Interconnection: Corporate Governance and Corporate Social Responsibility

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Abstract

This paper seeks to explore the interconnections between corporate governance (CG) and corporate social responsibility (CSR). Accordingly, the paper seeks to highlight the increasing cross-connects or interfaces between CG and CSR, capitalizing on fresh insights from a developing country perspective. A qualitative research methodology was adopted, drawing on in-depth interviews with the top managers with the results that the majority of managers conceive of CG as a necessary pillar for sustainable CSR. These results are significant and interesting with growing appreciation of their interdependencies and the need to move beyond CG conformance toward voluntary CSR performance. The research paper makes two important contributions. First, it suggests that there is definitely an interconnection and increasing overlap between CG and CSR. While much previous literature has researched CG and CSR independently, this paper makes the case for considering them jointly and systematically. Second, the paper outlines a number of theoretical propositions that can serve as the basis for future research on the topic, particularly in developing countries, given that the data and theoretical propositions are both derived from and tailored to developing country contexts.

This study can potentially alert managers to the increasing overlap between the CG and CSR agendas and the need to exert diligent systematic efforts on both fronts. CG and CSR share more in common than previously assumed, and this needs to be accounted for by practitioners. The research can also alert policy makers in developing countries to the need to increase the vigilance and capacity of the regulatory and judicial systems in the context of CG reform and to increase institutional pressures, particularly of the coercive and normative variety to enhance CSR adoption.

Keywords: Corporate Governance, Corporate Social Responsibility.

Introduction

CG is a well explained concept related to good financial performance, profit maximization and protection of those economic agents who have provided capital to the firm while CSR is a concept apparently in contrast with profit maximization because it is comprises of set of actions which is beneficial to external stakeholders and...
may conflict with the interest of the shareholders. Corporate Governance and Corporate Social Responsibility (CSR) are the concepts given by the developed countries, where their practices have developed tremendously in the last decade. During these periods the idea has been exported to other parts of the globe largely through the activities of multinational National companies. It may be noted that the Corporate Governance and CSR are two related and interwoven business concepts that are deeply accepted in business practices. In this context, an attempt is made to discuss the concept of CSR and Corporate Governance, and their interrelationship, within legal and regulatory framework in India. Corporate governance has gained a much higher profile in the last two decades in the wake of various corporate scandals and collapses. Corporate social responsibility (CSR) is now becoming much more a part of mainstream corporate governance as there is a recognition that a company cannot – in the long-term – operate in isolation from the wider society in which it operates. This research firstly, describes CSR its core principles. Second, it describes CG and narrates CG’s convergence with CSR.

**Statement of the Problem**

Corporations are generally more focussed today to widen the basis of their performance evaluation from a short-term financial focus to include long-term social, environmental, and economic impacts and value added (Hardjono and van Marrewijk, 2001). This is where the concepts of CG and corporate social responsibility (CSR) gets into picture. It in this perspective the following study is undertaken to find out the interconnection between CG and CSR.

**Objectives of the study**

1. To study the Corporate social responsibility importance.
2. To study about the Corporate Governance literature.
3. To relate the connection between CG and CSR.

**Research Methodology**

- Exhaustive literature survey regarding the topic and related concepts has been done.
- Secondary data inclusive of quantitative and collected from various sources including books, research papers, newspapers, magazines and websites is used for the purpose of study.
Limitations

- The findings are limited to the context of the study and it was limited to some companies. The sources of the data in this report were companies' annual reports and web sites only.

- Non availability of all company's data.

- Time constrain.

Corporate Social Responsibility

The definition of CSR is different from company to company and many other terms like sustainable growth, corporate responsibility, social responsibility or corporate citizenship. CSR is the business contribution to sustainable development, meaning the way a company balances its economic, environmental and social objectives while addressing stakeholder expectations and enhancing shareholder value. The success of CSR lies in practicing it as a core part of a company’s development strategy. It is important for the corporate sector to identify, promote and implement successful policies and practices that achieve triple bottom-line results.

Definitions

- The World Business Council for Sustainable Development defines the CSR as a “business' commitment to contribute to sustainable economic development, working with employees, their families, the local community, and society at large to improve their quality of life”. Under this point of view, the CSR rests on the fundamental pillars of both the economic growth and the quality of life as an engine for “sustainable” development.

- The Canadian Centre for Philanthropy: CSR is “a set of management practices that ensure the company minimizes the negative impacts of its operations on society while maximizing its positive impacts”. This definition therefore provides the link between the decisions tied to the social responsibility and “the business" derived from the respect of the lawyer instruments, the population, the communities, and the environment.
The Corporate Social Responsibility Newswire Service: the CSR is the integration of business operations and values whereby the interests of all stakeholders including customers, employees, investors and the environment are reflected in the company’s policies and actions.”

