THE IMPACT OF SOCIAL REPORTING ON THE PERFORMANCE OF ITALIAN SOCIAL ENTERPRISES

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Abstract

The Third Sector is a crucial social and economic system at an international level in supplying pub-lic services. The Italian law no 155/2006 and the consequent operating decrees have formally rec-ognised the social entrepreneurship, requiring social enterprises (SEs), among other things, to provide specific disclosure in relation to the social impact of their operations. This paper aims to in-vestigate whether there is a relation between the "quality" of SEs' social reporting and financial per-formance. In relation to this, the research has examined the SEs instituted as limited liabilities companies. The research contributes to the development of this field of studies, concluding that there is no cause-effect relation neither in the hypothesis that the quality of social reports affects the financial performance, neither in the hypothesis that financial performance affects the quality of so-cial reports.***

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1. Introduction

The importance of the Third Sector and Social Enterprises (SEs) is growing at a global level. In the last twenty years there has been a transformation of the welfare system with a progressive reduction in the supply of services by public administrations. This reduction has opened up new areas of activity for the Not-for-profit organisations (NPOs) now called to operate in strategic sectors such as culture and recreation, education and research, health, social services, development and housing, religion (UN, 2003).

The European legislations realized a progressive contracting-out of public services to NPOs (Angroff and McGuire, 2003): with the objectives of reducing public expenses and recognizing NPOs' skills and experiences (Vittadini, 2003). The Social entrepreneurship has thus shown a great growth in Europe (Nicholls, 2008). Today, NPOs are operating in a highly dynamic and competitive environment (Weerawardena and Sullivan Mort, 2006) especially after the crisis of the traditional welfare system managed by public agencies.

In particular, southern Europe is characterised by a "weak" welfare system, with a limited range of services and significant transfers of resources from the public to the Third Sector. SEs operating in different sectors, such as the integration of disadvantaged people in the job market, social assistance, cultural services, are most highly developed.

In Italy indeed we observe a steady growth of the role of NPOs, that now are a key element of the national economic system.

Since the beginning of the 90's the growth of SEs and the increase of workers employed in NPOs testify to the importance now attributed to the Third sector and to the phenomenon of SEs (ISTAT, 2006; ISTAT, 2008). Consequence of this development is the increasingly felt need for entrepreneurship and the need to introduce new tools of accountability.

The concept of SE appears for the first time in Italy in the early '90s as a precursor to the initiative of the Italian Parliament, which created, in 1991, the legal form of "social cooperatives". A basic boost of the non-profit sector's growth also came from some regulatory interventions that have predicted particular forms for NPOs as social promotion association (law no 383/2000), social cooperatives (law no 391/1991), voluntary organisations (law no 266/1991), SEs (law no 155/2006) (Bagnoli and Manetti, 2011).

With the approval of law no 155/2006, Italy has been at the forefront in terms of legislative recognition together with Belgium, which already provides a such rules since 2003, and the United Kingdom.

Due to these reasons, previous studies (Bagnoli and Megali, 2011; Becchetti and Castriota, 2011; Mancino and Thomas, 2005) used the Italian context as a significant case study to observe the different aspects of SEs.

SEs can be understood as organisations driven by a social mission (Borzaga and Defourny, 2001), that has to answer to the community rather than shareholders (Pearce, 2003). In this context, SEs have to reach high levels of social responsibility, accountability and disclosure in both financial and social dimensions. Social responsibility characterises the existence of SEs, because, essentially, it is a condition for the development and survival allowing the achievement of institutional goals (Mason et. al., 2007).

Italian legislation has introduced social reporting as a mandatory tool in the reporting system of SEs to ensure a high level of disclosure to all stakeholders. Many studies have addressed the relationship between social reporting and financial performance. Some authors argue that there is a positive relationship between the two variables. In particular, it has been observed that companies using social reporting are able to achieve better financial performance (Orlitcky et. al., 2003; Waddock and Graves, 1997).

However, the research results are not completely homogenous, as they depend on whether social reporting has been treated as an independent or dependent variable in predicting financial performance (Mc Williams and Siegel, 2000; Margolis and Walsh, 2003).

