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The effects of political connection on corporate social responsibility disclosure – evidence from listed companies in Malaysia

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ABSTRACT : *This paper examines the effects of political connection on CSR disclosure. The measurement of political connection is separated into two which were government ownership and representation of politicians on boards. From a sample of 300 non-financial companies listed in Bursa Malaysia for the year 2013, results from the regression analysis show that government ownership positively influences CSR disclosure. However, we are unable to find any significant effects of having politicians on boards on CSR disclosure. Findings from this study add to the literature on the impact of political connection on CSR disclosure. They also broaden the literature on the different effects of different political connection proxies on CSR disclosure from a developing country that is now economically recognized by the global community.*

KEYWORDS – *corporate social responsibility disclosure, emerging markets, government ownership, political connection, politicians on boards*

I. INTRODUCTION

Nowadays, the business world is facing challenging situations in order to survive as companies need to focus not only on financial aspects, but also on non-financial ones. For the financial aspects, companies need to focus on the use of companies' resources and profit generation that can benefit them and the shareholders. On the other hand, for non-financial aspects, companies may need to focus on activities such as corporate social responsibility (CSR) as implementing them may benefit the companies and the stakeholders at large. Prior studies by [1] Amran and Siti-Nabiha (2009), [2] Mohamad Taha (2013), [3] Kahreh et al. (2014), [4] Cahan et al. (2015) and [5] Usman and Amran (2015) show that the benefits can be seen in terms of improved financial performance, enhanced board image and company's reputation, and improved value of the company.

With the benefits that could presumably be attained from performing CSR activities, prior studies by [6] Bouten et al. (2011), [7] Othman et al. (2011), [8] Djajadikerta and Trireksani (2012), [9] Bowrin (2013), [10] Ahmed Haji (2013), [11] Kansal et al. (2014) and [12] Fatima et al. (2015) found a low level of CSR disclosure provided by the companies. As argued in [1] Amran and Siti-Nabiha (2009) and [8] Djajadikerta and Trireksani (2012), companies (or management) do not take full advantage of disclosing CSR information even though CSR disclosure could act as communication tools to potential investors and differentiate one company from another. This situation may occur due to the lack of awareness by companies or the structure of companies that does not support CSR disclosure. Further, the content of information that is to be disclosed depends on the management as there is no mandatory accounting standard issued by the standard setting bodies for CSR reporting. Thus, the level of disclosure may vary among companies.

Focusing on CSR disclosure in Malaysia, prior studies by [2] Mohamad Taha (2013) and [10] Ahmed Haji (2013) provide evidence that corporate governance attributes such as audit committee, board size, and independent directors could influence CSR disclosure. However, in a unique country like Malaysia that is richly populated by multi-ethnic groups whose economic status is different, government intervention may come into play. As a proxy for political connection, government intervention and existence of politicians on boards may affect companies' decision making and business trajectory. As for CSR disclosure, companies with political connection may have different intention when disclosing their CSR information ([13] Gao (2011), [14] Gu et al. (2013), [15] Snider et al. (2013) and [16] Lin et al. (in press)). It is shown that these companies disclose CSR information in order to build relationships and safeguard their interest with influential politicians.

The objective of this paper is to examine the effects of political connection on CSR disclosure. Specifically, it examines the effects of government ownership and representation of politicians on boards on CSR disclosure. Using these two proxies that represent political connection may fill the gap left by prior studies which normally examined the effects of political connection on financial reporting quality (for example [17] Md Salleh (2009), [18] Chaney et al. (2011), [19] Abdul Wahab et al. (2011)).

This paper may contribute to the body of knowledge, theory, and business practice in a number of ways. First, this paper may add to the literature on the effects of political connection on CSR disclosure. Second, as this paper uses a sample of Bursa Malaysia listed companies, findings of this paper may enrich the literature on the impact of political connection on CSR disclosure from a perspective of an emerging economy and developing country. Third, findings of this paper may help to explain the different impact that different political connection proxies could have on CSR disclosure. As an agent to shareholders, the involvement of government and politicians may have different effects on CSR disclosure. Lastly, this paper may be useful to business practices as it helps to explain how political connection could affect business decisions and trajectories.

The remainder of this paper is organized as follows. The next section discusses theory and hypothesis development, followed by the research method section. Findings and discussion will be discussed next. The final section concludes the paper.