As per the Indian Corporate: “Sustainable development implies optimizing financial position while not depleting social and environmental aspects and CSR implies supporting issues related to children, women and environment”.

The most common conceptualizations of CSR are those of Carroll (1979) and Lantos (2001). Carroll (1979; 1991) differentiated between four types of CSR, namely, economic (jobs, wages, services), legal (legal compliance and playing by the rules of the game), ethical (being moral and doing what is just, right, and fair) and discretionary (optional philanthropic contributions), while Lantos (2001) collapsed these categories into three: ethical, altruistic, and strategic. According to Lantos (2001), ethical CSR is morally mandatory and goes beyond fulfilling a firm’s economic and legal obligations, to its responsibility to avoid harm or social injuries, even in cases where the business does not directly get benefit. Altruistic CSR, according to Lantos (2001), is humanitarian/philanthropic CSR, which involves genuine optional caring, irrespective of whether the firm will derive financial benefits or not. Many scholars also conceive of CSR as encompassing two dimensions: internal and external. On the internal level, companies revise their in-house priorities and accord due diligence to their responsibility to internal stakeholders, addressing issues relating to skills and education, workplace safety, working conditions, human rights, equity considerations, equal opportunity, health and safety, and labor rights (Jones, Comfort and Hillier, 2005). With respect to the external dimension of CSR – which admittedly receives more attention in the literature (Deakin and Hobbs, 2007) –priority shifts to the need for corporations to assume their duties as citizens, and accord due diligence to their external – economic and social – stakeholders and the natural environment (Munilla and Miles, 2005). The environmental component addresses primarily the impacts of processes, products, and service on the environment, biodiversity, and human health, while the social bottom line incorporates community issues, social justice, public problems, and public controversies.

Corporate Governance

Corporate Governance is also intimately concerned with honesty and transparency, which are increasingly expected of the public both in corporate dealings and disclosure (Page, 2005). Investor’s trust and market
efficiency depends upon the disclosure of accurate information about corporate overall performance. To be of value in global capital markets, disclosed information should be clear, consistent, and comparable (OECD, 1999). Moreover, transparency and disclosure of information between managers and employees are essential to earn employee’s trust and commitment. These factors ensure an accurate and timely reporting of activities, thus providing the necessary foundation that would facilitate the application of sound governance mechanisms (Cadbury, 2000).

“Corporate Governance is about promoting corporate fairness, transparency and accountability”. It is concerned with structures and processes for decision making, accountability, control and behavior at the top level of organizations. It influences how the objectives of organizations are set and achieved, how risk is monitored and assessed, and how performance is evaluated or optimized.

- According to laureate Milton Friedman, “Corporate Governance is to conduct the business in accordance with owner or shareholders’ desires, which generally will be to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs.

- According to Sir Adrian Cadbury, “Corporate Governance is the system by which companies are directed and controlled to do with Power and Accountability: who exercises power, on behalf of whom, how the exercise of power is controlled.”

- According to OECD the Corporate Governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the Board, managers, shareholders and other stakeholders spells out the rules and procedures for making decisions on corporate affairs.

- Yet another definition is “Corporate Governance is about promoting corporate fairness, transparency and accountability.”

Although corporate governance frameworks differs from country to country based on the legal, regulatory and institutional environment, they have a common aim: to define clearly the rights, responsibilities and behaviors that are required of a company’s owners (the ‘principals’) and managers (the ‘agents’) for the business to operate successfully. A narrow view of CG portrays
it as an enforced system of laws and of financial accounting, where socio-environmental considerations are accorded a low priority (Saravanamuthu, 2004). There is, however, a broader CG conception, emphasizing every business’ responsibilities toward the different stakeholders that provide it with the necessary resources for its survival, competitiveness, and success (MacMillan et al., 2004). As such, managers are primarily accountable towards stockholders whose wealth and fortunes are at stake. But they are also responsible toward employees, suppliers, customers, and communities whose investments in the company are equally significant in other important respects. Thus, within this broader conception, the interests of all stakeholders are accorded due regard and consideration and posited as constraints on managerial action and shareholder rights (Kendall, 1999; Page, 2005).

