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Does Good Governance make the Companies More Socially Responsible?

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ABSTRACT

This paper is intended to examine the ways good governance accelerates company attitudes towards social responsibility. Social Responsibility Expenditure is considered as the proxy of the level of social responsibilities of the companies. Data of eighteen listed banks are selected randomly for five years span ranging from 2012 to 2016 to conduct the study. Descriptive Statistics and Multiple Regression are used as the methods of analysis. The study revealed that the Government shareholding is a variable that positively influences firms' social behavior. Increased government involvement generates pressures for firms to invest more for the benefit of the society as government is the body trusted by general public. Independent or non-executive directors act as a monitor and balanced mechanism to control behavior of authority. Research reveals that the firms containing board with more number of independent directors seem more socially responsible. The analysis also reveals that the ownership concentration is negatively associated with CSR practices of firm. It implies that firms where shares are not concentrated in the hand of only a few shareholders rather companies have a large number of shareholders each holding a small fraction of company's shares, are more accountable to public. Therefore, these firms require additional involvement in community or social development. The study may be useful to the regulatory bodies and organizations to take corporate governance factors into consideration that might influence companies focus on accomplishing their duties for the society.

Keywords: Corporate Social Responsibility, Corporate Governance, Board Independence, Ownership Concentration, Government Ownership.

1. INTRODUCTION

Corporate governance includes policies adopted by firms to attain its vision and objectives, enhance business opulence and ensure accountability towards the society while meeting the expectation of its stakeholders (Alam & Akhter, 2017). The role of governance is to maximize shareholder's wealth. In fact, it relies on a set of disciplines including managerial performance as well as corporate philanthropy, cultural environmental and ethical contribution, with a concentration on relevant stakeholders related to a firm (Wise & Ali, 2009).Good governance system will ensure effective corporate social responsibility practices by firms. Corporate governance and corporate social responsibility are interrelated (Said, Zainuddin & Haron, 2009). The technique commonly being used to measure CSR is Triple-Bottom-Line (TBL) accounting. It encapsulates Profit, People and Planet with an aim to measure financial performance, social contribution and environmental

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philanthropy. Firms will be rewarded and benefitted in a numerous way by practicing sound governance system and fulfilling social commitment in national and international arena with improved image (BEI, 2004). Such practices will also bring a positive vibe to the economy.

Although a lot of research previously conducted on Corporate Social responsibility (CSR) and Corporate Governance independently, present study sheds light on how they are related to each other. Corporate social expenditure is used as a proxy to measure CSR. Number of directors in the board, the proportion of independent directors to total board of directors, number of non-executive directors in audit committee, percentage of shares held by owners, managers, government and foreign investors to total equity share capital of the firm are used to measure Corporate Governance. The study aims at specifying corporate governance mechanisms that effect corporate social responsibility practices of firm.

2. LITERATURE REVIEW

2.1 Corporate Governance Scenario in Bangladesh

The term Corporate Governance evolves with the birth of Corporation. But the issues received considerable attention in the early 2000s due to the sudden collapse of world's biggest giant Enron Corporation, Tyco and World Co.etc. Scandals, mismanagement, economic depression, workers retrenchment and other factors further eroded investors' confidence during that period.

The banking sector is treated as lifeblood of a country's economy. Undoubtedly, the whole economy is portrayed by this largest industry. Even a slight instability in the banking sector may cause havoc in the country's economy. During 2010 to 2012; this industry has gone through lots of scandals. Sonali Bank Scandal of US $460 million, Hallmark group Scam of US $340 million where six commercial banks were involved are some of country's largest scandals. Some other companies who were also involved in such fraudulent attempts involve T & Brothers, Nakshi Knit, Paragon Group, DN Sports (Mahmood & Islam, 2015). Such repetitive events prove lack of corporate governance practices among banks.

Sound corporate governance and its proper practices is the key requirements for the efficient and stable banking system. Bangladesh Enterprise Institute 2004 issued a code of corporate governance for government, non-government, financial and non-financial institutions with a view to eradicate corruption, best utilization of resources and to assist firms to have a healthy cash inflow. Bangladesh Securities& Exchange Commission Notification (BSEC, 2012) contains a set of conditions regarding corporate governance that must be replaced by every public listed company to be listed on any stock exchange in Bangladesh. Mahmood & Islam, (2015) opined that to provide a shield against financial loss and fraudulent attempt and to rebuild trust among depositors and stakeholders only prudential regulation is not enough, rather adequate monitoring and appraisal system can make it possible.

