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Article

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The Control–Ownership Wedge and Corporate Social Responsibility: Evidence from Korean Business Groups (Chaebols)

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ABSTRACT

We examine the effect of the control–ownership wedge (the difference between voting rights and cash flow rights) in Korean business groups (Chaebols) on corporate social responsibility activities. The results of our analyses show that on corporate social responsibility activities decrease as the control–ownership wedge increases. This result remains consistent when on corporate social responsibility scores are used. This study provides evidence that a greater control–ownership wedge decreases engagement in corporate social responsibility activities in the context of Korean business groups (Chaebols), with their unique ownership structure.

Keywords: Control–Ownership Wedge, Chaebols, Ownership Structure, Corporate Social Responsibility, Korea

1. Introduction

For over a decade, academics and practitioners have paid close attention to corporate social responsibility (CSR hereafter). CSR is defined as the responsibility of firms to meet the environmental, ethical, and social expectations of society based on profit-generating economic activities. Ever since the International Organization for Standardization (ISO) officially published guidelines for CSR activities for business organizations (the ISO 26000) in November 2010,

this topic has received a significant amount of attention globally. In South Korea since 1991, the Korean Economic Justice Institute (KEJI hereafter) has provided guidelines reflecting Korean ethical values and outlining the social responsibilities for firms listed in the Korea Stock Exchange. The KEJI evaluates CSR activities based on these guidelines.

CSR activities are long-term social investments that firms initiate in order to improve their image and reputation (Garbett, 1988; Hart, 2005). Firms strengthen their capacity to continue business activities by engaging in CSR activities, which, in turn, reduces business risk by lowering uncertainty about future cash flows. CSR reduces the cost of capital in the capital market, which ultimately improves firm value (Diamond and Verrecchia, 1991; Richardson and Welker, 2001; El Ghoul et al., 2011). However,

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managers making decisions about CSR activities do not generally take a long-term perspective, since they do not directly associate expenditures related to CSR activities with firm profitability. In fact, several studies show that the costs of CSR activities outweigh their benefits, and that social investments in CSR activities may reduce firm value or firm performance (Pava and Krausz, 1996; Brammer et al., 2006). Since CSR activities are part of investment decision-making (McWilliam and Siegel, 2001), and ownership structure has been shown to affect this decision-making, investments in CSR activities are most likely to be influenced by ownership structure (Oh et al., 2011).

This study examines the effect of the control-ownership wedge on engagement in CSR activities in the context of Korean business groups (Chaebols). In firms with pyramid structures and cross-holdings, controlling shareholders may override the cash flow rights of minority shareholders. In such cases, the difference between voting rights and cash flow rights is defined as the control-ownership wedge. When this wedge is large, controlling shareholders are likely to make entrenchment decisions to increase their personal wealth rather than to allocate wealth to minority shareholders (Baek et al., 2004; Claessens et al., 2002; Lemmon et al., 2003; Bertrand et al., 2002; Cheung et al., 2006). In addition, controlling shareholders may exercise their voting rights to transfer resources in long-term-oriented CSR activities to other short-term-oriented projects. On the other hand, firms have an incentive to use CSR activities to improve their images or reputation in society, especially when controlling shareholders have greater voting rights. The association between the control-ownership wedge and engagement in CSR activities remains an open empirical question that requires elucidation.

The results of our study indicate a negative association between the control-ownership wedge and engagement in CSR activities based on a sample of firms listed in the Korea Stock Exchange from 2005 to 2010. These results remain consistent when we analyze the association between the control-ownership wedge and CSR scores. In firms with a large control-ownership wedge, controlling shareholders

are more likely to shift resources invested in CSR activities to other activities in order to increase their own private benefit. In an additional test, we find that the negative association between the control-ownership wedge and engagement in CSR activities is not moderated as the level of foreign investor monitoring increases. Oh et al. (2011) report that foreign investors make investment decisions based on long-term firm value, and their ownership is positively associated with CSR activities. Our results indicate that the effect of ownership by foreign investors is relatively limited.

In recent years, CSR activities have received a significant amount of attention from society. This study contributes to an understanding of the determinants of investment in CSR activities by linking the control-ownership wedge and CSR activities using data from Korea, where this phenomenon is very evident. This study presents evidence that controlling shareholders' values and ethics influence firms' CSR decision-making. In firms with a large control-ownership wedge, controlling shareholders are more likely to transfer resources previously invested in CSR activities to other projects in order to pursue their own private benefit. Thus, investors and interested shareholders should consider ownership structure when they evaluate CSR activities as part of firm performance.

The remainder of this study is organized as follows. Section 2 reviews prior literature and Section 3 develops the hypotheses. Section 4 shows research design. Section 5 presents the results of the empirical analysis, and finally section 6 discusses our results, presents the conclusion, and outlines the contributions of this study.

II. Literature Review

A. The control-ownership wedge

In general, shareholders obtain controlling rights over firms in proportion to their investments. Shareholders who have invested a significant amount

of capital in firms become controlling shareholders; they have substantial control over such firms. However, most owners who belong to large business groups in South Korea exercise substantial control over their business groups despite lesser investment. These owners exercise control rights over their business groups by sharing ownership with their relatives, employees, affiliates, and not-for-profit corporations. The difference between control rights and cash voting rights is known as the control-ownership wedge. The control-ownership wedge is greater in firms with pyramid structures or cross-holdings. Controlling shareholders are able to exercise power by using multi-level pyramid ownership structures or cross-holdings among affiliates to their advantage. According to the Korea Fair Trade Commission (KFTC hereafter), owner families of the 35 largest Korean business groups (Chaebols) have an average 4.4% of ownership. However, these owner families exercise approximately 50% of the control rights in an average of 43.6% of the companies affiliated with their business groups.

