Corporate Social Responsibility and Financial Reporting Quality

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INTRODUCTION

- CSR is the economic, legal, moral, and philanthropic actions of firms that affect the quality of life of relevant stakeholders.
- Financial reporting quality is the accuracy with which financial reports convey information about a firm's financial position that is complete, neutral, and free from error.
- There have been two opposing views of CSR in the literature – the stakeholder value maximization view and the shareholder expense view. They suggest opposing relationships between CSR and reporting quality.
- We examine this issue empirically using a sample of over 21,000 observations over 1991-2018.

DATA AND METHODOLOGY

- Final sample of 21,633 observations over 1991-2018.
- Construct measures of financial reporting quality (FRQ) using variables obtained from *I/B/E/S*, *Compustat* and *CRSP*
  - Accuracy of financial forecasts
  - Percentile-ranked forecast accuracy rank
  - Unexpected earnings reported by the firm
  - Number of analysts who issue forecasts for a firm
- CSR measure based on CSR strengths / concerns indicators from the MSCI ESG KLD database adjusted for scale.
- *Model:* $FRQ_{i,t} = \beta_0 + \beta_1 CSR_{i,t-1} + \beta_j X_{i,t-1} + \varepsilon_{i,t}$
- Controls $X_{i,t-1}$ include: Market-to-Book value, log of Assets, Leverage, ROA, R&D, Firm Age, and Institutional Ownership
- Firm and year fixed-effects regression analysis.

BASELINE RESULTS

- Firms with higher levels of CSR are associated with higher accuracy of financial forecasts, fewer earnings surprises, and greater coverage by financial analysts.
- We conduct several analyses to address potential endogeneity. Our findings remain consistent with the baseline results in the instrumented variables approach.
- Decomposition of CSR measures shows that a firm's financial reporting quality becomes better with both higher levels and larger increases in CSR.

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We examine the link between corporate social responsibility (CSR) and financial reporting quality and find a positive relationship.

- ❑ We find that firms with higher CSR are associated with higher accuracy of financial forecasts, fewer earnings surprises, and greater coverage by financial analysts.
- ❑ Additional analyses reveal that firms with lower agency concerns, higher customer awareness, more long-term institutional investors, and fewer financial constraints have a stronger positive relationship between CSR and financial reporting quality.
- ❑ Findings provide support for the stakeholder value maximization view of CSR.

Financial Reporting Quality and CSR

Ind. variables are lagged	Accuracy	Accuracy_Rank	Earnings_Surprise	Analyst_Num
CSR	**0.032****	**0.015****	**-0.002***	**0.510*****
	(2.25)	**(2.17)**	**(-1.75)**	**(3.35)**
Controls	Yes	Yes	Yes	Yes
Fixed Effects	Yes	Yes	Yes	Yes
N	20786	20786	20769	21188

Factors Affecting the Relationship between CSR and Financial Reporting Quality

We perform subsample analyses to examine how the relationship between CSR and financial reporting quality is affected by agency problems, customer awareness, institutional ownership, and financial constraints. All models include controls and fixed effects.

	Accuracy	Accuracy_Rank	Earnings_Surprise	Analyst_Num
	Low Agency Concerns Subsample (Leverage proxy)			
CSR (lagged)	0.027	**0.015***	**-0.004****	**0.501*****
	(1.40)	**(1.66)**	**(-2.33)**	**(2.70)**
	High Agency Concerns Subsample (Leverage proxy)			
CSR (lagged)	0.006	0.005	0.001	0.288
	(0.25)	(0.41)	(0.29)	(1.32)
	High Customer Awareness Subsample			
CSR (lagged)	**0.036***	**0.020***	**-0.007*****	**0.359***
	(1.66)	**(1.83)**	**(-3.11)**	**(1.70)**
	Low Customer Awareness Subsample			
CSR (lagged)	0.027	0.011	0.002	**0.397****
	(1.29)	(1.20)	(0.96)	**(2.06)**
	High Long-term Institutional Ownership Subsample			
CSR (lagged)	**0.034***	0.012	**-0.003***	**0.597*****
	(1.75)	(1.40)	**(-1.79)**	**(3.04)**
	Low Long-term Institutional Ownership Subsample			
CSR (lagged)	0.033	0.014	-0.001	0.328
	(1.29)	(1.16)	(-0.21)	(1.17)
	Financially Unconstrained Subsample			
CSR (lagged)	**0.036****	**0.017****	**-0.006*****	**0.424****
	(2.06)	**(2.10)**	**(-3.79)**	**(2.47)**
	Financially Constrained Subsample			
CSR (lagged)	0.030	0.009	0.004	0.331
	(0.83)	(0.56)	(1.14)	(1.25)

Economic Implications of CSR and Financial Reporting Quality for Firms

- We further perform subsample analyses to examine how financial reporting quality affects the information environment and firm risk for firms with different levels of CSR.
- Findings suggest that high CSR firms are more likely to experience a significant negative relationship between financial reporting and return volatility which proxies for risk. This enhances the benefits of reporting quality for these firms.
- We find some evidence that greater transparency in financial reporting decreases information asymmetry for high CSR firms
- Full paper available at SSRN and ASSA program.
- Comments are welcome.