International Journal of Scientific Engineering and Research (IJSER)
ISSN (Online): 2347-3878
Index Copernicus Value (2015): 62.86 | Impact Factor (2015): 3.791

Effect of Corporate Governance Practices on Corporate Social Performance: A Case Study of Manufacturing Firms in Thika

Emmanuel Chege Mburu[1], Dr. Dennis Juma[2], George Mawili[3]

[1]Jomo Kenyatta University and Technology, P.O. Box 620000-00200, Nairobi, Kenya
+254722 899 053
Mbemch[at]gmail.com
[2]Jomo Kenyatta University and Technology, P.O. Box 620000-00200, Nairobi, Kenya
+ 254723707462
Suleimanjumadj[at]gmail.com
[3]Part-time lecturer, Jomo Kenyatta University and Technology, P.O. Box 620000-00200, Nairobi, Kenya
+ 254728165416
Mawiligeorge[at]gmail.com

Abstract: ***Corporate governance is defined broadly as the rules, processes or laws by which businesses are operated, regulated and controlled to accomplish various objectives such as social practices or performance. The objective identified for this study was to identify the significant influence of corporate reporting and disclosure of manufacturing firms on their corporate social performance. This study used descriptive design where the population of interest was the entire composition of manufacturing firms within Thika town. Purposive sampling was used to select the respondents there was a total of 87 respondents. Primary data was collected using a questionnaire and collected data was edited for completeness and consistency. Statistical package for social sciences (SPSS) was used to analyze the collected data. The study revealed that the manufacturing firms in Kenyan are increasingly adopting corporate governance practices and mechanisms in their strategic thought process. Though a number of these firms have their plans as casual, most recognize the practice as one of their core values. Given that they all concede that long-term business planning is very important and essential to their success, it's reasonable to see greater adaptation of corporate governance practices in their formal plans in future and see the relevance of a positive corporate social performance.***

Keywords: corporate governance, environmental disclosure, financial disclosure, governance disclosure

1. Introduction

Strategic decision makers since time in memorial have seen both the emergence of a hypercompetitive global marketplace and increased contact and pressure for accountability from a multitude of external and internal stakeholders (Majeed, Aziz & Saleem, 2015). These two developments have placed top companies in a very difficult situation as they attempt to devise strategies that will enable their firms to survive and prosper in a turbulent environment that demands both financial performance and effective stakeholder responsiveness to their immediate surroundings (Majeed, Aziz &Saleem, 2015). Corporate governance is one of the new upcoming requirements that have been formulated to steer organizations and companies in accordance with ever changing national and global requirements.

Corporate governance refers broadly to the rules, processes or laws by which businesses are operated, regulated and controlled. The term refers to internal factors defined by the officers, stockholders or constitution of a corporation as well as to external forces such as consumer groups, clients and government corporations (Mensha, 1993). Corporate governance also refers to the manner in which the power of a corporate is exercised in the stewardship of the corporation's total portfolio of the assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission (Robert, 2005).

Corporate governance is seen as the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders. Claessens et al. (2002) maintain that better corporate frameworks benefit firms through greater access to financing, lower cost of capital, better performance and more favorable treatment of all stakeholders. Corporate governance is about promoting corporate fairness, transparency and accountability. The board is required to direct affairs of the corporation but not to manage them. Hence, there is a need to have a body that is responsible for governance separate and independent of management.

Corporate social performance on the other hand is the relationship of a company with society as a whole. It is a growing area of activity for management (Holder-Webb, Cohen, Nath, & Wood, 2009). Corporate social performance is the actions of a corporation to do good for the society beyond the compulsion of the law and the primary objective of corporation which is to perform for the interests of its shareholders (Holder-Webb et al, 2009). It has been recognized that the people usually face several environmental issues and this has led to environmental relate d legislation over the years. One prominent corporate response to this enhancement in environmental interest has been the appearance of deliberate environmental disclosures in a corporation's annual reports. This issue now has become a crucial topic for many researchers, mainly in the last two decades. Therefore corporate social performance has become a significant area under discussion in a corporation's activities. The relationships of companies to society are of great importance because many companies are following the lead of these large companies. Lack of research in this regard is the main motivation of this study.

