경영학석사학위논문

THE EFFECTS OF LARGE INSTITUTIONAL OWNERSHIP AND OUTSIDE DIRECTORS ON CORPORATE SOCIAL PERFORMANCE:

The moderating role of owner-CEO power

기관투자자와 사외이사가 기업의 사회적 성과에 미치는 영향에 관한 실증연구: 소유경영자의 역량 조절변수로 하여

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Abstract

Firms' corporate social performance has gained enormous attention from corporate governance scholars. However, empirical researches have shown a lot of contradictory results. This paper analyses the impact of large institutional ownership and outside directors on firms' CSP along with the moderating effect of the owner-CEO power in terms of ownership. The study attempts to explore the effects of large institutional ownership on CSP by arguing that the large extent of shareholdings indicates the abilities and incentives of institutional investors to encourage firms to invest more in CSP commitments. In addition, the role of outside directors on firms' CSP is also examined by integrating agency theory and dependency theory. As the monitor of shareholders and resources provider, outside directors encourage firm to invest more in CSP. I also proposed that the influence of both governance mechanisms will be mitigate by a powerful CEO. The hypotheses are tested using a sample which consists of 194 firms in Korea. The empirical results indicated that the first two direct effects of institutional ownership and outside directors are supported. Furthermore, the results also indicated the effects of CEO power on the relationship of outside directors and firms' CSP.

Keywords: Corporate social performance, Institutional ownership, Outside directors, CEO ownership

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I. Introduction

Based on the agency theory which is built on the premise that inherent characteristics of management and control separation in the agency theory (Wright and Ferris 1996), there would be a divergence of interest among agent and principal(Jensen and Meckling 1976) where managers act for their own benefits instead of shareholders' benefits. In order to minimize agency costs, proper governance mechanisms need to be applied to align the interests of managers and owners. For example board structure, managerial compensation, and ownership structure need to be applied (Lin 1995, Wahba 2010).After the financial crisis of 1997, corporate governance in Korea underwent a series of reformation with the introduction of global standard to companies. Government introduced a series of new reforms where in 1998 the board of a listed company needed to be occupied by more than 25% of outside directors and a large firm needed 50% of outside directors. Apart from that, in 2003, the law of prohibiting direct exercised voting rights by institutional investors was revisited and domestic institutional investors were allowed to exercise their voting rights.

All these changes enhanced the effectiveness of corporate governance in Korea. At the same time, these regulatory changes have gained great attention from scholars to examine the role of corporate governance in Korea. Many prior literatures investigated the changing effects of corporate governance mechanisms on firms after the reformation. Black, Jang et al. (2006) investigated the effects of the outside directors reform on firm value and the results indicated positive effects. Other than firm value, scholars also examined the strategic implication of governance mechanisms where Park and Kim (2008) empirical results showed that institutional ownership and corporate governance regulatory change had significant effects on firm restructuring.

In this study, I extend prior works and investigate the effects of two types of corporate governance mechanism which are institutional ownership and outside directors on firms' CSP. Large institutional investors and outside directors who have influence on firm strategies may consider CSP as a long term investment that can bring long term benefits to the firm(Johnson and Greening 1999). However, considering the governance structure in Korea that most of the companies are dominated by a CEO who is the owner himself, and the CEO may utilize his power in terms of ownership and control rights to reduce influences of other governance mechanisms. Therefore, even though large institutional owners and outside directors are able to influence firm decisions, things might be different when the CEO held greater power. Thus the interaction between both governance mechanisms and the owner-CEO is worthwhile to observe.

Through a hierarchical regression test, I found that large institutional ownership who owned more than 5% shares and outside director exhibit significant effects on corporate social performance. Large institutional ownership is prone to encourage firms to invest in CSP as a means to gain long term benefits and reduce uncertainties. However, influence of outside directors on firm CSP will reduce when the CEO is powerful vis-à-vis. This result suggests that owner CEOs with substantial stock ownership may be an obstacle for outside directors to exert their influence on firm's social strategies. This result sheds light on the excessive ownership by managers that may result to entrenchments that could consequently erode shareholders and other stakeholders' benefits.

The remainder of the paper proceeds as follow. First, I review the researched literature about the means and incentives of large institutional owners to influence firms CSP. Then I discuss the role of outside directors on firms' CSP. Further discussion continues with how the owner-CEO can reduce the monitoring effectiveness of both corporate governance mechanisms. The next section is followed by the description of the methodology of this research and also the empirical results. Discussion of the findings, limitation and future research are then provided.

II. Theory and hypothesis

1. Corporate social performance

1.1Definition of Corporate Social Responsibilities

There are lots of academic researchers who keep looking for a unified definition of CSR, however there is no strong consensus definition on corporate social responsibility(McWilliams, Siegel et al. 2006). The definitional ambiguousness surrounding CSR has prevented researchers from getting fruitful results of CSR results. Earlier literature of Davis (1973) defines CSR as " the firm's considerations of, and response to, issue beyond the narrow economic, technical, and legal requirement of the firm to accomplish social and environmental benefits along the traditional economics gains which the firms seeks". This research article explicitly contends that a firm cannot be considered as socially responsible if it merely abides by the minimum requirement of the law; it has to do more than what the law requires.

Apart from Davis, one of the most influential scholars in the CSR field, Carroll (1979), offered a three dimensional conceptual model of corporate social performance which consists of the definition of social responsibility, the social issue that is involved, and the philosophy of a firm in response to social needs. The definition part of this paper first suggests the four categories of corporate social responsibilities which embodies economic, legal, ethical, and discretionary. Later Carroll (1991)further revisited the four categories and referred to the discretionary as philanthropy. Caroll depicted the four domains of corporate social responsibilities in a pyramid format and emphasized that firms should fulfill these four at any time and not in a sequential manner. Works by Carroll provides an operational definition of CSR which was later adopted by a numbers of scholars as the measurement of firms CSR (Ramasamy and Yeung 2009, Yelkikalan and Can 2012).

