



# Angulating Social and Environmental Reporting to Firms' Advantage: A Resource Based View Approach from Ethiopian Companies' Perspective

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## Authors' contributions

*This work was carried out in collaboration among all authors. All authors participated in designing and conducting the study as well as preparing the report. All authors read and approved the final manuscript.*

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## ABSTRACT

**Aims:** To evaluate the strategic role of social and environmental reporting in Ethiopian large tax payer companies based on the resource-based view of the firm.

**Study Design:** The study employed explanatory research design.

**Place and Duration of Study:** Large tax payer companies for the year 2018, Ethiopia.

**Methodology:** The study used annual audited financial reports of 262 companies and structured questionnaire which were distributed to three individuals per each sampled company. Interaction effect model was developed for which ordinary least square (OLS) regression with robust standard errors on a cross-sectional analysis were used to test the hypotheses.

**Results:** The regression result showed that social & environmental reporting and the interaction effect of social & environmental reporting with companies' environmental sensitivity had significant positive impact on reputability of companies.

**Conclusion:** The study concluded that through social and environmental reporting, companies can develop valuable resource which in turn increase their reputability. Hence, environmental sensitive companies have more operational negative effect to society and environment, they are considered as dangerous by the society. Heretofore, these companies can strategically shift this perception to companies' advantage through social and environmental reporting.

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**Originality/Value:** In the availability of limited studies which explore social and environmental reporting practice within developing country perspective, this study shed some light about the Ethiopian companies reporting practice. Furthermore, the results of this study were an indication for companies' managers to strategically use social and environmental reporting, which in turn increase their reputability and prevent them from being perceived as dangerous by the society.

*Keywords: Social and environmental reporting; environmental sensitivity; resource-based view; reputability.*

## 1. INTRODUCTION

Rising social inequalities and emergence of global environmental problems cast companies under intense pressure to take responsibility for their impact on societies and environment in which they operate [1]. Thus, the goal of doing business should not be limited with maximizing profitability, but also firms have to deal with the need and interest of both internal and external stakeholders [2]. On the other hand, stakeholders also require information on the impact of companies' actions on people and environment in addition to being interested in economic issues [3]. In this regard, there is a convincing taught which state that as corporations draw resources from society, they have an obligation to give back to them [3]. These have led companies to be committed for social and environmental activities and to disclose it for the public.

Since engaging in social and environmental reporting (SER) involve costs, there is a debate among scholars concerning the type and degree of responsibilities that companies have for stakeholders; the financial impact of this responsibility; and its strategic role for the company [4,5,6,7,8,9,10,11,12,13,14]. Accordingly, several studies have reported insignificant relationship between SER and corporate economic benefit [6,11] and could not clearly conclude whether investment in SER returns more or less than its cost [13,14]. Others also criticize SER activities in its evasive market advantage with resource commitment; then investments on it became a luxury [15,16]. On the other hand, there are also researchers who reported in support of SER [10,12]. They stated that through social and environmental reporting, organizations can improve their image, value and reputation; this in turn makes it center for corporate marketing and product differentiation.

The above equivocal relationship between social and environmental performance with economic performance of the firm might be as a result of inconsistent tracing of how the social and

environmental policies of companies influence their economic performance. As stated by [17] this relation is more complex than a simple calculus equating higher costs with lower profits. These inconclusive arguments pose a significant strategic dilemma for corporate management. Thus far, there is an increasing perception of the public on companies' responsibilities to society and environment. This type of responsibility is anticipated as an element of the social contract. The notion of social contracts considered as a resource in which an organization's survival will be threatened if society perceives that the organization has breached it [18]. As a result, consumers may refuse their demand for the organization's products and suppliers may eliminate the supply of labor and financial capital to the business. These makes social and environmental reporting as an option less contract. Since, companies cannot be imaginable without the society and environment, then any firm going beyond compliance to the social contract would forfeit its economic performance and sustainability.