It is suggested that CG and Corporate social performance are two sides of the same coin as both corporate social performance and CG motivate firms to perform their role towards the goodness of society. Companies which are making contribution towards economic growth have been thought responsible for creating social problems in areas like safety and health, waste management, environmental pro-activeness, product quality and resource depletion. Due to the problems of considering profit as the ultimate indicator to compute company's performance, in 1970s some accountancy institutions included CSR disclosures in annual reports of company.

During recent years there has been a growing interest in Corporate social performance across a range of disciplines. Corporate social performance in its simplest form is corporations' broader responsibility towards society. Researchers and practitioners strongly believe that corporations should not be judged just on their economic success (Carroll, 1979, Jamali et al., 2008, Shahin and Zairi, 2007) as they are " no longer expected to be mere contributors to the global economy, but rather to reconcile and skill-fully balance multiple bottom lines and manage the interests of multiple stakeholders.

Drucker (2001) is of the opinion that companies should work on eliminating or at least minimize their impacts on environment, while maintaining the underlying activity itself. He cites the case of Dow chemical's, which made the elimination of its impacts into a profitable business opportunity. It undertook to develop polluting subsistence into salable products to create use and market for them. He also points out the case of DuPont, which became aware of many of the toxic side effects of its industrial products. It developed a laboratory to develop processes to eliminate the poisons.

A study done by Obulo (2008) focused on corporate social responsibility practices in the sugar industry in Kenya. The study sought to find out the impact of this corporates social activities on the society at large. The main objectives of the study was to assess the role of corporate social responsibilities in the performance of the organization especially sugar firms in Kenya. A case of Mumias, Sony, and Chemilil Sugar Company limited in, Butere Mumias, Migoriand Nyando Districts in Western and Nyanza provinces respectively. The study found out that these organizations are embracing social responsibility but only focusing on those that have some long-term benefit to them as for profit organizations. They also found out that lack of proper reporting and accountability mechanisms it was not possible to know to what extent are these organizations actually contributing to society. For example the only informational source in which was a newspaper article (Sunday Nation: Sept 12, 2004) which estimated that EABL contributes at least 1% of its net-profit to Corporate social performance activities.

Therefore there is no clarity on what extent do firms engage in corporate social responsibility, and given the concept of corporate governance which focuses on all stakeholders wellbeing, this study intends to investigate the impact of corporate governance elements and how they influence the organizations corporate social responsibility function.

1.2 Statement of the problem

Corporate governance describes the structure of rights and responsibilities among the parties that have a stake in a firm (Aguilera and Jackson, 2003). A corporate governance system can be a set of processes and structures used to direct a corporation's business. A key objective of a corporate governance system should be the enhancement of shareholder wealth. It is a system of structuring, operating and controlling a company with a view to achieve long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers, and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs.

Despite the definition given by academicians on corporate governance, looking at most of research issues that have been tackled in the past they all revolve around the concept of corporate governance and how it is a significant concept to organizations financial performance more specifically shareholder wealth maximization, equity value creation, profitability, return on assets etc. studies by (Amba (2014; LaPorta, Lopez-de-Silanes, Shleifer, and Vishny, 1999) evidently suggests that firms in emerging economies, compared with their counterparts in developed countries, are discounted in financial markets because of weak governance. As such, improvements in corporate governance can enhance investor confidence and increase these firms' access to capital. In addition to this proclamation most studies have concentrated on only one single measure of corporate governance (Bhagat& Bolton, 2008).

In recent years, corporate governance has received increased attention because of high-profile scandals involving abuse of corporate power and, in some cases, alleged criminal activity by corporate officers (Berrone & Phan, 2012). Part of this debate is whether social issues should be included in the strategic agenda of firms and organizations. Corporate scandals are not only of the financial nature but also social nature (Berrone & Phan, 2012). The Problems arising in the governance of organizations can be attributed to: ineffective institutions, lack of transparency and accountability, corruption and lack of respect for business ethics and corporate governance. In many developing countries like Kenya, systems of corporate governance are frequently 'relationship- based' which can foster insider trading and corruption (Oman & Blume 2005). In Kenya we have had profit making manufacturing organizations like Webuye paper mills going down due to major social issues, another case is recorded in Naivasha where a flower firm was condemned for its environmental related issues.

