



THE EFFECT OF GOVERNANCE AND CORPORATE SOCIAL PERFORMANCE ON LENDING JUDGMENT AND DECISION



 Aditi Shams

PhD Candidate, the Australian National University and Assistant Professor,
University of Dhaka, Bangladesh.
Email: aditishams@gmail.com



ABSTRACT

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The objective of the paper is to examine the effect of governance strength on the lenders' overall risk assessment judgment and their lending decision. It also examines whether the Corporate Social Performance (CSP) of a firm can moderate lenders' judgment about the firms' overall risk and decision making. This study adopts a 2x2 full factorial experimental approach to investigate the relationship. As board-related governance reforms are seen to be more frequently considered by regulators as a way to increase confidence about the reliability of the financial statement, this study assumes that it will also be an important factor of consideration for lenders for approving loan assessments. Study results show that board governance strength does not affect the loan assessment significantly, but Corporate Social Performance has a significant effect on loan assessment. So, given the board strength scenario, the subjects' loan assessment is affected by borrowers' CSP information. As a result, the corporate social image has a significant influence on lenders' creditworthiness assessment. It is concluded from the results that corporate social performance information of the borrower has more effect on loan assessment than governance strength.

Contribution/ Originality: This is the first study that contributes to the logical analysis of corporate social performance and lenders' loan assessment. The findings will serve to the need for firm's non-financial information and hence have implications for both loan assessment and loan approval.

1. INTRODUCTION

Academic literature and business research have increasingly prioritized non-financial information disclosures. Information on corporate governance has long been recognized as one of the most important components of the relationship between the business and its stakeholders. In the current economic environment, businesses are also facing pressure from their stakeholders to be socially responsible in their operation and maximize their corporate social performance. The high profile accounting scandals in 2000-2002 and 2007-2008 periods had shaken the confidence of millions of stakeholders. The accounting scandals in the early 2000s began with financial reporting failures and ended up with bankruptcies. Numerous examples of accounting scandals in this period have created much attention for reforms in the corporate sectors that can reduce this kind of failure or fraud. The Sarbanes-Oxley Act (SOX) 2002 has emphasized compulsory disclosure and maintenance of the minimum standard of corporate governance. It emphasizes the compulsory requirement of board composition and expertise and qualification of independent directors. One of the most important governance reforms in Singapore requires listed

companies to strengthen the independence and skill set of their board of directors. Even developing country like Bangladesh has emphasized board related reforms in the corporate sector to maintain stability and ensure stakeholders' confidence, and the released ordinance to compulsory abide by those board attributes. The Code of Corporate Governance 2005 (Ministry of Finance, 2005) emphasizes that a board's role is not limited to only providing management oversight; it also manages risk and creates value for the stakeholders. For the last couple of years, the World Bank and International Monetary Fund have also been pushing countries for corporate governance reforms that illustrate the importance of such reform to restore confidence to the suffered stakeholders.

In the history of corporate governance literature, there are more studies that are overwhelmingly focused on the relationship between corporate governance and shareholders' investment decisions. However, the studies related to creditors or lenders are ignored area of research in corporate governance. There have been very few studies conducted on firms' corporate governance strength and its impact on lending judgment and decisions. While there are ample examples of research, finding the relationship between corporate governance and corporate financial performance, there has not been much study on how corporate governance impact on the judgment of lenders or creditors. More recently, however, researchers have realized the interdependence of modern corporations with other social actors. An extensive study of Uzun *et al.* (2004) on corporate frauds and failures from 1978 to 2001 found that there is a significant relation between Board structure and corporate fraud. They reported that the characteristics of the board of directors affected the occurrence of U.S corporate frauds and afterwards bankruptcies. In recent reforms of corporate governance, board reforms are observed to get more attention from the regulators. So, this experimental study will put a particular focus on different board related attributes and its effect on the credit assessment of the borrower firm. This study also considers the impact of corporate social performance (hereafter, CSP) on lenders' judgment and decision making. Several researchers have found a relationship between CSP and corporate financial performance. CSP is considered to have a positive effect on companies' financial performance as CSP creates trust and image of a sustainable company in stakeholders' minds. Sometimes it is argued that firms performing CSP are less risky in terms of generating a future profit and paying off debt.

Subsequently, this experimental study investigates the effect of board-related governance and corporate social performance on lenders' judgment about the overall riskiness of the borrower firm and decision about loan approval. The contribution of this paper helps to bridge the gap between existing literature and to the real-world lenders. First, as per the author's concern, this is the first study to look at whether CSP affects the loan assessment judgment of the loan issuing officer at a given level of given governance strength. The author assumes it will have a contribution to the lenders in terms of their lending decision making process. This study examines the impact on lenders' decisions because lenders' are the most sophisticated users' of financial and non-financial information. Again, lenders through their credit decisions serve as a gatekeeper between lenders and borrowers and play a critical role in proper allocation of credit. The design of this study has manipulated the governance strength and social performance strength of the borrower company in a between-subject sample. The purpose of this manipulation is to create four scenarios: 1) A loan request from firm having strong governance and high CSP activity 2) A loan request from firm having low governance but high CSP activity 3) A loan request of firm having high governance but low CSP activity 4) A loan request of firm having low governance strength and low CSP. The second and third scenarios will specifically observe whether lenders' risk judgment about the borrower is moderated by the interaction effect of governance strength and CSP.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1. Corporate Governance Strength

