

# Correlates of corporate accountability among South Africa's largest listed companies

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## ABSTRACT

This paper explores the relationships between a publicly available measure of corporate accountability (the Accountability Rating™) and a range of other corporate variables for the largest 50 companies in South Africa. The rationale for this was to consider empirical evidence for a number of the major theoretical movements in the realm of corporate responsibility. The relationship between the Accountability Rating™ and company size, industry sector, and multiple securities exchange listings, on the other, suggested that the Accountability Rating™ is a crucial driver of corporate accountability. Finally, the relationships between accountability and executive remuneration variables were examined for evidence of stakeholder theory or slack resources theory. Statistically, the relationship between the Accountability Rating™ and executive remuneration variables was ambiguous and justify further investigation.

**Key words:** Accountability Rating™, corporate social responsibility, stakeholder theory, slack resources theory, institutional theory, agency problems, South Africa

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## Introduction

The growing recognition of emerging socio-economic and environmental crises confronting humanity has prompted wide-spread calls for all branches of society, including business, to participate in securing a sustainable future (UN WCED 1987). From a business perspective, these calls have led to the evolution of corporate social responsibility, corporate citizenship and various related concepts. These concepts call on businesses, as juristic persons, to behave in the same manner as any good citizen in working towards the betterment of their communities through participation in efforts to improve the life of all fellow citizens (De Jongh, Eccles & Nicholls 2008).

The rapid evolution of these concepts and calls for greater accountability among companies has not, however, proceeded without challenges. Principal among these has been the challenge presented by the advocates of the shareholder-centric business paradigm. This was, and in many cases still is, the dominant Western paradigm of business. In essence, it states that the sole responsibility of business is to generate profit for its owners (Friedman 1970). While superficially this argument appears to be devoid of any broader social conscience, this is in fact not necessarily the case. Morally, it was based on the market fundamentalist economic theories originally attributed to Adam Smith (1776). According to these, the market is the most efficient mechanism for allocating society's resources in the best interests of society. In other words, Smith argued that the 'invisible hand' of the market could be relied on to efficiently align the interest of shareholders with the interests of society.

Arguments presented by market fundamentalists against socially responsible corporate behaviour (particularly early formulations based on philanthropy) prompted advocates of corporate responsibility to pursue robust counter theories to motivate for responsibility. Indeed, this has probably been the primary pastime of academics in the field for the past 40 years (Walsh, Weber & Margolis 2003; Paul & Siegel 2006). Besides invoking the ethical argument that socially responsible corporate behaviour is simply 'the right thing to do', two broad motivational frameworks have been advanced: (1) a market-based motivation whereby socially responsible corporate behaviour is believed to be profitable; and (2) institutional fields of companies that force socially responsible behaviour.

### Market-based motives

This motivation is broadly premised on the argument that capital (as represented by business) alone does not control all the means of production and that other stakeholders in the broader society exert significant influence. This dependence of

business on a broader stakeholder group can then be extrapolated to suggest that 'healthy societies' will generally lead to profitable businesses (Porrit 2005). The reference to 'stakeholders' has led to this becoming known as the 'stakeholder theory of business' (Freeman 1984), and advocates of this theory have essentially argued that the market is indeed an efficient mechanism for allocating society's resources (Husted & Salazar 2006). The development of this theoretical avenue was instrumental in steering the practice of socially responsible corporate behaviour away from a philanthropic approach towards embedding corporate responsibility in the company's core business strategy (Freeman 1984; Porter & Kramer 2006).