Consequently, companies need to understand and plan the possibility of economic success by paying attention to social and environmental responsibility [19]; and consider it as a resource of organizations which can be manipulated through various disclosure-related strategies [20]. Along with this, it is believed that instead of binding companies in different mandatory reporting regulations, successful involvement of companies in social and environmental reporting can be achieved through creating awareness on the use of this resource. Thus, mandatory regulation might encourage counter-productive efforts such as the investment of resources in the research of loopholes and by-passes [21,22].

Although the social and environmental issues are common for all countries, but the importance of reporting it has been understood and practiced very recently around the world [23]. When it comes to developing countries like Ethiopia, such practice is by far more than infant. Moreover, Ethiopian economy is gears toward

industrialization with limited social and environmental policies. Such arena of industrialization must maintain the lifelong security of society and environment; however, this kind of economic development is not always followed by a high environmental sustainability [24]. In fact, the notion of social and environmental reporting is related to ethical and moral issues of corporate manager, it is difficult to believe that they will make decisions which will be unfavorable to the firm's economic performance. On top of this, there is no specific standard or regulatory requirement on disclosure or reporting of corporate environmental and social responsibility information in the country. Therefore, there is a need of evidence to justify social and environmental practice of companies as a wise investment or condemned as an agency problem. With this respect, our argument based on the resource-based view of the firm, highlights the strategic use of social and environmental reporting in Ethiopian large tax payer companies.

## 2. LITERATURE REVIEW

### 2.1 Theoretical Review and Hypotheses Development

The theoretical baseline of this study was resource-based-view (RBV) of the firm, which is a managerial framework used to determine the strategic resources a firm can exploit to achieve sustainable competitive advantage [25,26,27]. RBV postulates how acquisition and deployment of resources and capabilities enable firms to compete [25,28]. The internal competency developed by firms will provide an advantage that develop distinct capabilities and can leverage resources that are rare, valuable, inimitable/substitution-resistant, organizationally specific and heterogeneously distributed [25,28].

The RBV theory argued that firms generate sustainable competitive advantages by effectively controlling and manipulating their resources and capabilities. Resources includes assets that the firm uses to accomplish its practices and objectives [28,29]. Engaging in social and environmental practice can help firms to create some of these resources and capabilities [29]. Businesses operate in an environment where their activities exploit the societies and the environment resource. If management of a firm delinquently ignores the impact that firm's operation creates on the society and the environment, its reputation might

be ruined and the society might cast the business out of operation, which will threaten company's sustainability. But, if management of the firm thinks strategically, social and environmental accounting might mitigate the effect and even it can be converted into asset that the management can use.

Holding the expected negative impact of business operation at hand, firms environmental reporting can be used as a tool for promoting companies' communication, demonstrating their accountability regarding environmental issues, and providing useful information for decision-making. It refers to the systematic and holistic statements of environmental burden and environmental efforts in organizations' activities, such as environmental policies, objectives, programs and their outcomes, organizational structures and systems for the environmental activities, in accordance with the general environmental reporting principles [30]. If done well, social and environmental reporting can be viewed as a resource that will reassure the society that the firm is compensating the impact it has created with its operation and may even be viewed as a reputable firm. RBV theory is applied to corporate social and environmental responsibilities studies by previous researchers, such as [17,31,32,33]. According to which, firms could able to angulate their corporate social and environmental practice to their strategic use.

RBV can further be supported by legitimacy and stakeholder theories, which are considered as the most complete theoretical perspectives in explaining corporate motivations for social and environmental reporting [18,34,35]. Therefore, these two theories were employed to shade light in the framework of this research to compliment RBV theory.

When legitimacy and stakeholder theories are incorporated into the resource-based view of the firm, the focus of issues will be what is the final result of the firm for exerting its effort to satisfy the society as a whole as stated in legitimacy theory [18] or its stakeholder as stated in stakeholder theory [36]. These issues have to do with demonstrating the benefits to be gained from practicing social and environmental activities which can be measured by how reputable the firms have become.

