# CSR and Accounting Transparency: Comparison with Korean Chaebol

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**ABSTRACT**

This study is a response to increasing interests in corporate social responsibility (CSR) after the announcement of ISO26000 and investments in South Korea. The purpose of this study is to examine the relationship between CSR activities and accounting transparency. To this end, CSR was divided into two categories in this study: strategic and defensive CSR. The study employed two different theories–agency theory and stakeholder theory—to explain the relationship between two different kinds of CSR and earnings management, using data from the Korea Economic Justice Institute (KEJI) index from 2013 to 2017. The samples were divided into two groups: Chaebol firms and all firms including both chaebol and non-chaebol firms, of which KEJI score was available. A modified Jones model was employed to estimate earnings management. Two major findings were drawn from this study. For all firms, the study found a negative and significant relationship between defensive CSR and earnings management. For chaebol firms only, a positively significant relationship was found between strategic CSR and earnings management. This study contributes to a better understanding of Korean firms' CSR activities and their motivations.

Keywords: CSR; earnings management; Chaebol; KEJI

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## 1. INTRODUCTION

A historical meeting between Jae-In Moon, the president of South Korea, and Jong-Eun Kim, the chairman of the National Defence Commission of North Korea, was held in the demilitarised zone called Panmunjom in Korea on April 27, 2018; they agreed on opening a peaceful era in Korea. The meeting was the cornerstone of another meeting later between Jong-Eun Kim and Donald J. Trump, the president of the United States; they discussed ending the Korean War eventually. Due to this peaceful mood, the investment interest in South Korea (Korea hereafter) has soared. The total amount of direct investments from overseas into Korea was less than 5 billion USD in the first quarter of 2018 (from January to March); however, the figure was more than doubled in the second quarter (from April to June) (Ministry of Trade, 2018).

Depending on the definition, a business group would represent legally independent firms that are tied through official and unofficial channels (Granovetter, 1995; Khanna and Rivikkin, 2001; Luo and Chung, 2005). Particularly in Korea, a business group consists of many subsidiaries governed by one major shareholder, commonly with his/her family members, and


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a part of the group dominates certain markets (Seo, 1995). The existence of this type of business groups has played a crucial role in the growth of Korean economy and vastly influenced the Korean society through politics, economy, culture, and so on (Kim, 2011). The Korean government named this type of business groups as 'chaebol,' a Korean equivalent of conglomerates, and has imposed a high level of regulations on them. As their influences have increased, the owners who govern the whole business groups have become an object of public interest and attention. This has led to some studies on the governance structure of chaebol firms (Jin, 2000; Park and Paek, 2000; Song, 2007; Choi and Ahn, 2007; Kim and Choi, 2010; Jeon and Lee, 2013). However, research on the relationship between chaebol firms and their social responsibilities is rare. To fill this research gap, this study aims to investigate how chaebol firms take their social responsibilities, drawing on two different views.

Since the announcement of ISO26000 by the International Organisation for Standardization in November 2010, whether social responsibilities of chaebol firms are a mandatory (not selective) action has been briskly debated (Shin et al., 2011, Seo et al., 2012). According to the business literature, corporate social responsibility (CSR hereafter) is viewed as enhancing the value of firms, resulting in a positive impact on stakeholders by increasing their understanding of the firm (Husted and Allen, 2007). From the perspective of accounting, CSR is known to have a strong relationship with management sustainability. This study examines how CSR activities influence accounting transparency from two different theoretical angles: Agency theory' and stakeholder theory.

According to the stakeholder theory, CSR activities can give stakeholders a better understanding of and satisfaction with the firm. Frooman (1997) argues that there is a certain degree of interdependence between a firm and its stakeholders, and the firm needs to maintain a positive relationship with stakeholders to make and keep its business sustainable. CSR activities could heighten stakeholders' gratification, which, in turn, could bring positive impacts on the firm (Park, 2013). This, along with the direct effect of CSR in stakeholders (Schwartz, 1968), can contribute to reducing information asymmetry and enabling a deeper understanding of the firm. In this regard, CSR can enhance the value of a firm and its performance (e.g., revenues from increased customer loyalty) (Du and Sen, 2010; Balabanis et al., 1998; Orlitzky et al., 2003). It is also alleged that CSR has a positive relationship with accounting transparency and financial performance, particularly profit durability (Yoon et al., 1999; Jang and Choi, 2010; Han and Lee, 2013; Choi and Moon, 2013).

Meanwhile, it is argued that CSR may bring negative results, including increased agency costs. Studies show that expenditure for CSR activities could exceed the profit, resulting in a negative impact on a firm's value or performance (Bragdon and Marlin, 1972; Pava and Krausz, 1996; Brammer et al., 2006). Barnea and Rubin (2010) maintain that CSR can be appropriated as a tool to increase the manager's reputation rather than the firm's value. Due to these political and financial possibilities, the firm may have a motivation to do earnings management in the short term. Fan and Wong (2000) found that shareholders accumulated their private wealth from subsidiaries and, at the same time, were convicted of earnings management activities to conceal their embezzlement.

Literature has increasingly provided contrasting allegations, which could be explained by these two theories, reflecting two different types of CSR activities. One is called strategic CSR, which relates to active involvement in social issues and actions in an attempt to establish an effective relationship with stakeholders (Porter and Kramer, 2006; Bryan and David, 2007; Visser, 2010). The other is called defensive CSR, which relates activities to prevent risks from the firm's general operation and comply with regulations (Porter ad Krammer, 2006; Visser, 2010).


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This study defines strategic CSR as activities linked to the company's core business (performance), and defensive CSR as activities related to fending off regulations for the sake of stakeholders. It is assumed that different types of CSR (i.e., strategic CSR and defensive CSR), for which a firm has a different valuation, could be associated with earnings management, affecting accounting transparency. This study investigates not only CSR ratings but also CRS types to understand the characteristics of CSR activities and their relationship with accounting transparency by empirically comparing between chaebol firms and all firms including non-chaebol firms. The study uses quantitative data of CSR pulled out of the KEJI index. It also uses additional financial information from the KIS value between 2013 and 2017. The study employs a modified Jones model (Dechow et al., 1995) to estimate earnings management.

The composition of this paper is as follows. The next section is assigned to reviewing the literature on corporate governance, CSR, and Korean chaebol, to set research hypotheses. The following section describes methods employed in this study to test the hypotheses, including data collection and testing model. The fourth section presents findings from data analyses, and the last section discusses the implications of the findings and limitations of the study.

## 2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### 2.1 Earnings Management

Schipper (1989) defined earnings management as an intentional behavior of managers to involve the process of financial reporting to the outside of the company for their profit. They described two ways to engage earnings management activities: controlling the decision making process of finance or investment influencing actual cash flow and redesigning accounting methods. Watts and Zimmerman (1990) stated that managers adjust accounting information based on their strategic view. Scott (1997) noted that managers decide to maximize their profit, given authorized accounting regulations. Healy and Wahlen (1999) found that managers deliberately misled investors or creditors about their accounting information by amending information for contract relationships.

