# Directors’ Remuneration and Corporate Social Responsibility: A Study on Malaysian Listed Firms

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**Abstract**

The main objective of this paper is to examine the relationship between directors’ remuneration and Corporate Social Responsibility (CSR) for listed firms in Malaysia. All financial data such as firm size, performance and leverage can be collected from Thomson Reuters DataStream while directors’ remuneration and CSR disclosures were collected from annual reports. 377 samples of listed firms on Bursa Malaysia were collected from year 2014 to 2016. The results of this study show that increase director’ remuneration motivates the directors to perform higher CSR. The CSR practices should benefit people and firms. Therefore, more benefits gained by public and firms from CSR should not be compensated with low directors’ remuneration. The results also show that firm size and leverage have positive relationship with CSR. This study can be extended using other measurements of CSR such as Global Reporting Initiative (GRI), human rights and environmental reporting which could give new insights on the relationship between CSR and directors’ remuneration.

**Keywords:** directors, remuneration, corporate social responsibility, listed firm

## 1. Introduction

CSR does not only benefit society, but also shareholders. Previous researches showed CSR practices enhance shareholders’ value (Borghesi, Hauston & Naronjo, 2014). Greater CSR increases shareholders’ value as it increases the quality of employees (Greening & Turban, 2000), increases the sales of firm’s product or service (Navarro, 1988), and improves loyalty of customers to company (Sen & Bhattacharya, 2001). Besides that, CSR activities done for stakeholders strengthen relationship with them, and help to increase firms’ value. CSR also helps to gain reputation for a firm, therefore, increases the value of the firm (Schwaiger, 2004). Increase in firm value will lead to increase in shareholders’ wealth.

In Malaysian context, the disclosure of directors’ remuneration and CSR are less compared to the developed country such as United States. In year 2008, Malaysia was ranked 4th among 142 countries for its commitment towards investors’ protection by the World Economic Forum (UNICEF, 2009). These facts raise a question whether directors’ remuneration affects firm performance in CSR. Some research argued that performance based remuneration has not much impact to CSR performance (Peng & Chen, 2015).

According to agency theory, directors who found they gain benefits from CSR will invest in CSR. On the other hand, directors who found they do not benefit from CSR investment will less likely to perform CSR. Moreover, over investment in CSR can cause an extra transfer of wealth from shareholder to stakeholder such as community and employees. It happens because directors may want to increase their good image among the stakeholder without caring about the shareholders’ benefits (Barnea & Rubin, 2010). Besides that, the directors may delay the information to be released when the CSR investment is inefficient (Jian & Lee, 2014). The asymmetric information between shareholders and directors causes the shareholders to realize on the loss of value late. Therefore, by right, the directors who over invest in CSR should be given less remuneration.

According to Aripin, Salim, and Kamardin (2012), 68.88% of the Malaysian firms provided band of RM50,000 remunerations for directors in their annual reports. This result raises a concern about the asymmetric information between firms and stakeholders. Are directors willing to disclose the information to enhance transparency between firm and stakeholders? Based on annual report from Hong Leong Financial Group, the remuneration for executive director was RM 2,018,000 in 2016, and 200.3 times of the average staff expenses. The high pay of directors becomes an issue when stakeholders do not know about directors' performance. Thus, any occurrence of significant relationship between the directors' remuneration and CSR disclosure should be explored to determine whether the level of performance are in line with directors' high pay.

It can be concluded that the relationship of directors' remuneration and CSR practice is still vague. There is not much previous research studies for this relationship in Malaysia. Therefore, it is interesting to study this relationship of the public listed firms from different sectors in Bursa Malaysia to help shareholders set the directors' remuneration structure. Besides that, it also helps investors to decide on which firm should be invested in. Therefore, the main objective of this research is to examine the relationship between directors' remuneration and CSR for the firms listed in Bursa Malaysia. This study also examines the relationship between firm characteristics in term of firm size, performance and leverage and CSR.

