

# Corporate Social Responsibility and Offshore Outsourcing - The Case of Electrical & Electronics Firms Malaysia

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**Abstract.** *Offshore outsourcing (OO) of business activities from North to South does not only relocate investments and jobs, it has also brought about new business demands on suppliers activities and their social and environmental impact. The objectives of the study are firstly, to explore whether offshore outsourcing (OO) activities of Malaysian firms (herein refers to as contracting firms) matter in corporate social responsibility practices, and secondly, to examine whether government policy and support matters in the CSR practices of the contracting firms. The focus is on Malaysian based local or foreign vendors, contract manufacturers or subcontractors in the electrical and electronics industry. The findings of the study indicate, firstly, that the level of CSR practices is positively influenced by the degree of OO activities. In addition, the study also concludes that other firms' attributes, namely the size of the company's workforce and degree of foreign ownership have a significant impact on the firms' CSR practices, while no apparent relationship is found with firms' profitability and leverage. Secondly, that the government plays an important role shaping the perception, rhetoric and organisation of CSR activities by firms; nevertheless, most contracting firms do not recognize any support for CSR upgrading from the government or local institutions.*

**Keywords:** *corporate social responsibility, offshore outsourcing, codes of conduct, contract manufacturer.*

## 1. INTRODUCTION

The landscape of business, particularly that of the developed markets are changing as the market and consumers pressed for greater transparency and ethical practices from companies. The post Enron period has created an accelerating trend towards greater accountability that covers critical issues like corruption, child labour, global warming, pollution, discrimination and health and safety of workers etc. Thus, building corporate social responsibility (CSR) practices are becoming an important factor and determinant in competing for the scarce human and financial resources.

CSR refers to a set of policies and strategies that is said to occur when companies integrate social and environmental concerns in their business operations and in their interaction with stakeholders. In fact, the CSR agenda is created to fill the vacuum in international business regulation brought about by the globalisation of economic activities and the deregulation of economies in favour of

the liberal market mechanisms. (Pedersen 2006)

CSR has been conceived as a voluntary and corporate-driven agenda in the North, and thus the challenge for the developed countries is to move beyond the existing legislation. However, the CSR agenda in developing countries is different from that of the North because the CSR challenge in the South is to make firms comply with the legislation. (Prieto-Carrón, Lund-Thompson, Chan, Muro & Bhushan, 2006) In fact, in developing countries like Malaysia, the state agencies seem to play a crucial role in adopting and transforming the CSR discourse in line with the development strategy of the state and the interests of the government. Neither local firms, nor local civil society groups may have the interests or courage or capabilities to further the CSR agenda beyond the policies of the government. The potential role of public institutions in furthering CSR in developing countries have also recently been acknowledged by the World Bank (Fox, Ward & Howard, 2002; Ward 2004; World Bank & IFC, 2004).

The attraction of abundant natural resources, cheaper

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labour, trading rules that favours local production and improved capabilities of both the global and local suppliers have led many firms in the United States and Europe to move more extensively towards an international contracting model. This trend leads to the term “offshore outsourcing” (OO). (Gereffi and Sturgeon, 2004) “Outsourcing” involves delegating to a third party, the responsibility and authority for managing and operating a portion of the outsourcing company’s business at an agreed fee for a fixed period of time. (Blumberg, 1998) “Offshoring” refers to the decision to move supply of goods and services from domestic to “overseas” (foreign) locations (Gereffi and Sturgeon, 2004).

Ideally, from the developed countries’ perspective, the OO activities help shift out the low-value activities and old industries, freeing up capital and human resources for higher value activities, and help in the development of newer industries and cutting edge products. From the developing countries perspective, OO offers benefits such as jobs, skills and access to foreign markets. However, empirical evidence shows the increasing dependency, lock in and races-to-the-bottom as developing countries compete for contracts (Kaplinsky, 2000; Humphrey and Schmitz, 2001). In addition, the thresholds for accessing the OO markets have been increasing due to the rise of international quality standards and certification requirements instigated by the foreign firms (herein refers to as lead firms) (Gibbon & Ponte 2005; Wad 2006), and CSR are part and parcel of this new standard setting (World Bank & IFC 2004).

For Malaysia, an industrialising country in transition from a labour intensive to a technology intensive economy (Rasiah 2003), OO from the Global North has played a crucial role in a deliberate government strategy of catching up; and with the rise of the corporate governance agenda after the financial crisis 1997-98, CSR was easily added.

