“Solving the choice puzzle: Financial and non-financial stakeholders preferences in corporate disclosures”

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SOLVING THE CHOICE PUZZLE: FINANCIAL AND NON-FINANCIAL STAKEHOLDERS PREFERENCES IN CORPORATE DISCLOSURES

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Abstract

The paper delves into the relationship between accounting conservatism, valued by financial stakeholders, and corporate social performance (CSP), esteemed by non-financial stakeholders. This study assesses the potential impact of financial reporting practices, specifically accounting conservatism, on a firm's CSP activities, which has significant implications for diverse stakeholders. Employing an accrual-based proxy for accounting conservatism and the social contribution value per share from the Shanghai Stock Exchange as a proxy for CSP, the study utilizes a sample of 25,490 year-company observations of A-share listed companies on China's Shanghai and Shenzhen stock exchanges spanning from 2008 to 2019. Empirical findings indicate a negative correlation between accounting conservatism and CSP. The study suggests that higher levels of social performance are associated with reduced conservatism in financial reporting, indicating that firms prioritize CSP over the interests of financial stakeholders by adopting less conservative financial reporting policies. Aligned with agency theory, these results underscore that socially responsible firms are less inclined to employ accounting conservatism in reporting earnings. This study establishes a connection between firms' unconventional and less traditional activities, such as CSP, and conservative financial reporting, offering valuable insights for investors, analysts, and regulators.

Keywords accounting conservatism, corporate social responsibility, corporate social performance, earnings quality, China

JEL Classification G34, M14, M41

INTRODUCTION

Conservatism is among the key characteristics of financial accounting which has long been considered a major indicator of quality in financial reports and has impacted accounting practices for centuries (Basu, 1997; Cheng & Kung, 2016; Watts, 2003a). Conservatism implies "the asymmetrical verification requirements for gains and losses: the greater the difference in the degree of verification required for gains versus losses, the greater the conservatism" (Watts, 2003a, p. 208). Conservatism is associated with the contracting role of accounting (Cheng & Kung, 2016) and is instrumental in lessening the information asymmetry among stakeholders and mitigating agency problem (Ahmed & Duellman, 2007, 2011; Elshandidy & Hassanein, 2014; Pasko, Chen, Birchenko, et al., 2021; Watts, 2003a; Xia & Zhu, 2009) thereby contributing to more efficient financing and investment activities of firms (Cheng & Kung, 2016). The extant literature has made a valuable contribution through studying the effects of external auditing quality (Abdalwahab & ALkabbji, 2020; Pasko, Balla, Levytska, & Semenyshena, 2021), corporate governance attributes (Ahmed & Duellman, 2007; Elshandidy & Hassanein, 2014; Pasko et al., 2022), firm investment efficiency (García Lara et al., 2016), and share repurchases (Lobo et al., 2020) on the level of conservative reporting. Few studies so far (Anagnostopoulou et al., 2020; Burke et al.,

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2020; Cheng & Kung, 2016; Guo et al., 2020), however, examined whether stakeholder orientation of firms determined through their CSR activity manifested in dissimilar levels of the accounting conservatism compared with firms where CSR is in its infancy. Is the level of accounting conservatism influenced by the Chinese firm's efforts to strengthen its bonds with stakeholders through corporate social responsibility (CSR) activity? It is the question this paper seeks to find an explanation to, and, thus, contributing to this bourgeoning strain of literature through expanding its borders into China.

Thus, from the perspective of stakeholder theory, a positive association should be expected, whereas the agency perspective assumes a reverse association between a firm's enhanced commitment to stakeholders and accounting conservatism. Therefore, the interrelationship between corporate endeavor on stakeholder relations and accounting conservatism is an issue that belongs to the empirical realm and should be treated accordingly. The bulk of extant studies give credence to the argument that managers in CSR active firms have a propensity for discipline in the provision of high-quality earnings information, both related to conservatism and earnings management (Almahrog et al., 2018; Anagnostopoulou et al., 2020; Chen & Hung, 2021; Cheng & Kung, 2016; Choi et al., 2013; Guo et al., 2020; Makarenko et al., 2020; Martinez-Martinez et al., 2021; Sokil et al., 2020). Thus, examining the relationship between CSR and accounting conservatism could lead to useful findings and guide companies in the assessment of how sincere are firms about their stakeholders' involvement in CSR activities. Despite its merits, this strain of research is currently poorly presented in peer-reviewed literature. Moreover, to the best of the authors' knowledge, this study is the first investigating this relation on Chinese data covering the last decade, the jurisdiction deemed to be the world's largest economy by GDP measured through PPP (purchasing power parity) as opposed to more conventional MER (market exchange rates) (Allison, 2020).

1. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The extant literature put forward two competing perspectives claiming two opposed to each other outcomes. The relationship between accounting conservatism and corporate social performance, viewed from the perspectives of stakeholder theory, presupposes a positive association, because enhanced stakeholders' engagement is expected to lead to the adoption of stakeholder perspectives in the financial reporting realm as well. Alternatively, agency theory presupposes a negative association contending that CSR activities are used as a disguise for others repugnant for stakeholders' activities. Following the discussion, this paper employs those theories and arguments utilized by the extant literature to establish two competing hypotheses on the association between CSP and accounting conservatism.

1.1. 'Responsible' view/stakeholder theory

Preceding studies indicate that accounting conservatism fosters the exercise of caution in the recognition of income and assets and thus, might decrease the risk that the firm's financial prospects are exaggerated. Beaver and Ryan (2000) show that the "bias" component (incorporating conservatism as part of it) is instrumental in understating the book value of equity compared to the market value of equity and leading to a lower book-to-market ratio. Comparably, Givoly and Hayn (2000) testify that the last decade of the 20^{th} century has witnessed the patterns with an increase in conservative financial reporting over time (p. 287) and that conservative reports reduce the risk that a firm's accounting-based measure of performance considerably outstrips its cash flows from operations.

