Interlocking Directorships and the Corporate-Community Connection - Evidence from the Antipodes

Philippa Wells[1] and Coral Ingley[2]
[1]p.wells@federation.edu.au
[2]coral.ingley@aut.ac.nz

Abstract: Interlocking directorships (where the directors of any one board of directors sit on two or more other boards – with such directors being defined as multiple directors) have been regarded as both potentially desirable (in providing such additional resources as market insight, expertise and wisdom that can assist boards in formulating strategy and in improving corporate performance) and potentially undesirable (in allowing covert passing of sensitive information, encouraging concentration of interests and priorities and raising the spectre of self-interest and conflicts of interest) (e.g. Webb, 2004). Literature has focused on the philosophical issues, frequency and issues associated with them. Writers have also concluded that board diversity can moderate the potentially problematic aspects of interlocks.

Building on previous, related research into independent directors and their potential influence on corporate social responsibility (CSR) and sustainability policies, this paper explores a particular aspect of board composition – that of interlocking directorships – in seeking an answer to the question: Does the participation of independent multiple directors on company boards have an impact on the extent and focus of CSR and sustainability reporting or information provision, as reflected particularly in common themes, foci or levels of such reporting or information? If so, how does this impact play out?

One argument is that where firms are members of major sustainability indices, director interlocks on their boards contribute social capital that is important in addressing sustainability, generating valuable resources that have a positive influence on the sustainability performance of the firm. A possible reason for this is the value attunement (regarding personal and stakeholder values) of these directors. Organisational culture could also be a major moderator of board and social value regarding attitudes toward CSR and sustainability, as could incentives (financial and non-financial) although financial incentives are thought unlikely to be a significant constructive influencing factor.

The population selected for the study is the top 50 companies listed on the Australian ASX and New Zealand NZX indices. This choice not only permits insights into the nature and extent of the impacts of director networks in this particular context, but also compares such impacts between those in a developed economy with a small concentrated capital market and director pool (New Zealand) and those in a larger more dispersed economy (Australia). The paper has implications for director selection and appointment as well as adding to emerging theory on board capital and its effects on firms.

Keywords: Interlocking directors, non-financial reporting, social capital, value attunement, CSR, sustainability

1. Introduction

"*A company's corporate sustainability (CSR) report should be the first place investors and research institutions consult for information*."

- Joint statement from social investment firms representing $230 billion in assets. October 2004 (www.globalreporting.org)

This paper explores interlocking directorships in relation to the question: Does the participation of independent multiple directors on company boards have an impact on the extent and focus of CSR and sustainability reporting or information provision, as reflected particularly in common themes, foci or levels of such reporting or information? If so, how does this impact play out?

Director interlocks on boards are said to contribute social capital that is important in addressing sustainability, generating valuable resources that have a positive influence on a firm's sustainability performance (Bansal, 2005; Galbreath, 2012). Directors' value attunement (regarding personal and stakeholder values) may be an important influence in this regard (Galbreath, 2012). Organisational culture could also be a major moderator of board and social value in relation to attitudes toward CSR and sustainability, as could incentives (financial and non-financial) although financial incentives are thought unlikely to be a significant constructive influencing factor because of the potential to manipulate or misrepresent (e.g. cost and other) performance metrics (Ballou and Heitger, 2005).

We adopt a resource-based perspective and social capital theory as a basis for examining the contribution of board social capital to the organisation. With regard to board capital and the contribution directors can make to the board's leadership of the organisation, existing literature has paid little attention so far to a link between the board's role and the organisation's propensity to report on its corporate social responsibility (CSR) and/or sustainability activities (Ortiz-de-Mandojana and Aragon-Correa, 2013). Separately there is a growing literature in each of these areas (board capital and leadership role, and non-financial performance and reporting) but so far few studies have examined links between these two constructs (Jones et al, 2005; Rao, Tilt and Hester, 2012).

The paper proceeds with a review of resource-based theory which underpins the first construct for the study: board capital and the social capital value that interlocking directorships may contribute to a board. The concept of value attunement is also considered in this context. Non-financial reporting, which relates to the second construct, is then defined. Reviewed also is relevant empirical research examining links between independent directors and CSR/sustainability reporting. The methodology for the study is then described, the results are presented and discussed, and the paper concludes with suggestions for further research.