The expanding academic studies suggest that there is an association between corporate governance strength and financial performance of a firm (Monks and Minow, 1995; Dalton *et al.*, 1998). In an early study (Pfeffer, 1972), it has argued that board size and composition are not independent or random factors; they are somewhat rational

organizational processes to the conditions of the external environment. Recent studies have also found that stakeholders incorporate governance quality into their investment and lending decision (Sharma, 2006; Holder-Webb and Sharma, 2010). Recent corporate governance reform on board structures has suggested that the board is an important attribute for safeguarding the interest of stakeholders and reducing information asymmetry (Fama, 1980). In this paper, the corporate governance strength is tied to board specific attributes. Recent governance-related reforms across countries have suggested increased importance of board strength (Congress, 2002; ASX Corporate Governance Council, 2003; MoF, 2005). The study of Uzun *et al.* (2004) reported that in their sample of US companies from 1978 to 2001, as the number of independent outside directors increases the likelihood of corporate wrongdoings decreased. The study of Watts and Zimmerman (1986) suggest a direct link between firm performance and board composition. They found that the opportunistic behavior of the managers to misstate financial performance can be limited by increased board independence. Studies have considered board related attributes such as independence, financial expertise, industry expertise as important indicators of board strength (Agrawal and Chadha, 2005; Zahra and Pearce, 1989). Johnson *et al.* (1996) posit a direct relationship between board composition and firm performance. This study has considered the importance of the board of directors in interfacing between the company and its supplier of necessary resources. Jennings *et al.* (2006) in their experimental study, stated that SOX 2002 reform has emphasized more on corporate boards. They stated that the independence and expertise of the board members can alter pressures brought to corporate management. Arel *et al.* (2006) have also found a direct correlation between financial reporting quality and board independence and board members' financial expertise. The study of Sharma (2006) finds that when the board is comprised of most of the independent directors with relevant industry experience, the investors find it less risky in terms of investment risk and are more willing to invest in those firms.

Professional bodies argue that a board's role is more than just being a watchdog and safeguarding shareholders' value and maximization of profit. They argue that industry knowledge and industry experience in finance activity is important for strategic decision making of the firm. If the independent directors do not have industry knowledge and experience, then they are more likely to end up with less effective strategic decisions. Securities and Exchange Commission (SEC) of Bangladesh in a recent order has explicitly set the threshold (compulsory) for many independent directors on board and disclosure of industry knowledge and expertise of independent directors¹. The Code of Corporate Governance: Singapore, in 2005², also stated similar kinds of amendments about independent directors' board composition and expertise of the board are considered to be necessary for independent judgment by management. The Singapore Code and Bangladeshi SEC Ordinance have stated that industry experience and qualifications are important to create value for stakeholders. It is also considered that better qualification, industry knowledge, industry expertise and separation of CEO and chairman of a firm can limit the firms' tendency to manipulate earnings.

Firm performance is considered as a significant determinant of the ability to repay debt. The linkage between governance strength and firm performance also suggests linkages between governance strength and credit assessment (Holder-Webb and Sharma, 2010). Standard and Poor (S&P), a leading credit rating agency in their 2006 credit report has explicitly considered firm-level governance as an important determinant of rating the creditworthiness of a firm and its debt-paying ability. Holder-Webb and Sharma (2010) in their experimental study on 62 professional lenders of Singapore also find a significant positive effect of board strength in lenders' decision to extend credit.

Again, Wright and Davidson (2000) have characterized the processing of loan application as a sequential process. They studied that loan officers generally seek for financial and non-financial information of a firm using a

¹Securities and Exchange Commission of Bangladesh 'Ordinance 1969' Order No. SEC/CMRRCD/2006-158/134/Admin/44, 7 August 2012.

² *ibid.*, p. 2

'five C's of credit' framework (character, capacity, capital, condition and collateral). Loan officers as rational decision-makers are likely to integrate both financial and non-financial information into their knowledge structure and form a perceived level of risk as a basis for approval or rejection of loan requests. Guiral (2012) has also stated the importance of evaluating both financial and non-financial information in order to form a credit risk judgment and lending decision about a borrower. Based on the reviewed literature, the following hypothesis is proposed:

H1: Board strength affects lenders' judgment about the riskiness of the firm and lenders' lending decision.

2.2. Corporate Social Performance

Recently, corporate social performances of firms are getting more and more attention from the stakeholders. Turban and Greening (1996) have defined CSP as "a construct that emphasizes a company's responsibilities to multiple stakeholders, in addition to its traditional responsibility toward economic shareholders." Generally, CSP is understood to be the way firms integrate social, environmental, and economic concerns into their values, culture, and decision making to establish the best practices within a firm to create wealth and improve society³. Social Investment Organization, in a report in 2005, has stated that CSP of firms can improve risk management and reputation of the firm. It states that organization that performs well in CSR can build reputation and organizations that perform poorly can damage their brand image thus damaging their values, credibility, reliability, and quality which in turn can affect their future financial returns. Guiral (2012) also states that CSP has a positive impact on firms' financial performance by improving firms' relationships with various stakeholders. As this relationship improves, firms can build trust with their stakeholders. The study of Arendt and Brettel (2010) analyses the data from 389 European firms, and the study has examined the effect of corporate social responsibility performance of firms' on corporate image, identity and firm performance. The study finds that CSP affects corporate external image attractiveness, which improves the company-stakeholders relationship and eventually improves company financial performance. Using fortune magazine's ratings of corporate reputation, McGuire *et al.* (1988) suggest that a lack of social responsibility by the firm may expose a firm to additional risk from lawsuits and fines and may limit its strategic options. McGuire *et al.* (1988) argue that lenders may perceive low CSP firms' future riskier than the future of a high-CSP firm. Their study also suggests that firms with low social responsibility also experience a lower return on investment than firms with high social performance. Many studies also found that CSP reduces firm-specific systematic risk (Orlitzky and Benjamin, 2001). According to these studies, CSP provides insurance to protect, help and stabilize a firm's future cash flows, thus reducing uncertainties of expected cash flows.

