

## Corporate Governance Mechanisms And Corporate Social Responsibility (CSR): Evidence From Iran.

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**Abstract:** The aim of this study is to investigate the relationship between corporate governance mechanisms and corporate social responsibility in accepted companies in Tehran Stock Exchange. To measure of the corporate social responsibility as dependent variable, it was applied Singhapakdi *et al.* questionnaire (1996). Corporate governance mechanisms contain independent outside directors on the board (OBD), Percentage of institutional ownership (PIO), ownership centralization (OC), free float (FF) and auditor type (AT). In this study, the numbers of 92 observations were investigated during the years 2003-2009. To analyze the data was exerted EViews software. Our findings show that among of the corporate governance mechanisms, relation between PIO, OBD, and OC with CSR is positive and no significant, however, other variables such as FF, and AT have negative and no significant relations with CSR. Findings also show that bigger companies and companies with more liability ratio (LEV) have less corporate social responsibility; however, companies that have more cash flow from operating have more CSR. About 10% of changes CSR can be explained by corporate governance mechanisms during the study period and this amount increases to 26% by adding control variables to regression model.

**Key words:** Corporate Governance Mechanisms, Corporate Social Responsibility (CSR), IranianFirms.

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### INTRODUCTION

In recent years, there has been a proliferation of public interest into corporate governance as a result of corporate scandals such as Enron or WorldCom and abuses of managerial power in the form of fat cat salaries and bonuses (Plender, 2003). Also, in academic journals, a growing body of literature including (Frooman, 1999; Hillman *et al.*, 2001; Luoma and Goodstein, 1999; Ogden and Watson, 1999) has investigated governance issues from the perspective of stakeholders (Machold *et al.*, 2008).

The nexus between corporate governance and the management's and/or the entrepreneur/business owner's responsibility is a theme which, in recent decades, has moved to the forefront and has fully merged into the ethics of responsibility theory: the duty of management is to actualize a balance of interests among all stakeholders, and social responsibility can (and must) be redirected towards the emersion of moral preferences (Zamagni 2003). Jones and Thomas (1995) state that CSR is an instrument of governance that facilitates the compliance of a possible encounter among actors inside/outside the firm, and governance become simplified when trust in the management and/or the entrepreneur increases and even more so when the same trust is repaid by the right results, equitable and gratifiable for all (Baldo, 2009).

Where an adhesion to multiple declensions of CSR is present, corporate governance positions itself at the center of relations between stakeholders, strategic profile and internal processes, human capital (Gazzola and Mella 2006) and is experienced as enlarged governance (Sacconi 2008).

Considering the above discussion, this study because of the need for richness of the accounting literature in this field, investigates the relationship between corporate governance mechanisms and corporate social responsibility in Tehran Stock Exchange.

#### *Literature Review:*

##### *Corporate Governance:*

Corporate Governance focuses on the principal-agent problem of corporations. The problem results from the separation of ownership and control and the emancipation of management from owner control in public corporations (Ott, 2009). Owing to the separation of ownership and control (and the resulting agency problems) in the modern business world, a system of corporate governance is necessary, through which management is overseen and supervised to reduce the agency costs and align the interests of management with those of the investors (Messier *et al.*, 2008). A good corporate governance structure helps ensure that the management properly utilizes the enterprise's resources in the best interest of absentee owners, and fairly reports the financial condition and operating performance of the enterprise. The role of the corporate governance structure in

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financial reporting is to ensure compliance with generally accepted accounting principles (GAAP) and to maintain the credibility of corporate financial statements. The corporate governance mechanisms that are the focus of recent regulations and prior studies are attributes related to the organization and functioning of the board in general and its audit committee in particular (Lin & Hwang, 2010).

***Basic Elements of Corporate Governance:***

In a more specific sense, Corporate Governance implies 3 main areas of corporate control. These are:

- 1) Internal mechanisms of management control including the (supervisory) board and the general meeting of shareholders. Main issues in this context concern the obligations of managers to inform the board about relevant issues.
- 2) Corporate control by intermediaries. Auditors are responsible for controlling and certifying the annual balance sheets and reports of the corporation. One of the issues in this context concerns the liability of auditors towards the corporation, but also towards investors.
- 3) External mechanisms of corporate control are provided by the capital market under the condition of publicity and transparency. A main issue of corporate governance pertains to overcoming information asymmetry (Ott, 2009).

