Corporate Social Responsibility and Earnings Persistence

Subjects: Business, Finance

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Society has gradually realized that companies' actions have consequences. Companies can fulfill their accountability to society by disclosing information beyond their financial data, providing better decision making for stakeholders.

corporate social responsibility | persistence of earnings | sustainability reporting | voluntary disclosure

1. Introduction

Countries worldwide are reinforcing regulations to encourage firms to establish biocompatible technologies in response to the worsening environmental conditions of the world [1]. Policies, such as taxes on environmental damage, can be adopted for this purpose. These policies can target economic enterprises that operate as the primary sectors of the market and account for the major portion of pollution emissions [2].

Hart [3] believed businesses operate in a world with increasingly narrowing resources, meaning their competitive advantage will lie in activities which revitalize the environment. Biocompatible activities can thus be considered job opportunities that will determine firms' future visions for growth [4]. Environmental investments can protect firms against future auditing costs and reduce business uncertainty [5]. Firms that fulfill their environmental duties may take advantage of the payoffs in the long run, despite the costs they may have to endure over the short term [6].

Regarding creating value, ref. [7] inferred that reducing environmental risks increases productivity. Flack and Heblich [8] found that environmental responsibility could enhance employee efficiency, reduce a business unit's operational costs, and improve a firm's reputation.

In other words, firms can improve their reputation through activities associated with social responsibility. Meanwhile, stakeholders can play a prominent role in improving a firm's reputation by holding it to the social responsibility standard [9]. Such firms seek to avert incidents with negative impacts, disclose information, and hold themselves accountable to neutralize any negative consequences [10]. Firms that operate more transparently regarding the operations that are associated with the community and environment are found to be more financially stable and to suffer fewer fluctuations [11]. Moreover, the quality of earnings in these firms is more desirable than that of others [12].

The persistence of earnings is an index of earnings quality. An earning is considered persistent when it helps stakeholders assess the stability of businesses and predict their future performance [13]. Penman and Zhang [14] and Richardson et al. [15] believed that participants in the stock market use earnings persistence to evaluate stock values, since earnings hold important information for a firm's performance assessment. The persistence of companies in creating profit is an essential aspect of performance assessment. Park and Shin [16] argued that an earning is persistent as long as it is stable, permanent, and recurrent.

In this regard, ref. [17] suggested that firms adhering to social responsibility are less involved in earnings management activities and will perform more transparently. Therefore, according to the stakeholder theory, more accurate financial reports are expected to result in high-quality earnings. Prior et al. [18] believed that managers may want to divert the attention of stakeholders from their opportunistic operations by taking measures associated with social responsibility. Relying on the agent theory, the assumption is raised that managers have different incentives from shareholders and seek to maximize their advantage over the short term. Čajka et al. (2023) believed that having an executive director from outside the company could be very beneficial for companies [19]. A manager needs to possess specific management skills and be invested in the company's prosperity [20]. Managers are responsible for achieving organizational objectives through versatile prowess and managerial knowledge, coupled with excellent decision-making skills [21]. Capable managers who make the right decisions can ultimately improve the value of a firm [22].

Relevant studies indicate that the relationship between CSR and earnings quality can be positive or negative. Firms send a specific signal to their stakeholders when they prove committed to CSR activities [23]. There is a chance of firms using CSR activities to manipulate their stakeholders with the excuse of responding to their demands. Earnings quality thus appears vital to gain the trust of stakeholders and, consequently, meeting the demands of shareholders and creditors [24].

Furthermore, the signaling theory indicates to what extent firms send the necessary signals regarding their private information to financial statement users [25]. The persistence of earnings is a signal explaining earnings stability in the future. This index helps creditors and investors use earnings information as a consideration in their economic decisions. Turning to environmental responsibilities, the signaling theory explains that firms seek to send a signal regarding their quality of information [26][27]. This could signal high information quality [28] or persistence [29].

Meanwhile, information risk declines with information transparency. As a result, firms operating actively in terms of their environmental responsibilities pay more attention to the stakeholders, and they are seen as more trustworthy from the investors' and stakeholders' viewpoints, and can access financing institutions more easily [8]. Therefore, the theories mentioned above indicate that the more a firm is committed to its social responsibilities, the more it will gain the investors' trust [30]. Since CSR will increase and improve the reputation of companies [31][32], it can be said that it will improve the financial performance of companies [33][34][35][36]. Also, it will allow foreign lenders to give the necessary support to companies so that they can invest in new and green technologies [37][38]. Finally, the operational and financial performance of the company should be improved.

2. Corporate Social Responsibility and Earnings Persistence

The disclosure of financial and non-financial information about a company's impact on the environment and society is known as CSR reporting. Carroll [39] argues that CSR encompasses a society's economic, ethical, legal, and political expectations. In addition, paying attention to the legal system of countries can be very important [40]. It should be noted that an analysis of the behavioral standards of investors from the perspective of a reference to regulatory laws (such as regulatory independence, the political environment, and the flexibility to introduce new regulations) or a reference to social investment issues (such as human rights, labor, health, social responsibility, and poverty reduction) also plays a significant role [41]. Specifically, CSR reports on the economic, social, and environmental concerns affecting business are collected and published annually in corporate annual reports [42].

