

# Sustainability Reporting in Slovenia: Does Sustainability Reporting Impact Financial Performance?

Anja Ermenc, Monika Klemenčič, and Adriana Rejc Buhovac

## 1 Introduction

Corporate strategies and business operations have changed significantly in the last decades. This is the result of growing risks from more sources and with greater impacts: climate change, potentially dangerous products, interrupted and unsafe supply, and consumer and community reactions. The rapid development of international communication and companies achieving more global reach, using new technologies, applying financial instruments, and operating with global networks have further strengthened managers' need to make sustainable choices and avoid risks (Epstein and Rejc Buhovac 2015). Profit maximization, once the most important corporate goal, has given way to corporate sustainability which includes environmental protection, social progress, and economic growth. Corporate sustainability also includes improved management of corporate social, environmental, and economic impacts and improved stakeholder engagement (Epstein and Rejc Buhovac 2015), and this creates a strong link to corporate financial performance. Managers, however, need to understand the likely reactions of the corporation's various stakeholders to sustainability performance (environmental, social, and economic), and their impact on financial performance, to make the right choices. The sustainability business case and the payoffs must be clear. Corporate sustainability can thus be one of the elements contributing to successful operational and strategic management, without having a negative impact on business profits (Mulligan 1986).

---

A. Ermenc • M. Klemenčič • A. Rejc Buhovac (✉)  
Faculty of Economics, Academic Unit for Management and Organization, University of Ljubljana, Ljubljana, Slovenia  
e-mail: [adriana.rejc.buhovac@ef.uni-lj.si](mailto:adriana.rejc.buhovac@ef.uni-lj.si)

However, there are still many questions about the link between corporate sustainability and financial performance which require answers. How much should a company's management invest in corporate sustainability? Will the investment in corporate sustainability result in financial benefits for the company? If so, when and how strong might the impacts be? Researchers addressing these issues can be grouped depending on the nature of the discovered link between corporate sustainability and financial performance. There are three groups of empirical findings: the positive link group (e.g. Waddock and Graves 1997; Preston and O'Bannon 1997; Sun 2012; Tsoutsoura 2004; Van der Laan et al. 2008), the negative link group (e.g. Shane and Spicer 1983; Poelloe 2010), and the no link at all group (e.g. Freedman and Jaggi 1988; McWilliams and Siegel 2000; Mahoney and Roberts 2007; Fauzi 2009). The predominant reason for divergent conclusions on the relationship between corporate sustainability and financial performance is the different research techniques and methodologies used, especially in the measurement of variables and performance indicators (Griffin and Mahon 1997).

The objective of this study is to investigate the link between corporate sustainability reporting (SR) and financial performance in a Central and Eastern European (CEE) country where corporate SR is used as a proxy for sustainability. By voluntarily reporting on corporate sustainability, firms try to minimize political/social costs which they might incur in the absence of evidence of socially acceptable behavior. The objectives of SR are thus to benefit from long-term relations with different stakeholders, minimize risks of burdensome environmental and labor regulation, enhance company reputation, etc. This study contributes to the sparse body of literature on this topic, as it represents one of the few studies of this topic performed to date in CEE. We use a regression analysis and a sample of 80 Slovenian companies.

Our results indicate that there is a correlation between corporate SR and subsequent financial performance. We have also discovered that financial performance is not influential in making investment decisions in corporate sustainability, while size, industry, and quotation on stock exchange do influence these decisions.

The remainder of this study is structured as follows: In the first chapter, we provide a literature review and develop hypotheses. The second chapter explains the methodology with details on research method, sample, and variable measurement. The third chapter presents findings and provides discussion, while the fourth concludes with implications for academia and managers.

## 2 Literature Review and Hypotheses

Studies into the relationship between corporate sustainability and financial performance performed up to date are inconclusive. Griffin and Mahon (1997) reviewed 51 studies from the 1970s to the 1990s and found a positive link in 65% of the studies. Margolis and Walsh (2003) analyzed 127 studies in the period from 1972 to

2002. They found a positive link in 55% of the studies. The main reason is the different methodologies used including different measurements of corporate sustainability and financial performance, different control variables selected, and periods studied (McWilliams and Siegel 2000). Corporate sustainability can be measured internally through in-depth questionnaires or interviews or externally through independent rating agencies. Sometimes corporate sustainability is measured through disclosure in annual reports. Financial performance is mainly measured based on accounting or market measures.

