

# CONVERGENCE OF CORPORATE GOVERNANCE AND CSR: A VIEW FROM THE BOARDROOM OF INDIAN COMMERCIAL BANKS

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**Abstract** This paper attempts to study the relationship between corporate governance and corporate social responsibility (CSR) reporting practices among the Public and Private commercial banks of India. For the purpose of the research, data has been collected through secondary sources for a three year period 2013-2016. Content analysis has been done to collect data related to the CSR reporting practices from the annual reports of the banks. However, corporate governance variables have been determined using the CMIE Prowess database. TOBIT Regression model has been used to study the relationship between the dependent and independent variables. The findings provide some evidence supportive of the fact that corporate governance impacts CSR disclosure practices of commercial banks in India. Board size and banks' financial performance were found to be significantly affecting the CSR reporting practices among the Indian commercial banks.

**Keywords:** Corporate Governance, Corporate Social Responsibility (CSR), Commercial Banks, India

*“Something important was destroyed in the last few months of 2008. It is an asset crucial to production, even if it is not made of bricks and mortar... This asset is trust.” (Paolo Sapienza and Luigi Zingales, 2012)*

## INTRODUCTION

Scandals in the corporate world, whether they take place in a developed economy like the U.S. or an emerging economy like India, are capable of sending shock waves throughout the globe. These outrageous wrongdoings, centred around corruption, bribery, fraud, or other greeds, have one thing in common and that is stagnation and ultimate death of those firms. While most companies are destined to fail at some point, there are a few that do so in such a spectacularly corrupt manner that they make headlines. The Enron fiasco, the Worldcom breakdown, the Satyam Saga, the Lehman Brothers breakdown, etc, are some well known examples of the same. All these events have tarnished the image of corporates in the eyes of an investor, a customer, an employee or any other stakeholder. It has also increased a society's expectations in relation to companies' environmental, social and ethical responsibilities (Money and Schepers, 2007). As a result of this, there is a significant increase in the amount of funds employed by the firms in socially responsible investments, which is also termed as the Corporate Social Responsibility of the firm.

An increased focus on CSR appears to be driven by two key factors, namely, a moral responsibility, and business interests (Adams and Zutshi, 2004). Corporates preach a motive of “giving it back to society” in their every business undertaking because apart from earning a return for their shareholders, they also have a boarder moral responsibility towards the environment, workforce and local communities. Moreover, as the companies expand and go global, they are likely to have a growing impact on the social and ecological environment of both local and international communities. With this comes a growing expectation and a responsibility that they should be accountable to various stakeholder groups for all such impacts also. For example, a survey conducted to identify the desirability and feasibility of a CSR standard found that “consumers expect firms to meet high health and safety, human rights, consumer protection and environmental standards, regardless of where their operations are located” (Smith, 2002). Further, Gibson and O'Donovan, 2007 argue that good governance is now linked with undertaking high quality CSR initiatives and fully furnishing the information regarding these initiatives in the company annual reports.

The second factor, emphasising a greater importance on CSR, is that CSR activities are good for business. For example, Adams and Zutshi (2004) argue that firms acting morally responsible are regarded as good corporate citizens which helps them to attract the most talented workforce for their firms. Moreover, the production of social and environmental

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reports helps firms in developing better internal control systems and decision-making processes which further results in cost-savings and continuous improvements.

Corporate Governance and CSR are two well established disciplines. There is a lot of research that has been done in order to study these two aspects, sometimes individually and sometimes with other variables like profitability, firm performance, operational efficiency, etc. It has been established in the prior studies that CSR reporting impacts positively on stakeholders' perceptions of firm performance, firm value and firm risk, and thereby affecting a firms' profitability, cost of capital and share price (Gray *et al.*, 1995b; Simpson and Kohers, 2002; Scholtens, 2008; Godfrey *et al.*, 2009; Salama *et al.*, 2011; Ghoul *et al.*, 2011; Cormier *et al.*, 2011; Lourenco *et al.*, 2012). Moreover, CSR reporting also contributes in reducing agency problems by removing information asymmetry between managers, investors as well as other stakeholders. Effective boards of directors should, therefore, promote CSR reporting (Jamali *et al.*, 2008). If the firms engage in CSR activities and reporting, to acknowledge the societal concerns and not merely as a temporary fad or to appease managers' personal moral concerns, the boards of these firms can be expected to be effective.