***Corporate Governance Mechanisms:***

Corporate governance variables have been shown in other contexts to affect firm behavior. Such variables include percent of independent outside directors on the board, ownership structure and audit type. A firm's use of governance mechanisms determined by the relative benefits and costs of each as they align the interests of managers with those of shareholders. Thus, it is likely that governance mechanisms are not independent, but are endogenously chosen to maximize firm performance (Cornett, *et al.*, 2009).

***Corporate Social Responsibility:***

The concept of Corporate Social Responsibility opens a new dimension of corporate control. Corporate Social Responsibility widens the scope of corporate control beyond shareholders, managers, and board members, by including stakeholders. The idea behind CSR is: corporations should consider the impact of their activities not only on shareholders, but also on stakeholders. Stakeholders are all persons, groups, and institutions, related to and affected by the impact of corporate activities. Stakeholders are the employees of the firm and all types of external participants including suppliers, consumers, and other clients as well as creditors and eventually society at large and the state (Ott, 2009).

***Corporate Governance, Ethics and Corporate Social Responsibility:***

The recognition of an ethical and social dimension of business activity is founded on a vast corpus of theory. Four groups of theories form the core of this literature; they likewise correspond to four different approaches (Garriga and Mele, 2004). The first (Instrumental Theories) has Friedman (1962) as its most notable exponent, and is founded on the principle of the instrumentality of the business with respect to the creation of wealth, a goal that is synthesized as the firm's only responsibility (maximization of shareholder value; reaching the competitive advantage).

The second (Political Theories), which can be divided into three principle theoretical strands (corporate constitutionalism; integrative social contract, corporate citizenship), is focused on the role of business and of the rights/needs which connect them, and on the responsible use of power in political and social arenas (Davis 1960, 1973; Donaldson and Dunfee 1994, 1999).

The third body of studies (Integrative Theories), in which the approaches of issues management, public responsibility, stakeholder management and corporate social performance coexist, maintains that social demands are generally considered to be the way in which society interacts with business and gives it a certain legitimacy and prestige. As a consequence, corporate management should take into account social demands, and integrate them in such a way that the business operates in accordance with social values (Garriga and Mele, 2004, p. 57).

The last represents a collection of Ethical Theories which, focused on the right thing to achieve a good society (Ibid, p. 64) It includes the approach of the common good of society, in which space is made for theories concerning the common good (Maritain, 1966; Mele, 2002; Alford and Naughton, 2002; Alford, 2006; Sacconi, 2004; Catturi, 2006) and the Civil Economy (Zamagni, 1995, 2006; Bruni and Zamagni, 2004). Coffey and Wang (1998) in a research title "Board diversity and managerial control as predictors of corporate social performance" found that greater diversity in corporate governance will enhance a firm's corporate social performance.

**Research Hypotheses:**

**Main Hypothesis:**

There is a significant relationship between corporate governance mechanisms and corporate social responsibility in accepted companies in Tehran Stock Exchange.

**Sub-Hypotheses:**

- 1) There is a significant relationship between Percentage of independent outside directors on the board and corporate social responsibility in accepted companies in Tehran Stock Exchange.
- 2) There is a significant relationship between free float stock owned to shareholders and corporate social responsibility in accepted companies in Tehran Stock Exchange.
- 3) There is a significant relationship between Auditor type of addressed company and corporate social responsibility in accepted companies in Tehran Stock Exchange.
- 4) There is a significant relationship between Percentage of institutional ownership and corporate social responsibility in accepted companies in Tehran Stock Exchange.
- 5) There is a significant relationship between Ownership centralization and corporate social responsibility in accepted companies in Tehran Stock Exchange.

**Research Method:**

**Method:**

This study is a survey and archival research. In terms of purpose, this study is applied research that its results can be useful for extensive range of users including stockholders, auditors, and Tehran Stock Exchange. Companies' information collected through the Stock Exchange official website and then data analyzed by the econometrics software of EViews.