2.2 Corporate Social Responsibility

The term CSR encapsulates commitment or moral obligations of business to contribute to the sustainable economic growth of a country while taking care of its employees, families and local communities (WBCSD, 2001). Business for Social Responsibility, (2003) defined CSR as an integrative approach of some policies and procedures which attempt to maximize its positive impact on society. Caroll (1979; 1991) differentiated among four types of CSR activities encompassing economic, legal, ethical and philanthropic contribution. Lantos (2001) suggested three categories of CSR named ethical, altruistic, and strategic. Corporate social responsibility is typically summarized as "triple bottom line" because it evaluates firm's policies and actions towards maximization of profit, wellbeing for the people and for the planet. Market efficiency and investors confidence depend upon a large extent on corporations investment for the benefit of society.

As firms grow in size and influence, they are no longer expected to be mere contributors to the global economy, but rather to reconcile and skillfully balance multiple bottom lines and manage the interests of multiple stakeholders (Jamali, 2006). Recent evidences prove that Corporations are now not only inclined to financial performance rather they should focus on its long term impact in environment and society while taking care of shareholders expectation (Hardjono and van Marrewijk, 2001). Here lies the point where corporate governance and corporate social responsibility ties with each other. Corporate governance deals with transparency, accountability, ethics and fairness. Firms that follow proper code of governance are expected to generate profit while maintaining the standards and taking care of the society.

2.3 Stakeholder Theory

According to stakeholder theory, firms intend to maintain a sound and sustainable relation with stakeholders (Hill & Jones, 1992). Stakeholder groups like customers, employees and the community affect firm performance whether or not those stakeholder groups share ownership rights. Effectively responding to and managing these stakeholder relationships is critical to success. Successful relationships are based on trust, and trust is created and maintained by meeting and exceeding responsibilities to stakeholders. Corporate governance mechanisms play an important role in this process. They build and maintain trust by ensuring that responsibilities are met or exceeded. (Stuebs, 2015)

2.4 Hypotheses Development

2.4.1 Size of the Board and Corporate Social Responsibility

One of the most important factors of corporate governance is the presence of more directors in the board. Board size represents the total number of directors on a board (Panasian, Prevost & Bhabra, 2003). This body is responsible for overseeing all board activities. The structure of the board and their attitude and behavior play a pivotal role for governing the company and to take major investment decision. Large size of Board create communication gap among directors, declines the ability to control management and the ultimately results poor decision (Eisenberg, Sundgren & Wells, 1998, Jensen 1993). Some scholars opined that board member should be eight or nine (Lipton & Lorsch, 1992) whereas some other state board member should not exceed eleven (Leblanc & Gillies, 2003). Board member should play role to ensure effectiveness of board decision (Alam & Akhter, 2016). Large board size fails to carry out their responsibilities diligently, it will develop miscommunication and lead to distorted decision and generates substandard financial activities (Said *et al.*, 2009).Based on above literature; we can take the following hypothesis

H_{01}: There is no relationship between board size and corporate social responsibilities.
H_{A1}: Board size and corporate social responsibilities are significantly related.

2.4.2 Independent Directors and Corporate Social Responsibility (CSR)

Goshi (2002) states that board should consist of some non-executive directors along with executive directors. Advocates of agency theory opined that non-executive directors play a pivotal role in overseeing the actions of executive directors because those directors tend to take decision for the sake of stakeholders (Jensen & Meckling, 1976).A good number of previous researchers were in favor of presence executive directors in Board. Independent directors act as a monitor and balanced mechanism to control management behavior (Fama & Jensen, 1983, Brickley & James, 1987, Mak 1996, Pearce & Zahra, 1992). According to BSEC (2012), at least one fifth (1/5) of total board of directors must be independent. Webb (2004) conduct a research between socially responsible and non-socially responsible board structure of different firms and her research revealed that socially responsible firms have more independent directors as compared to non-socially responsible firm. Therefore, it is evident that Non-executive Directors play an active role in upholding corporate image. Therefore, it is hypothesized that

H_{02}: There is no relationship between the percentage of independent directors and CSR
H_{A2}: There is a significant relationship between the percentage of independent directors and CSR

2.4.3 Audit Committee and Corporate Social Responsibility (CSR)

Audit committee act as a helping hand for board of directors because they evaluate financial statements and assure them financial statements reflect true and fair view of company's financial position, operating performance and all associated affairs and also ensure sound internal control system (BSEC, 2012).Wright (1996) stated that authenticity of financial statements greatly depend upon the composition of audit committee. According to BEI, (2004) there must be at least three members in an audit committee with majority of Independent directors and the committee should be headed by an independent director. Higher number of independent directors in Audit Committee reduces agency cost therefore enhance reliability of financial reporting practices (Forker, 1992). Number of non-executive directors in audit committee is positively related to corporate social responsibility practices (Ho & Wong, 2001). This finding is consistent with (Bliss & Balachandran, 2003; McMullen & Raghunandan 1996).Therefore, it is assumed that

H_{03}: There is no relationship between presence of independent directors in Audit Committee and corporate social responsibility practices.
H_{A3}: Corporate social responsibility practices are significantly related with the presence of independent directors in Audit Committee.