What is the effect of the control-ownership wedge on firm value? In firms with a large control-ownership wedge, discrepancies between controlling shareholders and minority shareholders are also large and controlling shareholders are more likely to maximize their own private wealth by expropriating that of minority shareholders (Shleifer and Vishny, 1997; La Porta et al., 1999, 2002; Claessens et al., 2000, 2002). In addition, in firms where controlling shareholders have the most control despite owning only a small portion of available shares, internal controls are weak and entrenchment effects are evident (Stulz, 1988). Under these circumstances, monitoring by the board of directors, audit committee, or internal control mechanisms is likely to be ineffective. For example, controlling shareholders may reduce dividend payments to minority shareholders according to their own discretion without penalty. Also, controlling shareholders may transfer surplus funds from one firm to another affiliate (tunneling) in order to maximize their own personal wealth, which in fact expropriates minority shareholders' wealth (Claessens et al, 2002). The agency problem in firms with a large control-ownership

wedge exists not only in South Korea, but also in other East Asian countries. Yet, the control-ownership wedge is more evident in a country like South Korea, where the institutional environment is weak and protection of minority shareholders is poor. To alleviate this situation, the KFTC requires Korean large business groups (Chaebols) to disclose ownership information every year.

B. Corporate social responsibility

Many scholars and institutions have attempted to define CSR, but its role and definition have not been clearly established. Frooman (1997) defines CSR as an organizational strategy to influence shareholders. McWilliams and Siegel (2000) define CSR as integrated corporate efforts to create public goods beyond firm interests or legal requirements. Hopkins (2004) defines CSR as ethical and responsible actions taken by a firm to create higher standards for society. Many scholars describe CSR activities as voluntary actions taken by firms to integrate society and shareholders (Brown and Dacin, 1997; Sen and Bhattacharya, 2001; Luo and Bhattacharya, 2006; Kawk and Choi, 2015) and to improve society and the environment as a whole (Mackey et al., 2007). Although there is no agreed-upon definition of CSR, in this study, CSR is defined as voluntary actions taken by firms to support employees, customers, communities, and the environment.

Research has demonstrated that CSR activities incur direct costs and decrease profitability. Freedman (1970) suggests that the pursuit of economic activities to generate profit precedes CSR activities, and that heavy involvement in CSR activities reduces firm value. Despite the significant costs of engaging in CSR activities, firms choose to do so for the positive effects on firm value. Prior studies show that engaging in CSR activities has a positive effect on firm reputation and image, which ultimately increases long-term firm value. Heal (2005) suggests that engaging in CSR activities decreases opposition among shareholders within a firm, which, in turn, improves firm reputation. Clearly, engaging in CSR activities contributes to

sound relationships among shareholders, which can contribute positively to organizational innovation, firm reputation, and negotiation ability. For many firms, CSR is the optimal strategy to minimize potential conflicts of interest among shareholders (Freeman, 1984).

Prior studies emphasize the positive aspects of CSR, and report that firms with superior corporate governance actively participate in CSR activities. However, a majority of prior CSR studies is based on the U.S. firms, and the corporate governance structure of the U.S. firms is different from that of Korea. For example, Chang et al. (2017) report that managers in Korean firms are often closely related to the founders and majority shareholders. Thus, it is not suitable to apply agency theory in Korean CSR studies.

Current CSR studies based on Korean firms show that Korean firms with a high concentration of Chaebols do not actively participate in CSR activities. Youm and Griffin (2016) find that Chaebols do not perform CSR activities because the implementation and maintenance of CSR activities entail high costs. However, the negative association between Chaebols and CSR activities are alleviated when there is a government intervention. Sul et al. (2014) show that Chaebols with the large control-ownership wedge actively participate CSR activities, which are recommended by the government. In addition, the board of directors do not have positive influence on increasing CSR activities. Prior studies report that board independence has a non-linear relation with CSR activities (Kim et al. 2013; Chang et al. 2017). In addition, Choi et al. (2013) show that Chaebols use CSR activities to mask earnings management activities. Shin (2016) examine public perception of Chaebols' CSR activities based on interviews with the responsible CSR managers and newspapers.

III. Hypothesis Development

CSR is an orchestrated interaction between firms and society encompassing ethical, corporate governance, philanthropic, and community activities. Firms are not required to perform CSR activities, and CSR has no direct cause-and-effect association with profitability. However, ownership structure influences decision-making regarding CSR activities (Oh et al., 2011). CSR also reflects firm values and organizational culture, which are heavily affected by ownership structure (Aguilera et al., 2007; Trevino, 1986). In this study, we examine the association between the control-ownership wedge and engagement in CSR activities in South Korea, where the agency problem caused by the control-ownership wedge is evident.

The initial costs of engaging in CSR activities can be very high. Renneboog et al. (2008) report that the relationship between the level of engagement in CSR activities and firm value is unclear. If a firm spends excessive amounts on CSR activities, profitability will decline and shareholder value will ultimately decrease (Brammer et al., 2006). In some firms, controlling shareholders reduce CSR expenditures due to uncertainty about the return on investment (Coffey and Fryxell, 1991). In firms with a larger control-ownership wedge, controlling shareholders are more likely to transfer resources previously allocated to CSR activities to other projects, since CSR activities are not directly related to firm profitability. They also do this to maximize their own private benefit.