The objective of the study is *to explore whether OO linkages influence CSR practices of Malaysian firms (herein refers to as contracting firms).*

The focus is on Malaysian vendors, contract manufacturers or subcontractors and their reception of, strategising about and organisational adoption of CSR activities. The hypothesis is that the relationship between the level of OO and the degree of CSR practices is expected to be positive, although it is not anticipated that OO is the only explanatory factor of CSR practices of Malaysian firms.

The findings of the study indicate that the degree of CSR practices is positively influenced by the level of OO of the contracting firms. In addition, the study also concludes that other firms’ attributes, namely the size of the company’s workforce and degree of foreign ownership have a significant impact on the firms’ CSR practices,

while no apparent relationship is found with firms’ profitability and leverage.

In summary, the local CSR agenda is influenced by both economic globalization and domestic policies and strategies. Hence, firms in Malaysia are squeezed by international business linkages and the local institutional context. Nevertheless, the firms do not seem to have established any systematic approach or applied any integrated and coherent CSR strategy for CSR upgrading.

The paper is structured as follows. It starts with the introduction (this section). Section two locates the micro-level and business discussion in the institutional environment and not least political initiatives that have facilitated the emergence of a CSR debate and agenda in Malaysia. Section three describes the relevant theories relating to CSR and OO. Section four shortly outlines the methodology, research hypotheses and analytical framework applied in the article. In section five the empirical data are analysed and the interplay between OO and CSR is discussed. Section six winds up the analysis and presents the limitations of study and suggestions for future research.

## 2. INSTITUTIONAL DEVELOPMENT OF CSR

The emergence of a Malaysian CSR discourse takes place in a hybrid of a political economy, where the economy has been very open in terms of foreign trade and foreign direct investments for decades while the political system is very closed, defending the newborn sovereignty of 1957. The financial crisis of 1997-98 changed the political perceptions of corporate governance and nurtured the rise of a new CSR discourse. The section outlines the changing political economy of Malaysia, the government’s construction of a new CSR agenda, and the roles played by non-government organisations and the business community; and finally, Malaysia’s CSR record is assessed by international standards.

### 2.1 The Political Economy of the Emergent CSR Discourse in Malaysia

Malaysia is a multi-ethnic industrialising society that has been ruled by a coalition of ethnic based parties, called Barisan Nasional (BN) for decades. Since 1971 Malaysia has pursued and implemented an affirmative strategy in favour of the Bumiputera (Malays and other indigenous) community, in order to elevate the Bumiputeras to economic equality with the Chinese and Indian communities and to alleviate poverty among the Bumiputras. This development policy has tried to mobilise foreign direct investment (FDI) and partnerships with transnational companies, while simultaneously supporting

development of a Bumiputera Commercial and Industrial Community (BCIC). As a result, foreign owned corporate equity declined while both the Bumi and the non-Bumi Malaysian owned equities increased (Government of Malaysia, 1991).

However, in the wake of the East Asian crisis 1997 the issue of good corporate governance became a key issue internationally and among East Asian countries. Northern countries and international financial institutions claimed that the debacle of East Asian Miracle was due to deregulation of developmentalist regimes or bad corporate governance, especially corruption and 'cronyism' (Jomo, 1998; Rodan, Hewison and Robinson, 2001). During the financial crisis, Malaysia enacted controversial anti-IMF crisis governance, which re-regulated and restricted the cross-border flow of FDI for some time. Although the policy prevented the Malaysian economy from a meltdown and the Malaysian business community (especially the BCIC) from bankruptcy, it changed the reputation of Malaysia as a pro-FDI country.

As a result, the FDI inflow has never regained its former momentum. It dropped from USD7.3 billion in 1996 to USD2.7 billion in 1998, and recovered at a level of USD6 billion net inflow in 2006. The capitalisation of the stock market in Malaysia decreased slightly from 1996 to 2006 while the stock markets in Hong Kong, South Korea, India and Singapore increased several times (*The Economist*, 2 December, 2006, p. 33). As stock market capitalisation is an indicator of investors' confidence in the effective corporate governance of public limited companies, Malaysia's reputation has fallen behind several of its regional competitors for FDI.

In addition, political uncertainties in the aftermath of the general election held during March 2008 have also taken a toll on Malaysian equity market. The election results saw the ruling BN coalition losing its two-third majority and the opposition Pakatan Rakyat taking control of five states which, combined, contribute some 60% to total GDP (The Edge, 2008).

