Corporate Social Performance and Internal Control

Sahar Sepasi
Assistant Professor, Faculty of Management & Economics, Tarbiat Modares University,
Tehran, Iran
Corresponding author
sepasi@modares.ac.ir

Hassan Hassani
MSc in Accounting, Faculty of Management & Economics, Tarbiat Modares University,
Tehran, Iran

ABSTRACT

This study examines the relationship between corporate social performance and the Company's internal control. For the study, the definition of corporate social performance is used Wood (Wood, 1991) and social performance into the process (internal processes, management) and outcome (social impact) is divided. To assess the social performance of corporate social performance version of the questionnaire was used containers. The analysis of this study is generally divided into two main sections. The first part of the study to determine the ranking of the companies in the field of social functioning in both social accountability processes and consequences of the company's social behavior through the Analytic Hierarchy Process (AHP) was carried out and the second part of the study also examines the relationship between the level of social performance and the company's internal control using logistic regression. The results showed a positive and significant relationship between the environmental assessment and stakeholder management processes social element status of internal control there. If the management issues (one of the social processes) there was no significant relationship with the status of internal control. This relationship shows that companies that have better social performance (the majority of), the status of internal control are desired.

Keywords:
social functioning, internal control, environmental assessment, stakeholder management, Analytic Hierarchy Process (AHP).
1. Introduction

Wood (1991), presented the concept of corporate social performance by analyzing the previous research in the field of corporate social performance in a comprehensive model, and since then many studies in the field of corporate social performance and corporate financial performance is performed. However, Wood’s study is the first study corporate social performance. Corporate social performance (CSP) can be defined as follows: "One of the duties of a company relative to its stakeholders, including employees, the community, and the traditional duties to stockholders" (Clarkson, 1995; Freeman, 1984). Modern concept of corporate social performance of the 1970s was formed in America.

One of the misconceptions is that only companies responsible to social function can be evaluated in the context of corporate social responsibility, while Wartick and Cochran (1985) proved that all companies either responsible or irresponsible can be evaluated based on their social performance. This assessment of social performance can have a positive or negative result. That’s why corporate social performance in recent years has been highly regarded. A fundamental issue at the heart of corporate governance and corporate social performance is internal control effectiveness and transparency (Dubbink, et al., 2008).

It is expected the higher the corporate social performance, the more transparent the corporate reporting (Quaak, et al., 2007). Because companies that are committed to its social responsibility to its stakeholders have a responsibility to real and transparent reporting so their stakeholders can make the right decisions. The higher the corporate social performance the stronger the control process which is an important part of corporate governance mechanisms. This means “strong internal controls - No weakness” in the auditor's report on internal control status of the company. A good corporate social performance will be shown in an effective internal control.

This study examines the relationship between corporate social performance and the Company’s internal control. For the study, the definition of corporate social performance is used by Wood (1991); social performance is divided into the process (internal processes, management) and outcome (social impact). To assess corporate social performance, the social performance’s questionnaire is used. To examine the relationship between corporate social performance and the status of internal control a logistic regression test is done. To assess the internal controls, the auditor's report on the status of internal control is used.

2. Literature Review

Much of the literature which are related to Wood’s structural principles of social responsibility, are conceptual and not empirical. The legitimacy definition was taken from Davis (1973). It points out that: "Society gives legitimacy and power business. In the long run, those who do not use this power responsibly will lose". This principle is used in institutional analysis. The basic idea is that each business as a member of the business entity has a specific commitment to the society.

The principle of public responsibility is taken from Preston and Post (1975)'s definition. Wood (1991) defines it as follows: ’businesses are responsible for the primary and secondary conflicts with”. This principle is analyzed at the level of organizational and connects a particular company to a network of stakeholders in a larger socio-political environment. Also, research on stakeholder pressure - activists, boycott and public figure, programs, legislation, etc. - to change the company's behavior can be used as an indicator of the existence and content of the company's responsibility to the public.

