INDIAN BOARDS AND CSR SPENDING

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Abstract

Companies exist as sociological entities, who acquire resources from various stakeholders to achieve their objectives, thus stakeholder theory of corporate governance emphasizes their responsibility towards society to ensure success in the long term. As a result, companies should engage in corporate social responsibility (CSR) activities for society's welfare. To promote responsible business, CSR legislation was introduced in the Companies Act, 2013. However, the CSR policy of a company is influenced by management's inclination towards meeting stakeholders' expectations; they have discretion over the allocation of amount on CSR activities. Thus the existence of robust corporate governance becomes crucial in determining the extent of CSR expenditure. The study is therefore undertaken to investigate the role of the board in determining CSR spending, using panel data of 719 Indian listed companies for the period 2015 to 2017. The results found a negative impact of participation of non-independent directors in board meetings on CSR spending, indicating an ineffective role of the board in monitoring management's excessive control in CSR decisions. This implies need to review governance regulations and to take stringent action against noncompliance of CSR.

Keywords: Compliance, Corporate Governance, CSR, Stakeholder

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INTRODUCTION

The stakeholder theory which emerged in the later 20th century is based upon the foundation laid down by Freeman's seminal work in 1984. It proposed that the companies should design their corporate strategies considering the interests of all groups and individuals who can affect or are affected by the organization's purpose. Milton Friedman, however, opposed Freeman's view; he stated that the only social responsibility of the business is to utilize resources for activities meant to generate profits. Jensen (2002) [19], too supported Friedman's view by insisting that stakeholder theory conflicts with the objective of shareholder wealth maximization. However, due to the overemphasis of management on the maximization of profit and increasing market prices of shares, dozens of companies collapsed around the world. The short-term orientation of management has led to several corporate scams that not only harmed the shareholders but also had an impact on the whole economy, where employees were left jobless, consumers without goods and entire society suffered a setback. Therefore, companies should be made to behave in a socially responsible manner, for their survival as well as benefit of their stakeholders.

It is believed that management's inclination towards satisfying expectations of multiple stakeholders simultaneously would solve the problem of misconduct, corruption and irresponsible behavior of firms, and enhance their performance as well. Although socially responsible activities like commitment towards workers' safety and environmental issues may reduce the profits available to shareholders in the short run, it would build the reputation of the firm in the market which will guarantee sustainable returns to shareholders in the years to come. The management should, therefore, aim for 'stakeholder value creation' which will itself take care of value creation for its shareholders. Stakeholder theory is theoretically related to Corporate Social Responsibility as it is based upon the relationship between company and society (Clarkson, 1995; Harrison and Freeman, 1999; Mintzberg, 1983). According to Carroll (1979) [5], "the social responsibility of business consists of economic, legal, ethical and philanthropic initiatives aimed at fulfilling stakeholder expectations". The society provides resources, location and labour to companies for their smooth operations, and in return, expects the firm to improve their quality of life, provide employment

opportunities, protect environment by controlling pollution levels. “The aim is to align as nearly as possible the interests of individuals, corporations and society", as discussed by Sir Adrian Cadbury in 'Global Corporate Governance Forum', World Bank, (2000) [6]. Thus a company should take decisions ethically in order to protect interests of various stakeholders while fulfilling their responsibility towards society.

For enhancing the companies’ social responsible behavior, the Ministry of Corporate Affairs (MCA) in India took the initiative and released a voluntary code on corporate social responsibility under CSR Voluntary Guideline in 2009. However, the CSR activities undertaken by Indian companies were not satisfactory, and hence, legislation on CSR spending was issued by The Companies Act, 2013, effective from April 1, 2014, to address the notion of responsible business. Accordingly, under Section 135 of the Act, the board of companies that have net profit exceeding Rs 5 crores or net sales exceeding Rs 1,000 crores or net worth exceeding Rs 500 crores in the immediately preceding financial year, shall ensure that companies spends, in every financial year, at least 2 percent of their average net profit earned over the last three financial years on CSR. This aims to direct companies for conducting their business as a moral corporate citizen by integrating their mission with the social, environmental and economic objectives.