Other authors have shown that it is not possible to prove the existence of a correlation between social reporting and financial reporting (Abbot and Monsen, 1979; Griffin and Mahon, 1997).

The previous mentioned studies on the relationship between social reporting and financial performance are wholly referred to for-profit entities. It can be observed, however, a lack of similar analyses in reference to the non-profit sector and, even more, with regard to SEs. This study is aimed at helping to bridge the knowledge gap that exists regarding the relationship between social reporting and financial performance in SEs.

The research aim of this paper is meant to investigate whether there is a relation between the “quality” of SEs’ social reporting (Bronzetti et. al., 2011) and financial performance. As far as SEs are concerned, social reporting is a way to show their own values, to report corporate performance, to obtain the approval and involvement of stakeholders; these conditions are necessary for its existence and influence also financial performance.

This paper is structured as follows: section 2 analyses the existing literature review, addressing the related different conclusions. Section 3 illustrates the applied methodology and, in this context, the determination of the variables. Section 4 examines the starting hypothesis. Section 5 is dedicated to data analysis. The sixth and last section provides the conclusions of this research and the proposals for future complementary studies.

2. Literature Review

The literature has offered various definitions of “non-profit organisation”, sometimes referring to a main characterisation at an absence of profit, or in other cases to the system of financing and governance models. Salomon and Anheier (1997) introduced some basic NPO requirements that can be summarised as follows: possession of a formal organisation, a private nature, non profit-distribuiting, self-governing to control its own activity and a degree of voluntary participation in the operations.

More items, mostly related to the strategic perspective, have been identified to qualify an entity as "non-profit", such as the definition of a mission-oriented purpose related to advocacy and inspired by principles of altruism and community care (Kendal and Knapp, 1996).

Recently, the attention to the study of the elements that differentiate social entrepreneurship (Dees, 1998) from the pro-business entrepreneurship has increased, emphasising the elements of innovation in the social field related to social entrepreneurship. In particular, the social entrepreneurs are individuals motivated by a strong desire to introduce changes in the social context, feelings of altruism and social responsibility (Prabhu, 1999). They are, ultimately, people sensitive to opportunities to be seized in the social field (Eckhardt and Shane, 2003).

The scholars' attention is then directed towards the identification of the features that distinguish SEs from the more general concept of NPOs.

The concept of SE finds the first definition in Italy and subsequently a widespread acceptance, albeit with different approaches, in other European countries (Defourny and Nissens, 2001), in the United States, in Eastern Asia and Latin America (Borzaga and Spear, 2004). With SEs, in detail, we can indicate an organisation pursuing a social mission through the production of goods and services (Borzaga and Defourny, 2001; Nyssens, 2006; Kerlin, 2006) or through the assistance to particular categories of individuals or disadvantaged people (Becchetti and Castriota, 2011). The definition of SE is therefore based on criteria concerning the economic, entrepreneurial and social dimension of activities (Defourny and Nyssens, 2001).

In Italy, the SE represents a qualification which can be obtained by NPOs and businesses. Over time the majority of SEs has been created in the form of limited companies with social aims, welfare purposes and cultural goals (CNDCEC, 2012).

The SE is characterised by: the absence of profit goals; the requirement to allocate profits to the corporate purposes or to increase the equity; and the predominance of activities designed for social, welfare and cultural objectives (Bronzetti, et. al. 2011).

Matacena (2007), Bagnoli and Megali (2011) defined the accountability system of the SE on three different levels: social effectiveness (the ability to achieve social goals); institutional (the ability to respect legal and self rules); economic and financial performance. The three different dimensions of accountability need to develop integrated measurement systems (Bagnoli and Megali, 2011) as the accountability system should be focused not only on financial variables but also on the creation of social value (Costa et. al, 2011).

To broaden the accountability of SEs to the social value, the Italian legislation introduced a compulsory social report with the consideration that it is a necessary tool able to: highlight the corporate values and the ethical principles; provide information to the various categories of stakeholders in a mission-oriented and multistakeholder entity; stimulate broad participation and share of activity (Ebrahim, 2003; Ebrahim, 2005). The social report, including its structure and the information contained therein, is therefore mandatory for Italian SEs.