It is argued that the root of earnings management could be information asymmetry and agency problems. If managers do not inform accurate information to the market, shareholders could not make optimal decisions. Earnings management is also used to reduce taxes by earnings smoothing, to reduce political expenses, to maximize manager compensations, and so on. A terminology called earnings manipulation is similar to earnings management. Earnings management and earnings manipulation may have different notions; earnings management as adjusting management activities of accounting, finance or production within the regulations of the Generally Accepted Accounting Principles (GAAP), and earnings manipulation as accounting activities violating the regulations. Due to the difficulty in distinguishing motivations and consequences between them, most studies on earnings management have not distinguished these two notions (Kwon, 2010). This paper follows this practice; although only earnings management is used in this paper, it does not necessarily mean to distinguish it from earnings manipulation.

This paper employs discretionary accrual, one of the most popular methods to measure earnings management. Early studies used the Jones model (1991); however, a modified Jones model has been developed and widely used since Dechow et al. (1995). Palepu et al. (1996) show that external investors rely on the firm's profit information as one of the biggest factors in their decision for investment. Hence, managers have a temptation toward earnings


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management; they discretionarily configure account methods to acquire more investment. According to a survey study conducted by Graham et al. (2005) about how managers maintain short-term profits, 80% of managers who participated in the survey reported that they used discretionary accrual to meet the profit threshold, and 55.3% reported that they decided to delay a new project even though this decision might be harmful to the firm.

According to the agency theory, a conflict of interest between shareholders and the management may cause information asymmetry between them, adverse selection, and moral hazard. Previous studies show how easily the management engages earnings management. Studies have investigated the relationship between corporate governance and earnings management as well as between CSR and earnings management in an attempt to find ways to reduce or eliminate agency problems.

## 2.2 Corporate Governance

It may not be possible to define corporate governance with only one sentence. A narrow, classical definition focuses on the financial aspect of firms. For instance, Shleifer and Vishny(1997) defined corporate governance as “the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (p. 2). Parkinson (1994) considered it as a supervising and controlling process, which was intended to ensure that the firm’s management activities are aligned with shareholders’ interests. All activities are designed to establish internal rules to ensure business compliance with responsibilities imposed on the firm. It entails the trusteeship of the firm’s assets (Cannon, 1994). This shareholder-oriented view focuses on the conflict of interest between the management and shareholders.

Meanwhile, a broader definition of corporate governance considers adjusting balances between economic and social objectives and between individual and public goals. It is to align the concerns from individuals, firms, and society as close as possible (Sir Adrian Cadbury, 1999). Tricker(1984) notes that corporate governance is not simply related to managing the business itself but to giving a comprehensive direction to the firm, supervising and guiding management activities and meeting legal standards of accountability even beyond the firm’s boundary. Aguilera (2005) pointed to the balance between an absolute power of the chief executive and other stakeholders to resolve power struggles among them. Solomon (2007) described corporate governance as a system of supervision and balance to ensure that the firm unloads its accountability onto all of its stakeholders and assumes social responsibilities in all business activities. It can be understood as a set of relationships between the board of directors and other stakeholders. It is a structure through which corporate goals are set (Organisation for Economic Co-operation and Development, 1999). Unlike the narrow, classical view, the broad perspective is more likely to focus on the social roles of the firm. It cares about not only internal shareholders but also stakeholders beyond the firm. It is hard to determine which definition or view is more accurate, but the broad one is employed in this paper because the contemporary globalization circumstance emphasizes the role of firms, especially multi-national corporates, in different societies, which exist beyond the boundary of firms (Korten 2001; Mokhiber & Weissman, 1999).

Studies on transparency related to corporate governance have dealt with the possibility of collusions, which are commonly built around a hierarchical network in firms (Kofman and Lawarree, 1993). Agency problems have been another subject of those studies on the transparency of corporate governance in that managers embezzle firm’s financial assets for their extra profit or make a decision against shareholders’ interests, causing inefficiency in asset allocations (Rezaee, 2003). Studies reveal that, especially since accounting transparency would


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be the most important part of transparency of the corporate, lack of accounting transparency could result from a problematic corporate governance system. Earnings management, therefore, could be key in addressing agency problems as a way to improve corporate governance. Previous studies on the relationship between corporate governance and earnings management have dealt with earnings management activities, systems of the board of directors and audit committee, and ownership structures. Beneish(1994) investigated the relationship between earnings management and financial statements and found characteristics of earnings management, including increasing account receivables, the rate of revenues, and accruals. Dechow et al. (1996) found that the firm had no internal audit committee and slid into earnings management if the chief executive was the founder and had massive power in the board. Beasley (1996) discussed some conditions for lower possibilities of accounting fraud, including more non-executive directors (NED), a lower proportion of directors who have a special relationship with the firm, and the existence of independent audit committee. The existence of these conditions would indicate the existence of an already-established corporate governance system that would contribute to reporting transparent and objective financial information and preventing arbitrary accounting choices.

A comprehensive study on the characteristics of earning management companies discovered that fraudulent companies tended to be small-size ones, have not been listed on the market, and have comparatively poor performances; however, the cost of accounting fraud was large relative to the firm size; furthermore, the firms committed accounting fraud over several accounting years. In most cases (72%), CEO was involved in the fraud; there was no audit committee (or, it did not work properly, even though the company built the committee); the percentage of NEDs in the board of directors was low; and, the founder or owner of the firm was one of the directors (even the chairman of the board of directors). As such, studies have demonstrated a strong relationship between corporate governance and accounting fraud (Beasley et al., 1999). Leuz et al. (2002) empirically analyzed earnings management and investigated systematic differences across different countries. They assessed degrees of earnings management with data from over 8,000 firms representing 31 countries between 1990 and 1999. The findings revealed a trend of fewer events of earnings management under such conditions as a relatively scattered ownership structure and a well-organized investor protection system. Previous studies commonly focused on earnings management practices and investor protections in law and claimed that the protection is one of the essential factors in making decisions about firm's regulations on ownership, dividend policies, or financing. They showed that, due to a system to protect the rights of external investors, the power of insiders was not enough to convert firm assets to their profits. Xie et al. (2003) studied the degree of earning management, relating it to independence, expertise, or activism of the board of directors, audit committee, and management commission, and found that higher independence, expertise, or activism was related to a lower level of earning management activities. In sum, the literature demonstrates that such factors as a higher rate of NEDs in the board, and NEDs who had a career of CEO, and more frequent meetings are associated with a lower level of earnings management.

