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Determinants of Corporate Social Responsibility Disclosure for Financial Institutions

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ABSTRACT

Corporate Social Responsibility (CSR) disclosure levels of the financial institutions have been increasing consistently since the introduction of this concept; hence, it is important to understand the reasons behind this phenomenon. This research aims to identify firm-specific determinants on the CSR disclosure for financial companies at the United Kingdom. Our study brings a new perspective to the literature by utilizing from a multi-theoretical framework; including Agency, Legitimacy and Stakeholder theory; to determine the independent variables of our model, those are, size, leverage levels, economic performance and corporate governance performance of the companies. Also, we define the dependent variables of our model, CSR disclosure, in a more comprehensive way in comparison to many previous studies. CSR scores of companies, is obtained from Asset4 database that considers wide range of publicly available sources. This research confirms that size, corporate governance, and economic performance of companies have a significant positive relationship with CSR disclosure which shows that CSR performances of companies are related with visibility levels, political costs, and stakeholder perspective.

Keywords: Corporate social responsibility, corporate governance, determinants of CSR
Jel Codes: D21, G21, L21

1. INTRODUCTION

Corporate Social Responsibility is a concept evolving and adapting to changing environment, therefore, a unique general definition is not evident. Bowen (1953), accepted as the founder of CSR concept, summarizes the main idea of this concept by claiming that businessman should consider social norms, beliefs, and benefit of the society. Jan (2006) argues that CSR could simply be defined as ‘treating stakeholders of the firms ethically’ and it is expected for CSR to change and evolve as ethical beliefs of the stakeholders change. European Commission (2011) defined CSR as a voluntary action of corporations to satisfy social and environmental concerns of the stakeholders. Crowther and Aras (2008) states that corporations are classified as separate legal entities and they should consider interests of local society to which they belong. The common aspects of these definitions available for CSR are ‘being voluntary’, ‘beyond the sole interest of the firm’ and ‘considering socio-ethical values’.

CSR, beyond being an ethical issue, is also important for the healthy functioning of an economy. CSR assures that corporations are drifting from ‘profit maximizing for shareholders’ to ‘socially responsible approach for stakeholders’. CSR is becoming more important for corporations as awareness and demands of the stakeholders and the community increases. By creating more ethical and responsible institutions, CSR principles can contribute to sustainable economic growth. The importance of this concept has gained utmost importance for the last decade following 2007 financial crisis. It is widely accepted that unethical and irresponsible behaviors of the economic actors have been important contributors of the financial distresses. Argandona (2008) argues that to follow social norms and consider interest of the community by implementing socially responsible growth principles could have prevented the 2007 global financial crisis. Also, CSR could be an effective tool to regain the trust of the community over financial institutions that was largely undermined by the Crisis. Soana (2011) states that CSR could be used strategically to reconstruct positive image of financial institutions. Financial institutions have been at the center of this discussion because only with the help of a well-functioning, trustworthy and socially responsible financial

system, destruction of this catastrophe can be eliminated. So, understanding the motives of CSR disclosure of the financial system is beneficial for many parties, especially for bank managers and regulatory public authorities. Increasing attention towards CSR concept, its importance for a sustainable financial system and an healthy economy, and ever increasing CSR disclosure of financial companies make the identification of its determinants and enlightenment the motives behind it important. This research investigates the determinants of CSR disclosure for the financial sector of the United Kingdom. A considerably big and sophisticated financial sector of the United Kingdom which has many global players, is the main reason of selection this country to investigate the research question. Nevertheless, there are previous studies focused on the disclosure performance of financial institutions in the United Kingdom (El-Bannany, 2007; Day and Woodward, 2009), these studies assess the topic solely focusing on websites or annual reports of the companies. Our research will combine all publicly available CSR disclosure channels such as; annual report, website, separate CSR report by using Asset4 data stream. By this way, disclosure performance of corporations could be assessed more precisely and comparability between firms will be increased.

Literature review will identify relevant concepts and theories related including agency, legitimacy and stakeholder theory. Subsequently, methodology used will be explained. Then, empirical results and discussion will present findings of the research, followed by discussing the results. Lastly, key findings will be summarized in the concluding part of the research.