Recent works on CSR concepts are mainly expanded into the stakeholder dimension(Van Marrewijk 2003, Jamali 2008).Van Marrewijk (2003) contends that CSR is a firm's voluntary activities which are concerned with social, environment issues and interaction with stakeholders. However, in order to discard any confusions by the highly fragmented CSR definitions, I adopted the CSR definition approach proposed by Carroll (1979), which contends that concept of CSR should embody four different dimensions which are economic responsibilities, legal responsibilities, ethical responsibilities, and discretionary responsibilities.

1.2 Relationship between CSP and firm financial outcomes

Apart from CSR definition, an extant of literatures have examined the implication of firms engaging in CSP activities on a firms financial performance (Aupperle, Carroll et al. 1985, McWilliams and Siegel 2000, Simpson and Kohers 2002). However, the results are conflicting. Some argues that CSP does affect financial performance positively, while others found a negative link (Pava and Krausz 1996). Extant theoretical and empirical researches have three main propositions of CSP effects on a firm's financial performance which are positive, negative, or a no effect point of views.

Earlier literatures contend that even though short term cost might be incurred by a socially responsible firm, it will give benefits to the firm in long-term(Davis 1973). They noted that firms enjoy higher society legitimacy and less regulation sanctions from the government and eventually leads to long-term profitability. Meanwhile, scholars adopted different theories to generate theoretical grounds for CSP and firm value validity. Through the perspective of the instrumental stakeholder theory, literature contends that satisfying various stakeholder groups brings a better organizations performance especially in the long run due to the image and reputation improvements (Donaldson and Preston 1995, Orlitzky, Schmidt et al. 2003). On the other hand, Hart (1995) argues that firms will gain competitive advantage through the implementation of environment strategies which are pollution prevention, product stewardship, and sustainable development. Empirical results obtained by Waddock and Graves (1997) found a positive link between a firms CSP and its future financial performance by using KLD CSP ratings as measurement of a firms CSP. Ruf, Muralidhar et al. (2001) proposed a positive link between CSP and a firms financial performance based on stakeholder approach and found a positive relationship between these two variables through an empirical test of KLD ratings and certain firm financial performance indices which are return on equity, return on sales and sales growth.

There is another counter voice that proposed negative links of CSP and corporate financial performance as CSP activities incurred costs to firms and eventually undermines a firm's competitiveness (Friedman 1970). He states that firms that perform CSP strategies incur a competitive disadvantage because of the cost of doing CSP will erode a firm's financial performance and firms get no comparative advantages than other social agencies in handling social and environment issues. Instead, firms should focus solely on its main purpose to maximize its profits. Most of the empirical results that obtained a negative link between CSP and firm’s financial performance used the stock value as measurement of the firm’s financial performance (Pava and Krausz 1996, Boyle, Higgins et al. 1997).

Besides the contradictory views and findings that are alluded above, there is another model proposing an absence of a link between firms’ CSP and its financial performance. McWilliams and Siegel (2001) outlined a supply and demand model to prove a neutral relationship between social performance and financial performance. The research article states that firms implements social responsible strategies to cater to the demand of different types of stakeholders. Firms which invest in social activities will incur higher cost and revenues; conversely, firms which tend not to invest in social activities will have lower cost but at the same time lower revenues as well. Therefore, based on the argument, they proposed a neutral relationship of firms CSP and financial performance. Meanwhile, other than a neutral relationship, there is a proposition of an inverted U-shape relationship between a firm’s CSP and its financial performance by Barnett and Salomon (2003).

Inconsistencies of theoretical and empirical findings are perhaps due to different measurements of CSP and financial performance. However, despite the inconsistent results, according to research by Margolis and Walsh (2001), (Orlitzky, Schmidt et al. 2003), most of the previous literatures have reported a positive relationship between CSP and CFP . On a whole, this research article support the idea that firms engaging in CSR would be able to induce positive and long term benefits to the firm’s performance.

2. Large institutional ownership

2.1 Institutional ownership and firm strategy

Among all these governance mechanisms, institutional ownership has been identified as an important means in monitoring managers from any actions that could harm owners' benefits since dispersed ownership is associated with limited incentives to monitoring and evaluating a firm's decisions. Owners that hold significant shares can exert their power to influence on a firm's decisions (Shleifer and Vishny 1996).

There are a numbers of ways for institutional investors to influence firm strategies. Institutional investors can choose to utilize their sufficient shareholding to exercise voting rights and put pressure on managers to pursue efficient strategies (Shleifer and Vishny 1997). Besides voting on a firm's decisions, there are more active ways which are through shareholder activism activities such as filing a shareholder proposal or by voting on proxies in opposition to a firm's management (Gillan and Starks 2000, Shin and Seo 2011). In addition, private negotiation is also one of the options that institutional investors can choose to influence a firm's decisions. One of the most well known institutional investors which actively engages in shareholder activism-CalPERS is a very good example to illustrate the influences of an institutional investor on firms strategies and management(Smith 1996).

Great attention on research about the role of institutional ownership on firms started with the emergence of substantial institutional ownership in the Anglo-Saxon market of the 1980s.(Graves and Waddock 1994). Previous empirical literature examined the implication of institutional investors on firms' strategic decisions such as R&D strategies, diversification strategies, corporate social performance, advertising expenditure, and capital structure (Graves and Waddock 1994, Sherman, Beldona et al. 1998, Hoskisson, Hitt et al. 2002). Based on a computer company sample, Graves (1988) had found a negative relationship between institutional ownership and a firm's R&D. Tihanyi, Johnson et al. (2003) examined the relationship of the different institutional ownership propensity on a firm's diversification and the result indicated a statistically significant relationship between a firm's institutional investors and international diversification. Besides, Zahra (1996) found that long term institutional investors are able to influence a firm's entrepreneurship through the comparison with short-term institutional investors. Also, Hoskisson et al (2002)examined the mediating effects of the roles of the board of directors on the relationship between a firm's innovation strategies and different institutional owners. They argued that key owners of the firm influence corporate strategies directly and indirectly through the board of directors.

