The Impact of Adopting Corporate Social Responsibility on Corporate Financial Performance: Evidence from Jordanian Banks

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Abstract

This study aims to present a suggested framework for Corporate Social Responsibility (hereafter CSR) and to examine if there is a relationship between (CSR), bank size, the level of risk in the bank and Advertising Intensity (hereafter ADINT) on one hand and the Corporate Financial performance (hereafter CFP) on the other hand in the Jordanian banking companies. As such, this study relied on the financial reports from banking companies listed in Jordanian Stock Exchange for the year 2011 and conducted literatures and empirical studies to obtain the results. Statistical techniques are used to analyze data. Throughout this study, it is concluded that there is a significant positive relationship between (CSR), bank size, the level of risk in the bank and (ADINT) on one hand and (CFP) on the other hand in the Jordanian banking companies. The study has insisted on the importance of adopting (CSR) in the banking sector and the importance of preparing more researches related to (CSR) field.

KEYWORDS: CORPORATE SOCIAL RESPONSIBILITY, CORPORATE FINANCIAL PERFORMANCE.

1. Introduction

The financial statements are the main tool for external and internal stakeholders to measure the management performance. An important component in the financial statements which are often used as a tool to inform management performance is the net income. Therefore, profit is an indicator of the Corporate Financial performance (hereafter CFP), and it might also be used by stakeholders as a basic for economic decision making and to ensure the continuity of their main interests in the company. Furthermore, the government uses income as a basic for calculating corporate income tax. (Rahmawati and Putrid, 2011)

Corporate social responsibility (CSR) has become an important center of concentration among companies. A recent global survey shows that 76% of managers believe that corporate social responsibility contributes positively to long-term shareholder value, and 55% of them agree that sustainability helps their companies build a strong reputation (McKinsey 2010). In the Western countries today, consultancy firms have sprung up to advise corporations on how to implement Corporate Social Responsibility (hereafter CSR) and how to let the public knows about such implementation. Most multinational companies also have a senior manager explicitly charged with developing and coordinating the CSR function (Dusuki, 2008)
The aim of this study is thus to examine the relationship between (CSR), bank size, the level of risk in the bank and (ADINT) on one hand and the (CFP) on the other hand in the Jordanian banking companies.

2. Literature review and hypotheses

2.1 Theories supporting CSR

The discussion so far has described the emergence of CSR as a framework for the role of business in society, setting standards of behavior to which companies must subscribe to impact society and environment in a positive and a productive manner. The following represent the major theories that support the practice of CSR. (Dusuki, 2008).

2.1.1 The classical view of CSR

In this view the Social Responsibility of Business is to Increase Its Profits, Friedman argues that having corporate officials extend their social responsibilities beyond serving the interests of their stockholders is fundamentally a mistaken belief of the character and nature of business in a free economy. In such an economy: “there is one and only one social responsibility of business -to use its resources and to engage in activities designed to increase its profit.

2.1.2 Social contract theory

The central idea of the social contract theory is how to relate a corporation to society. According to this theory, business must act in a responsible manner not only because it is in its commercial interest to do so, but because it is part of how society implicitly expects business to operate. Furthermore, according to the social contract paradigm, a business is regarded as a social institution and should join with other social structures like the family, educational system and religious institutions, to help enhance life and meet needs.

2.1.3 Agency theory

Agency theory proposes that during a transaction, one transactor, (the principal) designates another person (the agent) to act on his or her behalf. This requires the principal to trust the agent under imperfect information and uncertain outcomes. Friedman (1970) draws on agency theory in his criticism of CSR, explaining that managers, as agents for the owners of the firm, have a responsibility to maximize the corporation’s profits; to spend money doing anything else is an abuse of the relationship. However, Carroll (1979) points out that the economic and societal interests of the firm are often intertwined; for example, product safety is of concern both at the economic and societal levels. Therefore, practicing CSR may be in the best economic interests of the firm. (Foote, et., al. 2010).