One of the most “confirming” studies is the meta-analysis of 52 qualitative researches on the link between corporate sustainability and financial performance performed by Orlitzky et al. (2003). The study investigated a population of 33,878 corporations and found a positive link between corporate sustainability and financial performance. The authors also conclude that the link between corporate sustainability and financial performance is not one sided, but simultaneous. The Waddock and Graves study (1997) included 469 corporations from Standard & Poor’s 500 Index in the period 1989–1991. The data on corporate sustainability was taken from the Kinder, Lydenberg & Domini Research & Analytics Inc. database, while financial performance was measured based on the profitability ratio’s return on assets (hereinafter: ROA), return on equity, and return on sales. Control variables (size, risk, and industry) were also considered. Waddock and Graves conclude, too, that there is a simultaneous and interactive cycle between corporate sustainability and financial performance, and that is hard to determine what comes first.

Studies into the link between corporate sustainability and financial performance in the ion similarly result in divergent findings. Vizetič (2011), for example, investigated a sample of Croatian companies in the period 1993–2010. She concludes that corporations that are more socially responsible have a better reputation and, consequently, better financial results. At the same time, she concluded that better financial performance enables better resource allocation toward sustainability. Vintila and Duca (2013) explored whether profitability and company size influence levels of corporate sustainability and found a positive link for a sample of Romanian companies. Zaborek (2014) explored the corporate sustainability and financial performance link for Polish small- and medium-sized manufacturers. Empirical findings show mixed results, the existence of a weak positive correlation based on sales profit margin and no correlation based on ROA. Gurviš et al. (2015) investigated the link between corporate SR and the corporate financial performance of Czech and Estonian listed companies and found that there is no direct linkage while testing ROA and market returns. Dagilienė (2013) concluded that corporate SR has no influence on the value of Lithuanian listed companies (accounting and market based), mainly due to the additional costs that it incurs.

Based on the CEE literature review, no final conclusion can be drawn on the causality between corporate sustainability and financial performance. To better understand the sustainability-financial performance link, a set of hypotheses for the link between corporate sustainability and financial performance in Slovenia was developed following Waddock and Graves (1997). Waddock and Graves (1997)

found a positive link between corporate sustainability and subsequent financial performance which is in accordance with the stakeholder theory (Freeman 1984) and the good management theory (Waddock and Graves 1997). Both theories are based on the assumption that a corporation first has to be socially responsible; this will, in turn, lead to favorable stakeholder reactions which will make it easier to achieve better financial performance. This was also discovered by McGuire et al. (1988), Preston and O'Bannon (1997), Tsoutsoura (2004), Mahoney and Roberts (2007), and Van der Laan et al. (2008). As a result, the following hypotheses were developed:

- Hypothesis 1: Better corporate sustainability leads to better average financial performance in the first 3 years after measuring corporate sustainability.
- Hypothesis 1a: Better corporate sustainability leads to better financial performance in the first year after measuring corporate sustainability.
- Hypothesis 1b: Better corporate sustainability leads to better financial performance in the second year after measuring corporate sustainability.
- Hypothesis 1c: Better corporate sustainability leads to better financial performance in the third year after measuring corporate sustainability.

Waddock and Graves (1997) similarly came to the conclusion that a positive link exists between financial performance and subsequent sustainability performance. This is based on the slack resource theory which states that a corporation with better financial performance has more funds available to invest in corporate sustainability. Slack resource theory thus states that a corporation has to be financially successful first to have resources available to invest in sustainability. This theory was also confirmed by Stanwick and Stanwick (1998) who conclude that the level of corporate sustainability depends on company size, corporate profitability, and the industry it operates in. Therefore, we hypothesize:

- Hypothesis 2: Better average historical financial performance leads to better corporate sustainability.

Most of the researchers (McGuire et al. 1988; Mahoney and Roberts 2007; Van der Laan et al. 2008) come to the conclusion that the link between corporate sustainability and financial performance is not direct, but is influenced by other variables. Waddock and Graves (1997) controlled for size, risk (as an indicator for indebtedness), and industry, which were also used in this research. Additional variables were considered, as half the corporations used in this study were not listed on the stock exchange. We therefore also hypothesize:

- Hypothesis 2a: Larger corporations achieve better corporate sustainability.
- Hypothesis 2b: Less indebted corporations achieve better corporate sustainability.
- Hypothesis 2c: Corporations from manufacturing industry achieve better corporate sustainability.
- Hypothesis 2d: Corporations that are traded on the stock exchange achieve better corporate sustainability.

### 3 Research Methodology

The goal of this study is to establish the link between corporate sustainability and financial performance, where size, indebtedness, industry, and stock-exchange listing are taken as control variables.

#### 3.1 Sample

The sample includes 80 nonfinancial Slovenian companies. Half of the companies were quoted on the Ljubljana stock exchange in 2011. Financial data was gathered for the period from 2007 to 2014. When researching the mutual relationship between two variables, a time lapse is important as the relationship is not direct (Fauzi 2009). Consolidated financial data was gathered from the GVIN database. The sample decreased to 79 companies, as the data was not available for one company.

For 44 companies, annual reports with sustainability data were available for 2011, the year when the content analysis of sustainability data was performed. For the remaining 36 companies, corporate sustainability was assessed based on annual reports from 2010 (Klemenčič 2012).