Stakeholder theory suggests that CSR facilitates effective stakeholder management and enables companies to create, develop, and maintain relationships with critical resources. Companies with superior CSR engage in more stakeholder communication [42].

Signaling theory suggests that stakeholders rely on information to make decisions that serve their best interests [43]. A company's competent CSR disclosure conveys a more positive image to the public than a company's insignificant CSR disclosure [44][45]. Refs. [46][47] have shown that CSR disclosure can help reduce corporate risk. Building strong relationships with consumers and suppliers, and developing a reputation for high-quality products and services enables businesses to share socially responsible information. Furthermore, attention to environmental and social changes can help organizations to increase their performance, reduce the chances of earnings mismanagement, and thus maintain the stability of high-quality financial statements while increasing earnings persistence [42].

The role of business units in the community has recently undergone immense changes, to the point that business units are expected to increase their earnings and hold themselves accountable to their community [48]. A mutual relationship has thus emerged between the business unit and the community [49]. Firm responsibility can benefit the business unit itself and the community it resides in. A better understanding of its potential advantages can lead to superior investment returns for a firm [49].

Empirically, ref. [50] found that customers expect business units to observe a code of ethics in their administration. The authors of [51] also demonstrated that customers prefer to purchase from firms that are more aware of their social responsibility. Among the other advantages of firm that are socially responsible, one could point to the increased capacity to recruit new and retain experienced staff. Some of these employees help develop and operate communication systems, while others are responsible for supporting and improving the communication system or work in the area of data protection [52]. As they progress toward full social responsibility, firms realize that it is easier to recruit new forces and retain experienced staff for a sufficient time period to ensure the business unit's success [53]. Government support is among the other advantages of being socially responsible, as altruistic businesses are more committed to social responsibility and are subject to fewer lawsuits from regulators, be it tax auditors, the government [49], or customers (company representatives, external auditors, competitors, and investors) [54].

Investors rely more on earnings information than other performance indices [55] (e.g., cash flows, cash earnings, and earnings changes). Reported earnings are one of the determining criteria for investors' expected returns [56]. The presentation of information must be made in a manner that enables the assessment of past performance so that the presented earnings can help users to evaluate a firm's performance and profitability, and enable investors to estimate their expected returns based on this information [57][58]. Aside from the fact that the reported earnings figure is important for investors and influences their decisions, the qualitative features of earnings can be of significance to the investors as one of the aspects of earnings information [59]. The persistence of earnings is among the qualitative features of accounting profits based on accounting information [60]. The persistence of earnings is an index which helps financial statement users and investors to assess a firm's cash flows and future earnings, and refers to the persistence and recurrence of current earnings [42]. The higher the persistence of earnings, the more capable a firm will be at maintaining its current earnings. Assuming that the market influences CSR information, one could expect stock price changes to be associated with more unexpected profits for firms with higher degrees of social responsibility [61].

According to [62], the persistence of earnings is a crucial scale for the long-term performance of firms that report earnings information. The persistence of earnings is known as a suitable scale for firm performance. Fulfilling CSR helps to improve production technology, increase employee productivity, and establish a significantly higher operational efficiency in a firm [63]. The benefits of CSR include reputation enhancement, shareholder wealth improvement, better risk management, the improvement of market demand from customers, an increase in disclosure and reporting transparency, and an overall ability to access financial markets with better conditions [64].

Furthermore, adopting corporate social responsibility (CSR) initiatives can enhance internal communication and address human resource challenges, ultimately leading to economic efficiency [65]. To implement CSR, companies need to change the existing production mode and encourage the adoption of more environmentally friendly technologies. Using new and green technologies improves a system's and a company's overall productivity [66].

In addition, higher operational efficiency is a source of competitive advantage that will ultimately influence a firm's performance. Corporate social responsibility is specifically dependent on higher-level duties that require changes to the current state of production, and incentives for firms to adopt biocompatible technologies [67]. Moreover, CSR can help establish a more active interaction between a firm and its employees, contributing to labor force productivity [68]. From a supply chain perspective, firms take on environmental responsibilities based on the needs of their stakeholders, such as customers, suppliers, and rivals, seeking to improve their reputation and attract consumers [69].

Empirical research has attempted to establish and explain the relationship between CSR and corporate financial performance. However, the results have been contradictory [70][71][72].

Therefore, companies are trying to use new and clean technologies in order to grow and improve their performance. As stated, CSR will raise the reputation of companies. This will allow companies to benefit from external support, such as from financial institutions and low-cost loans, in order to increase the financing capacity of companies' debt, reputation, and transparency of information [73]. In other words, CSR allows companies to secure more debt financing, which can help mitigate operational uncertainty, reduce earnings volatility due to market changes, and enhance earnings persistence [2].

CSR helps polluting firms take advantage of external aid, such as low-interest loans and from financial institutions, to enhance their cost financing capacity, improve their reputation, and increase transparency [74]. In other words, CSR allows economic enterprises to gain better financial support for their liabilities, helping them fight operational uncertainty. Such firms can thus reduce the revenue uncertainty in the market resulting from fluctuations in the credit market and improve their persistence of income. Corporate social responsibility enables firms to take advantage of sustainable competitive advantages, such as improved relations between firms and creditors, to reduce default debt risk [2].

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