Friendly Signal of "Good Governance": Will Corporate Governance Promote ESG Disclosure

Keyu Meng

Lingnan College, Sun Yat-sen University, Guangzhou, China.

mengky@mail2.sysu.edu.cn

Abstract: Up against the background of developing countries, this study empirically researches the relationship between corporate governance and environmental, social, and governance (ESG) disclosure based on samples of Chinese listed companies. The results show that the governance quality of listed companies significantly affects ESG disclosure. Through further heterogeneity analysis, this paper reveals the key role of enterprise nature when influencing corporate governance on ESG disclosure. Specifically, under the same governance capability, ESG disclosure of state-owned enterprises tends to be better than that of non-state-owned ones. From the perspective of corporate governance, this study not only enriches the understanding of the influencing factors of ESG disclosure, but also sheds new light on optimizing corporate governance and improving sustainable development. Meanwhile, policymakers have been provided with enlightenment to make decisions in setting policies and environmental standards.

Keywords: Corporate Governance; ESG Disclosure; Listed Companies; Ownership.

1. Introduction

This study focuses on the theme of the new era, that is, high-quality economic and social development. Especially in the context of increasingly serious resource shortages and environmental pollution, countries all over the world pay more attention to enterprises' performance in environmental protection, social responsibility, and corporate governance (ESG performance). China, as a major developing country in the world, is in a new phase of economic development with clear goals for sustainable development. As a comprehensive index to evaluate the enterprise performance, ESG includes three aspects subsuming environment, society, and corporate governance. Its emphasis is laid to bring public interests into the enterprise value system and guide the dynamic balance and sustainable development of enterprise economic activities and environmental society construction by internalizing the external influence of enterprise development on the environment and society. Consistent with the goal of China's high-quality economic development, ESG also aims to green development and low carbon. In China, the relevant policies of ESG investment are being further improved and explored. Major regulatory agencies such as the China Securities Regulatory Commission (CSRC) and Asset Management Association of China (AMAC) have begun to actively promote public funds and other institutions to participate in ESG investment. On September 30, 2018, the *Code of Corporate Governance of Listed Companies in China* revised by CSRC further intensified the requirements for environmental protection and social responsibility and clarified the responsibilities of listed companies in meeting stakeholders, employees, society, and the environment. On March 18, 2019, AMAC further issued the *Notice on Submitting Self-Assessment Report*, which is the specific implementation document of *Green Investment Guidelines (For Trial Implementation)*, marking that ESG has changed from a topic of concern to one of the practical principles that relevant asset management institutions must earnestly implement. Under such policy guidance, ESG disclosure of Chinese enterprises has improved. According to statistics, as of December 2018, the disclosure rate of corporate social responsibility reports of listed companies in the A-share market in 2017 reached 23.65%, increasing by 6.59% compared with last year. Although this growth rate is lower than 7.20% in the same period of last year, the proportion of ESG reports issued by A-share companies since 2010 has remained at a high level of 25%.

At present, academic research on ESG and its influence has become a trend. Lai and Zhang (2022) pointed out that ESG certification can reduce the company's excessive debt by easing the financing constraints, which leaves a positive impact on undermining the excess debt of the enterprise investment, and then promoting domestic expansion and investment efficiency. According to the research of Wen et al. (2022), good-quality and continuous ESG disclosure is imperative for companies to benefit from ESG implementation. Meanwhile, the research of Wang et al. (2023) also proved that enterprises under ESG rating agencies have improved significantly in green innovation, which was mainly reflected in green invention patents. Besides, enterprises with good ESG performance witnessed more obvious promotion in green innovation.

Corporate governance is to endow the owner with full power in decision and supervision through the establishment of a perfect corporate governance structure. This centralized power system can avoid agency problems and reduce information asymmetry to the maximum extent, thus improving the enterprises' operational efficiency and ultimately achieving the purpose of enhancing corporate performance. Meanwhile, it is conducive to forming a good corporate culture. After entering modern society, corporate governance has played a new role in a different era. Better corporate governance benefits companies through greater access to finance, lower cost of capital, better performance, and better treatment for all stakeholders (Claessens & Yurtoglu, 2013). Corporate governance mechanism is an important predictor of waste generated by global companies, while the independence of the board of directors and the sustainable development committee are negatively correlated with waste recycling (Shahab et al., 2022). However, the problem of corporate governance has always existed. Unresolved agency issues may result in managers being more or less involved in corporate tax avoidance (Armstrong al., 2015). In terms of innovation, companies with poor governance produce fewer green patents than all their innovations (Amore & Bennedsen 2016). Under the characteristic institutional background, the problems of China's corporate governance also show various forms. Different from the classic vertical agency in Western countries, the dominant agency in China is the horizontal agency conflict between controlling shareholders and minority shareholders caused by equity concentration, which stems from its centralized equity structure and imperfect laws and regulations (Jiang & Kim, 2020).