2. Theoretical Background

Resource dependence theory holds that a firm's corporate strategic orientation is linked to the opportunities available to access through their boards the required resources outside the firm (Galbreath, 2012; Hillman and Dalziel, 2003; Pfeffer and Salancik, 1978). From a resource-based perspective boards of directors are a tool to manage external dependencies and reduce uncertainty (Galbreath, 2012; Glass, Cook and Ingersoll, 2015; Hillman, Cannella and Paetzold, 2000; Pfeffer and Salancik, 1978). Board support is expected to be helpful with regard to sustainability performance which is characterised by uncertainty because of changing expectations, the complexity of the issues, and the difficulty in their resolution (Bansal, 2005).

These effects are particularly clear in situations of director interlocks. Board interlocks are typically regarded as conduits for transferring practices between interlocked firms, including strategies, structures, systems and processes (Galbreath, 2012; Johnson, Daily and Ellstrand, 1996; Ortiz-de-Mandojana and Aragon-Correa, 2013; Pfeffer and Salancik, 1978; Shropshire, 2010), as well as a source of organisational innovation (Chen, Lin and Chang, 2009; Haunschild, 1993; DiMaggio and Powell, 1983; Shropshire, 2010). Through their social network resources interlocked directors may also help manage environmental uncertainty, gain access to key skills, and provide legitimacy for their firms (Bazerman and Schoorman, 1983; Mizruchi, 1996) by acting as a mechanism for mimetic pressures to adopt similar strategies and behaviours as other interlocked firms in their network (DiMaggio and Powell, 1983; Haunschild, 1993; Mizruchi, 1996, 2004; Scott, 2001).

The importance of interlocks for corporate practice is confirmed by research which has examined the effect of interlinked directors on corporate social responsibility and environmental policy. Valuable information gained through network links is particularly important in the adoption of environmentally sustainable practices, because of the significant investments required and the uncertain returns (Walls and Hoffman, 2013). Firms that adopt environmentally sustainable practices often model their practices on other firms in the field (Bansal and Clelland, 2004). Webb (2004) found that firms which were known to be socially responsible tended to have more interlocked board members than non-socially-responsible firms. Ortiz-de-Mandojana and Aragon-Correa (2013) highlighted the importance of a firm's board with regard to sustainability issues. Based on their analysis of the relationship between director interlocks and a firm's environmental performance, they found that the firm's environmental performance is influenced by capabilities that are hard to imitate and are embedded in the directors' network relationships (Ortiz-de-Mandojana and Aragon-Correa, 2013).

Knowledge is argued to be more effectively acquired and exploited in firms with high levels of social capital (McFadyen and Cannella, 2004; Yli-Renko et al, 2001). In particular, intellectual and knowledge resources are considered to be helpful in addressing limitations of typical approaches to environmental challenges (Lopez-Gomero et al, 2011). A social capital perspective focuses on network ties and regards boards as social institutions, where consensus is the norm (Hill, 1995). Ortiz-de-Mandojana and Aragon-Correa (2013) define social capital as the sum of the actual and potential resources that accrue from the development of personal and social networking relationships by an individual or social unit. Lin (2001) advocates that social capital be regarded as a relational asset, while network theory focuses the concept on social relations and the outcomes of these relations (Maguire, 2014; Portes, 1998). Putnam (1996) associated social capital with civic engagement. Stevenson and Radin (2009) question whether social capital is a characteristic of civic engagement or a way to develop civic engagement in a society.

Boards are regarded as unitary bodies by their members, who work collegially on a consensual basis and have collective responsibility for the direction of their organisations (Forbes and Milliken, 1999; Hill, 1995; Pye, 2002; Zajac and Westphal, 1996). Ties between board members are assumed to be essential in negotiating this consensus and structuring social relations (Fine 1984). Board capital is defined as an investment in social relations with expected returns, based on the advantage of a person's location in a structure of relationships or ties to others (Ortiz-de-Mandojana and Aragon-Correa, 2013; Stevenson and Radin, 2009). The selection of directors is thus partially linked to their potential contribution to the social capital of the firm (Ortiz-de-Mandojana and Aragon-Correa, 2013). Interlocked directors may contribute a disproportionately larger share of human capital to a board from the experience gained while serving on multiple boards. Board members are assumed to be valuable advice givers and collaborators and their position in a network of ties on a board will affect the amount of influence they can exert on decisions (Stevenson and Radin, 2009).