On the other hand, engaging in CSR activities may increase support from shareholders by disguising earnings management (Prior et al., 2008). Firms occasionally satisfy consumers and shareholders by resorting to CSR reports through the media. In such cases, shareholders are likely to moderate their monitoring of firm activities. Firms with a larger control-ownership wedge are more likely to use CSR activities to enhance their images.¹⁾ Because the

1) CSR activities in South Korea have dramatically increased in the past decade compared to other Asian countries (Chapple and Moon, 2005; Welford, 2005). South Korean firms have received

association between the control-ownership wedge and CSR is predicted to be either positive or negative, the following hypothesis is presented in null form:

Hypothesis: There is no association between the control-ownership wedge and engagement in CSR activities.

IV. Research Design

A. Sample distribution

Table 1 presents the sample distribution by year and industry classification. Table 1, Panel A shows the number of large Korean business groups (Chaebols). The data is derived from mandated disclosures of information about the control-ownership wedge in each firm. The number of disclosing firms varies from 93 to 117 by year regardless of their level of active CSR participation. Table 1, Panel B shows the sample distribution by industry classification. In total, 172 firm-year observations, or 27.2% of the entire sample, are for firms involved in the manufacturing of machinery, electronic components, and transportation equipment. In addition, 119 firm-year observations, or 18.7% of the entire sample, are for firms involved in the manufacturing of refined petroleum products, chemicals, and plastic products.

B. The control-ownership wedge

The dataset used in the analysis was exclusively obtained from the KFTC. As shown in the formulas below, a controlling shareholder is defined as a person (or a firm) with true controlling power over a firm and who is acknowledged as the founder of a large business group (Chaebol) disclosure system, as defined

negative attention due to the complications of corporate governance of large Korean business groups (Chaebols) and the negative effects of pyramid structures during the Asian Financial Crisis of 1997. In response to this criticism, the majority of large Korean business groups (Chaebols) reformed their systems of corporate governance and began using CSR activities as a strategy to improve their images.

by the KFTC. A controlling shareholder is able to exercise power by using multi-level pyramid ownership structures or cross-holdings among affiliates to their advantage.

Table 1. Sample distribution

This table presents sample distribution by year and by industry classification. Panel A shows sample distribution by year, and panel B shows sample distribution by industry classification.

Panel A. By year

| Year | Sample size | Percentage |
|-------|-------------|------------|
| 2005 | 104 | 16.35 |
| 2006 | 109 | 17.14 |
| 2007 | 105 | 16.51 |
| 2008 | 93 | 14.62 |
| 2009 | 108 | 16.98 |
| 2010 | 117 | 18.40 |
| Total | 636 | 100.00 |

Panel B. By industry classification

| Industry Classification | Sample size | Percentage |
|--|-------------|------------|
| Manufacture of Food Products/ Beverages, Tobacco Products | 40 | 6.29 |
| Manufacture of Textiles, Apparel, Luggage, and Footwear | 12 | 1.89 |
| Manufacture of Wood, Pulp/Paper, and Paper Products | 6 | 0.94 |
| Manufacture of Refined Petroleum Products, Chemicals, Plastic Products | 119 | 18.71 |
| Manufacture of Other Non-metallic Mineral Products | 30 | 4.72 |
| Manufacture of Basic Metal Products, Fabricated Metal Products | 85 | 13.36 |
| Manufacture of Machinery, Electronic Components, Transport Equipment | 172 | 27.04 |
| Manufacture of Furniture/ Other Manufacturing | 72 | 11.32 |
| Wholesale and Retail Trade | 84 | 13.21 |
| Service Activities | 16 | 2.52 |
| Total | 636 | 100.00 |

Cash flow rights

$$= \frac{\text{Controlling shareholder's direct share ownership} + \text{Controlling shareholder's family ownership}}{\text{Number of common stocks} - \text{Treasury stock}}$$

Control rights

$$= \frac{\text{Controlling shareholder's direct share ownership} + \text{Controlling shareholder's family ownership} + \text{Affiliates' direct share ownership} + \text{Directors share ownership} + \text{for profit or organizations share ownership}}{\text{Number of common stocks} - \text{Treasury stock}}$$

$$\text{Control} - \text{ownership} \wedge = \text{Control rights} - \text{Cash flow rights}$$

C. CSR measurement

This study uses the KEJI Index to measure CSR activities. The data shown in Table 2 was disclosed by the KEJI, the foremost Korean institution for recording and disclosure of CSR. The KEJI Index has provided official CSR ratings for firms listed

in the Korea Stock Exchange since 1991, selecting the top 200 firms every year and disclosing their CSR performance. It consists of seven categories: soundness (25 points), fairness of firm activities (15 points), social service activities (10 points), customer protection (10 points), environmental protection (15 points), economic development contribution (15 points), and long-term-oriented economic development (10 points) for a total of 100 points. KEJI scores are based on both qualitative and quantitative evaluations. The qualitative evaluation is worth 25 points and is based on a survey questionnaire. The quantitative evaluation is worth 75 points, and data is derived from disclosed CRS reports and media coverage. The KEJI Index evaluation criteria and methods are similar to the KLD Social Index in the U.S. and the FTSE4Good Index in Europe. In this study, we classify firms with disclosed KEJI Index scores as active CSR participants and those without KEJI Index scores as non-active CSR participants. In addition, we utilize quantitative evaluations based on KEJI scores in an additional

Table 2. Korean Economic Justice Institute index (KEJI index)

KEJI scores (scores on the KEJI index) are based on both qualitative and quantitative evaluations. The numbers in parentheses refer to quantitative evaluation scores. In this study, aggregate scores from quantitative evaluation are used, and scores from subcategories are listed in the first column.

