

CORPORATE SUSTAINABILITY DISCLOSURE AND PROFITABILITY OF NIGERIAN LISTED FIRMS IN THE INDUSTRIAL GOODS SECTOR

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Abstract

The ongoing global economic crisis calls for a different but strategic approach to address the problem of profitability being witnessed by corporate entities, particularly in Nigeria. To this end, this research examined the impact of sustainability reporting on the profitability of listed Nigerian firms in the industrial goods sector. The research examined the entire listed companies in the Nigerian industrial goods covering periods from 2015 to 2020. In line with the global reporting initiatives, the research used content analysis to obtain the required information to measure sustainability disclosure. Information about the various dimensions of sustainability disclosure which includes economic, social, and environment was obtained from the annual reports of companies. The data used in this research was analyzed using multiple linear regressions. The research found that while economic disclosure has a significant positive (coef.=0.0249; p-value=0.000) influence on the Return on Assets (ROA), social disclosure has a significant negative (coef.= -0.0866; p-value=0.004) influence. Environmental disclosure does, however, have a statistically insignificant (coef.=0.0050; p-value=0.866) beneficial impact on the ROA. The study concluded that sustainability reporting has influence on the profitability of listed companies in Nigeria's industrial goods sector. Therefore, the research suggests that the government implement regulations for the implementation of corporate sustainability disclosure compliance, and that businesses that violate these regulations should face appropriate sanctions. To advance the principles of sustainability reporting, all parties and policymakers must work together.

Keywords: Corporate Sustainability Disclosure, Profitability, Return on Assets, Nigerian industrial goods sector.

Introduction

The ongoing global economic crisis, which was brought on by the COVID-19 pandemic and the Russia-Ukraine conflict, has made it extremely difficult for businesses to survive worldwide, especially in Nigeria (Nicola et al., 2020). The high cost of raw materials, the scarcity of human resources, the constant demand for wage increases by workers, and the high cost of energy are all symptoms of the world economic crisis. The reduction in customer desire for products due to hike in prices has a negative impact on businesses' sales as well. High operating expenses, weak revenue generation, and labour turnover are just a few effects of the current global economic crisis (Akyüz, 2022).

Therefore, it is worrisome to observe that many companies are currently operating at low margin and some are operating at loss. Literature revealed that many companies ceased operations because they could not, in the face of the present global economic crisis, be managed profitably. Others that continued to operate are on the brink of failing. In a similar vein, allegedly healthy business organizations are only employing survival tactics as a result of the profitability issue (IMF, 2022).

It is clear that business organizations cannot be saved from the current situation by the traditional business model, which is centred on maximizing shareholder wealth. In order to address the current issue, a

comprehensive and integrated strategy is suggested using the legitimacy theory and stakeholder theory as applications. The stakeholder theory and legitimacy theory both suggest sustainability approach to organizational management as panacea for resolving profitability issues. To this end, the research looked at how sustainability reporting affected the industrial goods sector profitability of Nigerian listed companies.

Theoretical Framework and Hypothesis Development

The stakeholder theory and legitimacy theory were applied in this research to investigate the relationship between sustainability disclosure and company profitability. Since these two theories overlap, we talk about them together rather than individually. According to the shareholder theory, the company was founded by its contributors—in this instance, the stockholders—to further their own interests. Therefore, according to proponents of shareholder theory, the goal of the company is profit maximization, and as a result, shareholder wealth maximization (Khaveshi, Nikhashemi, Yousefi & Haque, 2012). The theory also sees the company as a distinct legal entity from its owners, but one that is there to represent the interests of those owners who have ownership stakes in it. It indicates that the stockholders have a claim to the company's net assets. to be run efficiently They are frequently referred to as the firm's financial claims (Jensen, 2001; Low, 2016) However, those who offer a more comprehensive understanding of the firm's goal have harshly criticized this hypothesis. The traditional theory has a significant flaw in that it only has one limited and self-serving goal: maximizing shareholder wealth. In particular, the legitimacy theory and stakeholder theory rely on morality, ethics, and the social contract principle to create a different conceptualization of the firm's goal. According to the two theories, the company is a hub for various interest groups (Gray, Owen & Adams, 2009; Mio, Fasan, Marcon & Panfilo, 2020). That is, rather than serving the interests