However, relatively less attention has been paid in setting up a link between these two. The amount of funds invested in CSR, along with the extent of CSR disclosure in the annual reports, is influenced by the choices, motives and values of the executives which fall in the top-most shelf of the decision-making pyramid and are the highest controlling authorities in the organisation. Furthermore, since the sub-prime mortgage crisis and the worldwide credit crunch which followed it, financial institutions, in particular banks, have come under increasing pressure, to take a more long-term perspective of their investors' business interests and to acknowledge and respond to their obligations towards the society (Matten, 2006; Money and Schepers, 2007; Gill, 2008; Grove *et al.*, 2011). The perception of the banks' CSR activities is important not only for investors' and customers' risk assessment, but also for regulators' good-will and for the public's confidence in the financial system because poorly managed and controlled banks can impose substantial negative external effects on the society as a whole.

In the light of this issue, it becomes essential to study the relationship of corporate governance mechanisms, in particular, ownership structure and board composition with the CSR disclosure practices of the firms. This paper fills the gap in the literature by investigating whether corporate governance characteristics, in particular key features of the board of directors, impact on CSR disclosure in Indian commercial banks' annual reports, for the period after the credit crunch of 2007-2008. The study is divided into five sections. Introduction of the study is explained in section one which is followed by Section 2 that explains the existing

literature on this topic. Section 3 describes, in detail, the research methodology adopted. Findings and conclusions of The study are stated in section four. The last section enunciates the limitations of the study and scope for future research.

## REVIEW OF LITERATURE

Corporate social responsibility, as described by the World Bank, 2013 is an expectation that the corporates behave ethically towards their broad group of stakeholder including their employees and their families, communities and society at large. In a country like India which is facing large development challenges, CSR is no longer seen as corporate social assistance or philanthropy. It is all about what crucial roles the corporates can play in bringing about positive change in the area of human development and social inclusion.

CSR can have both financial and strategic advantages for the firms (Jizi *et al.*, 2014). By engaging in CSR activities and reporting them in the annual reports, firms can earn a substantial goodwill and trust among the stakeholders which provides them competitive advantages (Money and Schepers, 2007; Gill, 2008; Kolk and Pinkse, 2010). Vanhamme *et al.*, 2012, suggests that CSR reporting promotes a firms' image and reputation in the market as relationships with stakeholders are based on a positive exchange of benefits. Greater brand loyalty, higher levels of customer satisfaction and employee commitment are some of the strategic advantages experienced by socially responsible firms (Mackenzie, 2007).

Firms' CSR spending is often considered as an important factor which affects investment decisions or the potential investors while evaluating firm performance (Simpson and Kohers, 2002; Aguilera *et al.*, 2006; Matten, 2006). The major reason behind this is the fact that CSR spending and reporting can impact firms' cashflow variability and profitability. Research by Ghoul *et al.*, 2011, on US firms indicates that investment in employee relations, environmental policies and CSR product strategies helps lower firms' costs of capital. Investors, therefore, increasingly require boards and managers to engage in CSR and report on this engagement.

Expectations about firms' social responsibilities are affected by their potential impact on stakeholders and civic society (Grove *et al.*, 2011). This is one of the reasons why industries which can impose significant negative external effects on society, such as the financial service sector, tend to be comparatively tightly regulated and scrutinised by the governments. While governments have the responsibility to set regulatory frameworks for the operation of these firms, at national and international level, it is the board of directors, which is ultimately responsible for the development of

sustainable business strategies and the oversight of managers' use of the firms' resources (OECD, 1999).