Another side of an argument is found in the study of Prior *et al.* (2008). Their study on 593 industrial firms has investigated the relationship between CSR and earnings management practices. They explored in their study that the management manipulates the earnings in order to obtain some special benefits, and through this practice, they have damaged the interests of the stakeholders. Firms, through their CSP, can try to hide their earnings management. Prior *et al.* also argued that "a manager believes that by satisfying stakeholders' interests and projecting an image of social and environmental concern and awareness, he can reduce the likelihood of being scrutinized by satisfied stakeholders for his management of earnings."

The linkages of CSP and firm financial performance suggest that CSP is also related to lending judgment and decision. According to Guiral (2012), CSP contributes to the 'character' knowledge of the lender's decision-making process and thus develops a corporate good image and reputation in the mind of the lender. This leads the lenders to believe that the firm will fulfill its ethical responsibilities in the future, and that will reduce its systematic risk.

Considering the contradictory view of CSP activity interpretation by different empirical studies, this study will try to look at how CSP affects lenders' risk assessment and their lending decision. So, the above discussion leads to the second hypothesis.

³ Government of Canada, Retrieved from: www.lc.gc.ca

H2: Corporate social performance affects lenders' judgment about the riskiness of the firm and lenders' lending decision.

2.3. Corporate Social Performance and Board Strength

The above discussion suggests that both CSP and board strength can affect a lender loan judgment and decision. In today's business world, along with financial information, non-financial information is also considered to be necessary. Previous studies have documented that higher board strength can mean higher financial performance and fewer earnings management risk and better future strategies by the company. Besides, high CSP also can result in a reduction of risk by creating a reputation for the stakeholders. However, there have been no studies in the context of how lenders would factor in CSP in their judgment and loan decision in a given level of board strength. Lenders may be more sensitive to CSP when board attributes are low. They may rate the riskiness of the firm when there is a low level of CSP even though the board strength is high. On the other hand, lenders may not care about CSP if the board strength is high under similar financial conditions. In light of the lack of clearer expectations about the relationship between CSP and board strength, this experimental study will try to see whether CSR image or reputation irrespective of the board strength affects the lenders' judgment and lending decision. This statement leads to the third hypothesis,

H3: There is no interaction between governance strength and corporate social performance on lending judgment and decisions.

3. RESEARCH DESIGN

3.1. Experimental Design

The research design of this study involves a 2x2 (Corporate Board related strength were manipulated from High to Low and Corporate social performance were manipulated from high to low) between-subject randomized experiments. In this study, the experimental setting involves a commercial lending decision and judgment about the overall risk assessment of the borrower.

3.2. Experimental Task

Participants were given questionnaire (included in [Appendix](#)) containing information about a hypothetical company (borrower), background information, size of the loan requested, collateral and the company's current financial condition. Participants were requested to assume their position as a lender of a hypothetical financial institution. The author did not consider the bank as a lender because Banks have strict regulations from different regulatory bodies, whereas financial institutions have more freedom to its lending decision. Also, the author considered the major corporate scandals in the USA occurring in the 2007-2008 period, and it was a result of poor lending decisions by the financial institutions. So, lenders' hypothetical company belonging from financial institutions seemed more appropriate. The participants were given hints of their lending decision making process in the beginning because the author wanted the participants to have an initial idea about how to make a decision.

This fictitious case involved a consumer product company seeking a loan of amount \$ 50 million from a fictitious financial Institution ABC Company. The author considered the company from the consumer product industry as appropriate in this case so that the industry belongingness of the firm does not affect the judgment and decision of the lenders. The lender was told that this company is a new client for the lender so that the lender does not have any pre-conception about the history of the borrower company. The author did not put any real name of either the financial institution of the lender or company of the borrower because he tried not to influence the participants with any company resembling real companies. The purpose of the loan request is not mentioned in the questionnaire. The author tried not to destruct participants with too much information.

As mentioned above, board-related corporate governance strength and corporate social performance were manipulated. After given the general background and information about the board governance the participants were

asked to give their judgment about the strength of the board on each of the board attributes and they were also asked to rate the overall strength of the board. They were then asked to rate on a seven-point Likert scale (from low: 1 to High: 7). Then the participants were asked to form a decision to approve (given weight 1) or reject (given weight 0) the loan application. In Part-C of the questionnaire, the participants were given information about the CSP (manipulated from High CSP practice to low CSP practice) and asked to rate on a seven-point scale about participants' judgment and decision. The Information on the CSP was given after governance information so that the participants could include the governance and CSP information both in their judgment and lending decision.

