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Mediating Role of Independent Directors on Corporate Social Responsibility and Firm Performance

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Abstract

Corporate board members acquire responsibility to represent the stakeholders on whom it impacts; independent board members are entrusted to serve and protect those stakeholders not represented in the board. Independent directors are neither executive nor proprietor, so they are expected to consider the interests, needs and aspirations of non-represented stakeholders. The strategic nature of corporate social responsibility falls under the instructions of corporate board directors, and their independent directors' role becomes essential to ensure and protect the fair share for corporate socially responsible activities to protect the welfare of society and the environment. It has been evident in emerging markets, and corporate social responsibility influences the financial performance of companies. The present study examines the mediation role of independent directors on corporate social responsibility and firm performance. The result of the study shows independent directors mediates between corporate social responsibility and financial performance of firm. Further the findings of the study validate the arguments of stakeholders and shareholder theories of corporate governance. SPSS (AMOS) is used to perform mediation analysis by taking diversified companies listed in Bombay stock exchange (BSE).

Keywords: CSR, Board Independence, Firm Performance, Stakeholders Theory and shareholders theory.

Introduction

Since industrial revolution, corporates have been under the surveillance of criticism because of their role in social and environmental issues. Industries have caused a considerable change in our planet in the form of carbon emission, social inequality, water and air pollution, which have an inverse impact on our present and future generations living beings. Around the world, corporate social responsibility has become one of the essential aspects on their agenda (Terrero-De La Rosa et al., 2017). There has been a change in the way corporates operate today because managements are well aware of corporates' regular interaction with society and their preferences. (Tziner, Bar, Oren, & Kadosh, 2011), Stated that corporate social responsibility had gained huge intention from businesses, society, customers, and policymakers. The establishment and implication of CSR have generated much debate in recent years while businesses operate to maximise profits and economic development by compromising society and the environment (Martinez, Monserrat, & Serafin, 2015). According to

French (2013), corporate social responsibility has become necessary; CSR will restore corporate reputation and confidence to improve corporate social health. Molina & Clemente (2010) stated that in Europe, fund managers and other analysts believe proper and long term CSR will improve a company's credibility and higher economic performance. Corporates should consider CSR as strategic objectives to be achieved by establishing the department to communicate the actions taken (Aceituno-Aceituno, 2013).

Since Corporate governance origin in the business world, the debate on its roles and responsibilities has been going on among academics, researchers and policymakers. However, the theories of corporate governance (stakeholder's theory and agency theories) clearly state that corporate governance is there to protect the interest of all the stakeholders. Corporate governance consists of a board of directors that includes dependent and independent directors in its structures. Agency theory of corporate governance states that the board should consist of more independent directors than dependent directors, reducing agency problems and protecting the interest of shareholders and other stakeholders. This study has stated the mediation effect of independent directors on corporate social responsibilities and the firm's financial performance. As Board Independence has no direct or indirect relationship with the organisation, their impact or takes on corporate social responsibilities will be different from the board that has a direct or indirect relationship with the firm.

Theoretical Background

Corporate social responsibility has been in controversy throughout history, but its relevance has fought an ideological battle for a long time. Professor Milton had referred to CSR as a violation of the rights of owners and shareholders by making them spend on non-business problems. (Friedman, 1970) argued that CSR is an idea of stealing money from investors. If they want to spend, they could do it secretly on their own. In recent periods researchers have proved that not doing CSR is a violation of the rights of society.

Corporate social responsibility is a vast area in the ethical domain of businesses. According to the ISO 26000, decisions and activities taken by the organisation are responsible for their impact on society and the environment. CSR is an ethical responsibility of businesses to protect the environment, work for community welfare, and meet society's expectations. For decades research on CSR has been done on different dimensions. Most of the studies have concluded that CSR has a significant part to play in businesses. It benefits not only society but also businesses through image building and growth. The theories of CSR suggest that corporates are dependable on the existence of society. When corporates do not take care of society, they are more likely to go down by making no impression in society (Hahn & Kühnen, 2013). Stakeholder's theory further explains that society among customers, suppliers, employees, and other surrounding communities also has a stake in the organisation.

Stakeholder’s theory

(Freeman & McVea, 2001) stated that the purpose of every organisation is to meet the needs of those who are getting affected by their activities and decisions. Without the support of stakeholders, no business can survive, so companies should seek the help of their stakeholders by making them realise enterprises are not only for profit-making (Grey et al., 1995). Stakeholder theory further suggests that there is inter-dependence between a company and society. The company needs a healthy environment, an educated workforce, loyalty, skills, and talent. Without it, a business cannot achieve its objectives while society needs goods and services to fulfil its needs (Lenk, 1994). The main feature of CSR is that the company and its management is accountable to its stakeholders and can be claimed legally mentioned in the policy or morally.