2. LITERATURE REVIEW

There are several theories, aiming to explain the motive behind CSR disclosure of corporations. Even though there are many studies on the determinants of CSR disclosure, a consensus on a theoretical framework does not exist. Among several theories aim to explain the reasons behind CSR disclosure, one of the most important one is the Agency theory. Agency theory argues that managers act as agents and behave opportunistically to assure debt contractual obligations, maximize own compensation contracts and minimize political costs[1] (Freeman, 1984). In this respect, a managers' approach to the CSR may differ in several ways. Diez et al. (2011) state that within the absence of efficient control mechanisms or compensations related to CSR, the top managers acting as the agents of shareholders do not voluntarily focus on CSR issues. In contrast, Barnea and Rubin (2010) claim that the managers or large blockholders could over-invest on CSR manners for private benefits if they do not incur any significant costs. Friedman (2007) states that conflict of interest could occur due to the fact that CSR objectives could not be parallel with the interests of shareholders.

Neo-classical capitalist theory supporters argue that sole responsibility of a corporation is to generate profit rather than considering interests of the society. In contrast with this argument, Legitimacy theory defines relationship between corporations and society as a 'social contract' that considers norms, values and beliefs of the society. Companies should undergo socially desired actions and obey the social contract in order to survive and exist in the future (Rodrigues, 2006). Legitimacy theory also considers that CSR could positively affect the economic performance of the corporations. Engaging CSR activities could reduce cost and risks associated with companies, increase competitive advantage, build reputation and legitimacy (Forster, 2013). CSR could be beneficial for the image of the corporations which is an advantage especially in the long-run. Yip et al. (2011) argues that CSR disclosure is significantly related to earnings management and political environments of companies, where CSR is used as a tool to minimize political costs. Reputation, trustful image, and accountability are very important especially for financial institution consumers who deposit their savings to these companies. Idowu and Filho (2009) claim that 'social' CSR is the optimal way for financial institutions to regain legitimacy and trust of the consumers.

Freeman and Reed (1983); the early founders of the Stakeholders theory; argue that corporations should not solely focus on shareholders but consider interests of all stakeholders. Stakeholders consist of various groups such as shareholders, potential investors, customers, employees and ultimately the whole society. Corporations can reach to the long-term value maximization target only by considering interest of all stakeholders. However, to ignore moral values of the society for the short-term profits could cause significant value losses in the long-run for the firms

[1] Political cost concept argues that politicians can introduce policies to redistribute wealth among society by introducing taxes (Watts and Zimmerman, 1986).

(Jensen, 2001). The idea of Jensen (2001) is supported many empirical researches those found a significant positive relationship between stakeholder influence, CSR disclosure and economic performance (Madariaga and Cremades, 2009; Roberts, 1992; Tsoutsoura, 2004; Ullmann, 1985). Contradicting with the stakeholder theory some researchers argue that financial impact of CSR cannot be observed objectively and the long-run value creation process of the CSR is not clear (Forster, 2013).

We believe that these theories are complementary rather than competitive; hence, a multi-theoretical approach will be used in this research while determining explanatory variables of the model. There are many researches those investigate the determinants of the CSR disclosure and many different financial and non-financial independent variables were employed as potential determinants (Adams and Roberts, 1998; Andrikopoulos et al, 2014; Kansal et al, 2014; Tagesson et al, 2009). Two most widely discussed non-financial indicators related to the CSR disclosure of the firms are firm size and corporate governance. Size is an important determinant for CSR disclosure related to both legitimacy and stakeholder theory. Due to the higher visibility, larger companies exposed to higher political costs (Watts and Zimmerman, 1986). Also, larger companies have higher number of stakeholders who increase information demand extensively (Hackston and Milne, 1996). Many studies found a positive relationship between firm size and CSR disclosure of the firm (among others; Hossain and Reaz, 2007; Khan, 2014; Mamun et al., 2013; Muttakin and Rahman et al., 2011). CSR is considered as a dimension of 'good corporate governance' practices. Corporate governance is another possible determinant for the CSR disclosure which is closely related with ownership and governance structure of the companies. The CSR is considered as an important dimension of public accountability because companies having diversified ownership structure should disclose more information. Ghazali (2007) argues that companies those have independent directors disclose more CSR information. Samaha et al. (2012) found that companies with increased number of independent directors disclose wider CSR information. There is alsa a positive relationship between auditing company size and CSR disclosure where auditing quality and CSR could be related (Khlif and Souissi, 2010).