## 2.3 Corporate Social Responsibility (CSR)

Corporate Social Responsibility (CSR) generally refers to a business approach to seeking profits not only for the firm itself but also the whole society, including employees, local communities, and countries, contributing to sustainable development for all stakeholders. However, the way CSR is understood varies across different organizations and scholars. The


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International Organisation for Standardisation defines CSR as making profits to different stakeholders and society through a contribution to the economy, society, environment, etc. (Lars, 2016). The World Bank refers it to corporate activities contributing to sustainable economic development and improvement of social values (Mazurkiewicz, 2004). The Organization for Economic Cooperation and Development (OECD) defines CSR as firms' activities to develop and mature a symbiotic relationship between the firm and the society (Gordon, K., 2001). AS far as scholars are concerned, Ells and Walton (1961) described CSR as an ethical view connecting between the corporate and the society. Sethi (1979) defined it as corporate activities to be in harmony with social obligations, values, and expectations by addressing social and environmental issues and complying with ethical regulations. Carroll (1979) states that firms with a CSR policy are making an effort for profits and being an ethical firm complying with the law at the same time. Wood, D (1991) argues that it is not right for firms to consider economic responsibilities only. To be recognized by the public as a socially valuable firm, the process to make profits should be legitimate and ethical. An example of CSR activities would be that firms donate a part of their profits back to society to improve its welfare or address social problems (Kotler and Nancy, 2006). As such, firms with a CSR policy tend to focus not only on accountabilities and responsibilities for their economic profits but also on their responsibilities for the employees, their families, local communities, and the whole society.

Carroll (1991) developed a CSR pyramid that addresses four aspects of CSR: (1) economic responsibility to maximize profits, (2) ethical responsibility to satisfy ethical regulations, (3) legal responsibility to comply with the laws, and (4) eleemosynary responsibility to contribute to the society. Drawing on this topology, Carroll and Pinkston (1996) investigated CEOs of 591 multi-national chemical companies located in the United States for 10 years and found that while ethical responsibilities had increased, the other responsibilities had decreased. Carroll and Edmonson (1999) investigated 503 companies of which owners were black people and found that the top priority of CSR was on economic responsibilities and that ethical responsibilities were given a priority over legitimate responsibilities. Buton, et al. (2000), based on their analysis of 165 university students in Hong Kong and 157 American students, found that Hong Kong students emphasized economic responsibilities more than American students but that there was no difference between them in terms of ethical and legal responsibilities. Meanwhile, Crane and Matter (2004) found that each of the four responsibilities had different meanings in different countries.

As far as the relationship between CSR and corporate performance, Friedman (1970) suggested that the management should consider various stakeholders of the firm, including employees, clients, local communities, addressing environment and education issues for sustainable performance and growth. Using the data of company rankings in taking responsibilities for local society and environment, profit rates, and accounting index of the Fortune 500 from 1982 to 1985, McGuire et al. (1988) discovered a positive relationship between CSR and financial performance. Roman et al. (1999) also examined the relationship between CSR and financial performance and found that 33 out of 52 results were positive with 14 being neutral and 5 negative. According to Barnea and Ruin (2006), when the expenditure for social responsibilities has the nature of intangible asset, it would contribute to improving the firm's value; however, if firm managers, who have discretionary power to determine the expenditure size, make an excessive expenditure to increase their reputation, the firm value would decrease, incurring agency costs.

Meanwhile, mixed results have been found from the studies on the relationship between CSR and earnings management; some studies reported a positive relationship, while others found a negative relationship. However, the methods to measure earnings management and CSR ratings


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varied across different studies, and, therefore, the findings were not comparable among different studies. Prior et al. (2008) found a positive relationship between earnings management and the level of CSR; they explained the finding in terms of managers' opportunism, strategic use of CSR to hide earnings management activities. In the regulated industry such as gamble, cigarette, weapons or brewing, the relationship between CSR and earnings management turned out to be positive. According to Kim and Venkatachalam (2011), the firms in the regulated industry tended to announce excellent reports to boost their reputations. On the other hand, Chin et al. (2008) found that that firms with a higher level of CSR were more likely not to hide demerit information; fewer activities of earnings smoothing and loss avoidance were observed in these firms. Beaudin and Chihet (2008) also found that firms with a higher degree of CSR were more likely to comply with ethical and legal regulations and less likely to attempt earnings management activities. On the continuum, Kim et al. (2012) discovered a negative relationship between levels of CSR and corporate earnings management activities, using the KLD index. This represents a case in which managers tend to rely on earnings management in an attempt to report a short term profit for their personal reasons, scarifying long term profit. CSR would have a positive impact on improving the firm's reputation (Fombrun and Shanley, 1990; Grow et al., 20015). The more the firms care about their reputations, the less the incidents of immoral activities would be considered; as a result, it is expected that earnings management would decrease. However, a possibility for managers to appropriate the strategic CSR still exist. (Fombrun and Shanley, 1999; Verschoor, 2005; Linthicium et al., 2010) This can be considered an agency cost in that managers engage in CSR for their personal interests rather than profits for shareholders and stakeholders of the firm (Jensen and Meckling, 1976; Carroll, 1979).

This study approaches understanding CSR from two perspectives: agency theory and stakeholder theory. Table 1 presents a classification of CSR from various studies. While different terminologies of CSR were used in previous studies, CSR could be classified into two different categories: strategy CSR and defensive CSR as used in this paper. As presented in Table 1, strategic CSR activities are highly related to corporate performance and thus entails making decisions to use assets effectively and to satisfy shareholders, which relates to agency theory; meanwhile, defensive CSR activities involve actions about stakeholders and legitimate regulations beyond the firm to prevent predictable risks from rising from activities that a firm normally carries based on stakeholder theory (Porter & Kramer, 2006; Bryan & David, 2007; park, 2013; Kim, 2013). Previous studies have been limited in considering motivations since they relied on just one comprehensive rating information from evaluation of CSR. To overcome this limitation, this study distinguishes CSR activities by their motivations. A firms that appreciates CSR as their expenditures tend to focus on strategic CSR that serves the firm and its customer; however, from the perspective of agency theory, overspending on CSR activities to bolster the manager's reputation could deteriorate corporate performance (Prior et al., 2008), resulting in a high likelihood for managers to rely on earnings management (Fan and Wong, 2000). On the other hand, from the perspective of stakeholder theory, if a firm considers CSR as a long-term investment for society, then it more likely to conduct defensive CSR activities, which concentrate on stakeholders and compliance (Murray & Volgel, 1997; Hillman et al., 2001). CSR is an aggregate of activities that can be selectively and strategically taken by the management. This is the reason that this paper does not simply consider whether comprehensive CSR ratings have an impact on the firm's transparency but classify it two different categories (i.e., strategic CSR and defensive CSR) by motivations to empirically investigate. Here is the first hypothesis.