**Sample & Statistical Population:**

The statistical population in this study includes the accepted companies in Tehran Stock Exchange in the period of 2003-2009. Existence of some heterogeneousness among the accepted companies in Tehran Stock Exchange led to consider some special conditions for selection of studied companies as follows:

- 1) Companies selected must be accepted in Tehran Stock Exchange since the year 2003 in Tehran Stock Exchange is accepted.
- 2) Companies cannot change the financial course in the study period.
- 3) Companies should not be members of any financial investment and mediators.
- 4) With regard to the above conditions, 92 companies were selected as the statistical sample.

**Measurement of Variables:**

**Dependent Variable:**

In this research, corporate social responsibility (CSR) is dependent variable. For the measurement of this variable, it's used Singhapakdi *et al.* questionnaire (1996). This questionnaire was distributed among 525 workers in accounting and finance departments, which 460 of them were recollected.

**Independent Variables:**

**Percent of Independent Outside Directors on the Board (OBD):**

Independent directors refer to those directors who have been explicitly and clearly announced as independent directors in a listed company's annual report. We used OBD to stand for the percentage of independent directors on board, i.e. the ratio of independent directors to total number of directors on board.

**Percent of Institutional Ownership (PIO):**

This variable is owned stock by institutional organizations divided by issued stocks of a firm.

**Ownership Centralization (OC):**

This variable is calculated by summing stock percentage owned by 3 major stockholders.

**Free Float (FF):**

Free float is stock that belongs to the minority shareholders and easily and without any limitation on the market can be traded.

**Auditor Type of Company(AT):**

In this research, if company is audited by auditing organization, indicator variable is equals to one and otherwise zero is considered.

In this study, average of the above variables was applied as proxy for each variable.

**Control Variables:**

We include several control variables that the literature documents could potentially influence the corporate social responsibility.

**Size:**

Firm size is measured as the natural log of market value of equity in end of financial period.

**Cash Flow From Operating Activities (CFO):**

**Financial Leverage (LEV):**

Financial leverage is measured as the ratio of total liabilities to market value of capital in beginning of per year and is included to control for the possible effects (positive or negative) of firm risk.

**Results Analysis:**

Descriptive statistics for total companies (92 observations) were represented in table 1. It's obvious that among of original variables (dependent and independents), corporate social responsibility (CSR) had the lowest variation coefficient (0.06) and free float (FF) had the most variation coefficient (0.44) during study period. This matter indicates that despite of the high fluctuations in independent variables, dependent variable (CSR) has been stable during research period.

**Table 1:** Descriptive Statistics of the variables.

| Variables    | CSR  | PIO  | OC   | OBD  | FF   | AT   | LEV  | SIZE  | CFO  |
|--------------|------|------|------|------|------|------|------|-------|------|
| Criteria     |      |      |      |      |      |      |      |       |      |
| Mean         | 3.91 | 0.47 | 0.7  | 0.6  | 0.25 | 0.33 | 1.68 | 11.64 | 0.16 |
| Medium       | 3.96 | 0.49 | 0.74 | 0.6  | 0.21 | 0.37 | 1.29 | 11.5  | 0.14 |
| Maximum      | 4.33 | 0.85 | 0.96 | 1    | 0.56 | 0.5  | 8.35 | 13.01 | 0.5  |
| Minimum      | 3.29 | 0.15 | 0.26 | 0.3  | 0.05 | 0.13 | 0.44 | 10.31 | 0.01 |
| Std. Dev.    | 0.22 | 0.17 | 0.16 | 0.17 | 0.11 | 0.11 | 1.6  | 0.57  | 0.11 |
| C. V.        | 0.06 | 0.36 | 0.23 | 0.28 | 0.44 | 0.33 | 0.95 | 0.05  | 0.69 |
| Observations | 92   | 92   | 92   | 92   | 92   | 92   | 92   | 92    | 92   |

The correlation between variables is shown in table 2. Findings indicate that outside board of directors (OBD) has the highest correlation with CSR. This matter show that the increasing of OBD leads to the increasing of CSR. That is, companies have more OBD, they are more responsible sociality.

