The Relationship between Corporate Governance and Corporate Social Responsibility (CSR) Disclosure: Evidence from the USA

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Abstract

For the past twenty years, researchers have extensively debated the determinants of good corporate governance practices and relationship between corporate governance and firm performance. Nevertheless, relationship between corporate governance and corporate social responsibility has received minimal attention in the extant literature. This study thus seeks to fill this dearth by examining the relationship between corporate governance mechanisms and CSR using a sample of 247 US based firms for the period 2007-2011. Using a random-effects panel data model, we find that firms with strong internal corporate governance characteristics – compliant with the corporate governance code – are likely to invest more in their CSR activities. We conclude based on the paper's findings that, larger firms tend to care more about their external market reputation relative to small firms; whilst the former's CSR investment is also likely to have a significant positive association with their corporate image. In addition, larger firms tend to have more resources compared to small and medium firms, in terms of capital and talent; and hence they are capable of making huge investments in CSR activities.

Keywords: Corporate Governance, Corporate Social Responsibility, Disclosure Level

Despite the lack of extensive literature on the relationship between corporate governance and corporate social responsibility (CSR), this area has produced some interesting findings and also offers a promising avenue for research within the governance literature. The relationship between corporate governance and CSR disclosure has been largely examined through the stakeholder theoretic lens, where different researchers have attempted to identify factors which influence the quality of corporate governance and CSR practices (e.g. Said et al., 2009; Khasharmeh and Desoky, 2013; Naser and Hassan, 2013). These studies have used corporate governance indices to measure the quality of corporate governance and the quality of CSR disclosure of a firm. Consistent with the popular index-based approach widely used within finance literature (Fathi, 2013), we derived the corporate governance and CSR disclosure scores from the DataStream database, and then test the relationship between the two variables. Our study uniquely extends on the previous studies where we apply a comprehensive measure of corporate governance index which captures the quality of a variety of internal corporate governance mechanisms including: board independence, board activities, board structure and board diversity and the independence of board sub-committees. Upon analysisng a sample of 247 US-based firms between years 2007 and 2011, we find that corporate governance score is significantly positively related with the CSR disclosure. The findings imply that owing to the increasing oversight by the external stakeholder constituencies such as pressure groups and the media, larger firms tend to invest more in their CSR activities, as measured by the CSR disclosure index.

Literature review

Upon detailed review of literature, we attempted to establish the direction which prior research on corporate governance and corporate social responsibility has assumed. This is represented schematically on *Figure 1* below. Our paper found that past authors have conducted their studies within the four main research themes indicated in the diagram – corporate social responsibility, corporate governance, firm performance and corporate disclosures level. However, each of these themes has been studied differently in extant literature, where different researchers have utilised a range of various variables. The arrows in *Figure 1* indicate the direction of relationship among the four themes which are further critiqued in detail within this literature review discussion. Moreover, the amount of studies, which have examined the relationship between the four themes, is provided inside each arrow and enclosed in parentheses.

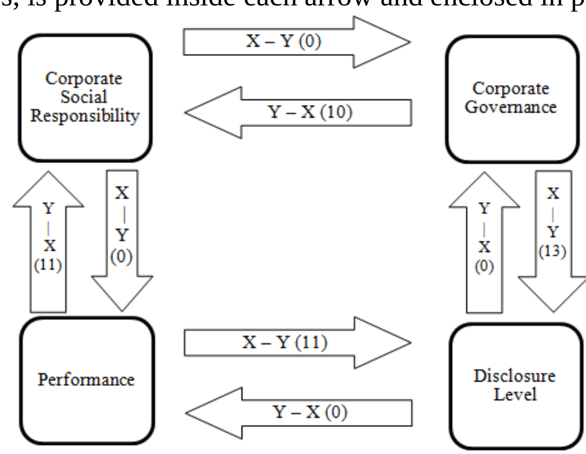

Figure 1. Scheme of interaction of variables under review (Compiled from the literature).