## 2.2 The Government's New CSR Agenda

In order to demonstrate its commitment to achieve economic progress that is consistent with good personal values and corporate ethics, the government presented the Malaysian 'Business Code of Ethics' in 2002 and supplemented the code with a 'National Integrity Plan'. This was followed by the establishment of the Integrity Institute of Malaysia (IIM) in 2004. Among the key objectives to be achieved by IIM within the next five years are the need to enhance the standards of corporate governance and business ethics and also to improve the quality of life and the well being of the citizens.

The state investment arm, Khazanah Nasional Bhd (KNB), launched The Silver Book on September 2006 under its Government-linked Company Transformation Programme, in line with the government's commitment and determination to support the development of the government-linked companies (GLCs). GLCs are seen as the drivers of the Malaysian corporate sector by the government because they "comprise more than a third of the capitalization of Bursa Malaysia and half of the KL Composite Index" (Yakcop 2007). The Book provides guidelines for GLCs to conduct their CSR activities that are in line with their business objectives and corporate philosophy, as well as enhancing stakeholder and shareholder value (Khazanah Nasional Bhd, 2006).

The Malaysian government are also demanding that the public listed companies (PLCs) report on their CSR practices (Yakcop 2007). To assist the PLCs in this respect, Bursa Malaysia (BM) launched the CSR framework in September 2006. The framework represents a set of voluntary guidelines for PLCs and GLCs to address matters related to responsibility and ethics in the course of their normal pursuit of profits (<http://www.klse.com.my/website/bm/>, access on: November 2006).

Interestingly, BM contends that the government has not taken the initiative in CSR. "Contrary to Europe where the UK government and the EU Commission have expanded ethical resources in pension funds," it is stated that: "in Malaysia we focus much more on competitiveness" (BM interview 2006-12-04). However, "no one really looked into what the PLCs were doing". As for the GLCs, the government wants to increase their competitiveness through improvement in their CSR record. Yet this approach had partly been influenced by civil society: "Many NGOs have been actively promoting CSR for years in Malaysia even within political parties" (BM interview 2006-12-04). Hence, it is ironic that the NGOs have been successfully promoting the CSR discourse for years, but when it is adopted at least rhetorically by state agencies and the government, the overriding purpose is to increase competitiveness and profitability in an international market environment.

Another key player in the construction of the Malaysian discourse on CSR has been the Securities Commission (SC). The SC focuses on raising public awareness about CSR issues. In addition, the SC's statement on its CSR agenda (interview 2006-12-15) discloses that:

"SC is keen to see more companies incorporate CSR into their corporate governance agenda to increase their profile, so that they can gain recognition from the perspective of international and domestic institutional investors. In view that the guides in UN Global

Compact is consistent with the teaching of Islam, it is also in SC's agenda to establish Malaysia as the centre for international Islamic capital market in line with the Capital Market Masterplan.”

It is a bit surprising that the SC encourages Malaysian firms to join the UN Global Compact because this Compact requires that the participants endorse the core ILO labour rights, including the freedom of association which the Malaysian government does not accept nor has it been ratified by the parliament!

## **2.3 Non-governmental Organisations and the Business Community**

The Institute of Corporate Responsibility (ICR), a private initiative fully supported by the SC, BM and KNB, has been established in November 2006 to promote socially responsible business practices. Apart from organizing conferences, dialogues, workshops and exchanges of ideas, ICR collaborated with the newsprint The Star in 2008 for the inaugural StarBiz-ICR Malaysia Corporate Responsibility Awards, whereby companies demonstrating outstanding CSR practices will be honoured. According to ICR, the award is significant as the institute wanted to move from building awareness to embedding responsible behaviour in strategy (StarBiz, 14 April, 2008).

Another initiative to identify and reward corporations for the disclosure of environmental, social or full sustainability information is the annual ACCA Malaysia Environmental and Social Reporting Awards (MESRA), organised by the Association of Chartered Certified Accountants (ACCA). The MESRA award winners for 2007 were Nestle (M) Bhd and UEM Environment (M) Sdn Bhd for social and environmental reporting categories respectively (The Star Online, 2008).