#### 3.2 Measuring Corporate Sustainability

Due to the fact that there is no database from which we would be able to obtain corporate sustainability ratings for Slovenian companies, corporate sustainability was measured by the disclosure of sustainability information in corporate annual reports. Measuring sustainability through annual reports disclosure can be a good indication of corporate sustainability performance, as this is typically the key channel through which companies communicate with their stakeholders. The problem with this kind of sustainability measurement is that disclosure in annual reports can be skewed, influenced by hidden motivational factors. Indeed, SR might be a fine marketing and public relations strategy with the ultimate end of improving profitability or deflecting attention from problematic issues to less exposed areas of social responsibility. In general, however, Abbott and Monsen (1979) conclude that disclosures in annual reports can be suitable for measuring corporate sustainability.

The database on corporate sustainability was obtained from Klemenčič (2012), who used the content analysis methodology developed by Slapničar (2004) to analyze corporate annual reports. Corporate sustainability was measured by an index comprising three key sustainability areas—environmental management, relationship with the local communities, and relationship with employees, suppliers,

and buyers—as well as by the availability of annual report. The index was based on the quality of disclosures in annual reports.

### ***3.3 Measuring Financial Performance***

In the past, researchers used different measures of financial performance. By the year 1997 approximately 70% of financial performance measures were used only once, making it difficult to confirm the validity and reliability of indicators (Griffin and Mahon 1997). Accounting measures should be better indicators of financial performance than market measures, as market measures mostly measure short-term influence on above average returns. Accounting data reflects decision-making capability and performance within the company (Orlitzky et al. 2003). For this reason, financial performance was measured using the accounting profitability ratio ROA, which was one of the indicators most widely used in more recent studies. In theory, the ROA indicator reflects the capability of the company to turn assets into profit, showing how successful the company is in using its assets to generate profit.

### ***3.4 Control Variables***

Based on previous research findings, the relationship between corporate sustainability and financial performance is not direct, but is influenced by other factors. The smaller the company, the smaller the amount it invests in sustainability. When a company grows and expands, it becomes more visible and more stakeholders apply pressure on the company to operate in accordance with their expectations (Waddock and Graves 1997). From the disclosure point of view, the larger the company, the more it is subject to regulation. In this study, company size is measured using a logarithm of total assets.

If the company is largely in debt, investments in sustainability can be negatively perceived by stakeholders. It is assumed that larger the indebtedness of company, the less management will invest in sustainability. Indebtedness can be also an indicator of how risky the company is and it reflects management's risk tolerance, as investment in sustainability is connected to certain costs (Waddock and Graves 1997). From this perspective, indebtedness can be an indicator to potential investors of how risky the company is in relation to its future cash flow fluctuations. Also, satisfied stakeholders decrease risk in future cash flow fluctuations (Orlitzky and Benjamin 2001). The second control variable is thus the indebtedness indicator measured as the ratio between financial and operating liabilities and total liabilities.

The industry impacts on the level of corporate sustainability investments (Waddock and Graves 1997). Different industries are characterized by different externalities, different levels of investments in research and development, and different regulation. Also financial ratios differ across industries. In our research,

industry is used as a control variable. In the regression model, value of 0 was used for the manufacturing industries and 1 for nonmanufacturing industries.

Corporate sustainability disclosure is influenced by stock exchange listing. Companies that are quoted on a stock exchange have a public company status and have to pay attention to a larger stakeholder group in comparison to companies that are not public (Slapničar 2004). As this is a dichotomous variable, in the regression model, a value of 0 was used for the companies that are traded on the stock exchange and a value of 1 for the companies that are not traded on the stock exchange.

The subsequent regression analysis used includes the following control variables: size, indebtedness, industry, and stock exchange quotation (compare to Waddock and Graves 1997; Slapničar 2004).

### 3.5 Regression Model

A multiple linear regression model was used to investigate the link between corporate sustainability and financial performance. The regression was performed with SPSS.

The first set of hypotheses tested the link between corporate sustainability and subsequent financial performance. A multiple linear regression model was used (see Eq. 1), where financial performance is measured 1 year (hereinafter:  $t0+1$ ), 2 years (hereinafter:  $t0+2$ ), and 3 years (hereinafter:  $t0+3$ ), respectively, after measuring corporate sustainability and as average of 3 years after measuring corporate sustainability (hereinafter: *av. t0+3*). All control variables are measured in the same time as corporate sustainability, as they explain the influence of corporate sustainability measured in 2011 or 2010 on future financial performance (Waddock and Graves 1997; Mahoney and Roberts 2007; Van der Laan et al. 2008; Fauzi 2009).