To begin with, CSR has been traditionally examined as an index of CSR disclosure constructed mainly through a content analysis of company disclosures and other corporate information (Monteiro et al., 2010; Post et al., 2011). To arrive at a CSR index, a score is usually assigned for each component of corporate disclosure against a CSR benchmark, and which is then aggregated to arrive at the CSR index (Laidroo, 2009). Nevertheless, upon further review of literature we established that CSR index has solely been treated as an independent variable by almost all studies, with no single research having treated it as a dependent variable. This is shown in the diagram above. Secondly, corporate governance is primarily represented as a set of attributes which highlight various corporate aspects including: board characteristics; firm ownership structures; executive compensation plans; financial disclosure; and internal controls. Such attributes have been widely used as variables within the regression models of various studies (see Donker and Zahir, 2008; Maingot and Zeghal, 2008; Said et al., 2009; Ben-Amar et al., 2014). Thirdly, our review of literature found corporate disclosure level to be the most popular variable within contemporary CSR research. We found a number of studies having analysed the concept of corporate disclosure levels in various countries through examining the quality of corporate information provided to stakeholders by the firms. However, majority of these studies have largely focused on CSR activities within emerging markets, with only a handful of them looking at companies within the developed countries. Lastly, corporate performance is another popular variable with researchers examining corporate governance, corporate social responsibility as well as corporate disclosure. Corporate performance is mainly measured by variables such as: return on assets (ROA), return on equity (ROE), turnover, sales, net profit, and weighted earnings per share, market value of equity, Tobin's Q, and cash flow (e.g. Aksu and Kosedag, 2006; Li and Tang, 2007; Monteiro and Aibaz-Guzman, 2010). The choice of the appropriate variable to use in capturing a company's performance is largely an individual researcher's choice. Accordingly, financially successful companies are argued to have a higher duty of disclosing more information in order to satisfy the information requirements of their stakeholders. In addition, more profitable companies are assumed to have a higher financial capacity to engage in more CSR activities especially on a larger scale compared to the less profitable companies (Aksu and Kosedag, 2006; Ponnu and Okoth, 2009; Sufian, 2012). Not least, corporate performance appears to be widely treated as an independent variable in the extant literature (Said et al., 2009; Akrout and Othman, 2013; Khasharmeh and Desoky, 2013).

The above critique of literature reveals an intertwinement among the four themes discussed in this study, that is: corporate disclosure level, corporate performance, corporate governance and corporate social responsibility. Nonetheless, whilst a number of studies have researched the relationships between two or more of the four variables – corporate disclosure level, corporate performance, corporate governance and corporate social responsibility – no single research has investigated the influence of both corporate governance and corporate social responsibility practices on corporate performance in the extant literature. Accordingly, our paper attempts to fill this gap in the scientific literature.

The table below provides a synopsis of the key empirical studies within existing literature, which addresses the four themes discussed in this literature review, including: corporate social responsibility, corporate governance, firm performance and corporate disclosures level.

Table 1. *Interactions between CSR, corporate governance, firm performance and corporate disclosures in scientific literature*

Dependent variable	Independent variables	Authors of papers studying relationship between dependent and independent variables
Corporate Social Responsibility	Performance	Sufian (2012); Chatterji et al. (2009); Echave and Bhati (2010); Haniffa and Cooke (2005); Hussainey et al. (2011); Khasharmeh and Desoky (2013); Naser and Hassan (2013); Peiro-Signes et al. (2013); Ponnu and Okoth (2009); Said et al. (2009); Uwuigbe and Egbide (2012)
Corporate Social Responsibility	Corporate Governance	Hamid and Atan (2011); Haniffa and Cooke (2005); Hussainey et al. (2011); II Park et al. (2014); Ioannou and Sefareim (2010); Khasharmeh and Desoky (2013); Naser and Hassan (2013); Perrigot et al. (2012); Said et al. (2009); Post et al. (2011); Razek (2014)
Disclosure Level	Corporate Governance	Akrout and Othman (2013); Cheung et al. (2007); Fathi (2013); Htay et al. (2013); Ienciu (2012); Laidroo (2009); Monteiro and Aibaz-Guzman (2009); Kolsi (2012); Omran and Abdelrazik (2013); Patel et al. (2002); Uyar et al. (2013)