II. THEORY AND HYPOTHESIS DEVELOPMENT

In examining the effects of political connection on CSR disclosure, this paper referred to an agency theory originated by [20] Jensen and Meckling (1976). Agency relationships are basically established between two parties – the principal and the agent where shareholders are the principal and companies' directors and management teams are the agent. Directors and management teams are given the authority to make decisions on behalf of shareholders in which both parties, in actuality, try to maximize their own interests. In this situation, conflicts may occur at some point.

In politically connected companies, agency conflicts may occur as politically influential directors may have their own interest in the companies. Their representation on the companies is supposedly to safeguard shareholders' wealth and companies' resources. However, there may be situations where their representation fulfils their own interest and agenda, bringing detrimental effects on shareholders' wealth and companies' resources.

Further, according to the model of bargaining between politicians and managers as proposed by [21] Shleifer and Vishny (1994), politicians can use subsidies to bribe managers when companies are controlled by the managers. In other situations when companies are controlled by the politicians, managers would possibly bribe them to safeguard their own interest and to avoid following the politicians' political interest. In both situations, political connection or politicians themselves could affect companies' decisions on certain issues.

Prior studies by [18] Chaney et al. (2011) and [19] Abdul Wahab et al. (2011) provided evidence that political connection could negatively affect financial reporting quality. [18] Chaney et al. (2011) used data of 4500 companies from 19 countries, while [19] Abdul Wahab et al. (2011) used data of 382 non-financial companies listed in Bursa Malaysia in 2001 to 2003. The negative effects revealed in these prior studies indicate that companies with political connection have poorer financial reporting quality than those that do not and have high possibility to misstate their financial statements. Using the data of 256 companies listed in Bursa Malaysia from 1999 to 2003 and interviews with 24 top managers from 24 companies, [17] Md Salleh (2009) found mixed results in his study; companies with politicians on boards have a poor financial reporting quality, similar to that found by [18] Chaney et al. (2011) and [19] Abdul Wahab et al. (2011). However, he also reported that government ownership could positively influence financial reporting quality. These positive effects that government ownership could have on CSR disclosure are as well pointed out by [22] Said et al. (2009). On the other hand, prior studies by [13] Gao (2011), [14] Gu et al. (2013), [15] Snider et al. (2013), and [16] Lin et al. (in press) found that companies with political connection have different orientation when implementing and disclosing their CSR information. [13] Gao (2011) examined companies categorized as state-owned and non-state-owned enterprises in China. [14] Gu et al. (2013) provided evidence from a survey conducted to 404 senior Chinese hotel managers. Similarly, [15] Snider et al. (2013) utilized survey information that was obtained from 166 managers. Lastly, [16] Lin et al. (in press) used data from A-Shares companies listed in either Shenzhen or Shanghai Stock Exchange in 2005 to 2009.

Having explained the theory and findings of past studies, this paper proposed that political connection could influence companies' CSR disclosure. Specifically, we developed the following hypotheses:

H_1: Government ownership, as a proxy for political connection, impacts companies' CSR disclosure.

H_2: Politicians on boards, as a proxy for political connection, impact companies' CSR disclosure.

III. RESEARCH METHOD

In examining the effects of political connection on CSR disclosure, information from 300 companies listed in Bursa Malaysia in 2013 was collected. The 300 companies were chosen using stratified random sampling. The use of 300 sampled companies was deemed justifiably sufficient as referred to the table of sample and population provided by [23] Krejcie and Morgan (1970)[1]. Year 2013 was chosen because of data availability when this study was conducted. The use of companies listed in Bursa Malaysia would be practical and relevant as it would add another view to the literature that is contextualized in Malaysia; a developing country and is considered as an emerging economy. Further, the authoritative bodies in Malaysia are concerned about the business environment and continue to improve protection for investors. This is done through improvements made to the Malaysian Code on Corporate Governance (MCCG). In addition, imbalances in economic status among ethnic groups provide opportunities for politically influential figures to intervene in the process. This allows for a scrutiny on their existence in companies' decision making in general and CSR disclosure in specific to take place. The use of one-year data was appropriate as prior studies by [10] Ahmed Haji (2013) and [12] Fatima et al. (2015) found a low level of disclosure from 2005 to 2009. Furthermore, other studies by [24] Embong (2014) found insignificant increase of disclosure for the year 2007 to 2009 and unchanged level of voluntary disclosure for the year 2009 to 2010 for a sample of companies listed in Bursa Malaysia. The use of companies' annual reports in collecting data was aligned with prior studies that examined CSR disclosure. Refer to the work by [10] Ahmed Haji (2013) and [12] Fatima et al. (2015).