Financial determinants of CSR disclosure has been widely elaborated in the literature and two frequently used one are economic performance of the firm and leverage. Understanding the relationship between CSR and economic performance of the corporations is crucial to clarify motives behind CSR disclosure. For example, profitability is an important determinant of the economic performance of the firm and directly related with CSR disclosure, as it is costly to finance the CSR projects. Gamerschlag et al. (2010) found a positive relationship between profitability and CSR disclosure. Ng and Koh (1994) argue that there is a relationship among profitability, political pressure, and CSR as expressed by the Legitimacy theory. According to this view, the CSR could be used as a tool to justify profits earned by the company and increase the legitimacy of the corporation by showing some of the profit used for the well-being of the society, hence reduce political pressure. Leverage is a financial determinant related to CSR disclosure on which there are contradictory findings in the literature. Yang et al. (2008) argue that higher leverage is negatively associated with CSR disclosure as it will limit financial sources available, similar to Bernea and Rubin (2010). In contrast, Andrikopoulos (2014) finds a positive relationship between leverage and the CSR disclosure and argues that high leverage level indicates higher risk levels which increases information demand of the stakeholders. Some studies cannot not find any significant relationship between CSR disclosure and leverage (Haniffa and Cooke, 2005; Kansal et al, 2014; Reverte, 2009).

3. DATA AND METHODOLOGY

3.1 Data

We investigate the determinants of the CSR disclosure performance of the financial institutions in the UK. Many previous researches focus solely on the annual reports or websites of the corporations to evaluate the CRS disclosure performance of the firms. However, we use Asset4 data stream, which includes all publicly available sources including stock exchange filings, annual reports, websites and news sources, to obtain the data for our dependent variable, which enables us to have a superior and more comprehensive understanding (Ribando and Bonne, 2010). Asset4 data stream takes the average of environmental and social performance indicators to reach overall CSR scores of a corporation. Environmental performance is determined by weighting 70 key performance indicators; including environmental asset management, emission reduction, and product innovation; according to their relevance to the industry. Similarly, social weights is determined by 88 key performance indicators; including health

and safety of employees, training opportunities, human rights, product responsibility, and quality by using the sector specific weightings.

Explanatory variables collected from annual reports of the corporations published for the year of 2014. Sizes of the corporations are assessed by total assets (non-current and current) of the company. Total assets is advantageous to determine the size of a financial institution as it is less subject to manipulation compared to profit figures (Branco and Rodrigues, 2008). Leverage levels of the corporations are determined by dividing total debt over book value of equity similar to the prior literature (Andrikopoulos et al., 2014; Reverte, 2008). Economic performance and corporate governance performance of the corporations are obtained from Asset4 data stream which combines multiple figures rather using a single ratio such as profitability. Economic performance score combines quantitative and qualitative data by employing many indicators including; client and shareholder loyalty, satisfaction and financial performance of the firms. Corporate governance score combines multiple factors using 68 key performance indicators; such as, board structure and functions, shareholders rights, CEO-chairman separation and compensations policies.

Our sample consists of 34 financial institutions including banks, asset management and insurance companies trading at London Stock Exchange and based in the United Kingdom.

3.2 Methodology

Andrikopoulos et al. (2014), Branco and Rodrigues (2008), Kansal et al. (2014), Reverte (2008), are some of the researchers used simple linear regression models to identify determinants of CSR disclosure. Similarly, this research uses a linear regression method in order to test the model extracted from multi-theoretical framework. The regression formula is;

$$CSR = \beta_0 + \beta_1 Size + \beta_2 Leverage + \beta_3 Economic\ Performance + \beta_4 Corporate\ Governance$$

The expectations generated prior to the analysis are as follows: The CSR disclosure is expected to be positively related with the company size because bigger companies are more visible and have more stakeholders which make the demand for the information higher (Khan, 2014). Firms with high leverage figures have lower resource available for the CSR, therefore a negative relationship is expected between these variables. Expectation of positive relationship between economic performance of a corporation and CSR disclosure stems from two reasons: first of all, similar to leverage, companies with higher economic performance have more resources available for financing the CSR policies. Besides, CSR has a role as justifying the profits by emitting the message that it was earned ethically (Kuznetsov, 2009). The demands of the stakeholders on CSR manners are increasing and CSR is considered as an important component of good governance which leads us to predict a positive relation between CSR and corporate governance performance of firms.

4. EMPIRICAL RESULTS AND DISCUSSION

Descriptive statistics are provided in order to visualize the characteristics of the sample and for preliminary analysis.