***H1: There is a significant relationship between accounting transparency and the difference***


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***of CSR categories.***
***H1-1: Strategy CSR effects on earnings management.***
***H1-2: Defensive CSR impacts on earnings management.***

**Table 1. Definitions of strategy and defensive CSR.**

| Author | CSR Classification | Strategic CSR | Defensive CSR |
|---|---|---|---|
| Porter & Kramer (2006) | Strategic CSR<br>Responsive CSR | Strategic philanthropy leveraging behaviors and developing salient sections, reconstructing value chain modifying strategy. | Good citizen.<br>Mitigating risks from the value chain. |
| Bryan,& David (2007) | Strategic CSR<br>Traditional CSR | Managing shareholder relations to capture values added to the company. | Conducting good activities is its own return and profitable in the long run management.<br>Involving in social activities beyond what is demanded by the company's interests and the regulations. |
| Visser (2010) | Defensive CSR<br>Charitable CSR<br>Promotional CSR<br>Strategic CSR<br>Sytematic CSR | Strategic CSR encloses charitable CSR and promotional CSR.<br>Respond to Shareholders & NGOs/CSOs. | Undertaken only if and when it can be shown that shareholder and stakeholder values will be protected. |
| Mattingly & Berman(2006), Minor & Morgan (2011) | Positive CSR,<br>Negative CSR | The company can participate in activities that contribute to the scheme of the firm 'does the right thing.' | Cases including events like involvement in fights against regulators over safety and unethical campaigns. |

## 2.4 Korean Chaebol

A chaebol, a large conglomerate run and controlled by an owner or family in South Korea, has emerged to minimize trading expenditures and unpredictable risks from market imperfections (Khanna & Palepy, 1997; Leff, 1978). The Korean chaebol system could be characterized by its subsidiaries (or companies) that are actually managed like departments in a single organization, although they are all legally individual companies (Park et al., 2010). The chaebol has played a crucial role in developing and growing the Korean economy, influencing most of the Korean societies, including politics, economy, and culture (Kim, 2011). Given the tremendous influence of the chaebol, the Korea Fair Trade Commission (KFTC


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hereafter) investigates and discloses the chaebol's corporate governance in an effort to protect market competitions from the dominance of chaebols. In a chaebol, one major shareholder governs all subsidiary firms by owning shares of key firms that dominate the whole group of subsidiary firms (Park and Paek, 2000). Recognizing this characteristic of chaebols, most studies on chaebols have focused on corporate ownership structures. Jin (2000) investigated top five chaebols, focusing on their corporate governance, capital structure, and cross payment guarantee and found the ownership structure of chaebols had a significant influence on cross payment guarantee for subsidiaries. Park and Paek (2000) grouped Korean firms into chaebol firms and non-chaebol ones, investigated the relationship among ownership structure, capital structure, and firm value, and found that chaebol firms were more likely to use stocks to increase their ownership and that they use ownership and capital structure to increase the valuation and procuration of ownership. Also, various social phenomena in Korea were found to be related to the sharing structure of internal and external stakeholders of chaebols (Choi and Ahn, 2007; Jeon and Lee, 2013; Kim and Choi, 2010; Song, 2007).

As far as chaebols' CSR activities are concerned, two different views of motivations for earnings management may be employed to explain chaebols' CSR activities. First of all, from the perspective of agency theory that is linked to strategic CSR, more attempts for earnings management have been observed (citation). Since chaebol firms have more pressure and expectations from the public about CSR, it makes them spend more money to meet the heightened expectations. Chaebols regard CSR as social contributions (Lee and Choi, 2002) and sometimes use it to cover up their mistakes or low performances (Jung and Song, 2006). On the other side, since chaebol firms are highly monitored by stakeholders such as the government, related authorities, and even the public, they are less likely to conduct earnings management activities. More specifically, short-sighted earnings management would be stifled due to the disclosed ownership structure of chaebols (James, 1999; Anderson & Reeb, 2003). Song (2007) discussed the development of CSR in chaebols; they turned out to care about reputation from CSR and create a certain team to handle CSR, leading to highly systemized and strategic management of CSR. They have managed their reputation and image using CSR. Hence, this study sets another set of hypotheses as follows:

***H2: There is no relationship between accounting transparency and the difference of CSR categories of Chaebol.***
***H2-1: Strategy CSR of Chaebol effects on earnings management.***
***H2-2: Defensive CSR of Chaebol does not impact on earnings management.***

## 3. RESEARCH DESIGN

### 3.1 Sample and Data Collection

The sample data used for this study is from non-financial companies included in the KEJI index from 2013 to 2017, and financial information for control variables is from the KIS value available from the National Information and Credit Evaluation, Ltd. (NICE hereafter). The KEJI index is one of the most reliable and the oldest CSR index available in Korea, which is reported by the Korea Economic Justice Institute (KEJI) affiliated with the Citizens' Coalition for Economic Justice (CCEJ) since 1991. The KEJI has developed their own rating models to calculate values, using accounting and finance information as well as survey data from experts and the public about all companies listed on the Korea Composite Stock Price Index(KOSPI).


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They report top 200 firms and awards the best firm of the year based on the KEJI index. The index consists of six main categories: soundness, fairness, social contribution, customer protection, environmental management, and employee satisfaction. For the annual award, the KEJI publishes a booklet that contains the specific information of the categories and criteria on how they categorized and evaluated. The data used for this paper were collected from the booklets.

The NICE has four different business units--credit information, financial service, manufacturing, and new business--and has provided comprehensive credit and financial information on their web since 1989. It has credit information of the economic population, which represents 42 million people, and 500,000 politicians and business people, as well as financial information of over 400,000 firms in Korea.

This study follows previous studies in defining strategic CSR as the activities of selective and strategic decision-making for business performance and shareholders. The key words to represent strategic CSR activities are 'economic performance,' 'shareholder,' and 'customer.' From the agency theory, the existence of CSR activities would be for economic performance (Frederick, 1988; Friedman, 1970; Steiner, 1980), and sometimes it can be a cause of declined performance due to an excessively high expenditure on CSR activities relative to the profit increase that can be ascribed to them (Bragdon and Marlin, 1972; Brammer et al., 2006; Pava and Krausz, 1996). Also, when CSR activities are used to enhance manager's reputation (Barnea and Rubin, 2010), the agency cost caused by this behavior could increase, and this can be a reason for the deteriorated relationship between the management and shareholders. Furthermore, CSR activities strongly influence the loyalty of customers (Bhattachaya et al., 2010), and this implies a positive impact on firms' performance. Firms tend to use CSR activities to benefit from these possibilities (e.g., improved corporate identity, stronger loyalty from customers (Choi and Moon, 2013; Han and Lee 2013; Lee et al., 2012; Na and Hong, 2011; Park et al., 2014; Yoon et al., 1999). The criteria 'soundness' from KEJI index evaluates the relationship with shareholders and financial indicators. Besides, 'customer protection' contains indicators to represent customer satisfaction and their rights.