Indeed, legitimacy consists of resources and control which an organization uses to achieve social support and these social supports can be

achieved through SER which is an influential tool of a company to communicate with society [37,38,39,40]. In this regard, legitimacy is important for every organization to manage its reputed position in the society. As stated by [18], legitimacy theory is closely aligned with stakeholder theory and these two theories are often used to complement each other. The stakeholder theory proposed that reputational payoffs to a firm of increased social responsiveness are contingent upon fitting socially responsive behavior to certain firm characteristics [41].

Prior investigation specified that even if SER is not directly linked to the characteristics of the product, given the beneficial effects on a firm's stakeholders and the society as a whole, it has become an action as well as supporting tool for organizations to reach its stakeholders. Which intern enhances overall performance and reputation [39,42]. When a firm is not perceived as legitimate, customers can refuse to purchase its products; shareholders might withdraw their financial support; media and social activist groups may engage in negative campaigns; and local communities may not grant permission to carry out activities there, so a company has to maintain its legitimacy in order to survive [43]. Based on the above stated theories, this study proposed the following hypothesis:

**H1:** Companies social and environmental reporting has significant effect on firms' reputability.

As noted above, RBV considers that social and environmental accounting enabled firms to create resources which leads to a sustained competitive advantage [28,31]. However, it is important to note that societies will not take their eyes off of industries that have high degree of impact, called environmentally sensitive firms. These firms are considered environmentally dangerous to the society and the environment, which puts them in the eye leash of the society. Management of a firm can use this to their advantage. Since, their industry has already caught the attention of its stakeholders, participating in social and environmental activity will help them develop the resource they require. Barney [44] reflected his argument by stating a resource that had significant valuable contribution in a particular industry might fail to have the same value in a different industry.

Along this line, previous studies [45,46,47] suggested that companies in environmentally

sensitive industries face stronger pressure to legitimize their actions than other low sensitive industries to manage the perception of stakeholders and maintain their reputability. Furthermore, from legitimacy theory perspective, the most common proxy used to test SER practice of companies is industrial sector sensitivity [48].

Thus, this study has proposed to observe the interaction effect of companies' environmental sensitivity with companies social and environmental reporting on their reputability by developing the following hypothesis.

**H2:** The interaction of companies' environmental sensitivity and companies' social and environmental reporting have significant effect on firms' reputability.

## 2.2 Empirical Review

From empirical perspective, several studies tried to evaluate the strategic use of SER in different standpoint. For Diyarbakir manufacturing companies, adoption of environmental accounting resulted competitive advantage and created value for the company [49]. In another study on European companies, social and environmental practice was analyzed by considering it as a marketing tool (i.e., measured by reputation and shareholder value creation) [50]. The findings showed that all social and environmental practices had a positive effect on shareholder value creation; however, none of the typologies of these practices undertaken had a relevant influence on corporate reputation of European companies.

In a similar study in UK, the result provided evidence in support of the link between reputation and social performance [41]. The relationship between shareholder value, stakeholder management, and social issue participation were also tested by [51]. The finding stated that building better relations with primary stakeholders lead to increased shareholder wealth by helping firms to develop intangible assets which can be a source of competitive advantage; while social issue participation was negatively associated with shareholder value. The study by [52] the effectiveness of social and environmental disclosure in gaining customer support which is proxied by revenue in Italian family and non-family firms. The finding revealed that positive effect of SER on customer support for family firms while negative for non-family companies. There were also studies which tried

to link social and environmental reporting with shareholders value creation as measured by profitability [6,9,12,53].

Over all, the above empirical findings stated that companies which reported or disclosed social and environmental practices obtained competitive advantage [49,52]; creates shareholders value [50,51]; and increased reputation [41]. However, there were also findings which reported negative relation of SER with shareholders value and customer support [51,52]. Although, social and environmental reporting of companies is not directly related to a specific feature of the organization's performance and may not have an immediate pay-off, most studies regarded as an instrument for building and maintaining corporate reputation; shareholders value; or competitive advantage [49,47,50,51,52]. However, some of the above studies were conducted by directly linking SER with profitability or revenue [6,9,12,53].