Lastly, the participants were asked about a few demographic data about their gender, education level, age group, experience and level of understanding of the terms used in the questionnaire.

3.3. Independent Variables

This study has two independent variables, namely corporate governance strength and corporate social performance. The between-subject corporate governance manipulation has featured 'high strength' governance and 'low strength' governance. In this study, the 'high' governance scenario features a slate of directors that are predominantly independent, with relevant industry experience and/or financial expertise. The 'low' governance features a low number of independent directors and a low level of financial knowledge and expertise. BRD_STRENGTH is the dichotomous variable assuming a value of 0 for the 'low' strength scenario and '1' for the 'high' strength scenario. The board strength attributes that are varied between the two governance classifications are the number of independent director of the board, finance and accounting knowledge of the board, appropriate business qualifications and experience of the independent directors of board and separation CEO and Chairman of the board. Board size has been held constant at seven directors as this is a minimum number of board members for public limited company. This study has adopted Holder-Webb and Sharma (2010) governance manipulation measures for manipulating governance strength. In the 'high' (low) strength board condition, there are five (two) independent directors. Three out of five (zero out of two) independent directors have finance and accounting knowledge. Five out of five (zero out of two) independent directors have related industry experience. In addition, CEO and Chairman is a separate person for 'high' board strength and vice versa. These attributes have been selected by Holder-Webb and Sharma (2010) from both findings of the literature and regulatory reforms. These attributes are also discussed in the hypothesis development section of this study.

The between-subject corporate social performance manipulation has featured information about the company's community involvement, employee relation and environment. The author deliberately does not put any CSP information on the product, as the fictitious company belongs to the consumer product industry, and CSP product information is particularly sensitive to this industry. The 'High' CSP scenario projects the company as a good corporate citizen and taking community, employee and environment under consideration while operating. On the opposite, 'low' CSP scenario projects the company not giving value to the community, employee and environment in its operations. CSP_STRENGTH is the dichotomous variable assuming a value of 0 for the 'low' CSP scenario and '1' for the 'high' CSP scenario. The detail of manipulation of each independent variable is mentioned in Table 3 (see Appendix).

3.4. Dependent Variables

Two dependent variables are elicited in this study: first, judgment and second, lending decision. Participants measure judgment respond toward the risk assessment of the company. This study first asks the participants to rate the future profit-generating ability of the firm, on a seven-point Likert scale from 1= low profit-generating ability to 7= high profit-generating ability. Then the participants are asked to assess the level of risk, on a seven-point Likert scale from 1= very low risk to 7= very high risk. Then the participants are asked to approve (response measured by 1) or reject (response measured by 0) the loan decision. In addition to judgment and decision making,

participants are asked separately to rate the importance of board strength and CSP in their decision making and how confident they are about their decision, on a seven-point Likert scale from 1= low to 7= high. Responses regarding importance and confidence level are expected to give additional insights to lenders' loan assessment.

3.5. Participants

Participants were a combination of students, academicians and employees of banks. The participants were randomly distributed one of the four treatments to control for the selection bias. However, to balance for the equal distribution of each treatment, the researcher tried to take the distribute note of the response in each treatment (see Table 2, Appendix A). In this experiment, subjects distributed the questionnaire through both hard copies and soft copies. Some of the participants took part in Bangladesh. As all the participants taking part in Bangladesh were either bankers or academicians, they had a good grip on the English language, so the questionnaire was not translated into their native language. Sixteen female and seven males participated in this experimental study. The participants were mostly of the age bracket between twenty to thirty-five years. Most of the participants had completed their post-graduate programs in commerce, so they were assumed to have better knowledge about the key terms used in the experimental survey questionnaire. Years of experience in their profession was not considered in this survey because most of the participants were students and those who are working as academicians or employees in a bank does not take direct lending decision by themselves. As per their profession, the participants are assumed not to have direct lending experience. However, the researcher put the question about participants' understanding of the key terms to get an idea about participants' understanding in that area. From the descriptive statistics, it is observed that most of the participants rated high about their understanding of the key terms used in the survey. Table 1 (see Appendix) provides descriptive statistics about the participants.

Table-1. Participants' demographic statistics.

Participants demographics (n=21)	
Gender	<u>n</u>
Male	7
Female	16
Age	
20-35 years	19
36-50 years	3
51-65years	1
Education	
Bachelors degree	8
Masters degree	11
PhD	5
Understanding of the key terms	
High	21
Low	2

Table-2. Response rate of each treatment.

Corporate social performance		
Board strength	High (1)	Low(0)
High (1)	26%	26%
Low(0)	26%	22%

Table-3. Experimental statistics.