Neoclassical economic theory views managers as rational decision-makers and profit-maximizers. Economic theories of firms and of corporate governance (agency theory) tend to treat values as neutral, i.e. decision-making is seen as free from moral values (Godos-Díez, Fernández-Gago, and Martínez-Campillo, 2011). Conversely, behavioral theories of the firm emphasise a moral imperative. Firms are morally accountable, not only for their economic decisions but also for the broader environmental and social consequences of their activities (Bosse, Phillips, and Harrison, 2009; Cyert and March, 1963; Swanson, 1999). Values should be included in the study of sustainability, according to Galbreath (2012) because of its normative implications: an underlying driver of the need for firms to respond to sustainability is societal norms, values, and expectations, which are reflected in a growing number of environmental and social issues that relate directly to sustainability. Galbreath (2012) argued that values play a role in the extent to which boards affect sustainability performance.

Directors who are aware of their personally-held values and consider those held by others are likely to be receptive to the societal issues stimulated by stakeholder demands and interests. Swanson (1999) refers to this as value attunement and suggests that values can affect the extent and direction of the relationship between board capital and task performance. Value attunement acts as a moderating influence in the relationship between social capital and sustainability performance because it facilitates board decision-making and increases the extent to which boards' monitoring and resource provision roles focus on meeting sustainability demands. Boards whose directors demonstrate value attunement will integrate their fiduciary relationship with shareholders and their moral relationship with other stakeholders. Value-attuned boards will commit holistically to all stakeholders while honouring the corporation's citizenship duties to society. Boards whose directors do not all adequately align their personal and societal values may have less influence on sustainability performance than may be expected (Galbreath, 2012).

3. Non-financial reporting

Over the past decade, demand for information related to corporate social, environmental, and governance performance has increased dramatically across a wide range of stakeholders, including investors, consumers, business partners, employees, communities and governments (Maguire, 2014). Non-financial reporting is a broad term that encompasses various forms of disclosure on social, environmental and sustainability performance (Perrini, 2006).

Berthelot et al, (2003, p. 1) define corporate environmental disclosure as "the set of information items that relate to a firm's past, current and future environmental management activities and performance… and the past, current and future financial implications resulting from a firm's environmental management decisions or actions." This disclosure is usually termed corporate social responsibility (CSR) reporting, but non-financial reporting is also known variously as: sustainability reporting, environmental reporting or environmental disclosure, social (and environmental) reporting, Triple Bottom Line (TBL) reporting, voluntary environmental disclosure, and integrated reporting (Mahmoudian, Nazari and Herremans, 2012; Perrini, 2006; Rao et al, 2012; Rupley, Brown and Marshall, 2012; Tschopp, Wells and Barney, 2012). Integrated reporting endeavours to provide a holistic account of an organisation's performance and brings together material information about its strategy, governance, performance and prospects so as to reflect the commercial, social and environmental context within which it operates (Mahmoudian, Nazari and Herremans, 2012). Current non-financial reports cover a wide range of topics, including social issues, philanthropy, human resource (labour, human rights, anti-corruption), health, stakeholder, sustainability and environmental issues.

Environmental reporting can improve financial returns and can increase firm value even if non-quantifiable (Adams and Zutshi, 2004, Rao et al, 2012). Studies have found that strong corporate governance mechanisms increase the level of corporate disclosure generally (Rao et al, 2012). Recent evidence suggests that directors play a key role in driving corporate social responsibility efforts, such as implementing best practices, developing policies aimed at increasing stakeholder engagement and advancing corporate transparency (Glass, Cook and Ingersoll (2015). Scholars also suggest that the existence of board members' affiliations may impact corporate decisions regarding non-financial disclosures (Kassinis and Vafeas, 2006; Webb, 2004).