of a singular group, the firm is seen as the hub where the interests of various constituents are coordinated and pursued. According to the stakeholder theory, businesses should be run so that the interests of all stakeholders are taken into consideration (Jensen, 2001; Tanjung & Wahyudi, 2019). Who are the corporate stakeholders? The legitimacy theory's underlying tenet, the social contract principle, postulates that the company is a part of the intricate social system it interacts with on a daily basis. According to Shocker and Sethi (1973); Macagnan and Seibert (2021) social organizations, including businesses, function on the basis of a social contract between themselves and the community. According to them, this agreement may be stated explicitly or impliedly. They go on to say that the firm's ability to meet the requirements of the society in which it works and, secondly, to give economic, social, and political benefits to the groups that determine its existence, are what will ultimately determine the firm's survival and development. The word "social contract" refers to the society's unrestricted expectations regarding how corporations should conduct their business (Deegan, 2000; Deegan, 2002). These expectations are shaped by societal views, cultural norms, and values. Some of these expectations are explicit in the sense that they are established as laws or legal demands that companies must abide by, while others are merely implied (Deegan, 2006). Therefore, according to proponents of the stakeholder theory, stakeholders are societal subgroups that are impacted by how a firm operates and as a result, how that firm performs. According to this definition, stakeholders are seen from the perspective of mutual effects on the company and community. Donaldson and Preston (1995); Pinto and Scalzo, 2023 defined stakeholders as those constituents whose support or withdrawal of support determines whether or not the firm would survive from the perspective of where the firm derives its power to survive and potentially expand. They consist of shareholders, current and prospective shareholders, holders of preferred stock and debentures, current and

prospective workers, suppliers, clients, environmentalists, local authorities, governments, labor unions, and political organizations. The organizations on this list of stakeholders can be divided into three categories: social, political, and economic. However, Jensen (2001) goes beyond this list of parties involved by including miscreants like terrorists and criminals as parties with an equal interest in the organization. Stakeholder theory proponents argue that instead of focusing only on maximizing shareholder wealth, businesses should have numerous goals to serve all stakeholders. The proponents of the wealth maximization objective, however, make an effort to provide clarification by claiming that in an environment where all goods are priced and there are no externalities and monopolies, the social welfare objective is achieved if all businesses in the economy maximize profit and, as a result, total market value (which includes but is not limited to equity value) of firms (Jensen, 2001; Jones et. al, 2018; Bridoux & Stoelhorst, 2022). According to this theory, resources are allocated through the capital market in such a way that only companies that are efficient can access the scarce resources (Jensen, 2001). It implies that when businesses are managed profitably in an economy, the needs of all stakeholders are met naturally. For instance, investors would receive a good return on their investments, creditors would be paid on time, employees would receive better pay, potential workers might be hired to fill labor gaps brought on by the company's expansion, and corporate social responsibility might increase. However, proponents of the stakeholder theory contend that each stakeholder group's interest should be regarded as a goal in itself rather than elevating the interest of shareholders above other interests by subsuming them as being supportive of shareholders' interest. (Donaldson & Preston, 1995; Pinto & Scalzo, 2023).

Similar to this, legitimacy theory is an organizational behavior theory (Deegan, 2006; 2019) that contends businesses constantly make sure they function in line with societal

expectations (Guthrie, Cuganesan, & Ward, 2007; Olateju et.al., 2021). As a method of legitimization, the theory offers an explanation for organizational behavior and routines. This definition makes it obvious that the organization's goal is to satisfy society as a whole, not just the expectations of its shareholders. The phrase corporate legitimacy is used to denote agreement between the firm's and society's value systems. It is a situation where corporate practices are in balance with societal laws, customs, expectations, values, and norms. It is the harmony between the cultural environment and organizational conduct. Consider the company's right to live indefinitely as another way to define legitimacy. Stakeholders' recognition of the firm's legitimacy acts as the basis for the firm's existence. It also supports a company's right to operate in society. According to Suchman (1995), legitimization is the process by which the firm informs the community that its social value system complies with the community, which functions as a justification for its existence (Verena, 2019; Girschik, 2020).