Experimental task	High	Low
Board strength	XYZ Ltd. has a <i>total of seven members</i> on its board. In the board composition, <i>five</i> board members are independent. <i>Three</i> of these independent directors have previous accounting and finance knowledge. In addition, <i>all five</i> independent directors have relevant business qualifications and <i>two</i> of the independent directors have related industry experience. Chairman and CEO of the company is a different person.	XYZ Ltd. has a <i>total of seven</i> members on its board. In the board composition, <i>two</i> board members are <i>independent</i> . <i>None</i> of these independent directors has previous accounting and finance knowledge. In addition, <i>none</i> of these independent directors has relevant business qualifications, and <i>none</i> of the independent directors has related industry experience. Chairman and CEO of the company is the same person.
Corporate social performance	<p>Community</p> <p>XYZ Ltd has the simple philosophy of demonstrating corporate leadership by doing the right thing. Their community investment aims to create a positive impact on both the community and the business.</p> <p>Community investment in the last three years shows an increasing trend. It took different initiatives to boost the community: ‘Support for Disadvantage people’, ‘Community Clinic in a rural area’, ‘New Eye’ program for children. They have also launched ‘GREEN’ initiative to beautify the community.</p> <p>Employee relation</p> <p>XYZ Ltd. has recently increased maternity leave from 4 months to six months with full pay. Increasing employee productivity by giving them happy, the friendly work environment is their objective. They have established a day-care center and a school for employee children.</p> <p>Environment</p> <p>XYZ, in its overall function, maintains a ‘GREEN’ concept. It has decreased its ‘water consumption’, and has decreased the level of carbon emission. It maintains a ‘Waste Recycles’. Plant and nothing is wasted here. They believe in the philosophy of ‘recycle and reuse’ in every department.</p>	<p>Community</p> <p>XYZ Ltd has the simple philosophy of demonstrating corporate leadership by doing anything that makes a profit. Their community engagement has decreased in the last three years.</p> <p>Employee relation</p> <p>XYZ Ltd. objective is to increase employee productivity by creating a formal relationship between management and employees. The company has a policy of no personal contact during office hours under any condition.</p> <p>Environment</p> <p>XYZ Ltd has its main plant by a river, which is used as throwing wastes. They believe that the establishment of ‘waste recycles’ and taking ‘GREEN’ initiative is costly and does not have any benefit. So, they do not follow any sustainability program.</p>

3.6. Manipulation Check

Manipulation checks were conducted to ensure the participants to understand the strength of the board and CSP as intended. For the board strength, participants were asked to rate the level of strength in each condition on a seven-point Likert-scale from 1= low strength to 7= High strength. Most of the participants correctly identified the level of board strength for their particular condition except for 2 participants. Specifically, these two participants rated exactly in the opposite end.

The participants were again asked to rate the level of CSP strength in each condition on a seven-point Likert-scale from 1= low strength to 7= High strength to check the manipulation of CSP strength. Here four of the participants failed to respond correctly to the question of ‘overall strength of CSP’ for XYZ Company.

Overall, five samples failed the manipulation check and were excluded from hypothesis testing. One possible explanation of this kind of response from the samples might be because of their lack of understanding of the background information. Another reason could be ambiguity in the questionnaire asked or background information

provided. Again, as no standard has been put in the questionnaire to compare the given data individual differences in judgment might have responded opposite to expectation.

4. RESULTS & DISCUSSIONS

This study performs a multivariate analysis of variance (MANOVA) to determine the effect of governance strength and corporate social performance (high and/or low) on the loan officers' assessment of the overall riskiness of the borrower's firm, and the decision to approve or reject the loan application. The MANOVA results are summarized in Table 4 (see Appendix).

Table-4. MANOVA analysis.

MANOVA results and cell means			
Effect	Pillai's Trace	F-Statistics	p-value
<i>Panel A: Multivariate analysis of variance</i>			
Intercept	0.5784	2.44	0.0440
BRD_STRENGTH	0.0667	0.61	0.5561
CSP_STRENGTH	0.3561	4.70	0.0237
Interaction	0.2274	2.5	0.1115
<i>Panel B: cell means for risk assessment</i>			
BRD_STRENGTH	CSP_STRENGTH		
	High	Low	
High	3.3333	4.5	
Low	4.1667	5.2	
<i>Panel C: cell means for loan decision</i>			
BRD_STRENGTH	CSP_STRENGTH		
	High	Low	
High	1	.16667	
Low	0.6	0.6	

The test results show that loan officers' assessments are affected by the corporate social responsibility strength ($p < 0.05$), but not by the board strength. Again, the interaction term of board strength and CSP does not show statistically significant results ($p\text{-value} = 0.493$). In addition to that, the cell means, reported in panel B and C of Table 4, indicate that a low level of corporate social responsibility produces a higher risk assessment and a lower likelihood of loan approval, which is consistent with the second research hypothesis of this study. Hence, the low level of CSP negatively impacts loan officers' judgment and decision even though the borrower has a higher level of board strength. So, there is sufficient evidence to reject the second null hypothesis (H_2).

The study results do not find any evidence that loan officers' assessments are affected by board-related governance strength; more specifically, the negative effect that accompanies a low CSP is not tempered by the board strength. As indicated above, the interaction effect is not statistically significant in the multivariate analysis. So, these findings are not consistent with the first and the third hypotheses. So, there is no sufficient evidence to reject H_1 and H_3 .

The mean scores of the experimental groups reported in Table 5 show that the loan officer in his loan assessment has rated board strength and CSP with a similar score (mean score) in each case in terms of this information's importance in his decision making. Loan officer's rating for borrowers' ability to generate profit has minimum value=4 and maximum value=5.16. These scores are not below the average value on a seven-point Likert scale. One explanation of this result might be, the loan officers do not consider the strength of the board and CSP to be a threat to the profit-generating ability of the borrower, and the participants find the financial information to be the determinant of the profit-generating ability of the borrower.

Table-5. Scores of different control questions of the experimental group.