The next argument is related to the fact that a wide array of stakeholders can benefit from conservatism in financial reporting. Watts (2003a, 2003b) demonstrates that accounting conservatism restrains opportunistic behavior and improves contracting efficiency within the firm. Considering that stakeholders bear substantial downside risk from overstated accounting information, "conservatism provides stakeholders with risk protection by reporting a verifiable lower bound of the firm's net assets and earnings" (Guo et al., 2020).

In line with this argument Zhang (2008) illustrates the contracting benefits of accounting conservatism in the debt contracting process by helping lenders to assess net assets and presage more timely signals of default risk. LaFond and Watts (2008) show that conservatism lessens the manager's incentives and ability to manipulate accounting numbers and so "reduces information asymmetry and the deadweight losses that information asymmetry generates" (LaFond & Watts, 2008, p. 447). Moreover, conservatism is a natural response to a growing level of information asymmetry as "conservatism increases following increases in information asymmetries" (LaFond & Watts, 2008, p. 476). Furthermore, Biddle et al. (2020), exploring U.S. listed firms, find that unconditional and conditional accounting conservatism assists in lowering the bankruptcy risk via cash enhancement and earnings management mitigation channels.

In general, conservative financial reporting contributes to the advancement of the interests of a firm's financial stakeholders, as this position lowers information asymmetry between insiders and outsiders, furthers aligning the interests of management and debt and equity capital providers, alleviates agency issues, assists in balancing managerial remuneration and compensation costs, and strengthens investment efficiency (Anagnostopoulou et al., 2020; Francis et al., 2013).

Previous studies on CSR offer a theoretical backdrop that integrates ethical expectations of business into a rational economic and legal framework (Anagnostopoulou et al., 2020; Carroll, 1979; Garriga & Melé, 2004a; Jones, 1995; Kim et al., 2012; Pasko, Marenych, et al., 2021). In particular, Carroll (1979) puts forward a model that outlines a firm's social obligations, in particular economic, legal, ethical, and discretionary responsibilities, while Jones (1995) formulates a theoretical framework that unifies economic theory and business ethics. Garriga & Melé (2004a) undertook "mapping the territory" by classifying the main CSR theories into four groups: (1) instrumental theories (the corporation is seen as only an instrument for wealth creation); (2) political theories (power of corporations in society and the political arena); (3) integrative theories (the corporation is focused on the satisfaction of social demands); and (4) ethical theories (based on ethical responsibilities of corporations to society). Those ethical, political, integrative, and instrumental theories on CSR imply that managers have incentives to be sincere and honest, trustworthy, and ethical as well as observe high standards of behavior in their business processes (Anagnostopoulou et al., 2020; Garriga & Melé, 2004a; Kim et al., 2012). In this context, the ethical view on CSR anticipates that managers are incentivized to 'do the right thing', as it is advantageous to the firm (Carroll, 1979; Garriga & Melé, 2004b; Jones, 1995; Kim et al., 2012).

A firm's CSR orientation and enhanced stakeholders' engagement are in line with a managerial determination to be involved in practices beneficial to a panoply of various stakeholder groups, and not just capital providers, for which evident advantages of conservative accounting reporting have been collected (Anagnostopoulou et al., 2020; Kim et al., 2012). Commitment to the principles of conservatism as opposed to aggressiveness in financial reporting means that the firm is financially responsible to financial stakeholders, mainly capital providers. As Atkins (2006) argues, being "socially responsible" by the investing and consuming public means to be transparent in firms' financial reporting and adds that corporate social responsibility actually "refers largely to what the company does not do". Moreover, Guo et al. (2020) suggest that corporate social responsibility is an important channel through which stakeholders influence the corporate selection of conservative reporting practices. Francis et al. (2013, p. 211) draw our attention to another positive interaction between accounting conservatism and CSR arguing that "conservative accounting is a mechanism that increases organizational slack, some of which can be invested in activities aimed at maintaining the support of stakeholders other than stockholders".

Thus, in line with the arguments presented above, a corresponding enhanced level of social responsibility could be expected from financially responsible firms. Accordingly, to the extent of financial responsibility manifested in a firm's accounting conservatism in financial reporting, we can also expect a corresponding level of commitment and ethical behavior to all stakeholders, not just financial, which gives grounds to two conflicting views (theories) on these relationships:

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1.2. 'Private benefits', 'Window-dressing' view/Agency theory

Alternatively, CSR orientation and stakeholder engagement can be coupled with the pursuit of a manager's self-interest (Anagnostopoulou et al., 2020; Kim et al., 2012; Park, 2021). A manager may engage in CSR activities to disguise, for example, the consequences of corporate misconduct. If management is drawn into CSR practices by opportunistic incentives, then they are predisposed to deceive and misguide stakeholders as to the value of a firm and the firm's financial performance. If these incentives prevail, then we are likely would establish a negative association between CSR and financial reporting conservatism. Therefore, firms that undertake stakeholder engagement aiming to mask their self-serving policies would be less likely to report accounting information conservatively, thereby getting an information edge over their stakeholders (Anagnostopoulou et al., 2020; Francis et al., 2013; Guo et al., 2020).