From the above discussion, it can be noted that the empirical findings revealed mixed result and their base was more on developed countries. This mixed result was primarily due to the difference in tracing companies' benefit derived from SER. More importantly, the proxies used to gauge the advantage of companies from SER was inconsistent. Some of them used only self-reported data (i.e., revenue and profitability), and failed to observe companies' economic performance other than profitability indicators. Since the relationship of SER and profitability could not easily observable or less useful mainly in short run, the studies revealed discordant results [50].

Therefore, the current study aimed to contribute to the existing literature and fill the identified gap, by enhancing the SER beyond the simple communication tool with the adoption of resource-based view [28]. The RBV assumes that strategic use of resources in maintaining social contract and managed it simultaneously in order to create value in a holistic perspective. Along with this, the advantage of companies from SER was proxied by reputability of the firm.

### **3. METHODOLOGY**

#### **3.1 Sample Procedures and Data Collection**

The population of this study was companies in Ethiopia classified under large tax payers. Companies, categorized as large tax payers are

usually subjected to a set of standards requiring both type and quality of the information that they have to disclose for stakeholders. According to the records held by Ethiopian Revenue and Custom Authority (ERCA), there were 1050 companies categorized under large tax payer. Based on the formula of Yamane [54] and random sampling 290 companies were selected as a sample. However, only 262 complete and valid data were obtained at a response rate of 90.3%. The data was obtained through structured questionnaire and annual audited financial report of companies.

The questionnaire was designed, tested and refined in the Ethiopian companies' context and it was distributed to three individuals (i.e. one financial manager or senior accountant, one employee and one external stakeholder) per each sampled company and the response received from each firm were averaged across criteria and respondents to produce a single proxy value for each company. External stakeholders were randomly selected out of customers or the surrounding community of the company for the purpose of fair evaluation of the companies' reputability. Before dispatching the questionnaires to respondents, they were briefed about the scope, purpose of the questionnaire and its sponsor for better understanding and providing reliable data. Moreover, before commencement of collecting the required data both permissions to collect any data pertaining to the company and clearance for ethical issues were granted by companies' manager; on the other side, anonymity of respondents and confidentiality of the response/information given by respondents about each company were kept closed.

#### **3.2 Variables and Measurement**

##### **3.2.1 Dependent variable**

Reputation can be understood as an essential intangible element in the creation of competitive advantages for companies and increase shareholders value especially from the perspective of strategic models based on resources and capabilities; and environment models as well [33]. There are organizations that rank firm's reputability across the world like Fortune, Global CSR Rep Trak 100, and etc. However, in Ethiopia there are no such organizations that can produce reputability index for the firms. Therefore, to measure firms' reputability, this study utilized the methodologies

used by the ranking companies [55,56,57] and evaluates the companies' reputability as per the criteria.

Three participants per each company were asked to rate the company by nine criteria: quality of management; financial soundness; ability to attract, develop and retain top talent; quality of products/services; value as a long-term investment; capacity to innovate; quality of marketing; community and environmental responsibility of corporate assets with a five bound Likert scale. The assessments received from each firm were averaged across criteria and respondents to produce a single reputational score.

### 3.2.2 Independent variables

The study considered two explanatory variables that were expected to influence companies' reputability i.e. social and environmental reporting; company's environmental sensitivity. Both variables are dummy. For SER, score 1 was given for companies reporting social and environmental practice and 0 for not reporting companies. For environmental sensitivity, 1 was assigned to companies considered sensitive and 0 for non-sensitive companies. To determine the industry sensitivity of the selected companies, the nature of their activities was considered. Companies were classified as environmentally sensitive because they pose a greater risk to the environment by the nature of their activities like manufacturing, oil and gas, paper convertor and beverage industries. The non-sensitive companies include banks and insurance firms.