Hypothesis Development

CSR AND FIRM PERFORMANCE

(Orlitzky et al. 2003) argued that businesses making an investment in society and the environment pays off through image building. Businesses and society always go along where businesses need a knowledgeable and skilful workforce, loyal customers and wilful suppliers. Spending on social and environmental causes gives an extra advantage to the corporates. (Bihari & Pradhan, 2011) further added that the introduction of Indian law on mandatory spending on society had changed the scenario than before. (Osisioma, Nzewi & Paul 2015) used time-series data positive relationship between CSR and profitability of corporates. Results further explain that corporates should continue their social and environmental spending because it will help them sustain themselves for a long time. (Flammer 2015) used the Regression discontinuity approach to investigate whether accepting CSR proposals leads to improve company financial performance. Results of the study showed that accepting the close call of CSR proposal improves stock returns and better accounting performance. Accepting CSR proposals leads to labour productivity and sales growth. (Maqbool & Zameer, 2018) provides great insights for company administration to integrate CSR with the business's strategic intent and renovate their corporate philosophy from traditional money-making to a socially responsible approach. Companies which are listed are more responsible towards society than the non-listed companies in India. Mishra & Suar (2010) further explain that responsible business practices will benefit Indian companies financially and non-financially. (Cho, Lee & Pfeiffer, 2013) used KLD and STAT scores to state both positive and negative affect.

Further, they argued that negative influence affects more than positive influence. CSR performance plays a positive role in investment by reducing information asymmetry. While Mitra (2021) argues that post mandatory CSR on listed firms shows a negative relationship between corporate social responsibility and return on assets and equity. She further explains that companies forced to invest in society and the environment are not impacting rather than investing by their own will. (Kim & Oh, 2019) submitted that improving CSR activities do not help companies improve their performance. Further, he stated that CSR shows weakened relationship with market-based performance measures such as TobinQ in group affiliated firms.

H1: Positive Relationship between CSR and Financial Performance of Firm

CSR, Firm Performance and Board Independence

The corporate board has the responsibility to protect the interest of the stakeholders and other surrounding communities. Board independence is a critical element of board structure to oversee the decisions and activities conducted by businesses that may directly or indirectly affect the society and environment**.** (Ahmad, 2017) investigated that board independence relationship with CSR depends upon the industry or sector-specific. Having many independent directors on board may negatively influence CSR initiatives because large boards tend to lack communication effectiveness than smaller boards. Corporate governance significantly influences CSR activities and reporting (Al Fadli et al., 2020); however, the independent board may encourage businesses to report more CSR activities to manage shareholders' expectations. (Dwekat et al., 2020) In the last five years, publications and citations show corporate governance has a significant influence on CSR. (Bansal et al., 2018) Argues that board independence encourages businesses to be active in CSR spending, especially in family-owned businesses where investors protection is low than in countries with the common law of CSR reporting. Integrity, faithfully and transparently. Independent board, as it holds the autonomy to decide without any influence, may encourage more CSR activity to the society and environment. (Hossain et al., 2016) argues that corporate governance enhances the moderate role between CSR and firm performance by monitoring and taking reasonable control of the organisation.

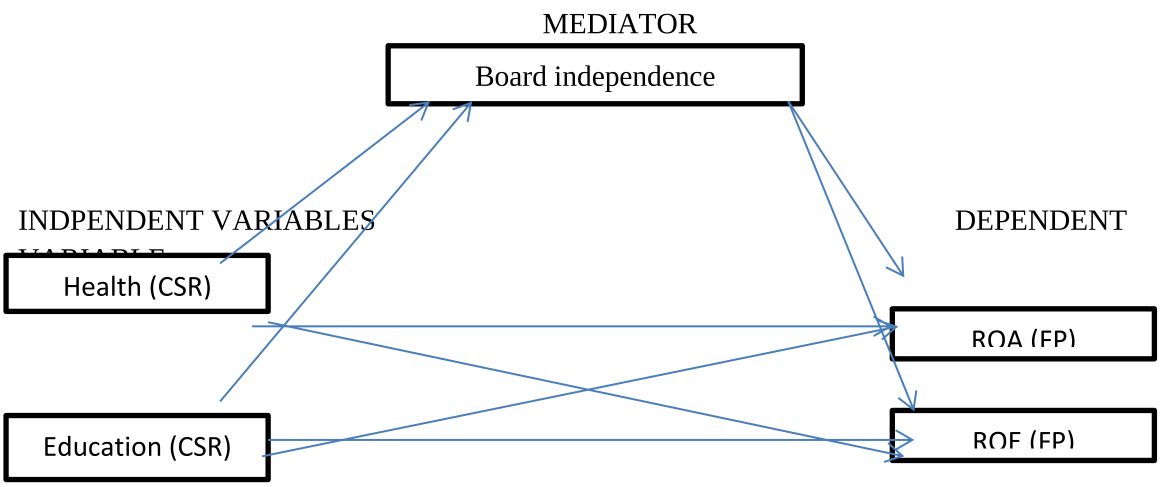
Further suggests that while board independence does not influence the company, it forms a mediation link by ensuring transparency in the organisation. (Calderón et al., 2020) defines board independence possess autonomy, and it is expected from them to work with