The management authority, fourth level of Carol (1979) model connects the "responsible authority" to the principle of moral autonomy. Wood (1991) defines this principle as "managers are moral actors. In the area of corporate social responsibility, they are committed to the use of the authority to achieve socially responsible outcomes when available". This principle is also analyzed in individual level. Broad literature in the field of organization ethics exists as well as corporate value and codes of ethics, with the keywords of corporate social performance few researches are found compared to business ethics.

Public relations and management issues are subjects that are not directly related to corporate social performance. However, these practices are among the most powerful communication mechanism that companies employ in their environment. With a focus on government relations - economic unit, including lobbying rules, joint campaigns through political action committees, public relations management to be a useful way to understand how to meet the demand of
institutional and stakeholders and therefore do or change responsibilities social. Management of public relations issues sometimes in a more comprehensive form includes stakeholder engagement activities (Wartick and Mahon, 1994). Company activities can be taken from companies policy. Their implementation requires money, time, attention and education and a natural target for researchers to find the relationship between corporate social performance and financial performance as they are. But a better theoretical reasons to continue the development and improvement of research in the field of corporate social performance exists.

In Iran, the researches does not show a significant relation between corporate social performance and corporate financial performance (Senobar et al. 2011, Arab Salehi et al., 2013). A survey to assess the company's vision of Tehran Stock Exchange with respect to the definition of corporate social responsibility on corporate social responsibility Carroll's pyramid was taken (Sharbat Oghly et al., 2010). The results showed that the legal responsibility of social responsibility was the more important factor among the four responsibility level of the carol pyramid is Carol. The relationship between corporate governance and financial performance has been studied in Iran. Ghalibaf Asl and Rezai (2007) found no significant relationship between the composition of the board and corporate financial performance.

Babai Zaklyly and Ahmadvand (2008) evaluated the impact of ownership structure on corporate financial performance. They evaluated the ownership structure using of the number of major shareholders and type of ownership. The results showed that by increasing the number of shareholders, shareholder rights increased efficiency. The importance of social responsibility on the relationship between corporate social responsibility and commitment is impressive (Mortazavi et al, 2010). In addition, corporate social responsibility is influenced by many factors and also influences many factors (Daraie and Parsa Amal, 2013). For example, customer loyalty is among many factors. Mojodi et al (2014) investigated the effect of corporate social responsibility at Pasargad Bank versus the customer loyalty. The survey showed that corporate social responsibility has a direct positive impact on customer satisfaction.

In regard to the relationship between corporate social responsibility and internal controls no research has been taken by now in Iran. However, Rajabi and Ganji (2010) found a significant relationship between corporate governance (19 criteria - seven floors) and firm performance (14 criteria - six floors) and found that five mechanisms of corporate governance had a relationship with firm performance. “Banks”, "audit and accountability" and "rights of shareholders" and between these variables "independent audit opinion" (the audit report) and “full respect for the obligations established by the General Assembly annual” (internal control) had the highest correlation with company performance criteria.

3. Methodology

The purpose of our analysis is to study the impact of CSP on status of company's internal control in Iranian listed companies. Our sample covers the period of 2013-2014 (since the report of internal control in audit report became compulsory in Iranian Companies from 2013). The analysis does not include banks and insurance companies, due to their specific core business and risk profile that would have altered the average results. In this sample we only considered the firms that had internal control status in their annual audit report. In this study, for all companies in the sample the questionnaire was send, only 80 companies responded to the questionnaire.

In order to collect information the questionnaires were used in the field of corporate social performance. The questionnaire consists of three parts, each section contains a series of questions on the Likert scale, in the field of environmental assessment, stakeholder management and administration issues, shortcomings and problems identified and resolved. To evaluate the reliability of Cronbach's alpha coefficient was used. For this purpose, a preliminary test of 20 questionnaires was distributed among corporate executives and Cronbach's alpha test results showed that the reliability of the questionnaire for each of the more than 0.7 is acceptable reliability.