Currently, many scholars have studied ESG and analyzed its influencing factors, but few paid attention to the influence of corporate governance, an essential internal system of enterprises, on ESG disclosure. Thus, this paper will explore the influencing factors of ESG from the perspective of corporate governance, which has vital and practical significance for the sustainable development of enterprises and the perfection of an internal management system. In this paper, Shanghai and Shenzhen A-share listed companies in China from 2008 to 2018 are used as initial research samples, with the Bloomberg database used to collect the ESG disclosure index. Drawing lessons from Ding et al. (2022), this paper uses principal component analysis to construct comprehensive indicators from supervision, incentive, and decision-making to measure corporate governance. Then, the impact of corporate governance on enterprises' ESG disclosure levels is analyzed. It is found that corporate governance significantly improves enterprises' ESG disclosure, which is more obvious for private enterprises and those with low power concentration. The findings provide some enlightenment for the ESG practice of enterprises and the reform of the corporate governance system.

This study has made contributions in three aspects as follows.

First of all, we further explore the influencing factors of ESG disclosure. Although social and institutional factors have been proven to affect ESG disclosure, Pan et al. (2022) pointed out that ESG disclosure is still a critical challenge for enterprises because China has not yet established a unified mechanism of fact disclosure. Therefore, they put forward the "ESG reporting assistant". Broadening the research of this field from the perspective of corporate governance, this stud enriches the understanding of the driving factors affecting ESG disclosure.

Secondly, this study expands the understanding of the consequences of corporate governance. With corporate governance being the core issue of research on corporate finance and enterprise economy, studies have shown that corporate governance may affect corporate financing constraints, corporate performance, and corporate innovation. According to Claessens and Yurtoglu (2013), better corporate governance can benefit companies by broadening financing channels, reducing capital costs, improving performance, and bringing more benefits to stakeholders. Meanwhile, Yang and Liang (2009) found that the quality of corporate governance determines innovation performance. However, few studies have investigated the impact of corporate governance on ESG disclosure from a micro perspective, which is a key enterprise strategy and the goal of sustainable development. Nowadays, with the increasing concern of environmental, social, and corporate governance, this study expounds on the impact mechanism of corporate governance on ESG disclosure and provides a new perspective for seeing the consequences of corporate governance in microeconomics.

Finally, using the sample from China, this study researches how corporate governance promotes the implementation of ESG strategy from the perspective of developing countries. Since the reform and opening up, China has developed by leaps and bounds in economy and society, which has become the second-largest economy in the world. Aiming to explore how to improve the sustainable development level of enterprises by optimizing corporate governance, and providing enlightenment for policymakers, this study has important practical significance.

The structure of the remaining paper is as follows. The second chapter reviews the literature on ESG disclosure and corporate governance. The third chapter explains the data source, variable definition, and test model. The fourth chapter discusses the regression results. The fifth chapter analyzes the heterogeneity. The sixth chapter is the conclusion and discussion.

2. Data Sources, Variable Definitions, and Test Model

2.1 Data Sources and Sample Selection

In this paper, Shanghai and Shenzhen A-share listed companies in China from 2008 to 2018 are used as initial research samples. ESG disclosure index comes from the Bloomberg database. Besides, financial information and board size of listed companies in China come from the CSMAR database.

Using the existing research for reference, the initial samples are treated as follows. (1) Eliminate the samples of financial companies and ST and ST* listed companies (Callen & Fang, 2015; Chen et al., 2021; Kim et al., 2014). (2) Eliminate other samples with missing data. (3) Up and down 1% of continuous variables get Winsorize processing. Finally, the annual observations of 6888 companies from 2008 to 2018 can be obtained.