The arguments of how firm stakeholder engagement is linked to preserving shareholder wealth have gained traction in the last decades as the debate transformed from undeniable shareholder wealth supremacy to incorporating the interests of wider stakeholders. Some authors contend that agency problems between owners and managers are exacerbated in a case when managers operate for the good of stakeholders other than shareholders (Goss & Roberts, 2011; Pasko, Zhang, et al., 2021; Tirole, 2001). Thus, CSR investments could be regarded as "a costly diversion of scarce resources. If the diversion occurs at the behest of shareholders, a firm can be viewed as a delegated philanthropic agent" (Goss & Roberts, 2011, p. 1794). Many recent studies have indeed found a loose connection between CSR and shareholder value. Lu et al. (2021), in the sample from China, found that the effects of the mandatory CSR reporting on profitability and shareholder value are negative. Bae et al. (2021) found that "pre-crisis CSR is not effective at shielding shareholder wealth from the adverse effects of a crisis, suggesting a potential disconnect between firms' CSR orientation (ratings) and actual actions". Bae et al. (2021) give valuable advice to investors to distinguish between genuine CSR and firms engaging better through cheap talk.

Therefore, in this regard it is worth mentioning CSR decoupling which refers to the gap between CSR disclosure and CSR performance (García-Sánchez et al., 2021; Basu, 1997; Che 2021; Tashman et al., 2019). CSR decoupling is a propensity on part of firms to engage in symbolic CSR reporting in ways that do not correspond with their actual CSR performance (Tashman et al., 2019). CSR decoupling is believed to assist managers in achieving opportunistic objectives and can harm a firm (Anagnostopoulou et al., 2020; García-Sánchez et al., 2021; Ikram et al., 2020; Tashman et al., 2019). In line with 'window-dressing' view on CSR one may assume that CSR is utilized as a cover-up of various corporate misconduct, thus "CSR is expected to work as a form of reputation insurance, giving managers a 'license to operate' in ways that damage shareholders" (Kim et al., 2012, p. 766).

Moreover, managers are believed to make a kind of cost/benefits analysis that best suits their interest: accounting conservatism or CSR (Anagnostopoulou et al., 2020; Guo et al., 2020). Indeed, both of these activities can be costly for managers because accounting conservatism limits the level of compensation, usually tied to the level of profitability of the firm, and CSR, in turn, also requires additional investments, which often are strategic and which have a time lag to take the effect, and this, in turn, does not coincide with the short-term approach of managers (Anagnostopoulou et al., 2020). Therefore, "strong engagement in CSR may be expected to act as window-dressing in cases where the management does not wish to incur the costs entailed in accounting conservatism" (Anagnostopoulou et al., 2020). Thus, CSR is a calculated choice by the manager who selects a lesser from two evils (from his/her private point of view).

Another contributing factor leading to 'private benefit', or 'window-dressing' outcome of CSR activities is multiple managerial objectives originating from various stakeholders' claims first put forward by Jensen (2001). Multiple objective hypothesis signifies that there is no objective, as managers cannot be held accountable because of the trade-offs among these objectives (Anagnostopoulou et al., 2020; Chih et al., 2008). The dilemma managers face is 'how to choose among multiple constituencies with competing and, in some cases, conflicting interests' (Jensen, 2001, p. 13) and thus, managers inevitably are going to make "the optimal tradeoffs among multiple constituencies (or stakeholders)" (Jensen, 2001, p. 12). Multiple objective hypothesis contends that in an effort to serve "many masters" (shareholders, financial claimants, employees, customers, local communities, governmental officials, authority and so on), rather than pursuing the single objective of value maximization, "managers are left unaccountable for the stewardship of the firm's resources" (Chih et al., 2008, p. 182). Therefore, because of the lack of clear criteria on which to assess their performance, managers cannot be appraised in any principled way (Anagnostopoulou et al., 2020; Chih et al., 2008; Gargouri et al., 2010). By dint of these multiple criteria, managers can redirect the firm's resources to pursue their interests, while sacrificing the interest of other stakeholders (Chih et al., 2008; Gargouri et al., 2010).

Furthermore, according to Leuz et al. (2003), those diversion activities related to the redirection of resources often manifest themselves in accounting earnings. Given that if caught self-serving insiders could be exposed to the risk of strong legal and other disciplinary actions by outside investors, insiders are incentivized to conceal the firm's genuine economic performance seeking to reduce the likelihood of outsider interference. Thus, acknowledging the line of argument put by Jensen (2001) and Leuz et al. (2003), CSR may as well worsen agency problems, thereby incentivizing insiders to lower accounting conservatism in financial reporting to camouflage their rent-seeking activities from outsiders.

Considering the foregoing, to assess the firms' commitment to stakeholders by their deeds embodied in the relevant financial reporting practices this study sets to investigate the association between accounting conservatism, measured as the asymmetric timeliness of recognition of economic gains and losses and corporate social performance (CSP).

Therefore, in compliance with the discussion above, the paper develops this hypothesis:

Hypothesis A: Corporate social performance is positively related to accounting conservatism.

2. RESEARCH DESIGN

2.1. Sample selection and data sources

The data in this paper comes from the China Stock Market & Accounting Research (CSMAR) database. The sample consists of A-share listed companies in China's Shanghai and Shenzhen stock exchanges from 2008 to 2019. Drawing lessons from previous research papers, this article deals with the samples as follows: (1) Remove financial and insurance samples; (2) Remove ST, *ST and other financial abnormal samples; and (3) Remove samples with missing variable data. Finally, 25,490 year-company observations were obtained. Table 1 shows the annual distribution of sample companies.

Table 1. Sample selection procedure, year-company observations

Sample Selection Process	No. of Observations
Initial firm-year sample from 2008 to 2019	32,265
Less: Observations that are financial firms	(908)
Less: Observations that are ST, *ST, and PT companies	(2,372)
Less: Observations with missing values for variables	(3,495)
Final samples	25,490

Note: ST, *ST, and PT denote Special Treatment and Particular Treatment companies.