The development of an integrated measuring system for social and financial performance in SEs leads us to reflect on the existence of an empirical relationship between financial performance and the level of disclosure in social and environmental reporting.

The topic has been widely debated in the literature with reference to for profit entities (Al-Tuwaijri et al., 2004) without a unanimous position.

The Voluntary Disclosure Theory (Dye, 1985; Verrecchia, 1983) gives a positive result to the relationship between financial performance and the level of voluntary disclosure in the sense that businesses with worse performance would have less interest to report their results in the social and environmental field and vice-versa. There are numerous studies that have shown a positive correlation between the availability of financial resources and the activities in the field of Corporate Social Responsibility (CSR) (Atkinson and Galaskienwicz, 1988; Buehler and Shetty, 1976) showing how the growth of financial resources also increases the investments in CSR (Waddock and Graves, 1997).

In contrast, the approaches of the legitimacy theory show a negative relationship between the two variables: the social and environmental reporting is identified as a function of the social and political pressures over the company (Patten and Dennis, 2002). The businesses which show a worse performance in the social sphere are, in fact, subject to greater pressure and then pushed to higher levels of disclosure in social and environmental reporting in order to recover legitimisation among stakeholders.

Recently, studies have focused on the conditions that influence the relationship between the availability of financial resources, financial performance and disclosure of social and environmental results (Amaeshi, et. al. 2006; Julian and Ofori-dankwa, 2013).

The same attention to the relationship between social reporting and financial performance has not been reserved by scholars to NPOs and SEs. There is, therefore, a lack in the studies aimed at the identification of a possible correlation between SEs' social disclosure and financial reporting, both at European and international level.

3. Methodology

According to the studies and research previously mentioned, this paper is meant to investigate whether there is a relation between the "quality" of SEs' social reporting and financial performance (Bronzetti et al., 2011; Lyon 2007; McWilliams and Siegel, 2000; Zhang and Swanson, 2013; Wang and Choi, 2013).

Specifically, the analysis should comprehend the role of social reports of SEs for their stakeholders (Coopera and Owen, 2007).

In order to pursue this objective, the research has analysed the annual reports deposited during the period of 2009-2012 in the Enterprises' Registry of the local Camere di Commercio (Chambers of Commerce) by the SEs, which are constituted as "Società di capitali" ("Limited Liabilities Companies").

In the Italian legislation, the reporting obligations of an organisation depend on its legal form and can imply the compliance with several different reporting activities: currently, it may consist in the preparation of financial reports, non-financial reports, or both financial and non-financial reports. It is worth recalling that the Italian legislation requires all Società di capitali to deposit their financial statements at the related local Chambers of Commerce within 120 days from the balance sheet date (which usually coincides with the year). This deadline can be postponed by 60 days in specific circumstances. In their annual reporting obligation, the Società di capitali, qualified as SE, are also required to contextually deposit their social reports from 2008.

In relation to this, the research has investigated the cited phenomena for the Società di capitali, which have continuously deposited their four annual reports 2008-2011 (financial statements and social reports) as of October 30th 2012.

As far as the availability of the data, the analysed financial statements are downloaded from the specialized database AIDA, Bureau Van Dijk, and from the Camera di Commercio website. In regard to this, it should be noted that all annual reports of the mentioned Italian enterprises' are public and can be downloaded by the authorized websites.

This study relates, as mentioned before, the quality of SEs' social reporting with their financial performance.

The correlation is given by the formula of Bravais-Pearson:

$$\rho_{XY} = \frac{COV(X,Y)}{\sqrt{V(X)V(Y)}}$$

The correlation coefficient (ρxy) is comprised in a range between -1 and +1. From our perspective, in the case that the coefficient is higher than zero, the direct correlation implies that the quality of social reports and the financial performance are directly correlated, and, consequently, that financial performance increases when the quality of social reports increases (or viceversa).

If the correlation coefficient is zero (or approximately zero), there is no correlation between the two variables; the two variables move independently, one from the other.