2.2 Variable Construction

2.2.1 Corporate Governance Level

Drawing lessons from Ding et al. (2022), principal component analysis is used to construct a comprehensive index from supervision, incentive, and decision-making to measure corporate governance level (Gov). Managers' payment (Mana_Pay) and the ratio of managers' share (Mana_Share) are selected to express the incentive mechanism in corporate governance. The ratio of an independent board of directors (Outratio) and board size (Board) is used to express the supervisory role of the board of directors. The ratio of institutional share (Inst_Share) and share balance degree, that is, the shareholding ratios sum of two to five major shareholders/the shareholding ratio of controlling shareholders (Share_Balance) are used to express the supervisory role of ownership structure. Besides, whether the chairman and general manager are in one (Dul) is used to express the decision-making power of the general manager. Based on the above seven indicators, the corporate governance index is constructed by principal component analysis. Taking the first principal component obtained from principal component analysis as a comprehensive index reflecting corporate governance level, we get the variable corporate governance level (Gov). The greater the Gov, the better the corporate governance level.

2.2.2 Enterprise ESG Disclosure Index

ESG Disclosure Index reflects the detailed degree of ESG disclosure of enterprises, which is scored by Bloomberg according to ESG data disclosed by enterprises. According to 100 of the 219 original data points collected as required by GRI (Global Reporting Initiative), the data points were weighted according to their importance. The ESG disclosure score was finally determined to range from 0.1 (the minimum number of data disclosed) to 100 (each data point disclosed). Meanwhile, due to the different ESG characteristics and risk challenges of different industries, each company only evaluates according to the data related to its industry, so the index is also applicable to various industries.

ESG data include three categories: (1) Environmental aspects, such as water consumption, total waste generation, total greenhouse gases, and energy use. (2) Social aspects, such as employee mobility, labor accidents, the total number of deaths, and women in the labor force. (3) Corporate governance, including the attendance rate of board meetings and independent directors.

2.2.3 Control Variables

Referring to the existing research, this paper controls the factors that may affect the stock prices crash, such as the size of the board of directors and the asset-liability ratio. Table 1 can be seen for the definition of specific variables.

Table 1 Variable Definitions

Variable Type	Variable Name	Symbol	Index Interpretation
Explained variable	ESG information disclosure index	$ESG_{i,t}$	Detailed level of ESG disclosure
Explanatory variable	Corporate governance level index	Gov	As mentioned above
Control variable	CEO duality	BOTH	If the chairman and CEO are the same people, the value is 1; otherwise, it is 0
	Board size	BOARD	Natural logarithm of the number of directors
	Asset-liability ratio	LEV	Total liabilities/assets of the company at the end of the period
	Return on assets	ROA	Company net profit/total assets at the end of the period
	Property right nature	STATE	State-owned enterprises are recorded as 1; otherwise, it is 0
	Year	Years	Control year fixed effect
	Company	Firm	Control firm fixed effect

2.3 Test Model

To test the hypothesis, this paper establishes the following OLS model:

$$ESG_{i,t} = \beta_0 + \beta_1 Govi,t + Controls_{i,t} + \sum Years + \sum INDUSTRY + \varepsilon_{i,t} \quad (1)$$

$ESG_{i,t}$ is the ESG disclosure index of the company i in phase t, anGov is the corporate governance of the company i in phase t. $Controls_{i,t}$ is the control variable affecting company i in phase t as shown in Table 1 for details. In the regression of this paper, both annual and industry fixed effects are controlled.

3. Experimental Results

3.1 Descriptive Statistics

Table 2 is the descriptive statistical result of the main variables in this paper. The average value of the ESG disclosure index is 19.98, with 1.24 and 61.72 as the minimum and maximum respectively, indicating that China's ESG disclosure is relatively good on the whole. The standard deviation of the ESG disclosure index is 6.37, which indicates that there are some differences in ESG disclosure among various enterprises in China. The mean value of GOV is 0.42, with -3.2, 2.99, and 0.94 as the minimum, maximum, and standard deviation respectively. Given differences in corporate governance level, various financial and board indicators of sample enterprises are different.

Table 3 shows the covariance between the variables in Model (1). It can be found that the covariance between the control variables is less than 0.5, which manifests that the correlation between the control variables is not obvious and the multicollinearity is not serious.

Table 2 Descriptive Statistics

	count	mean	sd	min	max
ESG	6888	19.98	6.37	1.24	61.72
GOV	6888	0.42	0.94	-3.20	2.99
SIZE	6888	22.91	1.30	19.45	28.51
LEV	6888	0.46	0.20	0.01	1.35
ROA	6888	0.05	0.07	-1.07	0.59
BOARD	6888	2.18	0.21	1.10	2.89
BOTH	6888	0.20	0.40	0.00	1.00
SR	6888	0.09	0.19	0.00	5.91
STATE	6888	0.51	0.50	0.00	1.00
N	6888				

