

Corporate Social Responsibility Performance, State Ownership and Executive Compensation: Empirical Evidence from China

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Abstract

This analysis focus corporate social responsibility and executive compensation in China and also tests the relationship between state possession and executive compensation in presence of CSR. The estimated results confirm our hypotheses true in the selected sample of 2011 to 2014 of China. The firms with high CSR performances positively moderate the previously negative or no relationship between state-ownership and executive compensation. Application of 2SLS and GMM guaranteed the robustness of the results to potential endogeneities.

Key Words

CSR Performance;
Executive Compensation;
State-Ownership; Agency
Theory; China

Introduction

The burgeoning implications of corporate social responsibility (CSR) in the modern corporate world have stimulated the researchers to probe its nexus with different mechanism of corporate governance. CSR practices and performance in its varying forms, such as economic, philanthropic, ethical and legal (Hill et al., 2007) are not only influenced by board characteristics, ownership structure, and governance mechanisms but also affects these distinct features of corporations. This phenomenon, though different theories i.e. agency theory (Jensen and Meckling, 1976) and stakeholder theory (Donaldson and Preston, 1995; Freeman, 1984; Michelon et al., 2013; Wood, 1991), has been analyzed by various scholars (Shahab and Ye, 2018; Shahab et al., 2018a, 2018b; Yu et al., 2017; Akisikand Gal, 2017; Yu and Rowe, 2017) in both developed and developing countries. As the debate over CSR and executive compensation relationship in developing countries is not mature therefore the consenses over the consequences and determinants of CSR has not built yet.

In developed markets the wide spread between the executives and employees' compensations stirred a wave of concerns on ethical and economic grounds. The literature from developed countries claims that CSR engagement is a key factor of CEO compensation (Callan and Thomas, 2011) and executives engaged in CSR activities for increased compensation and personal reputation (Barnea and Rubin, 2010; Mahoney and Thorn, 2006). Literature also found a reverse causal relationship among CSR practices, the compensation structure of CEO (Cai et al., 2011) and different characteristics of CEO's demographics and CSR performance (Huang, 2013). It is evident that there exists substantial association amongst corporate governance mechanisms, CSR and executive compensation (Hong et al., 2016). These imperative aspects has not been analysed by the literature so far especially in case of country like china.

Keeping in view the previous research gaps, in the present study we have attempted to bring forth exciting insights from the world's fastest-growing economy (China). In China, the state-owned firms (SOEs) constitute around two third of the total firms (Li and Zhang, 2010 and Li et al., 2013) and various state organizations are working to convince all of the firms mainly state-owned to pursue CSR activities. In October 2006, the 6th Plenum of the 16th Communist Party of China (CPC) Central Committee stated that "to build a harmonious society, China should increase the social responsibility of the citizens, business enterprises, and all kinds of other organizations." In September 2011, guidelines were issued by State-owned Assets Supervision and Administration Commission (SASAC) which proposed that "sustainable development should be the core of CSR,

and state-owned enterprises should be harmonious in development with society and the environment” (Marquis and Qian, 2014). Still, there is a wide gap in the CSR practices and disclosure mechanism of Chinese enterprises and that of those western enterprises. Accordingly, this study aims to present an integrative model to answer the unexplored questions from the CSR-executive compensation nexus and add to the literature in following ways. First, the impact of CSR performance, state-ownership and control variables (which include both governance and firms’ variables) on executive compensation of Chinese listed firms from the year 2011-2014 are analysed to strengthen the arguments of Khana and Palepu (1997) and Altman et al. (2007) that the economic, financial and governance system between developed and developing countries vary to a great extent.

Second, economy dominated by state ownership reacts to the involvement of CSR practices and activities has not been analysed yet. Literature propose that SOE has no or negative effect on executive compensation in developing economies (Firth et al., 2007; Conyon & He, 2011) they are interested in non-financial objectives (See, 2009). Therefore, drawing on agency theory this study investigate how CSR activities can modify the previously examined relationship between SOE and executive compensation. Our objective is to determine whether the firms who are actively engaged in CSR activities and have significant state ownership, present the similar negative/no effect on executive compensation. Alternatively, the presence of CSR activities in SOE firms changes that relationship into a positive one, thus acting as a beneficial tool for the nexus of state ownership and executive compensation. We analysed the moderating influence of CSR performance on the nexus of state-ownership and executive compensation. The use of CSR as an interaction term is non-existent in the literature relevant to the developing countries. Such moderation effect will help in understanding how firms with state ownership and distinct governance structure will determine the executive compensation in the presence of CSR.