| Item (Score) | Subsection | Score |
|--|--|-------|
| Soundness (20) | Soundness of shareholder composition | (7) |
| | Soundness of investment expenditure | (3) |
| | Soundness of capital financing | (10) |
| Fairness of firm activities (11) | Fair trade | (3) |
| | Transparency | (8) |
| | Cooperative relationship | |
| Social service activities (7) | Protection of neglected classes | (4) |
| | Contribution to public welfare | (3) |
| Customer protection (7) | Protection of consumer rights | (2) |
| | Quality | (3) |
| | Advertisement | (2) |
| Environmental protection (10) | Environmental reform | (4) |
| | Environmental assessment | (3) |
| | Violation and pollution | (3) |
| Employee satisfaction (10) | Health and safety in the workplace | (2) |
| | Investment in human resources | (4) |
| | Wages and welfare services | (4) |
| | Relations with unions | 2 |
| | Equal opportunity employment | 3 |
| Economic development contribution (10) | Research and development | 3 (3) |
| | Management performance and contribution to economic growth | 7 (7) |

analysis.

D. Research design

We construct a model to examine the effect of the control-ownership wedge on CSR activities, as outlined in equation (1) below:

$$\begin{aligned} CSR_DUM_{i,t} \text{ or } CSR_sc_{i,t} = & \\ & \beta_0 + \beta_1 \wedge_{i,t} + \beta_2 ABSDA_{i,t} + \beta_3 SIZE_{i,t} + \beta_4 LEV_{i,t} \\ & + \beta_5 MB_{i,t} + \beta_7 CFO_{i,t} + \beta_8 LOSS_{i,t} + \beta_9 ROA_{i,t} \\ & + \sum \in D + \sum YEAR + \epsilon_{i,t} \end{aligned} \quad (1)$$

The dependent variable, CSR engagement, is measured in equation (1) as two variables: CSR superiority and CSR scores. If a firm appears on the top 200 list of firms engaged in superior CSR activities provided by the KEJI Index, it takes a value of 1, and otherwise 0. The KEJI not only discloses information for the top 200 firms engaged in superior CSR activities, but also discloses firm-level scores. Therefore, we also use CSR scores to measure the quality of CSR activities. WEDGE measures differences in the control-ownership wedge between firms. As the coefficient of WEDGE increases, the difference between cash flow rights and control rights increases. In addition, as the coefficient of WEDGE (the difference between cash flow rights and control rights) increases, we examine the effect of the control-ownership wedge on CSR activities. Thus, our main variable of interest is the estimated coefficient β_1 of WEDGE.

We include control variables that affect CSR activities according to the protocol in prior studies. First, we include the absolute value of discretionary accruals (ABSDA) as a control variable following Hong et al. (2012), who report a negative association between earnings quality and CSR activities. We follow Kothari et al. (2005) to measure ABSDA based on performance-matched discretionary accruals. Equation (2) represents discretionary accruals as the absolute value of the estimated residual from equation (2).

$$\begin{aligned} TA_t | A_{t-1} = & \beta_0 + \beta_1 \left(\frac{1}{A_{t-1}} \right) \\ & + \beta_2 [(\Delta S_t - \Delta AR_t) / A_{t-1}] \\ & + \beta_3 ROA_t + \epsilon \end{aligned} \quad (2)$$

$TA_{i,t}$ = net income – cash flow from operating activities

$A_{i,t-1}$ = total assets

$\Delta S_{i,t}$ = changes in sales

$\Delta AR_{i,t}$ = changes in accounts receivable

$PPE_{i,t}$ = tangible assets – land – construction in progress

$ROA_{i,t}$ = net income/total assets

ϵ = residuals

We include firm size (SIZE), since larger firms are more likely to have surplus funds to invest in CSR activities and to receive close attention from the market, which may lead them to invest more in CSR activities. Also, we expect that a higher leverage ratio (LEV) is more likely to lead to excessive financing costs, which reduces investment in CSR activities. In addition, firms with a net loss (LOSS) are more likely to focus on improving firm performance rather than engaging in CSR activities. On the other hand, firms with high profitability (ROA), growth (MB), and operating cash flow (CFO) have the financial capacity to participate actively in CSR activities compared to firms with low values for these parameters. For industry codes, the 9th Revised Korean Standard Industrial Classification (KSIC) was used in order to reflect industrial characteristics of Korea.

V. Empirical Results

A. Descriptive statistics and Pearson correlation

The descriptive statistics for 636 firm-year observations for the variables of interest are presented in Table 3. We winsorize continuous values among the independent variables and dependent variables with continuous values at the 1% and 99% levels to mitigate the

Table 3. Descriptive statistics

$$TA_t | A_{t-1} = \beta_0 + \beta_1 \left(\frac{1}{A_{t-1}} \right) + \beta_2 [(\Delta S_t - \Delta AR_t) / A_{t-1}] + \beta_3 ROA_t + \epsilon(2), \text{ where}$$

This table summarizes the main variables of interest. Variable definitions: CSR_DUM = 1 if a firm belongs to the top 200 firms selected by KEJI, otherwise 0; CSR_SC = CSR scores evaluated by the KEJI; WEDGE = the control-ownership wedge (= control rights – cash flow rights); ABSDA = following Kothari et al. (2005), the absolute form of the residual value from equation (2), TA = net income – cash flow from operating activities, A = total assets, ΔS = changes in sales, ΔAR = changes in accounts receivable, PPE = tangible assets—land—construction in progress, ROA = net income/total assets, and ε = residuals; SIZE = Ln (total assets); LEV = total liabilities/total assets; MB = the ratio of the market value to the book value of total assets; CFO = cash flow from operations/lagged total assets; ROA = net income/lagged total assets; and LOSS = 1 if net loss is incurred in a given year, and 0 otherwise.