2.2. Variable definition

Dependent variable: Measurement of corporate social performance (CSP). This paper selects the social contribution value per share (SCVPS) featured in the "Notice on Strengthening the Social Responsibility of Listed Companies and Issuing the "Guidelines for Environmental Information Disclosure of Listed Companies on the Shanghai Stock Exchange" issued by the Shanghai Stock Exchange in May 2008 to measure corporate social responsibility performance (Shanghai Stock Exchange, 2008). SCVPS has many merits related to its simplicity and at the same time accuracy in assessing the phenomenon (Noronha et al., 2018; Zhang et al., 2020). SCVPS uses data from the annual financial reports and can reflect the social contribution made by the firm to its various stakeholders (Zhang et al., 2020). Furthermore, SCVPS can be used by industry peers to benchmark their so-

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cial performance and it is entirely reliant on the performance of firms and is not affected by market sentiments (Zhang et al., 2020), although SCVPS is informative to market (Noronha et al., 2018). Moreover, SCVPS is "balanced and powerful in a way that it condenses a great deal of crucial information into a single number" (Zhang et al., 2020). The SCVPS specific calculation formula is:

$$SCVPS = \left(NP + ITE + BTS + CPE + EC - \right. \\ \left. -ESP + FE + DONA\right) / \left(NS_{End} - NS_{Start}\right) \quad (1)$$

where *SCVPS* is social contribution value per share, *NP* is net profit, *ITE* is income tax expense, *BTS* is business tax and surcharges, *CPE* is cash paid to and for employees, *EC* is employee compensation payable, *ESP* is employee salary payable in the previous year, *FE* is financial expenses, *DONA* is donation, NS_{End} is the number of shares at the end of this year, and NS_{Start} is the number of shares at the start of this year.

SCVPS considers a firms' responsibilities and values created for manifold stakeholders (Table 2).

Independent variable: Accounting conservatism. This paper refers to the method of Ahmed and Duellman (2007) and Givoly and Hayn (2000) to reflect the accounting accruals in the following period. Accounting conservatism results in negative accruals, since the higher the negatives, the higher the level of conservative accounting in corporate financial reporting. Therefore, the accounting conservatism method is:

$$Accruals = \frac{EBEXTit + DEPit - OCFit}{TA}, \quad (2)$$

$$CONACC = Accruals \cdot (-1), \quad (3)$$

where *CONACC* – accounting conservatism based on the accrual-based measure of conservatism for firm *i* in year *t*; *EBEXT* – income before tax and extraordinary items; *DEP* – depreciation charge for the year; *OCF* – operating cash flow; and *TA* – total assets.

Grouping adjustment variables. This paper uses the nature of the actual controller of a company to measure the nature of its equity that is, set the nature of equity grouping dummy variable (STATE). If the actual control of the sample company is state-owned, the value of this variable is 1, otherwise, it is 0. This paper uses the Herfindahl-Hirschman Index as well to measure corporate equity concentration. The mean of HHI10 (the sum of the squares of the top ten largest shareholders' shareholding ratios) is used to group and regress the samples.

Control variables. This paper controls for various factors that may affect a firm's accounting conservatism identified by the previous literature. The definition and measurement of these control variables are shown in Appendix A2.

2.3. Model construction

This study tests the relationship between accounting conservatism and corporate social performance to estimate the following empirical model (4):

$$CSR_{i,t} = \beta_0 + \beta_1 CONACC_{i,t} + \beta_2 SIZE_{i,t} + \\ +\beta_3 TOBINQ_{i.t} + \beta_4 LEV_{i,t} + \beta_5 GROWTH_{i,t} + \\ +\beta_6 LOSS_{i,t} + \beta_7 CFO_{i,t} + \sum YEAR + \\ +\sum INDUSTRY + \varepsilon_{i,t}. \quad (4)$$

In model (4), the independent variable 〖CSR〗_(i,t) is SCVPS of company *i* in year *t*; the explanatory variable 〖CONACC〗_(i,t) is the accounting conservatism level of company *i* in year *t*, and the remaining variables are the control variables of the model.

Table 2. Linkage between components of SCVPS and components of stakeholder theory

Source: Zhang et al. (2020).

Components of SCVPS	Components of stakeholder theory
Earnings per share (EPS)	Shareholders
Taxes contributed to the country	Government
Salaries and various bonuses paid to employees	Employees
Interests paid to creditors	Creditors
Donations for the public good	Community
Social cost	Environment and community

3. RESULTS

3.1. Descriptive statistics

Table 3 shows the descriptive statistical results of the main variables.

Table 3. Descriptive statistics

Variables	(1) N	(2) mean	(3) sd	(4) min	(5) p50	(6) max
CONACC	25,490	–0.295	0.271	–0.901	–0.291	0.426
CSR	25,490	1.280	1.162	–0.639	0.984	6.385
SIZE	25,490	22.13	1.294	19.67	21.952	26.10
TOBINQ	25,490	2.472	1.730	0.865	1.912	10.60
LEV	25,490	0.439	0.209	0.0535	0.433	0.925
GROWTH	25,490	0.194	0.469	–0.564	0.113	3.188
LOSS	25,490	0.0903	0.287	0	0	1
CFO	25,490	0.213	0.409	0	0	1

It can be found from Table 3 that the mean and the 50th percentile of corporate social responsibility performance (CSR) are 1.280 and 0.984, respectively. The mean of accounting conservatism (CONACC) is –0.295, the 50th percentile is –0.291, which is far from the maximum of 0.426. This shows that the sample does include a small number of companies with high accounting conservatism, but for most companies, such a high level of conservatism is not the normal situation. In addition, in terms of control variables, the mean value of company size (SIZE) is 22.13, and the 50th percentile is 21.952, which shows that the size of the sample firm conforms to the normal distribution. The average value of the asset-liability ratio (LEV) is 0.439, and the 50th percentile is 0.433.