H2: there is a mediation role of board independence between CSR and Firm Performance

RESEARCH DESIGN

This study implied exploratory research design and utilised the data that involves expenditure in social responsibility and various accounting measures (ROA and ROE) and Board independence as a Mediator.

Model framework



VARIABLES

In this study, five sub-variables are used for analysis.

Description	Sub-variables	Explanation
Mediator	Board independence	Number of independent members in the corporate board
Independent	Health (CSR)	Percentage of total net profit
	Education (CSR)	Percentage of total net profit
Dependent	Return on assets (FP)	ROA = Net Income Divided By Total Assets
	Return on equity (FP)	ROE = Net Income Divided By Total Shareholders' Equity

Methodology and Analysis Tools

Data for this study was collected from the SEBI (security and exchange board of India) website and company websites from the period of 2014-15 to 2018-19 prior to the Companies act 2013, where a new policy framework about CSR was introduced, and the policy was fully implemented in the financial year 2014-2015. We have selected BSE S&P 100 index listed companies for the study. We excluded financial and insurance companies because of different accounting systems and high regulations from the government. The sample size was reduced to 63, and further, we excluded companies whose data were missing. The total sample size of the study is 58 listed companies. The sample for the study is diversified around ten industries in which 40 companies are from the oil, gas, mining, manufacturing and FMCG sectors. At the same time, the remaining 18 companies belong to service industries such as telecom, IT, software and hotels. Out of the total sample size, 31 firms belong to family-owned businesses, and the remaining 18 are from non-family businesses.

For data analysis, we have used IBM AMOS software which is well designed for mediation analysis. However, first, we have checked the validity and reliability of data through IBM SPSS by running Cronbach's alpha.

Results and Discussion

Cronbach's alpha is used to test the validity and reliability of data. Table1 presents the test result, which shows that the entire variables used` in this study are reliable. According to (Bonnett & Wright, 2014), values of Cronchbech alpha should lie between 0.7 to 0.9, but in this case, researchers argue that if the sample size is slow, Cronbach's alpha might be slightly low.

		Table 1		
Sr	Variables	Items	Valid items	Cronbach’s alpha
1	ROA	290	287	0.632
2	ROE	290	290	0.765
3	HEALTH	290	285	0.662
4	EDUCATION	290	288	0.689
5	BIND	290	290	0.698

After estimating model fit, Prabhu (2007) approach is adopted to estimate the regression coefficient to check the mediation effect between dependent and independent variables. This approach also inspects whether there is partial or complete mediation. In the initial stage, the direct effect of independent to dependent variables Is checked. In the next step, through mediation, the indirect effect between independent to dependent variables is checked

TABLE 2	**Model fit**		
Indexes of the direct model		Indexes of indirect model	
Factors	Values	Factors values	2.049
Chi square	2.694	Chi square	0.836
NFI	0.816	NFI	0.910
GFI	0.921	GFI	0.825
AGFI	0.920	AGFI	0.914
TLI	0.822	TLI	0.816
CFI	0.994	CFI	0.816
RMSEA	0.062	RMSEA	0.047

Results in Table 3 suggests that return on assets (ROA) and return on equity (ROA) has a significant positive relationship with corporate social responsibility initiatives of spending on health and education as it validates the argument of stakeholders theory (Barnett & Salomon, 2012) suggests that investing on stakeholders will increase the image of the company which leads to the better financial performance of firm which also proves my hypothesis H1. Results of the study suggest that corporates should involve and invest more in CSR activities, especially in health and education. Companies should invest in CSR activities beyond the compulsory amount according to the law. (Barnett & Salomon, 2012) argues that firms with higher corporate social performance have higher financial performance than those with moderate corporate social performance. (Bahta et al., 2020) suggests that companies with higher CSR scores and companies that disclose CSR information have a significant relationship with company growth

