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ARTICLE

Social responsibility and financial performance: The role of good corporate governance

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Abstract The objective of this theoretical–empirical study is to investigate the bidirectional relationship between Corporate Social Responsibility and Financial Performance in Spanish listed companies. A complete theoretical framework – based on agency, stewardship, dependency resources, and stakeholder theories – provides the basis for the conceptual model. An important contribution is the use of a social behavioral index formed by four components: Global Reporting Initiative participation, Dow Jones Sustainability Index firm inclusion, Good Corporate Governance Recommendations compliance, and Global Compact signee.

The conclusions drawn from the empirical study performed on the companies registered on the Madrid Stock Exchange demonstrate positive relationships in both directions, namely that the social is profitable and that the profitable is social, thereby originating a positive feedback virtuous circle.

The results of this analysis have practical applications in the boardroom; they are proof that all social policies increment financial resources, and vice versa, that increased financial performances lead to greater social benefits. As a consequence, this paper encourages all board members to seriously weigh investing financial resources in developing policies that boost the levels of social behavior components in order to contribute globally to the improvement of society.

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Introduction

Company concerns are increasingly focused toward issues of social content, all the while resolving to maximize economic performance in order to satisfy shareholders and act in a socially responsible manner for the benefit of society as a whole. Social, economic and environmental concerns are forcing companies to integrate systems that take into account the observance of the law in all spheres, and also

Abbreviations: CG, corporate governance; CSP, corporate social performance; CSR, corporate social responsibility; DJSI, Dow Jones Sustainability Index; FP, financial performance; GC, global compact; GRI, global report initiative; R&D, Research and Development; ROA, return on assets; ROE, return on equity; TOBINQ, Tobin's *Q*; UCGG, unified code of good governance.

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focus on the common good for society in general and stakeholders in particular.

Shareholders, through the general assemblies, exercise their role in demanding ethical attitudes and behaviors at the corporate level, thereby exercising strong influence on the formulation of strategies by the board of directors. They require transparency, efficiency and efficacy on the part of managers, in order to obtain economic benefits and, thus ensure the continuity of the company over the long term, whilst demanding that socially responsible policies be integrated into the companies themselves (Pava and Krausz, 1996). From an academic point of view, there exists an increasing demand in developing business ethics – by integrating as research objective the detection of illicit businesses contrary to social rights (Byrne, 2011). Business ethics is by no means a recent development, a present-day trendy topic; studies demonstrate that conformation to ethical standards and principles has been an issue persisting through the ages and withstanding the test of time (Michalos, 2008).

Presently CSR and business ethics are intricately related from both an academic and practical perspective. We consider a variety of CSR definitions proposed in the literature and by several institutions that emphasize a voluntary involvement in the solution of certain social issues; social responsiveness is fundamentally multidimensional and embodies a large and varied range of corporate behavior in relation to its resources, processes and outputs (Waddock and Graves, 1997).

A majority of research to date on this theme has focused on the relationship between Corporate Social Responsibility (CSR) and Financial Performance (FP). Generally, these findings show this relationship to be positive, however there exists a lack of homogeneity in the results. The reasons are twofold: (1) the absence of a general method that serves as yardstick for comparative studies, and (2) there exists no rigorous method of measuring return on CSR (Gjølberg, 2009).

Our work strives to fill this existing gap in the literature; and with this aim we set two main objectives: First, to determine if Financial Performance depends on Corporate Social Responsibility, represented as a combined function of four distinct social variables: Global Reporting Initiative (GRI) participation, Dow Jones Sustainability Index (DJSI) firm inclusion, Good Corporate Governance (CG) recommendations compliance, and Global Compact (GC) signee. Second, to test the inverse relationship, social responsibility dependence on financial performance, using a CSR index, or Social Behaviour Index, that includes the previous four social variables as equal weighted components aggregated in a unique value. In both cases financial performance is represented by three financial variables or ratios, namely ROA (return on assets), ROE (return on equity) and Tobin's *Q*.

A further objective sets to reveal whether firms are interested in developing CSR from an economic standpoint, based on the fact that it represents an important engine of development and contributes toward improving social and environmental protection. As collateral benefit, investors and consumers can better evaluate companies that take into account CSR actions. The projection of an image of social responsibility, by helping to shape customers of the entity, affects the evaluation of the service received. In their role as social agents, companies are expected to meet commitments that go beyond strictly business matters.

Our study will be centered on Spain, a representative member of the group of developed countries, where such a study has yet to be carried out and where the increasing internationalization of the country's largest firms should clearly illustrate the importance of adopting far reaching corporate social policies.

In shedding light on the key interplay between CSR and its FP, we expect the results of our work to go a long way toward convincing corporate boards that social policies must form an integral part of overall company strategy. Taken from a stakeholders' perspective, the study should also be of value to all interest groups that lay claim, or stake, in a corporation's wellbeing. Finally, both corporations and society at large benefit from increased awareness in company social undertakings, reconciling at times different viewpoints as to whether corporate profits are adequately distributed amongst all stakeholders.

The paper is structured as follows: 'Theoretical framework' section deals with the theoretical framework, presenting the main administrative theories and concepts on which the study is based. We introduce CG, CSR and FP as the three key pillars sustaining our conceptual model. 'Proposed model and formulation of hypotheses' section establishes the two basic hypotheses that address the question as to whether CSR explains FP and vice versa. In 'Empirical study' section, we empirically test our hypotheses using the Social Behaviour Index for measuring CSR and the three financial ratios representing FP. The last section consists of the conclusion and suggests future lines of research.

Theoretical framework

Review of the main theories applicable to the study

The theoretical framework underlying this work includes a number of different theories. Their distinct approaches are all pertinent in some measure. We can distinguish, on the one hand, the set of theories applicable to the relation between CSR, FP, and CG – conforming the conceptual model of our study – and, on the other hand, stakeholder theory – the unique theory – that supports the relation between CSR and FP. The integration of these diverse constructs enriches the literature and strengthens the proposed generic model. Fig. 1 illustrates the theoretical framework used in the study.

Agency theory (Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983) establishes that the principal (shareholder) and the agent (manager) have opposing interests that may trigger conflicts which will interfere with the smooth running of the company. In contrast, stewardship theory offers an alternative view, which states that there exist ethical and professional motives that will override and prevent conflicts of interest from developing between the principal and agent (Muth and Donaldson, 1998). This latter theory assumes that managers are good resource managers (Donaldson, 1990; Donaldson and Davis, 1991, 1994) who will achieve good business track records thanks to their efforts (Davis et al., 1997); in addition, managers, as honest people (Donaldson and Preston, 1995), endeavor to not hinder the

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