$$FP_{t0+x} = \alpha + \beta_1 CS_{t0} + \beta_2 SIZE_{t0} + \beta_3 INDEBTEDNESS_{t0} + \beta_4 INDUSTRY_{t0} + \beta_5 QUOTATION_{t0} \quad (1)$$

where:

CS	Corporate sustainability
FP	Financial performance
SIZE	Company size
INDEBTEDNESS	Indebtedness of a company
INDUSTRY	Manufacturing or nonmanufacturing industry
QUOTATION	Stock exchange quotation

To test the influence of financial performance on subsequent sustainability, we used a multiple linear regression (see Eq. 2), where the dependent variable corporate sustainability is measured in 2011 or 2010 (hereinafter:  $t0$ ), while financial

performance and other control variables (size and indebtedness) are measured as a 3-year average before measuring corporate sustainability (hereinafter:  $t0-av.3$ ) (Waddock and Graves 1997).

$$CS_{t0} = \alpha + \beta_1 FP_{t0-av.3} + \beta_2 SIZE_{t0-av.3} + \beta_3 INDEBTEDNESS_{t0-av.3} + \beta_4 INDUSTRY_{t0} + \beta_5 QUOTATION_{t0} \quad (2)$$

## 4 Results

### 4.1 Descriptive Statistics

The research period was characterized by turbulent macroeconomic environment, and consequently outliers had to be eliminated. We have limited the extremes with transformation of statistics called winsorization, where all data below 5% and above 95% was transformed to the value at 5% and 95%.

Table 1 represents descriptive statistics of the main variables used in the analysis. As already mentioned,  $t0$  represents the baseline period in which corporate sustainability was measured (2011 or 2010).

In the observed period from 2007 to 2014, ROA is a relatively stable variable. A median ROA of between 0.9% and 2% is achieved, while standard deviation amounts to 14.1%. Minimum ROA in the observed period amounts to negative 105.0% while maximum to 31.3%. The median of control variable indebtedness decreases from a historical average of 47% to 39.9% in the last year of the observation period.

The number of surveyed companies was 79, but certain financial information was not available for some companies (the main reason being bankruptcy); therefore, the sample was reduced by up to five companies, depending on the analyzed period.

Out of 80 companies included in the analysis of corporate SR, 38% did not publish an annual report on their website (mainly companies that are not quoted on the stock exchange). SR is based mainly on qualitative disclosures with the strongest orientation toward disclosing information related to company relationships with their employees. The frequency of sustainability disclosure on key sustainability areas on average amounted to 29.3% in 2011 or 2010, with standard deviation of 20% (Klemenčič 2012).



Table 1 Descriptive statistics

Variable	Time frame	Average	Median	Standard deviation	Minimum	Maximum	No. of companies
CS (%)	$t_0$	29.98	24.07	20.01	5.56	81.48	79
ROA (%)	av. $t_0-3$ (3 year historical average)	1.21	1.24	7.93	-38.36	26.72	79
	$t_0$	0.46	1.28	14.05	-105.00	28.02	75
	$t_0+1$	1.61	1.20	7.21	-21.50	24.61	76
	$t_0+2$	0.19	0.88	12.38	-78.96	28.10	76
	$t_0+3$	1.66	1.96	10.03	-30.08	31.35	75
	av. $t_0+3$ (3 year average)	1.17	1.47	8.16	-26.19	25.64	76
Assets (EUR)	pop. $t_0-3$ (3 letno historično povprečje)	262,331,573	45,397,090	753,353,618	153,479	5,726,579,898	79
	$t_0$	267,253,983	39,143,862	756,190,884	130,958	5,529,053,959	76
	$t_0+1$	264,998,424	37,387,597	760,173,597	104,644	5,626,879,758	76
	$t_0+2$	257,692,972	40,918,206	753,204,090	77,231	5,644,936,606	76
	$t_0+3$	251,916,357	38,674,454	744,025,043	948,646	5,556,644,000	75
	povp. $t_0+3$ (3 letno povprečje)	257,145,740	39,253,905	750,610,761	376,840	5,609,486,788	76
Indebtedness (%)	pop. $t_0-3$ (3 letno historično pov-prečje)	49.25	47.05	23.00	0.32	92.71	79
	$t_0$	46.81	46.04	25.15	0.21	102.20	76
	$t_0+1$	45.35	44.08	25.53	0.32	95.08	76
	$t_0+2$	46.85	41.37	29.67	0.29	142.01	76
	$t_0+3$	45.48	39.93	31.52	0.27	145.16	74
	povp. $t_0+3$ (3 letno povprečje)	46.21	41.32	27.90	0.29	118.49	76

## 4.2 Results

The results of the regression analysis are presented sequentially for each hypothesis. The hypotheses are one sided, which means the significance level (hereinafter:  $p$ ) is divided by 2. The significance level is marked in the tables by an asterisk (hereinafter: \*), whereby one asterisk means statistical significance at 10% and two asterisks indicate statistical significance at 5%.