Table 1: Firms CSR disclosure performance

	Number of Firms	Environmental Score*	Social, Ethical Score*	CSR Score*
Banks	6	78.57	79.28	78.93
Fin. Services	16	45.17	56.74	50.96
Insurance	12	58.61	59.26	58.94
Overall	34	54.82	60.94	57.88

* Scores are calculated over 100.

Table 1 provides descriptive statistics and characteristics for the sample. The sample consists of 34 financial institutions; 6 of them are banks, 16 of them are companies providing financial services (brokerage and asset

management) and 12 of them are insurance companies. It could be seen that banks have the highest environmental, socio-ethical, and overall CSR score compared to the others.

Table 2: Descriptive Statistics for the Financial Institutions

	Number of Firms	Size*	Leverage	Economic Score	Corp. Gov. Score
Banks	6	748741.00	4.85	69.40	81.99
Fin. Services	16	3616.37	15.50	53.13	78.06
Insurance	12	96454.99	16.40	65.25	78.62
Overall	34	145960.09	10.50	59.80	78.84

* Size is reported in Millions of Pounds

Table 2 provides descriptive statistics for the financial institutions. It could be seen that banks superior performance is evident for economic and corporate governance indicators. It is important to assure good corporate governance for banks because this business is mainly based on reputation and trustworthiness of the institutions. Banks leverage values are lower than the other institutions. National and international conventions on capital adequacy and leverage values such as Basel III force the banks to have low leverage values to assure stability. Also, banks have the considerably bigger in size which is followed by insurance companies.

Table 3: Descriptive Statistics for the Variables

	CSR	Size*	Leverage	EP	CG
Mean	57.88	145960.10	10.50	59.80	78.84
Median	56.00	4499.50	5.42	66.25	81.49
Maximum	94.07	1357906.00	51.17	97.64	95.43
Minimum	15.65	135.60	0.01	4.38	23.41
Std. Dev.	25.11	316294.50	12.69	27.89	14.10

* Size is reported in million pounds, EP represents economic performance score while CG stands for corporate governance score

Descriptive statistics for the dependent variable CRS and the independent variables; size, leverage economic performance and corporate governance performance are provided by table 3. The financial companies CSR scores differ from 15.65 to 94.07 and have a mean value of 57.88. The size of the sample varies from 136 million to 1.35 trillion where the average is around 146 billion Pounds which shows that companies from various sizes are included. The companies mean value for leverage ratio is 10.50 and range reaches to 51.17 from 0.01. Overall economic performance of companies is around 60 out of 100 and many under and over performers are present as the range is quite large; that is more than 93.

Table 4: Regression Results

	Coefficient	t-Statistic	Prob.	VIF
Constant	-9.64	-0.72	0.4952	
Size*	3.51×10^{-5}	4.16	0.0003	1.21
Ln(Leverage)	1.63	0.54	0.5871	1.20
EP*	0.51	5.53	0.0000	1.08
CG**	0.40	2.21	0.0351	1.06
R-squared	0.72980			
F-statistic	19.58224			
Durbin-Watson	2.19548			

* and ** refer statistical significance at 1% and 5% respectively. EP represents economic performance score while CG stands for corporate governance score.

Table 4 presents the result of the regression analysis conducted and diagnostic test results. According to the regression results, size, which is significant at 1% level, is a determinant of CSR disclosure for financial institutions. This finding is compatible with the descriptive statistics which shows that banks with greatest size have the highest mean value of CSR result over insurance and asset management companies. The positive relationship between size and CSR disclosure is also similar to the previous findings of the literature (Andrikopoulos et al., 2014; Branco and Rodrigues, 2008). The coefficient of size variable implies that CSR score will increases $3.51x10^{-5}$ when size of the corporation increases by one million Pounds. Even though coefficient is small, it should be noted that size of the financial institutions such as Barclays plc reaches up to 1.3 trillion Pounds. This result collaborates with stakeholder and political costs (visibility) theory where increased size relates to increased stakeholder involvement and size is positively related with visibility of corporations.

Economic performance score is significant at 0.01% level with a coefficient of 0.51 which shows that the CSR disclosure score increases by 0.51 units when economic performance score increases by 1 unit. The positive relationship between economic performance and CSR disclosure is compatible with our prior expectations. Firms with superior economic performance can increase funds to finance socially desirable projects. Also, the CSR can be used as a tool for long-term value maximization, to assure legitimacy of current earnings and minimize political pressure over high earnings of corporations. Some of the previous literature has contradicting results where majority (Andrikopoulos et al, 2014; Tagesson et al, 2009) of them used profitability ratios to assess economic performance of corporations in the short-run. Our research combines qualitative and quantitative economic performance indicators which is informative about both short and long-run economic performance of the firms.