**Table 2:** Correlation between Variables.

| Variables | CSR    | PIO   | OC    | OBD   | FF    | AT    | LEV   | SIZE | CFO |
|-----------|--------|-------|-------|-------|-------|-------|-------|------|-----|
| Criteria  |        |       |       |       |       |       |       |      |     |
| CSR       | 1      |       |       |       |       |       |       |      |     |
| PIO       | 0.12   | 1     |       |       |       |       |       |      |     |
| OC        | 0.14   | 0.78  | 1     |       |       |       |       |      |     |
| OBD       | 0.22   | -0.1  | -0.13 | 1     |       |       |       |      |     |
| FF        | -0.005 | -0.34 | -0.69 | 0.04  | 1     |       |       |      |     |
| AT        | 0.007  | 0.12  | -0.25 | -0.25 | 0.61  | 1     |       |      |     |
| LEV       | -0.02  | 0.01  | 0.1   | -0.15 | -0.06 | -0.13 | 1     |      |     |
| SIZE      | -0.16  | 0.07  | 0.11  | 0.21  | -0.34 | -0.37 | -0.11 | 1    |     |
| CFO       | 0.28   | .03   | 0.05  | 0.03  | -0.19 | -0.15 | -0.02 | 0.26 | 1   |

The results of general regression model mid to control variables in Table 3 show that among of corporate governance mechanisms, PIO is negatively related to CSR and OC, FF; OBD & AT are positively related with this variable. These relationships aren't significant statistically. The value of determination coefficient shows that approximately 26% of changes CSR can be explained by corporate governance variables and control variables during the study period. In general, regression model isn't significant with respect to F-statistic and the Durbin-Watson statistic shows that the model hasn't autocorrelation problem. Because of reciprocal relations between corporate governance mechanisms, it should be investigated relations these factors with corporate social responsibility separately.

The results of general regression model without control variables in Table 4 show that among of corporate governance mechanisms, PIO is negatively related to CSR and OC, FF; OBD & AT are positively related with this variable. These relationships aren't significant statistically. The value of determination coefficient shows that approximately 10% of changes CSR can be explained by corporate governance variables during the study period. In general, regression model isn't significant with respect to F-statistic and the Durbin-Watson statistic

shows that the model hasn't autocorrelation problem. Because of reciprocal relations between corporate governance mechanisms, it should be investigated relations these factors with corporate social responsibility separately.

**Table 3:** General Regression Model-with control variables.

| Dependent Variable: CSR |                    | Method: Least Squares |                   |
|-------------------------|--------------------|-----------------------|-------------------|
| Variables               | Coefficient        | t-Statistic           | Probability       |
| C                       | 4.38               | 3.73                  | 0.00              |
| PIO                     | -0.13              | -0.27                 | 0.79              |
| OC                      | 0.56               | 0.9                   | 0.38              |
| OBD                     | 0.41               | 1.51                  | 0.15              |
| FF                      | 0.36               | 0.53                  | 0.6               |
| AT                      | 0.07               | 0.12                  | 0.91              |
| LEV                     | -0.004             | -0.13                 | 0.9               |
| SIZE                    | -0.11              | -1.31                 | 0.2               |
| CFO                     | 0.7                | 1.87                  | 0.07              |
| R-squared               | Durbin-Watson Stat | F-statistic           | Prob(F-statistic) |
| 0.26                    | 2.25               | 0.95                  | 0.5               |

**Table 4:** General Regression Model- without control variables.

| Dependent Variable: CSR |                    | Method: Least Squares |                   |
|-------------------------|--------------------|-----------------------|-------------------|
| Variables               | Coefficient        | t-Statistic           | Probability       |
| C                       | 3.21               | 6.69                  | 0.00              |
| PIO                     | -0.17              | -0.37                 | 0.72              |
| OC                      | 0.59               | 0.96                  | 0.35              |
| OBD                     | 0.37               | 1.35                  | 0.19              |
| FF                      | 0.36               | 0.54                  | 0.59              |
| AT                      | 0.18               | 0.3                   | 0.76              |
| R-squared               | Durbin-Watson Stat | F-statistic           | Prob(F-statistic) |
| 0.1                     | 2.22               | 0.58                  | 0.71              |

The regression model between CSR & PIO in Table 5 indicates that relation between these variables is positive but no significant statistically. Determination coefficient shows that 15% of changes CSR can be stated by PIO during the study period. In general, regression model isn't significant with respect to F-statistic and the Durbin-Watson statistic shows that the model hasn't autocorrelation problem. The positive relation between above variables indicates that PIO as one of corporate governance mechanisms leads to increase CSR in accepted companies in TSE.