- Hypothesis 1: Better corporate sustainability leads to better average financial performance in the first 3 years after measuring corporate sustainability.
- Hypothesis 1a: Better corporate sustainability leads to better financial performance in the first year after measuring corporate sustainability.
- Hypothesis 1b: Better corporate sustainability leads to better financial performance in the second year after measuring corporate sustainability.
- Hypothesis 1c: Better corporate sustainability leads to better financial performance in the third year after measuring corporate sustainability (Table 2).

The results based on Hypothesis 1 show that better corporate sustainability on average leads to better average financial performance in the first 3 years after measuring corporate sustainability while controlling for size, indebtedness, industry, and quotation. This is consistent with the findings from Waddock and Graves (1997).

We can also conclude that better corporate sustainability on average leads to better financial performance in the first and second years after measuring corporate sustainability while controlling for size, indebtedness, industry, and quotation. The link between corporate sustainability and financial performance measured 3 years after measuring corporate sustainability is on average not statistically significant while controlling for size, indebtedness, industry, and quotation.

We find, on average, a statistically significant and negative link between indebtedness and subsequent financial performance while controlling for other variables. Companies with lower debt are perceived as less risky and will on average achieve better financial performance. This means that lower indebtedness can decrease risk related to future financial profitability. Corporate sustainability was also linked with decrease in risk, as responsible companies are more transparent and regulated,

**Table 2** Regression analysis for Hypotheses 1, 1a, 1b, and 1c

Dependent variable	ROA (av. $t0+3$ )	ROA ( $t0+1$ )	ROA ( $t0+2$ )	ROA ( $t0+3$ )
$R^2$	0.222	0.213	0.215	0.234
<b>Corporate sustainability</b>	<b>0.075*</b>	<b>0.079*</b>	<b>0.074*</b>	<b>0.081</b>
Size	-0.306	-0.168	-0.104	-0.391
Indebtedness	-0.131**	-0.111**	-0.136**	-0.163**
Industry	-0.852	0.066	0.188	-2.147
Quotation	2.101	4.694**	2.694*	1.000

\* $p \leq 0.10$ , \*\* $p \leq 0.05$

**Table 3** Regression analysis Hypotheses 2, 2a, 2b, 2c, and 2d

Dependent variable	Corporate sustainability
$R^2$	0.613
<b>ROA</b>	0.199
Size	7.803**
Indebtedness	0.061
Industry	-4.558*
Quotation	-9.158

\* $p < 0.10$ , \*\* $p < 0.05$ 

which strengthens the relationship with stakeholders. Over a longer period, markets reward company behavior that decreases risk (Orlitzky and Benjamin 2001).

- Hypothesis 2: Better average historical financial performance leads to better corporate sustainability (Table 3).

The historical 3 year average ROA indicator does not statistically explain the level of corporate sustainability while controlling for size, indebtedness, industry, and quotation. Based on Hypothesis 2, the results indicate that there is no link between historical financial performance and subsequent corporate sustainability. This is not consistent with the conclusion of Waddock and Graves (1997), but there are many other researchers who came to a similar conclusion. Fauzi (2009), for example, while controlling for size and indebtedness, too, concluded that there is no such link.

- Hypothesis 2a: Larger corporations achieve better corporate sustainability.

The size of the company has a statistically significant and positive effect on corporate sustainability, meaning that on average larger companies achieve better corporate sustainability while controlling for other independent variables. This is partially in accordance with the slack resource theory, as the larger the company, the larger the pool of resources it has at its disposal to invest in sustainability. Also larger companies have greater visibility and so receive greater pressure from stakeholders and various institutions. Orlitzky (2001) is of the opinion that size influences the level of sustainability, as smaller companies that are in the growth phase focus more on survival and market share acquisition than on ethical and philanthropic activities.

- Hypothesis 2b: Less indebted corporations achieve better corporate sustainability.

Indebtedness does not provide a statistical explanation for the level of corporate sustainability. This contradicts the majority of research conclusions, which state that indebtedness should be an indicator of how risky the company is, which should, in turn, influence the relationship between corporate sustainability and financial performance. The preliminary financial risk of the company should be negatively correlated to the subsequent level of sustainability, which means that companies

with lower indebtedness or risk invest more in sustainability as this does not increase risk. Moreover, Orlitzky and Benjamin (2001) proved that investments in corporate sustainability decrease the risk of the company, which means that companies with high risk can invest in corporate sustainability as this will not be negatively perceived by the market. Based on this theory we can conclude that there is no relationship between indebtedness and investments in corporate sustainability, as companies which have less or more debt will not achieve negative market response. Indebtedness is not one of the factors on which investment in corporate sustainability is based.

- Hypothesis 2c: Corporations from manufacturing industry achieve better corporate sustainability.

