CSR Reporting and Its Implication for Socially Responsible Investment in China

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Abstract Corporate social responsibility (CSR) reporting has grown significantly in China during the past decade. This chapter assesses the status of Chinese CSR reporting and its main drivers as well as firms' subsequent social, environmental and financial performance. Employing data from 130 Chinese listed companies, we assessed the development trend of CSR reporting and suggest that such a growth is mainly driven by external pressure (e.g. regulations). Our statistical testing found positive associations between CSR reporting and firms' subsequent social, environmental and financial performance. Our results have important implications for social responsible investors who focus on both financial and social returns. They, therefore, can leverage firms' CSR reports as indicators for their investment decisions.

1 Introduction

This contribution describes the development of corporate social responsibility (CSR) reporting and its connection with corporate social performance (CSP) as well as with the financial performance of firms in China. Since CSR reporting increased significantly over the last decade, it can provide helpful information for socially responsible investing. The paper will demonstrate that CSR reporting affects both CSP and financial performance positively. Consequently, socially responsible or responsible investors may use CSR reports of Chinese companies in order to analyse whether a company meets the non-financial criteria of (socially) responsible investing. Furthermore, we suggest that socially responsible investing in China is attractive from a financial perspective because CSR reporting and CSP positively influence the financial performance of firms.

The data presented in this chapter is for securities of Chinese corporations that are traded at one or more of the big Chinese stock exchanges, the Hong Kong stock

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K. Wendt (ed.), *Responsible Investment Banking*, CSR, Sustainability, Ethics & Governance, DOI 10.1007/978-3-319-10311-2_27

exchange and Shanghai and Shenzhen stock exchanges. The analysis is important from a responsible investment point of view because investments in emerging countries, and particularly in China, are becoming increasingly attractive financially and from a sustainable development point of view.

2 Background

China's economic miracle comes with huge environmental costs. To boost GDP growth and support the expansion of the manufacturing sector as a world factory, China consumed excessive energy resources and produced large amount of environmental pollution (Wang, Qin and Cui 2010). In 2007, China overtook the USA in becoming the world's largest emitter of greenhouse gases. Series of environmental scandals occurred lately, which include the foggy capital, cancer villages, toxic milk powder and coal mining accidents. Most of these environmental issues are related to business operations (Olivier et al. 2012).

We therefore focus our research on Chinese firms, particularly the listed firms, because they are under increasing institutional pressure to report their environmental initiatives and demonstrate their effort in advancing their environmental performance. Despite the significant environmental impacts of Chinese companies, firms' level of CSR reporting has been very low in the early 2000 (Wong et al. 2010). Chinese firms tend not to conduct or disclose any CSR practices (Liu and Anbumozhi 2009) since they perceive CSR as a trade-off to their bottom line (Winn et al. 2012). It has been the external pressure from government agencies that motivated firms to report their CSR activities. But often both firms and investors are unaware of the connection between CSR reporting and their subsequent environmental and financial performance.

We aim to examine the development of CSR reporting in China and investigate whether firms that report their CSR activities tend to be associated with better environmental and financial performances. We test these associations with data collected from 130 Chinese listed companies. Among them, 40 firms are listed in Hong Kong, 50 in Shanghai and 40 in Shenzhen stock exchanges. They constitute the index of the respective stock exchange.

2.1 Reporting of Key Performance Indicators

We examined whether the firms in the sample published a CSR report and whether they report about the key performance indicators (KPI) of their industry. KPIs are the most important indicators to measure the impact of an industry (Hesse 2010). KPIs are an indicator for focusing on CSR issues that are crucial for an industry and thus indicate the validity of a CSR report. Our results suggest that CSR reporting in China grew significantly since 2005, and such growth is mainly driven by government influence and regulations. Our statistical testing demonstrated that CSR reporting is positively associated with firms' subsequent environmental and financial performance.