Apart from direct influence, institutional investors are able to influence a firm's decisions indirectly. Based on the stakeholder salience theory, company managers will give different level of priority to the claims of various types of stakeholders (Gifford 2010). Mitchell, Agle et al. (1997) examined the salience of different stakeholder according to the combination of power, urgency, and legitimacy. This is applicable to shareholders as well since shareholders are one of the stakeholder groups. The investors with high level of saliency are likely to gain the attention of managers and the managers will devise the firm's decisions in those investors' favor.

In sum, institutional investors are able to effectively influence firms' decision through different types of mechanisms. The power of institutional investors is insufficient to explain the mixed results of empirical research. The motivation and incentives of institutional investors needs to be taken into account too.

2.2 Motivation of large Institutional ownership on CSP

Extant literatures outlined two contradictory views on institutional investors' preferences on firm CSR based on characteristics of institutional investors. In Hansen and Hill (1991) paper, the authors stated two competing theoretical perspectives which are the myopic institution theory and the market efficient theory. According to the article, in the myopic theory, institutional investors have high propensity toward short term gains when they invest in portfolio a firm. Institutional fund managers are under pressure to show superior results on a short term bases because the compensation largely depends on their performance in gaining high returns from the investments they made. They will adopt portfolio shuffling and choose to exit from the firm whenever the portfolio firms poor performance and invest in other favorable stocks(Kochhar and David 1996). Therefore based on these characteristics, advocates of the myopic theory contend that institutional investors are less likely to support long term projects in portfolio firms such as corporate social responsibilities strategies since a longer time is needed to reap the benefits from CSR commitments.

Another stream of research argues that with the increasing of shareholding by institutional investors, it is difficult for institutional investors to exit from the firm since they have been locked in to the portfolio firm. Exit from the firm through selling large amount of shares will result in substantial losses due to the severely affected share prices. As a result, institutional shareholders will tend to adopt buy and hold strategy and will influence management to be involve in long term projects. The long term orientation of institutional shareholders is therefore compatible with the time that is needed to realize the benefits of investment in CSP(Johnson and Greening 1999). Also, as institutional shareholders hold a large amount of shares they need to reduce their risks in the portfolio firm as much as they can. Therefore, risk aversion characteristics will encourage institutional investors to influence managers to invest in CSR. This is because investment in CSR is a good mechanism to avoid any possibilities of adverse legal action or consumer retaliation that will consequently lead to losses in share prices(Graves and Waddock 1994).

Prior empirical researches have been conducted to examine the links between institutional investments and firm CSP through different approaches (Graves and Waddock 1994,Johnson and Greening 1999, Neubaum and Zahra 2006). In the article of Graves and Waddock (1994), they argue that institutional investors will favor firms with high corporate social performance. The author used institutional ownership as a dependent variable and CSR as an independent variable and the analysis showed positive significant results on the relationship between numbers of institutions shareholders and firm social performance. Recent work of Wahba (2010) used an Egyptian sample to examine the effects of institutional investors on one of the dimensions of firm social performance- environmental performance. The analysis demonstrated significant positive effects of institutional ownership on firm environmental performance only under circumstances where financial resources were available and investment opportunities were limited.

Given the sufficient theoretical ground of the relationship between institutional ownership and firm CSP, I argue that the size of their shareholdings reflects the institutional investors' power and time horizon of investment on portfolio firms, such large institutional investors who own a substantial amount of shareholdings will influence firm to invest more in CSR. Therefore, I hypothesize:

H1. The extent of large institutional ownership is positively associated with a firm's CSP.

3. Outside Directors and corporate social performance

3.1 The role of outside directors

The role of the board of directors in a firm can be explained through different theoretical lens which are the agency theory and the resource dependency theory. The agency theory contends that board of directors plays a monitoring role to oversee managers on behalf of shareholder(Hillman and Dalziel 2003). Board of directors as one of the firm internal governance mechanism helps to reduce agency costs that arise as a result of the conflict of interest among agent and principal. According to Fama and Jensen (1983)the Board of directors is able to exercise their rights to hire or fire the managers and decides managers' compensations level according to the performance. They can also interfere or monitor in any important decisions of the firm.

However not every board of directors have the incentives to fulfill their responsibilities as a monitor of managers. Inside directors who are affiliated with a firm's managers have higher tendency to compromise with managers since their careers are tied to the hand of managers. In order to align the interest of the board of directors and shareholders and to accomplish their monitoring function, compensation plays an important role to increase directors' sensitivity to firm value(John and Senbet 1998). Another important antecedent of an effective board can be achieved through increasing the ratio of outside directors. Independent outside directors who do not affiliate with a firm is more effective in aligning the interest of owners and managers. Empirical research of Beasley (1996)examined the proportion of outside directors in companies that experienced financial statement fraud and no fraud firms. The results indicated that more firms without outside directors experience financial statements fraud than those with outside directors. This shows that the proportion of outside directors is a good indication of board monitoring effectiveness.

Advocates of the resource dependence theory, another alternative theoretical lens to explain the role of board of directors in firms, contend that the board of directors has another different function which is the provision of resources. According toHillman and Dalziel (2003) apart from taking care of shareholders interest, the board of directors with both the human capital and relational capital are a providers of resources to the firm. The author stated that there are four types of benefits provide by the board of directors to firm which are advice and counsel, legitimacy, channel to communicate between outside the organization and the firm, and preferential access to commitments or support from other stakeholder groups(Hillman and Dalziel 2003).