Industry has a negative statistically significant influence on the level of corporate sustainability, meaning that manufacturing companies on average achieve better corporate sustainability while controlling for other variables. The manufacturing industry is, in general, subject to greater influence for socially responsible operations, due to the larger amount of negative externalities that it produces. Difference exists among different industries related to environmental and social influences and regulation (Griffin and Mahon 1997).

- Hypothesis 2d: Corporations that are traded on stock exchange achieve better corporate sustainability.

Quotation has a negative statistically significant influence on the level of corporate sustainability, meaning that companies which are quoted on the stock exchange on average achieve better corporate sustainability while controlling for other variables. Companies that are quoted on the stock exchange have to operate more responsibly and disclose as much information on corporate responsibility as possible, as they are under greater scrutiny from stakeholders.

## 5 Discussion

The results show that better corporate sustainability on average leads to better average financial performance in the first year, second year, and in the first 3 years after measuring corporate sustainability while controlling for size, indebtedness, industry, and quotation. Based on our research, we can also conclude that there is on average no statistically significant link between average historical financial performance and subsequent level of corporate sustainability, which means that the relationship is not simultaneous, but one sided. Even though financial performance does not influence the level of corporate sustainability, other variables as size, industry, and quotation on the stock exchange do influence it, mainly due to the greater regulation and visibility which they are subject to, as already proven by Slapničar (2004).

Even though investments in corporate sustainability do increase costs, research shows that these investments, in the long run, lead to better financial performance. Profit maximization is an important corporate goal, but it is not the only one, as the company should operate in a sustainable manner. If managers wish to operate successfully in the long term, they have to take into account the interests of the various key stakeholders, the natural environment, and society at large. Sustainable operations improve corporate reputation and relations with stakeholders, and consequently the company has more and better options for cooperation with partners and can attract better employees (Bhattacharya and Sen 2004). A higher level of corporate sustainability also increases employee satisfaction and loyalty, which has a long-term influence on competitive advantage (Perini et al. 2009). Companies have the power to act as a role model, as they can encourage consumers and the wider community to also begin to support specific socially responsible initiatives or practices (Bhattacharya and Sen 2004).

Different stakeholders respond differently to the responsible operations of companies. Consumers respond with enhanced purchasing behavior and better loyalty, employees with increased productivity, investors with increased purchases of share, and society with a decrease in lawsuits and boycotts (Pelozo and Papania 2008). One of the most important stakeholder groups is consumers. Research performed in 2008 on a sample of 156 Slovenian consumers showed that they respond positively to corporate sustainability. Ethical consumers are more informed and positively respond to corporate sustainability in the form of a purchase or activism. One open question remains, however, whether there is a link between behavioral purchase intentions and actual purchases (Svetlič 2008).

Customers respond much more strongly to irresponsible business practices than to responsible ones. Yet, at the same time, companies that operate responsibly have more loyal customers, who are more resistant and more likely to overlook negative information about the company (Bhattacharya and Sen 2004). The consequences of socially irresponsible business may not be visible during normal operations, and if stakeholders do not pay enough attention to sustainability, then the company can still generate profits. In the event that a major problem occurs which also attracts media attention, such a company normally quickly gets into trouble and increasing the level of sustainability as a crisis management response will not be received positively by the stakeholders. Socially irresponsible business therefore may not have visible consequences in the short term; however, over the longer term, the dissatisfaction of stakeholders accumulates, public confidence decreases, and so the company operates with more and more expenses (Murray and Vogel 1997).

The relationship between corporate sustainability and financial performance is complex. The main reason for different research results assumed by Ullmann (1985) is the fact that there is no clear link and too many unclarified variables that influence the relationship. According to Ullmann it is also difficult and subjective to measure sustainability as this is an intangible variable.

Our study has several limitations. When interpreting the results, we need to pay attention to the fact that it is not necessarily true that corporate SR or disclosure reflects the actual level of sustainability performance. When corporate

sustainability was measured (2011 or 2010, respectively), there was no active legislation in Slovenia relating to corporate SR. Voluntary disclosure can be biased. The question remains, how well sustainability disclosures reflect the actual level of sustainability performance in the company. Ullmann (1985) concludes that the strength and direction of link between corporate sustainability and related disclosure depends on three factors: the stakeholders' power, the company's strategy related to sustainability, and financial success. When the power of the stakeholders is large, the company has an active sustainability strategy and the company is profitable, then corporate sustainability disclosure will be a good indicator of the company's corporate sustainability performance. When the power of stakeholders is lower, the company's sustainability strategy is more passive, and the company does not have good financial performance, sustainability disclosure represents an increasingly distorted picture of true sustainability performance. In such cases, the company's management tends to present biased information due to marketing goals. Ullmann (1985) concludes that studies which use disclosure of sustainability as an indicator of corporate sustainability can be unreliable.