Third, Mahoney and Thorne (2006) state that executive compensation has a significant impact on CSR. Therefore, we argue that there might be potential reverse causality between executive compensation and CSR performance (Cai et al., 2011) which can affect the reliability of our regression results. To tackle this issue, previous literature (Cai et al., 2011) has stressed the implementation of instrument variable technique to ascertain more robust results in the developed market. Thus, to deal with the above-suggested issue and contribute more effectively, 2SLS and GMM is used. By using agency theory, our findings will shed new insights to the existing literature and will have practical implications for the regulatory bodies, government, and firms.

Literature Review and Hypotheses Development

CSR Performance and Executive Compensation

Some early researchers (Atkinson & Galaskiewicz, 1988; Friedman, 1962; Wright & Ferris, 1997) have employed agency theories in studies related to CSR and corporate strategies primarily related to corporate boards. Similarly, some studies (e.g. Bear et al., 2010; Berrone & Gomez-Mejia, 2009; Oh et al., 2011) have discussed the positive aspects of CSR concerning the monetary and non-monetary performance of the organizations. They argued that CSR initiatives are encouraged by firms with state ownership, institutional ownership, and foreign investors as such financiers are more eager to invest in responsible and environmental-friendly companies to shun the financial menaces. Contrarily, the other scholarships provide limited evidence on the association between CSR and executive return with a particular focus on developed economies and have ignored the developing economies, e.g. Flammer et al. (2017) found that corporate social responsibility astringent is dominant in production-intensive businesses and has developed over time. Hubbard et al. (2017) provided empirical insights into the literature by proposing that CSR practices and performances play a vital role in the nexus among CEO’s career outcomes and firm’s financial performance. They empirically found that greater investment in CSR in the past, result in better financial performance with a boost in CEO’s career (ultimately in more compensation) and vice-versa. Cai et al. (2011) argued that there is a shortcoming in employing an integrated theory. The proposed two hypotheses, i.e. overinvestment and conflict-resolution hypotheses. They found empirical support only for the conflict-resolution hypothesis in USA and argued that the lag of CSR negatively determine CEO compensation (both total and cash compensation).

In the light of the literature review, we infer that previous studies have been focused on developed countries, and prevailing literature has not yet studied the relationship between CSR and executive compensation from a developing economy, i.e. in particular China. This study take huge data set of Chinese listed companies to fill the gap.

From the above discussion one can extract the following specific hypotheses;

Hypothesis 1

There is a positive association between CSR performance and executive compensation in Chinese listed firms.

State ownership, CSR performance, and Executive Compensation

Previous literature has discussed this relationship, e.g. Hong et al. (2016) concluded that the firms whose governance structure is more shareholder-friendly will be more inclined to compensate CEOs, subject to enhanced social performance outcomes of firms. They further claimed that executives' motivation to enhance firm's social performance increases with increase in incentives for CSR engagement or initiatives. It implies that corporate governance mechanism is a vital factor in determining the executive inducements for social activities and engagement in such social activities will not only increase the social performance but will also be favourable to shareholders. Faleye and Trahan (2011) claimed that corporate strategies which are labour and environmental-friendly, have been used by the managers and directors avoid the negative consequences of managerial extravagances at the board level. Callan and Thomas (2011) broadened this framework by investigating a multi-equation model of the executive compensation, CSR, and firm financial performance. They control for endogeneity and found a simultaneous relationship between financial and social performances. Their findings also showed CSR as an important determinant of the CEO reward. Kato and Long (2006) discussed that the pay to performance linkage is weaker for executives in firms. Firth et al. (2007) found that the corporate management mechanism have a substantial influence on CEO compensation and it is different in developed and developing countries which needs further exploration especially in developing countries. Welford (2007) claimed that good corporate governance leads to better CSR performance. He studied issues in corporate governance (specifically ownership and control) about CSR performance in Asia. He explained that the concentrated ownership by owners (which may be by shareholders or state) is the main reason for strong corporate governance in the Asian region as compared to the western region. Conyon and He (2012) found positive impact of both stock and accounting market performance on the CEO's pay structure. They also revealed that board characteristics and ownership design also influence the equity benefits, such as equity ownership and equity grants enjoyed by CEO. Conyon and He (2011) studied corporate governance and executive compensation of Chinese firms, and consistent with agency theory. Comparing the executive pay of Chinese firms with U.S. firms, they found that the executive compensation (salaries and bonuses) in the U.S. is greater than Chinese firms.