In the case that the correlation coefficient is lower than zero, the negative (or inverse) correlation means that the financial performance increases when the quality of social reports decreases (or viceversa).

The variables X and Y are respectively related to the quality of social reports and to the entities' financial performance, measured, in this circumstance, by the ratio of Return on Assets (ROA).

The identification of the indicators represented in the variables x and y is extremely relevant; it has been observed that the indexes construction can modify the results of the analyses (Orlitzky et al., 2003).

The first variable (X) included in the analysis represents the quality of the social reports. Specifically, this evaluation has been on the development of the enterprise's social reporting, period by period, considering the single social reports. It has been checked if each requirement of the Sections B-E of the social report has been full-filled. Each required piece of information provided in a correct and consistent way scores 1.

Section A has not been addressed, as it regards only the entities' general data, which does not present any added value to financial reports. In the consideration that social reports can only be judged from a qualitative perspective, it has been decided to add 10% to each Section, when the compilation provides more information than the minimum requirement. This means that a piece of information illustrating more than what has been required can score 1.1.

The total score of social reports is given by the following formulae:

$$X = \sum_{i=1}^{20} Bi + \sum_{i=1}^{9} Ci + \sum_{i=1}^{7} Di + \mathbf{E1}$$

where:

B_i = information required by Section B of the decree 155/2006;

C_i = information required by Section B of the decree 155/2006;

D_i = information required by Section B of the decree 155/2006;

E = information required by Section D of the decree 155/2006.

Due to the above explanation, the maximum score can be: 37 + 3.7 = 40.7

It is important to highlight that SEs presenting social reports identical to the previous period have been "penalized" by subtracting 10% from their previous score, as the presentation of the same report with updated values has to be addressed, in general terms, as a limitation to a faithful and useful disclosure.

The second variable (Y) included in the analysis is provided by the Return on Assets (ROA), represented by the relation between the operating profit (or loss) and the total assets.

Both the numerator and denominator are taken from published financial statements. The expressed considerations arise from the assumption that the financial statements' data are correctly determined.

The SEs included in this investigation apply the Italian Civil Code accounting requirements (art. 2423-2435-*bis*, civil code). In line with the limited liabilities' accounting requirements, the investigated SEs apply the accrual basis of accounting (IFAC, 2000; Lüder and Jones 2003). SEs Given this, the operating profit can be achieved by netting the revenue allocated to the macro-class A, "Production value" – with the exception of the line item A5, "Other revenue" – with the expenditures allocated in the macro-class B, "Production costs" – with the exception of the line item B14, "Other expenditures" (CNDCEC, 2009).

This margin can be illustrated as follows:

Revenue

1) Revenue from sales and services
2) Changes in inventories of works in progress, semi-finished products, products
3) Changes in construction contracts
4) Internal construction

Expenses

6) Cost of goods
7) Services
8) Use of third parties' goods
9) Personnel expenses
10) Amortisation and depreciation
11) Change in inventories of raw materials, consumables and supplies
12) Risk provisions
13) Other provisions

ROA has been preferred to the Return on Equity (ROE), already applied in similar research (Chand and Fraser, 2006), as SEs cannot pursue personal profit.

4. Research Hypothesis

This paper aims at addressing whether there is a correlation between the quality of social reports and financial performance. In this regard, the following hypothesis has been proposed:

Hypothesis 1. There is a correlation between quality of social reports and financial performance. This means that, in the case that the quality of social reports increases (decreases), the financial performance contextually increases (decreases).

This hypothesis could have two different explanations or sub-hypotheses:

Sub-hypothesis 1a. The financial performance is affected by the quality of the social report; according to this, the financial performance increases when the quality of the social report increases.

Considering this, the social reporting activity can be comprehended as an investment per se.

The "good management theory", as a characterisation of the stakeholder theory, affirms that this relation should be due to the fact that social reporting processes could support SEs in developing new skills and competencies (Orlitzky et al., 2003; Waddock and Graves, 1997)

Sub-hypothesis 1b. The quality of social report depends upon the financial performance; according to this, the quality of social report increases when the financial performance increases.