### 3.2.3 Control variables

Husted and Allen [58] recommended firm size to be used as control variable in doing corporate social responsibility related researches. In addition, firm size can influence company's reputability [51,59]. Therefore, this study employed firm size as a control variable which was measured by natural logarithm of total asset. The other control variable employed was financial performance which is measured by return on asset. Earlier researches indicated that when firm financial performance improved, managerial groups are motivated to disclose their social and environmental practice in order to show off good reputation [60,61].

## 3.3 Model Specification and Analysis Technique

Explanatory research design was employed. In addition, to test the proposed hypotheses, the following interaction effect model was developed. By using the developed model, ordinary least square (OLS) regression with robust standard errors on a cross-sectional analysis were used to test the hypotheses.

$$Reputation_i = \beta_0 + \beta_1 (SER_i) + \beta_2 (ES_i) + \beta_3 (SER_i * ES_i) + \beta_4 (SIZE_i) + \beta_5 (PROF_i) + \epsilon_i$$

Where:

$\beta_0$  = Intercept

$\beta_1 - \beta_7$  = Coefficients parameters

$SER_i$  = Social and environmental reporting of Company i

$ES_i$  = Environmental sensitivity of Company i

$SER_i * ES_i$  = Interaction of SER with ES of Company i

$SIZE_i$  = Size of Company i

$PROF_i$  = Profitability of Company i

$\epsilon_i$  = Error term where i is cross sectional

## 4. RESULTS AND DISCUSSION

### 4.1 Descriptive Statistics

Table 1 depicted that out of the total sample, 70.99% of companies reported their social and environmental practice, whereas 63.74% of companies were environmentally sensitive. The mean value of reputation, profitability and size were 4.02, 0.06 and 6.16 respectively.

### 4.2 Correlation

Correlation analysis was carried out to determine whether the level of reputability is associated with other companies' characteristics and ascertain the independent variables were not highly correlated with each other. As shown in Table 2, multicollinearity was not an issue given that the extent of correlation among the independent variables is below the recommended threshold of 0.8 [62]. The relation of environmental sensitivity with reputation was negative whereas, social and environmental reporting, profitability, and size were positively related with reputability.

**Table 1. Descriptive statistics**

	Reputation	PROF	Size	Dummy variables	
				SER	ES
Mean	4.019580	0.063154	6.155192	-	-
Median	4.000000	0.027012	6.495303	-	-
Maximum	4.780000	0.290129	9.953997	-	-
Minimum	3.330000	-0.027648	1.500000	-	-
Std. Dev.	0.415821	0.074898	2.327732	-	-
Frequency for score=1	-	-	-	186	167
Percentage	-	-	-	70.99	63.74
Observations	262	262	262	262	262

**Table 2. Pearson correlation matrix**

	Reputation	ES	SER	PROF	Size
Reputation	1				
ES	-0.209	1			
SER	0.2069	0.53	1		
PROF	0.1773	0.17	0.29	1	
Size	0.9212	0.16	0.54	-0.14	1

**Table 3. Robust OLS Regression result**

Reputation	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
ES	-0.00015	0.020696	-0.01	0.994	-0.04091	0.040606
SER	0.10764	0.028755	3.74	0.000	0.051013	0.164266
PROF	0.492199	0.122654	4.01	0.000	0.250659	0.733739
SIZE	0.159839	0.004172	38.31	0.000	0.151622	0.168055
SER*ES 1 1	0.115433	0.048576	2.38	0.018	0.019774	0.211093
_cons	2.919526	0.038708	75.42	0.000	2.8433	2.995752

**4.3 Regression Analysis**

Before running the regression models, Shapiro-Wilk W test was employed for testing normality. The result revealed p-value of .000 for the three variables: namely reputation, profitability and size, which indicated that the disturbances are normally distributed. However, since environmental sensitivity and social and environmental reporting are dummy variable, normality is not expected. Furthermore, assuming the data was cross-sectional, it was expected to have Heteroskedasticity problem then to mitigate the problem robust regression was used.