## 2. Literature Review

### *2.1 Directors' Remuneration and Corporate Social Responsibility (CSR)*

Ackerman and Collin (2004) stated that agency theory is an important criterion in setting the goal and strategic for business, as the agent or known as the directors have the power to make decisions. Agency theory considers people are rational in the market. People in the business sectors think wisely before making decisions to increase their own benefit. Agency problems happen when there is a different in interest between directors and shareholders. John (2004) suggested that the owner of business feel insecure when they do not monitor the business but employ an agent to manage. This is because they are afraid if their interests are being abused. John (2004) also explained the situation by the dismal assumption of self-interested opportunism which suggests that someone seldom believe in people other than themselves.

Moreover, agency theory is defined as a "theory of interest, motivation and compliance" (Donaldson, 1990). It was also mentioned that individual who seeks for maximization of personal interest or at least satisfy their utility will find his best trade-off between work and leisure. Those self-interest behaviors create agency problem in business as owners employ the agent or directors to manage and required the agents to fulfill owners' interest instead of theirs.

Corporate social responsibility (CSR) is a benefit to shareholders or equivalent to the owner of business (Borghesi et al., 2014). Therefore, it can be seen that it benefits more to the shareholders than the directors. In order to reduce the agency cost between them which rooted from asymmetric information, directors should disclose the CSR activities to public include the shareholders. The voluntary disclosure would enhance the trust between shareholders and directors as CSR disclosure creates transparency which allow shareholders to control the actions done by directors. Carina Chan, Watson and Woodliff (2014) pointed out that the efforts of directors to disclose CSR are compensated with better remuneration to encourage them perform optimistically.

For the scheme of directors' remuneration, Murphy and Jensen (1998) suggested that stock ownership should be given to directors as remuneration because stock option is tightly related to shareholders' value. Directors with stock options will perform better in activity such as CSR to improve the shareholders' value as it also helps to increase their own interest. This is supported by Donalson and Davis (1991) which stated that the long-term compensation aligns with shareholders' value.

There were several previous studies showed that there is a positive relationship between directors' remuneration and CSR. According to Heron (2016), a positive relationship can be found between directors' remuneration and CSR. Heron stated higher directors' remuneration in firms which provided all types of CSR in his studies. The author suggested that directors' voluntary communication was relevant to all users of firms, it stands for the effort of directors to distribute the message, this effort also being measured in the contract between directors and shareholders. This effort is measured because the disclosure of CSR information are interrelated with the firm value, suggesting that increase in CSR disclosure will increase in firm value. There are investors who look for long term return in their investments prone to find firms with high disclosure of CSR activities. Those investors are interested with whether the directors of firms have a strong preference in CSR activities. Therefore, when CSR is highly performed, directors should be given more remuneration as they improve the firm's value.

However, there is also a negative relationship found between directors' remuneration and CSR. According to Saphira, Karen, and Robert (2014), the relationship between Chief Executive Officer (CEO) compensation and CSR is negative. It indicates there is no influence of CSR performance on top managements' remuneration, thus, they would have a mindset to dissociate remuneration from CSR performance. The lack of relationship between short term remuneration and CSR performance indicated that directors are not rewarded for their high CSR performance. Furthermore, long term remuneration also linked CSR performance negatively. It shows that top management are self-motivated to involve in CSR activities because of other factors. The results also suggest with CSR disclosures, firms want to lower their agency cost by not giving too much of remuneration to directors.

### *2.2 Firm Size*

Larger firms have better organizational structure and procedure than smaller firms, as well as have more resources than smaller firms (Youn, Hua & Lee, 2015). Thus, larger firms are able to put more investment into CSR disclosure compared to smaller firms (Donaldson, 2001). Apart from that, majority of the larger firms tend to announce their CSR activities to public than the smaller firms. It is because reputation and image of the firms which disclose more CSR information will increase (Hermawan & Mulyawan, 2014). According to Udaya (2007), firms with smaller scale of operations, lower amount of resources and lower visibility refuse to participate in CSR projects.

### *2.3 Firm Performance*

Firm performance is expected to have a positive relation with company performance. This expectation is supported by a study done in Nigeria, showing that CSR is positively related to firm performance (Uadiale, 2012). The study also suggests that all firms should invest in CSR for long term to gain good reputation for their firms. A company with better image will attract new customers thus helps to boost income at a higher level.

