term financial disadvantage.

CONCLUSIONS AND IMPLICATIONS

The main objective of this study is to examine the association between corporate social responsibility and corporate sustainability in Saudi Arabia for the period between 207 to 2011. The hypothesis of this study is based on the premise of stakeholder theory suggesting that the higher the corporate social responsibility, the greater the financial success. The result indicates to an opposite significant direction of the association between corporate social responsibility and corporate sustainability in Saudi setting. Although this result is inconsistent with the suggestion of the stakeholder theory, several empirical studies support this finding (Pava & Krausz, 1996; Iskyan, 2010; Brammer, Brooks, and Pavelin, 2006; Makni, Francoeur, and Bellavance; Cardebat and Sirven, 2009; Bello, 2005; Nelling and Webb, 2009; Demacarty, 2009; Chih et al., 2010; López, Garcia, and Rodiquez). The main limitations of the study lie on the measurement of CSR and the proxy for corporate sustainability. Future line of research should put an effort to introduce these issues. Further research should replicate this model to determine its validity in different contexts of GCC countries, in different time periods, and with different sample size. These limitations may motivate more future research in the GCC market.

One important implication of these findings relates to the issue of corporate sustainability in Saudi Arabia. Saudi government, stock market, and accounting and auditing regulators would gain new insights from this study in terms of the extent to which regulations, laws, codes of corporate governance, decrees, and resolutions are implemented by companies especially those related to social and environmental issues. Further, the findings of this study will be useful to regulators in deliberating policies on issues related to corporate social and environmental and corporate governance issues in order to preventing the society and environment impair. One possibility is to make it mandatory for companies incorporating in Saudi Arabia to disclose in their annual reports their CSR activities and corporate governance information in a manner to determine the direction of future governance policies for Saudi corporations. Thus, regulators would be able to decide when and how CSR, corporate governance, accounting, and auditing practices are being carried out in Saudi setting. Moreover, the findings of this study may serve to enhance the financial performance, practices of CSR, corporate governance by the management and shareholders. The significance of enhancing financial performance by CSR activities and better practices of corporate governance. It has not been considered a suitable practice for listed firms which have lower CSR activities and weak internal system of corporate governance to enhance the financial performance. In this environment, the shareholders who control the listed firms have the tendency of depriving the private benefits of exploiting small shareholders. The results of this study would benefit societal and environmental agencies in the way they assess the level of social and environmental protection of incorporating companies in Saudi Arabia. Investors and financial analysts depend on audited financial statements to make decisions related to social and environmental, bond rating, and all other decisions related to investments in Saudi market. Accordingly, increased understanding and prediction of companies' events are important to this user group. Furthermore, the results of this study will be of interest to researchers and the academic community, due to a lack of a formal research body addressing the issues of CSR activities and corporate sustainability in the Saudi Arabia. Therefore, this study will provide them with substantial information about issues in the market of the Saudi Arabia, as well as premise data in the future. This study contributes to the body of knowledge and the growing empirical literature about CSR and CS, and encourages further research on such association.

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Biography

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مفهوم التدرج والتتالي في محتوى مناهج اللغة الإنجليزية

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ملخص الدراسة

تتناول هذه الدراسة اختبار علاقة المسؤولية الاجتماعية والبيئية للشركات مع استدامة الشركات في المملكة العربية السعودية، للفترة من ٢٠٠٧ وحتى ٢٠١١. تم استخدام تحليل انحدار المربعات الصغرى الاعتيادي المجمع لتقدير هذه العلاقة المفترضة. العينة النهائية، تمثلت بعدد ١٦٤ شركة مسجلة في السوق المالي السعودي (تداول). أوجدت هذه الدراسة أن هناك علاقة عكسية ذات دلالة معنوية بين المسؤولية الاجتماعية والبيئية للشركات واستدامة الشركات. تقترح هذه الدراسة أنه يجب على المشرعين في المملكة العربية السعودية، وخاصة السوق المالي السعودي أن يلزموا الشركات المسجلة بالإفصاح بشفافية عالية وبالتوقيت المناسب على المعلومات الملائمة ذات العلاقة بالمسؤولية الاجتماعية والبيئية؛ وذلك للتعرف على درجة الالتزام بهذه المسؤوليات. تقترح هذه الدراسة على الشركات أن تشدّد على تعزيز وجودة دور المسؤولية الاجتماعية والبيئية؛ للتعرف على القضايا المرتبطة بها في المملكة العربية السعودية.

كلمات البحث الأساسية: المسؤولية الاجتماعية والبيئية للشركات، استدامة الشركات، المملكة العربية السعودية