The role of the outside directors in a firm is more than a monitoring mechanism to reduce agency cost, there is another important role of providing resources and linking the firm with the outside environment that is difficult for the firm to reach. Based on arguments promulgated by the dependence resource theory, outside directors are particular important in the resource dependence role since they are more diverse and from different backgrounds compared to inside directors. Prior literatures of Kim (2007) analyzed the relationship between the proportion of outside directors and the social capital of the outside directors on firm value. The article used membership in economic association, affiliation with government institutions, and prestige school network as the measurement of social capital of outside directors and Tobin's Q as indication of firm value. The results indicated a strong positive relationship between social capital of outside directors and firm value. Based on the theoretical ground and empirical evidences, outside directors is vital in providing resources and establishing links with external environments.

3.2 Outside directors and CSP

The rationale of outside directors and firm CSP largely rely on the premise of the resources dependence theory. As indicated above, the presence of outside directors in a firm increase the diversity of board compositions. They have broader experiences and more knowledge about external environments and this lead to higher sensitivity of different stakeholders needs and eventually will make firm more conscious about the needs and expectation of various stakeholder (Wang & Dewhirst, 1992). Moreover, since outside directors are hired to manage the relationship between a firm and its external environment, they may help a firm to establish legitimacy through increased pressure on investments in a firm's CSR. On the other hand, by integrating agency theory, outside directors as a monitor on behalf of stockholders may consider CSP as a good measure to work in best interest of shareholders. Johnson and Greening (1999) noted that outside directors may have higher tendencies to influence a firm to do more CSR investments in order to protect shareholder value. All this explicitly indicates that outside directors have more stakeholder orientation and this is consistent with the argument stated in Ibrahim and Angelidis (1995), where companies started to increase the proportion of outside directors partly due to the increased interest in the corporate social responsiveness and outside directors are assumed to play an important role in it.

Prior empirical results show the effects of outside directors and firm corporate social performance. In Johnson and Greening (1999) empirical research of firm corporate governance and firm CSP, the results showed that outside directors are positively associated with people and product quality dimensions of CSP. Wang and Dewhirst (1992) also found a strong stakeholder orientation of outside directors using a survey method to gather the data. Recent work by Mallin and Michelon (2011) used firm's outside directors as one of the proxy of board reputation attributes to investigate the effects on a firm's social performance. The authors collected the data of board's composition which were outside directors, board competence, leadership, relational capital, and so on as independent variables and KLD ratings as dependent variables. The empirical evidence showed that the proportion of independents, female directors, and community influence have positive effects on a firm's CSR.

In sum, based on prior literatures and empirical evidence, outside directors have high stakeholder orientation due to higher diversity. Since they are more independent than inside directors from manager's control, a higher proportion of outside directors' representations can effectively exert influences on a firm to invest in corporate social responsibilities and consequently lead to an increase in a firm's CSP. Thus, I suggest the following:

H2. The proportion of outside directors is positively associated with a firm's CSP.

4. Owner-CEO power

Thus far, I have proposed that there is a direct effect of both corporate governance mechanisms which are large the institutional ownership and the outside directors on firms' social performances. Both governance mechanisms are able to effectively exert their influences on firms through their voting rights and direct voting on the board. However, the monitoring effectiveness of both corporate governance mechanisms may be neutralized under a circumstance of a powerful CEO existence (Khan, Dharwadkar et al. 2005). Among the different forms of power, ownership is considered as an important indicator of CEO power. Many scholars contend that corporate governance in Korea are characterized by owner-manager control where most of the CEOs are also the largest shareholder or a family member of the largest shareholders(Cho and Kim 2007). Furthermore, they enhanced their control right through the pyramid cross-shareholdings and gained substantial control rights with relatively small amounts of shareholdings (Chang 2003). Therefore in order to reveal the real ownership power that an owner-CEO has, shareholdings by all family members and affiliated companies need to be taken into account too.

A CEO who holds substantial controlling rights and voting rights simultaneously will lead to corporate governance mechanisms such as outside directors and institutional investors losing their monitoring effectiveness and the increase of agency costs. According to Cho and Kim (2007), a powerful manager who is an owner or dependent on large shareholders can lead to an increase of managerial discretion and power that could decrease the effectiveness of the outside directors. For example, in the article written by Khan, Dharwadkar et al. (2005) they argue that the monitoring effects of large institutional ownership will be diluted under high CEO ownership where CEOs with greater ownership may be able to extract higher levels of compensation or salary despite the presence of large institutional owners. Prior empirical result also indicates moderating effects of CEO power on board capital and strategic change where preferences of CEO on strategic change prevail when the CEO is powerful vis-à-vis the board.