The stakeholder theory has also prompted an extensive body of empirical work investigating the relationship between socially responsible corporate behaviour and corporate financial performance. Advocates of good corporate citizenship have presented studies that indicate positive correlations between socially responsible corporate behaviour and good corporate financial performance (Graves & Waddock 1994; Russo & Fouts 1997; Waddock & Graves 1997; Maignan, Ferrell & Hult 1999; Vitaliano & Stella 2006; Edmans 2007). Skeptics and 'fence-sitters' have found contradictory evidence (Alexander & Buchholz 1978; Statman 2000; Bansal 2005; Mill 2006). Furthermore, sceptics have presented a counter theory known as the 'slack resources theory' (McGuire, Schneeweis & Branch 1990; Waddock & Graves 1997; Orlitzky, Schmidt & Rynes 2003). According to this theory, socially responsible corporate behaviour and good corporate financial performance are correlated not because responsible behaviour results in good financial performance, but because good financial performance results in extra corporate resources (slack resources) being available for corporate citizenship programmes. Of course, according to the shareholder-centric paradigm of business, the allocation of slack resources to corporate citizenship programmes would only be legitimate if it yielded better returns for shareholders in a virtuous cycle (Waddock & Graves 1997).

The current status of this avenue of empirical research is perhaps best summarised in two comprehensive reviews of the literature published by Margolis & Walsh (2003) and Orlitzky et al. (2003). On the basis of a simple study-counting methodology, Margolis & Walsh conclude that empirical evidence was ambiguous and that no general conclusion regarding the relationship between socially responsible corporate behaviour and corporate financial performance was possible. Orlitzky et al. (2003), however, criticise the counting methodology adopted by Margolis & Walsh (2003) and present a statistically rigorous meta-analysis of the literature. This led them to conclude that, statistically, socially responsible corporate behaviour is significantly correlated with good corporate financial performance.

From a technical perspective, the methodological critique of Orlitzky et al. (2003) is valid and their statistically significant findings present a compelling

argument for companies to pursue socially responsible behaviour. However, the argument of Margolis & Walsh (2003) is supported by deductive logic (Chalmers 1999), namely, that a theory can never be proved, but can only be disproved. In light of this, it is perhaps most reasonable to conclude that there is no general ‘law’ that socially responsible corporate behaviour inevitably leads to good corporate financial performance. In other words, it appears that the market does not universally reward socially responsible corporate behaviour.

### Implications for the market

The conclusion noted in the preceding section is consistent with the theoretical challenge to the market fundamentalist world view that has emerged in mainstream economics (Stiglitz 2001, 2003, 2007). Stiglitz (2001) argues that the assumptions underlying the proposition of market efficiency are almost universally invalid. This breakdown of assumptions results in ‘market failures’, where the market rewards behaviour that is completely unaligned with the good of society at large. Indeed, this growing awareness of the fallibility of markets was a key driver for the emergence of the second major school of thought regarding the rationale for socially responsible corporate behaviour. This school focused attention on what Friedman (1970) referred to as ‘the rules of the game’ (although it was clearly not Friedman’s intent to provide this platform). In the face of systemic market failures, it was argued that society ought to “reassert social control over the markets” (Utting 2005: iii) and more specifically reassert control over business (Mackenzie 2006; Stiglitz 2003, 2007). The proposed mechanisms for asserting social control over companies have all broadly involved manipulation of the institutional fields of companies (North 1990; Scott 1995; Bansal & Roth 2000; Hamann 2004; Utting 2005), directing “attention toward forces that lie beyond the organizational boundary, in the realm of social processes” (Hoffman 1999: 351). These forces include legal frameworks, voluntary codes of conduct, and stakeholder awareness and resultant pressure.

### The agency problem

Apart from market failure, another source of misalignment between corporate activity and corporate responsibility is the so-called ‘principal–agent problem’ (Jensen & Meckling 1976) or agency problem. Traditionally, this problem relates to issues arising from the division between management (agents) and shareholders (principals), particularly in large listed companies. While this problem has usually been invoked to explain management behaviour that is not aligned with the interests