Considering group dynamics, smaller boards are often expected to be more effective at monitoring and controlling management than larger boards (Dey, 2008). Lesser number of directors on the boards facilitates higher levels of communications and co-ordinations among them in the decision-making which ultimately facilitates higher levels of commitment and accountability. However, smaller boards have a major drawback that individual workload of the members is comparatively higher which can limit the efficiency of the monitoring ability of the board (John and Senbet, 1998). Moreover, smaller boards can draw on a less diversified range of expertise than larger boards, which can impact on the quality of the advice and monitoring offered (Guest, 2009). Empirical research suggests that board size depends upon variety of factors such as industry type, size of the firm and complexity of the firm's business (Pathan & Skully, 2010). Commercial banks are complex structures as they provide bandwidth of services and has a diversified consumer base. Hence, it is expected that a larger board will be more efficient in undertaking and reporting of CSR activities. This leads to the first hypothesis.

H1 : Board size is positively related to CSR disclosure.

Further, it has been observed that independent directors are more interested in measures which enhance firms' long-term sustainability, such as engaging in and reporting on CSR (Ibrahim *et al.*, 2003). The reason behind this is that independent directors are involved in more bias-free decision-making as they are not directly associated with development of firm strategies and business policies. Moreover, independent non-executive directors' remuneration is also not linked with the firm's financial performance and growth. Hence, they have a more broader vision and are less interested in short-term financial performance targets. Banks with independent boards are, therefore, expected to display a greater engagement in CSR and CSR reporting (Jamali *et al.*, 2008; Arora and Dharwadkar, 2011). This leads to the second hypothesis.

H2 : A higher degree of board independence is positively related to CSR disclosure.

Empirical research suggests that boards of directors' attention to monitoring are negatively affected by CEO duality. Where a firm has the same person acting as the board chairman and the CEO/Managing Director, there are bound to be leadership and governance issues (Tuggle *et al.*, 2010). In this context, CEO-Duality can act as a sign as well as an instrument of managerial power. According to the agency theory, managers' private interests are likely to impact on the degree to which they engage in CSR activities and CSR disclosure. Therefore, powerful CEOs might use CSR as a safe weapon to pursue their own interests and moral convictions. In doing

so, they are reluctant in providing comprehensive, high quality disclosure of CSR activities. Since the effectiveness of external control by key stakeholders can be increased by the provision of CSR information, powerful CEOs are expected to use their influence to curtail voluntary disclosure, including CSR disclosure (Beyer *et al.*, 2010). This leads to the third hypothesis.

H3: CEO duality is negatively related to CSR disclosure.

## RESEARCH DESIGN

The paper seeks to investigate whether corporate governance characteristics impact the CSR disclosure of the public and private Indian Commercial Banks or not for the period 2014-2017. The sample includes all public and private commercial banks in India which are forty in total (480 observations).

The information with regards to the Governance variables viz., Board size, Board independence and CEO-Duality has been taken from the CMIE-PROWESS Database. However, data pertaining to CSR disclosure has been obtained from the bank's annual reports.

## Variable Definition

Corporate governance variables which have been included in the study are measured as follows:

**Table 1: Definition of Variables**

Name of the Variable	Definition
Board size (BS)	Log of average number of directors on the board of the banks for the period 2014-2017.
Board independence (BI)	Log of average number of independent directors on the board of the banks for the period 2014-2017.
CEO-Duality (CEOD)	Dummy variable which takes value 1 if a person is the Chairman and CEO of the firm; otherwise 0.

In order to remain persistent with the previous researches, this paper focuses on self reported information on CSR provided by the firms in their annual reports (Gray *et al.*, 1995). This is because, majorly, the content provided in the annual report is under much more control of the CEO and the board of directors, than the information given by the press or other interest groups (Barnea and Rubin, 2010; Bear *et al.*, 2010). The extent of CSR disclosure has been evaluated by constructing a measure which has been developed in line with the guidance provided by Gray *et al.* (1995). While constructing the measure, four CSR categories have been considered viz., community involvement, environment, employees, and product and customer service quality.