According to the ACCA report titled ‘The State of Corporate Environmental Reporting in Malaysia’ published in early 2002, corporate environmental reporting (CER) in Malaysia was still in its infancy. Chan (2000) argues that government direction to disclose environmental information is the influence most likely to cause a change of practice. Tan, Zainal and Cheong (1990) concluded that voluntary disclosure in Malaysia is an exception rather than the norm and that despite the fact that users would prefer to see more non-mandatory information. Thompson and Zakaria (2003) comment that the lack of pressure from other stakeholders such as the NGOs and pressure groups may explain why few companies take CER seriously. They further elaborate that CER requires the companies to be transparent and open, characteristics that are far from prevalent in Southeast Asian cultures.

The CSR 2007 Status Report commissioned by BM

reveals that the PLCs generally lagged behind international best practice in CSR disclosure and practice due to lack of knowledge and awareness. Using BM's CSR framework (defined based on four dimensions: marketplace, workplace, environment and community) as the benchmark for measurement, the report revealed that only one-third of the 200 PLCs surveyed was either in the above average, good, or leading categories for CSR practices; the remaining two-third of PLCs were ranked either as average (27.5%), below average (28.5%) or poor (11.5%). Listed multi-national companies achieved the highest score. The survey also found that high risk PLCs, which include companies in industries that were more regulated because of the nature of their business and their inherent social and environmental impact such as tobacco, alcohol and gaming, scored better results. In addition, the report revealed that few PLCs assessed their environment and there were little measure in place to improve diversity (Bursa Malaysia, 2008).

Nonetheless, it is important to note that the small and medium size enterprises (“SME”) which form the backbone of Malaysia's economic structure are still lagging behind in terms of CER, or CSR for that matter. This is because these companies view managing environmental and social matters a time consuming and unproductive affairs. The SMEs constituted 92% of the total number of companies registered with the Companies' Commission of Malaysia. 29.1% of manufacturing output comes from SMEs and they easily account for one third of the total employment. Thus their aggregate influence on environment and society should never be underestimated (Sustainability, 2005).

## **2.4 Malaysia's CSR Performance in an International Perspective**

Taking an international CSR standard perspective the record of Malaysia is rather bleak. The Malaysian government has ratified most of the core international labour rights except the right to form independent trade unions e.g. preventing the formation of a large electrical & electronics industrial union, but the enforcement of these ILO labour rights are far from international standards and the Malaysian Trades Union Congress complains about violations of trade union rights (MTUC 2002, ITUC 2007). Presently, the government together with the National Institution of OHS have established legislation of occupational health and safety standards together and also upgraded its environmental policy and planning.

However, the government is not known for taking a pro-active and progressive stance *in practice* on international labour rights, occupational health and safety standards and environmental issues. In fact, Malaysia does not rank high or even appear on several international CSR

indexes, for example:

- a) there is only one firm – and a foreign controlled firm (Dupont Malaysia Sdn Bhd since 2003<sup>1</sup>) that appears at the UN Global Compact 2007 list for Malaysia;
- b) no Malaysian bank participates in the group behind the IFC Equator Principles;
- c) Malaysia does not adhere to the OECD Guidelines for Multinational Enterprises although other non-OECD countries do, e.g. Brazil (see UNCTAD (2006) WIR 2006, ch. VI, section D);
- d) In terms of SA 8000 only two Malaysian firms are registered by June, 2006 (<http://www.sa-intl.org/>, access on November 2006): *Pan Century Edible Oils Sdn. Bhd.* which manufactures palm oil and palm oil products, and *Pan-Century Oleochemicals Sdn. Bhd.* that makes and distributes acids and glycerine;
- e) In 2004, only two Malaysian incorporated companies, the BAT Malaysia and Sime Derby, appeared on the Dow Jones Sustainability World Index (DJSI) among 310 companies; and BAT was accused of initiating trade union busting in 2006 by the global union federation, IUF (Osborne, M. 2007-05-17).
- f) Only 26 Malaysian companies including the Golden Hope Plantations Berhad subscribed to the Malaysian Chapter of the Global Forest and Trade and hence to minimum certification standards (Razak 2004).

### 3. THEORETICAL UNDERSTANDING OF CSR AND OO

#### 3.1 Legitimacy Theory and Social Contract Theory

Friedman's (1970) prescription of "the business of business is business" has been under fierce attack from various stakeholders in recent times. He argues that an organization's one and only one social responsibility is to maximize profits for its shareholders, and that the organization would have already utilized part of its profits for taxation and other statutory payments, thus any further obligations put on it by the society would be deemed as an "illegal tax". In fact, he equates the effort to use corporate resources for purely altruistic purposes to socialism.