Drawing on the stakeholder theory, defensive CSR is defined as decisions to prevent possible problems that could arise from general operations of the firm's management. Stakeholders consist of groups or individuals including the government and employees who can criticize and give pressure on the firm's management; they have a relationship, direct or indirect, with the management, influencing the firm (Freeman, 2010; Freeman and Evan, 1991). Schwart (1968) noted that expenditures on CSR activities could be understood as an investment in intangible assets, increasing the long-term values of the firm (Hillman et al., 2001). It is obvious that the long-term valuation has always been an important issue for the business, and CSR activities contribute to it by 'sustainable management' (KBCSD[1], 2007). Sustainable management is a comprehensive strategy for the whole society and environment, which means more than just environmental or ethical management (Kim, 2007; Kim et al., 2010). Recently, sustainable management is understood as the same concept of CSR; that is, it accepted that sustainability is the accounting concept of CSR and can be achieved through accounting transparency (Choi and Moon, 2013; IFAC[2], 2006). In this regard, it can be assumed that CSR and sustainable management, which deal with society and environment, have a strong relationship with stakeholders such as the government and employees. From this stream of business field, a desire to establish standards to evaluate or monitor activities for various and countless

[1] Korea Business Council for Sustainable Development.
[2] International Federation of Accountants


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stakeholders has emerged (Lee, 2008). Recognizing this, ISO established an international standard for CSR in 2001 and announced ISO 26000[3] in 2011. Although ISO 26000 is not legally binding, a reasonable level of international agreements has been made, and it has been accepted as the main agent of CSR to all organizations (ISO, 2010), including not only companies but also other organizations such as the dental association in Australia (Pearson, 2011). Another aspect of the CSR phenomena is that it is viewed as the reflection of legitimacy. To sum up, for defensive CSR that draws on the stakeholder theory, the keywords can be 'government,' 'employee,' 'environment,' 'society,' and 'legitimacy.' From the KEJI index, the category 'fairness' refers to complying with the fair trade law, representing transparency reported to the government and the public. Meanwhile, the category 'social contributions' covers such activities to the society as employment equality and contribution for welfare. The category 'environmental management' represents how the firm makes an effort for a better environment as exemplified by the investment in the environment or records of certificates or awards from the government. Finally, the category 'employee satisfaction' covers the safety at the workplace, the relationship between the management and the employees, assessing how much the management invests in the welfare and development of human resources. The 5 categories from the KEJI index are sorted into defensive CSR. Table 2 shows the keywords from the previous studies and the corresponding categories of the KEJI index.

**Table 2. KEJI categories corresponding to different types of CSR.**

| CSR types | Related theories | Key words | KEJI |
|---|---|---|---|
| **Strategic CSR** | **Agency Theory** | **Economic performance, Shareholder, Customer** | **Soundness, Customer Protection** |
| **Defensive CSR** | **Stakeholder Theory** | **Government, Environment, Society, Employee, Legitimacy** | **Fairness, Social Contribution, Environmental Management, Employee Satisfaction** |

Sub-level indicators to measure the KEJI categories are based on the main agents, stakeholders or the firm itself, influenced the CSR activities as shown in Table 2. Table 3 describes all specific indicators divided by two different types of CSR and by keywords. For strategic CSR, such indicators R&D expenditures, consumer spending, equipment investment, financial risk, affiliate financing and debt guarantee of affiliate are employed to measure the incentive for firm's economic performance that corresponds to 'soundness' category in the KEJI index. Such indicators as internal share rate, hiring CEO, NED activities, and ownership gap are used to evaluate the incentive for shareholders. Finally, indicators such as customer satisfaction or safety for certifications or awards are used to assess the customer protection category, which represents a strategy for customer relationship management (CRM) to acquire customer loyalty.

Regarding defensive CSR, the indicators for the categories of social contribution and employee satisfaction are tied into the society and the employees, respectively, as listed in Table

[3] http://www.iso.org/sites/iso26000launch/index.html


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3. For the environmental management category, such indicators as energy efficiency and investment in the environment are used to assess the keyword of the environment. Regulations about pollution are key indicators to measure the keyword of legitimacy. In case of fairness, such indicators as large corporate group, subsidiary relationship, report insincerity, business reporting, audit committee, and voting system are included to measure the keyword of government.

**Table 3. Indicators divided by two CSRs.**

| CSR types | incentives | KEJI index evaluation indicator |
|---|---|---|
| Strategic CSR | Shareholder, | Internal Share Rate, Hiring CEO, NED Activities, Ownership Gap, |
| | Economic Performance, | Consumer Spending, R&D Expenditure, Equipment Investment, Risk, Affiliate Financing, Debt Guarantee of Affiliate, |
| | Customer | Customer Satisfaction Certification, Customer Satisfaction Award, The Number of Customer Complaint, Customer Safety Certification and Quality |
| Defensive CSR | Government, | Large Corporate Group, Subsidiary Relationship, Report insincerity, Business Reporting, Audit Committee, Voting System, |
| | Environment, | Environmental Management Report, Energy Efficiency, Investment on Environment, Environment Protection Programme, Environment Affinity, |
| | Society, | Disables Employment Rate, Women Employment Rate, Employment Award, Donation, Welfare Support |
| | Employee, | Work Place Safety, Education Expenditure per Capita, Increase Rate of Education Expenditure, Labour Dispute, Temporary Employee Rate, Labour-Management Relation Improvement Programme, Wage and Welfare |
| | Legitimacy | Fair Trade Compliance, Separation of Industrial and Financial Capital, Tax Evasion, Contamination Violation |

### 3.2 Hypotheses Testing Model

This study uses discretionary accruals to examine earnings management activities. A modified Jones model (Dechow et al., 1995) is employed.

$$DA_{ijt} = \frac{TA_{ijt}}{A_{ijt-1}} - \left[a_0\left(\frac{1}{A_{ijt-1}}\right) + a_1\left(\frac{\Delta REV_{ijt} - \Delta AR_{ijt}}{A_{ijt-1}}\right) + a_2\left(\frac{PPE_{ijt}}{A_{ijt-1}}\right)\right]$$


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Where, $DA$ is discretionary accruals for firm i in industry j in year t,
$TA$ is total accruals for firm i in industry j in year t,
$\Delta REV$ is the change of revenue for firm i in industry j between year t-1 and t,
$\Delta AR$ is the change of accounting receivable firm i in industry j between year t-1, $PPE$ is gross property, plant and equipment for firm i in industry j in year t and
$A$ is total asset for firm I in industry j at the end of year t-1.

$$DA_t = \beta_0 + \beta_0 csrs\ (or\ csrd)_t + \beta_2 size_t + \beta_3 big_t + \beta_4 cfo_t + \beta_5 ni_t + \beta_6 lev_t + \beta_7 gro_t + \epsilon_t$$

where, $csrs$ is KEJI index for strategic CSR,
$csrd$ is KEJI index of defensive CSR,
$size$ is firm size (=ln $A$),
$big$ is hiring big accounting firm or not (dummy, when the company hired one of the big 4 companies – PwC, KPMG, E&Y and Deloitte-, it is coded as 1, or 0 when not hired),
$cfo$ is cash flow for operation / underlying asset,
$ni$ is net income (dummy, when the net income increases, it coded as 1, or 0),
$lev$ is debt ratio (liability / asset) and
$grw$ is firm's growth ((total asset – underlying total asset) / underlying total asset).