Therefore, legitimacy happens when the firm's value system mimics the laws, customs, cultures, beliefs, values, and expectations of the community of which the firm is a part. Additionally, validity is dynamic and evolves over time (Deegan & Rankin, 1997). This is due to the fact that cultural and religious views can alter over time. For instance, female circumcision used to be a socially normal practice, but in the modern world it is no longer acceptable due to a strong campaign against it in the media and on other platforms. Therefore, any group that still promotes female circumcision risk losing the legitimacy that was previously bestowed upon it when this practice was deemed acceptable by society. It means that where there is a discrepancy between organizational practices and societal expectations (actual or prospective), a firm's legitimacy may be in jeopardy (Guthrie, Cuganesan & Ward 2007; Olateju et.al., 2021). Since legitimacy is granted based on the impression or presumption that businesses operate within their cultural environment, it could be

jeopardized if there is a discrepancy between the behavior of a company and what is expected of it by society. On the other hand, it has occasionally been seen that legitimate businesses will disregard social norms without losing that legitimacy. This further demonstrates that legitimacy is not static but also a societal perception or presumption about the company. The legitimacy type—pragmatic, moral, or cognitive—explains how groups become legitimate. The pragmatic legitimacy is concerned with how the company is rated by institutional investors and environmental authorities for its capacity to distribute financial gains to society's constituents. Instead of evaluating a firm's actions based on the distribution of financial benefits, the general public tries to determine whether they are morally right or wrong (Suchman, 1995; Burlea & Popa, 2013; Kuruppu et.al., 2019). On the other side, understanding the firm rather than evaluating it is what gives the firm its cognitive legitimacy. Constituents attempt to accept organization as essential in this situation based on a culture that is taken for granted. Considering both evaluative and cognitive perspectives, Suchman (1995); Olateju et.al., (2021) defined legitimacy as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions." According to the legitimacy theory, organizations continually make sure that their actions reflect what society expects of them. It indicates that organizations regularly seek at least one of the following: establishing, preserving, or reestablishing legitimacy. Repairing a damaged legitimacy is an organization's most challenging goal of legitimacy. Organizational legitimacy is typically difficult and troublesome. It is complicated in that it has many facets based on the fluidity of people's cultures and the fact that validity is based on the collective opinion of society's members. Legitimacy is a challenge because social expectations and values are frequently incompatible, dynamic, and challenging to practically measure, particularly for large corporations and

multinational organizations with stakeholders from various nations with varied cultural backgrounds and religious backgrounds. This issue is also related to the stakeholder theory, which suggests numerous goals for the company. Organizations that have numerous goals and stakeholders with divergent but conflicting interests will undoubtedly experience crises. It is not realistic to pursue numerous objective functions simultaneously without making any trade-offs (Jensen, 2001; Bridoux & Stoelhorst 2016). Because legitimacy is a perception, organizations find it challenging, if not impossible, to maintain legitimacy in the face of shifting societal norms and a variety of objective duties. To close the legitimacy gap, organizations are urged to stay current on developments in their cultural environment. However, when organizational legitimacy is at risk, the following things may happen: reduced demand for products; employees' potential to leave the company, which would increase labor turnover; the withdrawal of financial support from investors like shareholders and holders of debentures and suppliers, which would stop supply; and public pressure on the government to raise taxes or impose sanctions on the company (Deegan & Rankin, 1997; Diouf & Bioral, 2017). According to Dowling and Pfeffer (1975), affected firms may implement the following strategies to manage this situation (illegitimacy): the organization may alter its current practices, processes, operations, activities, policies, and values to comply with societal expectations. The public is informed of such changes, among other ways, through the media and the organization's yearly reports. While no changes are made to the organization's current practices, the second possible approach involves making an effort to change how the public perceives the organization. This tactic is typically used when an organization believes that the public only misunderstands its present behavior and not how far away from societal values its actions actually are. Thirdly, if an organization is completely aware that its current behavior violates societal norms but is unwilling to change, it may try to deflect attention from the