The amount of information with regards to the four CSR categories has been assessed using scores based on the existence and comprehensiveness of information disclosed in each category (see appendix Table-7). Each CSR category has been divided into sub-heads. Community involvement has six sub-heads; environment has four sub-heads; employees has thirteen sub-heads and the last category of product and customer service quality has eight sub-heads. In all, the sample firms are rated on the basis of reporting of these thirty one sub-heads in their annual reports for the period of three years, where maximum score attainable by any firm comes out to be sixty three.

The disclosure measure (CSRDS) is the ratio of points awarded over the maximum points a bank could achieve.

$$CSRDS = \sum \text{points of (community, environment, employees and product \& customer service category)} / 63$$

It has been observed that the quality of CSR disclosures is also affected by other governance variables like size and expertise of the audit committees, audit committee meetings, firm’s financial performance, leverage, firm size, firm risk, etc. (Goh, 2009, Arora and Dharwadkar, 2011, Reverte, 2009). In order to avoid model misspecifications, this study has employed two control variables viz., audit committee size (ACS) i.e. log of number of directors which form a part of the audit committee, and firm’s financial performance which is measured using average Return on Assets (ROA) ratio.

Using the variables described above, the regression equation so formed comes out to be

$$CSRDS = \alpha + \beta (BS) + \beta (BI) + \beta (CEOD) + \beta (ACS) + \beta (AVGROA)$$

where CSRDS = Total CSR disclosure score obtained by the banks, BS is log of the average board size, BI is the log average board independence, CEOD is the average CEO-

Duality score of the banks, ACS is the log of average audit committee size and AVGROA is the average return on assets ratio of the banks.

As the dependent variable of the this study is censored, TOBIT regression model has been used. If the values of the dependent variable in some of the observations are grouped at a limiting amount, which is commonly zero, TOBIT regressions become more powerful than other regressions, since they make use of all observations regardless of whether they are at the limit or above (Tobin, 1958). The regression equation obtained using this model is

$$y_t = X_t\beta + u_t \quad \text{if } X_t\beta + u_t > 0 \\ = 0 \quad \text{if } X_t\beta + u_t \leq 0 \\ t = 1, 2, 3, \dots, n.$$

where N denotes the number of observations;  $y_t$  denotes the dependent variable at time  $t$ ;  $X_t$  denotes the independent variables at time  $t$ ;  $\beta$  are the coefficients, and  $u_t$  represents the error term.

## Descriptive Statistics

### CSR Disclosures

The analysis of the CSR disclosure practices of the banks revealed that the banks CSR polices varied in terms of the intensity and focus in their reporting with respect to the four categories viz., community development, environment, human resources and product and customer services. Appalingly, twelve out of a total of forty one banks didnot report their CSR expenditures in their annual reports. However, the percentage of banks reporting their CSR policies in their annual reports had increased from 95 percent in 2014 to 97 percent in 2017. The detailed analysis has been described in the table below.

**Table 2: Analysis of CSR Disclosure by the Banks**

Description	Total score	Community involvement	environment	employees	Product and customer services
Maximum disclosure score	60	18	12	27	12
Minimum disclosure score	15	0	0	6	0
Mean	37	11	7	14	6
Standard Deviation	11.22	4.03	4.56	4.73	3.45
Total percentage disclosure	54.87pc	60.13pc	55.2pc	36.34pc	25pc

According to the table above, the mean of the total disclosure score is thirty seven and the standard deviation is 11.2. The highest CSR disclosure score is 60 points out of a total of 63 across the four CSR categories. Out of the total four categories, the maximum percentage of disclosure was done with respect to the contributions towards community

involvement as this category formed a majority portion of the CSR expenditures by the banks. Products and customer service category was the least disclosed one, with only 25pc disclosure, which highlights the fact that majority of our banking sector still hasn’t realised the importance of serving to the differential customer base.

**Corporate Governance and CSR**

The descriptives of the corporate governance variables, along with the control and dependent variables, have been

stated in the table below. It includes the mean, median, standard deviation, minimum and maximum values.

