THE INFLUENCE OF CORPORATE GOVERNANCE ON ENVIRONMENTAL, SOCIAL, AND GOVERNMENT DISCLOSURE: EMPIRICAL EVIDENCE ON THE EUROPEAN UNION BANKING INDUSTRY

Paolo Capuano *

* Department of Business and Management, LUISS Guido Carli University, Rome, Italy

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Abstract

This study evaluates the impact of corporate governance on environmental, social, and governance (ESG) disclosure in the banking industry. This aspect has been little investigated in the business literature and there are even fewer empirical studies on the European Union (EU) banks. The analysis methodology is based on an empirical analysis, using a dynamic generalized method of moments and quantile regression analysis, on a large sample of EU banks over the period 2014–2023. The first results highlight that some governance variables are factors that positively influence the overall levels of ESG disclosure of EU banks. The study would encourage banks to carefully define their internal corporate governance mechanisms, paying particular attention, especially to the careful selection of board members.

1. RECENT EVOLUTION OF ESG DISCLOSURE

Correct and meaningful disclosure of risks related to ESG factors is particularly important since they can materially influence the financial stability and risk profiles of the banking system, directly impacting the financial system as a whole.

Within the EU banking system, there has recently been a fundamental regulatory development to ensure better disclosure with the European Commission defining new regulations relating to the disclosure of ESG risks.

Of great importance is the banking package approved in June 2023 by the European Council and the European Parliament (innovations in the prudential framework and changes to the Capital Requirements Directive (CRD) and the Capital Requirements Regulation as the last step towards completing the implementation of Basel III), the European Banking Authority (EBA) is called upon to carry out 140 mandates.

The first phase, which will last a year, will be marked by 32 EBA mandates, including the CRD modifications in the ESG area: the package requires banks to identify, disclose, and "systematically" manage the risks deriving from factors ESG as part of their risk management.

In January 2024, the EBA released a consultation paper regarding the Draft Guidelines on the management of ESG risks. The EBA is currently taking into account the feedback received from this consultation when finalizing the guidance. The consultation ended on April 18, 2024.

Therefore, the topic of ESG factors in the banking sector is highly topical also considering the recent regulatory evolution in the EU.

2. THEORETICAL FRAMEWORK

The academic literature has examined issues relating to CSR and ESG reporting by adopting different theoretical perspectives which can mainly be traced back to stakeholder theory and institutional theory.

The stakeholder theory is at the center of non-financial disclosure factors where the stakeholders impact the organization's activities (Doshi et al., 2024).

It should be highlighted that ESG disclosure practices are characterized by high complexity and that this complexity makes the use of a single theoretical perspective insufficient in identifying the underlying motivations and variations in corporate ESG reporting behaviors. Therefore, it is necessary to adopt a broader theoretical framework that combines the institutional logics of institutional theory with the economic perspective of stakeholder theory (Nicolo et al., 2023).

In recent years, scholars have begun to question the traditional view of corporate governance represented by stakeholder theory, based on the priority of maximizing shareholder value.

Institutional theory argues for the existence of a "social contract" between a business organization and society in which the purpose of the organization is not only to make profits but also to act in a socially responsible manner, so as to align with values, principles, and stakeholder expectations.

Therefore, according to this vision, ESG disclosure represents a fundamental strategy that a company can adopt to respond to the social concerns of stakeholders and therefore to respect the social contract.

It should be highlighted that ESG disclosure is influenced by the subjects involved in formulating strategic decisions within companies (the subjects of corporate governance).

Therefore, it is logical to consider that the corporate governance structure can influence ESG factors when they are integrated into the corporate mentality and placed at the center of the company's strategic and operational planning.

In line with this reasoning, companies with good corporate governance should be more likely to satisfy stakeholders' need for corporate ESG disclosures.

Furthermore, the empirical studies on the topic covered by this study are very scarce and have mainly focused on environmental disclosure practices, in particular in the United States. This study, however, seeks to analyze the impact of good corporate governance on the ESG factors of the EU banking industry. It is noted that few studies have examined ownership structure and ESG disclosure.

For credit institutions, the incorporation of variables related to the environment, social impacts and governance is a significant challenge, with various critical issues, but it also offers development opportunities for those who know how to adapt virtuously.

3. ANALYSIS METHODOLOGY AND FIRST RESULTS

Considering that previous studies have provided inconsistent results on the impact of corporate governance on ESG disclosure, especially in the banking industry, it is useful to highlight that more research is needed to better understand these relationships. In order to verify whether there is a relationship between bank governance and ESG disclosure, a significant sample of banks was considered. The sample analyzed includes EU banks with total assets greater than 10 million euros, in the period 2014–2023. The analysis period is influenced by the availability of historical data series. The methodology used concerns a dynamic generalized method of moments and quantile regression analysis, also considering some control variables to make the model more robust. The data sources used in defining the analysis sample are different. The dependent ESG disclosure variable is obtained from the annual report data while the governance variables were obtained from the BoardEx database. The control variables, on the other hand, were identified from the Moody's Analytics BankFocus.

In particular, banks with a higher board gender diversity and larger board size have a higher level of ESG disclosure while the results are uncertain with regards to independent board members, CEO duality, CSR/sustainability committee, and experiences of directors.

These first results require robustness checks that will be carried out in the full version of the study. Assuming that these results are confirmed, then it will be possible to precisely outline what the corporate governance levers could be to improve banks' ESG disclosure and help banking supervisory authorities define specific guidelines.

Furthermore, these results could also be useful for shareholders since achieving and maintaining higher ESG disclosure allows for guaranteeing a higher value for the stakeholders and therefore for the banks.

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