current situation by employing emotive symbols. Last but not least, the organization might make an effort to redefine what societal expectations are in order to represent its current practices. It is crucial to note that organizations' legitimization tactics largely rely on whether their goal is to establish, preserve, or restore legitimacy (Deegan, 2006; Deephouse, 2017). Dowling and Pfeffer (1975) divided their four potential legitimacy strategies into two categories: symbolic and real legitimization strategies. The first strategy is classified as substantive because it calls for the organization to modify its existing procedures. Although it can be very expensive, it is significant because the organization would need to change its current practices to meet societal standards. Managers often favor the symbolic strategy, even though society typically favors the substantive strategy due to the difficulties and costs associated with it (Suchman, 1995; Deephouse, 2017; Lodhia et al., 2022). On the other hand, symbolic strategy focuses primarily on impression management and the use of emotive symbols to persuade the public that the organization adheres to societal ideals. The second, third, and fourth legitimization techniques are therefore categorized as metaphorical. Most organizations that are facing threats to their legitimacy and trying to fix it use this approach. Both symbolic and substantive legitimization tactics depend heavily on communication. The media and corporate reporting, which among other things includes reporting on sustainability, are typically the channels of communication. Therefore, sustainability reporting is viewed in this research as a channel of communication between organizations and the public that leads to legitimization. More specifically, sustainability reporting is taken into account in this research as a component of the intricate legitimization process that has the power to affect organizational performance.

According to Blake and Barrie (1990), legitimacy is a resource that can be used as a competitive advantage by a company, especially when it is granted by the society. Suchman (1995) asserts that there are two

approaches to legitimacy, namely, strategic and institutional, in order to create this notion. Legitimacy is an operational resource that the organization extracts from its cultural environment for its own advantage over rivals, according to the strategic approach that partially explains the current study (Suchman, 1995; McWilliams, Siegel & Wright, 2006; Lehner et al., 2019). It demonstrates the close relationship between an organization's legitimacy and success. This can be explained by saying that when a company is given legitimacy, it is proof that its methods (operations, activities, input, practices, policies, and so on) and objectives (products, employee satisfaction, corporate social responsibility performance, distribution of benefits to constituents, and corporate disclosures, among others) are acceptable to the society. Additionally, it demonstrates that the group has the support and cooperation of the relevant stakeholders. Therefore, maintaining a customer's loyalty, for example, has a big impact on the income of an organization and, as a result, the profit. Second, an organization's performance would be impacted favorably if it could garner public support by informing the public about the alignment between its activities and societal values through corporate disclosure, especially sustainability reporting. To this end, the current study makes the following hypothesis that economic reporting, social reporting and environmental reporting significantly affect firms' profitability.

Previous studies have used the stakeholder and legitimacy theories to explain organizational behaviors as a part of the legitimization process to secure the support of stakeholders for survival and development. The theories have served as a lens through which to assess disclosure-related motivations, especially sustainability reporting (Freeman 1984; Miles, 2019; Dmytriyev, Freeman & Hörisch, 2021). Stakeholder theory and legitimacy theory have specifically been used to examine organizational behavior, specifically voluntary disclosure, mandatory disclosure, stakeholder management, sustainability reporting, and corporate social

responsibility performance reporting. These investigations' conclusions are conflicting and ambiguous. However, there are few studies that have examined the relationship between organizational behavior, such as legitimization activities, stakeholder management, and organizational success using a strategic approach to legitimacy and the instrumental power of stakeholder theory. As a result, this research investigates the relationships between sustainability reporting (a legitimization activity and stakeholder management practice) and profitability. Legitimization activities of legitimacy theory are similar to stakeholder management of stakeholder theory. Few studies that looked at the connection between sustainability reporting and company performance came up with contradictory findings. Researchers such as Lopez, Garcia, and Rodriguez (2007), Nur, Boon, and Tze (2016), Clarissa and Rasmini (2018), Tri and Yuni (2018), Swarnapali and Li (2018), Emeka, Nwokeji, and Osisioma (2019), and Oncioiu, Petrescu, Bilcan, Petrescu, Popescu, and Anghel (2020) in particular discovered a favorable relationship between corporate performance and sustainability reporting. However, Ighosewa, Enaibre, and Felix (2021) discovered a substantial, yet adverse, correlation between performance and sustainability reporting. Asuquo, Dada, and Onyeogaziri (2018), Memed and Amir (2020), Agu and Amedu (2018), Asuquo, Dada, and Onyeogaziri (2018) on the other hand, did not discover any proof of a link between sustainability reporting and performance.