Despite indications that corporate governance plays a role in environmental reporting, research that considers this relationship is limited (Rao, Tilt and Hester, 2012), and only a few studies have explicitly investigated the relationship between corporate governance and environmental disclosure, with even fewer specifically in New Zealand and Australia. Among these studies, Cormier et al, (2009, 2010) found that external board representation is positively associated with quantitative human and social capital voluntary disclosures. Rao, Tilt and Hester (2012) undertook a quantitative analysis of CSR/sustainability reporting among the Australian ASX top 100 companies and found a significant relationship between the extent of environmental reporting and the proportion of independent and female directors on a board. They concluded that Australian firms attribute importance to environmental reporting and that strong corporate governance appears to have an effect. Other studies have also found that independent directors were significantly related to the organisation's voluntary non-financial disclosure (Mahmoudian et al, 2012) and CSR activities (Harjoto and Jo, 2011). Against their predictions, Haniffa and Cooke (2005) found that boards dominated by non-independent members are associated with corporate social disclosures. They also found that executive directors and board chairs with multiple directorships were influential in the decision to voluntarily disclose social information in annual reports. Jiang and Habib (2009) found that New Zealand companies' voluntary disclosure practices were negatively associated with ownership concentration and institutional factors but positively associated with managerial and government factors. Rupley, Brown and Marshall (2012) examined the relationship between specific aspects of governance, media coverage and the quality of voluntary environmental disclosure (VED) and found that board of director attributes including independence, diversity, and multiple directorships are associated with VED.

CSR and sustainability reporting, while less well developed in its methodologies and standards than financial reporting (Kolk, 2005), is nevertheless being adopted by a growing number of organisations. In most jurisdictions CSR/sustainability reporting is voluntary but many organisations report publicly on their performance against existing criteria for a variety of reasons, in addition to their conventional, mandatory financial reporting. For this research we make several assumptions:

- that interlocked directors contribute valuable social capital to the boards on which they serve
- that interlocked directors influence their board culture and decisions based on their knowledge of the activities undertaken by other organisations on whose boards they serve, including non-financial initiatives, such as corporate-community connections
- that boards with interlocked directors may be influential in promoting, encouraging, and/or leading and reporting on their corporate-community connections.

4. The study

Our approach entailed identifying initially the core business of the companies of both the ASX and the NZX indices. We selected these companies on the premise that they are more likely to be active internationally, have a broad range of shareholders and stakeholders, and therefore more exposed to scrutiny from trading partners and competitors on the global stage. Their directors are more likely to have a greater breadth of experience and may be more conscious of stakeholder interests, concerns and demands, and of a need to display a social conscience.

The selected companies were engaged in one of five industry sectors: Transport and Transport Facilities; Finance and Investment; Property; Resources and Energy; and Goods, Food, Services and Entertainment, which take into account the activities and focus of the companies concerned. Details of the companies' mix, background and status of directors were extracted from annual reports or corporate websites. This information was used to compare directors' experience or background and their other board activity with the nature and focus of CSR and sustainability reporting.

The analysis involved surveys of annual reports and other information to determine ~~identifying~~ the extent to which companies in which these directors were involved reported on CSR and/or sustainability, and whether this was common across all of the companies. ~~Content a~~Analysis of the data th~~en~~us focused on ~~entailed~~ an examination of differences between levels (whether limited (mention or brief summary), full (with a clear description and results reported) or detailed (through a separate document or section with detailed information), and focus of reporting (including whether inward or outward focused, collaborative or self-driven and with or without direct benefit to the company.~~, i.e. where companies do, or do not, report on CSR and/or sustainability~~.

While it was our original intention to consider independent interlocked directors, we found that independence per se was not necessarily important. While independent directors are more likely to sit on several boards it is not always the case. As at 31 December 2014, there were 53 interlocked directorships on the ASX Top 50 and 35 on the NZX Top 50, excluding directors who sit on both Australian and New Zealand Top 50 boards. Further, ~~analysis indicated that~~ 70 percent of interlocked New Zealand directors hold three directorships (30 percent hold two positions), compared to 23 percent of Australian interlocks. In addition, 40 percent of Australian Top 50 companies have multiple directors from both countries. For Australia multiple directorships are more likely to be cross-sector than intra-sector except in the case of finance and investment. Trans-Tasman interlocks are also more likely than not to be cross-sector. Single sector interlocks are more common among New Zealand Top 50 companies but are represented by just three interlocks in the goods, food services and entertainment sector. The highest cross-sector interlocks for New Zealand are in resources and energy, and goods, food services and entertainment.