2.4.4 Ownership Concentration and Corporate Social Responsibility (CSR)

Another significant corporate governance mechanism is Ownership Concentration. It refers stocks held by investors to total paid up capital of firm. Owners intend to exercise their power to influence and control management as well as create a safeguard to protect their interest. Concentrated ownership means more power in the hands of a dominant shareholder that translates into better monitoring and decreasing the benefit of other controls such as the board of directors (Bozec & Bozec,2007). An inverse relation is proven by (Bhatala &Rao, 1995; Prevost, Rao, &Hossain, 2002; Rediker& Seth, 1995) between owners and non-executive directors. Wang and Coffey (1992) found that there was negative relationship between ownership concentration and corporate philanthropy. Owners are reluctant to invest in corporate philanthropy rather they focus more on profit earnings and mandatory giving. (Chau & Gray ,2002) . This finding is consistent in line with previous research of Prevost *et al*., (2002) and Bhatala & Rao, (1995). But Ghazali and Wheetman (2006) found no significant relation between ownership concentration and corporate social responsibility.
Based on above literature, it is hypothesized that:

H_{04}: Ownership concentration and CSR have no significant relationship
H_{A4}: There is a significant relationship between ownership concentration and CSR

2.4.5 Managerial Ownership and Corporate Social Responsibility (CSR)

Earlier researches revealed that increased level of managerial ownership reduces agency conflict. Agency theory predicts when managers hold little control over corporation they intend to seek opportunistic behavior and pursue to act on their own interest (Jensen and Meckling, 1976).Coffey and Wang (1998) stated that managerial ownership is positively related to voluntary contribution.The finding is supported by (Nasir and Abdullah, 2004) who also concluded that managerial ownership is positively associated with voluntary disclosure practices.But the findings are in contrast with Eng and Mak (2003)and Guan Yeik (2006). Managerial ownership and corporate donations for social welfarewere inversely related to each other (Guan Yeik, 2006). He explored when proportion of managerial ownership exceed forty five percent (45%) of total equity capital, they try to influence corporation for lower social investment and lower voluntary disclosure. The finding is pertinent to Eng and Mak (2003) also found lower managerial ownership is associated with increased voluntary disclosures. Based on previous literature, it is hypothesized that:

H_{05}: Managerial ownership has no significant relationship with CSR
H_{A5}: Managerial ownership and CSR are significantly related

2.4.6 Government Shareholding and CSR

Another important determinant of corporate governance is Government shareholding. Government is a body trusted by everyone (Said *et al*, 2009).More government involvement means firms are compelled to abide by the regulations imposed by Government (Said *et al*, 2009).Eng and Mak (2003) found that government ownership was associated with increased voluntary contribution and disclosures. The finding is consistent to Nasir and Abdullah (2004) who found that voluntary contribution of firms are influenced by extent of government shareholdings. According to Bangladesh Bank Guideline in 2008, Banks are advised to involve more on corporate charity (Mahbuba & Farzana, 2013). Government offer tax rebate facilities to motivate firms for contributing in neglected areas. Common CSR practices in Bangladesh by different organization are centered on mainly poverty alleviation, healthcare, education, charity activities, cultural enrichment, youth development, women empowerment, patronizing sports and music etc. (Azim, Ahmed, and D'Netto, 2011). National Board of Revenue and Securities & Exchange Commission has taken initiatives to motivate firms to contribute more for the welfare of the society.