A finding in United States also support there is a positive relationship between CSR and firm performance. According to Alshammari (2015), the publicity of firms' activities can strengthen the relationship between CSR and firm performance. It means that when all the stakeholder can see the CSR activities done by firms, performance of the firm can be improved. According to Hackston and Milne (1996), the profitable companies disclose more CSR practices.

### *2.4 Leverage*

Leverage means that the amount of debt a company has. According to Najah and Jarboui (2013), cost of debt and CSR showed a negative relationship. It means that firms with high debt are less involved with CSR practices. It is because the high level of debt require the firm to pay high interest in the future, thus firms are less likely to invest in CSR which as it does not guarantee them to gain a high return. On the other hand, firms with less leverage have much more extra fund to invest in CSR. A stable firm with lower level of leverage has lower level of risk, thus may invest more in CSR (Cochran & Wood, 1984: Orlitzky & Benjamin, 2001).

However, there are some research showed that there is a positive relationship between leverage and CSR (Saphira, Karen, & Robert 2014; Zhang, 2015; Hong et al., 2016). This is because higher level of leverage provides more fund for companies to invest in, which can be used to invest in CSR activities. It is because management tends to use all the fund to generate income in projects with positive net present value. Therefore, there is a positive relationship between leverage and CSR.

## 2. Methodology

### *3.1 Sample*

377 samples in this study were taken from listed firms from many sectors in Bursa Malaysia. Secondary data such as annual reports of listed firms and financial data from DataStream are main sources of data for this study. Primary data was not used in this study. This study covers 3 years; from years 2014 to 2016. Data for directors' remuneration and corporate social responsibility were obtained from firms' annual reports. While, data for control variables such as sales, firm size, firm performance and leverage were obtained from Thomson Reuter DataStream. Sample with insufficient data was excluded.

### *3.2 Corporate Social Responsibility (CSR)*

CSR is measured by content analysis of listed firms' annual report similar to studies done by Hackston and Milne in 1996 and Smith in 2007. A self-constructed index for CSR is determined and guided by previous research done on CSR in Malaysia. The item of the CSR index is decided by referring to previous studies about regulatory suggestion (Nejati & Amran, 2009; Saleh, Zulkifli & Muhamad, 2010), CSR disclosures (Drews, 2010; Lin, Yang & Liou, 2009) and CSR disclosures (Hassan & Harahap, 2010; Pratten & Mashat, 2009). The following areas are considered important for CSR determination.

- development and social goals/philanthropy
- employees
- environment
- customers
- general/public stakeholder/community
- workplace
- marketplace

A dummy variable is used in this study. The extent of CSR disclosure is measured by analysis of the contents in annual report. "1" is denoted if the item is disclosed, however "0" is given when item is not disclosed. Each annual report will be read carefully until no similar information is detected before giving "0" or "1" for each item under CSR index. For each annual report, the CSR index score is calculated as score given to the firm divided (x) by the maximum potential score awarded to that firm (n). The CSR index used for each firm in order to measure the level of CSR is calculated as follows:

$CSR_i = \sum X_i / n_i$

Where $n_i$ = number of items expected for i firm, $n_i \leq 26$

$X_i$ = 1 if the item is disclosed, 0 if the item is not disclosed, so that $0 \leq CSR_i \leq 1$.

The unweighted score is used in this study. There are several reason why it is being used. First, the unweighted score assume all items disclosed are having similar importance during decision making process by stakeholders. Next, the subjective judgement by weighted score affects the results of CSR disclosure as it reduces the objectivity of index as measure of CSR. Furthermore, the results from weighted and unweighted score are almost similar. Finally, the unweighted score are supported by previous research related to disclosure score (Gray Kouhy, & Lavers, 1995; Haniffa & Cooke, 2005).

*3.3 Regression Model*

The multiple regression analysis is used in this study to determine the relationship between corporate social responsibility disclosure and its independent and control variables. This model likely to capture the factors which affect corporate social responsibility significantly.