5. Results

With regard to the extent of reporting, the figures overall indicate that where directors are involved in more than one company, it is more than likely that both companies will report or provide accessible information on CSR and/or sustainability. Among companies that provide this information, five companies do not report on CSR and two companies do not report on sustainability. In the few instances where this information was not accessible, these companies were allocated a nil value for that category of reporting, which may not be a true reflection of their actual policy. Because the numbers of interlocking directors vary among the three cohorts (Australian, New Zealand, and Trans-Tasman), percentages confirm that Australian companies with multiple directors are consistently more likely than not to report on CSR. Companies with Trans-Tasman boards where the director interlocks sit on three boards in total, are most likely to report on sustainability. New Zealand companies do not feature well for either type of reporting. Whether or not the interlocks involve single or cross sectors appears to have little influence on such reporting. Although New Zealand companies in the resources and energy, and the goods, food, services and entertainment sectors with interlocks on their boards were most likely to report, other pressures (such as from regulators, or international supply chains) may also have an important influence on board strategy.

Consistency in levels of reporting (whether limited, full or detailed) was next examined. Considerable disparity exists among the three cohorts as to the extent of reporting by interlocked companies, even when expressed as a percentage (Figure 1). The left hand set of columns in the figure shows the percentage of companies that provide at least minimal/limited CSR or sustainability information. The right hand column expresses the percentages based on those providing at least limited information. The proportions thus reflect the size of the cohorts and the proportions of each that report. The companies of almost all interlocks in Australia report on both CSR and sustainability; the companies with Trans-Tasman interlocks are more likely to report on CSR; New Zealand companies are more likely to report on sustainability (although at lower levels than for the Australian and Trans-Tasman companies).

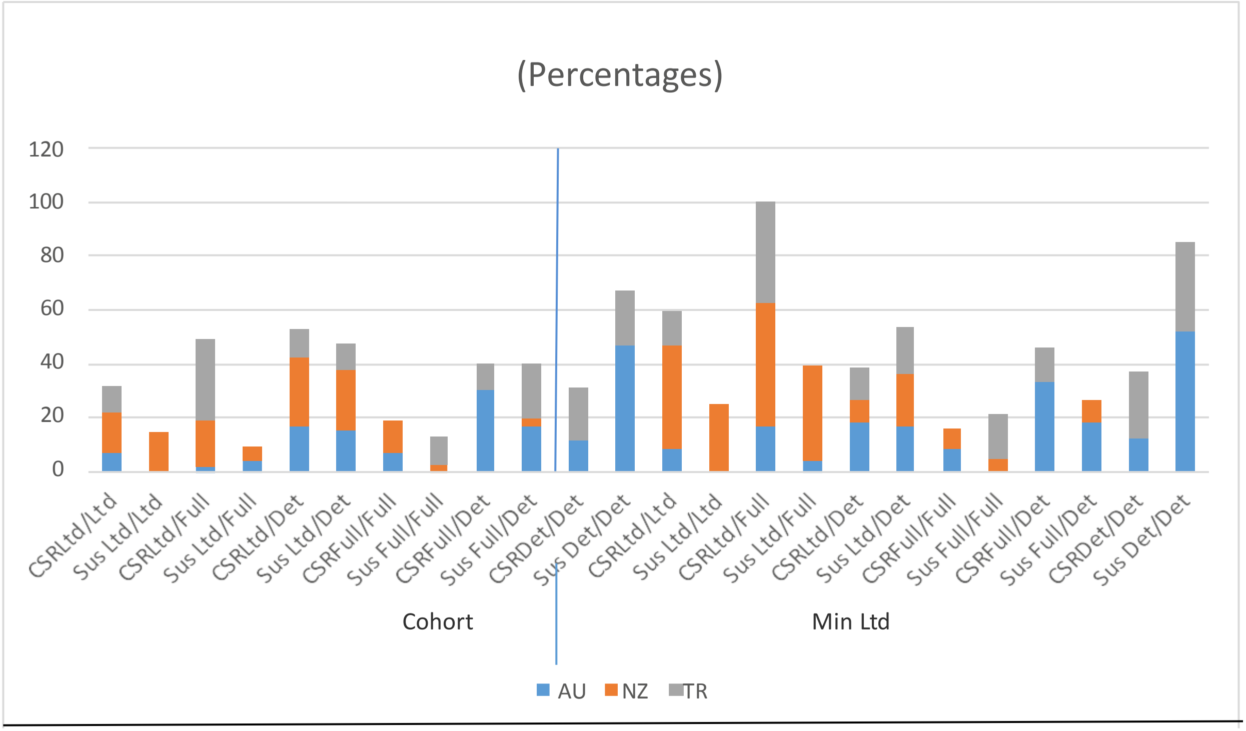


Figure 1: Reporting levels with multiple directors (by cohort and minimal/limited)

The reporting focus and commonalities were next examined. Only reporting which is either full (describing the activities, level of involvement and outcomes) or detailed (description plus detailed cost, benefit and future plan information) was included in this analysis.