Provided that CSR spending depends on management’s discretion on the amount spent by companies on CSR, they decide whether to invest in CSR activities or not and what proportion of profits earned over the past three years is to be allocated for CSR. The management may under-invest or not invest in CSR altogether to increase profits available to shareholders, or they may also over-invest to enhance reputation and media coverage of the company. Since the attitude of management act as a determinant of investment in CSR, the role of the board becomes crucial in overseeing and monitoring these decisions. The corporate boards act as trustees in the company and have a direct effect in addressing concerns of stakeholders; therefore, the rising issue of corporate social responsibility has brought good governance in the limelight.

The study is undertaken to inspect the impact of board characteristics in influencing the decision to invest in CSR, using firm-level panel data from 2015 to 2017 on 719 Indian listed companies. The existing empirical literature on the relationship

between the role of board and CSR spending is unavailable as the legislation on CSR spending is recently introduced in Indian corporate law; the study hence aims to fill this research gap by employing fixed effects panel regression to examine impact of board characteristics on managerial decision to spend on CSR. The findings revealed negative impact of participation of non-independent directors on CSR spending, indicating that corporate governance polices, particularly with respect to role of independent directors need to be reviewed to address company's accountability towards society. The rest of the paper is organized as follows: next section reviews the related literature on role of board and CSR, and then research design provides data description and construction of sample and methodology, thereafter the analysis of results is presented and finally conclusion is drawn.

LITERATURE REVIEW

The relationship between Board and CSR is studied by researchers through an examination of managerial motives behind decisions on stakeholder policies. They have examined the perceptions of board members regarding their stakeholder orientation (Agle, Mitchell, & Sonnenfeld, 1999; Ibrahim & Angelidis, 1995; Wang & Dewhirst, 1992). The effects of board composition on a firm's stakeholder performance (Hillman, Keim, & Luce, 2001) and corporate social performance (Johnson & Greening, 1999; Waddock, S. A., & Graves, S. B., 1997) is explored in the literature. It was found that board variables act as major determinants of CSR engagement, indicating that the board structure adopted by the company determines the involvement of the firm in CSR activities. Jo, H., & Harjoto, M. A. (2011) examined whether CSR engagement along with corporate governance mechanisms enhance firm value and found that internal and external governance measured by board leadership, independent boards, institutional investors, and security analysts are positively related to the choice of CSR engagement.

The empirical evidence suggests that board size influences the level of CSR disclosure (Majeed, Aziz, and Saleem, 2015; Javaid Lone, E., Ali, A., & Khan, I., 2016). Razek (2014) also reported a positive relationship between board size and corporate social responsibility disclosure for a sample of Egyptian companies. He established multiple directorships as a factor that positively influences the CSR activity of Egyptian companies. Haniffa and Cooke (2005) too found positive impact of multiple directorships

on corporate social responsibility practice in Malaysia. This is due to the directors' greater knowledge and diverse experience while serving in more than one company, which helps in advising the company on how to implement various corporate social responsibility practices. They would be able to judge the quality of CSR proposal and help the firm in taking a wise decision. Ayuso, S., & Argandoña, A. (2009) analyzed board composition required to ensure responsible CSR and propose that the board members should be selected based on their ethical background. Outside board members will be more likely than inside directors to oppose the focus of the firm primarily on financial measures as an indicator of organizational performance. They tend to be more sensitive to society's needs (Ibrahim and Angelidis, 1994; Ibrahim, N. A., Howard, D. P., & Angelidis, J. P., 2003), empirical support has been found for a better CSR performance of firms with independent boards (Webb, 2004). Besides, outside directors are more knowledgeable about the changing demands of various stakeholders (Johnson and Greening, 1999; Zahra et al., 1993). There is a positive link between CSR disclosure and independent directors (Subramaniam, 2015). Khan, Muttakin, and Siddiqui (2013) pointed out the significant positive impact of board independence and the presence of audit committees on CSR.

According to Luoma and Goodstein (1999), three dimensions of board structure and composition are particularly important in reflecting the degree to which concern about stakeholders has been integrated into corporate decision-making. These dimensions are; the presence of stakeholders as directors, the appointment of stakeholder directors in monitoring board committees (audit, compensation, nomination), and the existence of a committee composed mainly of stakeholders or dedicated to CSR. The governance mechanisms, therefore, play important role in monitoring the investments made by managers in CSR, as they tend to over-invest in CSR to build a reputation in the market which will provide them better career opportunities.