Regression model:

$$CSR_{i,t} = \beta_{0i,t} + \beta_1 CASH\ DR_{i,t} + \beta_2 NON\_CASH\ DR_{i,t} + \beta_3\ SIZE_{i,t} + \beta_4 PERF_{i,t} + \beta_5 LEVERAGE_{i,t} + \varepsilon_{i,t}$$

CSR = corporate social responsibility disclosure

CASH DR = cash directors' remuneration

NON CASH DR = non cash directors' remuneration

SIZE = firm size

PERF = firm performance

LEVERAGE = leverage level

$B_0$ = constant

β = coefficient

ε = standard normal, randomly assigned error term

i = firms

t = time

*3.4 Measurement of Variable*

| Variable | Measurement |
|---|---|
| CSR | Total item disclosure obtain from annual reports |
| CASH DR | natural logarithm of total cash directors' remuneration |
| NON CASH DR | natural logarithm of total non-cash directors' remuneration |
| SIZE | natural logarithm of total asset |
| PERF | return on equity (ROE) |
| LEVERAGE | natural logarithm of total debt |

## 4. Finding and Discussion

Table 1. Descriptive statistic

| | N | Minimum | Maximum | Mean | Std. Dev |
|---|---|---|---|---|---|
| CSR | 1131 | 0.0000 | 21.0000 | 8.1813 | 3.9141 |
| CASH DR (RM'000) | 1131 | 38 | 391,000 | 6,269.952 | 23,125.501 |
| NON CASH DR (RM'000) | 1131 | 0.0000 | 14,976.538 | 188.5278 | 805.4852 |
| SIZE | 1131 | 6.9160 | 11.1230 | 8.7641 | 0.6875 |
| PERF | 1131 | -24.5940 | 79.4390 | 0.3792 | 4.7314 |
| LEVERAGE | 1131 | 4.7993 | 10.6054 | 7.9721 | 0.9685 |

CSR is measured by content analysis of listed firms' annual. A self-constructed index for CSR is determined guided by previous research done on CSR in Malaysia. These are the area in CSR which being analyzed in this study are development and social goals/philanthropy, employees, environment, customers, general/ public stakeholder/ community, workplace, marketplace. The value of CSR stated in Table 1 is from 0 to 21 items disclosure by each firm with the mean 8.1813 items disclosure and standard deviation of 3.9141.

For the directors' remuneration, it is divided into two categories which are; cash remuneration and non-cash remuneration. Natural logarithm is applied to both cash and non-cash remuneration. The value of cash remuneration ranges from RM 38,000 to RM 391,000,000. It has a mean of RM 6,269,952 and standard deviation of 0.4840 after natural logarithm is applied to it. While for the non-cash remuneration, the range is from RM 0 to RM 14,976,538, which implies that some of the firms are not giving non-cash remuneration. The mean of non-cash remuneration is RM 188,527.8 and standard deviation for non-cash remuneration is 2.5082 after applying the natural logarithm to its initial value.

In addition, firm size shows how large a firm is and it is measured by logarithm of total asset. Value of firm size ranges from minimum value of 6.9160 to maximum value of 11.1230. The mean is 8.7641 and firm size with a standard deviation of 0.6875. Besides that, return on equity (ROE) is a proxy for firm performance. It is measured by net income divided by total equity. Higher value of ROE shows that the firm is well performed. Minimum value for ROE is -24.5940 times which means that those firms suffer from loss, meanwhile the maximum value is 79.4390 times. The mean value is 0.3792 times and standard deviation is 4.7314. Finally, leverage represents the total debt level of firms. It is measured by logarithm of total debt. The value of leverage is ranged from minimum value of 4.7993 to a maximum value of 10.6054. The mean of leverage is 7.9721 and standard deviation is 0.9685.

Table 2. Disclose of Directors' remuneration

| Number of firms disclose remuneration based on cash and non-cash | Number of firms |
|---|---|
| Cash remuneration | 377 |
| Non cash remuneration | 241 |
| Total | 377 |

Table 2 showed that the number of firms which disclose total remuneration are 377. The firms which disclose cash remuneration are 377 while disclose non cash remuneration are 241. It means that there are still 136 firms out of 377 samples may not apply the non-cash remuneration.