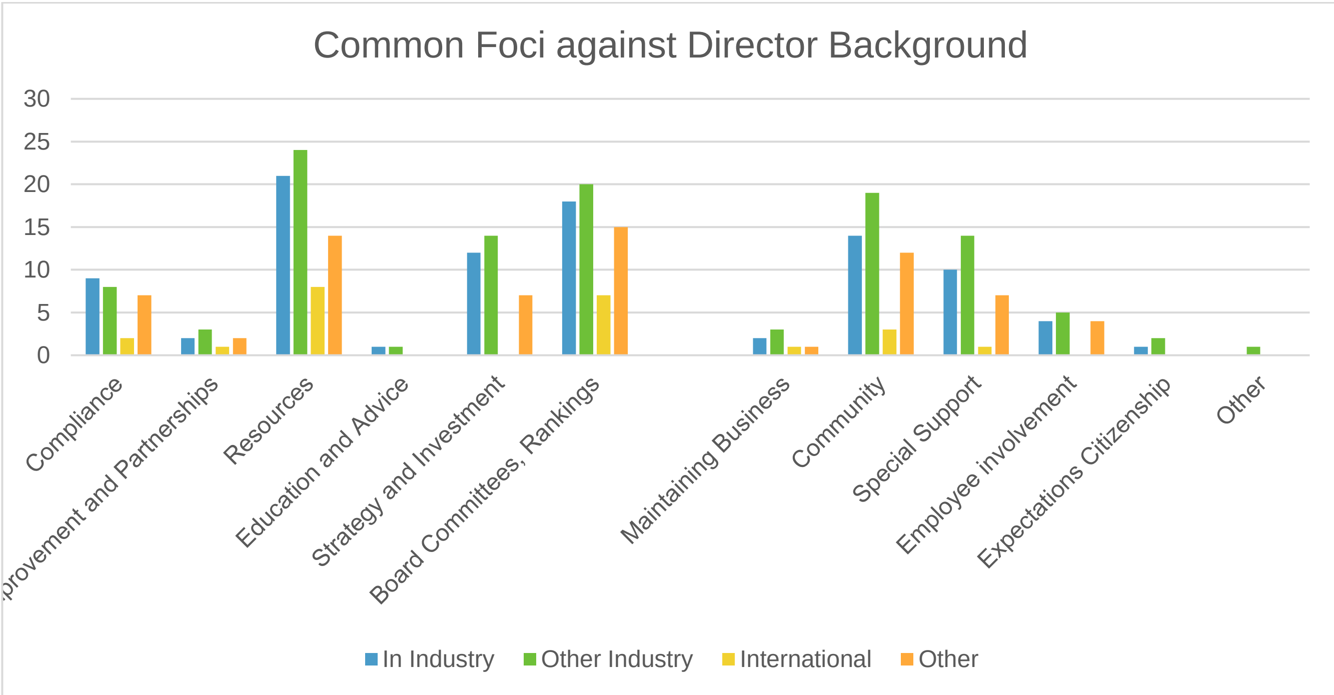
For sustainability reporting among all three cohorts, the most likely focus was on efficiencies or reduction in the use of resources. Among the Australian cohort (and to an extent for the Trans-Tasman interlocks) with full or detailed reporting, the second most likely focus was the creation of board committees or participation in independent sustainability rankings, with sustainability-focused strategy and investment third. Compliance was also reported by approximately one-third of the Australian cases and by the two New Zealand cases that provided such reports.

For CSR reporting, commonalities emerge only in the Australian and Trans-Tasman cohorts providing full/detailed reports and are confined to three areas: community support (23 of the 24 Australian companies and three Trans-Tasman companies), followed by special group or charitable support (for Australian companies only), and CSR with a focus on maintaining the company's business (such as sponsoring industry-related educational opportunities).

Collation of reporting data with directors' experience is shown in Figure 2, which refers only to Australian directors who are involved in at least two companies on the ASX Top 50 that provide at least full reports/information on CSR and/or sustainability. While the numbers in the other two cohorts were too small to include in the figure, analysis revealed a pattern similar to the Australian cohort, with reporting most commonly associated with resource reduction, strategy and board committees (for sustainability) and ~~maintenance of business,~~ community and charitable/selected group support (for CSR).