3.2. Correlation analysis

Table 4 presents the analysis of the result of the correlation coefficient of the main variables. From Table 4, accounting conservatism (CONACC) is negatively correlated with corporate social responsibility performance (CSR), but this is only a correlation analysis between the two variables and no other control variables are added. Therefore, further regression analysis is needed to test the relationship between variables. In addition, there is a significant correlation between control variables and corporate social responsibility performance (CSR). The correlation coefficients between the variables in the table are basically below 0.7, and the VIF values are all less than 3, which indicates that there is no serious multicollinearity problem between the variables.

3.3. Regression analysis

3.3.1. Accounting conservatism and corporate social performance

This paper uses model (3) to test the relationship between corporate social responsibility performance and accounting conservatism in the full sample of companies. The data in this paper are panel data. A reasonable estimation model was selected through the Wald test and Hausman test, and the test results support the use of the fixed-effect model. The regression results of the model are shown in column (1) of Table 5. From the regression results, the estimated coefficient of accounting conservatism (CONACC) is significantly negative (–0.049, $p < 0.01$), which indicates that there is a negative correlation between accounting conservatism and social responsibility performance.

In addition, the regression results in Table 5 also show that the regression results of the con-

Table 4. Correlation analysis

Variables	CONACC	CSR	SIZE	TOBINQ	LEV	GROWTH	LOSS	CFO
CONACC	1							
CSR	–0.110***	1						
SIZE	0.301***	0.376***	1					
TOBINQ	–0.305***	–0.082***	–0.471***	1				
LEV	0.682***	0.132***	0.459***	–0.331***	1			
GROWTH	–0.062***	0.175***	0.039***	0.076***	0.040***	1		
LOSS	0.334***	–0.298***	–0.069***	–0.00400	0.190***	–0.159***	1	
CFO	–0.013**	–0.144***	–0.066***	–0.00700	0.116***	0.016**	0.137***	1

Note: ***, **, and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

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Table 5. Accounting conservatism and corporate social performance

Variables	(1)	(2)	(3)	(4)	(5)
	CONACC	STATE=1	STATE=0	HHI10>=mean	HHI10<mean
CSR	−0.049***	−0.037***	−0.058***	−0.040***	−0.060***
	(−22.01)	(−17.16)	(−20.67)	(−17.74)	(−19.64)
SIZE	−0.005	−0.013***	−0.003	−0.008*	0.008
	(−1.13)	(−2.69)	(−0.52)	(−1.88)	(1.54)
TOBINQ	−0.009***	−0.010***	−0.010***	−0.009***	−0.007***
	(−5.39)	(−5.89)	(−5.32)	(−4.79)	(−4.55)
LEV	0.917***	0.864***	0.928***	0.956***	0.891***
	(62.56)	(44.16)	(50.05)	(46.59)	(56.95)
GROWTH	−0.002	−0.003	0.000	0.003	−0.003
	(−1.11)	(−1.08)	(0.15)	(0.90)	(−1.12)
LOSS	0.106***	0.094***	0.112***	0.087***	0.104***
	(20.47)	(18.95)	(19.37)	(13.37)	(20.97)
CFO	−0.020***	−0.016***	−0.019***	−0.015***	−0.021***
	(−6.35)	(−4.66)	(−4.63)	(−4.03)	(−6.73)
INDUSTRY	YES	YES	YES	YES	YES
YEAR	YES	YES	YES	YES	YES
Constant	−0.472***	−0.258**	−0.511***	−0.428***	−0.770***
	(−5.25)	(−2.44)	(−3.67)	(−4.06)	(−6.78)
Observations	25,490	10,723	14,767	10,305	15,185
R-squared	0.564	0.520	0.600	0.560	0.560
Number of id	3,289	1,165	2,331	1,822	2,315
Company FE	YES	YES	YES	YES	YES
F test	0	0	0	0	0
r2_a	0.562	0.516	0.597	0.557	
F	617.1	374.9	551.3	2733	

Note: t-statistics in parentheses; ***, **, and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

trol variables are consistent with the results of the correlation analysis in the previous table. The company size (Size) is negatively (–0.005), although not statistically significant association which indicates that company size plays no major role in the shaping of corporate image through fulfilling corporate social responsibility. The coefficient of company value (TOBINQ) is negative (–0.009, $p < 0.01$), which means that companies with high company values tend to assume less social responsibilities.

When the asset-liability ratio (LEV) is high (0.917, $p < 0.01$), companies tend to perform corporate social responsibility. Moreover, in case of depleting resource base, companies are curtailing their social activity: When a company reports a loss that year, the company is more inclined to fail to perform corporate social responsibility (0.106, $p < 0.01$), and the same is related to the case when the operating cash flow for the year is negative (–0.020, $p<0.01$).

3.3.2. The impact of the nature of equity

Columns (2) and (3) of Table 5 report the test results on the nature of equity. Grouped samples of the nature of equity to perform regression analysis on the model (3) are used to verify whether there is a difference in the negative correlation between accounting conservatism and social responsibility performance. Among them, column (2) is the regression result of the sub-sample of SOEs: the estimated coefficient of CONACC is negative at 1% and significant. Column (3) is the sample regression situation of non-state-owned companies. The estimated coefficient of 1% of CONACC is significantly negative, which shows that there is a significant negative correlation between AC and CSP in the sample of state-owned and non-state-owned companies. Therefore, there is no difference in the significance of the negative correlation between accounting conservatism and corporate social responsibility when the nature of equity is different, and the social responsibilities of state-owned and non-state-owned companies are easily affected by the level of accounting conservatism.