of shareholders (for example, in the case of Enron), it is possible to extend this to explain instances of generally irresponsible corporate behaviour (Mackenzie 2006). In general, such irresponsible executive, and therefore corporate, behaviour will arise when executive incentive systems reward such behaviour. Corporate social responsibility has, of course, fallen on both sides of the agency debate. Friedman (1970) declared that it is an example of the agency problem when company managers act in a manner that is not necessarily consistent with the financial interests of shareholders by pursuing costly corporate citizenship programmes. This position was more recently reiterated by Wright & Ferris (1997) in the context of South African disinvestment by US companies. Supporters of the stakeholder theory have argued the contrary, however (Mackenzie 2006). Mackenzie raises an additional dimension by noting that currently, most listed company shares are controlled by pension, insurance and mutual funds, and as such are owned by society in general (the 'universal owner'). For these reasons, the relationships between executive incentive systems and both corporate financial performance and socially responsible behaviour are of great interest to both shareholders and the broader stakeholders.

In summary then, the discussion has presented a précis of the major theoretical movements and supporting empirical developments that have taken place over the past forty years in developing an understanding of, and justifying, the responsibility (or lack thereof) of business towards society. The empirical investigation presented in this paper explores a number of the theoretical positions raised in the context of large South African companies. In doing so, the relationships between a publicly available measure of company accountability, as a central element of socially responsible corporate behaviour, (Wood 1991; Carroll 1999), and a range of publicly available corporate variables were examined. Specifically, the relationship between accountability and company financial performance was examined to investigate evidence for either the stakeholder or slack resources theories. The relationships between accountability and company size and proxy institutional field variables were examined as evidence that institutional fields may represent strong drivers for corporate accountability. Finally the relationships between accountability and executive remuneration variables were examined for evidence of agency problems.

## Methodology

As already described, this study set out to explore the relationships between a measure of corporate accountability and a series of other corporate variables. All variables used in this study were either publicly available or easily derived from publicly available data.

## Accountability

The corporate accountability scores, which formed the anchor of the study, were the 2007 Accountability Rating™ South Africa scores as published in the *Financial Mail* (2007). The stated aim of this rating was to evaluate how companies account to their stakeholders for the socio-economic and environmental impacts of their core business. While the full Accountability RatingAustralia method is not publicly available, the method is described as considering all the major domains of standard business architecture including strategy, governance, performance management, stakeholder engagement, public disclosure and assurance (*Financial Mail* 2007; AccountAbility & csrnetwork 2006). The evaluations are based on company published reports including annual reports, sustainability reports and web reports (AccountAbility & csrnetwork 2006). The limitations of, and justifications for, assessments of socially responsible corporate behaviour based on company disclosures have been discussed by Bansal (2005), who argues that:

- These assessments have been shown to be consistent with third party evaluations.
- They are unobtrusive and avoid posturing.
- They provide a means for gathering time-sensitive data.

In terms of the Accountability Rating™ methodology, the explicit consideration of assurance efforts is likely to further mitigate the potential risk that the method may evaluate how accountable companies say they are rather than how accountable they actually are.

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For company financial performance, both market and accounting-based measures were considered. As a measure of market-based performance, the holding period return (Reilly & Norton 2003) on company stocks for a five-year period from 2002 to 2007 was calculated as dividend income, plus price change, divided by the purchase price based on publicly available share prices and dividend yields. Companies without a five-year return history were excluded from the analysis. Beyond this 'raw' return, the relationship between the Accountability Rating™ scores and the standard deviation of the annual holding period returns over this five-year period was examined as a measure of the financial risk associated with the companies. Treating raw return and this measure of risk separately rather than deriving a risk-adjusted measure of return was deemed to deliver a richer interpretation of the data. This is relevant in light of the suggestion that corporate accountability may be a

mechanism for managing corporate risks, and that more accountable companies may be less financially volatile (Graves & Waddock 1994). In terms of accounting-based measures of corporate financial performance, we examined return on assets in the same reporting year as the Accountability Rating Australia™. Data used for this calculation were published in the *Financial Mail Top Companies* (2007).