Figure 2 shows that for sustainability (left-hand side), resource reduction is the highest priority for most of these companies and for interlocks regardless of background or experience. Strategy and creation of board committees and/or involvement in international or national sustainability rankings are far more important than compliance. However, where interlocking directors have international experience the companies are more likely to report on the latter, and not at all on the former. This suggests that insights provided by interlocks with a strategy/board sustainability committee/sustainability ranking background may encourage their companies to engage in these areas. Compliance is a most likely reporting focus where directors have intra-industry experience.

With CSR reporting, community or special group support is a most common reporting focus regardless of director background. Approaches to supporting or developing the company's business scarcely feature and employee participation or fundraising is not a common focus for companies with interlocks who have international experience.



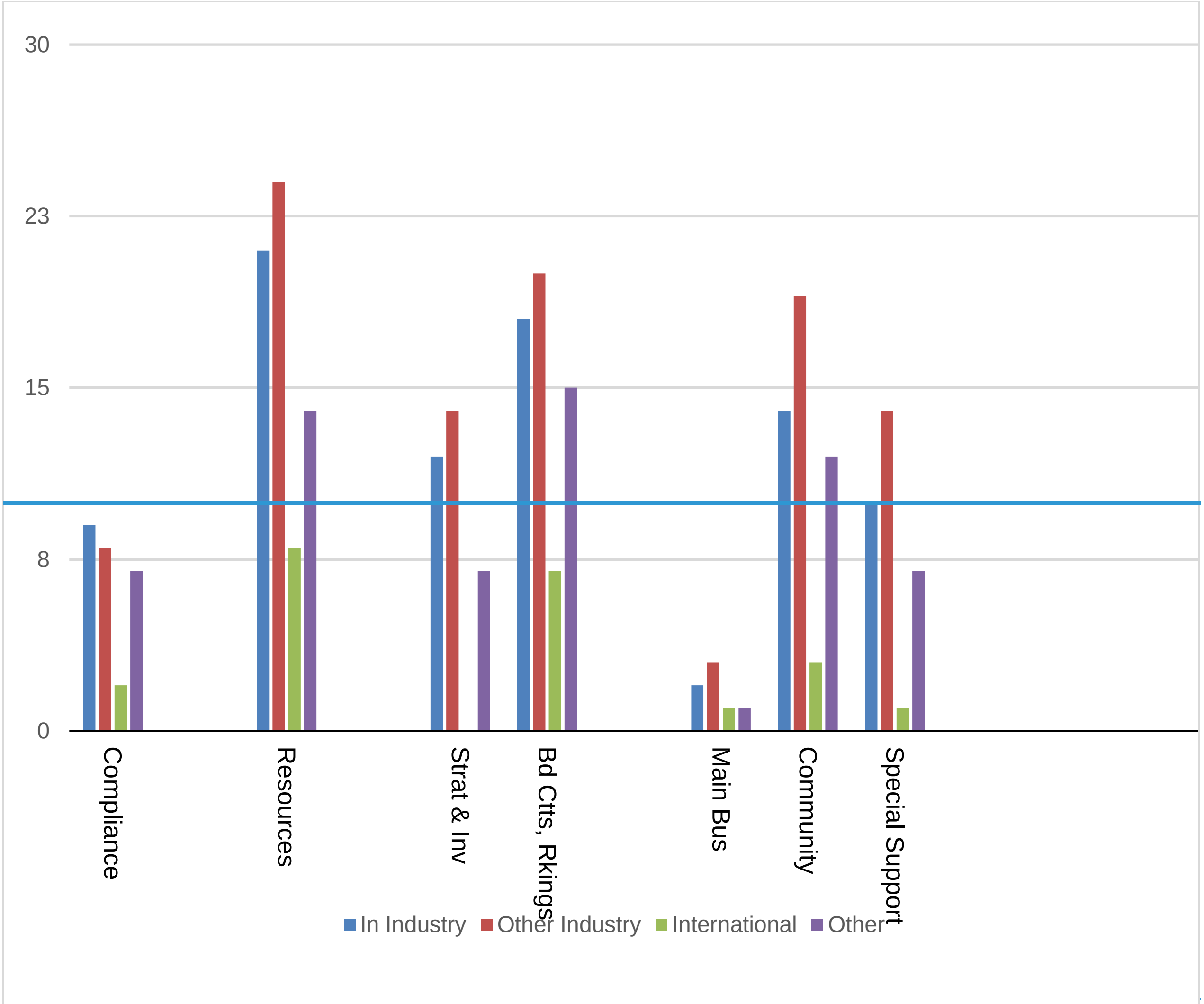


Figure 2: Common foci for reporting sustainability/CSR - Australia only (N=53)