**Table 5:** Regression Model of PIO on CSR- with control variables.

| Dependent Variable: CSR |                    | Method: Least Squares |                   |
|-------------------------|--------------------|-----------------------|-------------------|
| Variables               | Coefficient        | t-Statistic           | Probability       |
| C                       | 4.91               | 5.82                  | 0.00              |
| PIO                     | 0.17               | 0.73                  | 0.47              |
| LEV                     | -0.006             | -0.25                 | 0.8               |
| SIZE                    | -0.1               | -1.37                 | 0.18              |
| CFO                     | 0.66               | 1.81                  | 0.08              |
| R-squared               | Durbin-Watson Stat | F-statistic           | Prob(F-statistic) |
| 0.15                    | 2.5                | 1.16                  | 0.35              |

The regression model between CSR & OC in Table 6 indicates that relation between these variables is positive but no significant statistically. Determination coefficient shows that 16% of changes CSR can be stated by OC during the study period. In general, regression model isn't significant with respect to F-statistic and the Durbin-Watson statistic shows that the model hasn't autocorrelation problem. The positive relation between above variables indicates that OC as one of corporate governance mechanisms leads to increase CSR in accepted companies in TSE.

**Table 6:** Regression Model of OC on CSR- with control variables.

| Dependent Variable: CSR |                    | Method: Least Squares |                   |
|-------------------------|--------------------|-----------------------|-------------------|
| Variables               | Coefficient        | t-Statistic           | Probability       |
| C                       | 4.88               | 5.8                   | 0.00              |
| OC                      | 0.22               | 0.88                  | 0.39              |
| LEV                     | -0.008             | -0.34                 | 0.74              |
| SIZE                    | -0.1               | -1.42                 | 0.17              |
| CFO                     | 0.65               | 1.81                  | 0.08              |
| R-squared               | Durbin-Watson Stat | F-statistic           | Prob(F-statistic) |
| 0.16                    | 2.47               | 1.23                  | 0.32              |

The regression model between CSR & OBD in Table 7 indicates that relation between these variables is positive but no significant statistically. Determination coefficient shows that 20% of changes CSR can be stated by OBD during the study period. In general, regression model isn't significant with respect to F-statistic and the Durbin-Watson statistic shows that the model hasn't autocorrelation problem. The positive relation between above variables indicates that OBD as one of corporate governance mechanisms leads to increase CSR in accepted companies in TSE.

**Table 7:** Regression Model of OBD on CSR- with control variables.

| Dependent Variable: CSR |                    | Method: Least Squares |                   |
|-------------------------|--------------------|-----------------------|-------------------|
| Variables               | Coefficient        | t-Statistic           | Probability       |
| C                       | 4.97               | 6.08                  | 0.00              |
| OBD                     | 0.35               | 1.49                  | 0.15              |
| LEV                     | -0.001             | -0.05                 | 0.96              |
| SIZE                    | -0.12              | -1.64                 | 0.11              |
| CFO                     | 0.67               | 1.9                   | 0.07              |
| R-squared               | Durbin-Watson Stat | F-statistic           | Prob(F-statistic) |
| 0.2                     | 2.38               | 1.64                  | 0.19              |

The regression model between CSR & FF in Table 8 indicates that relation between these variables is negative but no significant statistically. Determination coefficient shows that 13% of changes CSR can be stated by FF during the study period. In general, regression model isn't significant with respect to F-statistic and the Durbin-Watson statistic shows that the model hasn't autocorrelation problem. The negative relation between above variables indicates that FF as one of corporate governance mechanisms leads to decrease CSR in accepted companies in TSE.

**Table 8:** Regression Model of FF on CSR- with control variables.

| Dependent Variable: CSR |                    | Method: Least Squares |                   |
|-------------------------|--------------------|-----------------------|-------------------|
| Variables               | Coefficient        | t-Statistic           | Probability       |
| C                       | 5.008              | 5.36                  | 0.00              |
| FF                      | -0.06              | -0.17                 | 0.86              |
| LEV                     | -0.006             | -0.25                 | 0.8               |
| SIZE                    | -0.1               | -1.3                  | 0.2               |
| CFO                     | 0.65               | 1.77                  | 0.08              |
| R-squared               | Durbin-Watson Stat | F-statistic           | Prob(F-statistic) |
| 0.13                    | 2.56               | 1.01                  | 0.42              |

The regression model between CSR & AT in Table 8 indicates that relation between these variables is negative but no significant statistically. Determination coefficient shows that 14% of changes CSR can be stated by AT during the study period. In general, regression model isn't significant with respect to F-statistic and the Durbin-Watson statistic shows that the model hasn't autocorrelation problem. The negative relation between above variables indicates that AT as one of corporate governance mechanisms leads to decrease CSR in accepted companies in TSE.