## Company size

The relationship between company accountability and company size, as represented by market capitalisation, was investigated. This variable was again sourced from the *Financial Mail Top Companies* (2007).

## Additional variables

Apart from company size, a number of variables that can be considered proxies for various institutional fields were examined. Consistent with previous work considering the relationship between Accountability Rating™ scores and industry sector institutional characteristics (Eccles, Hamann & De Jongh 2008), companies were classified according to industry sectors based largely on Johannesburg Securities Exchange (JSE) sectors. This is based on the observation that different sectors are exposed to institutional fields of varying strength. Furthermore, companies were classified as having (1) any stock exchange listing/s in addition to their JSE listings, and also (2) specifically as having a London Stock Exchange (LSE) listing in addition to their JSE listings. The reason for this was to investigate whether these two classifications accounted for significant variation in the Accountability Rating™ scores, based on the rationale that listing requirements represent a crucial set of institutional forces governing listed companies. Assuming that there is variation in the listing requirements in terms of accountability from one securities exchange to the next, it is possible to hypothesise that multiple listings might yield better accountability due to an additive effect. Finally, companies were classified according to their geographical zones of operation, other than South Africa. Specific consideration was given to:

- Companies with European operations
- Companies with US or Canadian operations
- Companies with operations in Australia or New Zealand
- Companies with operation in Asia
- Companies with operations in other African countries.

The rationale for this was similar to that advanced for multiple listings, namely, that operations in multiple geographical zones might yield better accountability due to the cumulative effect of variation in institutional expectations between the geographical zones.

## Executive remuneration

Finally, to investigate the relationship between company accountability and executive incentives, the base salaries and annual performance bonuses of the CEOs as well as the base salaries of chairpersons were extracted from the 2006 annual company reports. Companies that did not provide such data were excluded from the analysis. The relationships between holding period return and these executive remuneration variables were also examined.

## Statistical analysis

In evaluating the various relationships considered, a least squares regression approach using the SAS GLM procedure was used. While this approach evaluates the amount of variation in a 'dependent' variable that can be explained by an 'independent' variable, these analyses were carried out to explore relationships, and the choice of dependent and independent variables should not be taken to infer causation. Furthermore, only relationships for pairs of variables were examined. No attempt was made to develop multivariate models, or to consider any interactions between variables.

## Results and discussion

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There is no evidence in the data of any significant relationship between company accountability and financial performance as measured by either the holding period return (market-based measure), or return on assets (accounting-based measure) (Table 1). This finding is entirely consistent with the broad body of empirical studies investigating relationships between socially responsible corporate behaviour and corporate financial performance as reviewed by Margolis & Walsh (2003) and Orlitzky et al. (2003).

From a theoretical perspective, the lack of relationships in these variable pairs suggests that there is no evidence to support either the slack-resources theory or the stakeholder theory in this particular sample. This finding may initially be disap-

**Table 1:** Summary of *F*, *p* and *n* values for the relationships between Accountability Rating™ scores and other variables

Factor	Variable	F	p	n
Financial Performance	Holding period return (HPR)	0.45	0.5044	46
Financial Performance	Return on assets	1.98	0.1655	50
Financial Performance	Standard deviation of annual HPR	0.78	0.3809	46
Company Size	Market capitalisation	19.01	<b>&lt;0.0001</b>	<b>50</b>
Institutional Field	Sector	16.27	<b>0.0002</b>	<b>50</b>
Institutional Field	Other listing	10.28	<b>0.0024</b>	<b>50</b>
Institutional Field	UK listing	5.75	<b>0.0205</b>	<b>50</b>
Institutional Field	European operations	0.13	0.7201	45
Institutional Field	US/Canadian operations	0.03	0.8704	45
Institutional Field	Australian/New Zealand operations	0.35	0.5555	45
Institutional Field	Asian operations	0.72	0.4007	45
Institutional Field	Other African operations	1.80	0.1865	45
Executive Remuneration	CEO base remuneration	2.46	0.1239	47
Executive Remuneration	CEO bonus	0.83	0.3681	46
Executive Remuneration	Chair base remuneration	1.71	0.1969	49