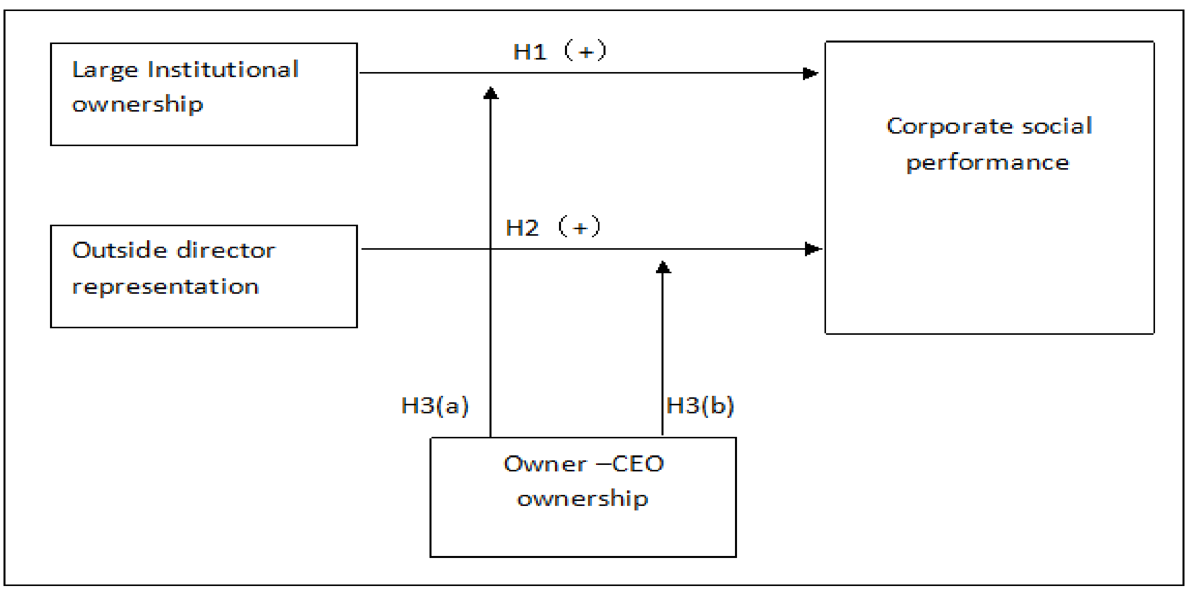
As discussed above, a powerful CEO with a large amount of ownership and greater control rights can reduce the influence exerted by institutional owners and outside directors. A powerful CEO can leverage their formal position and ownership to pursue their own preferences. Thus, in order to investigate the effects of owner-CEO on the relationship between institutional ownership and outside directors on firm CSP, preferences of owner-CEO on firm CSP needs to be discussed as well. Generally, there are two contradictory points of view regarding CEO ownership, these being the entrenchment proposition and interest convergent proponent. Interest convergent advocates argue that CEO ownership bond the interest between managers and shareholders as CEO wealth ties with corporate outcomes and make them favor CSP investments that will benefit in firm financial performance (Johnson and Greening 1999). However, on the other hand entrenchment theory contends that managers with excessive levels of ownership are likely to act in their own interests instead of other shareholders. Owner-CEO will excessive ownership concentration may utilize their power as the firm CEO and also ownership power to expropriate minority shareholders value and act in enriching their own benefits instead of other stakeholders. Meanwhile, there is also other view suggests that significant ownership may encourage hubris and may lead managers to underestimate the risks of poor social performances (Hayward and Hambrick 1997). Prior empirical research examined by Oh, Chang et al. (2011) indicated a negative relationship between managers ownership and firm CSP and argued that managers with ownership in Korea might only be making decisions that in are in their own best interest and neglect other stakeholders and lead to reducing firm’s CSP.

Theoretical arguments and empirical evidences indicate that owner-CEO with substantial power in terms of ownership might influence institutional and outside directors' effects on firm strategies and pursue their own agenda in enriching their wealth but not stakeholders needs. Thus, I suggest that ownership of owner-CEO will reduce the effects of institutional ownership and outside directors on firms' CSP. Accordingly:

3a.The positive relationship between large institutional ownership and firms' CSP grows weaker as owner-CEO ownership increases

3b.The positive relationship between outside directors and firms' CSP grows weaker as owner-CEO ownership increases

(Figure 1) Research model



III. Methods

1. Data and sample selection

All firms in the sample were large Korean firms listed on Korea Stock Exchanges which are available on the list of the 20th Top-200 best corporate citizens assessed by Korean Economic Justice Institute (KEJI). The institute provides a reliable assessment of Korean firms' corporate social performances for 20 years started from its first publication in 1991(Oh, Chang et al. 2011). The Keji index referred to the ratings of corporate social performance. The 20th Keji index was announced in 2011 based on firms' social performances in 2010. The initial sample was 200 firms drawn from the Keji list and due to the lack of financial data availability; I excluded some firms from the sample. The final sample consist 194 firms.

All the data about firms' large institutional ownership and owner-CEOs ownership data were retrieved from TS-2000 database which is provided by Korean Listed Companies Association. The outside directors' data were hand-collected from the annual reports submitted by Korean firms to the Financial Supervisory Services. All annual financial reports are available on the website which is run by the Financial Supervisory Service (darf.fsss.co.kr). Other firm level financial data were collected from KIS-Value which is a database similar to COMPUSTAT in U.S. All the ownership and financial data were collected for the year 2009 in order to create a one year lag between the independent variables and the dependent variable. This will help us to check the causality which is the effect of corporate governance on CSR rating, not the opposite direction.

2. Variables

***2.1 Dependent* variable**

- Corporate Social Performance

In this article, I measured firm CSP by using the Keji index that was assessed by Korea Economic Justice Institute- the only Korean CSP evaluating organization. This institute has been evaluating Korean firms' corporate social performance for 20 years and every year it announces the top 200 firms that scored the highest ratings in corporate social performance. Keji used qualitative and quantitative methods to assess firms' social performance. Quantitative evaluation was based on annual reports, news reports and other information from some organization such as the Fair Trade Commission. Qualitative evaluation was conducted by doing a survey of the industry leaders so that they could give some information which was not available publicly. The evaluation was supervised by Keji auditing committee which is composed by professional auditors to ensure the quality and the reliability. The Keji index has been widely used in extant literatures especially for researchers who investigated CSR in the Korea context(Oh, Chang et al. 2011). Therefore, it is consider as a reliable source to measure firms CSP ratings. The Keji index is similar with the KLD rating in United States where both of the ratings are based on firm's multi-dimensions social performances. The full score of Keji index is 75 and it consists of 7 dimensions. In this thesis I used the 2011 Keji index which is based on corporate social performance in 2010. To provide a sufficient time lag, 1 year lag of ownership and financial data were collected. The table below shows the 7 main domains of Keji Index:

<Table 1> Keji index dimensions

Keji dimension	description
1. Soundness (25)	Stockholder composition Capital expenditures Financing efforts
2. Fairness (15)	Fair trade Economic concentration Transparency Cooperation with suppliers
3. Contribution to society(10)	Care for minority groups Donations
4. Consumer protection(10)	Protection of consumer sovereignty Product quality Promotion
5. Environmental performance(15)	Environmental improvement efforts Environmental friendliness Regulation violations
6. Employee satisfaction(15)	Workplace safety Human resource investment Wages and welfare Labor-management relationship Gender equality
7. Contribution to economic development(10)	R&D efforts Operating performance

2.2 Independent variables

- Large institutional ownership

Large institutional ownership data were obtained from TS-2000 database and supplemented with firms annual reports. According to the Security Exchange Code, the Bank Law, and Corporate Tax Law an institutional investor is defined as those incorporated investors such as investment trust companies, insurance companies, and pension fund that collect capital from small investors and invest in bonds and shares on behalf of those small investors(Yang 2006). Large institutional ownership was measured according to total percentage of shareholdings by different types of institutional shareholders who held more than 5% shares of the company. The Amended 5% Disclosure Rule of 2005 in Korea require firms to disclose information about any outside shareholders who own 5% or more of the equity in issue(Choi, Sul et al. 2012). Higher ownership shows higher power and willingness to monitor firm's management. Investors who owned more than 5% equity of the firm are able to use their shareholder rights such as their voting power, and shareholder activism to influence management(Khan, Dharwadkar et al. 2005).

- Outside director proportion

Outside director proportion was classified as the number of outside directors who are not affiliated with the firm, divided by the board size(Wang and Dewhirst 1992, Johnson and Greening 1999). Data on the board composition was obtained from firm's 2009 annual reports that stated the total outside directors through the website of fsss.

2.3 Moderating variable

- Owner-CEO ownership

Data of owner-CEO was obtained through TS-2000 and firm's annual report. I first indentified whether the CEO of the company was the largest shareholder or a family member of the largest shareholder. If he was then I sum up the total outstanding shares held by the largest shareholder, family members, and affiliated companies. The reason I adopted this measurement was because most of the companies adopted cross-shareholding that made large shareholders' control right exceed its voting rights. Besides from their own stocks, the controlling shareholder also owned stock of other family members and affiliated companies(Cho and Kim 2007). Therefore, collecting only ownership of CEOs alone was insufficient to show the power they actually have.

2.4 Control variables

- Firm age

I included several control variables in order to control for the firm characteristics and increase the accuracy of the predictions. I measured firm age as years since incorporation. Previous empirical works by Moore (2001) had found a positive relationship on firm age and corporate social engagements based on a supermarket industry. However, there was also another contradictive result that showed that firm asset age was negatively associated with firm social performance based on the argument that old firms were built in those old times when regulations such as environmental protection were less strict than modern time. Also, old firms also lack flexibility to social change and respond less on business and social dimensions(Cochran and Wood 1984).

- Firm size

Firm size was the total employees in the company measured by the natural logarithm of total employees. Numerous previous literatures used total employees as measurements for firm size (Johnson and Greening 1999,Hoskisson, Hitt et al. 2002, Arora and Dharwadkar 2011). Larger firms tend to attract more attention and institutional pressure to respond to stakeholders. In order to gain legitimacy, large firm may respond in high level of stakeholder engagements. The reason I avoid using total asset as measurement of firm size like in most of previous literature is because I used the ROA measurement as a proxy of firm performance and using total asset might cause a multicollinearity problem.

- Firm performance

Consistent with researches of slack resources on firm CSP, firms with higher performance are more likely to have more slack resources. With extra slack resources, firms will be more willing and capable to invest in CSR even though CSR commitment will incur certain amounts of costs(Chiu and Sharfman 2011). Waddock and Graves (1997) also argue that firms engage in CSP when they generate economic return especially when those returns are retained as slack resources. In this article, firm performance was measured by accounting performance- return on asset (ROA). This measure was calculated by dividing net income by total assets.

- Debt ratio

Debt ratio was calculated by total liabilities to total asset. Consistent with the slack resources argument, firms with high debt ratio are more reluctant to engage in CSP investment since they are incapable in bearing the costs of CSP. Therefore, firms with higher debt ratio are more likely to reduce their social investments.

- Industry dummy

Industry dummy was used to control the industry effect and investigate whether firms in different industries have different levels of CSP. Firms may have to face different types of stakeholders and receive different kinds of institutional pressure on CSP investment. There are 70-80 categories of industries classified by the Korean Stock Exchange and using this classification on a relatively small sample may cause mislead in statistical result. Instead of using the industry classification by KSE, I adopted industry categories provided by Keji index. There are four types of industries in the Keji list which are the *metal/steel/chemistry* industry, the *food/textile/paper* industry, the *service/nonmanufacturing* industry, and the *electronics/IT* industry. Therefore, I used the *electronics/IT* industry as a reference industry and created 3 industry dummies. The table below provides a sample distribution by industry:

<Table 2> Sample distribution by industry

Industry category	No of firms	%
metal/steel/chemistry	51	26.29
food/textile/paper	55	28.35
service/nonmanufacturing	45	23.20
electronics/IT	43	22.16
Total	194	100

3. Analysis

I used the cross-sectional data to examine and investigate the relationships of the variables. The main effect of institutional ownership and outside directors as well as the effect of moderating variable on firms' CSP are tested using hierarchical regression. First, the control variable was inserted, follow by direct effects, and finally the interaction variable was inserted. Hierarchical regression was a suitable method to test the interaction effects and it revealed how well each independent variable predicted the dependent variables by showing the changes of R-squared of each model and it told the explanatory power among the models.