Factors	Experimental group			
	High Board Strength/High CSP	Low Board Strength/High CSP	High Board Strength/Low CSP	Low Board Strength/Low CSP
Ind_brd	6	2.16	5.83	3.2
Finexp_brd	5.83	2.16	5.16	2.2
Qual_brd	6.16	2.16	5.66	2.6
Indexp_brd	4.8	2.33	5	2.4
Gen_prf	5	4.33	5.33	4.4
Brw_risk	2.8	3.8	3.5	3.4
Imp_decs	5.16	5.16	4.83	3.8
Gencsr_prf	5.16	4.33	3.66	4
Csr_risk	3.3	4.16	4.5	5.2
Imp_csrdecs	5.16	5.66	4.83	4.6

Source: Sample of survey questionnaire.

5. CONCLUSION

The results of the study have designed to investigate the effect of board strength and corporate social responsibility on loan officers' assessment of a company's creditworthiness. Sarbane-Oxley Act 2002 requires the US companies to follow a compulsory level of board attributes, whereas OECD's principles of good governance do not require firms to follow the governance requirement compulsorily. Again, in recent times, many firms have gone for board-related reforms as it is considered to be one of the most important attributes to boost confidence with the stakeholders. CSP has also gained momentum in recent years, and it is found to affect the stakeholders' image toward the company. Study results show that board governance strength does not affect the loan assessment significantly, but CSP has a significant effect on loan assessment. So, given the board strength scenario, the subjects' loan assessment is affected by borrowers' CSP information. So, the corporate social image has a significant influence on lenders' credit worthiness assessment. This result is consistent with the finding of Guiral (2012) that CSP of the borrower affects loan assessment.

6. LIMITATIONS

Manipulation of CSP might have different interpretations from different participants because there is no standard or threshold established to measure high and low CSP. In developing the experimental materials, the study could not do much pre-testing due to time limitations. So, the responses might cluster at either end of the response scale. This study does not consider the fact that some lenders might prefer to lend to high-risk companies in general to charge higher interest rates. So, in the future, this study will try to ask participants to assess the probability that lenders will approve credit at a reasonable rate of interest determined by the financial institution. Another limitation of the study is that the participants were directly asked to accept or reject the loan application. This straight view might provide distortion to participants because the limited information provided in the questionnaire is not sufficient to give a straightforward response to the decision. Instead, the study would have asked participants to assess the probability (0-100%) that they would approve the loan. No preliminary test is done before the final response due to time constraints. So, improving the survey based on the inputs from the participants was not possible. This study considered literature supporting the assumption that the loan officers view CSP as a positive sign for the firm to generate future profit, but the results can also be interpreted in different ways. Firms that have better CSP activities actually investing more in CSP activities more than other direct profit-generating avenues, so the lenders might be discouraged to give loans to firms having better CSP. Specifically, this study did not give detailed financial information for the participants to make an informed judgment, so the author might have biased the participants' judgment and decision to be only influenced by the governance and CSP information. To

reduce this bias, the author can give more background information (financial and information regarding five 'C's) about the company and keep it fixed for each treatment, to make loan officers take more informed judgment.

7. FUTURE RESEARCH

Future research in this area can try to look at other attributes of corporate governance, and/or take a composite rating of corporate governance strength. That may also investigate whether that has any effect on loan assessment.

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APPENDIX

An Examination of Creditors' Lending Judgment & Decision

CONDITION 1

The following experiment provides information on a hypothetical situation.

General Instruction:

This study focuses on creditors lending judgment and decision. There are no correct answers, and the researchers are solely interested in your most likely course of action given the facts provided in this case study.

For the purpose of the study you are asked to respond to a series of questions. Your responses to the questions in this case study should reflect the information provided in the case and your own lending circumstances.

Response manner:

You will be asked to record your responses using both qualitative and numeric measures. Where qualitative responses are required, you will be asked to MARK the box that best represents your response.

For the numerical responses you will be provided a 7 point likert scale (1=Very Low to 7 = very high) and will be asked to put TICK in the position on the line that best corresponds to your estimate.

Once you have provided responses in a **particular question** and moved to the next question, **please do not change your earlier responses**.

Please note that all responses that you provide will be kept confidential, and will be used only for the purpose of this research.

If you have any query while completing this study, please do not hesitate to ask.

This case study should take 20 minutes to complete.

Thank you very much for your involvement in this research.

Part A : Background Information

The following information is background information on an Australian Consumer product company Ltd(XYZ Ltd.) and a lending firm (ABC ltd) Please read the following information carefully and respond to the questions in

the next page.

You are the Credit Manager of a reputed Australian Financial Institution (ABC Ltd.) and your primary responsibility is to make credit decisions given the direction of the firm and also putting your own judgment. Your company always tries to follow six 'C' (Capacity, capital, character, Collateral& condition) in evaluating a loan application. You have a fair (not much strict and not too soft) view in approving loan. You try to assess firms' overall position using financial and non-financial performance of the firm. You are very sincere about performing your responsibilities and avoid bias and personal perceptions about particular matters away from professional judgment.

Recently you got a loan application for \$ 50 million from a new firm XYZ ltd, working in the consumer product industry. Your firm does not know anything about the new client. So you searched for information about the firm and came up with the followings:

- Loan amount of the XYZ firm is an average loan amount in terms of the industry.
- The company has enough collateral to cover its loan amount.
- With the growing level of consumption, the company has a fair purpose to applying for loan to expand further.
- The financial performance of XYZ Ltd shows an average financial position compared to the industry financial performance index.