pointing to advocates of socially responsible corporate behaviour, as a strong positive relationship would intuitively have provided grounds for arguing for better accountability by companies. However, it is important to note that, given the temporal order in which the variables were measured, a positive relationship would have been more strongly suggestive of the slack resources theory than the stakeholder theory. The holding period return investigation considered Accountability Rating™ scores against historical financial performance, while the return on assets investigation considered accountability and performance for the same period. At best, a positive relationship would have provided a justification for a call for further investigation into the virtuous cycle between socially responsible corporate behaviour and corporate financial performance, as proposed by Waddock & Graves (1997).

The lack of any negative relationship between the Accountability Rating™ scores and these measures of financial performance does, however, imply that there is no 'net' financial penalty associated with accountability. This idea of zero net gain/loss is an important possibility that has been proposed by a number of authors (Kurtz 1997; Vitaliano & Stella 2006). This suggests that the inevitable costs associated with social responsibility programmes must be offset by cost savings or improved returns elsewhere in the business. To some extent, this nullifies the hard-line critique of social responsibility from the shareholder paradigm, namely, that anything that

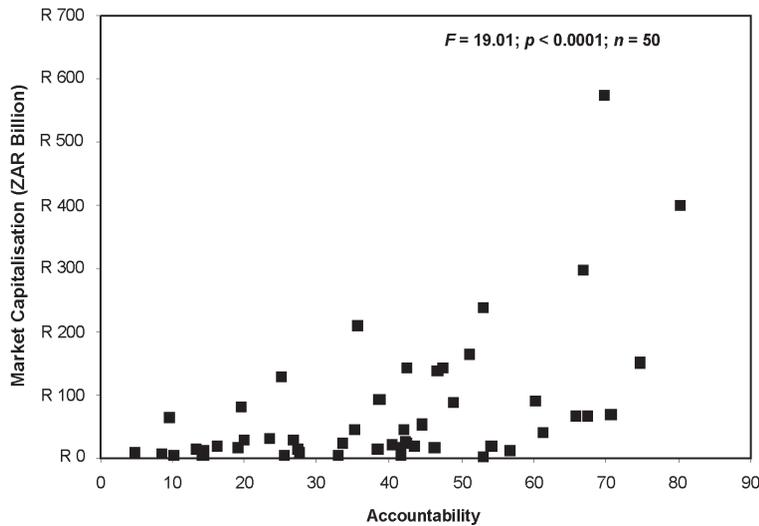
costs shareholders money cannot be entertained. Accountability, in this system at least, does not seem to ‘cost’ shareholders anything.

Central to stakeholder theory is the suggestion that, by balancing the expectations of a company’s stakeholders, companies are better able to respond to the changing external context (Freeman & Evan 1990). This theory resonates with the concept of risk, suggesting that companies that are more ‘in touch’ with diverse stakeholder groups will be in a better position to anticipate and pre-emptively respond to emerging risks. This possibility has received particular attention from an investment perspective (Alexander & Buchholz 1978; Graves & Waddock 1994; Mill 2006; Viviers 2007), where risk and return are both essential elements of the decision-making process. The results in this study, however, provide no indication that accountability and risk, as measured by the variation in holding period returns, are statistically related (see Table 1), as also indicated by Alexander & Buchholz (1978) and Mill (2006). Once again, while the lack of a positive relationship may be a disappointment to advocates of socially responsible business, the lack of a negative relationship is important.