< Table 3> Summary of variables

Types	Constructs	Measurements
Dependent	Corporate social performance	The 20th Keji index (2011)
Independent	Large Institutional ownership	Total shareholding of institutional owners who held more than 5% of firm's equity
	Outside directors	Total outside director divided by board size
Moderator	Owner- CEO power	Total shareholding held by owner-CEO himself, family members, and affiliated companies
Control	Firm size	Ln(employees)
	Financial performance	ROA
	Debt ratio	Total liabilities/total asset
	Firm age	Years of incorporation
	Industry	3 industry dummies (electronic/IT industry was taken as reference category)

IV. Results

The means, standard deviations, and correlations of variables are reported in Table 4. As shown in Table 4, the average large institutional ownership is 4 percent and ownership by the owner-CEO and their affiliates accounts for 10 percent. The average of outside directors' ratio is 0.37 which is more than the 25% regulated level. The correlations analysis shows that large institutional and outside directors are significantly correlated with firms' CSP. In order to test multicollinearity, I carried out a test of variance inflation factor (VIF), no variables reached the threshold and this suggested that multicollinearity is not a concern in the data.

< Table 4> Descriptive statistics and correlation

	Mean	S.D	1	2	3	4	5	6	7	8	9	10	11
1. CSP	47.98	2.30	1.00										
2. Large institutional ownership	4.084	5.89	0.17*	1.00									
3. Outside directors	.371	.13	0.22*	0.09	1.00								
4. Owner- CEO ownership	19.95	21.51	-0.09	0.00	-0.04	1.00							
5. Firm age	36.46	14.92	-0.02	0.08	-0.05	0.04	1.00						
6. Debt ratio	.375	.16	-0.01	0.04	0.22*	-0.10	0.08	1.00					
7. Ln(employees)	6.528	1.41	0.39*	0.15*	0.39*	-0.16*	-0.01	0.34*	1.00				
8. ROA	.068	.05	0.21*	0.02	-0.11	0.00	-0.24*	-0.27*	0.01	1.00			
9. Metal/steel/chemistry	.262	.44	0.002	-0.07	-0.11	-0.00	-0.00	-0.09	-0.19*	0.04	1.00		
10. Food/textile/paper	.288	.45	0.13	-0.06	-0.12	0.081	0.18*	-0.05	-0.00	-0.01	-0.38*	1.00	
11. Service/nonmanufacturing	.231	.42	-0.02	0.09	0.09	-0.14*	-0.16*	0.16*	0.03	-0.00	-0.32*	-0.35*	1.00

Table 5 presents hierarchical regression results of firms' CSP. Model 1 includes the control variables, whereas Model 2 includes the independent variables and the last model includes the interaction effects. Model 1 only includes control variables and the results shows that firms' age is insignificant to firms' CSP. The addition of direct effects on Model 2 explains that there is significantly more variance where ΔR-squared is 0.041($p<0.05$). The hypothesis 1 tests whether greater extant of shareholdings by large institutional owners is associated with high CSP. The results show in Model 2 indicated that large institutional ownership is significantly associated with firms' CSP (p<0.05). This provides support for hypothesis 1. Model 2 also shows a significant results of outside directors on firms' CSP (<0.05) and hypothesis 2 is supported. The addition of the interaction terms in Model 3 shows that the interaction of large institutional ownership and owner-CEO ownership on firms' CSP is insignificant; therefore hypothesis 3a is not supported. However, the interaction between outside directors and owner-CEO ownership is significant (p<0.10). Thus hypothesis 3b is supported. In sum, the results of the 2 direct effects which are large institutional shareholder ownership and outside directors on firms' CSP are consistent with earlier the theory base. Furthermore, the expectation of the moderating effects of the owner-CEO power only exists for outside directors.

<Table 5> Regression results

Regression results for corporate social performance

	Model 1	Model 2	Model 3
Controls			
Firm age	-0.002	-0.003	-0.001
	(0.010)	(0.010)	(0.010)
Debt ratio	-1.693*	-1.843*	-1.953**
	(0.998)	(0.979)	(0.972)
Ln(employees)	0.770***	0.632***	0.615***
	(0.113)	(0.120)	(0.119)
ROA	6.985**	7.498***	7.340**
	(2.890)	(2.855)	(2.833)
Metal/steel/chemistry industry	1.278***	1.395***	1.389***
	(0.433)	(0.428)	(0.425)
Food/textile/paper industry	1.458***	1.660***	1.748***
	(0.419)	(0.415)	(0.415)
Service/nonmanufacturing industry	0.881**	0.829*	1.015**
	(0.440)	(0.436)	(0.441)
Main effects			
Institutional ownership		0.052**	0.024
		(0.025)	(0.032)
Outside directors		2.953**	4.982***
		(1.216)	(1.568)
Owner-CEO ownership		-0.005	0.028
		(0.007)	(0.021)
Interactions			
Institutional ownership x Owner-CEO ownership			0.001
			(0.001)
Outside director x Owner-CEO ownership			-0.105*
			(0.054)
Constant	42.225***	41.894***	41.271***
	(0.935)	(0.989)	(1.033)
N	194	194	194
R-squared	0.264	0.305	0.324
ΔR-squared		0.041**	0.019*
F	9.507209***	8.030672***	7.216477***

* p<0.10, ** p<0.05, *** p<0.01

V. Conclusion

1. Discussion

In this study, I investigated the effects of large institutional ownership and outside directors, along with ownership by the owner-CEO, for firms' corporate social performance. The result showed that large institutional investors' shareholding is positively associated with firms' CSP and is consistent with the theoretical expectation as discussed earlier. This suggests that, an increase in large institutional shareholding would promote the monitoring role of institutional investors due to the needs and abilities of large institutional owners(Khan, Dharwadkar et al. 2005). Different from prior researches where institutional ownership were measure by sum of the shareholdings of all institutional owners this paper used the shareholdings of institutional owners who owned more than 5% stocks in the company to measure institutional ownership. Using the measurement of institutional ownership by adding up all ownership of institutional investors is insufficient to present a clear picture of the differences between minority institutional owners and blockholders since power and incentive of an investor largely depends on the extent of the ownership they have.

