The Mediating Role of Corporate Governance on Corporate Social Responsibility and Shareholder Wealth Maximisation

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Abstract: Corporate social responsibility has been a popular topic for these past few years. As far as the knowledge of the author, there is no study that examines the relationship of corporate social responsibility and shareholder wealth maximisation mediate by corporate governance. The main purpose of this paper is to provide a review of how corporate governance can mediate the relationship between corporate social responsibility and shareholder wealth maximisation. Moreover, this study refers to stakeholder theory as the underpinning theory for drawing up the conceptual framework of the relationship between corporate social responsibility, shareholder wealth maximisation, and corporate governance. There is plenty of research investigated the relationship between corporate social responsibility and shareholder wealth where most of it focuses on the developed and some of the developing countries. However, very minimum research that uses corporate governance as a mediator variable especially for this relationship. Therefore, this review forms a concept of corporate governance as a mediating variable for corporate social responsibility and shareholder wealth maximisation.

1 INTRODUCTION

The notion of corporate social responsibility varies across different nations and sectors which depends on the context of the culture, religion, law, society, economic condition and some factors (Ahmad and Crowther, 2013). CSR can be defined as a self-regulating business that helps an organization to be socially accountable to the public and shareholders. As the development of CSR is getting stronger, it able to promote business strategies by making profits to the firms. Customer awareness of CSR is noticeably elevated when they actively seek products from businesses that operate ethically. A business that implements CSR proves that it takes an interest in wider social issues which bring many benefits. Some of the benefits of implementing CSR are it improves the public image, increase brand awareness and recognition, cost savings in terms of packaging, and increase customer engagement (Collier, 2018).

CSR effects on shareholder wealth have been studied by focusing on corporate donations as a proxy of CSR (Hall and Rieck, 1998) and proved corporate donations evoked the highest rise in share return. As the years go by, scholars started to focus on empirical analysis for the impact of CSR on shareholders' value in the capital market (Becchetti et al, 2009). The study highlights a significant upward trend of abnormal returns and a significant negative effect on abnormal returns. As CSR consists of few aspects, there were few scholars conducted studies that focus on the environmental program specifically to reduce greenhouse gas emissions to know its effect on shareholder's value (Fisher-Vanden and Thorburn, 2011; Guenster et al, 2011). This empirical evidence shows that CSR did contribute to maximise shareholder wealth.

Corporate governance has been recognized as one of the elements of organizational performance (Kyerehoah-Coleman, 2007). Standard & Poor's (S&P's) corporate governance score has few components that assess the policy of a company based on ownership structure and influence, financial stakeholders' rights and relations, financial transparency and information disclosure, and board structure and process. Previous studies proved that various proxies of corporate governance show a positive, negative and insignificant relationship with shareholder wealth maximisation. Therefore, it is compulsory to collect more studies in this area that focus on the mediating role of corporate governance.

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2 CONCEPTUAL FRAMEWORKS

Stakeholder theory suggests firms to use CSR to solve the conflicts existed between managers and non-existing stakeholders. Stakeholders can be defined as "any group or individual who can affect or is affected by the achievement of the organization's goals" (Freeman, 1984). Stakeholder theory is a concept where it is about what the organization should be and how an organization should be conceptualized (Fontaine and Schmid, 2006). The main type of stakeholders are customers, employees, local communities, shareholders, suppliers and distributors. The involvement of shareholders, employees, customers, suppliers, governments, organizations of non-governmental, organizations of international and stakeholders are a main component of CSR. In 2005, organizations recognised three main categories of stakeholder which are investors, customers and suppliers, employees and social environmental groups Papasolomou-Doukakis et al, 2005).

In addition, stakeholder theory also stated that CSR investing is one of a way to keep a good relationship with company stakeholders. The activities of CSR were used to satisfy stakeholders' interest (Odriozola and Baraibar-Dier, 2017). CSR investing is profitable, improve the satisfaction of customers and suppliers, enhance employee relationship, corporate financial performance and corporate reputation (Gelb and Strawser, 2001; Baron, 2001; Chih et al, 2008; Ghoul et al, 2011; Dhaliwal et al, 2014).

Stakeholder theory also provides a base to the connection between CSR and corporate governance. According to Freeman (1994), firms should use CSR as a mechanism to extend the effectiveness of corporate governance. Effective corporate governance should give a positive impact on CSR engagement and thus CSR positively related to corporate financial performance. This is because CSR will minimize the conflicts of interest between managers and stakeholders which will improve financial performance.