## Company size

In contrast with the company financial performance, there was evidence for a strong positive relationship between market capitalisation and the Accountability Rating<sup>TM</sup> scores (see Table 1 and Figure 1). Three possible interpretations of this observation justify consideration. Firstly, it could imply that better accountability causes companies to grow larger. Supporting this interpretation, Russo & Fouts (1997) present a significant correlation between company growth rate and a measure of environmental responsibility (as a dimension of socially responsible behaviour). However, despite this correlation, their study found no significant correlation between company size and environmental performance. They interpret these observations as suggesting that the relationship between socially responsible behaviour (and environmental performance specifically) and economic performance strengthened in higher growth industries.

The suggestion that socially responsible behaviour may be affected by industry characteristics, taken together with the temporal limitations of the current study methodology already discussed, introduces the second possible interpretation of the correlation; namely, that it is a statistical coincidence, with both size and accountability co-varying with some other variable (such as industry character), and does not have any real causal relationship. This is indeed a possibility that is discussed in more detail under the section dealing with institutional fields.

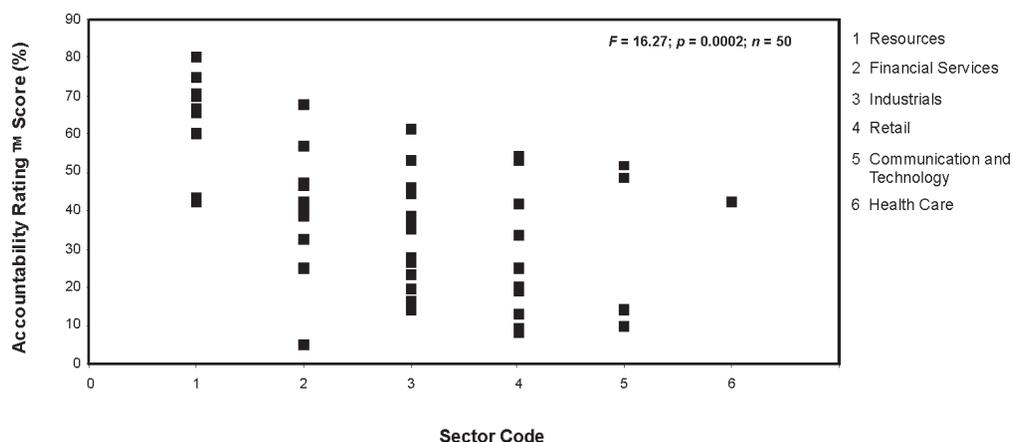


**Figure 1:** Market capitalisation correlated with Accountability Rating™ scores

The third possibility is that this is evidence for a variant of the slack-resources theory in that the cost of accountability is more easily borne by larger companies than smaller ones. While this possibility is commonly articulated anecdotally, it is perhaps somewhat weakened in this sample, which comprises only the largest listed companies in South Africa. In other words, while there is variation in size between these companies, they are all very large companies in absolute terms in the South African context.

### Industry Sector

Industry sector accounted for significant variation in the Accountability Rating™ scores observed (Table 1, Figure 2). In the rank order of sector performance, the resources sector is the most ‘accountable’ sector, followed by the financial services, industrial and retail sectors (Table 2). The apparent relationship between industry sector and company Accountability Rating™ scores in the mining, financial services and retail sectors in the South African context has been addressed by Eccles et al. (2008). They suggest that sectors such as the resources sector, which have relatively ‘strong’ institutional fields that combine robust legal frameworks, strong voluntary codes of conduct and stakeholder awareness and pressure, are likely to be more accountable than sectors without such strong institutional fields. The result here offers further legitimacy to this view by providing statistical support to the suggestion that industry sector might be an important proxy determinant of accountability.