The motivation of this study revolved around the concept of causality effect between corporate governance and CSR. According to recent studies for example by Berrone and Phan, (2012) four key elements give the research gap for this research, one of the elements is that they was limited academic research in this topic, and two corporate social responsibility is a very broad topic not fully researched on, third there are practically no dominant theoretical paradigm and finally there are contradictory findings when it comes to the relationship between corporate governance and Corporate social performance (Berrone and Phan, 2012), hence the gap of this study.

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The General objective of the study

The general objective of the study was to establish the influence of corporate reporting and disclosure on corporate social performance and of manufacturing firms in Kenya.

The Specific objectives of the study

1. To find out the influence of environmental disclosure on corporate social performance and of manufacturing firms in Kenya.
2. To evaluate the influence of governance disclosure on corporate social performance and of manufacturing firms in Kenya.
3. To establish the impact of financial disclosure on corporate social performance and of manufacturing firms in Kenya

Theoretical Review

Agency Theory

Emery, Finnerty and Stowe (2004) define the agency theory as how to minimize the cost of having someone else making decisions on your behalf. This refers to the cost of managing a situation in which you have a stake, albeit, through other people. according to Emery, et, al. (2004), the cost of managing a situation is creating incentives, constraints and punishments having reasonable monitoring procedures and identifying and using contracts, at the outset, that minimize the possibility of conflict interest. The agency theory and problem discussed above identify the fundamentals of corporate governance problem. The conflicting interests of the principal and the agent, this being the shareholders and managers of the firm, respectively, is the differing financial interests of these two corporate governance stakeholders. Management is interested in high salaries and bonuses whereas shareholders are interested in dividends, high profits, and high cash flows (Tiessen & Water house, 1983).

Emery et, al. (2004), define agency costs the incremental cost of working through others (agents). He identified five basic agency costs which include: (1).The transaction costs of setting up a contract i.e. the commission and legal fees. (2).The opportunity costs imposed by constraints on decision making. (3). The costs of incentives paid to encourage behavior in line with the principal's objective.(4).The costs of monitoring the agent(.5).The loss of wealth due to misconduct, despite the monitoring associated with excessive management expense accounts unproductive time fraud and negligence (Emery et, al., 2004). According to Jensen and Meckling, (1976) the agency relationship is defined as contract under which the principal engages the agent to perform the activities on their behalf. As part of the above the principal will delegate critical decision making authority to the agent. The impact of agency theory on corporate governance research can be observed in the predominance of studies that examine two key questions, namely, how the composition of boards of directors affects firm performance and how the leadership structure of the company (i.e., the duality of the CEO/chairman role) affects corporate performance. As previously outlined, the findings from these studies have been contradictory. Studies of outsider ratios and firm performance, for example, have produced findings ranging from positive correlations (Pearce & Zahra, 1992), to negative (Beatty & Zajac, 1994), to no significant correlation at all. In summary, extensive research in the area has shown any relationship between composition and/or leadership structure and firm performance to be "inconsistent and conflicting" (Rhoades et al., 2000: 77). Moreover, as research interest has increased, there has been "a growing diversity of results".

Conceptual Framework

The study adopted the following conceptual framework:

Independent Variable Dependent Variable

Source: Author 2017
Conceptual framework

Corporate reporting and disclosure

Large scale surveys of UK (CBI, Deloitte and Touche, 1996) and US (Daily and Dalton, 1994) companies a decade ago suggested that the majority of respondents felt that the heightened focus on corporate governance had no positive impact on corporate performance. The general feeling emerged that sound financial performance excuses poor governance (Pic, 1997). However, interest in corporate governance has grown tremendously in the past decade. Corporate scandals, environmental concerns and globalization have all played their part in raising shareholder and public awareness of how companies should be governed. The recent international disasters in financial reporting including Enron and Worldcom in the US, Parmalat in Italy, the Maxwell saga in the UK, Daewoo in Korea, Leisurenet and Regal Bank in South Africa demonstrated the growing need for transparency and disclosure in governing companies.