The second result indicated that outside directors enhance firms' corporate social performance. This is consistent with extant previous literatures that indicated that a significant effect of outside directors on firm CSP. This suggest that in order to protect shareholder value, the board of directors may encourage managers to invest in CSP commitments to reduce any uncertainties or potential risks resulted from environmental or regulation violations that could eventually lead to a drop in share prices. Furthermore, diversity of outside directors also contributes to the firm's

CSP as directors from different backgrounds might have concerns on different groups of stakeholders.

This paper also proposed that the influence of large institutional ownership on firms CSP might be mitigated by the extent of the ownership of CEO who is the owner as well. However, the results showed that this was insignificant as the increase of owner-CEO shareholdings did not influence the effects of institutional ownership on firm's CSP. This finding can be explained by the fact that most of the large institutional investors who owned more than 5% were composed by pension funds and mutual funds. According to (Lee 2010), pension funds held 60% of total share value at the market and held more than 5% shares in 71 companies. These types of institutional investors have the characteristics of pressure resistant as they do not have direct business relationship with firms they held the equity for so the fund managers have less influence on the firms they invest in, but can actively monitor the portfolio of the firms(Dalton, Daily et al. 2003). Therefore, ownership of the owner-CEO has very low or no influence on those investors.

The results show that influence of outside directors on firms' CSP will be reduced with the existence of high owner-CEO shareholdings. In other words, when a CEO is powerful, he will try to limit the effects of the board of directors. This finding suggests that CEOs will use their power to oppose recommendations from the outside directors. One example is during 1999 outside directors together with the audit members of SK telecom a filed proposal to oust the CEO during the shareholders meeting. However, this proposal failed with an opposed vote of 57.2%by largest shareholders which has relationship with CEO(C.H 2000). This showed that the monitoring power of outside directors will be diluted when there is other owner-CEO that is more powerful. Another possible explanation is the outside directors in Korea less independent from CEO and largest shareholders influence because most of them are tied to the CEO or the largest shareholders. According to a survey by Korean Listed Companies Association in 2009, most of the outside directors were recommended by CEO or largest shareholders (KLCA 2009). This shows that outside directors may receives influence from owner-CEO and thus influence the judgments of the boards. Therefore, owner-CEO may utilize their power to neutralize or opposed the CSP investments suggestions by outside directors and neglect stakeholders needs, eventually reduce firm CSP ratings.

2. Limitations and future directions

There are a few of limitations in this research. This study was designed to examine the effects of institutional investors and outside directors on firm CSR rating in one country context which is Korea. Generalization questions arise since single institutional context cannot apply to other country due to the difference context settings. The characteristic of institutional investors might be different among countries due to different institutional context. Furthermore, the concept of corporate social responsibilities might not highly be favored by investors in other developing countries.

In addition, we aggregated different types of institutional investors into a single group and this couldn't provide a clear picture that preferences of CSR are contingent according to the types of investors such as the institutional investors like pension funds, mutual funds, banks, insurance companies and so on. In the same vein, we also combined the various dimensions used to measure the CSR rating construct into one aggregate measure (Griffin and Mahon 1997). This, Griffin and Mahon (1997) argued that collapsing the CSR multiple dimensions into a unidimensional index may mask the individual dimensions that are equally important and relevant. Future research can examine the effect of foreign investors on each sub-dimensions of CSR respectively.

Furthermore, the Keji index used in this research only stated the top 200 companies that scored the highest ratings of corporate social performance. Since only the best companies were included, the sample failed to represent the average Korean firms. This might have lead to a sample selection bias problem. Therefore future studies can consider other available proxies for CSP such as philanthropy and environmental performance that can address the non randomness of the Keji sample.

Additional studies could investigate the diversity of the board on firms' CSR. Instead of using the outside director representation, investigating the diverse background and characteristics like age, education, or occupation of the outside directors might able to provide a clearer picture of the effects on firms' CSP.

In this paper, we did not conduct a longitudinal examination to show the relationship between foreign ownership and CSR rating across time. Future research can conduct longitudinal examination and include year effects to verify the hypothesis. This can provide more reliable results.

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국문초록

기관투자자와 사외이사가 기업의 사회적 성과에 미치는 영향에 관한 실증연구:

소유경영자의 역량 조절변수로 하여

서울대하교 대학원

경영학과 국제경영/전략 전공

유강려

기존 연구는 기업 지배구조가 기업 사회적 성과에 관한 연구들을 많이 했지만 논란이 있다. 이에 따라 본 연구는 기관투자자와 사외이사가 기업의 사회적 성과에 어떤 영향을 미치는지 연구하며 그 영향은 소유경영자의 역략에 따라서 변화가 있는지 연구하고자 하였다.

이러한 연구목적을 달성하기위해 기업내의 큰 기관투자자의 (5% 이상 지분 소유) 총 소유 비중, 사외이사 비중, 소유 경영자의 소유비중이 기업의 사회적 성과에 어떤 영향을 있는지 실증분석 하였다. 또한, 기업의 사회적 성과에 영향을 미칠 수 있는 통제 변수는 기업연령, 기업성과, 부채비율, 기업규모, 산업더미를 포함하여 통계분석을 하였다. 이때 194개 기업을 표본으로 선정하였다.

그 결과 큰 기관투자자 지분율이 증가 할수록 기업의 사회적 성과는 증가하였다. 또한 기업의 사외이사가 이사회에서 차지한 비율이 높을수록 기업의 사회적 성과는 높았다. 한편 소유경영자 지분율을 상호작용항으로 적용한 경우 소유경영자의 지분율이 클 수록 사외이사가 기업사회적 성과에 미치는 영향는 감소한 것으로 나타났다.

주요어: 지배구조, 기관투자자, 사외이사, 사회적성과

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