Table 3: Correlation Analysis

ESG	GOV	SIZE	LEV	ROA	BOARD	BOTH	SR	STATE
ESG	1							
GOV	0.238***	1						
SIZE	0.440***	0.414***	1					
LEV	0.171***	0.257***	0.500***	1				
ROA	-0.036***	-0.033***	-0.066***	-0.415***	1			
BOARD	0.108***	0.653***	0.228***	0.137***	-0.032***	1		
BOTH	-0.099***	-0.507***	-0.138***	-0.105***	0.061***	-0.188***	1	
SR	-0.163***	-0.634***	-0.286***	-0.263***	0.171***	-0.188***	0.223***	1
STATE	0.209***	0.513***	0.334***	0.267***	-0.159***	0.283***	-0.304***	0.451***

3.2 Corporate Governance Level and ESG Information Disclosure

Table 4 reports the estimated results of the baseline model (1). Columns (1)-(2) show that the GOV index is positively correlated with the ESG disclosure index, with a significance level of 1% and estimation coefficients of 1.456 and 0.636 respectively. Therefore, the above empirical results prove that the improvement of corporate governance level is positively related to ESG disclosure.

Good quality and consistent ESG disclosure are vital for companies to benefit from implementing ESG practices (Wen et al., 2022). Enterprises with good corporate governance are more inclined to actively disclose ESG information. A good corporate governance structure means a clear responsibility and power distribution mechanism, an efficient decision-making process, and an effective internal control system. This structure can make enterprise management pay more attention to ESG and incorporate it into enterprise strategy and decision-making. Thus, such enterprises are more likely to actively disclose ESG-related information to show their performance in the environment, society, and governance. In addition, enterprises with high levels of corporate governance tend to follow high standards of ethics and laws in information disclosure, which can reduce the possibility of information distortion and manipulation, making it more transparent and reliable. Besides, transparency is one of the core elements of ESG disclosure. Investors pay attention to improving ESG performance by boosting information transparency and easing financing constraints (Xi. Et al., 2023). It is easier for such enterprises to convey their ESG performance and achievements to the world, and increase the confidence of investors and stakeholders in their sustainable development strategies. The improvement of corporate governance can also promote the internal information circulation and communication mechanism, and further enhance the ESG disclosure. When effective information transmission and communication channels exist within the enterprise, the information about ESG issues can be better captured, integrated, and transmitted to decision-makers and relevant departments. The process improvement is helpful to improve the accuracy and completeness of ESG disclosure.

Table 4 Baseline Regression Results

	(1) ESG	(2) ESG
GOV	1.456***	0.636***
	(0.080)	(0.165)
SIZE		1.990***
		(0.069)
LEV		-2.497***
		(0.459)
ROA		-2.201*
		(1.175)
BOARD		-1.310***
		(0.504)
BOTH		0.032
		(0.209)
SR		0.971*
		(0.549)
STATE		1.098***
		(0.168)
_cons	19.362***	-22.430***
	(0.079)	(1.835)
N	6888.000	6888.000
r2	0.136	0.250

Standard errors in parentheses * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

4. Conclusion

Sustainable development, as a global challenge, has become more crucial in the economic society. With the increasing attention of enterprises, investors, and the government to sustainable development, ESG has also been widely valued. Historical research has shown that ESG disclosure not only reflects the practice of corporate social responsibility, but also has far-reaching influence and value on the company itself. From the perspective of corporate governance, this study discusses the influencing factors of ESG disclosure and selects Chinese listed companies as research samples to investigate the relationship between corporate governance and ESG disclosure in detail. According to empirical results, the corporate governance of Chinese listed companies has a significant impact on the level of ESG disclosure. Through the regression of the lag term, the robustness test is implemented and the conclusion is consistent with it. Heterogeneity analysis further reveals that the influence of corporate governance on ESG disclosure of listed companies is related to the nature of enterprises. Specifically, for companies with the same corporate governance level, the ESG disclosure of state-owned enterprises is usually better than that of non-state-owned ones.

Enriching the research of influencing factors of ESG disclosure, this study expands the understanding of the impact results of corporate governance. Based on the background of developing countries, this study discusses how corporate governance promotes the practice of ESG strategy, which provides enlightenment for optimizing corporate governance and improving sustainable development. A certain reference value is also provided for policymakers in formulating environmental rules. The research on ESG is in progress, and the research on ESG disclosure level will be further deepened. Future research can comprehensively explore its influencing factors from more non-institutional perspectives. Meanwhile, it can also conduct detailed research on specific governance aspects based on corporate governance to further explore the impact on ESG disclosure.

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