During the 1990s, a number of high-profile corporate scandals in the USA and elsewhere in the world, triggered an in-depth reflection on the regulatory role of the government in protecting the interests of shareholders. In view of the growing number of scandals, and the subsequent wide-spread public and media outcry, a plethora of governance 'norms,' 'codes,' 'best practices,' and 'standards' have sprouted around the globe. For instance, the Sarbanes-Oxley legislation in the USA, the Cadbury Committee recommendations for the European Union (EU) companies, and the OECD principles of corporate governance, are perhaps the best-known among these. The Cadbury Committee (1992) advocated, first of all, disclosure as "a mechanism for accountability, emphasizing the need to raise reporting standards in order to ward-off the threat of regulation. Improved disclosure results in improved transparency, which is one of the most essential elements of healthy CG practices." Similarly, the Hampel Committee (1998) regulated disclosure as "the most important element of accountability and in introducing a new code and set of principles stated that their objective was not to prescribe corporate behavior in detail but to secure sufficient disclosure so that investors and others can assess companies performance and governance practice and respond in an informed way." According to the OECD's (2006) 'Guidance on Good Practices in Corporate Governance Disclosure,' "All material issues relating to CG of the enterprise should be disclosed in a timely fashion. The disclosure should be clear, concise, precise, and governed by the substance over form principle."

In light of these recent developments, Dragmore (2009) very aptly remarked, "New regulations, new requirements and ever-increasing demands for transparency determine companies to follow the recent trends in corporate reporting (or disclosure) in order to comply with 'best practice' regulations: viz., narrative reporting, balance in the structure of reports, inclusion of management report, reporting CG and social responsibility, balancing financial and non-financial information, comparability over time, etc." To quote FASB (2001), "the quality of financial and non-financial disclosures depends significantly on the robustness of the reporting standards on the basis of which the financial/non-financial information is prepared and reported. In addition, disclosure indicates the quality of the firm's product and business model, its growth strategy and market positioning, as well as the risks it is facing (Chahine & Filatotchev, 2008). Disclosure of information, thus, enables the shareholder to evaluate the management's performance by observing, how efficiently the management is utilizing the company's resources in the interest of the principal. As Solomon (2004) pointed out: "disclosure can be viewed from two perspectives: corporate disclosure and financial accounting disclosure." Therefore, information and its disclosure are the areas where company law and accounting regulations join hands together. It is a key objective of accounting rules, in general, to ensure that users' have sufficient and timely availability of information in order to participate in the market, on an informed basis.

2. Research Methodology

The study adopted a descriptive research design that helps the researcher gain an in-depth insight into determining the impact of corporate governance elements on corporate social performance by manufacturing firms in Kenya in their implementation. A descriptive study was chosen because according to Cooper and Schindler (2001), it is concerned with finding out the 'who' the 'what' the 'where' and the 'how, of a phenomenon which was the concern of the study. A descriptive survey seeks to obtain information that describes existing phenomenon by asking individuals about their perceptions, attitudes, behavior or values.

A population or universe for a survey is any group of individuals or institutions which have one or more characteristics in common that are of interest to the researcher. Mugenda & Mugenda, 2003 defines a population as an entire group of individuals, events or objects having common characteristics that conform to a given specification. There is a population of 29 manufacturing firms in Thika Kenya according to the business directory list of companies. The researcher targeted three respondents composed of managing directors and corporate affairs managers in each firm. The study employed purposive sampling technique in selecting the respondents in each manufacturing firm. With this sampling technique, only case objects that contain information required by the researcher are selected. The sample was selected because it has the information that the researcher was looking for. The researcher targeted 3 respondents in each manufacturing firm from the corporate governance, public relations and operations management office that are directly related with the corporate social responsibilities.

The researcher employed the use of questionnaires in gathering firsthand information from the respondents which comprised of open ended questions to allow ease in data analysis, interpretation and tabulation of the questionnaires, and the closed ended questions which restricts respondents to yes and no answers. The instrument of research was then distributed prior to the actual research date in order to test the validity of the question and the availability of the respondents in a pilot study.

The completed questionnaires were edited for completeness and consistency. The data was then coded to enable the responses to be grouped into various categories. Data collected was purely quantitative and it was analyzed by descriptive analysis methods such as measure of central tendency e.g. mean, mode, median and measure of dispersion e.g. standard deviation, ration as well as percentages. The descriptive statistical tools assisted in describing the data and determining the extent to be used. Data analysis also used SPSS to generate quantitative reports. The researcher then presented the analyzed data through tables, pie charts, and graphs.

3. Results and Discussions of the Findings

Organizational values.