The analysis of this study is generally divided into two main sections. The first part of the study, determines the ranking of the companies according to their social functioning in both social accountability processes and consequences of the company's social behavior using Analytic Hierarchy Process (AHP); the second part of the study examines the relationship between the level of social performance and the company's internal control using logistic regression.
In connection with this study, the question arises:

In companies with higher corporate social performance, the internal control status report in auditor report is higher compared to companies with lower corporate social performance?

Hypothesis of the study are divided into two categories: primary and secondary hypotheses. Main assumption underlies the relationship between corporate social responsibility and internal control status reported in annual audit report. Secondary hypotheses are based on the relationship between corporate social performance sub-criteria and the status of internal control. Previous research has shown that sub-criteria may indicate a relationship (Mahoney and Roberts, 2007).

Based on the assumption those stronger internal controls the better the social performance (Dando and Swift, 2003), the hypothesis given as follows:

**Hypothesis 1:** In companies with higher corporate social performance, the internal control status report in auditor report is higher compared to companies with lower corporate social performance.

This hypothesis is tested by three sub-criteria according to WOOD Model. These assumptions are modified using assumptions triple relationship between social performance and the company's financial results (Makni et al., 2009).

According to the definition of environmental assessment, the stronger a company's environmental evaluation, the more favorable the report on internal control status they will get.

**Hypothesis 1-1:** There is a significant relationship between the environmental assessment and the status of internal controls.

Based on the definition of a stakeholder management, as one of the consequences of corporate social performance, the stronger management of stakeholders, internal control reports published would also be more favorable.

**Hypothesis 1-2:** There is a significant relationship between stakeholder management and the status of internal control.

According to the definition of management issues, as one of the consequences of corporate social performance, it is expected that companies that manage social problems better, their internal control reports published are more favorable.

**Hypothesis 1-3:** There is a significant relationship between management issues and status of internal control.

To test the above hypotheses, we estimated a logistic regression model, using the ordinary least squares (OLS) technique. The model is specified as follows:

\[ \text{IC} = \alpha + \beta_1 \times \text{EA} + \beta_2 \times \text{SM} + \beta_3 \times \text{IM} + \varepsilon \]

where:

- **IC:** dummy variable. 1 if the company does not have significant weaknesses in internal control statement in annual audit report. 0 otherwise;
- **Environmental Assessment (EA):** Collect the information needed to understand and analyze the social, legal, political and ethical aspect of the company. For example, assessment of company expectations (the "company does not have a strategic plan in the" up "the company's plans in this field has reached maturity") call instructs specialized construction crews on these issues are as follows:
  1) for actions related to environmental change, the company has designed a system to identify and assess the social environment. For example, changes in the information needs of the stakeholders of the company.
  2) to identify risk company social consequences of its activities (such as poverty, addiction, loss of health, unemployment, etc.), has designed and implemented risk management system. For example, staff health assessment program.
  3) to respond to future changes in their social environment, practical preparation. For example, increase quality and reduce prices due to changes in consumer expectations.

- **Stakeholder management (SM):** active and constructive relationships with stakeholders using stakeholder management tools such as weekly, staff, and community relations programs according to enterprise features such as size, profitability, ownership and leadership of the CEO.(the "company has no plans / strategies in this regard." to "the company's plans in this field has reached maturity") call instructs specialized construction crews on these issues are as follows:
1) The company has designed a system to identify its stakeholders.

2) Company means to communicate with stakeholders and provided they meet the requirements, such as stakeholder dialogue sessions.

3) The company has developed a process for managing stakeholders (stakeholder management system).

Issues management (IM): a process in which the company's ability to identify, analyze and measure the social and political issues that may affect the company gives. Management issues include internal and external processes for managing the company's response to social issues (social) is to reduce unexpected events. (the "company has no plans / strategies in this regard." to "the company's plans in this field has reached maturity") call instructs specialized construction crews on these issues are as follows:

1) to identify social issues, the program is designed. For example, zero emissions program.

2) tool for analyzing social and environmental issues has developed. For example, social impact assessment tool or system to measure emissions.

3) The Company has established a process to respond to social issues. For example, sustainable supply chain (only with socially responsible suppliers and environmental works).