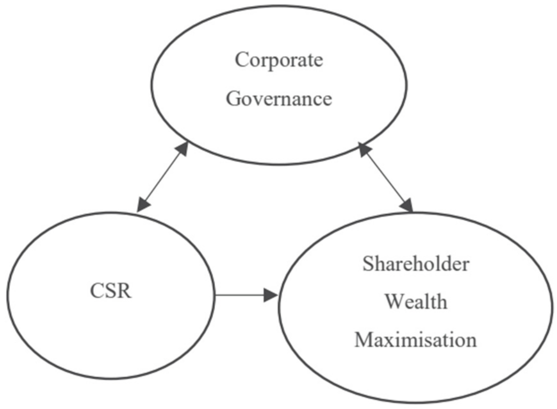

Figure 1: Conceptual framework of the relationship between CSR and shareholder wealth maximisation mediate by corporate governance.

2.1 Corporate Social Responsibility

Corporate social responsibility has no single universal definition that can be used by firms and researchers. So, it has many different definitions that focus on different perspectives. CSR is "the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large" (World Business Council, 1999). The European Union defined CSR as a "concept whereby companies integrate social and environmental concerns in their business operations and their interaction with their stakeholders voluntarily" (Verma and Kumar, 2012).

However, another scholar (Friedman and Miles, 2006) wrote that the social responsibility of business is to increase the profits as high as it can by consuming the resources and staying in activities. Firms' main objective is to earn profit without any criminal deceiving or personal gain (Younkins, 2006). The increase of the profit is for shareholders, stakeholders and society as profit can improve employee's life and firms' sustainability, and provides a higher return to shareholders (Friedman, 1962). Social responsibilities have been expanded in business into a pyramid of four dimensions which are economic, legal, ethical and philanthropic (Carroll, 1979; 1991).

2.2 Shareholder Wealth Maximisation

The firm's main goal is to generate a profit from the business. Firm gains profit when the revenue of the business exceeds the expenses of the firm. Hence, shareholder wealth maximisation is used to measure business sustainability as it is can be considered as the most appropriate measurement (Khan and Hussaine, 2018). Shareholder wealth is the value enjoyed by a shareholder by owning shares of a particular firm (The Economic Times, n.d.). According to Blair (2003), the company makes the right social goal by maximising shareholder value as it maximises the overall value of the company as well. The profits gain by a firm through maximising the value help it to survive in business and prevent it from getting replaced by others.

Financial advisors have concluded that the owner of the companies are shareholders. So, it is compulsory for a company to please shareholders by maximising their wealth. Shareholder wealth maximisation brings meaning maximising the price of a firm's common stock to provide a maximum return to shareholders (Lea, 2018).

2.3 Corporate Governance

Corporate governance focuses on the impact of corporate activities on all stakeholders of the corporation. Based on the stakeholder theory, officers and directors that act as corporate managers should consider the interest of each stakeholder in each of the governance processes (Gordon, 2015).

Corporate governance helps to reduce the conflicts of interest among internal and external stakeholders. So, in the CSR context, a previous study disclosed that CSR and corporate governance have the same mechanisms which look for larger equilibrium and consistency between profit and ethics. Furthermore, corporate governance is positively related to the company's environmental activities which add proves that corporate governance is related to CSR (Stuebs and Sun, 2010). Another study adds that corporate governance can only improve the reputation of a firm with the presence of social responsibility practices (Chalise, 2014).

3 DEVELOPMENT OF HYPOTHESIS

3.1 Corporate Social Responsibility & Shareholder Wealth Maximisation

The capabilities of corporate play a crucial role in creating shared value for the long term of success of the firms which encourage the value of the economy and indirectly create the society value (Porter and Kramer, 2006; 2011). Shareholder wealth maximisation is different from short term profit maximisation. Creating shareholder wealth is the same to satisfy the stakeholders' interests (Gennari and Salvioni, 2017).