In the model, the KEJI index of $csrs$ and the KEJI index of $csrd$ are independent variables, measured as sum of scores from the categories representing strategic CSR and defensive CSR, respectively. For $csrs$, the total score from soundness and customer satisfaction is 45 for strategic CSR, and the total score from fairness, social contribution, customer protection, environment management, and employee satisfaction is 55 for defensive CSR. Regarding control variables, hiring big account companies, firm size, cash flow for operation, net income, debt ratio and return on asset (ROA hereafter) are used. Among them, $big$ and $ni$ were used as dummy variables. More specifically, for $ni$, when net income increased compared to the last term, it is coded as 1. Increasing or decreasing income is easily used to conceal deterioration of business performance or save current income for the later term, respectively (DeFond and Park, 1997). Becker et al. (1998) found that whether firms hire big accounting firms such as PwC, KPMG, E&Y or Deloitte for auditing could influence the discretionary accrual, so it is also included in the model as a control variable. According to Defond and Jiambalvo (1994), a higher debt ratio may indicate a higher possibility to violate the debt contract, and in this case, managers are more likely to try earnings management. However, a negative relationship between debt ratio and earnings management was also reported (DeAngelo et al., 1994). Firm size, another control variable, seems to be a cause of reporting reduced accounting profit due to increased political expenditure (Watts and Zimmerman, 1996), but some other empirical investigations revealed a mixed result, either positive or negative (Son, 2008). Previous studies provide a negative relationship between cash flow for operation and accruals (Derwall et al., 2005).

### 3.3 Chaebol Data

In 2010, the KFTC reported 45 chaebols, each of which has a total asset of over 5 trillion Korean Won(KRW hereafter); the law of monopoly regulation and fair trade banned these


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chaebols from cross investing or guaranteeing the liabilities. The KFTC report is available on a yearly basis.[4]

The criteria for listing up chaebol firms for this study are as follows:

1) Firms are governed by one management scheme effectively owned by one person or his/her family, but they are officially individual firms by the law.
2) If firms do not have owners, they are not classified as chaebol firms for this study.
3) When the owner is a firm, and when it is also influenced by the owner or their family, the firm is classified as a chaebol firm.
4) Among the chaebol firms selected based on the criteria 1) through 3) above during the whole period between 2013 and 2017, only firms that have the KEJI index are included for the purpose of this study.

**Table 4. Chaebol company selection**

| Restricted firms by the regulation of KFTC from 2013 to 2017 | Restricted companies with KEJI index | Companies DO NOT have owners or public enterprises | Companies have certain owners (Chaebol firms) |
|---|---|---|---|
| Samsung, Hyundai Motors, SK, LG, Lotte, Posco, GS, Hanhwa, Hyundai Heavy Industry, Shinsegye, KT, Doosan, Hanjin, CJ, Buyong, LS, Daerim, Kumho-Asiana, DSME, Mirae asset, S-oil, Hyundai Department Store, OCI, Hyosung, Youngpung, KTNG, Daewoo Construction, KCC, Kolon, Korea Tire, Kyobo, Dongbu, Hanra, Seah, GM Korea, Eland, Amore Pacific, Taekwang, Dongguk | SK, LG, Posco, GS, Hanhwa, Shinsegye, KT, Doosan, Hanjin, CJ, LS, Hyundai Department Store, OCI, Hyosung, Youngpung, Daewoo Construction, KCC, Kolon, Amore Pacific | KTNG, GM Korea | SK, LG, Posco, GS, Hanhwa, Shinsegye, KT, Doosan, Hanjin, CJ, LS, Hyundai Department Store, OCI, Hyosung, Youngpung, Daewoo Construction, KCC, Kolon, Amore Pacific |

## 4. RESULTS

### 4.1 Results of the First Hypothesis

The sample data represents 1,634 firms from 2013 to 2017. Mean, standard deviation SD hereafter), minimum and maximum values are shown in Table 5. From the Discretionary accruals, mean and SD are -0.0005 and 0.1294, respectively. The mean values of strategic and defensive CSR are 26.2848 and 37.1336, respectively. Since the full scores of each category are 45 and 55, the mean value of defensive CSR is a little higher than strategic CSR. When calculated again to simply compare two scores, strategic CSR gets 58.41, and defensive CSR

[4] Korean Fair Trade Commission, "the Cross Investment Limit Regulation", (01/04/2010)


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takes 67.51 out of 100.[5] This result shows that the score of defensive CSR still higher than strategic CSR.

**Table 5. Descriptive statistics of all samples**

| Variable | Mean | Std. | Min | Max | 0bs |
|---|---|---|---|---|---|
| 1.Discretionary accruals | -0.0005 | 0.1294 | -0.9193 | 1.2221 | 1634 |
| 2.Strategy CSR | 26.2848 | 1.8419 | 19.8338 | 32.4585 | 1634 |
| 3.Defensive CSR | 37.1336 | 2.8675 | 27.0691 | 42.8834 | 1634 |
| 4.Firm size | 11.6078 | 0.6201 | 9.8519 | 13.7343 | 1634 |
| 5.Return on asset | 0.0244 | 0.1895 | -1.5149 | 5.0132 | 1634 |
| 6.Debt ratio | 0.3984 | 0.2193 | 0.0007 | 1.5239 | 1634 |
| 7.Cash flow from operation | 0.0479 | 0.0864 | -0.7527 | 0.7906 | 1634 |
| 8.Net income | 0.5232 | 0.4996 | 0 | 1 | 1634 |
| 9.Big4 | 0.6603 | 0.4737 | 0 | 1 | 1634 |

As shown in Table 5, the sample firms included in this study have a debt ratio of 39.84%. Nearly 70% of the firms (0.6603 to be specific) have employed 4 major accounting firms for auditing.

Table 6 presents the correlations between variables. The variables from 1 to 9 in Table 6 represent the same variables in Table 5.