| Variables | Mean | STD | Min | Median | Max |
|-----------------------------|--------|-------|--------|--------|--------|
| CSR_DUM _{<i>t</i>} | 0.446 | 0.497 | 0.000 | 0.000 | 1.000 |
| CSR_SC _{<i>t</i>} | 48.660 | 2.827 | 43.850 | 48.378 | 57.151 |
| WEDGE _{<i>t</i>} | 0.280 | 0.206 | -0.044 | 0.294 | 0.936 |
| ABSDA _{<i>t</i>} | 0.057 | 0.059 | 0.000 | 0.040 | 0.492 |
| SIZE _{<i>t</i>} | 28.209 | 1.524 | 24.488 | 28.269 | 31.506 |
| LEV _{<i>t</i>} | 0.501 | 0.187 | 0.113 | 0.525 | 0.910 |
| MB _{<i>t</i>} | 1.537 | 1.223 | 0.224 | 1.169 | 6.895 |
| CFO _{<i>t</i>} | 0.058 | 0.075 | -0.128 | 0.055 | 0.265 |
| LOSS _{<i>t</i>} | 0.139 | 0.346 | 0.000 | 0.000 | 1.000 |
| ROA _{<i>t</i>} | 0.042 | 0.061 | -0.194 | 0.043 | 0.177 |

effects of outliers. The mean of the first dependent variable, CSR_DUM, is 0.446, which implies that approximately 45% of sample firms were selected as firms with superior CSR activities according to the KEJI Index. The second dependent variable, CSR_SC, represents the top 200 firms listed in the KEJI Index, with a maximum score of 75. In our sample, the minimum score is 43.85 and the maximum score is 57.15. The mean of our main variable of interest, WEDGE, is 0.28, which implies that the control rights of controlling shareholders are greater by 28% on average compared to cash flow rights. The minimum and maximum values of WEDGE are 0 and 0.94, respectively, which indicates that the control-ownership wedge ranges from 0% to 94% in the firms in our sample.

Table 4 presents the Pearson’s correlation coefficients among the main variables. First, there is a correlation between the control-ownership wedge and engagement in CSR activities (CSR_DUM, CSR_SC) that is significant at the 1% and 5% levels, respectively. When the control-ownership wedge increases, engagement

in CSR activities decreases; CSR scores are also low even for firms included in the KEJI Index. This implies that controlling shareholders are not likely to invest actively in CSR activities in firms with a large control-ownership wedge. However, control variables may affect the association between the control-ownership wedge and CSR activities: therefore, we conduct a multivariate analysis to validate the results from Table 4.

In this secondary analysis, the control variables show a significant correlation with engagement in CSR activities. SIZE, MB, CFO, and ROA show positive associations with CSR activities. This implies that larger firms with high growth, operating cash flows, and profitability are more likely to invest in CSR activities. In addition, LEV and LOSS are negatively associated with engagement in CSR activities. This means that firms with high costs of capital from outside, those that are highly leveraged, and those that have experienced losses lacked the financial capacity to invest in CSR activities.

Table 4. Pearson correlation

This table presents the Pearson's correlation coefficients among the main variables. Values in parentheses are p-values. See Table 3 for variable definitions.

| | CSR_DUM_t | $WEDGE_t$ | $ABSDA_t$ | $SIZE_t$ | LEV_t | MB_t | CFO_t | $LOSS_t$ | ROA_t |
|--------------|--------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| CSR_DUM_t | 1.000 | -0.179 (<.0001) | 0.001 (0.9879) | 0.171 (<.0001) | -0.151 (0.0001) | 0.091 (0.0202) | 0.136 (0.0005) | -0.163 (<.0001) | 0.233 (<.0001) |
| CSR_SC_t | | -0.121 (0.0401) | -0.061 (0.3048) | 0.283 (<.0001) | -0.282 (<.0001) | 0.276 (<.0001) | 0.215 (0.0002) | -0.063 (0.2844) | 0.264 (<.0001) |
| $WEDGE_t$ | | 1.000 | -0.008 (0.8351) | -0.234 (<.0001) | 0.001 (0.9761) | -0.140 (0.0004) | -0.029 (0.4556) | 0.069 (0.0786) | -0.095 (0.0157) |
| $ABSDA_t$ | | | 1.000 | -0.024 (0.5426) | 0.197 (<.0001) | 0.051 (0.193) | -0.061 (0.1232) | 0.168 (<.0001) | -0.178 (<.0001) |
| $SIZE_t$ | | | | 1.000 | 0.211 (<.0001) | 0.079 (0.0455) | 0.127 (0.0012) | -0.090 (0.0223) | 0.121 (0.0021) |
| LEV_t | | | | | 1.000 | 0.159 (<.0001) | -0.338 (<.0001) | 0.255 (<.0001) | -0.407 (<.0001) |
| MB_t | | | | | | 1.000 | 0.245 (<.0001) | -0.088 (0.0249) | 0.246 (<.0001) |
| CFO_t | | | | | | | 1.000 | -0.299 (<.0001) | 0.517 (<.0001) |
| $LOSS_t$ | | | | | | | | 1.000 | -0.685 (<.0001) |
| ROA_t | | | | | | | | | 1.000 |

B. Hypothesis testing

Table 5 presents the results of testing for the effect of the control-ownership wedge on CSR activities. Model (1) is a logit analysis using the dependent variable, WEDGE, and the KEJI Index as a dummy variable. The coefficient of WEDGE is significantly and negatively associated with the KEJI Index at the 1% level ($\beta_1 = -1.925$, $Z = -2.67$), which provides support for our hypothesis. We observe that as the control-ownership wedge increases, engagement in CSR activities declines in the superior CSR group. In other words, as the control-ownership wedge increases, engagement in CSR activities decreases.