2.1.4 Stakeholder theory

While previously only the effects of corporate actions on actual shareholders were considered, Freeman and Reed developed the theory that there are other groups whose needs should be considered as well, adding employees, customers, and society at large, among others, to the list of a firm’s constituents: ‘There are other groups to whom the corporation is responsible in addition to stockholders: those groups who have a stake in the actions of the corporation’ (Foote, et., al., 2010).

2.1.5 The resource-based view of the firm

Barney and Zajac (1994) countered the popular assumptions that resources are equally distributed to all firms and developed the theory that not only is resource distribution unequal throughout an industry, but firms can capitalize on their strengths and use them as a competitive advantage. McWilliams and Siegel, 2000) point out that for profit-maximizing firms, CSR can be utilized for purposes of creating strategic advantages.

2.2 The CSP-CFP relationship

A review of the different theoretical proposals on the relationship between corporate social performance (CSP) and (CFP) offers arguments for all the possibilities, negative, neutral or positive, among which the most relevant are: (Jose et al, 2007)

– Negative: Justified by the fact that companies that behave responsibly are at a competitive disadvantage as they incur costs that they would otherwise avoid, or could pass on to other agents (for example, customers or government). According to this reasoning, there are few economic benefits for socially responsible behavior, at the same time as there are many costs, thus leading to the expectation of a fall in the FP of the company (Friedman, 1970).
Neutral: A denial of the existence of any kind of relationship, either positive or negative, between social and financial performance. The authors who hold this view (Ullman, 1985) argue that there are so many factors or variables that intervene between social and FP that there is no reason for the existence of any relationship between the two variables, except possibly by chance, which, together with the measurement problems that have plagued CSP research, may have masked any such relationship.

Positive: This third perspective proposes that there is a tension between the explicit costs of the company (for example, payments to bondholders) and their costs implicit to other agents (for example, product quality costs or environmental costs). So, a company that tries to reduce its implicit costs by means of socially irresponsible acts will incur greater explicit costs, the result of a competitive disadvantage.

The lack of consensus on the impact of CSR on firm performance can be attributed to many different causes such as a lack of a clear and precise definition of CSR, a lack of a clear CSR metric, and the impact of contextual factors.

2.3 Measuring CSR or corporate social performance

Corporate Social Performance (CSP) can be defined as ‘a business organization’s configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm’s societal relationships.

How to measure a company’s CSP has been a topic of much debate. Having a valid measure is important for researchers, investigating the relationship between different organizational measures and CSP and for stakeholders employing social performance information in their decision making models. Past measurements have been based on various information sources such as government pollution indices, financial reports, reputational surveys, and CSR orientation studies. While all of these have virtues, none accurately measure the outcomes of CSR initiatives.

3. Previous studies

The quantity of research produced has increased enormously over the last decade, and touches nearly every facet of business theory and some of these research’s are:

3.1 Moses L. Pava, Joshua Krausz, 1996, aimed to explain the relationship between (CSR) and traditional financial performance, through examining long-term financial performance. They used the literature review in the first section to show that the paradox of social cost could be explained by five explanations and used The CEP ratings, based on an assessment of 12 specific CSR components as a measurement of (CSR), and then put the criteria for measurement of the (FP) depend on market base, accounting base, measure of Risk. Other firm specific characteristic. They took 53 company listed in Council on Economic Priorities (CEP) {socially response} and compared the financial performance of this group with another group as a control sample, which is similar in both size and industry, and they found a little evidence to suggest a positive association between SR and traditional financial performance.

3.2 Lee E. Preston, Douglas P. O’Bannon, 1997, analyze the relationship between indicators of Social Responsibilities and Financial Performance, through examining data from 67 large U.S Corporation for 1982-1992, by using a typology and analysis; they used four trends in discussing this relation 1) social impact hypothesis 2) Trade-off hypothesis 3) available Fund and 4) Finally managerial opportunism hypothesis, and they found a strong positive correlation either by positive synergies or by available funding.