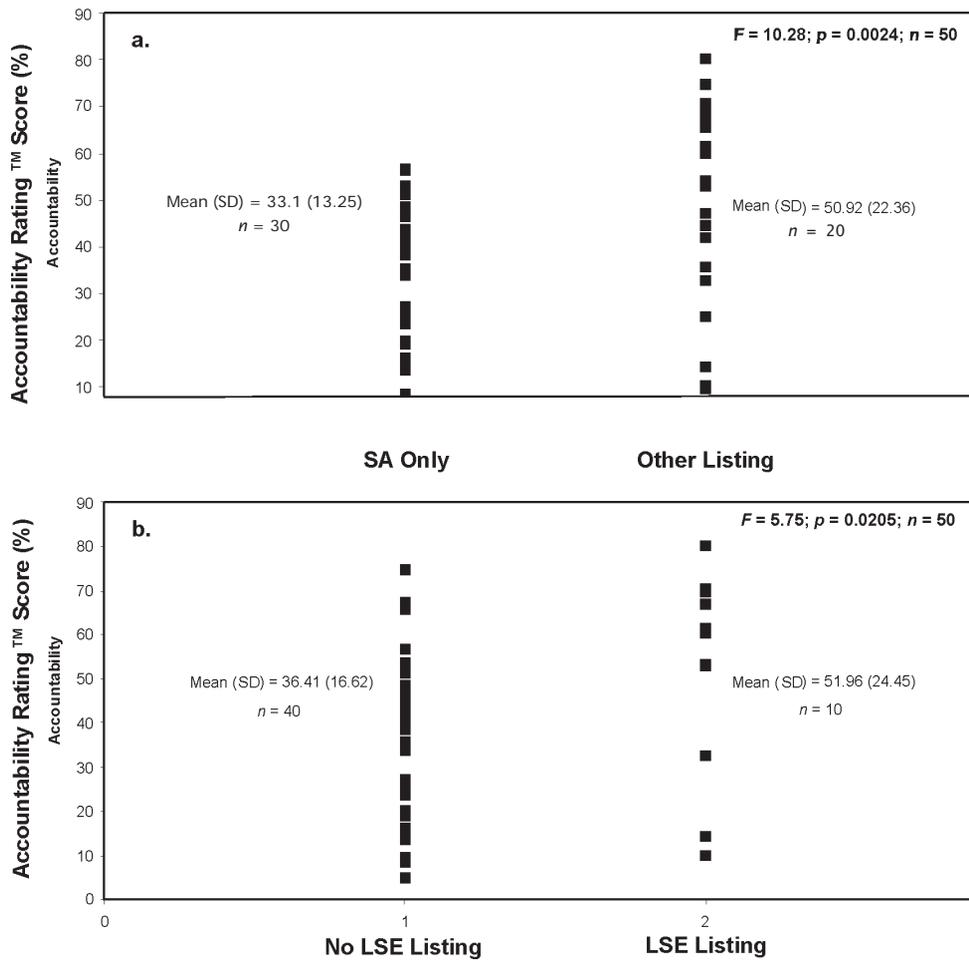
**Figure 2:** Accountability Rating™ score correlated with industry sector codes

**Table 2:** Average Accountability Rating™ (AR) scores (%) and market capitalisation per industry sector

Industry Sector	AR mean (standard deviation)	Market Capitalisation mean (ZAR)	<i>n</i>
Resources	61.68 (14.05)	184 billion	10
Financial services	40.21 (14.15)	67 billion	10
Industrials	33.55 (14.34)	58 billion	14
Retail	29.10 (16.66)	19 billion	11
Communication and technology	31.13 (21.91)	67 billion	4
Health care	42.49 (NA)	25 billion	1

In terms of multiple listings, the results support the hypothesis that multiple listings should lead to better accountability. Having either a listing on the London Stock Exchange or any other listing accounted for significant variation in the Accountability Rating™ scores and yielded higher average scores (Figure 3).

Returning to the correlation between company size and accountability previously discussed, it is possible that the significant variation in Accountability Rating™ scores explained by both industry sector and multiple listings could also be explained by co-variation with industry size, and the variant of the slack-resources theory already described. Certainly, it seems logical that larger companies will be more likely to have multiple listings and indeed, the average market capitalisation of companies with other listings (ZAR 134 billion) is much higher than for companies only listed on the JSE (ZAR 38 billion). Likewise, industry sector accounts for a significant amount of variation in market capitalisation in this sample ( $F = 11.34, p = 0.0015$ ), and the rank order of average market capitalisation by sector closely mirrors the



**Figure 3:** Security exchange listings plotted against Accountability Rating™ scores: (a) South Africa only compared with any other listing; (b) London Stock Exchange (LSE) compared with no LSE listing

rank order of Accountability Rating™ scores (Table 2), again suggesting strong co-variation.