Based on their literature review, Griffin and Mahon (1997) state that there are different conclusions related to the link between corporate sustainability and financial performance, mainly due to the different methodologies used, conceptual and methodological differences in measuring these two variables, and the use of different control variables. As mentioned, one of the biggest limitations of this study is measuring sustainability, which is hard to measure and quantify. One of the limitations is also measuring financial performance, which was measured with only one accounting variable, ROA. Further limitations of the study are also the small sample size (79 companies) and the inclusion of companies from different industries. Griffin and Mahon (1997) claim that research on this topic should be performed within one industry, as the accounting ratios can differ among industries, as do internal and external pressures. The time period is also one of the limitations of the study as the period includes a crisis period when a lot of companies were fighting for survival.

## 6 Implications for Managers

The purpose of this article is to show how important it is to understand the connection between corporate sustainability and financial performance, mainly for managers to be able to make better decisions in relation to resource allocation toward corporate sustainability. Sustainable practices do not always lead to win-win scenarios. In fact, in the short run, win-lose scenarios are quite common—doing some good for the society/environment/economy but not being able to provide any benefit for the business. And yet, sustainability should be about the business case. This, of course, requires clarity of objectives. The sustainability business case and payoffs must be clear. Managers need to understand the causal relationships between the various alternative actions that can be taken and the impact of these

actions on sustainability performance. They need to understand the likely reactions of the company's various stakeholders to sustainability performance and to financial performance. By carefully identifying these interrelationships and by establishing relevant performance metrics to measure success, a company can improve operational decision-making and make the "business case" for corporate sustainability. In this case, both sides will win.

Our research concludes that financial performance is not an important factor when managers consider sustainable investments. Companies which are larger, operate in the manufacturing industry, and are quoted on stock exchange are more visible and subject to increased oversight by stakeholders, regulators, and the larger public, in general. Management should be aware of the fact that sustainable investments can positively influence a company's operations in turbulent times (e.g., during a crisis), if the investments are in accordance with the overall business model and strategy. Corporate sustainability strengthens core values, even if it does not lead directly to improved financial performance (Fernández-Feijóo Souto 2009).

Managers should also be aware that investing in sustainability is also important in terms of lowering the risk of the company. Companies with higher levels of corporate sustainability are more transparent and have better relations with stakeholders. Such companies can better cope with future negative effects, and the frequency of negative impacts (risk of corruption incidents and actions) is expected to be lower (Orlitzky and Benjamin 2001). In addition, socially responsible companies have easier access to capital (Johansson et al. 2015).

## References

- Abbott, W. F., & Monsen, R. J. (1979). On the measurement of corporate social responsibility: Self-reported disclosures as a method of measuring corporate social involvement. *Academy of Management Journal*, 22(3), 501–515.
- Bhattacharya, C. B., & Sen, S. (2004). Doing good at doing better: Why, why and how customers respond to corporate social initiatives. *California Management Review*, 47(1), 9–24.
- Dagilienė, L. (2013). The influence of corporate social reporting to company's value in a developing economy. *Procedia Economics and Finance*, 5, 212–221.
- Epstein, M. J., & Rejc Buhovac, A. (2015). How sustainability leaders are implementing sustainability. *The European Financial Review*, April–May: 48–52.
- Fauzi, H. (2009). *Corporate social and financial performance: Empirical evidence from American companies*. Indonesia: Sebelas Maret University.
- Fernández-Feijóo Souto, B. (2009). Crisis and corporate social responsibility: Threat or opportunity? *International Journal of Economic Sciences and Applied Research*, 2(1), 36–50.
- Freedman, M., & Jaggi, B. (1988). An analysis of the association between pollution disclosure and economic performance. *Accounting, Auditing & Accountability Journal*, 1(2), 43–58.
- Freeman, E. R. (1984). *Strategic management: A stakeholder approach*. Boston: Pitman Publishing.
- Griffin, J. J., & Mahon, J. F. (1997). The corporate social performance and corporate financial performance debate: Twenty-five years of incomparable research. *Business and Society*, 36(1), 5–31.