You also find the following information related to corporate governance and corporate social performance about the firm.

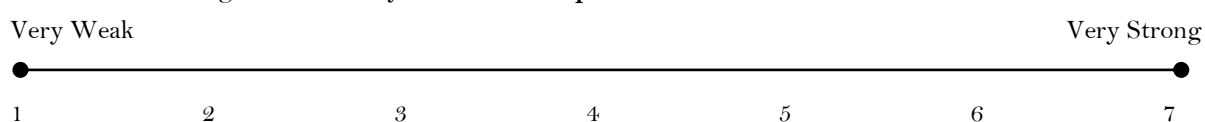
Other Non-Financial Information:

Corporate Governance (Board-related) Practices of XYZ Ltd.

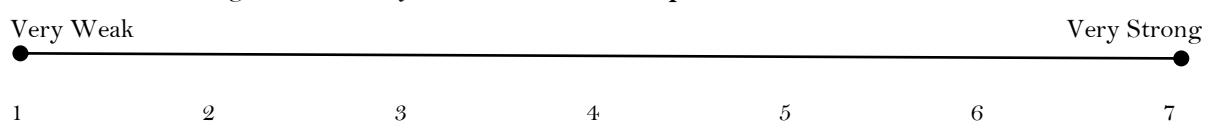
XYZ Ltd. has *total seven members* in its board. In the board composition *five* board members are independent. *Three* of these independent directors have previous accounting and finance knowledge. In addition, *all five* independent directors have relevant business qualifications and *two* of the independent directors have related industry experience. Chairman and CEO of the company is different person.

Part B

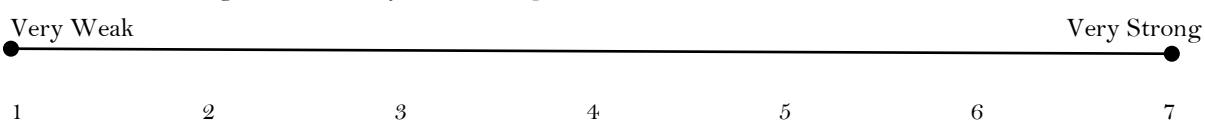
1. As a credit manager how would you rate the **independence** of the board firm?



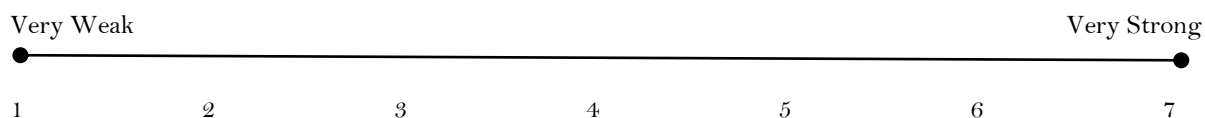
2. As a Credit Manager how would you rate the **financial expertise** of the board?



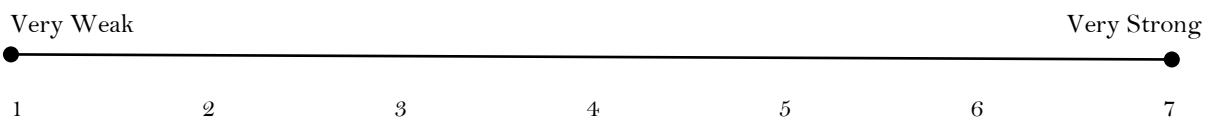
3. As a credit manager how would you rate the qualifications of the board?



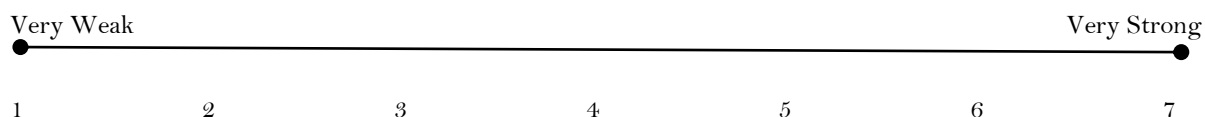
4. As a credit manager how would you rate the industry expertise of the board?



5. How would you rate the overall board related governance strength of the firm?



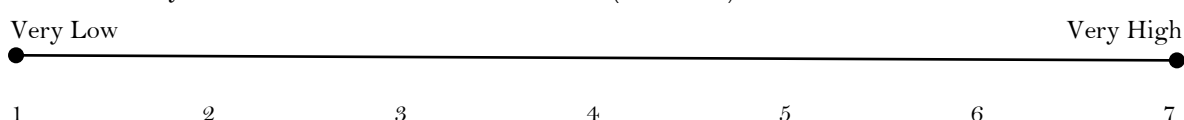
6. How confident you are regarding your board related judgment (response of question 5)?



7. How would you rate the ability of the borrower (XYZ Ltd.) to generate future profits in its investments?



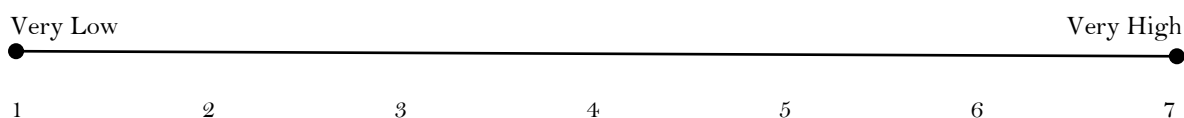
8. How would you rate the overall risk of the borrower (XYZ Ltd.) to serve the debt?