In addition, we perform a robust standard errors clustered regression analysis at the firm level using KEJI scores as the dependent variable. The coefficient of WEDGE is significantly and negatively associated with KEJI scores at the 1% level ($\beta_1 = -1.925$,

$Z = -2.67$). This result indicates an association between a large control-ownership wedge and lower CSR scores even for firms listed in the KEJI Index. The results show a negative effect of the control-ownership wedge on engagement in CSR activities in both the logit and regression analyses. As the control-ownership wedge increases, controlling shareholders choose to reduce engagement in CSR activities, transferring resources previously allocated to CSR activities to other projects.

It is possible that the results reported above may be driven by variables that have not been included in the analysis. Therefore, we perform a fixed effects analysis to control for omitted variables. The results show that the control-ownership wedge is negatively associated with engagement in CSR activities ($\beta_1 = -5.344$, $t = -2.55$), which supports our hypothesis. As the control-ownership wedge increases, engagement in CSR activities decreases.

Table 5. Effect of the control–ownership wedge on CSR

This table presents the results of testing for the effect of the control–ownership on CSR activities. Model (1) is a robust standard errors clustered logit analysis using the dependent variable. In model (2), we perform a robust standard errors clustered regression analysis at the firm level using KEJI scores as the dependent variable. In model (3), we use CSR scores as the dependent variable in fixed–effects analysis. See Table 3 for variable definitions. ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively.

| Dependent variables | (1) Logit(robust and clustered by firm) CSR dummy | | (2) OLS (robust and clustered by firm) CSR Score | | (3) Fixed–effects CSR Score | |
|--|---|------------|--|------------|-----------------------------------|-----------|
| | Intercept | -5.399 | (-1.83)* | 39.426 | (6.70)*** | 51.152 |
| WEDGE _{<i>t</i>} | -1.925 | (-2.67)*** | -3.786 | (-3.09)*** | -5.344 | (-2.55)** |
| ABSDA _{<i>t</i>} | 1.78 | (1.11) | -0.755 | (-0.28) | 1.347 | (0.48) |
| SIZE _{<i>t</i>} | 0.184 | (1.82)* | 0.379 | (1.86)* | 0.034 | (0.04) |
| LEV _{<i>t</i>} | -2.51 | (-2.58)** | -6.885 | (-4.25)*** | -4.718 | (-1.7)* |
| MB _{<i>t</i>} | 0.129 | (1.02) | 0.650 | (4.00)*** | 0.095 | (0.41) |
| CFO _{<i>t</i>} | -0.674 | (-0.37) | -7.181 | (-2.82)*** | -4.790 | (2.06)** |
| LOSS _{<i>t</i>} | -0.258 | (-0.62) | 0.773 | (1.10) | 1.108 | (1.49) |
| ROA _{<i>t</i>} | 3.992 | (1.29) | -0.353 | (-0.06) | 1.541 | (0.33) |
| Industry dummies | Included | | Included | | Included | |
| Pseudo R ² /Adjusted R ² | 0.132 | | 0.318 | | 0.609 | |
| No. of observations | 636 | | 289 | | 289 | |

C. Effect of the control–ownership wedge on CSR subcategories

The KEJI Index consists of seven subcategories: soundness (CSR1), fairness of firm activities (CSR2), social service activities (CSR3), customer protection (CSR4), environmental protection (CSR5), employee satisfaction (CSR6), and economic development contribution (CSR 7). In this analysis, we examine the effect of the control–ownership wedge on each CSR activity subcategory. Table 6 shows that the effect of the control–ownership wedge is negatively associated with soundness (CSR1), fairness of firm activities (CSR2), and **employee satisfaction** (CSR6). In other words, as the control–ownership wedge increases, soundness, transparency, and negotiation ability evaluation scores decrease. In addition, evaluation scores for employee benefits and investment in human resources also decrease.

D. Effect of corporate governance on the association between the control–ownership wedge and engagement in CSR activities

Engagement in CSR activities is associated with decision-making regarding long-term allocation of resources. Therefore, it is necessary to examine the effect of corporate governance on the association between the control–ownership wedge and CSR activities. In the Korean stock market, foreign investors invest significantly in terms of amount and scale from a long-term perspective compared to Korean investors. Therefore, monitoring by foreign investors is likely to have a positive effect on CSR activities due to their long-term perspective on investment (Oh et al., 2011). In addition, we expect that monitoring by foreign investors moderates the negative association between the control–ownership wedge and engagement in CSR activities.

We now examine the board of directors’ role to increase our understanding of the interests of diverse shareholders in the context of CSR decision-making.