However, organizational legitimacy does not arise from merely making a profit and abiding to legal requirements. Lindblom (1983) defines organizational

legitimacy as "a condition or status which exists when an entity's value system is congruent with the value system of the larger social system of which the entity is a part. When a disparity, actual or potential, exists between the two value systems, there is a threat to the entity's legitimacy."

A social contract is a phenomenon that envelopes the whole legitimacy process. (Deegan, 2002; Khor, 2004; Wartick and Cochran, 1985) According to Godfrey, Hodgson, Holmes and Tarca (2006) the social contract aims to explain the boundaries of acceptable interaction within the society. Donaldson (1982) shares similar belief that corporate management, via its social contract with other stakeholders within the community, aims to perform socially desirable actions, which become CSR activities, in return for acceptance of their entity's objectives, and hence gain organizational legitimacy. Thus, management actions are guided by social expectations of their performance. Deegan and Rankin (1996) state that a breach of social contract, ie. failure to comply with societal expectations may lead to a revocation of contract. As a result, a corporation will cease to trade profitably, lose its customers, destroy its shareholders' wealth, or may even cease to exist eventually. For example, the Enron debacle not only brought the collapse of the corporation, it also led to the demise of the once globally reputable accounting firm Arthur Anderson. (Weiss, 2006)

#### 3.2 Stakeholder Theory and Resource Dependent Theory

The stakeholder theory is a theory assessing the role of actors in the firm's environment. Freeman (1984) defines a stakeholder as "any group or individual who can affect or is affected by the achievement of an organization's objectives." He argues that stakeholder management is central to putting any conception of CSR into practice. Stakeholder management directs management to pursue outcomes that optimize the results for all involved stakeholders rather than maximizing the results for one stakeholder group (ie. shareholders). The firm's management must therefore strive to put organizational resources to their most economically productive use and establish proper control systems to ensure that this occurs, or face eventual dismissal. (Jones, 2005) For example, Nike's contract factories in Indonesia were alleged to have abused the labour force; as a result, it suffered damages to its corporate reputation, brand value and of course a drastic fall in its shareholders' value. (<http://en.wikipedia.org/wiki/Sweatshop/>, access on April 2007)) Another example would be the case of Bougainville copper and gold mine in the late 1980s operated by Bougainville Copper Ltd, where non-satisfactory environmental and community relationships management

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<sup>1</sup> In 2006, Ford Malaysia did also appear among the UN Global Compact participants in Malaysia. In 2007, a new Malaysian service company has entered the list, Shah Educational Systems Sdn Bhd.

eventually led to the closure of the world's biggest open cast mines then. (Riar, 2006)

According to Lee (2003), the resource-dependence theory can be used to explain why corporations consider stakeholders' interests or norms and try to respond to them by using CSR activities. Resource-dependence theory states that an organization needs to reply to the demand of those in its environment that provide resources necessary for its continued survival. Thus, the ability of stakeholder communities to withdraw the organizational resources gives them power over the organization. Stakeholder communities can use their own power to advocate responsible corporate behaviour; and corporations respond to stakeholders through CSR activities.

### **3.3 Agency Theory and Global Value Chain Theory**

The environment of business in the new millennium has become extremely complicated, competitive and turbulent. With the increasing societal pressure, the lead firms are increasingly held responsible for the conditions under which their products are being produced. Keesing and Lall (1992) argue that producers in developing countries are expected to meet requirements that frequently do not apply to their domestic markets. This may create a gap between the capabilities required for the domestic market and those required for the export market, which raises the degree of monitoring and control required by the lead firms. As a result, the lead firms adopt the concept of CSR by introducing codes of conduct, which is a set of written principles, guidelines or standards that are expected to ensure socially responsible business practices throughout the global value chain. These codes often go well beyond the boundaries of the individual organization and include social and environmental requirements for suppliers. (Jenkins, 2005)

In order to successfully implement these codes, active commitment from all parties in the global value chain is required. However, the incentive to comply with the codes does not necessarily extend to all the actors in the chain. Moreover, it is difficult to enforce because the companies involved are separated geographically, economically, legally, culturally and politically. (Pedersen, 2004)

The lead firm-contracting firm relationship can be further understood by examining the principal-agent relationship. Agency theory assumes that individuals are self-interest creatures. In order to avoid opportunism, it is necessary to provide the agent with incentives to act in accordance with the principal's interests. This can be done either by monitoring behaviour or rewarding outcomes. Specifically, the lead firm secures compliance with the OO cum CSR contract through monitoring and sanction against

non-compliance (opportunism). Opportunism in relation to codes of conduct and other CSR standards becomes relevant due to the fact that these initiatives can be costly and time consuming (Godfrey, Hodgson, Holmes and Tarca, 2006).