3.3 Curtis C. Verschoor, 1998, here The researcher examine the 500 largest public U.S companies that make a commitment to their stakeholders to deal with their interest with a code of ethics. Upon the researcher it’s the first time that takes this scale of companies in the studies and the result showed that the financial performance of the companies stated commitment in their reports is higher than those not report or didn’t make any reference to ethics.

3.4 A. McWilliams and D. Siegel, 2000, studies the impact of (CSP) on financial performance, they used two models to study this equation; the first is “the relationship between (CSP) and CFP and they used the statistical regression to emphasize the correlation between corporate social responsibilities and corporate financial performance through including R&D and advertising intensity to the second model they found that there is a high correlation between (CSP) and R&D. when they use the R&D the (CSP) shows a natural effect on CFP.
So the researchers encourage readers to be aware of models that claim to explain firm’s performance and not to include important strategic variables such as R&D intensity.

3.5 **Marc Orlitzky, 2001**, This study investigate wither the relationship between (CSP) and CFP regarding to level of the corporate size and the researcher use for this purpose integrating three variables meta-analysis first: (CSP) and CFP, second: firm size and (CSP), third: firm size and CFP.

The individual-link and fit analysis suggest that organizational size has no significant path to (CSP) or CFP, and the only path that cannot be dropped in these three variables model, is from (CSP) to CFP.

3.6 **A. Mackey, et. al. 2007**, In this paper the researchers built a theory on a sample observation that equity holders may sometimes have interest besides simply maximizing their wealth when they make their investment decisions, they developed a model adapting a market definition of firm’s performance by focusing on how socially responsible corporate activities affect firms market value, this model used to describe the impact that beginning or ending socially responsible activities that reduce the present value of firms cash flow will have on the firm’s market value.

The model suggests that there will be a positive correlation between firm’s choices about investing in socially responsible activities and firm’s value.

The paper provides an explanation of, when investment in these kinds of socially responsible activities will occur.

3.7 **Chung-Hua Shen and Yuan Chang, 2009**, The purpose of this study is to investigate the financial performance with regarding to (CSR)) and (NON-CSR), they used a sample of Taiwan’s data from 2005-2006, and used matching theory and propensity score matching methodology to emphasize the effect of adapting (CSR) on financial performance and distinguish between two a broach, first: the social impact hypothesis and the second: the shift of focus hypothesis

They found a positive relation with the CFP regarding to (CSP) companies.

3.8 **J. Surroca, et. al., 2010**, examined the relationship between (CSP) and CFP with regarding to intangible recourses, they advanced the understanding of the relationship between CRP and CFP in three ways: theoretically, empirically, and methodologically.

The main proposition of this paper is that intangibles mediate the relationship between CRP and CFP which operates in both directions, they used an international database provided by sustainalytic responsible investment services, and their sample was 599 firms from 28 nations.

The result of this study shows positive associations between firm’s intangibles and both measures of performance (CSP) and CFP.

3.9 **R. G. Castro, et. al., 2010**, This article deals with the specific issue of the endogeneity of strategic decisions through studying the relationship between SP and FP. They used a panel based on the 658 firms included in KLD database and covered 15 years (1991-2005), and used standard OLS regression analysis.

The result suggest that KLD doesn’t impact performance, the positive impact found is due mainly to the fact that firms that adopted high standards of KLD self selected themselves, that positive effect dilutes when Endogeneity is properly taken into account.

3.10 **Jong-Seo Choi, et. al., 2011**, studied the empirical relation between (CSP) and CFP in Korea, they used a sample of 1222 firm during the years 2002-2008, and they measure (CSP) by both equal weighted (CSR) index and stakeholders weighted (CSR). And they measure CFP by (ROA),(ROE) and (Topin’Q). They used cross-sectional regression model using four factors model, they analyzed wither investors can obtain abnormal returns by employing socially responsible screens.

