

A Review on the Impact of Corporate Governance and Corporate Social Responsibility on Firm Performance

Don Jerome Pryantha Jayamana^{1*}, Dewi Fariha Abdullah², Maisarah Mohamed Saat³

^{1,2,3} Department of Accounting and Finance, Azman Hashim International Business School, Universiti Teknologi Malaysia, Johor Bahru, Malaysia

*Corresponding author: jerome@graduate.utm.my

Abstract

Corporate governance (CG) has always been in the centre of discussion, since the 1997 Asian economic crisis and the exposed financial scandals of Enron in 2002. In Malaysia, reforms have taken place over the past decades, particularly post Enron scandal. Recent development in Malaysia includes the new Companies Act 2016 and the Malaysian Code on Corporate Governance 2017. Effective mechanisms and controls with the aim of minimizing agency conflicts and emphasizing on the legal safeguards to protect shareholder interest have been established. While, corporate social responsibility (CSR) engagement by companies are increasing trend for companies to contribute to the society, which eventually provides greater business opportunities and competitive edge. This paper aims to discuss the changing landscape of corporate governance framework, as well as CSR engagement undertaken by public listed companies, thus drawing attention at how it benefits the firm's performance, both financial and non-financial. The nature of the CG, CSR and firm's performance relationship will be reviewed based on existing literature in the area. Finally, a framework and recommendations for future research is put forward.

Keywords: Corporate Governance, Corporate Social Responsibility, Minimizing Agency Conflict, Firm Performance

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Introduction

Countries around the world have taken initiatives to boast their corporate governance framework, particularly in wake of Enron's business collapse in 2002. Malaysia too has introduced a number of initiatives to strengthen its laws and regulatory framework. Therefore it is not surprising that there is more and more research being done focusing on how corporate governance affects firm performance (Brown and Caylor, 2004; Bhagat and Bolton, 2008; Earnest and Sofian, 2013). This paper discusses the trends in Malaysia on corporate governance, corporate social responsibility and the impact of these elements on firm performance.

Corporate Governance

In Malaysia, MICG or The Malaysian Institute of Corporate Governance was established in March 1998 with the aim of enhancing the system and practices of good corporate governance. The Institute of Chartered Accountants of England and Wales refers corporate governance as the system by which companies are directed and controlled (www.icaew.com/principles-articles).

The importance of good corporate governance is much highlighted to positively influence firm performance (Earnest & Sofian, 2013; Arora & Sharma, 2016). Additionally, Pickett (2004) states that corporate governance is about how companies conduct their business activities in order to achieve good performance. When the company carries out its business operations with the aim of fulfilling society's expectations in terms of good corporate governance, the end results is normally that it gains confidence of investors, customers and other stakeholders. A company with good governance framework would have a structure that enables, its board of directors to set the company's strategic aims and objectives on a solid foundation, which would define the company's

interaction with its internal and external environment (Windsor and Preston, 1988). This is important so that proper leadership in matters of the management of its business operations, are found on ethical principles. Such practices can then be translated into means that can benefit all stakeholders (Hosmer, 1995). Collins and Porras (1998), state that companies that focus only on maximising profits will tend to perform worse off in comparison to those who focus on other aspects, besides that of maximising the wealth for their shareholders. Corporate Social Responsibility or CSR is of the means that stakeholders can readily benefit from the ethical and responsible practices of the organisation (Barnett, 2007; Ho and Hartojo, 2012).

The stewardship role performed by the directors is a crucial one, and thus the board must be accountable in ensuring that the requirements of the laws and regulations are fulfilled, in order to protect the shareholders' interest in the company (Committee on the Financial Aspects of Corporate Governance, 1992). The Malaysian Institute of Corporate Governance, in its official website has the following quotation, which remains relevant until today:

"Good corporate governance is the key to a robust and competitive corporate sector, which serves as a source for sustainable economic growth".

Corporate Social Responsibility

Stakeholder Theory which was developed in the 1970s, attributed greater corporate responsibility to the firm which included covering its accountability to all their stakeholders, rather than only to shareholders. Freeman (1984) is widely attributed as the founder of this theory. In his "Strategic Management: A Stakeholder Approach", which has contributed to much literature in areas such as corporate social responsibility (Solomon, 2004, Brink, 2011).