Based on previous literature, it is hypothesized

H_{06}: There is no significant relationship between proportion of Government shareholding and CSR
H_{A6}: There is a significant relationship between proportion of Government shareholding and CSR

2.4.7 Foreign Ownership and CSR

Foreign ownership captures the portion of firm's equity share held by foreign investors (McGuinness, Vieito & Wang, 2017). The study revealed that CSR rating is high for firms dominated by foreign owner. Foreign owners and stakeholders demand more social and environmental disclosures. Even in some cases they insist firm to donate more for social welfare. Firms where a significant portion of shares hold by foreign owners,they need to provide more social and environment disclosure. Haniffa and Cooke (2005) found a significant relationship between corporate social disclosure and foreign shareholders. Again another study found that foreign ownership doesn't have any influence over level of CSR (Said *et al*, 2009).Therefore, it is hypothesized that

H_{07}: Foreign ownership has no significant relation with CSR Practices
H_{A7}: Foreign ownership has a significant relationship with CSR Practices

3. RESEARCH METHODS

3.1 Sample and Sampling Strategy

The study is conducted on the banking industry of Bangladesh. Eighteen listed banks of Dhaka Stock Exchange (DSE) are taken as samples to carry out the study. Annual reports of sample banks are chosen to collect all the relevant data because annual reports are worldwide accepted means of reliable information for stakeholders (Raman, 2006; Adams, 2004). The study is conducted using five financial years taken as sample ranging from 2012- 2016 with a view to find out whether corporate governance factors have any influence over corporate social practices of the firm. Corporate social expenditure (CSE) is taken as a proxy to measure corporate social practices of firm.

3.2 Selection of Variables

In most of the earlier studies conducted on CSR, a content analysis on Annual report covering dimensions like environment, human resource, community, product and energy are used (Haniffa and Cooke, 2005; Manasseh , 2004; Hackston and Milne, 1996) to explore CSR activities through a disclosure Index. But banking sector of Bangladesh is mostly well structured in terms of disclosing CSR related issues. All the sample banks disclose information regarding the five dimensions as mentioned earlier. A pretest has also been conducted in this study but a very little and statistical insignificant variance has been seen in CSR disclosures. Thus, to ensure internal validity of the research, total corporate social expenditure (CSE) disclosed by banks in their annual report has been taken as the proxy to measure corporate social responsibility of the banking sector in Bangladesh. Corporate governance factors such as Board size, Board Independence, presence of non–executive directors in Audit Committee, Ownership Concentration (top ten shareholders), Managerial ownership, Government ownership and ownership of foreign investors are selected as the independent variables representing corporate governance.

3.3 Model Specification

The fitted regression model for the study is as follows,

$$CSE = a_0 + a_1BDSZ + a_2BIND + a_3NEDAC + a_4OWNC + a_5MNGOWN + a_6GOVOWN + a_7FROWN + E$$

Where,

Dependent Variable

CSE = log of total corporate social expenditure (a proxy to measure CSR)

Independent Variables

BDSZ = Number of Directors in a Board
BIND = Percentage of Independent Directors in the Board
NEDAC =Proportion of Non-executive directors in Audit Committee
OWNC = Percentage of shares held by top ten shareholders
MNGOWN = Percentage of shares held by executive Directors
GOVOWN = Percentage of shares held by Government

FROWN = Percentage of shares held by investors
a_0 = Constant
E = error term

SPSS 20 is used to analyze the collected data to examine the relationship between corporate governance and corporate social responsibility practices. Descriptive Statistics, Bivariate Correlation and Multiple Linear Regression techniques are used as the tools of analysis.

4. RESULTS AND DISCUSSIONS

Table 1 Descriptive statistics

	Mean	**Std. Deviation**	**N**
CSE	7.2137	3.24389	90
BDSZ	13.4889	4.47275	90
BIND	18.2018	11.37312	90
NEDAC	41.4889	19.71952	90
OWNC	26.7559	17.54795	90
MNGOWN	36.5409	22.17482	90
FROWN	6.6876	15.67021	90
GOVOWN	2.7400	8.18930	90

Before conducting multiple linear regression analysis, Pearson correlation coefficient is tested.

Table 2 Correlations

	CSE	BDSZ	BDIND	NEDAC	OWCN	MNGON	FRNOWN	GOWN
CSE	1							
BDSZ	.180	1						
BDIND	.391**	.047	1					
NEDAC	.222*	.199	.415**	1				
OWCN	-.329**	-.087	.076	.154	1			
MNGON	-.073	-.160	.329**	.301**	.169	1		
FRNOWN	.172	.246*	.269*	.276**	-.072	.134	1	
GOWN	.400**	.021	.214*	.185	.105	-.151	-.130	1

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed)

The above Table 2 indicates that Percentage of Independent Directors in the Board, Proportion of Non-executive directors in Audit Committee and Percentage of shares held by Government are positively and significantly related with corporate social responsibilities in terms of CSR expenditure whereas Percentage of shares held by top ten shareholders has a negative correlation with CSR. On the other hand Board Size (Number of Directors in a Board) .Percentage of shares held by executive Directors and Percentage of shares held by investors are not significantly related with CSR.