4. Results

4.1. Descriptive Statistics

Table 1 presents descriptive statistics of the data employed in the study stratified by company status. The descriptive statistics include the means, median, standard deviations, minimum, and maximum for each variable. The mean value of Internal Control (IC) is 0.337 (median =0.000). Result shows that 33.7% of companies have strong internal controls. The mean value of Environmental Assessment (EA) is 3.075 (median =3.000). The results show that the sample companies, environmental assessment in order to meet the expectations of stakeholders have good social performance. The mean value of Stakeholder Management (SM) is 3.742 (median =4.000). The results show that the sample companies, active engagement and constructive relationship with stakeholders to demonstrate good social performance.

The mean value of Issues Management (IM) is 2.475 (median =2.333). These results show the company to identify, analyze and action the social and political issues that may affect the company, effective actions are not taken.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Median</th>
<th>Std-dev</th>
<th>Max</th>
<th>Min</th>
</tr>
</thead>
<tbody>
<tr>
<td>IC</td>
<td>0.337</td>
<td>0.000</td>
<td>0.402</td>
<td>1.000</td>
<td>0.000</td>
</tr>
<tr>
<td>EA</td>
<td>3.075</td>
<td>3.000</td>
<td>0.862</td>
<td>4.667</td>
<td>1.000</td>
</tr>
<tr>
<td>SM</td>
<td>3.742</td>
<td>4.000</td>
<td>0.937</td>
<td>5.000</td>
<td>1.333</td>
</tr>
<tr>
<td>IM</td>
<td>2.475</td>
<td>2.333</td>
<td>0.863</td>
<td>5.000</td>
<td>1.000</td>
</tr>
</tbody>
</table>

4.2. Analytic Hierarchy Process (AHP)

In the first phase, data was collected by questionnaire; the Analytic Hierarchy Process (AHP) was performed. In this study, for the implementation of the AHP, the data from the questionnaires were collected and the performance metrics weighting was processed on the data and outcome were analyzed. For every level of social performance, 3 questions were raised in the questionnaire and respondents were asked to compare the situation of your company on any of the questions are based on a 5-point Likert scale (from "negligible" to "very important") answer. The questions in the questionnaire about the outcome social functioning level processes as follows:

1) What is the importance of environmental assessment to stakeholder management?

2) What is the importance of environmental assessment of the management issues?

3) What is the importance of stakeholder management to management issues?

The data collected from questionnaires, were analyzed using hierarchical analysis of dyadic matrix to calculate the weight values of each company in the field of social performance. After calculating the couple values, based on the data ranked according to the questionnaires, for each of the variables in the field of social performance AHP test was done. A couple of weighting matrices in the analytic hierarchy process of social performance is shown in Table 2:
After the test matrix, each cell data by dividing the sum of your column was normal and average of each question were calculated as a multiple of the importance of the issue. Results are presented in Table 3:

**Table 3 - Normalized matrix process**

<table>
<thead>
<tr>
<th>Questions</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>average</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.646</td>
<td>0.73</td>
<td>0.431</td>
<td>0.604</td>
</tr>
<tr>
<td>2</td>
<td>0.188</td>
<td>0.21</td>
<td>0.458</td>
<td>0.287</td>
</tr>
<tr>
<td>3</td>
<td>0.165</td>
<td>0.08</td>
<td>0.110</td>
<td>0.109</td>
</tr>
</tbody>
</table>

AHP method generally needs inconsistent judgments by calculating the inconsistency rate. The calculated inconsistency rate should be 10 percent or less. If the rate is bigger than 10 percent, the judgment may be contradictory and should be revised. Here the inconsistency rate calculated for the matrix of social performance processes 0.0533 levels is less than 0.1 are obtained. Finally, after obtaining the weighted values, companies were ranked based on data collected from questionnaires. Rank of the first ten companies is shown in Table 4:

**Table 4 - Social performance ratings**

<table>
<thead>
<tr>
<th>Company code</th>
<th>Industry</th>
<th>Overall Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Pharmaceutical industry</td>
<td>88.08</td>
</tr>
<tr>
<td>2</td>
<td>Pharmaceutical industry</td>
<td>86.54</td>
</tr>
<tr>
<td>3</td>
<td>Pharmaceutical industry</td>
<td>84.89</td>
</tr>
<tr>
<td>4</td>
<td>Food industry</td>
<td>84.75</td>
</tr>
<tr>
<td>5</td>
<td>Pharmaceutical industry</td>
<td>84.15</td>
</tr>
<tr>
<td>6</td>
<td>Pharmaceutical industry</td>
<td>83.51</td>
</tr>
<tr>
<td>7</td>
<td>Pharmaceutical industry</td>
<td>82.69</td>
</tr>
<tr>
<td>8</td>
<td>Food industry</td>
<td>82.08</td>
</tr>
<tr>
<td>9</td>
<td>Pharmaceutical industry</td>
<td>81.24</td>
</tr>
<tr>
<td>10</td>
<td>Pharmaceutical industry</td>
<td>80.94</td>
</tr>
</tbody>
</table>

**4.3. Regression Analysis**

Results of the logistics regression analysis are shown in Table 4. The evaluated regression model is significant as a whole because the significance of the calculated LR is 0.0002%. The degree of explanation of the model is the adjusted coefficient of determination comes to 19%.

The evidence from table 4 reveals the relationships between each of the three firm CSP level and internal control. Our results indicate that EA has a positive estimated coefficient (β=0.953) and statistically significant (at 95% confidence level). Accordingly, we can be concluded that environmental assessment leading to increased deployment of internal control is better. Thus this result supports the hypothesis 1-1. The SM has a positive estimated coefficient (β=1.178) and statistically significant (at 95% confidence level). The positive association between stakeholder management and internal control implies that stakeholder management leading to increased deployment of internal control is better. The results provide support for the hypothesis 1-2. The IM has a positive estimated coefficient (β=0.274), but is not statistically significant. The results do not support hypothesis 1-3.

**Table 5 - corporate social performance (CSP) and internal control**

<table>
<thead>
<tr>
<th>Variables</th>
<th>coefficient</th>
<th>Std. Error</th>
<th>t-statistics</th>
<th>Sig</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>6.9508</td>
<td>1.7786</td>
<td>3.9079</td>
<td>0.000</td>
</tr>
<tr>
<td>EA</td>
<td>0.9529</td>
<td>0.3199</td>
<td>2.9787</td>
<td>0.003</td>
</tr>
<tr>
<td>SM</td>
<td>1.1778</td>
<td>0.3625</td>
<td>3.2491</td>
<td>0.001</td>
</tr>
<tr>
<td>IM</td>
<td>0.2743</td>
<td>0.3321</td>
<td>0.8263</td>
<td>0.408</td>
</tr>
</tbody>
</table>

Adjusted R² 0.189  LR -statistic 19.359  Prob (LR -statistic) 0.0002

5. Discussion and Conclusion

In order to assess the social performance of companies in this study, corporate social performance was assessed by Wood (1991) model. This model has three dimensions, where only two dimensions that had a more logical and theoretical relation with internal control was selected: Social Process and Social Issues. Then, using a questionnaire, data from 80 companies active in the field of food and pharmaceutical
industries were selected. To give weight to the social dimensions of AHP method and rate method was used for rankings. The rating of the social dimension for the overall score of each company was calculated in relation to its social function. Then the relationship between social performance and internal control were discussed. Logistic regression models were used to investigate this relationship.

The results show that the relationship is meaningful between environmental assessment and stakeholder management processes and internal control. Thus, management issues not related to internal control. The results show that companies with good internal control situation had higher social functioning compared to companies with internal control undesirable situation.

This study examines the relationship between corporate social performance (assessed using a model of corporate social performance Wood (1991) and internal control, and a significant relationship exists between corporate social performance and internal control. This relationship shows that companies that have better corporate social performance, have more favorable internal control.

The result of this research can be used by investors, law makers and managers. There were some limitations in this research, e.g. lack of access to quantitative data and the lack of databases for data, particularly for social and environmental dimensions of corporate social performance.

References