Source: Compiled from previous empirical researches

As indicated in *Table* 1 above, the impact of firm performance on CSR appears to be the widely researched themes in the contemporary literature; while the impact of corporate governance on CSR, and quality of disclosure respectively are the other areas which have attracted the attention of various scholars. As is the tradition with studies of this nature, the aggregate indexes used in measuring the level of corporate social responsibility as well as the corporate disclosure levels are usually developed and gathered from international and national databases such as DataStream or developed by the researchers themselves (e.g. Bauer et al., 2008; Ioannou and Serafeim, 2010). On the other hand, measures that have been used to capture the quality of corporate governance in literature include both qualitative and quantitative variables such as board characteristics including: *board independence* (Omran, et al., 2013; Perrigotet al., 2012; Post et al., 2011), *board size* (Monteiro da Silva & Aibar-Guzman, 2010; Ponnu & Okoth, 2009; Post et al., 2011), *multiple directorships* (Haniffa & Cooke, 2005; Ponnu & Okoth, 2009), *CEO-Chair duality* (Ioannou & Serafeim, 2010; Monteiro da Silva & Aibar-Guzman, 2010; Post et al., 2011). Moreover, various authors have reported a positive relationship between CSR disclosure and board independence. For instance, Post et al. (2011) demonstrated such a relationship using a sample of 78 firms from the Fortune 1000 for the year 2007. In addition, the statistical significance of board independence for the determination of corporate disclosure index is confirmed by Omran and Abdelrazik (2013), following a literature review of 34 publications related to the interaction between corporate governance and corporate disclosure level. The authors emphasized that board size has a positive impact on CSR index. This is because independent directors bring a sense of objectivity to board decisions thereby ensuring that board actions are conducted in the best interest of shareholders. Such directors play a useful monitoring role which improves the management efficiency in a firm thus resulting in more voluntary disclosure of corporate information. Jan and Baloch (2011) while investigating pharmaceutical companies in Pakistan find that CSR don’t exist at strategic level however its practices are observed at tactical level.

Similarly, board size has been argued to affect the ability of company boards to monitor and evaluate executive actions. Smaller boards are noted to enable faster decision making processes, whilst on the other hand the ability of directors to control and promote value-creating activities has been found as more likely to rise with the increase in number of directors on the board. Consequently, the need for information disclosure will be higher (Post et al., 2011; Samaha et al., 2012; Omran and Abdelrazik, 2013). Razek (2014) reported a positive relationship between board size and corporate social responsibility disclosure for a sample of Egyptian companies. Razek (2014) established multiple directorships as a factor which positively influences the CSR activity of Egyptian companies. On the other hand, Haniffa and Cooke (2005) studied 139 Malaysian companies listed on the Kuala Lumpur Stock Exchange for the years 1996 to 2002 and established the same relationship. As a result, multiple directorships have important positive implication for corporate social responsibility practice due to the likelihood for directors to obtain greater knowledge and diverse experience while serving in more than one company, including how to implement various corporate social responsibility practices (Samaha et al., 2012).

Our review of literature further established that there are inconclusive results concerning the relationship between ownership structure and CSR disclosure (Haniffa & Cooke, 2005; Hussainey et al., 2011; Naser & Hassan, 2013; Said et al., 2009). In particular, Said et al. (2009) showed that government ownership had positive impact on CSR disclosure in Malaysian companies. In contrast, studies by Naser and Hassan (2013) for the 65 companies listed on the Abu-Dhabi Stock Exchange, and Hussainey et al. (2011) for 111 Egyptian listed companies provided contrary evidence arguing that the impact of government ownership was statistically insignificant. Using the case of Malaysian telecommunications firms for the period 2002-2005, Abdul et al., (2011) reported that controlling shareholders were the originators of firms' CSR activities. In the context of Egyptian companies, Razek (2014) further found that private companies disclosed more information about their CSR practices. In view of this discussion, we find that different researchers have attempted to assess the effect of corporate governance quality on the CSR index using various corporate governance attributes, which they assume to accurately reflect the state of corporate governance within the researched firms. Notwithstanding, we found very few papers which have attempted to use the overall corporate governance index as an independent variable. For instance, Uyar et al. (2013) and Fathi (2013) have considered the impact of corporate governance index on the disclosure level.