This can be due to the fact that SEs address social reports as vehicles to promote their operations, to encourage stakeholders to trust the enterprise's operations and legitimate their role (Hooghiemstra, 2000). This could be related to the SEs' wish to disclose their financial efficacy and efficiency through the social reports addressed, utilizing them as a useful communication instrument.

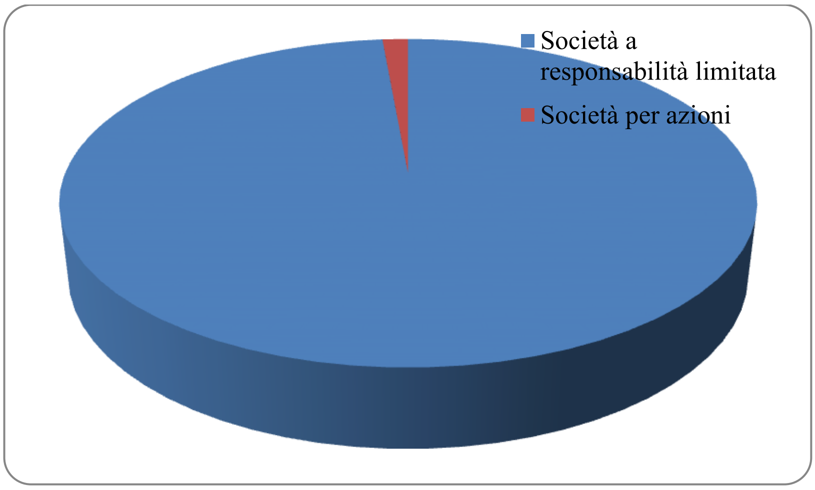
5. Data Analysis

This paragraph aims to test the hypothesis in its two characterization.

The universe of SEs has been represented by 770 entities. The research has also considered the SEs which are under liquidation process, as they maintain their reporting obligations. Almost of the SEs are represented by Società di capitali while, essentially, the other typology of SEs are legally constituted as of Società di persone (Unlimited Liability Companies), Società cooperative (Cooperatives), Enti non profit (Not-for profit organisations, such as foundations and associations).

The portion of società di capitali included in this universe is composed of 355 entities. 350 of these entities are Società a responsabilità limitata (Limited Liability Companies) – 57 of which have a unique stockholder – and 5 are Società per azioni (Companies Liability by Shares) – 2 of which have a unique stockholder. This means that 99% of the analysed SEs are Società a responsabilità limitata. The reasons for the predominance of Società a responsabilità limitata are probably that these companies, on the one hand, are usually based and built upon the personal features of stockholders and, due to this, are more adapted to the not-for profit purpose of SEs and, on the other hand, are less administratively complex and onerous.

Figure 1. The composition of the legal form of the analysed SEs



The SEs that have satisfied the above criteria and have deposited social reports in the years 2008, 2009, 2010 and 2011 are 18. This low number is due to a set of different reasons, the most important of which being:

a. history of the entity. It is possible that some SEs did not exist or had not yet achieved the status of SE in 2008, and therefore could not deposit their social reports. The majority of the investigated entities have achieved the status of SEs after the 31st December 2008;

b. irregularity. SEs have not deposited their social reports for one or more periods. With this in mind, it is to be noted that the relating legislation has not specifically determined the sanction for this omission. Some SEs do not prepare their social reports, while some other SEs draw up their social reports, even if they do not likely deposit it;

c. timing. The research closed with the financial statements deposited on 30th October 2012. Some SEs could have deposited their social reports after that date.

The entire set of analysed SEs are small companies in compliance with the definition provided in the art.2435-bis of the Civil Code. According to this, they can prepare abridged financial statements (CNDCEC, 2012).

The two sub-hypotheses have been tested in relation to each single period.

The sub-hypothesis 1a affirms that financial performance increases in the case that the quality of social report increases. This correlation is visible when the financial performance “follows” the better quality of social reporting, which means that financial performance would be affected by the quality of social reporting in the subsequent period. a social report could impact the financial performance, starting from the moment that they are disseminated to stakeholders. From this perspective, the 2008 social report should impact the 2009 financial performance, and so on.