**Table 3: Descriptive Statistics of the Variables**

Variable	Mean	Median	S.D.	Minimum	Maximum
Board size	0.99	1.00	0.94	0.73	1.13
Board independence	0.74	0.74	0.13	0.36	1.00
CEO-Duality	0.35	0.00	0.44	0.00	1.00
Audit committee size	0.68	0.66	0.12	0.30	0.97
Average ROA	0.44	0.45	0.63	-0.89	2.10
Total CSR score	0.54	0.52	0.19	0.00	0.95

According to the above table, the mean board size is approx. 1, with a standard deviation of 0.94. With regards to board independence, the mean and the median scores are same, 0.74 with a very low standard deviation of 0.13. CEO-Duality had the lowest mean value of 0.35 with a standard deviation of 0.44. The two control variables viz., audit committee size and average ROA had a mean score of 0.68 and 0.44 respectively. Lastly, the dependent variable, total CSR score, had a mean value of 0.54 which indicates that, on an average, the sample firms scored 0.54 out of one in the overall CSR disclosure rating. In the present day scenario, this value is quite low. Five out of total 21 private sector banks and seven out of total 20 public sector banks didnot publish a separate

CSR report in their annual reports. However, the same were available on the company websites but only the broad policy on CSR was specified. The amount of expenditure incurred on the CSR activities was not disclosed.

**Pearson Bivariate Correlation Analysis and VIF Values**

A Pearson correlation analysis has been conducted in order to study the type and level of association among the model variables. the table below shows the results of the this analysis.

**Table 4: Correlation Analysis**

Variable	VIF Values	Total CSR score	LogBS	LogBI	AVGCEOD	LogACS	AVGROA
Total CSR score		1.00					
LogBS	2.29	0.18	1.00				
LogBI	2.49	0.24	0.74	1.00			
AVGCEOD	1.67	-0.40	-0.42	-0.41	1.00		
LogACS	1.22	-0.13	0.01	0.10	0.29	1.00	
AVGROA	1.64	0.51	0.37	0.43	-0.55	-0.27	1.00

The results donot show any serious correlation problems among the dependent variables which are to be used in the model. LogBS, LogBI and AVGCEOD have moderate to low positive association between them. However, AVGROA and AVGCEOD have comparatively higher and negative values of correlation with the dependent variable. This shows that there is a comparatively stronger negative association among these variables. In order to test for the problem of multi-collinearity, VIF values for all the independent variables have been shown above. All the obtained values are way less

than 10, which indicates that the model does not suffer from any multi-collinearity problems.

**Regression Analysis**

The analysis of the impact of corporate governance characteristics on the CSR disclosure of the banks has been done using TOBIT regression models. the results of the regression model as interpreted and reconciled in the table below.

**Table 5: Relationship between Corporate Governance and CSR Disclosure**

Independent Variables	TOBIT regression model coefficient (p-values)
Constant	0.535 (0.000)
LogBS	0.010 (0.047)
LogBI	-0.000 (0.869)
AVGCEOD	-0.056 (0.394)
LogACS	-0.000 (0.967)
AVGROA	0.118 (0.011)

\*tested at 0.05 level of significance.

The analysis of the regression model shows that out of the three governance independent variables viz., board size (BS), board independence (BI) and CEO-Duality (CEOD) and two control variables viz., audit committee size (ACS) and average return on assets (AVGROA), two of them have been found to be statistically significant at 0.05 level of significance. These are board size (BS) and average return on assets (AVGROA). Consequently, hypothesis one which assumed that Board size is positively related to CSR disclosure stands accepted. Banks which have larger boards, disclosed more CSR related information. The reason for this might be that as banks are complex organisations, having more number or directors share the work, has a positive impact on the bank's attitude towards stakeholders.

However, hypothesis two which assumed that a higher degree of board independence is positively related to CSR disclosure stands partially accepted because there has been found a positive relation between board independence and CSR disclosure, but this relationship is not statistically significant. Similarly, there has been found a negative relation between CEO-Duality and CSR disclosure, but this relationship is not statistically significant. Hence, the third hypothesis which states that CEO-Duality is negatively related to CSR disclosure also stands partially accepted. Summary of the hypothesis acceptance and rejection has been stated in the table below.