Methodology

For the investigation, an explanatory research design was used. However, this design is considered suitable because it enables the researcher to focus on how changes in one variable affect or are caused by changes in another variable.

In order to gather data for this study, pertinent information was taken from the audited annual reports of the sample companies that were chosen. The companies included in this study's sample were given a score for their sustainable disclosure

performance (independent variables) using content analysis. Based on the performance indicators for the Specific Standard Disclosures given in Global Reporting Initiative Guidelines G4, these independent variables were scored (GRIG4). Using a multiple regression model, the obtained disclosure index was then used to assess the effect of corporate sustainability reporting on company profitability. All registered industrial goods companies in Nigeria make up the study's population. Thirteen (13) companies are currently listed in the industrial goods category. The researcher used all 13 listed companies in the industrial goods industry because of the size of the industry.

Disclosure on the company's sustainability is one of the independent variables. This disclosure is broken down into three categories: economic, environmental, and societal sustainability (Dissanayake, Tilt & Qian, 2019). Economic disclosures, environmental disclosures, and social disclosure make up the three independent variables for this research. The independent variables were evaluated using the Disclosure Index. The economic aspect of sustainability, according to the Global Reporting Initiative (2013), Christensen, Hail & Leuz (2021), Awodiran (2019), Orazalin & Mahmood (2019), Al-Shammari (2022) relates to how an organization affects the financial health of its constituents and the local, national, and international economic systems. The environmental aspect of sustainability looks at the organization's impact on living and non-living natural systems, including land, air, water, and ecosystems (Morales-Raya, Martín-Tapia & Ortiz-de-Mandojana, 2019; Mijatovic, Maricic & Horvat, 2019), while the social aspect of sustainability refers to the effects the organization has on the social networks in which it operates. These two aspects of sustainability do not focus on the organization's financial situation. The disclosure-related categories were given a score of "1" for presence of disclosure and "0" for absence of disclosure. Information on sustainability reporting was taken from the yearly reports using content analysis.

Quantifying qualitative material is possible thanks to content analysis. Consequently, a firm could score a minimum of 0 and a maximum of four, twelve and thirty (4, 12 & 30) points on economic, environmental and social categories respectively.

The formula used to calculate the index score is:

$$\text{Index of CSD_GRI Disclosure Rate} = \frac{\text{Total Actual Disclosure}}{\text{Total GRI Disclosure Requirement}}$$

From the above formula, the denominator represents the overall amount of items that the firms are expected by GRI standards to report. As a result, it requires values of 4 for the economy, 12 for the ecosystem, and 30 for society. The numerator is the total score for the actual disclosure, which has a value of 1 if a company reports a particular item under the economic, environmental, or social categories and a value of 0 otherwise. The number 0 indicates that the firms did not disclose any items in accordance with GRI guidelines, while the index of 1 indicates complete disclosure (i.e., all items were disclosed). Values that fall exclusively between 1 and 0 denote limited disclosure. The dependent variable, profitability, was assessed using return on assets (Margaretha & Supartika, 2016; Grewatsch & Kleindienst, 2017; Dwi Sihono & WIDARTI, 2021). Profitability

gauges how much profit a business can make from its assets. In other words, it demonstrates how effectively a company's management produces profits from the resources or assets.

The formula of ROA:

$$\text{ROA} = \frac{\text{Profit after tax}}{\text{Total assets}}$$

The formulated hypotheses were put to the proof using multiple linear regression analysis. This method evaluates the impact of two or more independent factors on a dependent variable.