Nevertheless, most of the studies from China depict a negative or no affinity between state ownership and executive compensation as these executives are bureaucrats whose appointment is subject to a specific time span and fixed salaries. However, a strong evidence claim that the SOEs' main interest is to pursue non-financial objectives which are stated in the contracts of CEOs (Bai & Xu, 2005) and such state-owned firms emphasize the executives to achieve those non-financial objectives keenly (See, 2009). Drawing on agency theory, we argue that the written description in executives' contracts to pursue non-financial objectives can stimulate CEOs of such firms to engage in CSR practices and improve CSR performance to achieve not only those non-financial objectives of the firms but also to enhance their compensation.

We propose our second hypothesis from the above argument and suggest that the better CSR performance engenders a moderating mechanism between the presence of state ownership in firms and executive compensation link where the previous negative or no relationship between SOEs and executive compensation is changed due to the inclusion of CSR in the form of non-financial objectives. Our second hypothesis is as follow:

Hypothesis 2

CSR performance moderates the association between state ownership and executive compensation in Chinese listed firms.

Methods

Data

In China, the rating agencies started evaluating the CSR related performance-indicators of Chinese listed firms from 2010. Therefore, we employed an unbalanced panel data of 554 firms (i.e. 1946 firm years' observations) listed on two stock exchanges in China, i.e. Shenzhen Stock Exchange (SZSE) and Shanghai Stock Exchange (SSE) from 2011 to 2014. Our initial sample includes all those firms who report CSR in the stated period. However, we used unbalanced panel due to missing observations in some particular years. China Stock Market and Accounting Research were consulted for data on executive compensation. We extract the data on CSR performance of firms from HEXUN, one of the Chinese professional financial service websites, specialized for high-end investors in China. This database evaluates all firms listed on SZSE and SSE and develops an index by ranking the CSR performance of the firms. STATA software interactive tools were used for analyzing this data, and we employed Winsorization technique to control the issues of outliers.

Variables description

Following Conyon and He (2011), and Kato and Long (2006) we measured our dependent variable: executive compensation by the top three executives' average pay which includes base salary, bonuses, and commissions in China. Like western enterprises, the data on segregated heads of CEO compensation is not available for Chinese listed firms. This variable is dealt in natural log.

Corporate Social Responsibility performance: Corporate Social Responsibility performance is measured by index provided by HEXUN website (Li and Foo, 2015; Shahab et al., 2018a, 2018b). This database divides CSR into five different categories; (i) shareholder responsibility; (ii) employee responsibility; (iii) supplier; (iv) customer and consumer right responsibility; and (v) environmental responsibility and public responsibility. These five categories are further sub-divided into second (13) and third (37) class indicators. Although the typical distribution of CSR index is similar amongst the industries, each industry follows their distribution method for CSR index's development by priority. The value of CSR index is between 1 and 100 where 1 indicates the low level of CSR and 100 means high CSR.

State Ownership: Hardly a study can be found that considered the importance state-ownership variable affecting executive compensation via an interaction of these variables with CSR performance. Therefore in case of this study SOE is measured by dummy when it is 1 for state-ownership and 0 otherwise.

Control Variables: Board size (Cai et al., 2011) taken in log, board independence (Conyon and He, 2011) measured in %age of outside directives on the board, CEO duality (Firth et al., 2007) is proxy by dummy, CEO age (He, 2008) is taken in years, firm size (Kang, 2013) is calculated by number of employees in a firm, Return on Assets (Cai et al., 2011) is the income before extraordinary items divided by total assets of the firm, firm age (Gomez-Mejia et al., 2003) is calculated as the year that has been elapsed since the foundation of the firm and dividend (Bhattacharyya et al., 2004) used as a dummy variable.