3.3.3. Influence of ownership concentration

Columns (4) and (5) of Table 5 report the test results of the ownership concentration. The paper uses the average value of the equity concentration index HHI10 to group the samples and use the above-grouped samples to perform regression analysis on the model (3) to verify whether there is a difference in the relationship between AC and CSP under different equity structures. Among them, column (4) is the sample regression in a situation where the concentration of equity is higher than the average value. The estimated coefficient of CONACC is negative and significant (–0.040, $p < 0.01$). This shows that the negative correlation between accounting conservatism and corporate social responsibility has a significant negative correlation in the sample companies with concentrated equity. Column (5) is the sample regression in a situation where the equity concentration is lower than the mean value. The estimated coefficient of CONACC is significantly negative (–0.060, $p < 0.01$), which shows that there is a significant negative correlation between AC and CSP in the sample companies with relatively dispersed equity. Therefore, there is no significant difference in the negative correlation between AC and CSP in the case of different equity concentrations, and corporate social responsibility is easily affected by the level of accounting conservatism.

3.4. Robustness test

This paper inspects the robustness of its main results resorting to a host of alternative specifications and covariates and report relevant results in table 8. In this subsection, this paper uses an OLS model to replace the fixed effects model in column (1) (Table 6). This study alternatively uses CSR substantivizing data that come from the website of HEXUN (CSRH) including shareholder responsibility, employee responsibility, supplier, customer and consumer responsibility, environmental responsibility, and social responsibility in column (2). The paper finds that study's basic conclusion is unchanged from the results reported in Appendix A3.

Table 6. Effect of CSR performance on accounting conservatism of firms – robustness control I

Variables	(1)	(2)
	OLS	CONACC
CSR	–0.039***	
	(–23.23)	
CSRH		–0.002***
		(–5.56)
SIZE	–0.000	–0.006**
	(–0.10)	(–2.37)
TOBINQ	–0.015***	–0.018***
	(–9.19)	(–8.35)
LEV	0.887***	0.852***
	(42.15)	(34.02)
GROWTH	–0.006	–0.013***
	(–1.48)	(–3.43)
LOSS	0.143***	0.149***
	(22.12)	(21.37)
CFO	–0.044***	–0.036***
	(–11.89)	(–9.58)
INDUSTRY	YES	YES
YEAR	YES	YES
Constant	–0.561***	–0.457***
	(–14.08)	(–10.06)
Observations	25,490	22,821
R–squared	0.668	0.654

Note: t-statistics in parentheses; ***, **, and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

Secondly, as in the previous test, this paper uses the mean group regression of HHI10, here study further uses the mean group regression of HHI1, HHI3, and HHI5 (the sum of the squares of the shareholding ratios of the first largest shareholder, the top 3 and the top 5 largest shareholders) to repeat the regression. The empirical results (see Appendix A3) indicate that the negative relationship between CSR performance and accounting conservatism is more significant in the sample group with dispersed ownership.

In addition, to exclude potential endogeneity bias, lagged regression models are used to provide more reliable inferences in Appendix A4. The independent variable lag by one period in column (1), the independent variable lag by two periods in column (2), the independent and control variables lag by one period in column (3), and the independent and control variables lag by two periods in column (4). These are consistent with previous results, suggesting that our main results are robust to the endogeneity test.

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However, the effect of accounting conservatism on CSR performance shows a declining trend from year to year.

Next, to test the robustness of the study's findings, this paper uses two-stage least-squares (2SLS) regressions to help alleviate omitted variables bias (Appendix A5). This paper uses an OLS model to predict a firm's CSR performance score in the first stage of regression. This study regresses accounting conservatism on the predicted value of the CSR score from the first-stage regression and other control variables in the second-stage regression. Good instrumental variables in this context must be related to the CSR performance but unrelated to the error term in the second-stage equation. This study selects CEO duality (DUALITY), Fixed asset (PPE), Largest shareholder (TOP1), Executive pay (PAY), Turnover of total assets (TURNOVER), Institutional shareholders (HOLD), and Foreign shareholders (FROHOLD), as the instrumental variable because a firm's CSR performance is generally related to these variables.

Appendix A5, column (1), shows that paper's instrumental variables are highly significant in explaining the first-stage regression's dependent variable (CSR). Therefore, the paper's 2SLS results are less likely to suffer from bias attributable to weak instruments. In column (2), this paper reports the second-stage regression results with accounting conservatism as the dependent variable. The coefficients of CSR in the model are significantly negative, indicating that CSR activities have a negative impact on accounting conservatism.

4. DISCUSSION

The paper's findings show that Chinese firms that display a higher level of CSP report less conservative earnings, and these results are on par with those of Anagnostopoulou et al. (2020) and Burke et al. (2020), both studies were conducted on an inter-jurisdictional sample retrieved from KLD database although contradict findings of earlier studies (Cheng & Kung, 2016; Francis et al., 2013; Guo et al., 2020). This study provides intriguing implications for the debate over the benefits of CSR activity. Given that conservatism in accounting is an ancient phenomenon, while corporate social responsibility is a relatively recent practice (Pasko, Chen, et al., 2021), it can be inferred that wider stakeholders enjoy a sort of preferential treatment as contracted with financial stakeholders because immersing in CSR, companies let loose its grip on conservatism in financial reporting thereby failing its financial stakeholders. There is, however, an alternative explanation, although arguably less popular in the literature, arguing that CSR performance aids the development of a firm's information environment and thus mitigates information asymmetry, which in turn lowers the demand on conservatism by outside investors (Burke et al., 2020, p. 29). The authors believe that conservatism is an indispensable tool developed over a long time for safeguarding from agency problems, and it is premature to argue that it can be replaced by still fledgling CSR. In general, the paper's findings do not support the inference by Guo et al. (2020) that the level of accounting conservatism can be nurtured (increased) by a firm's efforts to enhance its stakeholder relations. The findings more leaning toward the view on CSR as a conflict between shareholders (Barnea & Rubin, 2010) and here can be argued rather that the conflict is between stakeholders, not shareholders.