There are a number of arguments that may help to resolve this interpretive impasse. Firstly, as already argued, the size variant of the slack-resources theory is significantly weakened in this particular sample, since all the companies considered are large companies in absolute terms. More fundamentally, however, in order for the slack-resources theory to manifest itself, there must be significant pressure on companies to be more accountable. After all, without pressure, neither small

nor large companies would have any inclination to be accountable, whether they have slack resources or not. Finally, company size may itself be a proxy variable for institutional force based on the argument that larger companies are likely to be subject to greater external scrutiny.

In contrast with listing requirements, there was no evidence that companies operating in multiple domains were either more or less accountable (Table 1). Perhaps the most obvious explanation for this lies in the declaration commonly contained in many company public disclosures that they ‘comply with local legislation’. The implication of this sentiment is that companies do not aim to roll out best practice throughout their operations, but rather meet minimum requirements locally. This explanation is speculative and certainly requires further consideration.

It is also interesting to speculate on why evidence for the additive effect exists in terms of listing requirements, but not in terms of zones of operation. A possible explanation is that this is perhaps a reflection of the ongoing priority given to shareholders over other stakeholders by business. As already mentioned, listing requirements have evolved largely with a view to protecting the rights of shareholders, and the apparent combining of listing requirements may be indicative of the desire to keep as many within this priority stakeholder group content as possible. This suggestion must, however, be treated with some caution based on the apparent lack of correlation between executive remuneration and corporate financial performance discussed later, suggesting that an agency issue may well be operative in this particular system.

## Executive remuneration

There is no evidence that any of the executive remuneration variables investigated were correlated with the Accountability Rating<sup>TM</sup> scores (Table 1) in this sample. This may at first seem hardly surprising given that there was no apparent relationship between accountability and company financial performance either. Indeed, advocates of the shareholder paradigm would argue that this is, in fact, evidence that there is no corporate citizenship-related agency problem in the companies in this sample. This is indicated by the apparent lack of incentive schemes that encourage company agents to focus attention on issues that are not financially material to the owners.

However, advocates of the shareholder paradigm might have reason for concern given the lack of evidence for a correlation between executive remuneration variables and historical company financial performance from the shareholder perspective (holding-period return) (Table 1). This is a strong indication of the existence of a disconnection between the returns that shareholders receive and the rewards that executives receive.

## Conclusion

This study investigated relationships between corporate accountability and a range of corporate variables. At a purely statistical level, there was evidence for significant relationships between accountability and company size, as well as between accountability and the institutional proxies of industry sectors and multiple securities exchange listings.

Although it is somewhat difficult to disentangle causal relationships from covariance, the correlations between Accountability Rating™ scores on the one hand, and company size and institutional field proxies on the other, together these provide strong evidence of the centrality of a company's institutional field in motivating socially responsible corporate behaviour.

In contrast to this, evidence for the centrality of market forces as a driver of social responsibility is absent. The lack of any relationships between the Accountability Rating™ scores and corporate financial performance measures suggests that, in this sample, profitability is unlikely to have been a driver of corporate accountability. The corollary to this is that profitability cannot be advanced as a reason for not pursuing accountability, since there was no negative correlation.

Finally, the empirical relationships regarding evidence for agency issues were somewhat ambiguous. There was no evidence that corporate accountability is correlated with executive remuneration. This is consistent with the finding that there is no correlation between accountability and financial performance from an agency perspective. However, there is also no correlation between executive remuneration and holding-period returns.

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