3 The Development of CSR Reporting in China

CSR refers to the social and environmental impact and responsibilities that businesses should consider to include in their business operation (Wang, Qin and Cui 2010). CSR reporting is an activity to present the performance of a firm and a means of communication to stakeholders such as shareholders or investors (Chan and Welford 2005; Ziek 2009), employees, clients or communities. CSR reports are mainly published to communicate positive achievements of the publishing company (Niskanen and Nieminen 2001; Spence 2009). They are also useful tools for both the reporting firm and stakeholders, such as investors, and are clearly an indicator of the importance of CSR in a firm.

Chinese firms did not disclose any CSR information (Liu and Anbumozhi 2009) prior to 2000. The growing environmental pressure in China and the need for an efficient use of resources, however, caused a change in the attitudes from pure financial goals to a more integrated model of growth that integrates environmental risks. In 2001, Chinese listed firms were required to disclose their environmental risks in the prospectus for initial public offering (IPO). Responding to this requirement, the China National Petroleum Co Ltd released China's first CSR report in 2001 (Wang et al. 2010). Between 2001 and 2004, CSR reporting in China developed very slowly (Ying Xu and Jie Niu 2010), and there was still lack of transparency, reflected by the relatively low amount of CSR reporting, in Chinese firms. Some CSR studies showed that about 40 % of the sampled companies did not disclose substantial environmental data to the public (Kuo et al. 2011; Noronha et al. 2012), which could partially be explained by firms' intent to maintain business confidentiality (Kimber and Lipton 2005).

This stagnate phenomenon changed in 2005, however, when China CSR Association developed its first China CSR Standard and released China CSR Beijing statement. This agency started to rate and publish the environmental performance of Chinese companies (Liu and Anbumozhi 2009). Further, a Chinese Company Law in 2006 required companies to conduct social responsibility in their businesses. The Chinese Ministry of Environmental Protection also regulated environmental reporting and introduced mandatory environmental reporting for heavy-polluting companies. During the process, more attention has been paid to corporate CSR systems, and there is a growing public awareness and expectation regarding companies' roles and responsibilities in addressing social and environmental problems (Wang et al. 2010). These series of regulations and policies, and heighten public awareness, put significant pressures on Chinese firms to report their CSR performance. CSR and connected reporting activities have experienced increasing

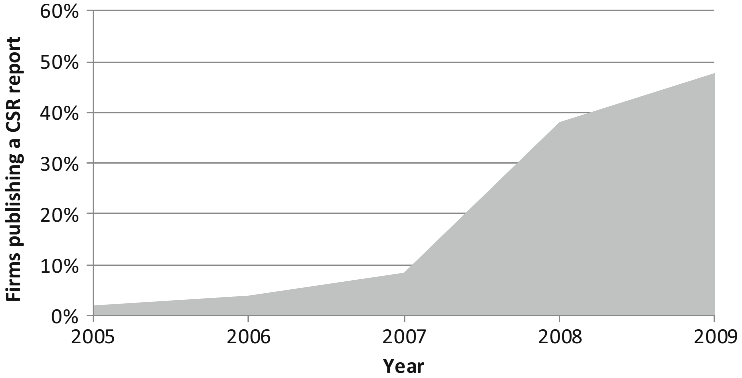

Fig. 1 Percentage of Chinese firms publishing CSR reports

growth in China (Moon and Shen 2010), with most of the growth concentrated on year 2005 onwards.

Our data analysis of the 130 Chinese listed firms between 2005 and 2009 also suggests a similar, remarkable development trend. The percentage of CSR reporting among Chinese listed companies increased significantly from below 5 % in 2005 to more than 80 % in 2009 (see Fig. 1). Along with the growth in the number of firms that conduct CSR reporting (quantity), we simultaneously observed the improvement of their reporting quality. In 2009, about 96 % of Chinese listed firms disclosed information related to one of their industry's key performance indicators, 39 % disclosed two key performance indicators, while 38 % disclosed three key performance indicators.

In line with other Asian countries, international reporting frameworks are increasingly used in China (Gill et al. 2010). Frameworks such as the Global Reporting Initiative (GRI) and third-party verification help enhance the quality of CSR reports (Fonseca 2010; Lober et al. 1997) in China. As we described above, many Chinese companies use the global GRI reporting standard for their CSR reporting. According to the latest statistics of the Global Reporting Initiative (www.globalreporting.org), 203 Chinese companies report their sustainability performance using the Global Reporting Initiative (GRI) Framework in 2011. This is 5.8 % of all reporting organisations worldwide.

