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Ethical and Social Responsibility of Financial Institutions: Influence of Internal and External Pressure

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Abstract

Financial institutions are expected to embed sustainable business practices as part of their ethical approach in conducting their businesses. This study examines the role of internal and external pressures in encouraging corporate social responsibility (CSR) reporting among financial institutions in Malaysia. The sample for the study comprised of 20 financial institutions in Malaysia over a four-year period from 2008 – 2011. Content analyses of annual and sustainability reports were undertaken to measure the quality of ethical and social responsibility reporting among the financial institutions. An un-weighted CSR quality disclosure index was developed to measure the quality of information reported. The findings of the study revealed that the quality of CSR information disclosed improved over the four-year period. This is a positive development suggesting that the financial institutions are becoming more socially responsible. The results of the study also revealed that it is the external pressure in the form of concentrated ownership and customers' pressure that can either inhibit or motivate the quality of CSR reporting while the internal pressure prove not to be a significant driver in promoting the quality of CSR reporting.

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1. Introduction

The drivers for organisations to behave ethically and responsibly have been a subject of interest to researchers in recent years. Both internal and external drivers are viewed as contributing factors that could provide incentives for management to behave responsibly. Vormedal and Ruud (2006) argued that the growth of sustainability reporting can be explained with reference to a range of market-based, societal, political, regulatory and ethical drivers. For example, evidence of market drivers can be found in the growing number of ethical, social and environmental investment funds, which has generated an emergent demand for sustainability disclosures on the part of stockbrokers and analysts (Holden Meehan, 1999; Slater & Gilbert, 2004).

This study explores the influence of internal and external drivers of corporate social responsibility (CSR) reporting in the context of the availability of financial resources, the international exposure of top management and the ownership structure of the financial institutions in Malaysia. The focus on financial institutions in this study is because the financial sector can exacerbate or improve the economy of a country financially. Therefore, these financial institutions are being increasingly demanded to act in a responsible and ethical manner.

The remainder of this paper is organized as follows. Section 2 discusses the literature review and hypotheses generation. Section 3 discusses the research methodology. The research findings are reviewed in Section 4. The final section highlights the conclusion and implications of the results.

2. Literature Review and Hypotheses Generation

Prior studies have identified legislation, demands from investors and other stakeholders, specific events, awards, economic activities, politics, media attention, corporate governance mechanisms; firms' performance, economic and moral motives and community awareness as among the factors that contributed towards an increase in CSR disclosure among organisations (Hillman & Keim, 2001; Deegan, 2002; Margolis & Walsh, 2003; Douglas et al., 2004; Khan, 2010; Farook et. al 2011; Darus, Yusoff & Othman, 2014). For example, Khan (2010) revealed that non-executive directors and the existence of foreign nationalities on the board are significant in influencing the extent of CSR disclosure among financial institutions. In this study, it is argued that internal drivers due to the availability of financial resources and the international exposure of top management and external pressure from stakeholders in the form of concentrated ownership, customer pressure and government ownership is expected to influence the quality of CSR reporting of financial institutions in Malaysia.

2.1 Internal Drivers and CSR Reporting

As part of the social player in society, firms are expected to carry out social activities and to do so; firms require resources to fund such activities. Resources can be defined as "basic constitutive elements out of which firms transform inputs into outputs, or generate services" (Mathews, 2002, p.23). A review of prior literature suggests that human, informational, technical and financial resources connect resource-based theory with CSR (Petrache, 2008). In this study, financial institutions with financial resources in the form of organizational slack are expected to be internally driven to participate in social initiatives. This is because the availability of additional resources will expedite opportunities for firms to be involved in social activities (Waddock & Graves, 1997). In addition, to financial resources the exposure of CEO to international experience can provide rare and valuable resources which could lead to an increase in CSR performance (Slater and Dixon-Fowler, 2009). Carpenter, Sanders and Gregersen (2001) support the above contention by arguing that international experience by CEOs will provide inimitable knowledge, worldviews, and professional ties that help them to better manage their companies' extensive operations. Therefore, the following hypotheses were developed:

H1: The availability of financial resources is positively associated with the quality CSR reporting.
H2: The international exposure of top management is positively associated with the quality of CSR reporting.

2.2 External Drivers and CSR Reporting

The external pressure from stakeholders in the form of concentrated ownership, customer pressure and