9. What will be your lending decision as the credit manager? (Please TICK the appropriate box)

Approve the Reject the Loan

10. How confident you are about your lending decision (response in question 9)?



11. How would you rate the impact of the board strength on your decision in question 9?



Please **do not change your response to PART B** while moving to the next page

Part C

Corporate Social Responsibility Performance of XYZ Ltd:

Community

XYZ Ltd has the simple philosophy of demonstrating corporate leadership by doing the right thing. Their community investment aims to create a positive impact for both the community and the business.

Community investment in the last three years shows an increasing trend. It took different initiatives to boost the community : ‘ Support for Disadvantage people’, ‘ Community Clinic in rural area, ‘New Eye’ program for childs. They have also launced ‘GREEN’ initiative to beautify the community.

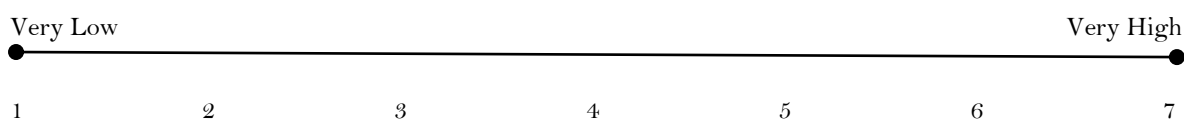
Employee relation

XYZ Ltd. has recently increased maternity leave from 4 months to six months with full pay. Increasing employee productivity by giving them happy, friendly work environment is their objective. The have established a day-care center and a school for employee children.

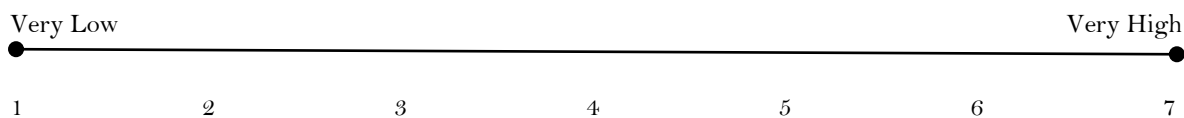
Environment

XYZ in its overall function maintains a ‘GREEN’ concept. It decreased its ‘water consumption’, decreased the level of carbon emission. It maintains a ‘Waste Recycle ‘plant and nothing is wasted here. They belief in the philosophy of ‘recycle and reuse’ in every department.

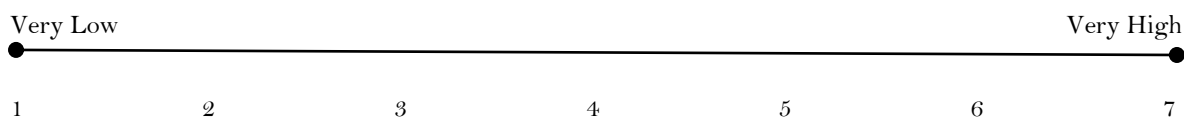
12. How would you rate the overall corporate social responsibility performance of XYZ Ltd?



13. How would you rate the ability of the borrower (XYZ Ltd.) to generate future profits in its investments?



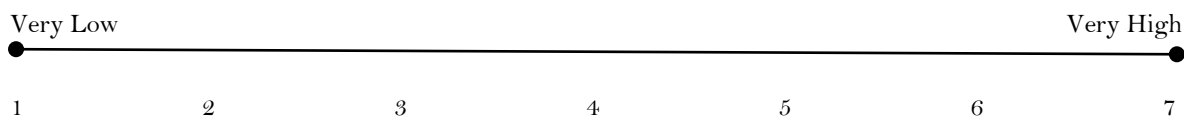
14. How would you rate the overall risk of the borrower (XYZ Ltd.) to serve the debt?



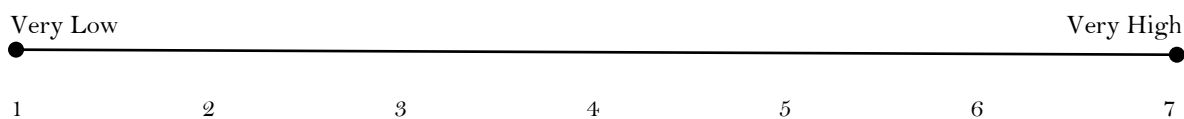
15. What will be your lending decision as the credit manager? (Please TICK the appropriate box)

Approve the	Reject the Loan
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16. How confident you are about your lending decision (response in question 13)?



17. How would you rate the impact of corporate social performance on your response to question 15?



Part D (Please TICK the correct information)

16. Gender: - * Male * Female

17. Age Group:

Age group	TICK the right box
20-35 Years	<input type="checkbox"/>
36-50 Years	<input type="checkbox"/>
51-65 Years	<input type="checkbox"/>

18. Last education level:

PhD	<input type="checkbox"/>
Masters Degree	<input type="checkbox"/>
Bachelor	<input type="checkbox"/>

19. Experience:

< 1 year	
1-2 year	
3-5 year	
6-10 Year	
> 10 years	

20. How would you rate your understanding of the terms used in this questionnaire?

Very Low knowledge

Very High Knowledge



1

2

3

4

5

6

7

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