4 CSR Reporting in China: External Pressures as the Main Driver

Cultural, developmental, market, regulative, and political influences play an important role in firms' activities, and this is also valid for activities such as CSR reporting (Husted and Allen 2006; Jennings and Zandbergen 1995). Environmental and sustainability management in Chinese corporations are mainly externally driven (Wing-Hung Lo et al. 2010; Wong 2009). In the case of CSR reporting, our study suggests that the growth, both in frequency and in quality of CSR reporting in China since 2005, is mainly driven by external pressures such as government regulations.

Along with regulation, government control and ownership play significant roles in influencing Chinese firms' likelihood to report CSR. Compared to other Asian Pacific countries, China's economy is dominated by state-owned enterprises (SOEs), and governments have strong influence over SOE's operations (Kimber and Lipton 2005). In 2008, the State-Owned Assets Supervision and Administration Commission of the State Council (SASAC) released a guideline on Social Responsibility Implementation for about 150 government-controlled enterprises (Lin 2010). Such regulation explained why state-owned corporations tend to disclose more environment, social and governance (ESG) information than other corporations (Tagesson et al. 2009). Our data analysis of 130 Chinese listed firms also suggested that government-controlled corporations are more likely to publish a CSR report than non-government-controlled firms.

Further, our data analysis of CSR reporting shows significant variances among the three stock exchanges and that companies listed in Hong Kong stock exchange tend to report CSR less than companies listed in two other stock exchanges. Such CSR reporting variances can be explained by regulation. In 2008, the Shenzhen Stock Exchange and the Shanghai Stock Exchange both introduced social responsibility instructions (Noronha et al. 2012) and published guidelines on ESG and environmental disclosure for listed companies (Lin 2010; Siddy 2009). The Hong Kong Stock Exchange, however, did not introduce such guidelines until 2013 (Hong Kong Stock Exchange 2012). As such, the introduction of CSR Guidelines at Shenzhen and Shanghai Stock Exchange has significant impact over their listed firms' likelihood to report CSR.

We use firms' size as a proxy of firms' external pressures. Our data analysis results suggest that larger firms that are subject to stronger external regulatory forces tend to report their CSR performance more than smaller firms. The partial explanation of this phenomenon is that smaller firms are not aware of positive benefits associated with CSR reporting (Wong et al. 2010) as such their CSR reporting behaviour is less likely to be internal driven. There is limited research assessing the association between firms' CSR reporting and their subsequent environmental and financial performance. In the following section, we will fill this literature gap by assessing these associations.

5 The Association Between CSR Reporting and the Subsequent Corporate Social and Financial Performance

Would CSR reporting send authentic signal regarding firms' corporate social performance (CSP)? Previous literature shows controversial results regarding the association between firms' CSR reporting behaviour and their subsequent social and environmental performances. In general, CSR reporting is seen as an important tool to improve CSR management and environmental or social performance (Sumiani et al. 2007). While Clarkson et al. (2008) found a positive association between environmental performance and the level of discretionary environmental disclosures, Patten (2002) indicated a negative relation between CSP and the disclosure for the corporations.

A recent China study by Liu et al. (2010) found that companies publishing environmental information under the government-oriented disclosure programme improved their environmental performance because the publication encourages the corporations to manage their environmental problems. In line with this study, we further tested the association of CSR reporting and firms' CSP using the China Top 100 Green Companies Report (China Entrepreneur Club, 2012) data. This report uses proprietary methods and different criteria from CSR reporting to rank the sustainability performance of Chinese companies. It thus provides an independent measurement of CSP compared to CSR reporting. We tested whether companies that frequently report CSR are more likely to be listed as Top 100 Green Company. Our statistical tests suggest that CSR reporters are more likely to have greener environmental performance. The likelihood to be listed in the Top 100 Green Companies list was 7 % lower for non-reporters than for those that have published CSR reports.