Uyar et al. (2013) examined the corporate governance index (XCORP) for 131 Turkish manufacturing companies listed in the Borsa Istanbul (BIST) for the year 2010. The XCORP represents the price and return performances of the companies traded on the BIST market, and also acts as a corporate governance rating score according to the Corporate Governance Principles issued by the Turkish Capital Markets Board. The companies included in this index are considered to have implemented the best practices of corporate governance including public disclosure and transparency. However, Uyar et al. (2013) have used the XCORP index as dummy variable representing the participation of the surveyed companies on the BIST.

Fathi (2013) on the other hand developed three corporate governance sub-indices including the board characteristics index, ownership structure index and audit quality index. The writer used 31 items in constructing the board characteristics index, 16 items for the ownership structure index, and 17 items for the audit and control index. Fathi (2013) concluded that the use of overall corporate governance index demonstrated a positive relationship between the quality of corporate governance and the quality of financial reporting.

Using a corporate governance index developed by the Research Center for Corporate Governance at Nankai University, China, Li and Tang (2007) investigated the relationship between corporate governance index and corporate performance/and found that strong corporate governance mechanism contributed to the enhanced corporate profitability, operating efficiency, growth ability and the strengthening of financial flexibility and security. This corporate governance index incorporated six dimensions, namely: (a) behaviors of controlling shareholders; (b) board governance; (c) top management governance; (d) information disclosure; (f) stakeholders' governance; and (g) supervisor committee governance.

Proponents of such a broad measure of corporate governance index using multiple considerations argue that the evaluation of corporate governance based on a single dimension is likely to overlook the other important factors which determine a firms quality of corporate governance (see Bozec and Bozec, 2012; Donker and Zahir, 2008; Boehren and Oedegaard, 2003; Bauer et al., 2008; Bhagat et al., 2008).

Although their approach attracts criticism, Bozec and Bozec (2012) used corporate governance indices without focusing on specific governance attributes. This is because their corporate governance measure which constituted a multifactor index was likely to have increased the possibility of measurement errors. In this regard, more provisions would imply a greater risk of error in measuring the value of any one component, as well as that of the overall quality of corporate governance. Such potential errors may result in the misspecification of corporate governance index during the statistical analysis. Notwithstanding the argument above, there is still no generally accepted methodology for the calculation of an overall index, which could fully and fairly reflect the quality of corporate governance. In addition, attempts to equate effect of individual corporate governance elements with the entire governance system seem to be unsatisfactory and controversial.

The study of individual corporate governance attributes may provide useful information about the individual impact of each corporate governance factor on CSR practices. As such, the information about role of various corporate governance attributes may be used as a basis for the management of future corporate governance researches. For example, knowing the impact of board size may help to understand how an optimal board size promotes good firm CSR practices. However, the effect of individual corporate governance attributes may not necessarily reflect the impact of overall corporate governance improvement on CSR. Consequently, it becomes impossible to find evidence regarding the main question about how an improvement in corporate governance may lead to higher efficiency and better CSR practices.

Moreover, the overall level of corporate governance is defined by various attributes. Accordingly, the assessment of relationship between corporate governance elements and CSR provides mixed results, and an incomplete picture of the actual influence of corporate governance on CSR practices. Not least, the most common method of analyzing the relationship between CSR and corporate governance has remained to be predominantly regression analysis. However, regression models may not always be able to include plenty of corporate governance attributes as independent variables. Such models mostly give statistically insignificant results due to large number of explanatory variables. In the context of our research, the establishment of an overall corporate governance index is nonetheless important. Our corporate governance index is dynamic enough to capture a number of internal corporate governance attributes, and therefore there is no need to separately include these mechanisms in the econometric model.

Against the above background, we propose to shift the focus of our research from the parts, i.e. the various corporate governance attributes, to a single corporate governance measure in order to be able to effectively assess the impact of corporate governance index on CSR. As a result, stakeholders would be able not just to determine current level of corporate governance and the state of its attributes, but also to assess the effect of better corporate governance on the quality of CSR policies.