CSR disclosure was measured using three-point Likert scale. The scale of zero was assigned for non-disclosure, one for information provided in general term, and two for information disclosed in detail including the quantitative one. The information was collected based on CSR disclosure checklist developed in this study[2]. The checklist was developed after reviewing the CSR disclosure checklists that were utilized in prior studies and referring to Bursa Malaysia CSR framework. The score for the quality of CSR disclosure for each company was divided by its possible total score.

Political connection was separated using two measurements. The first measurement was the percentage of government ownership as per listed in the 30 largest shareholders in companies' annual report. Government ownership is proxied by five public institutional investors – *Permodalan Nasional Berhad (PNB), Lembaga Tabung Angkatan Tentera (LTAT), Tabung Haji (TH),* the Employee Provident Fund (EPF), and National Social Security Organization of Malaysia (SOCSO). The second measurement for political connection was the representation of politicians on boards. The score of one was given if at least one director held a position at a state or federal level or was a committee member of a political party, while zero if otherwise.

This paper used six control variables, namely total assets which represented the size of the company, profitability, leverage, independent directors, and industry type. These variables which were normally used as control variables in prior research were imperative for the present study in examining corporate disclosure. We constructed the following equation to test the hypotheses.

$$CSRD = \beta_0 + \beta_1 PGOV + \beta_2 PPOL + \beta_3 SIZE + \beta_4 PROFIT + \beta_5 LEV + \beta_6 BIND + \beta_7 BSZE + \sum INDMY + \varepsilon_{it,} \quad (1)$$

where:

CSRD	=	Corporate social responsibility disclosure,
PGOV	=	% of government ownership,
PPOL	=	The existence of politicians on boards, scoring 1 if at least one director was connected to a political party or a minister at a state or federal level, 0 otherwise,
SIZE	=	Size of the companies, measured as the natural log of total assets,
PROFIT	=	Profitability, measured as net income/total assets,
LEV	=	Leverage, measured as total liability/total assets,
BIND	=	Proportion of independent directors on boards,
BSZE	=	Board size, being the number of board members, and
INDMY	=	Dummy variables for industry type.

IV. FINDINGS AND DISCUSSION

Referring to Table 1, the mean of CSR disclosure is .2427 with a minimum and maximum disclosure of 0 and .86. This indicates that there are companies that do not disclose their CSR information in the annual reports. Some of these companies only provide pictures in reporting their CSR activities. The government ownership ranges from 0 to 74.43% with a mean of 3.02%. The minimum and maximum number of politicians on boards represents companies with and without politicians on boards. From the table, it can be seen that 23 companies have politicians on boards, while the remaining 277 companies have no politicians on their boards. As for the control variables, the geometric mean of natural log of total assets is MYR 452 million ($e^{19.93}$) and it

[1] The total number of companies listed in Bursa Malaysia in 2013 was 815 companies. According to [23] Krejcie and Morgan (1970), this population requires a sample size of 256. Thus, the use of 300 companies was above the required sample size and sufficient for the population.

[2] The CSR disclosure checklist is available from the authors upon request.

ranges from MYR 24 million ($e^{17.02}$) to MYR 99 billion ($e^{25.32}$). The ranges for profitability and leverage are -.408 to .832 and .0029 to .98 respectively. The mean for the board independence is .483, indicating that a majority of the companies fulfill the requirement to have 30% independent directors. Lastly, the average board size is 7, with a minimum and maximum of 4 and 17, respectively.