Long term investors choose to maximise shareholder wealth by lowering the risk of cash flow rather than increase the cash flow (Nguyen et al, 2017). This study proved that CSR activities can create value for shareholders but on one condition where managers of each firm need to be monitored by long term investors. In particular, managers that have been monitored by long term investors tend to have an extra 5% stock valuations but that firms experienced low volatility of profitability and lower future stocks return. Another recent study tests the impact of CSR on shareholder wealth maximisation by performing an event analysis method as it is an effective tool to identify the perception of investors of corporate social responsibility. This is because the Efficient Market Hypothesis stated that the effect on share return should immediately be incorporated with the market. The authors found that positive CSR activities show positive effects on shareholder wealth to firms that relate to donations and environmentally-friendly activities. However, recycling and social policy activities are statistically insignificant to shareholder return. More than 2720 of CSR proposals have been examined (Elammer, 2013), which cover both social and environmental performance in the United States publicly traded firms. This study found that firms that implement CSR able to increase shareholder wealth by 0.92%. Hence, the following hypothesis is built:

H1: CSR has a positive relationship with shareholder wealth maximisation.

3.2 Corporate Social Responsibility & Corporate Governance

There is growing literature regarding the conflict-resolution hypothesis (Zubeltzu et al, 2018; Jo and Harjoto, 2011; 2012). This hypothesis tests the positive and significant relationship between CSR practices and corporate governance policies where it stated that CSR acts as a tool on behalf of corporate governance that makes the resolution of conflicts between managers and non-investing stakeholders easier (Jensen, 2010), and allows for a more sustainable form of business (Zubeltzu et al, 2018).
According to Zubeltzu et al (2018), corporate governance aims to enhance the protection rights of corporate stakeholders. This study was conducted to analyse and compare the existing relationship

between corporate governance, CSR and financial performance. Statistics of the econometric model show that 79% of previous studies proved that CSR and corporate governance have a positive relationship while 14% of previous studies show a negative relationship. Based on the reviews, CSR and corporate governance are compulsory in business models to fulfil the needs of stakeholders and shareholders and thus improve the value of the firm. In 2011, the relationship of CSR and corporate governance have been studied (Jo and Harjoto, 2011) by using few corporate governance proxies such as board independence, insider block holder ownership, outsider institutional ownership and number of analysts from the year 1993-2004. The finding from this study is CSR positively correlated to corporate governance. Then, they (Jo and Harjoto, 2012) furthered their previous study by examining corporate governance and CSR to know the causal effects. Finding from this study revealed that CSR does not give any impact on corporate governance but corporate governance positively correlated with CSR. Corporate governance variables in this study are board leadership, independent boards, institutional investors and security analysis where all of these positively significant to CSR activities.

A recent study suggests that to increase the disclosure of CSR, managers should focus to improve the quality of corporate governance (Chan et al, 2014). This study referred to stakeholder theory and annual reports of 222 listed firms. This is the first study that examines corporate governance as an overall measure and proved that firms with good corporate governance tend to have good CSR compare to firms with poor CSR. Another empirical study (Kolk and Pinkse, 2010) focused on the effect of corporate governance in CSR disclosure for multinational enterprises. Multinational enterprises have various activities in many contexts which force them to be more transparent and disclose more information about CSR issues due to higher demand from around the world. This study proved firms that report their internal CSR information on a wider range have more privilege to link corporate governance to CSR issues. Furthermore, another study examined the differences between corporate governance in the United States and the United Kingdom. It stated that the differences in CSR disclosure in United States and United Kingdom will give different impacts on corporate governance in these two countries Aguilera et al, 2006). Fund managers and investment consultants in United Kingdom increase in collaboration to develop corporate governance and CSR. This is supported by an earlier study which stated that the CSR issue in United Kingdom is more advanced in United States (William and Conley, 2005). However, CSR activities in both countries, United States and United Kingdom are positively related to corporate governance. Based on the studies mentioned, the hypothesis will be written:

H2: CSR has a positive relationship with corporate governance.

3.3 Corporate Governance & Shareholder Wealth Maximization

Corporate governance has a significant relationship between firms' management and shareholder wealth maximisation. It is also crucial in speeding the firms' performance and the growth of the economy (Aggarwal et al, 2011; Hasan et al, 2014). Shareholder wealth maximisation can improve almost everything in the firm such as workers, consumers, suppliers and distributors while the problem that prevents shareholder value creation is because of self-serving among managers for their benefits (Lazonick and O'Sullivan, 2000). Corporate governance also suggests more transparency and ethics to outline the leaders' responsibilities. A stable corporate governance structure in one particular institution is needed to build a corporate environment that deterrent the personal intention of corporate insiders and managers which will give a bad impact on firms. The categories of corporate governance that famous among researchers to test its relationship with shareholder wealth are ownership structure, board independence, the board size, CEO duality, or presence of outside directors and audit committee independence. Another empirical study (Maroun and Moez, 2015) investigated whether the separation of ownership in management is significant to shareholder wealth creation or not by using agency theory. This study used a sample of 30 Tunisian listed companies from the year 1997 to the year 2006 and corporate governance proxies that have been used are ownership structure, capital concentration and presence of outside directors. The result shows that managerial ownership is significant in enhancing shareholder wealth creation. This is because the presence of institutional investors in ownership structure plays an effective role to control managers. There is a study that proved board characteristics, auditor's quality, ownership structure and compensation mix also contribute in creating shareholder wealth (Mir and Seboui, 2008). Corporate governance is important to minimize the cost of the conflicts that occurred. Another study

