CORPORATE GOVERNANCE, CSR AND FINANCIAL PERFORMANCES: WHAT TYPES OF RELATIONSHIPS EXIST BETWEEN THESE DIMENSIONS?

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How to cite: Tutino, M., Mattei, G., Paoloni, N., & Santolamazza, V. (2019). Corporate governance, CSR and financial performances: What types of relationships exist between these dimensions? *Corporate Governance: Search for the Advanced Practices,* 231-240. https://doi.org/10.22495/cpr19p12

Received: 07.12.2018
Accepted: 19.12.2018
JEL Classification: G34, L25, M41
DOI: 10.22495/cpr19p12
Keywords: Board of Directors' Composition, CSR Performances, Financial Performances, Relationships, Corporate Governance, Companies' Strategy

Abstract

Starting from the assumption that Corporate Social Responsibility (CSR) performances and financial performances are the results of the plan of actions of companies and depend on the financial and sustainability policies, the aim of this paper is to understand, thanks to a traditional literature review, what kind of relationship exists between the companies' strategy and the composition of the corporate governance, already identified from scholars. From this, it is possible to hypothesize, thank the support of the literature, others types of relations not yet test, enclosing these in a framework that will be used in a following part of the present research.

1. INTRODUCTION

A review of the existing studies reveals the intention to explain only a specific kind of relation instead of testing a circular relationship between corporate governance, strategy and performance. A thorough analysis was carried out on the basis of the previous studies.

In order to accomplish this broad objective, the analysis was divided into two different steps: firstly, to identify the existing literature regarding the typology of relations already ascertained by scholars and, from this evidence, to reflect and try to hypothesize if the previous studies have considered all types of relations. Moreover, to create a framework that is useful to analyze and to test the situation in different countries and in different industries.

The second step of the project will concern the testing of the hypothesis elaborated in the previous step, obviously, after having created a sample composed by listed companies. To do this, it will be necessary to identify specific indicators that could be used to analyze the CSR and financial performance such as the KPI and the sustainability performances indicators, defined by GRI Framework, both measures of professional and skills identity of people that compose the corporate governance.

It will also be important to define which items are useful and efficient use, to define the composition of the board of directors (BoD) that is an important board inside the corporate governance' companies.
The empirical analysis is useful to explore the relationship among the composition and different types of performances (such as CSR and financial). From the findings, it will be possible to affirm or deny the hypothesis elaborated from the authors in the first part of the project, that have been inspired by already existing references in the literature about the single relation existing between these variables. The project allows understanding an unexplored field as the combined relationships existing between the composition of BoD, CSR and financial performances.

The present article represents the first part of the project. In Section 2, the methodology used to carry out the analysis is briefly explained. Section 3 focuses on understanding, through a literature review, which relationships are already ascertained by scholars considering the composition of BoD, in terms of quality and quantity, and what kinds of influences exists between it and the two elements of strategy that, nowadays, deserve to be given greater attention on account of their social impact, CSR policies and financial policies, affecting, as a consequence, the performance in these areas.

In Section 4, the authors' positions are explained and some conclusions are indicated. The last section contains the limitations of the work and the future direction of research.

2. METHODOLOGY

Corporate governance has been vastly debated in literature from a long time and is now a trending field. In this research, a literature review was carried out to understand which kinds of relationships were already identified in previous studies and to create the basis for future research, focusing on relationships that have not been analyzed yet.

A traditional literature review was chosen to approach this theme, being one of the most common techniques in management research, in which researchers summarize and interpret previous contributions in a subjective and narrative fashion (Denyer & Tranfield, 2006) because, as is well known, the literature review starts from the previous specific studies from which it is then possible to use the findings to provide a guide for future studies (Petticrew & Roberts, 2008), that is exactly the objective of the authors.

3. THEORETICAL BACKGROUND AND REVIEW OF LITERATURE

One of the most important bodies of corporate governance that regulates the markets economies mechanisms is the board of directors (BoD) (John & Senbet, 1998).

