ABSTRACT

Board Capital, CSR Engagement and Firm Performance: Empirical Evidence From India

Sumod S D, Indian Institute of Management (IIMK)

Extant literature acknowledges the role of corporate social responsibility engagement and sustainability practices on the financial success of business enterprises. Consequently many studies also examine the various drivers of CSR engagement- the process through which firms identify activities to fulfill their social and environmental commitments, allocate resources and execute them. One of the major drivers of firm level CSR engagement is identified by current literature is the board of directors. Studies that explore the relationship between corporate boards and CSR engagement of firms have been mainly conducted in developed markets using the perspective of Agency theory. However, in recent years, corporate social responsibility has emerged as a significant differentiator of firms even in emerging markets. Yet, studies that investigate Board-CSR engagement dynamics in emerging markets are limited. Moreover, this relationship is not explored comprehensively from a resource dependence perspective which some scholars consider as a better theory to explain the workings of corporate boards and their impact on firm outcomes in emerging markets. This thesis attempts to address the research gap by studying corporate boards- corporate social responsibility engagement relationship from a resource dependence perspective in emerging markets.

We argue that the relationship between corporate boards and CSR engagement that are established in developed markets on the basis of agency logic inspired corporate governance mechanisms may not hold true in emerging markets. First, unlike the developed market firms that have dispersed ownership, emerging market firms usually have concentrated ownerships with owners often handling key managerial positions. Therefore, typical agency problems that exist between management and owners in developed market firms are not found in emerging markets. Hence, the monitoring role of the board, and mechanisms created to support this role are less relevant in emerging markets. Second, unlike developed market firms, firms in emerging markets operate in a less munificent environment characterized by severe resource constraints due to under-developed product, capital and labor markets. Easy access to critical resources is

more important for emerging market firms. Therore, they are likely to pack boards with directors who can act as boundary spanners and provide access to resources to which can help them to reduce external dependencies and uncertainties. Also, owner-managers may lack sufficient experience to process complex information and understand multifaceted aspects of business that are needed to devise strategies beneficial to the firm. Expert directors can help firms to overcome these deficiencies in human and social capital at the managerial level. Therefore, firms in emerging markets constitute their boards with an emphasis on the resource dependence and advisory roles of directors rather than the monitoring role. Hence, an exploration of the board-CSR engagement relationship in the context of resource dependence theory in emerging markets is very pertinent.

A focus on the resource dependence role of directors highlights the significance of individual director's human and social capital. Aggregated at the board level this is called an board capital. It determines the advising and resource provision capabilities of the board that influence its effectiveness to guide the firm in achieving its objectives. While board capital as a driver of firm performance has found some traction in corporate governance literature, most of these studies examine financial performance of firms. However, we argue that boards that are made up of directors with better human and social capital would also be in a better position to understand the interests of various stakeholders that make up a firm's business environment and hence would be able to give superior advice to the firm in managing their demands. Based on this logic, we examine a comprehensive set of board human and social capital attributes, and their impact on firm level CSR engagement, reflected by the annual CSR expenditure of Indian firms. Additionally, we investigate the impact of CSR engagement on the financial performance of Indian firms.

We test our hypotheses on an unbalanced panel of 5582 firm year observations consisting of 1036 unique firms, ranging over the period 2014-15 to 2018-19 using Tobit random effects panel regression. We find that though board capital in general has a positive influence on CSR engagement, not all the attributes are equally significant. We find support for a positive influence of community related and business related expertise of board members on CSR engagement. Similarly, boards consisting of members with advanced education and international experience

show a positive impact on CSR engagement. Our results also indicate that higher levels of external social capital improves CSR engagement whereas increased levels of internal social capital impair CSR engagement. Finally, we find a positive association between CSR engagement and firm financial performance. In order to affirm that our results are not affected by the choice of dependent variable, we also used another measure of CSR engagement, the Environmental, Social and Governance score of firms to validate our findings. The results from the study demonstrate the robustness of our findings.

Our work is relevant from a theoretical, managerial and policy perspective. The study examines the impact of board capital on an important dimension of non-financial performance of firms in resource constrained environments- the CSR engagement. We also answer the recent calls by corporate governance scholars to move on from simplistic concepts of board structure and composition, and examine the knowledge and expertise of boards that can influence firm performance in non-economic domains. In this context, we also confirm that general human capital of directors also has a major impact on strategic decision making in firms. From a managerial perspective, the results influence the identification and nomination of directors to boards. Firms need to ensure the availability of a broad level of human and social capital in boards by replenishing and renewing the board memberships in a timely manner. From a policy perspective, our findings indicate that universal prescriptions of good governance without a contextual understanding are not effective in ensuring effective corporate governance.