Better the corporate governance, higher will be the CSR was not supported by the study done by Chintrakarn, Jiraporn, Kim, and Kim (2016). Moreover, they found that firms with more effective corporate governance practices make significantly less investment in CSR. This is due to managers' engagement in CSR to maximize their self-interest as explained by agency theory (Barnea and Rubin, 2010). The entrenched

managers tend to invest more in CSR for gaining favor from stakeholders (Cespa and Cestone, 2007; Surroca and Tribo, 2008). They satisfy stakeholders by promoting CSR, and hence reduce their risk of removal from the job by pleasing them. Several studies have found no relationship between board independence and CSR, the higher proportion of independent directors do not have a significant impact on the degree of CSR disclosure (Majeed, Aziz, and Saleem, 2015). Wang and Dewhirst (1992) suggest that inside and outside directors do not differ in their stakeholder orientation, McKendall et al. (1999) too found that the proportion of inside directors to outside directors is not related to environmental law violations. Rashid (2018) found that the structure of the board of directors (size, independence, CEO duality) did not influence CSR disclosure. CEO duality didn't have any significant impact on CSR disclosures (Khan, Muttakin, and Siddiqui, 2013), there is a negative relation between CSR and CEO duality (Subramaniam, 2015). Wellalage, Locke, and Acharya (2018) also found that board composition had no impact on firms' CSR.

Although governance mechanisms play a crucial role in lessening the agency conflict, the literature has no consensus on the link between board and CSR. Since the board monitors that managers do not exploit firm resources by overinvestment in CSR for maximizing private benefits at the expense of stakeholders, the link between the board and corporate social responsibility exists. With good governance by a board of directors in the company, it would invest in CSR for the benefit of its stakeholders, thus the role of boards in driving corporate decision-making towards increasing CSR in companies is explored empirically.

RESEARCH DESIGN

Sample and Data

Among 5477 Indian listed firms as on March 31, 2017, the sample constitutes 719 companies which are required to spend on CSR under Section 135 of The Companies Act, 2013 during all three years from 2015 to 2017, and also have data available on board characteristics and performance in all years. The data is extracted from the Prowess database, annual reports and company websites on the variables used in the study.

Table 1: Definition and Measurement of Variables

Variable	Definition	Symbol
Independent variables: Board Characteristics		
Board Size	Total number of directors in the board	BS
Board Independence	Percentage of independent directors in the board	BI
Board Leadership	Dummy variable 1 if Chief Executive Officer (CEO) and Chairman is different otherwise 0	BLDR
Board Meeting	Number of meetings held during the year	BM
Independent directors' participation	Average number of meetings attended by the independent directors in a year	BIDPART
Non independent directors' participation	Average number of meetings attended by the non-independent directors in a year	BNDPART
Board Busyness	Average number of other directorships held by directors.	BBUSY
Dependent variable: CSR		
CSR expenditure	Amount spent on CSR during the year	CSRspent
CSR as % of profit	CSR expenditure divided by average profits over last 3 years	CSRprofit%
Control variables		
Debt Equity Ratio	Total debt divided by total assets	DER
Age	Present year – Incorporation year	AGE
Size	Total assets of the company	ASSETS

Source: Author's Compilation

Methodology

The study employs fixed effect regressions in panel data, based on Hausman test which gave statistically significant chi-square for the model. In order to provide adequate time to board characteristics in influencing the decision on CSR spending, the independent and control variables are lagged by one year. This helps in examining the impact of the board on future level of CSR spending in companies, and also ensures that the direction of causality runs from independent variable to dependent variable in the model (Chen& Hsu, 2009; Pakes and Schankerman, 1984). The standard errors robust to heteroscedasticity and autocorrelation are computed as regression estimates.

To test the effect of board characteristics on CSR expenditure, the following model is used:

$Y_{it} = \beta_0 + \beta_a X_{it-1} + \beta_s C_{it-1} + v_{it}$

where

Y_{it} : is CSR indicator,

X_{it} : is board characteristic variable, and

C_{it} : is a vector of control variables for firm i at time t.

t: 2015, 2016, 2017.

