Global Finance Journal 27 (2015) 18–45

Contents lists available at ScienceDirect

Global Finance Journal

journal homepage: www.elsevier.com/locate/gfj

Corporate social responsibility and stakeholder governance around the world☆

Hoje Jo [a], Moon H. Song [b,*], Albert Tsang [c]

[a] Santa Clara University, Santa Clara, CA, USA
[b] Department of Finance, College of Business Administration, San Diego State University, San Diego, CA, USA
[c] Chinese University of Hong Kong, Hong Kong

ARTICLE INFO

Article history:
Received 9 January 2015
Accepted 5 May 2015
Available online 15 May 2015

JEL classification:
G30
G34

Keywords:
Corporate social responsibility
Stakeholder governance
Board governance
Conflict resolution
Management perquisite

ABSTRACT

In this paper, we examine the impact of stakeholder governance on corporate social responsibility (CSR) around the world to determine whether CSR is employed as a mechanism to mitigate conflicts of interest between managers and diverse stakeholders, or used as managerial perquisites. To examine this relation properly, we not only employ a large and extensive sample of international firms, but also control for endogeneity by using dynamic panel generalized method of moments (GMM), propensity score matching, and difference-in-difference approach. Our results suggest that stakeholder governance positively influences firms' CSR engagement with a greater magnitude than board governance after controlling for endogeneity and other confounding factors of traditional corporate governance mechanisms, firm characteristics and national factors. Stakeholders' influence in CSR engagement is more prevalent when investor protections and board governance are relatively weak.

1. Introduction

Corporate governance takes up a central role in many academic disciplines. Management, accounting, business law, economics, and finance scholars, among others, examine the relation between parties of interest

☆ We thank Ye Cai, Sandra Dow, Joseph T. Mahoney, Niki Den Nieuwenboer, Maretno A. Harjoto, Hellen Jo, Woo Chan Kim, Yongtae Kim, Tammy Madsen, Jungbien Moon, Carrie Pan, Lawrence C. Rose, Chamu Sundaramurthy, Lorne Switzer, Yulia Veld-Merleoulova, and Demir Yener and Korea University Business School (KUBS) for many valuable comments. We also appreciate Sebastian Brinkmann of MSCI ESG for generously providing us the ESG IVA database and research assistance provided by Jinhua Cui and Hyunil Lim at Korea University Business School (KUBS). This study was initiated while Jo was visiting KUBS.

* Corresponding author. Tel.: +1 619 594 5334; fax: +1 619 594 3272.
E-mail addresses: hjo@scu.edu (H. Jo), song1@mail.sdsu.edu (M.H. Song), Albert.tsang@cuhk.edu.hk (A. Tsang).

http://dx.doi.org/10.1016/j.gfj.2015.05.001
1044-0283/

to corporations. To date, these collective efforts have centered on agency theory (Dalton, Hitt, Certo, & Dalton, 2007), which emphasizes the conflicts of interest among diverse stakeholders arising from the separation of ownership and control in corporations (Eisenhardt, 1989; Jensen & Meckling, 1976). While corporate governance aims to minimize the conflicts of interest, these agency conflicts cannot be removed completely by a firm's governance mechanisms. Thus the debates related to our understanding and conceptualization of the agency problem and related governance mechanisms continuously grow.

The theoretical foundations of these debates relate to the primacy of the various stakeholders[1] in the corporation. First, the so-called shareholder primacy model re-emphasizes that shareholders, as the legal owners, hold residual claim of the firm, and thus hold primacy over any other stakeholder in the corporation (Bebchuk, 2005, 2006; Eisenhardt, 1989). Second, the alternative model, dubbed the stakeholder primacy model (Bainbridge, 2006), highlights that all stakeholders join in team production; thus, the objective of the firm is to maximize the risk-adjusted returns to all participants (Lan & Heracleous, 2010). While the shareholder primacy view advocates value creation for the shareholder, the stakeholder primacy model promotes value creation for the corporation as a whole.

Well-designed corporate governance systems according to the stakeholder primacy model should align managers' incentives with those of nonfinancial stakeholders, and reduce the conflicts of interest between management and stakeholders; not only do good stakeholder relations help firms to gain performance advantages, but they enable those performance advantages to persist (Choi & Wang, 2009). Kacperczyk (2009) also contends that catering to non-shareholding stakeholders contributes to the long-term value of the firm. Freeman (1984) argues that firms can use corporate social responsibility (CSR) as an extension of effective governance mechanisms to resolve conflicts between managers and non-investing stakeholders, and Mannix (2003) maintains that conflict resolution and conflict management should be an essential part of a group's strategic management decision-making process. On the other hand, Zajac and Westphal (1994) claim that there are costs associated with governance mechanisms, and top managers prefer to take value in the form of perks. Baron (2009) asserts that managers can opportunistically invest in CSR as a management perquisite.

In this paper, we examine the relation between stakeholder governance and firms' CSR activities across countries to determine whether CSR is employed as a mechanism to mitigate the conflicts of interest between managers and stakeholders, or used as management perks. To the best of our knowledge, there is little evidence for an international set of firms on the significance or economic magnitude of this CSR-stakeholder governance relation. Thus, our study pertains not only to the literature on how conflict resolution or management perquisite influences corporate strategy but also provides a novel empirical lens on the increasingly important context of CSR. Previous studies have empirically examined the role of CSR across a broad set of countries (e.g., Chapple & Moon, 2005; Jackson & Apostolakou, 2010; Maignan & Ralston, 2002) or the empirical determinants of CSR based on social and environmental metrics (Ioannou & Serafeim, 2012). Their main focus, however, is not on stakeholder governance.

While board governance is extensively documented, shareholder governance is relatively less examined, and there is no universally accepted definition of stakeholder governance. [2] We define stakeholder governance as the stakeholder orientation of corporate governance pertaining system of checks and balances that trade off benefits and costs of firm decisions and that provide various incentives, controls, and regulations to minimize conflicts of interest between firms and stakeholders, to maintain financial stability, and to prevent potential corruption and fraud. Despite the lack of a universally agreed-upon definition of stakeholder governance, we are keenly interested in the impact of *incremental* contribution of stakeholder governance

[1] Mahoney (2012) defines stakeholders as "…those persons and groups who contribute to the wealth-creating potential of the firm and are its potential beneficiaries and/or those who voluntarily or involuntarily become exposed to risk from the activities of a firm…Thus, stakeholders include shareholders, holders of options issued by the firm, debt holders, employees (especially those investing firm-specific human capital), local communities, environment as latent stakeholders, regulatory authorities, the government, inter-organizational alliance partners, customers and suppliers".

[2] Spitzeck and Hansen (2010) define stakeholder governance mechanisms as the system of how stakeholders influence corporate decision making and help align the worldviews of those inside and outside the firm. Böhling (2011) defines stakeholder governance as the system of how multiple stakeholders bring diverse stakeholders together, negotiate collectively on regulatory arrangements for the provision of stability, and provide a means to accommodate competing interests in decision-making in the global economy. We closely follow the MSCI ESG IVA's definition of stakeholder governance as multi-stakeholder initiated strategic governance (see more details in data, measurement, and research design section as well as Appendices I and II).