**Table 6. Correlation of all samples**

| Variable | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|---|---|---|---|---|---|---|---|---|---|
| 1.DACC | 1 | | | | | | | | |
| 2.CSRS | -0.7633 | 1 | | | | | | | |
| 3.CSRD | -0.0529 | 0.0565 | 1 | | | | | | |
| 4.SIZE | -0.0377 | -0.0161 | 0.0128 | 1 | | | | | |
| 5.ROA | -0.0218 | -0.0220 | 0.0121 | 0.1233 | 1 | | | | |
| 6.LEV | 0.0169 | 0.0044 | -0.0231 | 0.0639 | -0.1994 | 1 | | | |
| 7.CFO | -0.0167 | 0.0101 | -0.0001 | 0.2190 | 0.3656 | -0.0199 | 1 | | |
| 8.NI | 0.0423 | -0.0555 | 0.0106 | -0.0068 | 0.1870 | 0.0180 | 0.1195 | 1 | |
| 9.BIG4 | -0.0238 | 0.0037 | 0.0109 | 0.4535 | 0.0678 | 0.0012 | 0.1117 | 0.0062 | 1 |

The relationships between discretionary accrual and strategic CSR and defensive CSR are all negative. This means that, regardless of the types of CSR, CSR activities could have a suppressive effect in earnings management. As far as other control variables are concerned, some correlations are similar to those presented in previous studies. Cooperating with big 4 companies and cash flow from the operation have a negative relationship with earnings management (Becker et al., 1998; Derwall et al., 2005). Some studies reported different results (Defond and Jiamblavo, 1994; DeAngelo, 1994; Watts and Zimmerman, 1996; Son, 2008).

[5] Strategy CSR = 26.2848*100/45, Defensive CSR = 37.1336*100/55


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Table 7 presents the result of multivariate regression to test the first set of hypotheses. Based on the 0.05 alpha level, the coefficient of strategic CSR turned out to be -0.0004 but insignificant. On the other hand, the coefficient of defensive CSR was -0.0024 and statistically significant; hence, it can be concluded that defensive CSR is negatively and significantly associated with discretionary accrual, confirming the hypothesis *H1-2*. This implies that the possibility of earnings management can be reduced if firms focus more on defensive CSR activities. This finding suggests that firms should consider stakeholders, including society and environment beyond their business boundary, for a long-term profit, since defensive CSR activities have an effect in refraining firms from earnings management activities.

**Table 7. Multi-variable regression of all samples**

| Variable | Strategy CSR | | Defensive CSR | |
|---|---|---|---|---|
| | Coeff. | Pr > ltl | Coeff. | Pr > ltl |
| **Strategy CSR** | **-0.0004** | **0.821** | | |
| **Defensive CSR** | | | **-0.0024** | **0.031*** |
| Firm size | -0.0064 | 0.282 | -0.0062 | 0.294 |
| Return on asset | -0.0144 | 0.445 | -0.0141 | 0.454 |
| Debt ratio | 0.0081 | 0.589 | 0.0073 | 0.623 |
| Net income | 0.0120 | 0.068 | 0.0122 | 0.062 |
| Big4 | -0.0022 | 0.772 | -0.0021 | 0.777 |
| Cash flow from operation | -0.0099 | 0.808 | -0.0107 | 0.792 |
| _cons | 0.0768 | 0.348 | 0.1541 | 0.048* |
| Ind. dum. | Included | | Included | |
| Year dum. | Included | | Included | |
| $R^2$ | 0.0041 | | 0.0070 | |
| Adj. $R^2$ | -0.0001 | | 0.0027 | |
| 95% Conf. Interval | | | | |

Note. * and ** represent the level of significance at 0.05 and 0.01 respectively.

### 4.2 Results of the Second Hypothesis

Twenty-two chaebol firms, which are restricted on mutual investment and payment guarantee by the KFTC and are included in the KEJI index, are included in this study; the duration is the same (2013 – 2017). Table 8 presents descriptive statistics for the chaebol firm. Mean and SD are -0.0175 and 0.0744, respectively. Both strategic (38.5864) and defensive CSR (42.3064) turned out to be relatively higher than the mean values of the total sample. These higher scores can be explained by the fact that chaebol firms are well organized for CSR activities (e.g., having a designated department to handle CSR) (Park, 2017). When recalculated for a direct comparison between strategic CSR and defensive CSR, the former is 83.74756 with the latter being 76.9207 out of 100. Unlike the whole samples, the figure for chaebols' strategic CSR activities is higher than that for defensive CSR. This may imply a trend in which chaebol firms are more likely to strategically manage CSR activities. Regarding


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control variables, the size of chaebol firms (12.6877) is higher than the average size of the whole firms (11.6078); most of them have employed big 4 accounting firms.

**Table 8. Descriptive statistics of Chaebol**

| Variable | Mean | Std. | Min | Max | 0bs |
|---|---|---|---|---|---|
| 1.Discretionary accruals | -0.0175 | 0.0744 | -0.2035 | 0.0219 | 100 |
| 2.Strategy CSR | 38.5864 | 2.9418 | 30.7426 | 44.8663 | 100 |
| 3.Defensive CSR | 42.3064 | 3.1436 | 34.7426 | 49.1194 | 100 |
| 4.Firm size | 12.6877 | 0.4442 | 11.9822 | 13.7343 | 100 |
| 5.Return on asset | 0.0251 | 0.0551 | -0.2174 | 0.3309 | 100 |
| 6.Debt ratio | 0.3934 | 0.2253 | 0.0339 | 0.8513 | 100 |
| 7.Cash flow from | 0.0472 | 0.0389 | -0.0638 | 0.1789 | 100 |
| operation | 0.4900 | 0.5024 | 0 | 1 | 100 |
| 8.Net income | 0.9800 | 0.1407 | 0 | 1 | 100 |
| 9.Big4 | | | | | |

Table 9 presents the result of correlation analysis for chaebol firms., Both strategic and defensive CSR turned out to have a positive relationship with earnings management, implying that chaebol firms conducting CSR activities tend to be involved in earnings management. There is also a negative relationship with firm size, which is the same as the total samples. In Korea, as the public expects higher responsibilities from bigger-size firms and keep eyes on them, relatively smaller firms that are less exposed to the public are more likely to do earnings management (Song, 2007Even relatively smaller chaebol firms that do not draw the public attention much would be more liable to conduct earnings management. Most chaebol firms employ big 4 accounting firms for auditing, and a positive relationship with earnings management is found, which is different from that of the total samples.