Table 3. Correlation

| Probability | CSR | CASH DR | NON CASH DR | SIZE | PERF | LEVERAGE |
|---|---|---|---|---|---|---|
| CSR | 1.0000 | | | | | |
| | ----- | | | | | |
| CASH DR | 0.2142*** | 1.0000 | | | | |
| | (0.0000) | ----- | | | | |
| NON_CASH DR | 0.1696*** | 0.1984*** | 1.0000 | | | |
| | (0.0000) | (0.0000) | ----- | | | |
| SIZE | 0.2798*** | 0.4770*** | 0.1399*** | 1.0000 | | |
| | (0.0000) | (0.0000) | (0.0000) | ----- | | |
| PERF | 0.0296 | 0.1044*** | -0.0081 | 0.1448*** | 1.0000 | |
| | (0.3191) | (0.0004) | (0.7838) | (0.0000) | ----- | |
| LEVERAGE | 0.2757*** | 0.5054*** | 0.2009*** | 0.7712*** | 0.1117*** | 1.0000 |
| | (0.0000) | (0.0000) | (0.0000) | (0.0000) | (0.0002) | ----- |

*** significant at 1 % level.

In this study, the significant level is fixed at 1% significant level. It shows that CSR and cash directors' remuneration and non-cash directors' remuneration have a positive significant relationship at 1 % significant level. Besides that, the control variables such as firm size and leverage have a positive significant relationship with CSR except firm performance which has a positive insignificant relationship with CSR. For cash remuneration, non-cash remuneration has a positive significant relationship with it, while all control variables such as firm size, firm performance and leverage have a positive and significant relationship with it. Moreover, the non-cash directors' remuneration has positive and significant relationship with firm size and leverage. However, the non-cash remuneration has a negative insignificant relationship with firm performance. Firm size has a positive and significant relationship with firm size and leverage. Finally, the firm performance has positive significant relationship with leverage.

Table 4. Model description

| Model | R-squared | Adjusted R-squared | S.E. of regression |
|---|---|---|---|
| Pooled OLS | .507(a) | .257 | .254 |

The table above shows the influence of total directors' remuneration together with control variables such as sales, firm size, return on equity and leverage have a of R-squared value of 0.507. This indicates that panel data analysis of corporate social responsibility disclosure as dependent variable is 50.7% explained by total directors' remuneration and other control variable. Another 49.3% can be explained by other variables which are not included in this equation. In addition, the adjusted r-squared is 0.257, indicates that the equation is 25.7%, explaining the effect of CSR.

Table 5. ANOVA Statistics

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 162361.747 | 5 | 32472.349 | 77.826 | .000(a) |
| | Residual | 468981.585 | 1124 | 417.243 | | |
| | Total | 631343.332 | 1129 | | | |

a Predictors: (Constant), CASH DR, NON_CASH DR, SIZE, ROE, LEVERAGE

b Dependent Variable: CSR

The ANOVA Statistics for regressions conducted with the control variables in table above indicate that the overall regression model was significant because of the reported probabilities is 0.000 which less than significant value 0.05. This shows that all the independent variables and control variables are good joint predictors of dependent variable.

Table 6. Summary of Multiple Regression Analysis

| Model | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| (Constant) | -64.427*** | 9.066 | -3.8584 | 0.000 |
| CASH DR | 4.259*** | 1.500 | 0.087 | 0.005 |
| NON_CASH DR | 0.122 | .252 | 0.013 | 0.629 |
| SIZE | 6.669*** | 1.340 | 0.369 | 0.000 |
| PERF | 0.078 | .127 | 0.019 | 0.542 |
| LEVERAGE | 0.713* | .427 | 0.124 | 0.095 |

*** significant at 1 % level, ** significant at 5 % level, * significant at 1 % level.

The coefficient of cash directors' remuneration to corporate social responsibility (CSR) is 4.259 with probability of .005. In addition, the coefficient of non-cash remuneration to CSR is 0.122 with probability of 0.629. It means that non cash directors' remuneration does not affect CSR. However, the relationship between CSR and directors' remuneration in cash is positively significant at 1% significant level. It is consistent with previous research which found significant positive relationship between these two variables (Dunbar, Li, & Shi, 2016; Heron, 2016; Hong, Li & Minor, 2016; Washington, 2016). The result suggests that director remuneration should be increased to motivate directors to perform CSR. Previous research showed CSR enhanced shareholders' value (Borghesi et al., 2014). The more the CSR practice that carried out may result to more benefits to people and the firm itself. Therefore, adopting more benefits to public and firms should not result to a decrease in remuneration.