Similar to the literature (Casey and Granier, 2014; Khlif and Souissi, 2010; Said et al, 2009) and our prior expectation a significant positive relationship between corporate governance performance and CSR was found. The coefficient shows that CSR disclosure score increases by 0.40 units when corporate governance performance increases by 1 unit. This finding complies with the argument that CSR is an important component of corporate governance performance.

The leverage coefficient is not statistically significant.

The diagnostic tests are conducted following the regression analysis as well. To have a preliminary knowledge about the structure of the error term, the graph of the regression residuals plotted over dependent variable (CSR). The scatter plot shows that no pattern is evident in the residuals and they are randomly distributed as shown in appendix table 1. To have a better understanding formal tests are applied to test the relevancy of the assumptions of classical linear regression model. To test heteroscedasticity Glejser test is performed where, absolute value of residuals are regressed over independent variable. The null hypothesis of homoscedasticity could not be rejected as presented in appendix table 2. Autocorrelation is tested by Durbin-Watson test (1951). The Durbin-Watson value of 2.195 implies that the null hypothesis; ‘No positive or negative autocorrelation’ could not be rejected. Variance inflation factor (VIF) is used to detect multicollinearity problem. The VIF values are a little bit higher than 1 which is much below the critical level of 10 (Marquardt, 1970). This results show that there is no multicollinearity problem for our data set.

5. CONCLUSION

It is important to understand the determinants of CSR disclosure given the ever increasing importance of this concept. There are several theories discuss the determinants of the CSR and provide a general framework for the empirical researchers. We claim that these theories are not competitive but complimentary hence, we adopt a multi-theoretical understanding to establish our model. The determinants tested consist of financial and non-financial measures including size, leverage, economic performance and corporate governance. Even though there are a wide range of empirical research has been conducted on this area, majority of them used quantitative determinants only. Our research created a more comprehensive perspective by combining quantitative and qualitative information.

Descriptive statistics show that banks have considerably higher size and banking sector has the highest CSR score compared to the insurance and other financial service providing companies. Similarly, regression analysis found a positive relationship between the company size and CSR disclosure of the firms which confirms the claims of

Stakeholder and Legitimacy theories. Economic performance of the corporations is another determinant of the CSR disclosure. CSR could assure legitimacy of profits earned and economic growth of corporations. In addition, it is used as a long-term positive image building method (strategic CSR). CSR could be used as a tool to reduce political pressure and to avoid future political costs. A significant positive relationship between CSR disclosure and corporate governance performance of financial institutions implies that promoting CSR activities of the institutions could have a positive impact on corporate governance performance. Therefore governance boards should consider promoting and implementing good CSR policies other than solely focusing on short-term financial figures to assure good governance.

Future research could use a similar methodology to investigate wider industries rather than solely focusing on financial companies. In addition relationship between corporate governance and CSR disclosure is an area needing further exploration. Investigating the views of stakeholders could enlighten the role of CSR practices on corporate governance and economic performance.

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Appendix:

Table 1: Graph of Residuals over CSR

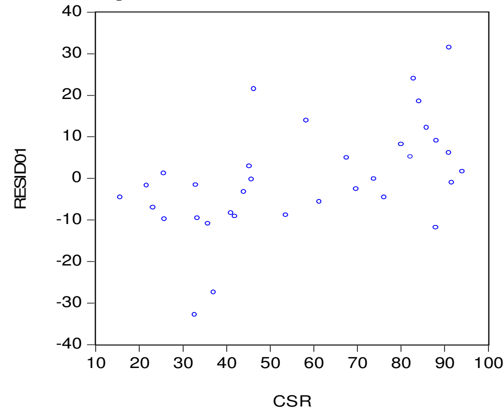

Table 2: Glejser test for heteroscedasticity

	Coefficient	Std. Error	t-Statistic	Prob.
Constant	-3.76	8.78	-0.42	0.672*
Size	-9.21 x 10^{-6}	5.31 x 10^{-6}	-1.73	0.093*
Ln(Leverage)	2.92	1.87	1.57	0.128*
Economic P.	0.02	0.06	0.43	0.669*
Corp. Gov.	0.15	0.11	1.30	0.203*

*represents that results are not significant at 5% of confidence.