**Table 9:** Regression Model of AT on CSR- with control variables.

| Dependent Variable: CSR |                    | Method: Least Squares |                   |
|-------------------------|--------------------|-----------------------|-------------------|
| Variables               | Coefficient        | t-Statistic           | Probability       |
| C                       | 5.05               | 5.18                  | 0.00              |
| AT                      | -0.09              | -0.23                 | 0.82              |
| LEV                     | -0.007             | -0.27                 | 0.79              |
| SIZE                    | -0.1               | -1.31                 | 0.2               |
| CFO                     | 0.65               | 1.78                  | 0.09              |
| R-squared               | Durbin-Watson Stat | F-statistic           | Prob(F-statistic) |
| 0.14                    | 2.56               | 1.02                  | 0.42              |

Vector Autoregressive Estimates in table 10 show that about 35% of the changes in CSR in companies is determined by the corporate governance mechanisms and two prior year's CSR. The findings dictate the more than 19% (%35-%26) of the changes in CSR in companies is affecting by prior year's CSR (see table 3 & 10).

### Conclusion & Discussions:

This study was investigated relationship between corporate governance mechanisms and corporate social responsibility during the period 2003-2009 in Tehran Stock Exchange.

To measure of the corporate social responsibility as dependent variable was applied Singhapakdi *et al.* questionnaire (1996). Corporate governance mechanisms such as independent outside directors on the board (OBD), Percentage of institutional ownership (PIO), ownership centralization (OC), free float (FF) and auditor type (AT) are independent variables.

**Table 10:** Vector Autoregressive Estimates.

| Dependent Variable: CSR |             | Method: Least Squares |
|-------------------------|-------------|-----------------------|
| Variables               | Coefficient | t-Statistic           |
| C                       | 5.92        | 3.37                  |
| PIO                     | -0.33       | -0.65                 |
| OC                      | 1.06        | 1.38                  |
| OBD                     | 0.41        | 1.28                  |
| FF                      | 0.8         | 0.95                  |
| AT                      | -0.23       | -0.36                 |
| LEV                     | -0.01       | -0.39                 |
| SIZE                    | -0.1        | -1.22                 |
| CFO                     | 0.76        | 1.9                   |
| CSR (-1)                | -0.26       | -1.15                 |
| CSR (-2)                | -0.21       | -0.9                  |
| R-squared               | F-statistic |                       |
| 0.35                    | 0.95        |                       |

The results of this study have summarized in bellow:

- (1) Among of the original research variables, FF variable was of the most variation coefficient in study period; however, CSR was of the lowest variation coefficient in this period.
- (2) Findings indicate that outside board of directors (OBD) had the highest correlation with CSR. This matter show that the increasing of OBD leads to the increasing of CSR. That is, companies have more OBD, they are more responsible sociality.
- (3) The result shows that approximately 10% of changes CSR can be explained by corporate governance variables during the study period and this amount increases to 26% by adding control variables to regression model.
- (4) There is a positive and no significant relation between CSR & PIO.
- (5) There is a positive and no significant relation between CSR & OC.
- (6) There is a negative and no significant relation between CSR & FF.
- (7) There is a negative and no significant relation between CSR & AT.
- (8) There is a positive and no significant relation between CSR & OBD.
- (9) There is a negative and no significant relation between CSR & SIZE.
- (10) There is a negative and significant relation between CSR & LEV.
- (11) There is a positive and no significant relation between CSR & CFO.

#### **Suggestins For Future:**

For richness of conceptual basis in this field, it's suggested:

- (1) The investigation of the relationship between corporate governance mechanisms and other aspects of ethics such as professional commitment, organizational commitment; personal benefit and so on.
- (2) The investigation of the relationship between corporate governance mechanisms and the various aspects of ethics by nonlinear regression models.

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