In literature, the composition of the board of directors has been analyzed from different points of view:

– the independence of the board (Baysinger & Butler, 1985), that consists on the fact that the majority of directors are not affiliated with the top executives;

– the CEO duality (Duru et al., 2016), that can be equated to the independence;

– the gender diversity on board (Campbell & Mínguez-Vera, 2014).

This is the reason why it is necessary to introduce the concept of identity. Several theories have been elaborated to understand this topic; e.g., the social identity theory is based on the idea that people tend to classify themselves into several social categories, such as organizational membership, religious affiliation, professional association membership, gender and age (Tajfel & Turner, 1985). Group membership has an influence on forming individual value since it internalizes the value of the groups one belongs. In different studies, it has been demonstrated that ethical climate, organizational culture, company codes of ethics, but also stakeholders that encounter a firm influence the individual value of managers (Pearce, 2013) and, as a consequence, their decision making that impacts on strategy.

In particular, it is possible to distinguish two types of identity, which are useful for our analysis: professional identity that is a sense of belonging to the profession and professional association whereas organizational identity that is the identification and affiliation with the firm in which the director works. Both organizational and professional identities can impact strategy formulation since, as it is possible to imagine, knowledge, skills and personal work experience influence the thought process of directors and the way in which they make decisions. Evidence of that can be seen in a recent study in which the authors shown that professional and organizational identities drive commercialization in an audit firm, as their empirical findings have suggested (Broberg et al., 2018). Skills of directors may affect also the company level risk (Lippi & Di Battista, 2017). Besides the positive influence of gender diversity, older members and independent members, it has also been demonstrated that there are differences in risk appetite according to the kind of degree. Directors with Economics and Law degrees reduce the company level risk whereas engineers seem to have a higher risk tendency.

Analyzing the existent gender diversity it is possible to conclude that an equal representation of men and women entails a widening of the discussion, the presence of different points of view makes it possible to take into account various interests. In addition, the presence of CEO duality affects firm performance. In fact, the overlapping of the role of CEO and chairman of the board leads to the elimination of a monitoring figure and a guarantor for both shareholder and stakeholder. This could influence the strategy formation process and, in the end, it could have a negative impact on financial performance. However, the impact of CEO duality on Firm performance is not certainly negative. In fact, another study (Yang & Zhao, 2014) points out the benefits of CEO duality for firms. It has a positive impact especially in case of changes in the economic and competitive environment because it's proved that CEO duality makes it possible to save information costs and make speedier decisions.

Some studies mentioned above have shown that, changing the composition of the board, it is possible to influence (positively), among others, financial performances, so it is possible to conclude that a direct correlation exists between corporate governance and financial performances that sometimes starts from the theorization of the agency theory (Jensen & Meckling, 1976).

Another important search term of the existing literature dealt with the influence of the composition of corporate governance (BoD) on corporate social performances.

In recent years, the issue of Corporate Social Responsibility has recovered some lost ground and it is becoming central in the public debate on corporate governance. Evidence of that can be seen in a recent research that shows that companies all over the world are facing increased stakeholder pressure to be sustainable (Chen & Wang, 2011). This is because the corporations must not take into account only the interest of people that help to keep the firm alive with their investments (shareholder and other public or private investors), but it must take into account also people that can have, in various ways, other interests in itself and its past, present, or future activities, (Clarkson, 1995). This concept is the basis for the stakeholder theory, developed by Freeman (1984) in which it is suggested that there are other parties involved, including employees, customers, suppliers, financiers, communities, governmental bodies, political groups, trade associations, and trade unions and corporation must be able to satisfy their needs. Corporate social performance is analyzed on the grounds of the GRI framework, which has identified three sustainability dimensions (economic, social, and environmental). Corporate governance items, and, in particular, board composition, can affect in a different way these three dimensions. Regarding the board composition and the relationship with the corporate social performances, it was proved that the presence of women in the top position could positively affect social and environmental performance (Setó-Pamies, 2015). This is because women are associated with a greater accountability and they improve relations with stakeholder enhancing the level of CSR reporting (Fernandez-Feijoo et al., 2014). However, the effect of women on CSR firm-behavior is not clear. In fact, although firms with women CEOs and women interlinked board members are less likely to suffer from environmental concerns than other firms (Glass et al., 2016), the presence of women on the board is not the only factor that makes it possible to improve CSR performance. Gender diversity on the board, in general, and the broad integration of women on the board are far more crucial to CSR-related policies and practices (Cook & Glass, 2018). In addition to gender diversity on the board, other corporate governance items have been taken into consideration to verify the influence on CSR performance. In a recent study, the authors investigate the impact of selected corporate governance mechanisms on each dimension of sustainability performance, as defined by the GRI framework (Hussain et al., 2018). The corporate governance mechanisms taken into account were board size, board independence, CEO duality and board meetings, women on the board and CSR committees' existence.