They founded a positive and significant relationship between CFP and stakeholders weighted (CSR) index but not the Equal weighted (CSR) index

3.11 **Maria-Gaia Soana, 2011**, This article studies the relationship between the (CSP) which is measured by an ethical rating and CFP which is measured by market and accounting ratios, to overcome the limitations of previous studies, she took a sample of banks working in Italy, she carried out a quantitative analysis of 21 international banks rated by ethical on 31-12-2005 and 16 Italian bank rated by AXIA on 31-12-2005, and used a correlation methodology and the result was that there is no statistically significant link between (CSP) and CFP.
3.12 A. M. Esteves, and M.-A. Barclay, 2011, the focus of this article is on the minerals industry, where companies currently face the challenge of matching corporate drivers for strategic partnership with community needs for programs that contribute to local and regional sustainability. While many global mining companies advocate a strategic approach to partnerships, there is no evidence currently available that suggests companies are monitoring these partnerships to see if they do, in fact, represent ‘strategic’ investments. This article argues that applying the management concept of ‘investment performance’ to corporate–community partnerships requires questioning traditional evaluation methods that focus on the results of programmes or activities. they adopt a case study approach to introduce an evaluation framework that considers performance from both corporate and community perspectives and that conceptualizes partnership performance as comprising four aspects: (1) the contribution of the partnership to the overall portfolio of a company’s community investment programs, (2) the appropriateness of the partnership model, (3) the effectiveness of the partnering relationship and (4) the ability of the partners to achieve program goals. The application of this evaluation framework to an established corporate–community partnership program provided some useful insights as to how partnership performance can be improved.

And the approach applied to the LCF evaluation involved a combination of method qualitative and quantitative

3.13 M. L. Andersen and L. Olsen, 2011, A major stream of research has resulted from efforts to understand the relationship between social performance and financial performance that exists for corporations. Can a company do well by doing well? Using canonical correlation, the results of this study indicate a strong relationship between a company’s social performance and its financial performance. Further, this association differs across industries. In examining social performance, both strengths and concerns are important and should be considered separately.

Finally, this study points to the importance of operating income as a key financial performance measure.

They used canonical correlation analysis which examines the simultaneous relationship between two set of variables

3.14 Z. TANG, et. al., 2011, hypothesize that (CSR) engagement involving a slow pace, a consistent approach, a focus on related (CSR) dimensions, and an internal-to-external path will enhance the positive contribution of (CSR) to financial performance. Panel analysis on longitudinal data collected from 130 firms from 1995 to 2007 verified most of their hypotheses. They collected sample from environment social and governance (ESG) database provided by Morgan Stanley capital international (MSCI), and match these data with company financial data from the compustat data

3.15 D.J. Wood, 2010, This paper reviews the literature on corporate social performance (CSP) measurement and sets that literature into a theoretical context. Following a review of (CSP) theory development and the literature on relationships between (CSP) and corporate financial performance, Wood’s (CSP) model (Wood, D.J. (1991). Corporate social performance revisited. Academy of Management Review, 16, pp. 691–718) is used as an organizing device to present and discuss studies that use particular measures of (CSP). Conclusions emphasize the need for (CSP) scholars to refocus on stakeholders and society, and to incorporate relevant literatures from other scholarly domains

3.16 Rahmawati and Putrid Septia Danita, 2011, examined the relationship between the (CSR) and earning management in the impact of this relationship on corporate performance in the future, the study was about 27 company in Indonesia stock exchange during 2006-2008. They developed model depending on secondary data taken from annual reports for companies listed on Indonesian stock exchange and they used ordinary least square regression and they give an evidence that the earnings management have no influence on (CSR) and the practice of earning management negatively affect the financial performance.