The stakeholder theory is in direct contrast to the shareholder theory, which is attributed to Adam Smith, Berle and Means (1932) as well as the work of Jensen and Meckling (1976). The shareholder theory treats an organisation as a means for shareholders to maximise their returns from their investment in the organisation, where in theory shareholders are deemed to be “residual risks bearers” (Berle and Means, 1932). This means that the organisation focuses all its efforts towards generating profits for those who have “a monetary share of the organisation” Here the other stakeholders’ rights are based on the contractual relationship between themselves and the organisation (Lazonick and O’Sullivan, 2000). The contract would, amongst others provide the stakeholders’ contribution to the organisation’s productive processes, and the returns that they are entitled in return to the contribution that they have made.

Malaysian Efforts to Strengthen Corporate Governance

The 1997 Asian Financial Crisis sparked a flurry of initiatives taken by countries in the region to strengthen their respective corporate governance framework. Such measures were necessary to ensure that the countries’ financial and capital markets were operating in a stable and well-regulated environment.

In Malaysia, these measures included the setting up of the Minority Shareholder Watchdog Group (MSWG) with the aim of not only protecting the interest of minority shareholders but also to ensure that there was a mechanism to check and put into practise good corporate governance principles. Other initiatives included the introduction and subsequent revisions of the Malaysian Code on Corporate Governance, the latest was released in April 2017 (MCCG 2017). This is addition to the Corporate Governance (CG) Blueprint 2011, which was launched by the Securities Commission of Malaysia.

Besides these, notable developments include the establishment the Malaysian Code for Institutional Investors (MCII), the Institutional Investors Council Malaysia (IIC), the amendments to Bursa Malaysia Listing Requirements and the much-awaited Companies Act 2016, which revamped the previous Companies Act 1965 with its many amendments.

These initiatives were all aimed at strengthening the corporate culture prevalent in the country, anchoring on the foundations of accountability and transparency, ensuring that every effort is taken to enhance its capital markets, not to mention ensuring its sustainability.

For example, a key feature of the new MCCG 2017 is in introducing the “Comprehend, Apply and Report” or CARE approach, which was aimed at encouraging listed companies to think through policies and procedures when adopting and reporting their corporate governance practices.

The Relationship between Corporate Governance, Corporate Social Responsibility and Firm Performance

The importance of the stakeholder theory has become very significant today, this is mainly because companies have become very large and that their influence in society has grown significantly. Such incidences as “Massive Facebook data breach left 50 million accounts exposed” (NewScientist, 1st October 2018) or “Volkswagen’s Emissions Scandal” (Cultbizztech, Corporate scandals we cannot forget, 27 Feb, 2018) have highlighted lapses in these organisations’ operations and their impact on their customers and other stakeholders.

A good example of this is the Deepwater Horizon oil spill (Abbriano et al., 2011) which resulted a catastrophic environmental disaster of the Gulf of Mexico in 2010. BP has leased the rig from an offshore-oil-drilling company, and as a result of the accident and the resulting oil spill, the company had lost almost a quarter of its market value as well incurred almost USD40 billion in cost due to the subsequent cleanup and recovery efforts.

Such scandals are really “not good for business”. Therefore, it is not surprising to see why companies are going overboard in getting and keeping a good name. A good image will eventually translate towards

contributing to improved profitability. Companies today are espousing their vision, mission, objectives and values to reflect their efforts towards good corporate governance practices, translating these into positive efforts in CSR to build on the positive brand image of the company.

On the other side of the coin, we have seen organisations suffering declines in profits due to increased competition and dwindling market share. These have forced companies into what is now called the “lean mode”, where employees at all levels are now expected to do more, with fewer resources being made available and negligible or no increase in pay rates. Indeed, according to Ho and Hartojo (2012), the more a company engage with community and other stakeholders, it affects corporate financial performance positively.