6. Discussion

If boards are to be seen as a source of social capital provided by board members, both individually and as part of the collective, then it may also be argued that where the experience of board members is gained via their involvement with other boards, or otherwise externally, some manifestation of their experience in the non-financial aspects of reporting can be expected (contrary to financial aspects that are prescribed in provision and content through regulation and "soft" law such as requirements imposed by the Security Exchange(s) on which these companies list). The question is: Do our results indicate this to be the case or are other factors involved?

The first aspect is that where directors are interlinked, these companies tend to report on both CSR and sustainability. This result may indicate that these directors are providing insights from their experience with one company to the other, motivating or influencing the other company to report. This also aligns with the linkage concept described by Pfeffer and Salancik (1978) and is consistent with the organisational similarities identified by Haunschild (1993). Also of interest is the finding that Australian companies with Australian interlocked directors are far more likely to report on both CSR and sustainability, whereas New Zealand companies trail at a poor third across both categories. This suggests that other influences – e.g. market, institutional (mimetic) norms, stakeholder demands or sector pressures – play a role in shaping whether and how board capital is utilised, and its impact on non-financial reporting in particular.

The second aspect is the level of reporting and the degree of consistency. Our findings reflect those regarding reporting overall but further emphasise the high proportion of the Australian cohort of interlinked companies that report on both CSR and sustainability. This group of companies is also consistently higher than those interlinked companies in either the New Zealand or the Trans-Tasman cohort. This finding suggests that directors do provide insights from one board to another via their own experience and those of their networks (Mizruchi, 1996). However it also suggests that the interlocking influences can be positive or negative.

The third aspect is the foci for reporting. This aspect was examined on the assumption that directors manage external resources and uncertainties (Hillman et al, 2000; Pfeffer and Salancik, 1978) and at least some of those external resources and uncertainties are likely to be common to at least two companies on whose boards they serve, including labour, capital, raw materials and reputational factors. Based on this assumption, our results indicate that for sustainability reporting the most common focus was resource efficiency or reduction. This suggests that the most desirable foci are the intrinsic value (of cost reduction) and reputational benefits. Interlocked directors, whether or not they are experienced within the sector, could contribute to the social capital of their companies' boards through advice and insight into appropriate strategies, values and advantages. Notable, however, is the inconsistency where two companies have created board committees with a focus on sustainability, or where they participate in independent rankings. The interlocked directors on these boards have international experience yet those that embed sustainability into their strategy and investment do not.

With reference to CSR reporting, community or special/charitable support are the most likely foci. The prominence of interlocked directors with other industry or other external experience highlights the potential importance of social capital for board decisions (Putman, 1996) and its reflection in civic engagement through CSR (Putman, 1996; Stevenson and Radin, 2009). This potential is strengthened by the finding that the main foci for these common levels of CSR reporting tend to be those that are the most reputationally valuable and are directly connected with the company.

7. Conclusion

In response to our question regarding the impact that interlocking directors may have on the extent and focus of CSR and sustainability reporting or information provision, our examination of company listings records and material for the top 50 Australian and New Zealand publicly listed companies suggests that these directors do have at least some influence on such reporting. How this impact plays out in relation to common themes, foci and levels of such reporting or information is rather more mixed with regard to country context, industry sector and interlocked directors' international experience.

The association between board interlocks and non-financial reporting in our study is consistent with resource dependence and social capital theorising. While interlocked directors may through their social capital have some influence on companies' non-financial reporting practice, our results suggest that other factors may also have an impact. Institutional and other theoretical perspectives may be useful in revealing additional factors that influence companies' propensity to report on non-financial performance. More conclusive findings may also result from an expanded sample of listed companies with board interlocks, e.g. the top 100 on both country's stock exchanges, as well as those of other countries. Our question lends itself to more in-depth study examining the quality as well as extent of reporting. A comparison with non-interlocked boards in companies on these indices might bring further insight, as might closer examination of the board's role with regard to non-financial performance.

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