Based on the assumptions underpinning the stakeholder theory and consistent with the empirical evidence presented in extant literature on corporate governance and corporate social responsibility, we propose the following hypothesis:

H1: *There is a positive relationship between the overall corporate governance score of a firm and the CSR index.*

Research Methodology

Sample

The sample consists of 247 firms listed on the New York Stock Exchange for the period of 2007-2011. The largest number of firms belongs to telecommunication, healthcare, retail food and beverage sectors. The categorization of firms from the different sectors is as follows:

Table 2. *Industrial Classification of firms*

Industries	Number of firms
Technology	36
Telecommunications	6
Energy (Oil and Gas)	11
Basic resources	6
Media	3
Real estate	4
Health care	25
Retail	32
Food & beverage	20
Chemicals	11

Multi-utilities	17
Construction and materials	10
Travel and leisure	3
Automobiles and parts	12
Personal and household goods	6
Manufacturing	19
Others	26
Total	**247**

Source: *Compiled from DataStream*

Regression model

Regression analysis has been applied to examine the relationship between corporate governance and corporate social responsibility. The regression model developed to analyze this study's data is as follows:

$$\mathbf{CSR = Corporate\ Governance + Control + \varepsilon}$$

CSR and corporate governance are the DataStream's corporate social responsibility and corporate governance scores respectively. The control variable comprises: (a) *firm size* – as measured by the natural logarithm of a firm's total assets; (b) *leverage* – as measured by the percentage of debt taken by a firm during a financial year; (c) *beta* – a measure of firm specific risk obtained by the regression of a company stock against the market index. Table 3 below provides a summary of the variables used in the regression model.

Table 3: *Definitions of Variables*

Variable	Definition
Corporate Governance Score	The corporate governance pillar measures a company's systems and processes, which ensure that its board members and executives act in accordance with long-term expectations of firm shareholders. It reflects a company's capacity, through its use of best management practices, to direct and control its rights and responsibilities through the creation of incentives, as well as checks and balances in order to generate long-term shareholder value.
Leverage	This is measured as a percentage of total debts to total assets.
Firm size	This is measured as a logarithm of total assets.
CSR score	The social pillar measures a company's capacity to generate trust and loyalty with its workforce, customers and society, through the use of best management practices. It is a reflection of the company's reputation and the health of its license to operate, which are key factors in

	determining its ability to generate long-term shareholder value.
Beta	This is a control variable and a measure of firm-specific risk.

Table 4 below reports summary statistics for our paper's analyzed data, a sample of 247 firms reported for the period 2007–2011. The corporate governance score represents the quality of internal corporate governance practices of firms, as reflected in the DataStream database of corporate governance score. The mean value of the corporate governance score is 80.59277, which shows that majority of the companies studied have strong corporate governance practices in place. The average CSR score for the sampled firms is 69.069, which is relatively below the average corporate governance scores of the same firms.

Table 4. *Summary statistics*

Variables	Obs	Mean	Std. Dev.	Min	Max
Corporate Governance	1,482	80.59277	12.44337	9.37	96.93
Corporate social responsibility	1,482	69.06995	10.97188	12.51	86.51
Leverage	1,482	0.520675	11.10543	0.20	0.65
Firm size	1,482	225.7368	112.3743	1	476
Beta-firm specific risk	1,482	1.161242	0.484149	0.11	3.4

Number of firms = 247, Time period 2007–2012

Results

Table 5 below reports the results on the relationship between corporate governance and corporate social responsibility. The relationship between corporate governance score and corporate social responsibility score is positive and the results are significant with a p-value of 0.000. This indicates that firms with strong corporate governance mechanisms are likely to adopt a stakeholder-based approach. These results concur with previous research findings which found a connection between corporate governance and corporate social responsibility practices (Hamid and Atan, 2011; Haniffa and Cooke, 2005; Hussainey et al., 2011; II Park et al., 2014; Ioannou and Sefareim, 2010; Khasharmeh and Desoky, 2013; Naser and Hassan, 2013; Perrigot et al., 2012; Said et al., 2009; Post et al., 2011; Razek, 2014). The corporate governance score (index) used in this study is a comprehensive index which captures a variety of corporate governance attributes including compliance with the corporate governance code, board structure, board independence, remuneration policy, internal control system and the effectiveness of a firm risk management system. Using a composite index like the Datastream corporate governance score offers a benefit to researchers of being able to use a single measure of corporate governance in which all pertinent internal corporate governance mechanisms have already been incorporated in the development of a composite index.