The discussion on which to prioritise, shareholder or stakeholder perspective has been an on- going debate. The shareholder perspective focuses on the maximisation of the long-term value of the firm, through the appreciation of its stock or share price. The stakeholder perspective on the other hand focuses on the maximisation of the firm’s total value to its stakeholders, which include its employees, shareholders, creditors, customers and the immediate community within the vicinity of the business operations, as well as the general public as a whole (Jensen, 2002).

The Underpinning Theory

In his book “Strategic Management: A Stakeholder Approach”, Freeman (1984) has been recognized as having launched the stakeholder theory concept, in which he has described stakeholders that have a common interests or rights arising from that common interest, can be classified as form a group. Freeman attempted to describe the relationship between the company and its environment, as well as how the company will behave within that environment. The author depicted his model on a chart, whereby he set the company as the centre, surrounded with the stakeholders which are associated with the company (Figure 1). The conceptualization of this theory was developed so that the organisations are able to identify, assess and analyse their various characteristics, as individuals and as groups and hoe these influences or being influenced by the company (Wagner et al., 2011). The link between this paper and the stakeholder theory is the link between the company and its stakeholders and how the corporate governance practices and corporate social responsibility engagement will impact the various stakeholders of the company.



Fig. 1. Stakeholder Theory Diagram (Freeman et al., 2007)

Discussion

Following the points discussed earlier, a proposed research framework is developed with the aim to look at corporate governance and corporate social responsibility and how this will affect the company in terms of its performance, both financial and non-financial performance (refer Figure 2). The framework for this paper will be structured to look at the corporate governance practices of listed companies on the Bursa Malaysia, as well as the CSR engagement of



the companies and how these impact the firm performance. Using the stakeholder theory, one question that would arise would to identify what role a company would play in terms of its social responsibilities in light of the regulatory changes that are taking place in Malaysia pertaining to corporate governance.

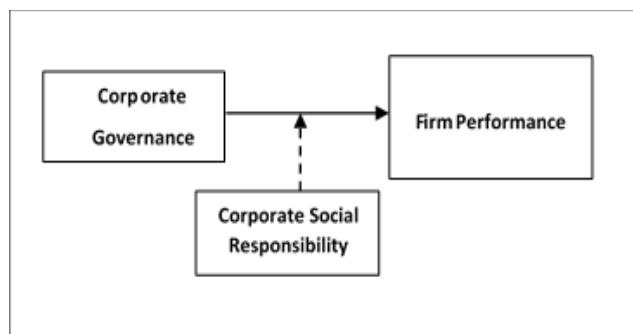


Fig. 2. Research Framework

Conclusion

This paper would open up opportunities for research in such areas in corporate governance as the impact of the different elements of board size, Proportion of Independent non-executive directors and proportion of women directors on the ability of the company to engage in CSR activities in light of the corporate governance reform in the country. Also with the growing emphasis of sustainability reporting and Integrated Reporting (Globalreporting.org.,2019), how are Malaysian listed companies adopting to this new trend. As per the GRI website (Globalreporting.org.,2019), sustainability reporting is defined as:

A sustainability report is a report published by a company or organization about the economic, environmental and social impacts caused by its everyday activities. A sustainability report also presents the organization's values and governance model, and demonstrates the link between its strategy and its commitment to a sustainable global economy.

Through sustainability reporting, organisations are now able to measure and understand, as well as communicate its performance not only pertaining to its economic performance, but also its environmental, social and governance performance. This will enable the organisations to set goals, formulate effective strategies and manage change in an effective manner.

International Integrated Reporting Council (2013, p. 7) defines Integrated Reporting or IR as:

A concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term.

According to Abdullah et.al. (2017) it was reported that despite efforts to encourage public listed companies to implement IR both in Malaysia and Singapore, there exist differences in the way IR elements are reported by the respective companies in these countries. Moreover, Ho and Hartojo (2012) indicated that corporate governance and corporate social responsibility has positive impact on corporate financial performance. Consistent with those views and the increasing emphasis on this matter, it would be interesting to see how these differences apply to corporate governance and CSR, thus affecting firm performance.

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