In literature, it is stated that board size can affect CSR performance and both financial performance because a smaller board entails faster decisions and this, in the final analyses, positively influences the firm performance. However, even though board size can have a positive impact on financial performance (Kalsie & Shrivastav, 2016) there is not the same evidence in support of the relationship between board size and corporate social performance. Another corporate governance mechanism analyzed is board independence. This is probably one of the most researched areas in corporate governance but there is no a clear and unambiguous evidence of a robust relationship between board independence and firm performance. Nevertheless, most of the literature is currently in agreement in saying that board independence is positively and significantly related to firm performance, especially in government-controlled firms and in firms with lower information acquisition and monitoring costs (Liu et al., 2015). In addition, it was demonstrated that board independence has a positive impact on CSR performance.

Neglecting for an instant the BoD composition, the focus turns to the existing relationship between corporate social performance and financial performance.

In fact, at a first glance, it may seem obvious to state that CSR policies negatively influence financial performance considering that some CSR policies have a very significant cost. However, CSR normally has a positive effect on financial performance and this is because CSR has to be seen as an explicit part of a corporate strategy that plays an important role in financial and market outcomes (Taylor et al., 2018). The relation between corporate social performance and financial performance is still unclear but most of the studies made on this topic have shown the existence of a statistically significant positive relation between the two (Margolis et al., 2009). In particular, the research has also focused on identifying what kind of corporate social sustainability activity is associated with greater financial gain. It was demonstrated that companies that carry out activities consisting on practices that foster radical changes, which are designed to unseat existing products and process have a more positive effect on financial performance than those companies that restrict themselves to improving the sustainability of companies' existing products and processes (Kurapatskie & Darnall, 2013). The above-mentioned relationship has also been analyzed from another point of view since it is difficult to state which is the element that affects the other. In fact, it is possible to imagine that also the financial performance can affect the decisions with regard to sustainability. It was demonstrated that, in support of the slack resources theory, firms with slack resources potentially available from strong financial performance may invest them more freely in corporate social activities because they can afford them (Waddock & Graves, 1997).

Since the relationship between financial and sustainable performance is still unclear, a part of the research tries to analyze the relationship between the representation of women on boards of directors and financial performance mediated by corporate social performance. The study suggests that, whether or not gender quotas are mandated by law, having women on boards appears to be linked to more substantial CSR activities and programs, which in turn here appears to be positively linked to financial performance (Galbreath, 2018).

In this section, numerous studies have been presented but there is a scant number of studies that simultaneously analyses the relationship among corporate governance, financial performance and sustainable performance.

Considering that strategy can be defined as a long-term plan of action designed to achieve a set of goals consisting of several kinds of policies (financial, social, IT, etc.), the dissertation is focused on two specific elements of strategy: financial and corporate social policies.

4. DISCUSSION AND CONCLUSION

In this study, some papers were presented in which scholars demonstrated that the composition of BoD affects strategy (composed of financial and CSR policies) and, consequently, how it affects both financial and corporate social performance. The aim of the present work is to understand if the premises for others types of relationship exist, in addition to those already identified, e. g., a reversal relationship as the financial performances, as well as CSR performances, influenced the composition of the corporate governance.