4. Research Method

According to the previous studies, the researchers found that most studies reviewed seem to confirm the existence of a positive relationship between CSP and CFP, the results cannot be generalized to all markets and sectors so this study will examine this relation in the banking sector in Jordan, so the study determines the factors as follows:

- **(CFP):** Dependent variable and the financial performance are measured using the Return on Assets (ROA). ROA is the ratio of net income before tax to total asset value
- **CSR:** independent variable it is measured in this study by the ratio of the amount of donation disclosed to interest revenue plus the ratio of training expenses to interest revenue, In the opposite, earlier studies have used number of
pages, number of sentences, number of documents, proportion of a page proportion of total disclosure and number of words. (S. Manasseh, 2004)

- Firm size (SIZE): independent variable, Size of company is measured by the total assets.
- RISK: independent variable is a source of corporate finance from third parties (i.e., deposits). Leverage is measured by the ratio of total liabilities to total assets. Leverage a previous period represents an enterprise risk that could affect the company’s financial performance in the future.
- Advertising Intensity (ADINT) of the bank: independent variable measured as (adv. Exp./ interest revenue)

Upon these factors we hypothesize that

**H01**: There is no significant relationship between the levels of bank (CSR) and the bank’s (CFP).
**H02**: There is no significant relationship between bank size and (CFP).
**H03**: There is no significant relationship between the level of risk in the bank and (CFP).
**H04**: There is no significant relationship between the level of advertising exp. in the bank and (CFP).

To test our hypothesis, we used the model estimated by McWilliams and D. Siegel, 2000 after omitting the industry of firms because we select only banking sector for this study although we omit research and development from the model because there is no R&D expenses in Jordanian banks to measure the effect of this factor on the financial performance.

$$\text{CFP} = f (\text{CSR}_i, \text{SIZE}_i, \text{RISK}_i, \text{ADINT}_i)$$

### 4.1 Data and Sample

All data to test the model of this study are secondary data taken from annual financial reports from banking companies listed in Jordanian Stock Exchange for the year 2011, with the aim of verifying the relationship between CSP and CFP; we carried out a quantitative analysis on a sample of Jordanian banks out of thirteen Jordanian commercial banks.

### 4.2 Hypothesis Test

Depending on the statistical analytical plus simple and multiple regressions, using SPSS, the study found the following results:

- **H01 Test**: There is no significant relationship between the levels of bank (CSR) and the bank’s (CFP).

Where the calculated t is larger than Scheduled t. Therefore, we reject the null hypothesis that said there is no significant relationship between the levels of bank (CSR) and the bank’s (CFP), and we accept the alternative hypothesis that said there is a significant relationship between the levels of bank (CSR) and the bank’s (CFP).

- **H02 Test**: There is no significant relationship between bank size and (CFP).

Where the calculated t is larger than Scheduled t. Therefore, we reject the null hypothesis that said there is no significant relationship between bank size and (CFP), and we accept the alternative hypothesis that said there is a significant relationship between bank size and (CFP).

- **H03 Test**: There is no significant relationship between the level of risk in the bank and (CFP).

Where the calculated t is larger than Scheduled t. Therefore, we reject the null hypothesis that said there is no significant relationship between the level of risk in the bank and (CFP), and we accept the alternative hypothesis that said there is a significant relationship between the level of risk in the bank and (CFP).

- **H04 Test**: There is no significant relationship between the level of advertising exp. in the bank and (CFP).
Where the calculated $t$ is larger than Scheduled $t$. Therefore, we reject the null hypothesis that said there is no significant relationship between the level of advertising exp. in the bank and (CFP), and we accept the alternative hypothesis that said there is a significant relationship between the level of advertising exp. in the bank and (CFP).

**Model Test**

Depending on the statistical analytical plus simple and multiple regressions, using SPSS, we found the following result:

Where the calculated $f$ is larger than Scheduled $f$. Therefore, the model is accepted.

**5. Results**

5.1 There is a significant relationship between the levels of bank’s (CSR) and the bank’s (CFP).

5.2 There is a significant relationship between bank’s size and (CFP).

5.3 There is a significant relationship between the level of risk in the bank and (CFP).

5.4 There is a significant relationship between the level of advertising expenses in the bank and (CFP).

5.5 (CSR) relate to society’s needs and the nature of surrounded environment.

**6. Recommendations**

6.1 Banks should take into their consideration the positive effect of (CSR) on their (CFP), and Stockholders should support the management to use (CSR) because of its great impact on the surrounded society.