Table 1: Descriptive statistics

Construct	Operation measure	Mean / (SD)	Max.	Min.
1. CSR Disclosure	Three-point Likert scale	.2427 / (.1637)	.86	.00
2. Government Ownership	% of government ownership	3.0163 / (9.5200)	74.43	.00
3. Politicians on boards	0/1		1 / (23)	0 / (277)
4. Company size	Natural log of total assets	19.9328 / (1.5525)	25.32	17.02
5. Profitability	Net income/total assets	.0396 / (.1073)	.832	-.408
6. Leverage	Total liability/total assets	.3811 / (.2044)	.98	.0029
7. Board Independence	% of independent directors	.483 / (.134)	1.00	.25
8. Board size	Number of directors on boards	7.29 / (1.839)	17	4

The correlation analysis reported in Table 2 shows that government ownership, company size, profitability, leverage, and board size have a significant and positive association with CSR disclosure. This indicates that these elements are able to improve companies' CSR disclosure. Looking at the value of correlation coefficient, company size has a moderate strength to affect CSR disclosure, while the other variables have a mild strength to influence CSR disclosure, given that the coefficient value is below 0.3. The correlation coefficient among independent and control variables provide an indication that these variables are free from multicollinearity issue, given that the values of correlation coefficients are below 0.7.

Table 2: Correlation analysis

Construct	1	2	3	4	5	6	7
1. CSR Disclosure							
2. Government Ownership	.274**						
3. Politicians on boards	.090	.172**					
4. Company size	.559**	.326**	.117*				
5. Profitability	.131*	.032	.025	.203**			
6. Leverage	.127*	.175**	.006	.261**	.-2.62**		
7. Board Independence	-.050	-.014	.045	-.052	-.152**	-.016	
8. Board size	.232**	.151**	-.011	.340**	.094	.132*	-.368**

**$p < .01$, *$p < .05$ (two-tailed)

Notes: N= 300. Descriptive statistics and correlation coefficients for industry are available from the authors upon request.

Next, this paper reports the results from multiple regression analysis and they are as illustrated in Table 3. From the table, only one measurement for political connection that is government ownership is positive and significant in influencing CSR disclosure. With $p < .10$, H_1 is supported and it substantiates the assumption that government ownership is able to improve the quality of CSR disclosure. This positive effect is similar to that found by [17] Md Salleh (2009) and [22] Said et al. (2009). The positive effect that might be interpreted as one percent increase in government ownership would increase companies' CSR disclosure by .002. The positive effect might also suggest that companies with government ownership provide better quality of CSR disclosure in order to show that they are responsible and trying to maintain the good relationship with the government. Further, the positive effect might indicate that the government, through its proxies, induces companies to implement and disclose more information about their CSR activities that they have performed to show to the stakeholders that both parties (the government and the companies) are responsible. However, this study was unable to find any significant effects of politicians on boards on CSR disclosure, thus H_2 is not supported. This insignificant finding could be due to a small percentage of companies that have politicians on boards. With a significant result for H_1 and insignificant one for H_2, this paper provides some evidence that political connection could affect CSR disclosure. For control variables, only one variable, the company size, significantly influences companies' CSR disclosure. This positive and significant effect signifies that companies with large amount of resources are able to implement and provide better quality of CSR information to the stakeholders. Results from the regression analysis were checked for robustness and they fulfilled the statistical assumptions such as normality, multicollinearity and heteroscedasticity.

Table 3: Regression analysis

	Coefficients	**t-stat**	***P* value**
Constant	-.956	-7.651	.000***
Government ownership	.002	1.957	.051*
Politicians on boards	-.008	0.276	.782
Natural log of total assets	.060	9.236	.000***
Profitability (ROA)	.019	.234	.815
Leverage	-.025	-.555	.580
Board size	.001	.236	.813
Proportion of independent directors	-.008	-.127	.899
Construction	.035	.743	.458
Consumers	.037	.970	.333
Industrial products	.010	.283	.777
Plantation	.006	.117	.907
Properties	-.063	-1.545	.123
Trade and services	-.008	-.231	.818
Adjusted R^2	.323		
F Statistics (for model summary)	11.966***		
N	299		

**p < .10, **p <.05, ***p<.01*

V. CONCLUSION

This paper examines the effects of political connection on CSR disclosure. From a sample of 300 non-financial companies listed in Bursa Malaysia for the year 2013, this paper find that one proxy for political connection, that is government ownership, could positively and significantly influence CSR disclosure. Results for another proxy that is politicians on boards are found to be insignificant. While the findings of this paper benefit the body of knowledge on the different proxies for political connection that could affect CSR disclosure, this paper is subject to some limitations. First, this paper only uses two proxies that represented political connections. Second, the scoring for CSR disclosure was only accounted for quantitative and qualitative information. Future studies may use other proxies for political connection such as golden share and political connectedness. Further, the scoring for CSR disclosure may consider to account for picture as one of the scoring scale, as a picture is able to provide some information about companies' CSR activities.

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