**Table 6: Summary of Hypothesis Acceptance / Rejection**

Hypothesis	p-values	Accepted / Rejected
H1	0.047	Accepted
H2	0.869	Partially accepted
H3	- 0.394	Partially accepted

The examination also highlighted that one of the control variables viz., firm's financial performance measured by average ROA has also been found to be statistically significant in impacting the CSR disclosure by the firms. This is because of the obvious reason that firm's with better

financial performance have more spared resources with them. Therefore, they are better capable of investing in social activities than firm's suffering from poor returns.

## FINDINGS AND CONCLUSION

Present study aimed to analyse the impact of corporate governance on the CSR disclosure of the public and private sector Indian commercial banks. Content Analysis of the banks' annual reports has been done in order to ascertain the quality of CSR disclosure made by them. Using the CSR measure developed by Gray *et al.*, (1995) as the base, the results showed that the average rate of CSR disclosure by the banks was 54.87 percent. This implies that the actual CSR spending by the banks is being done only for the 50 percent of the categories which form a part of the measure, which is quite low as compared to 95 percent in the U.S. (Jizi *et al.*, 2014). With regards to the relationship between corporate governance and CSR disclosure, using TOBIT regression model, it has been concluded that board size and financial performance impacted the extent of CSR disclosure by the Indian banks. However, board independence and CEO-Duality did show a certain type of association with the CSR disclosure, but that was not found to be significantly impacting it. The findings of this research are in line with John and Senbet (1998), Guest (2009) and Jizi *et al.* (2014).

## LIMITATIONS AND AREAS FOR FUTURE RESEARCH

Apart from the results indicated by the study, it suffered from some limitations. Starting with the time-period and the sample size, both could be extended. Instead of a three year period, maybe a five or eight year study period could give better results. Additionally, the sample of the study can be increased in scope by including Private Foreign Banks, Scheduled And Non-Scheduled Co-Operative Banks, Regional Rural Banks, etc. While conducting the content analysis of the banks' annual reports, there were some areas of CSR expenditure which were not found to be covered by the measure developed by Gray *et al.*, (1995). For instance, there were a lot of banks which were spending on the recovery of the flood prone areas or the cyclone affected areas. Therefore, it is felt that this measure of CSR disclosure should be tailored a bit, according to the country specific needs, before actually being used for analysis.

The findings for the this study can be generalized only on the public sector and private sector commercial banks. Nevertheless, a research can be conducted to study the relationship between corporate governance and CSR disclosure of the firms in the non-financial industry also. With regards to the areas of future research, a more comprehensive study can be undertaken by including more

corporate governance variables like frequency of board meetings, audit committee independence, frequency of audit

committee meetings, etc. and controlling for firm size, firm riskiness, etc.

## APPENDIX

**Table 7 : CSR Categories and Sub-categories**

CSR Category	CSR sub-category
1. COMMUNITY INVOLVEMENT	Contributions and donations to charities, NGOs and community activities Provision of support to students to continue their education Sponsoring health programmes Sponsoring arts and culture Supporting sports and/or recreational projects Participation in social government campaigns
2. ENVIRONMENT	Bank's environmental policies and concerns Implemented systems for environmental management Environmental projects such as recycling and protection of natural resources Energy saving in performing business operations
3. EMPLOYEES	Number of employees Equal opportunities in employment (e.g. minorities, women) Training and education provided to employees Employee assistance/benefits Employee compensation Employee expertise and backgrounds Employee share purchase schemes The confidence and self-esteem of employees Employees' appreciation Issues related to the recruitment process Photos to document employee welfare (e.g. at social activities, award ceremonies) Discussion of employees' welfare Policies adopted regarding staff profit sharing
4. SOCIAL PRODUCTS AND SERVICE QUALITY	Diversity of social products (e.g. climate products, educational loans etc.) Discussion of the types of social products Geographical distribution and marketing network of the offered social products Discussions in relation to customers feedback Provision for disabled, frail and difficult-to-reach customers Investments in social responsibility activities Strategies and plans for future expansion in social products and services Loyalty programmes and gifts to customers

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