Econometric Model

The data period of our study ranges from 2011 to 2014. Since there are many observations per firm in our data, therefore, unobserved heterogeneity was an issue. We checked the problem of heteroskedasticity in our data by applying Wald test suggested by Baum (2001), and we obtained a significant probability results. The autocorrelation in data was tested by Wooldridge (2002) technique, and we also got significant value. Furthermore, we also checked the within and between variation in our data. The findings showed that on average the value of between variations was greater than within variation in our variables. Cameron and Trivedi (2010, pp-607) say that if between effect values are greater than within variation then Hausman test becomes inconclusive and fixed effect results are inconsistent. Therefore, to tackle these problems, we used panel generalized least square (GLS). We employ the following econometric model in our analysis:

$$EXCOMP_{it} = \beta_0 + \beta_1 CSR_{it} + \beta_2 SOE_{it} + \beta_3 SOE * CSR_{it} + \beta_4 BS_{it} + \beta_5 BC_{it} + \beta_6 CEO_{it} \\ + \beta_7 CEOAGE_{it} + \beta_8 LNSIZE_{it} + \beta_9 ROA_{it} + \beta_{10} Firmage_{it} + \beta_{11} Dividend_{it} + \epsilon_{it}$$

Where "i" shows the firm and "t" represent the period, while, the rest of the variables are described in detail in variable section and appendix (A).

Results

Descriptive Statistics

Table 1 displayed the descriptive statistics where the average value of executive compensation is 798000 with a standard deviation of 805000. It represents quite a high mean value for the CEO compensation. 37.11 is the average for CSR with 11.33 standard deviation. This suggest poor trend in CSR performance in comparison to the highest values of CSR performance in developed countries. The mean value of state ownership is 63 percent, confirming the claim of Li and Zhang (2010) by arguing that more than 60% firms in China are state-owned. Mean value of board size is almost near to 10 while board independence value shows that approximately 1/3 of the board associates in Chinese firms are independent. The values of CEO duality show that the culture of the dual role of the CEO is less evident in China, and mostly CEO and chairman of the board hold separate offices.

Table 1. Descriptive Statistics

Variables	N	Mean	Sd	P25	P50	P75
total compensation	1940	798000	805000	386000	591000	882000
Csr	1946	37.11	11.73	29.40	34.20	41.51

Soe	1910	0.631	0.483	0	1	1
Bs	1945	9.357	2.020	9	9	11
bc	1945	0.375	0.0600	0.333	0.357	0.400
ceod	1929	0.158	0.364	0	0	0
age	1764	49.48	5.966	46	50	53
lnsize	1946	8.375	1.379	7.493	8.287	9.248
roa	1946	0.0420	0.0570	0.0150	0.0370	0.0660
firmage	1946	11.15	5.622	6	12	16
divdum	1946	0.803	0.398	1	1	1

Author's Calculations

Table 2 depicts the values for correlation and Variance Inflated Factors. CSR and rest of the other variables has substantial correlation with executive compensation. The values of VIF are well below the standard threshold of 10 in our study.

Table 2. Correlation and VIF

Variables	VIF	1	2	3	4	5	6	7	8	9	10
<i>Ln(total compensation)</i>		1									
<i>Lncsr</i>	1.18	0.251*	1								
<i>Soe</i>	1.34	0.050*	0.167*	1							
<i>Bs</i>	1.29	0.138*	0.166*	0.233*	1						
<i>bc</i>	1.15	0.014	0.030	-0.024	-0.320*	1					
<i>ceod</i>	1.14	0.055*	-0.043*	0.248*	-0.127*	0.110*	1				
<i>age</i>	1.13	0.135*	0.075*	0.192*	-0.021	0.033	0.159*	1			
<i>lnsize</i>	1.29	0.321*	0.388*	0.236*	0.264*	0.073*	-0.086*	0.162*	1		
<i>roa</i>	1.27	0.223*	0.006	0.165*	-0.027	-0.027	0.058*	-0.030	-0.039*	1	
<i>firmage</i>	1.14	0.127*	-0.035	0.297*	0.040*	-0.033	-0.124*	0.128*	0.021	-0.120*	1
<i>divdum</i>	1.26	0.246*	0.088*	-0.016	0.071*	-0.020	-0.022	0.027	0.056*	0.418*	-0.116*