Besides that, the coefficient between firm size and CSR is 6.669 with a probability of 0.000. It indicates there is a strong positive significant relationship between firm size and CSR. This result is consistent with previous researches which showed a positive relationship between firm size and CSR (Fabrizi, Mallin & Michelon, 2014; Jian & Lee, 2014;

Saphira, Karen & Robert, 2014). The reason is because larger firms have better organizational structure and procedure than smaller firms, larger firms also have more resources than smaller firms. Thus, the larger firms are able to put more investment into CSR part compared to smaller firms. Firms with smaller scale of operation, lower amount of resources and lower visibility more refuse to participate in CSR projects.

In addition, the coefficient for PER is measured by return on equity (ROE) and CSR is 00.078 and probability of 0.542. It means that there is positive insignificant relationship between ROE and CSR. This result is not consistent with previous study (Zhang, 2015). The reason for such situation happen is because high performing firms do not invest more in CSR. The other way round, CSR do not give much impact to firm performance. Moreover, firms generate income mainly from its operation and not from CSR projects. Study made by Razali et al., (2018) proved that CSR enhanced financial health of listed firms by providing competitive advantages, improved firm's image and created new opportunities in the marketplace.

Finally, the coefficient for leverage and CSR is 0.713 while probability is 0.095. It means that there is significantly positive relationship at 10% between leverage and CSR. There are some research showed that there is a positive relationship between leverage and CSR (Saphira, 2014; Zhang, 2015; Hong et al., 2016). This is because the higher level of leverage provides more fund for firms to invest in. The fund may use to invest in CSR activities, it is because the management tend to use all the fund to generate income in projects with positive net present value. Some management teams which do not want to hold more free cash flow which give back to shareholders, as it will reduce the directors' power, management may invest in any project although it does not guarantee to be a positive NPV project. Thus, management may invest in CSR projects although the uncertainty of risk in CSR projects may not provide positive NPV.

## 5. Conclusion and Implication of the Study

The main objective to conduct this study is to examine the relationship between directors' remuneration and corporate social responsibility (CSR). Directors' remuneration is to examine two relationships which are; relationship between cash remuneration and CSR, then relationship between non-cash remuneration and CSR. Both cash and non-cash remuneration shown a positive relationship with CSR. The results suggested that director remuneration should be increased to motivate directors to perform CSR. Previous research showed CSR enhance shareholders' value. Greater CSR increases shareholders' value as it increases the quality of employees, boost the sales of firm's product or service, and enhances loyalty of customers to firms. The more the CSR practices carried out result to more benefits to people around and the firm itself. Therefore, adopting more benefits to public and firms should not result to a decrease in remuneration.

In addition, firm size and CSR have a significant positive relationship. The reason behind this is because larger firms have better organizational structure and procedure than smaller firms. Additionally, larger firms also have more resources than smaller firms. Thus, the larger firms are able to put more investment into CSR part compared to smaller firms. The firm with smaller scale of operations, lower amount of resources and lower visibility are more reluctant to participate in CSR projects. Moreover, other control variable such as leverage is having a positive and significant relationship with CSR in this study. This is because the higher level of leverage provides more fund for firms to invest in. The fund can be used to invest in CSR activities, as management tend to invest the fund in income generating projects with positive net present values.

This research gives insights to all stakeholders to have a better understanding on the relationship between directors' remuneration and CSR. Investors can choose to invest in those firms with high corporate social responsibility (CSR) because greater CSR enhances shareholders' value. It helps the shareholders to observe whether increase or decrease in remuneration of directors lead to better CSR disclosure for firms. Significant positive relationship between remuneration and CSR shows that shareholders should focus on compensation to motivate directors to perform CSR. Moreover, the findings of the study can be used by local regulators and other professional bodies as a hint for policy guidelines such as director's remuneration disclosure. As significant relationship between remuneration and CSR is found in this study, Government of Malaysia can decide whether to increase requirement for firms to disclose their details remuneration to increase the transparency between firm and stakeholders. This study can be extended using other measurements of CSR such as Global Reporting Initiative (GRI), human right, environmental reporting could give new insight the relationship between CSR and directors' remuneration.

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