(Cunat et al, 2010) mentioned that board independence is positively significant in enhancing shareholders' return but the effects are weak. Thus, firms' corporate governance that removes anti-takeover provisions enhances shareholder value maximisation by implementing the discipline of management and reducing the agency cost. Firms with better governance associated with higher shareholders' wealth.

A study conducted by Aggarwal et al (2011) compared the United States firms with foreign firms such as Canada, Japan and United Kingdom by using board independence and audit committee as proxies for corporate governance. United States and United Kingdom put a lot more focus to maximise shareholders wealth rather than firms in other countries which they focus to maximise the welfare of stakeholders. The findings revealed that companies with board independence and audit committees enhance shareholders' wealth. After comparison has been made, the result shows that governance in other countries is significantly lower than the governance of United States firms in enhancing shareholders' value maximisation except for Canada and United Kingdom. Apart from that, few scholars (Kusi et al, 2018) take this opportunity to test the effect of corporate governance on shareholder wealth of African banks. Corporate governance proxies in this literature are CEO duality, size of the board, non-executive members, audit independence and gender. Based on the findings, audit independence and the size of the board are positively significant to shareholder wealth maximisation in African banks. This is because a large number of people on board adds more skills, experience, capabilities and increase competition among the board of directors which increases shareholders' wealth. Hence, the following hypothesis is built:

H3: Corporate governance has a positive relationship with shareholder wealth maximisation.

3.4 Mediating Effect of Corporate Governance between CSR & Shareholder Wealth Maximization

To analyse mediator, scholars are most often adopted the procedures and guidelines by Baron and Kenny (1986). Scholars connected corporate governance with various variables to study its significance. In this research, corporate governance is adopted as a mediating variable between CSR and shareholder wealth maximisation.

According to Hayes (2013), mediation is the order of a causal relationship where the independent variable shows its effect on the dependent variable through the impact of the third variable. The latter assists to evaluate the total effect (the direct effect and indirect effect). So, this study adopts four steps by Baron and Kenny (1986) that help to justify corporate governance as a mediator.

- There should be a significant relationship between independent and dependent variables. Based on the literature review mentioned above, CSR and shareholder wealth maximisation have a significant relationship (Hall and Rieck, 1998; Nguyen et al, 2017; Elammer, 2013).
- There should be a significant relationship between independent and mediator variables. Based on the review of past studies mentioned above, CSR and corporate governance have a significant relationship (Zubeltzu et al, 2018; Jo and Harjoto, 2011; 2012; Chan et al, 2014; Kolk and Pinkse, 2010).
- There should be a significant relationship between the dependent and mediator variables. The literature review shows that there is a significant relationship between corporate governance and shareholder wealth maximisation (Anggarwal and Ferreira, 2011; Hasan et al, 2014; Maroun and Moez, 2015; Cunat et al, 2010).
- There must be the inclusion of corporate governance that makes the direct relationship between CSR and shareholder wealth maximisation turns to zero. Then, perfect or complete mediation is said to have occurred (James and Brett, 1984). If the direct relationship turns not to zero, partial mediation is said to have occurred.

Based on the previous studies mentioned above, it proved that corporate governance can be a mediator for the relationship between CSR and shareholder wealth. This is because it is significant with independent and dependent variables. Hence, the following hypothesis is built:

H4: The impact of CSR on shareholder wealth maximisation is mediated by corporate governance.

4 CONCLUSIONS

This review study has provided a theoretical relationship between CSR and shareholder wealth maximisation and the mediating factor of corporate governance between CSR and shareholder wealth maximisation. The fact that this area of study is still new and lack of related literature, it is expected to make a contribution to the body of knowledge of corporate governance practices.

For future studies, this model can be applied by using a sample from other developed and developing countries. This is because as far to the knowledge of the author, no study uses corporate governance to mediate the relationship between CSR and shareholder wealth.

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