Generally, this study makes a sizable contribution to furthering the understanding of how a financial reporting practice (accounting conservatism) can affect a firm's CSR activities, which are more consequential for firm stakeholders. Ultimately, this paper contributes to the ongoing discussion on accounting conservatism across researchers, standard setters, and practitioners (Mora & Walker, 2015; Watts & Zuo, 2016) by demonstrating that firms' non-conventional and less traditional business activities, namely CSR engagement, touch upon conservative financial reporting.

CONCLUSION

The paper investigates the link between accounting conservatism, determined by the asymmetric timeliness of recognition of economic gains and losses, and CSP (proxied by SCVPS). The goal was to appraise the magnitude to which a commitment of firms' senior management to financial stakeholders, evident by engagement in conservative reporting, is associated with the extent of responsibility and commitment towards an array of stakeholders, manifested through a CSR engagement (SCP). This study hypothesizes that CSR active companies expending their effort and putting their resources into implementation of CSR practices are more often able to match ethical expectations of society and thus, are more likely to provide more transparent financial information characterized by a higher level of conservatism. Alternatively, it is supposed that if managers engage in CSR pursuing their self-interest just trying to mask the impact of corporate misconduct, they could mislead stakeholders with opportunistic financial reporting associated with a low level of conservatism.

On the sample of 25,490 year-company observations of A-share listed companies in China's Shanghai and Shenzhen stock exchanges from 2008 to 2019 retrieved from the CSMAR database, the study finds that there is a negative association between accounting conservatism and social responsibility performance. Moreover, there is no significant difference in the negative association in the case of different equity concentrations as well in state and non-state-owned enterprises. The study's results are robust on several alternative specifications and testify that current and past accounting conservatism drives current and past CSP.

AUTHOR CONTRIBUTIONS

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APPENDIX A1

Table A1. Prior studies on the relationship between accounting conservatism and CSR

Authors	Dependable variables	Independent variables	Sample	Main findings	Lend support to
Anagnostopoulou et al. (2020)	CSR	Conditional conservatism	14,204 year-company observations collected from Compustat, KLD database and BoardEx – international settings	"Our findings show a strong negative association between conditional conservatism and CSR during our sample period" (Anagnostopoulou et al., 2020)	A negative association
Guo et al. (2020)	Accounting conservatism	CSR	18,076 firm-year observations for 3621 firm over the fiscal years 2003–2013. COMPUSTAT, KLD ratings and Thomson-Reuters Institutional Holdings (13F) are used	"We find that companies that commit to stakeholders through socially responsible practices significantly promote accounting conservatism… Our paper identifies corporate social responsibility as an important channel through which stakeholders influence corporate selection of conservative reporting practices." (Guo et al., 2020).	A positive relation
Burke et al. (2020)	Firm-year measure of conditional conservatism	CSR ratings from the KLD database	27,697 firm-year observations comprised by 1,578 matched pairs of KLD and non-KLD firms	"We find that CSR performance in the prior period is negatively associated with conditional conservatism in the current period. We provide strong evidence suggesting that CSR performance is negatively related to conditional conservatism" (Burke et al., 2020)	A negative association
Cheng & Kung (2016)	Accounting conservatism	CSR	4,367 firm-year observations of listed on the Shanghai and Shenzhen Stock Exchanges firms between 2007 and 2009	"The empirical results indicate that actively fulfilling CSR, even if firms are simply mandated to do so by government policy, is positively associated with earnings conservatism" (Cheng & Kung, 2016, p. 17)	A positive relation
Francis et al. (2013)	Corporate Social Performance	Accounting conservatism	966 firm-year observations over the 5-year period (1998-2002), 217 firms in 43 different two-digit SIC codes. Data comes from KLD Social Ratings and COMPUSTAT	"Our empirical observations support the hypothesis that accounting conservatism results in increased CSP strengths" (Francis et al., 2013, p. 211)	A positive relation

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APPENDIX A2

Table A2. Description of the variables used in the study

Variable Name	Mnemonics	Role	Measurement	Unit
Corporate Social Performance	CSR	Dependent variable	SCVPS = (net profit + income tax expense + business tax and surcharges + cash paid to and for employees + employee compensation payable in the current period - employee salary payable in the previous period + financial expenses + donation) / the average of the total number of shares at the beginning and end of the period	number
Accounting conservatism	CONACC	Independent variable	Formula (1) and (2)	Number
The nature of equity	STATE	Grouping adjustment variables	The nature of equity, state-owned takes 1, non-state-owned takes 0	Dummy variable
Ownership concentration	HHI		HHI-score: HHI10 threshold is used to group and regresses the samples	Dummy variable
Company size	SIZE	Control variables	Natural logarithm of total assets	Natural logarithm
Company value	TOBINQ		Tobin's Q value	ratio
Leverage	LEV		Asset-liability ratio	ratio
Company growth	GROWTH		Operating income growth rate	ratio
Losses	LOSS		Dummy variable, take 1 when the company reported a loss that year, otherwise, take 0	Dummy variable
Cash flow	CFO		Dummy variable, take 1 when the company's operating cash flow is negative, otherwise, take 0	Dummy variable
Year	YEAR		Annual dummy variable	Dummy variable
Industry	INDUSTRY		Industry dummy variables	Dummy variable

APPENDIX A3

Table A3. Effect of CSR performance on accounting conservatism of firms – robustness control II