Table 6. Effect of the control-ownership wedge on CSR subcategory scores: OLS regression (robust and clustered by firm)

The KEJI index consists of 7 categories: soundness (CSR1), fairness of firm activities (CSR2), social service activities (CSR3), customer protection (CSR4), environmental protection (CSR5), employee satisfaction (CSR6), and economic development contribution (CSR 7). This table shows the effect of the control-ownership wedge on CSR subcategory scores. See Table 3 for variable definitions. ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively.

| Dependent variables | (1) CSR1 | (2) CSR2 | (3) CSR3 | (4) CSR4 | (5) CSR5 | (6) CSR6 | (7) CSR7 |
|--|-------------------|-------------------|-------------------|-----------------|-------------------|-------------------|-----------------|
| Intercept | 12.438 (5.29)*** | 14.496 (10.55)*** | 1.237 (0.47) | 1.582 (2.37)** | -0.966 (-0.56) | 10.689 (5.49)*** | -0.053 (-0.04) |
| WEDGE _{<i>i</i>} | -1.330 (-1.91)* | -0.764 (-2.5)** | 0.080 (0.15) | -0.118 (-1.09) | -0.256 (-0.64) | -0.930 (-1.8)* | -0.467 (-1.51) |
| ABSDA _{<i>i</i>} | 2.768 (2.04)** | 1.142 (1.28) | 2.207 (2.1)** | -0.650 (-1.39) | -3.314 (-3.66)*** | -1.631 (-1.34) | -1.277 (-1.39) |
| SIZE _{<i>i</i>} | 0.187 (2.25)** | -0.199 (-3.77)*** | 0.107 (1.23) | 0.065 (2.81)*** | 0.276 (4.4)*** | -0.196 (-2.87)*** | 0.138 (3.34)*** |
| LEV _{<i>i</i>} | -4.196 (-3.49)*** | 0.391 (0.75) | -0.252 (-0.38) | -0.380 (-1.63) | -1.537 (-2.53)** | -0.103 (-0.17) | -0.807 (-2)** |
| MB _{<i>i</i>} | 0.114 (1.12) | -0.066 (-1.55) | 0.036 (0.52) | 0.017 (0.8) | 0.121 (2.3)** | 0.359 (5.01)*** | 0.067 (1.89)* |
| CFO _{<i>i</i>} | -1.552 (-1.19) | -0.172 (-0.22) | -3.817 (-3.66)*** | -0.595 (-1.32) | -1.271 (-1.34) | -0.166 (-0.16) | 0.396 (0.57) |
| LOSS _{<i>i</i>} | -0.642 (-1.28) | 0.234 (0.87) | 0.617 (1.75)* | 0.158 (1.43) | -0.413 (-1.52) | 0.351 (1.17) | 0.467 (2.33)** |
| ROA _{<i>i</i>} | -3.308 (-1.14) | 2.363 (1.52) | 3.394 (1.65) | 0.519 (0.54) | -3.143 (-2.12)** | -1.111 (-0.49) | 0.934 (0.69) |
| Industry dummies | Included | Included | Included | Included | Included | Included | Included |
| Pseudo R ² /Adjusted R ² | 0.235 | 0.088 | 0.192 | 0.085 | 0.423 | 0.335 | 0.529 |
| No. of observations | 289 | 289 | 289 | 289 | 289 | 289 | 289 |

The board of directors both advises and monitors the CEO. While inside directors focus on their advisory role, outside directors play a monitoring role as independent parties (Bushman et al., 2004; Armstrong et al., 2010). Prior studies report a negative association between the outside director ratio and the frequency of fraud occurrence (Beasley et al., 1996). In a similar vein, as the ratio of outside directors on the audit committee increases, a positive effect on audit quality is observed and accounting treatments become more conservative (Klein et al., 2002; Xie et al., 2003). Therefore, we conjecture that a higher outside director ratio moderates the negative effect of the control-ownership wedge on engagement in CSR activities. Given the fact that corporate governance structures in East Asian firms (including Korean) are notoriously weak, however, this may not be the case. Classens et al. (2000) suggest that outside directors do not play an effective monitoring role in such circumstances due to weak monitoring mechanisms, lack of independence from management, lack of accurate information, and vagueness about their responsibilities. Therefore, in this study, we examine

how board independence influences the association between the control-ownership wedge and engagement in CSR activities.

Table 7 presents the results of the analysis testing for the effect of corporate governance (foreign investor ratio and outside director ratio) on the association between the control-ownership wedge and engagement in CSR activities. The dependent variable in model (1) is CSR_DUM, which takes a value of 1 if the firm belongs to the top 200 CSR firms, and 0 otherwise. In this model, the coefficient (z-value) of the foreign investor ratio is 4.283 (1.84), which is positive and significant at the 10% level. This result indicates that firms with high foreign investor ratios are more likely to belong to the top tier of the KEJI Index. Models (2) and (3) use CSR scores as the dependent variable. The results are consistent with our previous results. However, the interaction between the foreign investor ratio and the control-ownership wedge is not significant in models (1) to (3). These results demonstrate that while monitoring by foreign investors may have a positive effect on engagement in CSR activities, it does not moderate

Table 7. The effect of corporate governance on the association between the control-ownership wedge and CSR

This table presents the results of the analysis testing for the effect of corporate governance (foreign investor ratio and outside director ratio) on the association between the control-ownership wedge and CSR activities. Variable definitions: FOREIGN = foreign investor ratio; OUT = outside director ratio. See Table 3 for variable definitions of other variables. ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively.