- Gurviš, N., Startseva, E., Strouhal, J., & Nikitina-Kalamae, M. (2015). Finding the link between CSR reporting and corporate financial performance: Evidence on Czech and Estonian listed companies. *Central European Business Review*, 3(12), 48–59.
- GVIN. (n.d.). *GVIN.com*. Retrieved February 1, 2016, from <http://www.gvin.com/GvinInformator/Pages/Analizator/Analizator.aspx?Mode=GvinSI&App=GvinInformatorSI&Lang=sl-SI>
- Johansson, S., Karlsson, A., & Hagberg, C. (2015). *The relationship between CSR and financial performance*. Kalmar: Linneaus University.
- Klemenčič, M. (2012). *Analiza informacij o družbeno odgovornem poslovanju v letnih poročilih slovenskih podjetij [Analysis of information on socially responsible operations in annual reports of Slovenian companies]*. Ljubljana: Ekonomska fakulteta.
- Mahoney, L., & Roberts, R. W. (2007). Corporate social performance, financial performance and institutional ownership in Canadian firms. *Accounting Forum*, 31, 233–253.
- Margolis, J. D., & Walsh, J. P. (2003). Misery loves companies: Rethinking social initiatives by business. *Administrative Science Quarterly*, 48(2), 268–305.
- McGuire, J. B., Sundgren, A., & Schneeweis, T. (1988). Corporate social responsibility and firm financial performance. *Academy of Management Journal*, 31(4), 854–872.
- McWilliams, A., & Siegel, D. (2000). Corporate social responsibility and financial performance: Correlation or misspecification? *Strategic Management Journal*, 21, 603–609.
- Mulligan, T. (1986). A Critique of Milton Friedman's essay 'the social responsibility of business is to increase its profits'. *Journal of Business Ethics*, 5(4), 265–269.
- Murray, K. B., & Vogel, C. M. (1997). Using a hierarchy-of-effects approach to gauge the effectiveness of corporate social responsibility to generate goodwill toward the firm: Financial versus nonfinancial impacts. *Journal of Business Research*, 38(2), 141–159.
- Orlitzky, M. (2001). Does firm size confound the relationship between corporate social performance and firm financial performance? *Journal of Business Ethics*, 33(2), 167–180.
- Orlitzky, M., & Benjamin, J. D. (2001). Corporate social performance and firm risk: A meta-analytic review. *Business & Society*, 40(4), 369–396.
- Orlitzky, M., Schmidt, F. L., & Rynes, S. L. (2003). Corporate social and financial performance: A meta-analysis. *Organization Studies*, 24(3), 403–441.
- Pelozo, J., & Papania, L. (2008). The missing link between corporate social responsibility and financial performance: Stakeholder salience and identification. *Corporate Reputation Review*, 11(2), 169–181.
- Perini, F., Russo, A., Tecanti, A., & Vurro, C. (2009). *Going beyond a long-lasting debate: What is behind the relationship between corporate social and financial performance?* Milan: Bocconi School of Management.
- Poeloe, A. (2010). *Is there a trade-off between social responsibility and financial performance?* Rotterdam: Erasmus University Rotterdam.
- Preston, L. E., & O'Bannon, D. P. (1997). The corporate social-financial performance relationship. *Business and Society*, 36(4), 419–429.
- Shane, P. B., & Spicer, B. H. (1983). Market response to environmental information produced outside the firm. *The Accounting Review*, 58(3), 521–538.
- Slapničar, S. (2004). Poročanje o družbeni odgovornosti [Reporting on corporate social responsibility]. V S. Prašnikar (ur.), *Razvojnoraziskovalna dejavnost ter inovacije, konkurenčnost in družbena odgovornost podjetij [R&D and innovation, competitive advantage, and CSR]*, (519–542). Ljubljana: Finance.
- Stanwick, P. A., & Stanwick, S. D. (1998). The relationship between corporate social performance and organizational size, financial performance, and environmental performance: An empirical examination. *Journal of Business Ethics*, 17(2), 195–204.
- Sun, L. (2012). Further evidence on the association between corporate social responsibility and financial performance. *International Journal of Law and Management*, 54(6), 472–484.
- Svetlič, N. (2008). *Odziv potrošnikov na družbeno dogovorna dejanja podjetij [Consumer response on corporate social responsibility]*. Ljubljana: Fakulteta za družbene vede.



- Tsoutsoura, M. (2004). *Corporate social responsibility and financial performance*. Berkeley: Haas School of Business, University of California.
- Ullmann, A. A. (1985). Data in search of a theory: A critical examination of a relationship among social performance, social disclosure, and economic performance of U.S. firms. *Academy of Management Review*, 10(3), 540–557.
- Van der Laan, G., Van Ees, H., & Van Witteloostuijn, A. (2008). Corporate social and financial performance: An extended stakeholder theory, and empirical test with accounting measures. *Journal of Business Ethics*, 79(3), 299–310.
- Vintila, G., & Duca, F. (2013). A study of the relationship between corporate social responsibility, firm size and financial performance. *Revista Română de Statistică Trim*, 1, 62–67.
- Vizetič, N. (2011). Correlation between social responsibility and efficient performance in Croatian enterprises. *Zbornik Radova Ekonomskog Fakulteta u Rijeci*, 29(2), 423–442.
- Waddock, S. A., & Graves, S. B. (1997). The corporate social performance—Financial performance link. *Strategic Management Journal*, 18(4), 303–319.
- Zaborek, P. (2014). CSR and financial performance: The case of Polish small and medium manufacturers. *International Journal of Management and Economics*, 43, 53–73.