6.2 Banks need to think beyond what’s affecting them in this time to what’s going to happen in the future. This is not just about addressing changes to technology or the needs of customers, but also taking into consideration changes in social, governance and environmental aspects.

6.3 Researchers should study the positive role that (CSR) plays in the (CFP), and explore whether or not CSR should stem from organization, or consumers.
References

## Annexure

### Table (1) Taxonomy of studies

<table>
<thead>
<tr>
<th>Dependent dimensions</th>
<th>Sub dimensions or discretion</th>
<th>Researchers</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFP accounting based ratio</td>
<td>- ability to select and retain good</td>
<td>- Lee E. et. al. 1997</td>
</tr>
<tr>
<td></td>
<td>- quality of products and services</td>
<td>- Curtis C. Verschoor, 1998</td>
</tr>
<tr>
<td></td>
<td>- stakeholders management</td>
<td>- A. McWilliams and D. Siegel, 2000</td>
</tr>
<tr>
<td></td>
<td>- fund a discrete bundle of socially responsible initiatives</td>
<td>- A. Mackey, et. al. 2007</td>
</tr>
<tr>
<td></td>
<td>- charity giving</td>
<td>- Chung-Hua Shen and Yuan Chang, 2009</td>
</tr>
<tr>
<td></td>
<td>- affirmative action’s and or diversity practices</td>
<td>- J. Surroca, et. al., 2010</td>
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<tr>
<td></td>
<td>- employee relations</td>
<td>- R. G. Castro, et. al., 2010</td>
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<tr>
<td></td>
<td>- environmental protections</td>
<td>- Jong-Seo Choi, et. al., 2011</td>
</tr>
<tr>
<td></td>
<td>- product safety and quality practices</td>
<td>- Maria-Gaia Soana, 2011</td>
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<td></td>
<td>- corporate image management practices</td>
<td>- Z. TANG, et. al., 2011</td>
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<tr>
<td></td>
<td>- political contributions</td>
<td>- D.J. Wood, 2010</td>
</tr>
<tr>
<td></td>
<td>- public affairs activities</td>
<td>- Rahmawati and Putrid Septia Danita, 2011</td>
</tr>
<tr>
<td></td>
<td>- corporate governance</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Human rights</td>
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**Dependent dimensions**
- CSR
- Ethical responsibilities
- Legal responsibilities
- Economic responsibilities

**Sub dimensions or discretion**
- ability to select and retain good
- quality of products and services
- stakeholders management
- fund a discrete bundle of socially responsible initiatives
- charity giving
- affirmative action’s and or diversity practices
- employee relations
- environmental protections
- product safety and quality practices
- corporate image management practices
- political contributions
- public affairs activities
- corporate governance
- Human rights

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- Jong-Seo Choi, et. al., 2011
- Maria-Gaia Soana, 2011
- Z. TANG, et. al., 2011
- D.J. Wood, 2010
- Rahmawati and Putrid Septia Danita, 2011
Table (2): The model of study

Discretionary Responsibilities

Ethical Responsibilities

Legal Responsibilities

Economic responsibilities

CSR

SIZE

RISK

R&D EXP.

ADINT EXP.

CFP accounting based ratio
1) ROA,
2) ROE,
3) Pretax income to net sales (RPTI),
4) Gross profit to net sales (RGM),
5) Earnings per share

market base ratios
1) Market to book value
2) Price to book value
3) Price/earnings adjusted
Table (3): testing of hypothesis (1)

<table>
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<th>Scheduled t</th>
<th>t Significant</th>
<th>Hypothesis Acceptance</th>
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<td>21.958</td>
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Table (4): testing of hypothesis (2)

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Table (5): testing of hypothesis (3)

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Table (6): testing of hypothesis (4)

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<td>20.402</td>
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Table (7) Model test

<table>
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<th>Scheduled f</th>
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<td>4.892</td>
<td>4.260</td>
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