FINDINGS AND IMPLICATIONS

In order to find the impact of board on CSR spending of companies, descriptive statistics, and correlation matrix is drawn before running the panel regression.

Descriptive Statistics and Correlation Matrix

The descriptive statistics of the sample and correlation matrix is presented in Table 2 and Table 3 respectively:

Table 2: Descriptive Statistics

Variables	Obs	Mean	Std.Dev.	Min	Max
CSRspent	2157	94.334	434.48	0	7605.8
CSRprofit%	2157	2.18	8.916	0	202.273
BSize	2157	10.809	3	2	25
BMeeting	2157	5.89	2.37	0	23
BIndependence	2157	.461	.114	0	.909
B Ind Participation	2157	4.426	1.843	0	20.25
B Non Ind Participation	2157	3.734	1.825	0	19.667
B Busyness	2157	2.734	2.029	0	15.143
B Leadership	2157	.66	.474	0	1
AGE	2157	37.787	21.757	3	138
DER	2155	.735	1.307	0	12.76
ASSETS	2157	117000	546000	202.8	8640000

Source: Analysis of research data (STATA output)

The descriptive statistics displays mean, standard deviation, minimum and maximum value of variables used in study. The average board size is 11, and less than half of the board is independent. The participation of both independent as well as non-independent directors in board meetings is satisfactory; directors attend 4 board meetings on an average out of 6 meetings held during the year. The directors do not seem to be too busy as they hold 3 directorships on average. The board leadership at 0.66 indicates that

for every 100 CEOs, 66 of them are not serving as board chairman. It shows that two-third of the sample firms have voluntarily separated the position of CEO and chairman. The average CSR spending is 94 million, and average of 2.18% of profit is spent by firms on CSR which indicates positive response of companies for CSR guidelines.

Table 3: **Pearson's correlation matrix**

Var.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
CSRspent	1.000								
CSRprofit%	0.343*	1.000							
BS	0.435*	0.086*	1.000						
BM	0.180*	0.012	0.124*	1.000					
BI	0.292*	0.040	0.702*	0.025	1.000				
BIDPART	0.173*	0.006	0.003	0.726*	-0.016	1.000			
BNDPART	0.173*	0.032	0.057*	0.789*	0.085*	0.627*	1.000		
BBUSY	0.255*	-0.027	0.114*	0.004	0.198*	0.067*	0.028	1.000	
BLDR	-0.021	-0.041	0.021	-0.020	-0.026	0.023	-0.054*	0.035	1.000
VIF			2.671	4.075	2.455	2.226	3.157	1.224	1.019

Source: Analysis of research data (STATA output)

Table 4 then displays the correlation matrix of variables; it indicates that independent variables are not correlated with each other. The correlations among independent variables and their Variance Inflation Factor (VIF) is less than 0.80 and 8 respectively, hence multicollinearity is not an issue in the data. The effect of board characteristics on CSR variables is explored through regression analysis. The significant F statistic shows that the models are statistically significant in explaining the relationship between board characteristics and CSR and that 82% variation in the amount spent on CSR as a percentage of profits is explained by explanatory variables by Model 2. It is found that when the participation of non-independent directors in meetings increases, then CSR spending decline significantly. None of the other variables has a significant effect on any of the CSR indicator, which indicates that mere compliance with governance regulations do not necessarily ensure that CSR spending in companies would improve. This shows that the independent directors have failed to effectively monitor the reduction in CSR spending by management.

Table 4: Regression results

	Model 1	Model 2
Variables	CSRspent	CSRprofit%
BSize	0.001	-0.000
	(0.023)	(0.021)
BMeeting	0.003	-0.019
	(0.024)	(0.029)
BIndependence	0.013	-0.010
	(0.028)	(0.030)
BInd Participation	0.027	0.019
	(0.020)	(0.018)
BNon Ind Participation	-0.032	-0.061*
	(0.032)	(0.033)
BBusyness	-0.037	-0.059
	(0.037)	(0.038)
BLeadership	-0.097	0.125
	(0.152)	(0.133)
AGE	0.037	0.007
	(0.042)	(0.042)
logDER	-0.115**	0.027
	(0.049)	(0.049)
logASSETS	0.016	-0.229
	(0.182)	(0.185)
_cons	0.898	-1.839
	(1.942)	(1.909)
Obs.	1056	1049
R-squared	0.970	0.820
Adj. R2	0.932	0.593
F	1.864	1.070
Prob>F	0.0420	0.0383
Year Dummies	Yes	Yes
Industry Dummies	Yes	Yes