The analysis has highlighted that there is no correlation in this perspective and that, therefore, the social disclosure has not taken advantage to the SEs’ financial position.

The sub-hypothesis 1ab theorizes that the quality of social reports increases when financial performance increases. From this perspective, the 2008 increase in financial performance should imply a better quality of the 2008 social report, and so on. Even in this case, the analysis has not found any correlation, so to confirm that in the investigated universe the two variables (quality of social report and financial performance) are not related with a cause-effect correlation.

6. Conclusions and limitations

The research concludes that there is no relevant correlation between the two variables in line with a part of the research conducted upon this issue (Abbot and Monsen 1979; Griffin and Mahon, 1997; Rowley and Berman, 2000). There is no relevant correlation, even in the further sub-analyses considered in the determined hypotheses 1a and 1b (Margolis et al., 2009).

This, *de facto*, means that the investigated Italian SEs substantially consider social reports as an administrative duty and, in general terms, do not attribute relevance to social disclosure (Gibbon and Affleck, 2008). It should be addressed that this situation is in opposition to the logic that led to the enactment of the decree 155/2006, which addresses social reports as instruments to provide stakeholders with exhaustive disclosure concerning the management of available resources and social objectives to be pursued. Generally, SEs should have an important level of social disclosure, as they should be more interested in being accountable and transparent with the community than with shareholders (Pearce, 2003).

It is to observed that the Italian case represents a circumstance where the social report has been required by the legislation and it is not a voluntary decision taken by SEs’ administrators; this does not mean that SEs are not losing an important chance to obtain a managerial advantage from this requirement. The potential included in the preparation of social reports has not been grabbed by SEs; the preparation of social reports implies a managerial thinking, which can contribute to the entities’ creation of value over the medium long term, as advocated by the International Integrated Reporting Council (IIRC, 2013).

At the same time, it is to be observed that all the analysed entities are small companies, as they are defined by the local legislation. Smaller companies do not have a public interest and they can directly provide their main stakeholders with the needed information.

In addition, SEs operating in social fields could base their networks essentially on references expressed by “clients” and “past clients”. Oral and visual communication could take the priority of written communication.

As far as limits are concerned, it is fair to highlight that, although this research has stressed that it has not found any correlation between quality of social reporting and financial performance, it does not deny a possible correlation. This survey refers to a specific local sector and relates two variables. It can be noted that – as explained in this section – other variables could play a significant role in the increase/decrease of the addressed variables themselves.

In addition the analysis of social reporting is based upon a qualitative analysis, as most of the research measuring social reports’ quality and reliability. This implies that the correlation cannot be founded on completely objective data. The subjectivity that determines the investigation could affect the examination and the conclusions as well. The purpose of the score was not finalized to explore new methods to measure the quality of social reports, but it was essentially a system to determine the efforts produced by SEs to communicate their position to the related stakeholders.

Furthermore, the portion of the SESs that have satisfied the required criteria to be analysed (SEs constituted as limited liabilities companies having deposited the last four financial and social reports) is quite limited in respect to the related portion of the universe that has been taken into consideration (SEs constituted as limited liabilities companies). It represents only around 5% of the analysed portion. This does not depend upon this research, but more upon specific circumstances in the correct application of the local requirements. The period is, then, quite limited and this research should be repeated in a longer term, in order to understand if the trend can be confirmed, as social responsibility could pay off in the long run (Zairi and Peters, 2002).

Another limit of this research is related to the global (and, more specifically, European) financial and economic crisis. This general condition has naturally affected the local SEs' financial performance. Many Italian SEs collaborate with public sector entities and, more specifically, with local governments, which have been obliged to reduce their contribution to private social organisations. SEs, on the other hand, are in many circumstances strictly linked to the potential of families to require social services, such as schools and nursing homes. Consequently, businesses have generally reduced their targets and ambitions, independently from their attitude towards social reporting.

Lastly, it would be interesting to verify whether the SE's availability of cash equivalents could modify the quality of social reports (Julian and Ofori-dankwa, 2013; Park et al., 2011) or, if they could motivate SEs to invest in social reports, independently from their financial position.

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