Regression Results

In the first model, we included our independent variable (CSR performance) to test the first hypothesis by checking its impact on executive compensation (See table 3). CSR performance is substantial and suggest that 1% change in CSR performance changes the executive compensation by 0.493%. It is a strong evidence in support of our first hypothesis. Our findings are in coherence with the previous literature (Barnea and Rubin, 2010; Callan and Thomas, 2011; Mahoney and Thorn, 2006) which claimed that engagement in CSR practices and enhanced CSR performance increase executive compensation. In the second model, we incorporated all the other control variables including state ownership and examined the effect of CSR performance on executive compensation to test our first hypothesis in the presence of control variables. We found significant results for CSR performance here too (See Table 3).

In the model 2 we found inverse relation between SOE and executive compensation (See Table 3). This negative relationship has been discussed in some previous studies in Chinese context (Conyon & He, 2011). They

argued that due to increased involvement of the state in firms, the executive compensation of CEOs is adversely affected and a negative relationship exists between SOE and executive compensation. Further, we followed Li and Zhang (2010) that more than 60% Chinese firms are state-owned, and this study found that CSR performance moderates the relationship between SOE and executive compensation. Therefore, we developed the interaction of state-owned firms and CSR in model 3 to check how the combination of these two (SOE×CSR) affects executive compensation. Model 3 depicts a positive and significant (at 1%) coefficient of 0.120 for our proposed interaction term, i.e. SOE×CSR. That shows that greater is the CSR performance more will be the association with executive compensation.

Lastly, in model 2 and model 4 of table 3, we included the control variables and results support our hypothesis of their relation with executive compensation. The findings of the firm characteristics control variables (size, ROA, firm and dividend pay-out) also suggest that these variables increase executive compensation.

Table 3. Generalized Least Squares (GLS) Estimates for Effect of CSR Performance, Corporate Governance on CEO Compensation

	(1)	(2)	(3)	(4)
Variables	Ln(total compensation)	Ln(total compensation)	Ln(total compensation)	Ln(total compensation)
Lncsr	0.493*** [0.000]	0.363*** [0.000]	0.416*** [0.000]	0.264*** [0.000]
Soe		-0.111*** [0.000]	0.039*** [0.000]	-0.096*** [0.000]
Bs		0.021*** [0.000]		0.021*** [0.000]
Bc		0.111*** [0.000]		0.093*** [0.001]
Ceod		0.121*** [0.000]		0.126*** [0.000]
Age		0.007*** [0.000]		0.007*** [0.000]
Lnsiz		0.117*** [0.000]		0.117*** [0.000]
Roa		1.818*** [0.000]		1.881*** [0.000]
firmage		0.021*** [0.000]		0.021*** [0.000]
divdum		0.175*** [0.000]		0.181*** [0.000]
soe*csr			0.120*** [0.000]	0.112*** [0.000]
Constant	13.308*** [0.000]	11.330*** [0.000]	13.260*** [0.000]	11.286*** [0.000]
Year effect	Yes	Yes	Yes	Yes
Observations	1,871	1,646	1,831	1,646
Number of id	553	520	542	520

Endogeneity

The overall results are quite meaningful. However, there might be inverse causation and omitted variable biasness in the model. To test this we employed 2SLS and GMM techniques to reduce and tackle the potential problem of endogeneity. Following Cai et al., (2011); Shahab et al., (2018a, 2018b) we used industry-median CSR as an instrumental variable (IV) for CSR performance. CSR performance is different from industry to industry, (McWilliam and Siegel, 2001; Waddock and Graves, 1997). Therefore, we estimated industry-median CSR as an IV. (See Table 4). The outcome of 2SLS and GMM two-step shows that industry median CSR is positively associated with CSR index at 1% level by controlling the effect of governance and firm-specific characteristics and at 10% level of significance on total executive compensation. The validity of our instrumental variable is tested through F-stat test suggested by (Staiger and Stock, 1997) and found that the value of the instrumental variable was greater than 10 (value less than 10 represent weak instrument) which is considered as a strong instrument.