Furthermore, frameworks such as the Global Reporting Initiative (GRI) and third-party verification contribute to the quality of reports (Fonseca 2010; Lober et al. 1997) and to their transparency (Kolk and Perego 2010) in China. As we described above, many Chinese companies use the global GRI reporting standard for their CSR reporting.

5.1 The Development and the Quality of CSR Reporting

Before we report on the connection between CSR reporting and financial returns, we further assess whether firms' CSR reporting is associated with higher financial performance. CSR reporting often comes with a cost. CSP, which involves stakeholder management and environmental management, requires significant resources (Orlitzky et al. 2011), and Chinese corporations are not an exception to this rule (Zeng et al. 2010). As such, it is important for firms and investors to become aware of whether CSR reporting may associate firms with higher long-term financial benefit.

In order to analyse the connection between CSR reporting and financial returns, we used data for the years 2007–2009 for CSR reporting, and we applied a 1-year lag in measuring these firms' subsequent financial returns. Adopting such a data collection method (1-year time lag) is due to the time interval that is needed for the market to react to the publication of a CSR report. We also control for market capitalisation, risk (covariance), government control and industry in our models.

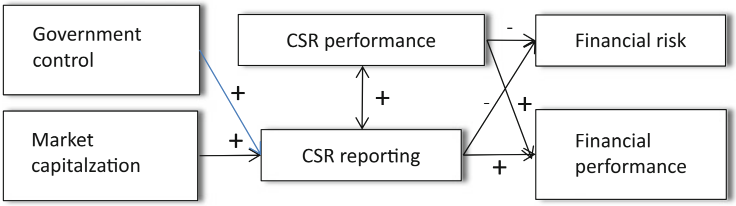

Fig. 2 Connection between CSR reporting, firm size, CSP and financial indicators

Our statistical model suggests that CSR reporting is positively associated with firms' subsequent financial performance, and 24.4 % of the variance in firms' financial performance can be explained by firms' prior CSR reporting behaviour. The result suggests that the financial return of firms that published CSR reports are 2 % higher than the return of those not publishing CSR reports. The only control variable that had an impact in addition to CSR reporting was covariance, representing risk. As expected, higher financial risks were correlated with lower financial returns.

Conclusions

Our assessment of the correlation between CSR reporting and the subsequent corporate social performance (CSP) not only contributes to the academic literature but also enhances the knowledge of socially responsible investors; it is important to know whether good CSR reporting corresponds to high CSP.

We assessed the development of CSR reporting in Chinese corporations and its relation to financial market returns. The analysis was based on data of members of the three main Chinese stock exchanges indexes SZSE Component Index, Hang Seng Index and SSE Composite Index. Our results demonstrated a significant increase in both the frequency and quality of CSR reporting in Chinese companies since 2005. While in 2005 only 4 % of the corporations in our sample published CSR reports, in 2009 more than 80 % of the corporations published CSR information.

These findings have important managerial contributions. CSR reporting increased significantly over the last decade and therefore provides helpful information for socially responsible investing. Whether firms publish a CSR report signals to socially responsible investors the firms' subsequent environmental and financial performance. As such, these investors may have more confidence in using CSR reports of Chinese companies for analysing whether these firms comply to the non-financial criteria of (socially) responsible investing. Furthermore, knowing that CSR reporting may enhance investors' confidence and lead to positive financial returns will also motivate Chinese firms to report their CSR practices.

The connection between CSR reporting and the different variables analysed in this study is presented in Fig. 2.

(continued)

Our results suggest that CSR reporting is influenced by the size of a firm (e.g. proxy of external pressures) and by their government ownership. Bigger firms and those that are government controlled are more likely to publish CSR reports. Our results also suggest that CSP is positively associated with CSR reporting. CSR report helps communicate CSP to stakeholders, which consequently increases the transparency of the firm. CSR reporting thus reduce corporate financial risks, because they are means to manage corporate risks and opportunities.

As such, CSR reporting is a tool that helps (socially) responsible investors to analyse Chinese firms. Through the analysis of CSR reports, investors are not only able to gather information about the corporate social performance, but also enhance their awareness of corporate financial risks and opportunities. The growing number of CSR reports also enables socially responsible investors to invest in Chinese securities.

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