= TABLE 3

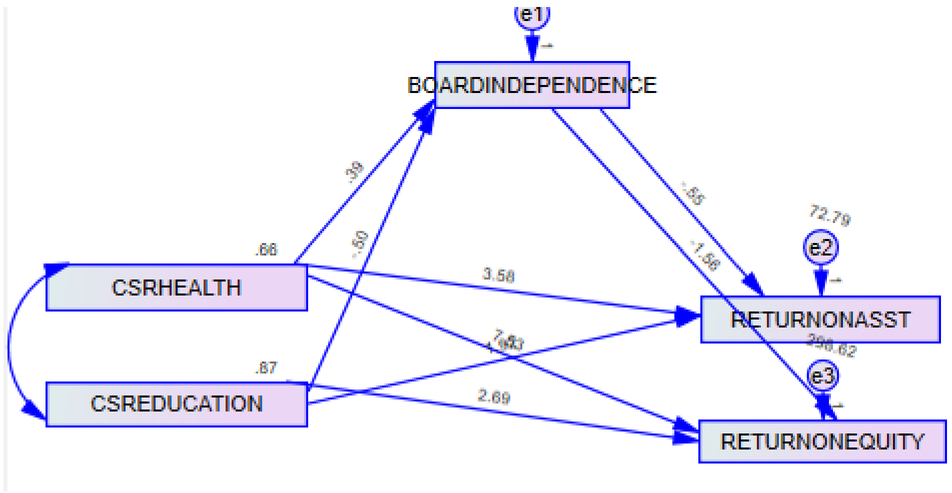
Regression Weights (direct effect)			ESTIMATION	S-E	CR	P LEVEL
ROA	<---	HEALTH	0.425	0.756	5.21	***
ROA	<---	EDUCATION	0.351	0.96	6.35	0.005
ROE	<---	HEALTH	0.529	0.97	7.762	***
ROE	<---	EDUCATION	2.688	0.865	3.108	0.002

TABLE 4

Regression Weights (indirect effect)			ESTIMATION	S-E	CR	P LEVEL
BIND	<---	HEALTH	0.392	0.094	4.159	***
BIND	<---	EDUCATION	0.303	0.082	-6.104	***
ROA	<---	BIND	1.238	0.754	3.125	***
ROE	<---	BIND	1.564	0.454	-3.448	***

The other result shows that board independence has a significant positive relationship with CSR activities. (Ahmad, 2017) suggests that board independence have a positive association with CSR, which shows result partially supports agency theory. More independent directors will have more responsibility to protect the stakeholders' interests (Álvarez & Zubeltzu, 2017). This further suggests that countries with CSR laws have a more significant impact on board independence and CSR activities.

Table 5		(board independence)				
Variables			Direct effect		Indirect effect	
			Estimation	P value	Estimation	P value
ROA	<---	HEALTH	0.425	****	0.361	*****
ROA	<---	EDUCATION	0.351	0.005	0.210	0.004
ROE	<---	HEALTH	0.529	****	0.522	****
ROE	<---	EDUCATION	2.688	0.002	2.386	****



The main focus of this study is to investigate the mediation effect of board independence between CSR and firm performance. The mediation effect shows a significant relationship. We accept the null hypothesis that board independence has a mediation effect between corporate social responsibility and the firm's financial performance. Historically few studies have supported the result (Huang, 2010; Hossain et al., 2016).

Conclusion

In recent decades correlation between corporate social responsibility and independent directors has become imperative in the corporate governance debate. Independent directors are selected based on their knowledge and expertise with no direct or indirect involvement with the organisation. Generally, risk management, accountability, transparency and disclosure are considered the primary responsibilities of independent directors. According to the modern definition and specific theories of corporate governance, independent directors represent all stakeholders, especially those with no representation in the company board and with no such influence from those whose interest is involved. One can expect independent directors to engage the organisation towards corporate social and environmental activities. The relationship between corporate social responsibilities and independent directors and the relationship between independent directors and firm performance has no considerable criticism from scholars on having a positive relationship. There is a minimal number of studies on mediating the role of independent directors on corporate social responsibility and firm performance. The present study provides empirical evidence to examine the role of independent directors between corporate social responsibility and form performance.

Findings of the study suggest that independent directors significantly mediate between corporate social responsibly and firm performance. The other result suggests corporate social responsibility has a significant positive impact on the firm's financial performance. The result of the study supports the stakeholders and shareholders theories. Where stakeholders' theory suggests investment in society would positively impact corporates image and may lead to better performance or growth. In contrast, agency theory suggests that having independent members on the board will be best in the firm's interest and stakeholders. Agency theory further explains that independent directors' involvement in social activities will reduce the agency problem in the firm.

The study's findings are helpful for the companies, investors, and policymakers as the above results suggest that investing in social activities can lead to a firm's better performance, which is beneficial for all the stakeholders, including investors and policymakers. The future gap includes more mediating variables and performance variables.

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