The results further show that the control variable and firm leverage have no effect on CSR, which is consistent with the results of various recent studies (e.g., Uwuigbe and Egbide, 2012;, Naser and Hassan, 2013; Echave and Bhati, 2010; Khasharmeh and Desoky, 2013; Haniffa and Cooke, 2005. The studies which estimated the relationship between CSR and leverage indicated that it had a negative sign.

Table 5. *Regression Results, Random Effects Model (Dependent variable CSR score)*

Variable	Coefficient	Std. Error	Prob.
Corporate governance score	.1046184*	.019703	0.000
Leverage	-.0199581	.0142165	0.1600
Firm size	.0205343*	.0040183	0.000
Beta	1.732189*	.5490181	0.002
R-squared	0.1282		

Note: * shows that the results are significant.

As expected, the relationship between firm size and CSR score is positive, which means that larger firms will care more about their market reputation. In addition, larger firms are more visible to media and other market-based environmental pressure groups, where the large firms are expected to invest in stakeholder relations, comprising of employees, customers, suppliers, and the environment. Firm size is usually used as control variable within the contemporary researches on corporate social responsibility and corporate governance. Accordingly, most of researches indicated the presence of influence of firm size on corporate social responsibility practices (Bayoudet al., 2012; Naser & Hassan, 2013; Perrigotet al. 2012). The significantly positive relationship between firm size and CSR disclosure indicates that larger firms are more sensitive to external market oversight, particularly that exerted by external pressure groups, such as the environmental protection agencies and the investigative media. In addition, larger firms have substantial financial resources to afford investment in CSR activities. Another reason for a positive relationship could be that larger firms may initiate CSR activities as a symbol and/or strategy for appealing to investors in order to attract capital from the financial markets, particularly targeting those investors who may be more concerned about the environment.

There is also positive relationship between the variable beta and CSR. Beta describes the rate of risk associated with corporate stocks, which an investor can tolerate. A higher beta coefficient reflects a higher the risk of volatility in market value of stocks and returns. However, stocks with higher market risk simultaneously offer investors a higher return as compensation for accepting that risk. In order to compensate high volatility, companies endeavor to improve investor’s confidence in the quality and reliability of its stocks. In such conditions, an improvement of corporate social responsibility may be used as an instrument for increasing the investment attractiveness of a company's stocks as a way of diverting attention about that company's risk levels.

Overall, the positive relationship between corporate governance and CSR disclosure indicates that besides the shareholder value maximization, the aim of corporate governance is also to maintain a balanced approach by maximizing the value of shareholders as well as addressing the interests' of firm stakeholders. Although corporate governance regulations in the Western markets primarily emphasizes on shareholders' value creation, stakeholders including pressure groups play a significant role in defining the ultimate objectives of larger organizations.

Conclusion

The objective of this study was to assess the impact of the overall corporate governance index on firm corporate social responsibility score. Our paper examines the relationship between corporate governance index and corporate social responsibility score for a sample of 247 firms listed on the New York Stock Exchange for the period 2007-2011. We used a linear regression analysis to examine the association among corporate social responsibility score and corporate governance index, leverage, firm size and beta. The study's results show that the CSR score has a positive and significant relationship with the corporate governance index, firm size and beta.

This study has also expanded knowledge by providing rigorous empirical evidence concerning the influence of a composite corporate governance index on CSR. The results of our study confirm our hypothesis regarding the existence of significant influence of corporate governance on the CSR practices of surveyed firms. Lastly, we conclude that efficient corporate governance mechanisms of firms listed at the New York Stock Exchange assists in bringing improvement of associated firms' corporate social responsibility practices.

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