A functional relationship was developed in the form of a multiple linear regression model with dependent and independent variables in order to accomplish the goals of this research and test the hypotheses. The equation for multiple linear regressions is given as follows;

$$\text{ROA}_{it} = \beta_0 + \beta_1 \text{ENVIND}_{it} + \beta_2 \text{SOCIND}_{it} + \beta_3 \text{ECOIND}_{it} + \varepsilon_{it}$$

Where;

ROA= Return on Asset

β_0 - β_3 are the regression coefficients

ε_{it} = error term

ECOIND= Economic Performance Disclosure Index

ENVIND= Environmental Performance Disclosure Index

SOCIND= Social Performance Disclosure Index

Result and Discussion of Findings

Table.4.1: Model Estimation Results

Variables	Pooled OLS	p-value
ENVIRONMENTAL INDEX	0.0049851	0.866
SOCIAL INDEX	-0.0866155	0.004
ECONOMIC INDEX	0.2488832	0.000
Constant	-0.1219527	0.015
Wald Test	25.33	0.000
R^2	0.5135	
No of Group	13	

Source: Researcher's compilation (2022).

The regression results for listed Nigerian companies in the industrial goods sector are shown in Table.4.1. The results have a 95% confidence interval and are considered as significant at p values less than 5%. The model describes about 51% of the data, according to the R² value of 0.5135. According to the study of the coefficients, ROA at 5% is positively affected by ENVIROINDEX in a statistically insignificant way (0.0049851) (p=0.866). ROA at 5% is negatively affected by SOCIALINDEX by a statistically significant amount (-0.0866155; p=0.004). It suggests that a 1% rise in SOCIALINDEX will result in a 0.08615% reduction in ROA. At 5%, ROA is positively impacted by ECONINDEX in a statistically significant manner (0.2488832; p=0.00). According to this, ROA will rise by 0.2488832% for every 1% growth in the ECONINDEX. Therefore, this research concludes that while environmental performance disclosure has a negligible impact on the ROA of listed industrial goods firms in Nigeria, economic and social performance disclosure has a significant impact on ROA of listed firms in the sector.

According to the research, social performance significantly reduces the assets returned by Nigerian listed industrial goods companies. This result confirms the work of Mtaturu & Muloli (2021). The research also discovered that the return on assets of listed industrial goods firms in Nigeria is significantly enhanced by the disclosure of economic performance. The result of this research concurs with those of Babalola and Abiodun (2012); Kasbun, Teh & San Ong (2016), Bacinello, Tontini and Alberton (2021). This suggests that economic performance during the studied time influenced the return on asset favorably. Consequently, there is a need to increase the economic performance disclosure of the listed companies in Nigeria's industrial goods industry. The results of this research concur with those of Nur, Boon, and Tze. (2016). The research also discovered that environmental performance disclosure has a negligible impact on listed companies in Nigeria's industrial goods sector's return on assets. This suggests

that the return on asset during the study time was unaffected by environmental performance disclosure. As a result, the phenomenon of increased disclosure of environmental performance has not resulted in a substantive improvement of the real segment of the economy. This outcome is consistent with what Asuquo, Dada, and Onyeogaziri (2018) found.

Conclusion and Recommendation

This study's findings demonstrate that the disclosure of economic and social performance has a substantial impact on return on assets. This suggests that firms' disclosure requirements should effectively take into account disclosure of economic and social success. Additionally, it demonstrates that environmental transparency positively and negligibly affects ROA.

This research comes to the conclusion that the profitability of listed Nigerian companies in the industrial goods sector is not statistically significantly impacted by sustainability reporting. The researchers advise the government to incorporate sustainability disclosure in partnership with private and public agencies and to take into account the requirements for business sustainability framework and database to coordinate social, economic performance, and environmental reporting across the nation. Our results generally imply that better governmental regulation, enforcement, and environmental impact analysis should be seriously considered rather than voluntary measures for companies to behave in a socially responsible way. The sample size is the main drawback of this research. Additionally, these results were materially impacted by the companies' failure to reveal corporate sustainability disclosure in the annual reports. The adoption of the international standard on social responsibility (ISO 26000) in Nigeria will be an intriguing topic for future study into the new trend in the quality and quantity of environmental disclosure in annual reports.

To improve their company's image, it is advised that managers of listed Nigerian firms in the industrial goods sector maintain

complete sustainability disclosure, particularly the Economic performance, Environmental, and Social disclosure index. There is a need however, for additional research because the issues raised by this study cannot be addressed by a single investigation.

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