Result from the regression analysis are shown in Table 3 above. The R-squared value was 0.8708, which indicated that the explanatory variables explained 87.08% of the variations in reputability of companies with p-value of .000.

The regression result showed that social and environmental reporting had significant positive impact on reputability of companies which

suggested that companies which report their social and environmental practice were more reputable than companies whose activities were not reported. This finding is in line with RBV theory because it indicated that firms that engaged in social and environmental reporting, created intangible resource namely: reputability which in turn makes them advantageous over their competitors. Therefore, the decision to report social and environmental reporting was perceived as a sign of better company which makes this result in line with previous findings by [39,42,49,63].

The interaction effect of social and environmental reporting with companies' environmental sensitivity had significant positive effect on reputability of the firm as expected. This indicates that when environmental sensitive companies reported their social and environmental practice, then it can positively affect their reputability. Thus, being more transparent by legitimizing their practices could inflict an honorable reward from stakeholders. These results were in accordance with the

finding obtained previously, such as [45,47,64,65,66].

Environmental sensitivity had negative but insignificant effect on reputability of the firm. The negative relation was as expected but its insignificance was not expected given that sensitive industries had high pressure to legitimize their action, whereas failing to do so can be a source of reputational risk [43].

## 5. CONCLUSION

Ethiopia has embarked on a massive industrialization program as a part of vision to become a middle-income country by 2025. With this vision, company's accountability to the society and environment in the absence of any mandatory framework is in question. However, if there exist an evidence of the strategic use of SER, then firms will try to successfully report to their advantage whether there exist any mandatory or voluntary framework. Accordingly, this study employed a theoretical framework of Resource-Based View in combination with stakeholder and legitimacy theory as compliment theories to empirically test this proposition by developing two hypotheses.

The results of the first hypothesis revealed that SER had positive and significant impact on reputability. Besides, the second hypothesis, which was proposed to test the interaction effect of SER with environmental sensitivity on reputability, resulted positive significant effect. This indicates, environmental sensitive companies could exploit the fruit of reporting their social and environmental practice, as a result they will develop and maintain their reputability. These results were in support of Resource Based View. In a sense, it could be said that the same policies that internalize negative environmental spillovers can pay back through social and environmental reporting in generating greater positive organizational spillovers that accrue internally and privately to the firm. From this point of view, the philosophy of companies' managers should incorporate SER as a way to mitigate their operation effect to the society and environment. Furthermore, the results indicated that SER can be converted into asset that the management can use strategically in promoting companies' communication, demonstrating their accountability regarding environmental issues and providing useful information for decision-making.

More specifically, managers should consider increment of commitments in social and environmental reporting in the way of differentiating themselves from their competitors, so that competitors will be unable to imitate them. However, this does not mean that managers should concern too heavily on praising their company for being socially and environmentally responsible or defending their unsustainable action. Instead, things must be presented neutrally as they really are, describing what the company has done and readily admitting when the company has failed to act sustainably. Because, being open for unfavorable event is considered by stakeholders as a sign of taking sustainability seriously. Through this situation, companies can obtain competitive advantages in which different stakeholders, especially customers can be able to identify them. Therefore, companies' managers should design and establish holistic environmental information system which allows communication among all company's operation process, systematically provides social and environmental information and ensures periodic reporting for all stakeholders.

One keystone issue evidenced from this research was SER as one of the basics to develop reputability of Ethiopian companies who are within voluntary framework. Thus, for this conceptual reason, the finding of the study is believed to be potential for affecting managements ideology towards reporting their social and environmental practices more successfully and they should design their corporate strategy accordingly.

Finally, for conducting this research SER was considered as dummy variable but it would be better to conduct content analysis of SER. The impact of such reporting might vary substantially with its extent and quality. Furthermore, since this study was conducted in the absence of reputability indexes, the measurement of reputability and the way it was employed should not be regarded as decisive enough. From our perspective, future studies should extend the way and the measurement of reputability in more convenience way.

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## COMPETING INTERESTS

Authors have declared that no competing interests exist.

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