Table 3 Results of regression analysis

	Unstandardized Coefficients		t	Sig.
	B	Std. Error		
(Constant)	7.019	.643	10.922	.000
GOWN	.146	.034	4.314	.000
OWCN	-.074	.016	-4.690	.000
BDIND	.097	.024	4.003	.000

a. F=19.767,P=0.00,R= .641 ,R square=.411,Adjusted R square=0.390
b. Dependent Variable: CSR, Predictors: (Constant), GOWN, OWCN, BDIND

The R square (coefficient of determination) is a portion of the total variation in the dependent variable that is explained by the variation in the independent variables.The regression output reveals that the dependent variable is explained by the explanatory variables in the model with R-square and adjusted R-square of 41.1% and 39% respectively.

The F- statistic of 19.767 is also significant with P- value of .000, suggesting that corporate governance has an impact on CSR.

The independent variable that is most significant is government ownership and positively correlated with $\beta = .146$ and P value = 0.000. It implies that Government ownership in a firm has an influence over its Corporate Social Behavior. This finding is consistent with Said *et al* (2009), Nasir and Abdullah (2004); Eng and Mak (2003). Increased Government involvement persuades organizations to concentrate more on social commitment even people tend to rely on such firms. Ownership Concentration, another independent variable having $\beta = -.074$ and P value = .000 interprets negative relationship between ownership concentration and corporate social performance. The result is consistent with Chau and Gray (2002) and Wang and Coffey (1992). It depicts that companies where decision making power are concentrated in the hand of owners, are not motivated for corporate philanthropy rather they focus more on profitability and mandatory disclosure. Board Independence shows a positive relationship with CSR, ($\beta = .097$ and P value = .000). The finding is consistent with Haniffa and Cooke (2005), Independent Directors are entrusted to protect the interest of relevant stakeholders. They are professionally accountable to stakeholders to act in the best interest on behalf of them. It is the demand of stakeholders that organizations should spend a portion of their profit for the welfare of society. Therefore, non-executive or Independent directors are committed to satisfying social responsibilities of the firm to uphold the honor and prestige of the firm and increase their credibility among stakeholders.

5. CONCLUSION AND MANAGERIAL IMPLICATIONS

The study sheds light on corporate governance mechanism and its association with corporate social responsibility (CSR) practices of the firm. Although most of the earlier researchers used CSR Disclosure Index (CSDI) to evaluate CSR practices of firms, this study uses social expenditure made by a firm in different sectors like poverty alleviation, education, sports, art & culture, natural disaster etc. to examine the CSR practices. Results based on regression model suggest that three corporate governance variables are directly associated with firms attitude and behavior towards CSR practices. Government ownership and Board Independence positively influence social responsibility practices of the firm. Government shareholding is the most significant variable that influences positively firms' social behavior. Increased government involvement generates pressures for firms to invest more for the benefit of society because the government is the body trusted by the general public. Independent or non-executive directors act as a monitor and balanced mechanism to control the behavior of authority. Research reveals that firms containing board with an increased number of independent directors seem more socially responsible. Independent directors to some extent set the tone of a firm. They influence the authority to take decision for the best interest of stakeholders and to comply with all legal standards and voluntary requirements. Therefore it is evident that higher portion of Independent or non-executive directors positively affects firms behavior towards social responsibility. The analysis also reveals that ownership concentration is negatively associated with CSR practices of firm. Ownership concentration is negatively associated with firms CSR practices. Descriptive statistics revealed that mean value of Ownership concentration is 26.7559%. It implies that shares are non-concentrated in the hand of top ten shareholders rather companies have a large number of shareholders each holding a small fraction of companies shares. Such firms are more accountable to the public because in future these companies might be held by the public at large. Therefore, these firms require additional involvement in community or social development. The finding is consistent with Ghazali (2007).

6. SCOPE FOR FURTHER RESEARCH

Although the research provides some useful insight into corporate governance system and corporate social responsibility practices of firms, it is not free from limitations. First, the study is limited to eighteen listed commercial banks operating in Bangladesh for five years time period ranging from 2012 o 2017. A larger sample would have been more representative of the whole banking sector to depict better picture. If other industries could be taken as a sample, more accurate and reliable results could be obtained. Other voluntary disclosure practices of firms such as Intellectual capital disclosure pattern can be examined to check whether it has any relation to corporate governance system. The study is confined only to Bangladesh. Future research can be conducted across the border.

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