Findings/Analysis

Interconnection between CG and CSR

The perception of CSR was, initially, purely in terms of philanthropy or charity. However, the post-liberalization phase has seen a fundamental shift from this philanthropy-based model of CSR to a stakeholder-participation based model. Furthermore, CSR is gently getting merged into companies’ Corporate Governance practices. Both Corporate Governance and CSR focus on the ethical practices in the business and the responsiveness of an organisation to its stakeholders and the environment in which it operates. Corporate Governance and CSR results into better image of an organisation and are directly related to the performance of an organisation. The OECD principles on Corporate Governance, UN Global Compact Participation throw light on CSR scheme but in India CSR, by virtue of clause 49 of the listing agreement, have been made totally optional. It is pertinent to mention here that transparency, disclosure, sustainability and ethical behaviour is central theme in both CSR and Corporate Governance. Further, it is worthwhile to mention that CSR is based on the concept of self governance which is related to external legal and regulatory mechanism, whereas Corporate Governance is a widest control mechanism within which a company takes it management decisions.

Both CG and CSR call on companies to assume their depository and moral responsibilities towards stakeholders. This act of accountability is important for a business to gain and preserve the trust of its financial investors and other stakeholders (Page, 2005). Both concepts thus draw endurance from the same sources, namely transparency, accountability, and honesty (Van den Berghe and Louche, 2005). Marsiglia and Falautano
(2005) similarly suggest that good CG and CSR initiatives are gradually advancing from a philanthropic variant of corporate capitalism to authentic strategies intended to regain the trust of clients and society at large. While CG implies “being held accountable for,” CSR means “taking account of” and both mechanisms are increasingly used by firms to regulate their operations (Beltratti, 2005; Marsiglia and Falautano, 2005). Windsor and Preston (1988) argue that, within the framework of legitimacy theory, CG and CSR are related conception defining the interaction between an organization and its internal and external sociopolitical environment, with both increasingly considered as complementary fundamental prerequisites for sustainable growth within a globalizing business environment (Van den Berghe and Louche, 2005).

Furthermore, the objectives and benefits of CSR and Corporate Governance are similar in nature, some of them are stated herein below:

· Re-building of public trust and confidence by increased transparency in its financial as well as non-financial reporting and thereby increasing the shareholder value.
· Creating strong brand reputation of the company.
· Making substantial improvement in the relationship with various stakeholders.
· Contributing to the development of the region and the society around its area of operation
· Addressing the concerns of its various stakeholders in such a way so that a strong market position is maintained.

Furthermore, it may be worthwhile to note that in case of unlisted companies there is not robust system of corporate governance, although there are some provisions in the Companies Act, 1956, in this context the relationship between Corporate Governance and CSR is very important and significant. In order to appraise present position of CSR and Corporate Governance, it would be worthwhile to examine the legal and regulatory framework dealing with CSR and Corporate Governance.

Both disciplines are also perceived to negotiate important long-lasting benefits and to ensure the tenacity of the business. With respect to CG, it is observed that good governance mechanisms integrate the interests of owners, managers, and all those dependent on the corporation, allowing corporations to secure long-term capital, retain
the confidence of financiers, and to use the obtained capital efficiently. Gompers, Ishii and Metrick (2003), for example, find evidence that CG is significantly correlated with both stock returns and firm value. Ho (2005) reports evidence that good CG generally enhances firm’s competitiveness and results in superior financial performance. CSR in turn increases the trustworthiness of a firm and strengthens relationships with core stakeholders (Aguilera, Rupp and Ganapathi, 2007), which may lead to decreased transaction costs and increased attractiveness in the eyes of investors (Hancock, 2005). While the business case for CSR remains contentious (Margolis and Walsh, 2003), a bulk of accumulating evidence suggests that CSR can result in lower environmental costs, enhanced innovation capability, improved recruitment/retention rates, increased employee satisfaction, and positive perceptions of the firm (Hancock, 2005; Aguilera et al., 2007; Barnett, 2007). Admittedly, short-term costs may be incurred when designing good CG and CSR initiatives, but there are also several indicators pointing to positive outcomes for businesses that are seriously committed to both (Marsiglia and Falautano, 2005).

Conclusions

Whereas CSR is the philosophy and the concept of how a corporation should act and behave, it can be suggested that CG is the mechanism with which CSR strategies and policies can be put into practice. Although the two terms might be occasionally used interchangeably, it is again suggested in this paper that CSR is a storage under which CG can be located. Both CSR and CG are inter-related, interlinked and integral to each other. The growing importance and of CSR and CG is a testament to the role they play in a business as well as non- business and other areas. However, the creation of a CG system without having the total support and due attention from board level down to shop floor would not be taken seriously by the multiple stakeholders organisations possess. We believe this study makes important contributions and constitutes a significant advancement in CG–CSR research. The study indeed has explored and explained a relatively new ground by investigating CG and CSR perceptions and applications in developing countries as well as interpretations of CG–CSR consolidations, suggesting that both CG and CSR need to be considered as interconnected pillars for sustainable business growth in a globalizing environment.

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