Table 4. Endogeneity Results for effect of CSR performance, Corporate Governance on CEO compensation

Variables	(2SLS)		(GMM)	
	First stage	Second stage	First stage	Second stage
	Incsr	Ln(total compensation)	Incsr	Ln(total compensation)
Industry_med CSR	1.208*** [0.000]		1.208*** [0.000]	
Incsr		0.963* [0.068]		0.963* [0.068]
soe	0.037** [0.016]	-0.126*** [0.007]	0.037** [0.016]	-0.126*** [0.007]
bs	0.007* [0.056]	0.011 [0.243]	0.007* [0.056]	0.011 [0.243]
bc	0.152 [0.182]	0.022 [0.930]	0.152 [0.182]	0.022 [0.930]
ceod	0.005 [0.756]	0.132*** [0.003]	0.005 [0.756]	0.132*** [0.003]
age	0.006 [0.588]	0.008*** [0.004]	0.006 [0.588]	0.008*** [0.004]
Insize	0.071*** [0.000]	0.093** [0.016]	0.071*** [0.000]	0.093** [0.016]
roa	0.037 [0.754]	2.072*** [0.000]	0.037 [0.754]	2.072*** [0.000]
firmage	-0.002* [0.054]	0.022*** [0.000]	-0.002* [0.054]	0.022*** [0.000]
divdum	0.039** [0.025]	0.254*** [0.000]	0.039** [0.025]	0.254*** [0.000]
Constant	-1.490* [0.097]	8.121*** [0.000]	-1.490* [0.097]	8.121*** [0.000]
Wald F-state		23.14		23.14
Observations		1,722		1,722
R-squared		0.208		0.208

Discussion

The purpose of this study is to test the relationship between CSR performance, state ownership and executive compensation in China. Although, sufficient amount of literature is available in developed economies by testing the relationship between CSR and executive compensation which is largely based on two opposing theories namely agency theory and stakeholder theory (Freeman, 1984; Jensen & Meckling, 1976). Li and Zhang (2010) argued that Chinese government own more than 60 percent of the firms. Firth et al. (2007) suggested that the structure of the executive compensation is quite different in China and CEO of Chinese state-owned firms are state bureaucrats who are hired for a specific time-period and are entitled to a fixed salary. Bai and Xu (2005) and See (2009) argue that SOEs in China are interested in achieving non-financial objectives and these objectives are mentioned in CEO contract. We explored and provided empirical evidence on this interesting research gap by analysing the moderating role of CSR performance on the inconclusive relationship between state ownership and executive compensation. We explored these two research questions by empirically testing our proposed hypotheses. The findings based on generalized least squares (GLS), two-stage least squares (2SLS) and GMM, all provide significant evidence for our claim by drawing on extensive data-set from Chinese firms. Both of our hypothesis were supported by data. Our findings contribute to the existing literature by shedding new insights from the perspective of the interaction effect of CSR performance on the nexus between SOE and executive compensation.

Conclusion

This study analyzed the impacts of CSR performance on compensation of CEOs by drawing on a longitudinal sample of Chinese listed firms. We develop an argument that CSR performance not only determines the executive compensations in Chinese firms but also influence the connection between state ownership and compensation structure. Chinese firms are characterized by the dominance of the state ownership over the decades due to the complex structure of controlled Chinese economy in comparison to the free economies of the western world. This study bridge the existing gap in research on the moderating role of CSR performance between the state ownership and executive compensation. Our findings are pertinent to both theory and practice. Given the motivation of increased incentives or compensation, executives will be inclined to put more efforts in activities related to CSR and social welfare. We shed new acumens to the literature by empirically proving that independent ownership of Chinese government has a negative or no effect on firm's compensation structure, however, if CSR-performance is established as the missing link in the chain, the outcomes will be changed. In China, the role of the state is dominant in firms and CEOs are either part of the state councils or have political ties (Firth et al., 2007; You & Du, 2012). We claim that if the government puts more focus on CSR practices and directs the CEOs to enhance the CSR performance, the increased CSR level will lead to an increase in CEO compensation structure. This study has practical implications for the practitioners by proposing to introduce a CSR-performance related system, where the enhancement in financial benefits of CEOs is related with the CSR enactment of the firm.

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