Some valuable qualities possessed by the board components such as judgement, maturity, leadership can affect strategy formulation and implementation (Baysinger & Butler, 1985). For this reason, identifying the corporate governance's characteristics, investigating the composition has become a priority.

In summary, what emerges from the literature review is that in the composition of the BoD, strategy and performance are connected to each other.

In fact, the strategy decision-making process of companies depends on several aspects: first and foremost, the professional and organizational identity of directors who assume the value and the selection criteria of the groups they belong to (company and professional association). Secondly, other elements (gender diversity, board independence, etc.) entail a broader discussion during the board meeting and this makes it possible to consider the interests of other stakeholders.

In fact, starting from the theoretical analysis it is possible to assert that:

H1: The BoD composition directly influences the financial policies;

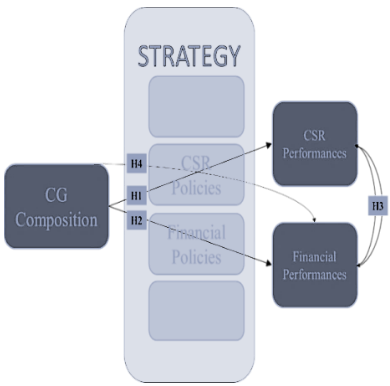
H2: The BoD composition directly influences the CSR policies;

H3: A double relationship between CSR and financial performances exists;

H4: The BoD composition influences the CSR policies that cause an improvement of financial performances.

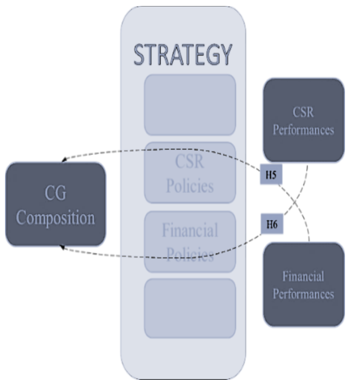
Those relationships are depicted in Figure 1 and represent the hypothesis that will be tested in the second part of the work.

Figure. 1 Relationships arose from the literature review



Source: authors' elaboration

Figure 2. Relationships hypothesized by the authors



Source: Authors' elaboration

Unlike what is found in the existing literature, the present analysis does not restrict the field to a specific relationship, but, instead, the idea is to understand and explain the relationship between the composition of corporate governance and companies' strategy overall. Attention is given to two specific items of strategy, CSR policies and financial policies and their output, because they summarize the interests of all stakeholders. In several studies, it has been demonstrated that board composition can affect CSR and financial performances. We must also take into consideration that CSR performance and financial performance have an impact on each other, as the literature reveals.

Starting from the beginning of this circuit, the opinion of the authors is that the BoD composition is not only the cause of the modified policies but could also be a consequence of the changes of policies. Furthermore, it is assumed that performances can also influence policies and, consequently, the composition of the BoD. From this assertion, it is possible to elaborate other two hypotheses that have to be tested in the future:

H5: The financial performances could influence the CSR policies and then, the BoD composition;

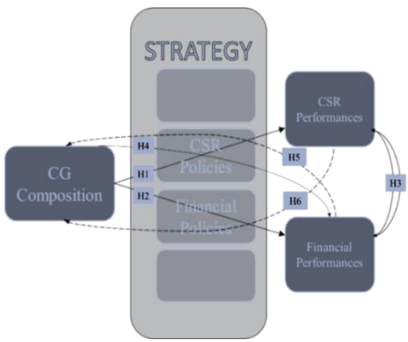
H6: The CSR performances could influence the financial policies and then, the BoD composition.

Those hypothetical relationships see in Figure 2.

5. LIMITATIONS AND FUTURE RESEARCH DIRECTIONS

As we said in the introduction, this is only the first part of our project. It will be necessary to test all the relations graphically represented in Figure 3, that have attempted to detect the statistical significance of our assumptions, and this will be done on a sample of listed companies. To carry out the test, before identifying specific items to define the composition of corporate governance, some KPI will be necessary in order to talk about financial performances and some CSR performance indicators.

Figure 3. Overall relationships that have to be tested



Source: Authors' elaboration

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