| Dependent variables | (1) Logit(robust and clustered by firm) CSR_DUM | | (2) OLS (robust and clustered by firm) CSR_SC | | (3) Fixed effects CSR_SC | |
|---|---|-------------------|---|-------------------|--------------------------------|-----------------|
| | Intercept | -5.968 (-1.83) | -7.811 (-2.41) | 43.840 (8.26) | 40.167 (6.74) | 34.928 (1.59) |
| WEDGE _{<i>t</i>} | -3.745 (-1.99)** | -3.536 (-3.17)*** | -3.040 (-1.93)* | -4.202 (-2.43)** | -4.735 (-1.82)* | -4.557 (-1.83)* |
| FOREIGN _{<i>t</i>} | 4.283 (1.84)* | | 5.334 (2.15)** | | 6.468 (3.17)*** | |
| WEDGE _{<i>t</i>} × FOREIGN _{<i>t</i>} | 8.862 (1.22) | | -5.785 (-0.80) | | 0.016 (0.01) | |
| OUT _{<i>t</i>} | | 0.303 (0.55) | | 0.348 (0.29) | | -0.059 (-0.05) |
| WEDGE _{<i>t</i>} × OUT _{<i>t</i>} | | -0.030 (-0.02) | | 1.306 (0.33) | | -1.699 (-0.37) |
| ABSDA _{<i>t</i>} | 2.659 (1.26) | 1.884 (0.94) | -0.827 (-0.31) | -0.690 (-0.25) | 1.834 (0.72) | 1.914 (0.64) |
| SIZE _{<i>t</i>} | 0.167 (1.47) | 0.242 (2.17)** | 0.166 (0.90) | 0.360 (1.71)* | 0.538 (0.71) | 0.103 (0.11) |
| LEV _{<i>t</i>} | -2.032 (-1.99)** | -2.428 (-2.47)** | -5.094 (-3.47)*** | -6.649 (-3.87)*** | -4.191 (-1.68)* | -4.392 (-1.44) |
| MB _{<i>t</i>} | 0.115 (0.91) | 0.151 (1.17) | 0.510 (3.50)*** | 0.577 (3.59)*** | 0.140 (0.68) | 0.045 (0.18) |
| CFO _{<i>t</i>} | -0.667 (-0.31) | -1.312 (-0.69) | -5.763 (-2.34)** | -6.967 (-2.77)*** | -5.213 (-2.48)** | -4.623 (-1.94)* |
| LOSS _{<i>t</i>} | -0.287 (-0.56) | -0.349 (-0.71) | 0.811 (1.19) | 0.638 (0.86) | 0.790 (1.18) | 0.649 (0.82) |
| ROA _{<i>t</i>} | 0.362 (0.11) | 1.723 (0.55) | -1.224 (-0.24) | -0.080 (-0.01) | -1.387 (-0.33) | 2.343 (0.45) |
| Industry dummies | Included | Included | Included | Included | Included | Included |
| Pseudo R ² /Adjusted R ² | 0.227 | 0.149 | 0.358 | 0.293 | 0.297 | 0.768 |
| No. of observations | 636 | 636 | 289 | 289 | 289 | 289 |

the decrease in CSR involvement caused by the control-ownership wedge. The coefficient of outside directors (OUT) is not significant in the association between the dependent variable and either CSR_DUM or CSR scores. The interaction between the control-ownership wedge and outside directors is also not significant. These results suggest that monitoring by outside directors has neither a positive nor a negative effect on engagement in CSR activities.

VI. Conclusion

Firms may improve their reputations by increasing engagement in CSR activities. Doing so may also maximize employee productivity and meet shareholders'

needs by accommodating interests of diverse shareholders (Garbett, 1988; Hart, 2005). However, engaging in CSR activities is not directly related to firm profitability, and long-term investment in CSR is required to increase firm value. In addition, the choice of CSR activities is influenced by firm values and organizational culture, both of which are associated with ownership structure (Aguilera et al., 2007; Trevino, 1986).

This study contributes to an understanding of CSR determinants based on ownership structure by examining the relationship between the control-ownership wedge and engagement in CSR activities. Among Korean firms, the agency problem is caused by differences between controlling shareholders and minority shareholders. In firms with a large control-ownership wedge, controlling shareholders are more likely to pursue their own private benefit by expropriating the wealth of minority shareholders.

In such circumstances, controlling shareholders may exercise their voting rights to transfer resources from long-term-oriented CSR activities to other short-term-oriented projects.

The results of the empirical analysis show a negative association between the control-ownership wedge (the difference between voting rights and cash flow rights) and engagement in CSR activities, which support our hypothesis. In firms with a large control-ownership wedge, the agency problem between controlling shareholders and minority shareholders is increased, which decreases CSR activities. The negative association between the control-ownership wedge and engagement in CSR activities remains consistent when scores from the KEJI Index are included as an additional dependent variable. In addition, foreign investors and outside directors do not moderate the decrease in CSR involvement caused by the control-ownership wedge while monitoring by foreign investors may have a positive effect on engagement in CSR activities.

This study makes the following contributions. We examine the agency problem between controlling shareholders and minority shareholders in the context of the relationship between the control-ownership wedge and engagement CSR activities, while most prior studies examine the agency problem between management and shareholders in the context of voluntary engagement and CSR activities. The results show a negative association between the control-ownership wedge and engagement in CSR activities. Given the weak corporate governance structures of East Asian firms, including those in Korea, scholars have examined the agency problem between controlling shareholders and minority shareholders as the main cause of decreasing firm value. According to Johnson et al. (2000), weak corporate governance was the main cause of the Asian Financial Crisis at the end of the 1990s due to the fact that managers of East Asian firms were controlled by controlling shareholders. This study extends the findings of prior literature, improving our understanding of the unique ownership structure of large Korean business groups (Chaebols), and the effect of the control-ownership wedge on

engagement in CSR activities.

Finally, the results provide useful insights for various interested parties, including regulators, credit rating agencies, and investors. Regulators may use the findings from this study to improve corporate governance of firms with a large control-ownership wedge. Credit rating agencies and investors may wish to consider ownership structure more carefully when they look at CSR activities as part of a firm valuation.

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