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	HHI1>=mean	HHI1< mean	HHI3>=mean	HHI3< mean	HHI5>=mean	HHI5< mean
CSR	–0.040***	–0.061***	–0.041***	–0.061***	–0.040***	–0.060***
	(–16.93)	(–21.17)	(–17.93)	(–19.37)	(–17.90)	(–19.52)
SIZE	–0.006	0.006	–0.007	0.008	–0.007*	0.008
	(–1.56)	(1.22)	(–1.60)	(1.52)	(–1.82)	(1.54)
TOBINQ	–0.007***	–0.008***	–0.009***	–0.007***	–0.009***	–0.007***
	(–3.47)	(–4.71)	(–4.84)	(–4.60)	(–4.75)	(–4.54)
LEV	0.948***	0.903***	0.954***	0.891***	0.955***	0.892***
	(48.13)	(58.08)	(46.17)	(58.06)	(46.16)	(57.17)
GROWTH	–0.001	–0.001	0.002	–0.003	0.003	–0.003
	(–0.20)	(–0.51)	(0.84)	(–1.00)	(0.96)	(–1.15)
LOSS	0.088***	0.103***	0.086***	0.104***	0.088***	0.104***
	(14.84)	(20.21)	(13.14)	(20.64)	(13.33)	(21.04)
CFO	–0.015***	–0.020***	–0.014***	–0.021***	–0.015***	–0.021***
	(–4.13)	(–6.39)	(–3.86)	(–6.81)	(–3.97)	(–6.79)
INDUSTRY	YES	YES	YES	YES	YES	YES
YEAR	YES	YES	YES	YES	YES	YES
Constant	–0.460***	–0.749***	–0.449***	–0.768***	–0.435***	–0.771***
	(–4.55)	(–6.37)	(–4.01)	(–6.78)	(–4.15)	(–6.76)
Observations	9,974	15,516	10,340	15,150	10,316	15,174
R-squared	0.560	0.565	0.561	0.561	0.560	0.560
Number of id	1,657	2,377	1,801	2,315	1,816	2,312
Company FE	YES	YES	YES	YES	YES	YES
F test	0	0	0		0	
r2_a	0.556	0.562	0.557		0.557	
F	2292	456.9	3097		2977	

Note: t-statistics in parentheses; ***, **, and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

APPENDIX A4

Table A4. Effect of CSR performance on accounting conservatism of firms – robustness control III

Variables	(1)	(2)	(3)	(4)
	CONACC	CONACC	CONACC	CONACC
L.CSR	−0.021***		−0.035***	
	(–11.02)		(–16.29)	
L2.CSR		−0.008***		−0.023***
		(–4.45)		(–12.54)
SIZE	−0.016***	−0.026***		
	(–3.94)	(–5.75)		
TOBINQ	−0.010***	−0.013***		
	(–5.50)	(–7.20)		
LEV	0.885***	0.869***		
	(60.74)	(53.16)		
GROWTH	−0.022***	−0.016***		
	(–8.48)	(–6.15)		
LOSS	0.134***	0.133***		
	(24.94)	(26.40)		
CFO	−0.012***	−0.013***		
	(–4.14)	(–4.40)		
L.SIZE			0.028***	
			(5.11)	
L.TOBINQ			−0.010***	
			(–5.41)	
L.LEV			0.511***	
			(19.37)	
L.GROWTH			−0.009***	
			(–3.07)	
L.LOSS			−0.018**	
			(–2.53)	
L.CFO			−0.010***	
			(–2.97)	
L2.SIZE				0.050***
				(9.34)
L2.TOBINQ				−0.005**
				(–2.06)
L2.LEV				0.240***
				(6.93)
L2.GROWTH				−0.009***
				(–3.51)
L2.LOSS				−0.012*
				(–1.87)
L2.CFO				−0.001
				(–0.25)
INDUSTRY	YES	YES	YES	YES
YEAR	YES	YES	YES	YES
Constant	−0.166*	0.102	−0.973***	–1.266***
	(–1.70)	(0.97)	(–7.16)	(–9.04)
Observations	21,621	18,464	21,621	18,464
R-squared	0.517	0.494	0.201	0.094
Number of id	3,182	2,795	3,182	2,795
Company FE	YES	YES	YES	YES
F test	0	0	0	0
r2_a	0.515	0.492	0.198	0.0894
F	502.1	466.7	352.2	96.89

Note: t-statistics in parentheses; ***, **, and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

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APPENDIX A5

Table A5. Effect of CSR performance on accounting conservatism of firms – robustness control IV

Variables	(1)	(2)
	first	second
	CSR	CONACC
DUALITY	0.116***	
	(7.25)	
PPE	–0.179***	
	(–3.18)	
TOP1	0.004***	
	(6.59)	
PAY	0.271***	
	(22.48)	
TURNOVER	0.625***	
	(34.42)	
HOLD	0.002***	
	(6.52)	
FROHOLD	0.005***	
	(4.46)	
CSR		–0.117***
		(–30.78)
SIZE	0.284***	0.031***
	(33.03)	(15.46)
TOBINQ	0.067***	–0.008***
	(13.15)	(–8.04)
LEV	0.203***	0.906***
	(4.69)	(115.45)
GROWTH	0.232***	0.019***
	(15.63)	(6.54)
LOSS	–0.821***	0.063***
	(–32.26)	(10.46)
CFO	–0.210***	–0.066***
	(–11.99)	(–19.52)
INDUSTRY	YES	YES
YEAR	YES	YES
Constant	–9.903***	–1.149***
	(–46.39)	(–24.40)
Observations	19,273	19,273
R–squared		0.572

Note: t-statistics in parentheses; ***, **, and * represent statistical significance at the 1%, 5% and 10% levels, respectively.