Robust Standard errors are in parenthesis (*** p<0.01, ** p<0.05, * p<0.1)

Source: Analysis of research data (STATA output)

Since investment decisions in market are based on company's immediate financial performance and share price performance, the decline in profits could affect public investments adversely. A recent study by Manchiraju & Rajgopal (2017) also suggested that mandatory CSR activities can impose social burdens on business activities at the expense of shareholders. The management is therefore inclined towards maximization of

shareholders' return instead of satisfying expectations of all stakeholders ignoring the positive impact of socially responsible activities on company's long term performance.

Additionally, the spirit of making provisions of Section 135(5) gets diluted by the second proviso to this subsection[3], according to which the board of directors shall ensure that the company which qualifies the provisions of section 135(1) spends at least 2% on CSR or shall provide explanation for not spending the required amount. The management is, therefore, using it as an escape route by explaining that no suitable opportunity on CSR could be identified. Since companies were not taking CSR sincerely due to the weak enforcement of regulations and the absence of penal provisions on noncompliance with section 135(5), the High-Level Committee constituted by MCA recommended monetary penalty as well as imprisonment for up to three years in case of non-compliance. But due to objections raised by industry, default with CSR norms is still treated as a civil offense. The government is, however, considering making CSR expenditure eligible for a tax deduction to motivate companies for increasing their CSR spending.

The corporate governance relies upon the presence of directors, especially independent directors who are expected to guide management for assigning necessary resources to satisfy stakeholders' claims while making decisions on CSR in a boardroom. But the findings highlight the weak role of governance mechanisms, the independent directors exist merely to fulfill the requirement of law. The will on their part to contribute positively and dedication to enhancing the CSR undertakings by the firm is largely missing. They lack time and effort in developing an understanding of the company's business environment to assess CSR investment proposals accordingly. Hence their presence is ineffective in monitoring management's influence in CSR decisions. There is a need to make directors responsible to ensure that they act in the interest of stakeholders instead of safeguarding their self-interests.

[3] Penalise firms not spending 2% of profits on CSR: Parliamentary Panel, December 4, 2015, accessed at //economictimes.indiatimes.com/articleshow/50045003.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

CONCLUSION

The empirical analysis of Indian listed companies that are required to spend on CSR under The Companies Act, 2013 for all the years from 2015 to 2017 is undertaken, to investigate the impact of board characteristics on CSR spending in companies using fixed-effect regression in panel data. The study found a negative impact of participation of non-independent directors in board meetings on CSR spending in companies. The management has failed to appreciate the important role played by stakeholders in the company's business operations, and hence do not gear themselves to satisfy their claims. There is insignificant impact of all other board characteristics on CSR, particularly the presence of independent directors and their participation in meetings, which revealed that the board of directors has remained unsuccessful in monitoring the decisions taken by management despite being heavily relied upon by corporate governance regulations.

The findings hence develop the need to debate over the efficacy of provisions on CSR in the Act as well as corporate governance regulations in the country. Under CSR legislation, the time period for which a company is allowed to explain should be fixed, beyond which penalty should be imposed. Moreover, the government should strictly verify the explanations given by companies for less CSR spending or not spending at all for their authenticity. The external experts should be engaged in overseeing the quality of CSR expenditures in companies and to ensure compliance with CSR provisions.

The regulators should also take action to make boards reliable that would ensure augmentation in companies' CSR activities. To make corporate governance effective, the selection and evaluation of the contribution of board members should be made more transparent to make them accountable towards stakeholders. The active participation of independent directors in decision making needs to be thoroughly assessed, as a means to influence CSR spending in companies. Unless management begins to take into account the importance of CSR in contributing to a firm's long-term performance, the law will remain ineffective and companies will keep pursuing the objective of profit maximization at the cost of CSR.

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