Table of corporate social reporting and disclosure

Statements	SD	D	NS	A	SA
The heightened focus on corporate governance disclosure practices has a great impact on corporate social performance of manufacturing firms.	0	0	0	100%	0
Past corporate scandals and environmental concerns in manufacturing firms has led to a growing need for transparency and disclosure.	0	0	0	100%	0
Disclosure as a mechanism for corporate accountability wards off the threat of poor corporate social performance.	0	15%	10%	75%	0
Improved disclosure practices by manufacturing firms has resulted in improved transparency of essential and healthy corporate social practices.	0	0	15%	85%	0
Manufacturing firms, in relation to corporate governance, usually disclose all material issues relating to corporate social performance in a timely manner.	0	38%	10%	52%	0
Manufacturing firms disclosure practices are clear, concise and governed by the substance over form principle.	0	52%	0	48%	0
Manufacturing firms comply with the recent trend in corporate reporting that require them to disclose management reports, environmental impact reports, corporate governance practices reports and financial reports.	0	15%	0	85%	0

4. Summary of the findings

CG disclosure is a fundamental theme of the modern corporate regulatory system, which encompasses providing information by a company to the public in a variety of ways. In the light of CG compliance requirements and disclosure standards, as envisaged by provisions (Bhasin, 2010). In regards to this first the respondent were in total agreement 100% that the heightened focus on corporate governance disclosure practices has a great impact on corporate social performance of manufacturing firms. The respondents were also 100% in agreement that past corporate scandals and environmental concerns in manufacturing firms has led to a growing need for transparency and disclosure. But when it comes to how each individual firm is influenced by corporate reporting and disclosure, the respondents were not in total agreement having 15 % disagreeing, 10 % neutral while 75% agreeing. This was an indication that poor incorporation of corporate governance practices by other firms is not a 100% factor that would determine how other organizations operated. 85% agreed that improved disclosure practices by manufacturing firms has resulted in improved transparency of essential and healthy corporate social practices. Only 52 % agreed that manufacturing firms, in relation to corporate governance, usually disclose all material issues relating to corporate social performance in a timely manner, this was an indication that not all firms disclosed all their operations fully to the respected and relevant parties.52% of the respondents disagreed that Manufacturing firms disclosure practices are clear, concise and governed by the substance over form principle.

5. Conclusions

The study observed that many organizations were highly sensitive to issues of governance disclosure practices because they had a great impact on corporate social performance of manufacturing firms. The study further found out that recent and past corporate scandals have led to the state requirement for organizations to disclose their operations in their reporting activities. The study observed that not all organizations were comfortable in disclosing their operations to the public due to the fact that most of them don’t adhere to the corporate disclosure and reporting requirements. In addition to this the respondents disagreed that Manufacturing firms disclosure practices are clear, concise and governed by the substance over form principle. This was an indication that lack of disclosing allowed organizations to engage in selective corporate social practices. According to large scale surveys of UK (CBI, Deloitte and Touche, 1996) and US (Daily and Dalton, 1994) companies a decade ago suggested that the majority of respondents felt that the heightened focus on corporate governance had no positive impact on corporate performance. The general feeling emerged that sound financial performance excuses poor governance (Pic, 1997). While many academics have stated that sound corporate governance practices will reduce the risk of corporate failure (Collis and Montgomery, 2005), the key question faced by investors is rather the issue of whether an investment in sound corporate governance practices by a company results in an increase in shareholder value. Therefore the findings of this research remain inconclusive due to the fact that shareholder value is an intervening factor to establish the relationship between corporate disclosure and corporate social performance.

6. Recommendations

Given the growing attention to CSP, especially it’s recently documented positive impact on firm returns, it is crucial to better understand its firm level drivers and how they influence performance of developing states firms. Secondly shareholder value should be considered as an intervening variable in establishing the relevance of the discussed corporate governance practices and how it finally impacts on CSP. The study first recommends that institutions and companies should frame their governance structures in a manner that they promote and answer to the interest of the shareholders. Secondly, based on the level of significance of internal control mechanism on CSR, the study recommends further research should be done to assess this aspect in different firms in order to a have a firm finding on its influence. Finally more variables should be considered in explanation of CSR since it's still a new concept in the field of finance and studies are limited in the area.

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