**Table 9. Correlation of Chaebol**

| Variable | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|---|---|---|---|---|---|---|---|---|---|
| 1DACC | 1 | | | | | | | | |
| 2CSRS | 0.2230 | 1 | | | | | | | |
| 3CSRD | 0.1907 | 0.9653 | 1 | | | | | | |
| 4SIZE | -0.0103 | -0.0741 | -0.0518 | 1 | | | | | |
| 5ROA | 0.2041 | -0.0214 | -0.0422 | 0.0915 | 1 | | | | |
| 6LEV | -0.0550 | -0.1958 | -0.2513 | 0.0232 | -0.3886 | 1 | | | |
| 7CFO | -0.0731 | -0.1304 | -0.1610 | 0.3645 | 0.3174 | -0.1397 | 1 | | |
| 8NI | 0.1605 | 0.0831 | 0.0783 | 0.0221 | 0.3727 | 0.0239 | 0.2078 | 1 | |
| 9BIG4 | 0.1634 | 0.0830 | 0.1554 | 0.1479 | 0.3101 | -0.2696 | 0.1218 | -0.0029 | 1 |


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**Table 10. Multi-variable regression of Chaebol**

| Variable | Strategy CSR | | Defensive CSR | |
|---|---|---|---|---|
| | Coeff. | Pr > ltl | Coeff. | Pr > ltl |
| **Strategy CSR** | **0.0053** | **0.045*** | | |
| **Defensive CSR** | | | **0.0041** | **0.108** |
| Firm size | 0.0027 | 0.878 | 0.0016 | 0.928 |
| Return on asset | 0.2852 | 0.091 | 0.2948 | 0.087 |
| Debt ratio | 0.0254 | 0.497 | 0.0266 | 0.490 |
| Net income | 0.0136 | 0.405 | 0.0136 | 0.411 |
| Big4 | 0.0615 | 0.274 | 0.0559 | 0.328 |
| Cash flow from operation | -0.2702 | 0.209 | -0.2648 | 0.226 |
| _cons | -0.3287 | 0.182 | -0.2799 | 0.254 |
| Ind. dum. | Included | | Included | |
| Year dum. | Included | | Included | |
| $R^2$ | 0.1293 | | 0.1156 | |
| Adj. $R^2$ | 0.0630 | | 0.0483 | |
| 95% Conf. Interval | | | | |

Note. * and ** represent the level of significance at 0.05 and 0.01 respectively.

The findings of multivariate regression for chaebol firms are opposite to those for the total firms, as presented in Table 10. No significant relationship between defensive CSR and discretionary accrual was found; however, the correlation of strategic CSR with earnings management turned out to be positive and significant, confirming the hypothesis *H2-1*. It can be interpreted that, because chaebol firms have more attention from the public, they tend to manage and use CSR for their reputation. This may motivate them to concentrate on strategic CSR than defensive CSR; moreover, firms that are more likely to conduct strategic CSR activities also have a greater possibility to do earnings management activities.

## 5. CONCLUSION

The inter-Korea summit in April 2018 led to more interests in investing in Korea, especially the south part, has increased (Ministry of Trade, Industry and Energy, 2018). In 2010, after the introduction of ISO26000, corporate social responsibility had arisen as one of the most vigorously debatable issues around the world and in Korea as well (Kwon, 2014). However, research on CSR activities of Korean firms is still not enough (Na, 2017). One of the characteristics of Korea economy could be the existence of chaebol firms, which are huge business groups that dominate the economy as well as society in Korea (Seo, 1995). A Korean chaebol can be defined as a large business group that have many subsidiaries, which are legally independent of each other but are actually managed like different departments in a firm by one person or his/her family who possess ownership of subsidiaries holding a significant proportion of their shares (Jin, 2000; Park and Paek, 2000; Song, 2007; Choi and Ahn, 2007; Kim and


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Choi, 2010). The government designates those business groups as chaebols and strictly manage them (Jeon and Lee, 2013). This study selected chaebol firms from the list reported by the KFTC.

CSR activities can be explained by two different theories of corporate governance: agency theory and stakeholder theory. Firstly, from agency theory's view, the main issue about CSR activities would be that the expenditure on CSR activities exceeds the benefits from them and that CSR can be appropriated as a means to enhance the manager's reputation (Bragdon & Marlin, 1972; Brammer et al., 2006; Pava & Krausz, 1996; Barnea & Rubin, 2010). Secondly from the perspective of stakeholder theory, firms should focus on satisfying not only shareholders but also other stakeholders like the government and employees (even their families), and thus they conduct CSR activities that contribute to the society beyond the firm's boundary, which, in turn, can positively influence the firm (Frooman, 1997). The satisfaction from the stakeholders could be the biggest part of CSR, and that would help escalate the firm value in the long run, having a positive impact on corporate performance (Hilman et al., 2001, Park, 2013). This study categorized CSR into two different ones (i.e., strategic CSR and defensive CSR) and employed two theories to explain why a firm choose one over the other. Strategy CSR can be defined as pre-emptive and strategic activities concentrating economy performances of the firm for shareholders' interests. In contrast, defensive CSR can be defined as CSR activities focusing on society; it considers stakeholders and long-term corporate valuations, so-called sustainable management. This study used the KEJI index to collect sample data; the KEJI provides an index covering 374 companies between 2013 and 2017 and is the oldest and one of the most reliable rating index of CSR in Korea (Park, 2017). Chaebol firms individually have a total asset of more than 5 trillion KRW and are restricted on cross-investment and a payment guarantee. The number of sample chaebol firms included in this study is 22 from 2013 to 2017. The study employs a modified Jones model (Dechow et al., 1995) to investigate earnings management (i.e., discretionary accrual).

The results from testing hypotheses posed in this study can be summarised with two main findings. First, the study found a significant relationship between CSR and accounting transparency for the whole firms including both chaebol and non-chaebol firms. More specifically, defensive CSR turned out to be negative and significantly associated with earnings management; however, the relationship between strategic CSR and accounting transparency turned out to be insignificant. This implies that the firms that focus more on defensive CSR activities are likely to avoid performing earnings management activities. This indicates that defensive CSR may play a significant role in preventing earnings management and thus increasing accounting transparency. This finding can be explained by the stakeholder theory that firms that care about stakeholders such as the government and employees are less likely to be involved in earnings management; their CSR activities are relative more focused on addressing social and environmental issues for their sustainable management, which can bring positive influences on their long-term performance. Descriptive statistics support this explanation because the average score of defensive CSR activities of the total firms is higher than that of strategic CSR activities. This implies that firms in the KEJI index in Korea generally care more about defensive CSR than strategic CSR.

Second, the study found that the score of strategic CSR activities was larger than defensive CSR and that there was a positive relationship between CSR and earnings management in chaebol firms. This confirms the findings from Song (2007) that the public in Korea expect a higher level of ethics from chaebol firms, motivating chaebol firms to care more about their reputation by meeting the expectation from the public. They created a department designated for handling CSR to manage their reputation by actively responding to the public expectation.


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It can be concluded that chaebol firms tend to perform earnings management along with strategic CSR activities since they have more interests in maintaining their reputation. Descriptive statistics show a positive correlation between CSR and discretionary accruals.

Research on CSR with Korean firms is rare (Na, 2017). This study tried to fill this gap by analysing CSR divided into two categories (i.e., strategic and defensive). The study also contributes to adding a different way to analyze CSR. The study used data only from the KEJI index; although there is another index called KSI (Korea Sustainability Index), it was not possible to use the data from the KSI due to the lack of comparability between the KEJI and the KSI. The KEJI does not provide scores for sub-level incentives but gives scores on the category level.

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