Opportunisms can easily be dealt with if the codes of conduct include all contingencies. However, most codes of conduct are incomplete, lack of efficient monitoring systems, lofty intent and purpose without specific content. Therefore, the potential conflict of interest between the companies and the incomplete nature of codes of conduct makes it relevant for the initiator of the codes of conduct (ie. the lead firm) to safeguard from non-compliance on part of its contractor. Safeguards, or protective mechanisms, are basically means to ensure that an agent fulfils his or her obligations according to the agreement (Koch, 1995). Pedersen (2004) discusses six safeguards for securing compliance with codes of conduct in global supply chains which all apply to OO cum CSR activities in global value chains (GVC): Direct sanctions; goal congruence; third party intervention; trust; and reputation effects. In a similar way Gereffi, Humphrey and Sturgeon (2005) contend that network actors can control opportunism through the effect of repeated transactions, reputation and social norms that are embedded in a particular geographical locations or social groups.

### **3.4 Integrated Theoretical Perspective on CSR Practices of Business in Developing Countries**

OO and CSR are not entirely new phenomena in international business, but they attracted increasing public scrutiny and debate in the global North during the 1990s and early 21st century in the wake of rapid economic globalisation, offshoring of jobs on a massive scale, disclosure of corporate financial scandals and breach of international labour and environmental standards.

With the expansion of global value chain (GVC), leading corporations with global activities increasingly engaged developing country firms in non-equity based business transactions while disintegrating and focusing their vertically integrated corporate structures around their core competencies and activities. Concomitantly, the thresholds for accessing global value chains have been increasing as indicated by the rise of international quality standards and certification requirements instigated by corporate chain leaders, while GVCs simultaneously turned out to be or changed into bi-polar or multi-polar driven chains (Gibbon & Ponte 2005; Wad 2008). Finally, the lead firms in the North have increasingly engaged in developing and implementing governance forms and safeguards, in order to enhance cost-reduction, quality improvement and reliable delivery, and also to prevent opportunism and non-

compliance of contract agreements among OO contracting firms in developing countries. In sum, agency theory can be seen as part of the wider GVC perspective, while the weaknesses of GVC theory in institutional matters are remedied by adding legitimacy theory and stakeholder theory

#### **4. METHODOLOGY**

The literature review on the CSR discourse in Malaysia and CSR-oriented social research disclose that a CSR agenda is emerging especially after the East Asian financial crisis, and that the government and government linked institutions and corporations seemed to promote the CSR agenda (Teoh and Thong, 1986; Abdul Rashid and Ibrahim, 2002; Tay, 2006; Zulkifli & Amran, 2006). Even international surveys have been undertaken based on investigation of corporate websites (Chapple & Moon 2005) or written policies of large corporations (Welford 2005). However, few case studies have been conducted, and they were directed toward foreign TNCs like Swedish SKF with manufacturing operations in Malaysia (Johansson, E. & Larsson, P. 2000). No published case-oriented field study of Malaysian companies has been identified. Hence, an explorative type of a multiple case study within the manufacturing sector was applied before the present survey was conducted. (Wad & Chong, 2007)

The study is focused on manufacturing firms in the electrical and electronics (E&E) industry located in and around the states of Selangor, Melaka, Negeri Sembilan, Perak, Johor and Penang. The E&E industry is the largest contributor to output, exports and employments opportunities in Malaysia, and thus the most suitable industry to carry out the study. Based on Malaysian Industrial Development Authority (MIDA)'s records, there are 1,385 companies in operation with investments of RM72.2 billion, and employment of more than 548,000 persons or 8.3% of total employment in the manufacturing sector. (<http://www.mida.gov.my/>, access on: June 2007) In 2005, Malaysia's exports of E&E products worth RM264.7 billion which accounted for 64.1 per cent of Malaysia's total exports of manufactured goods. In addition, Malaysia is a major destination for outsourcing after China and India. It is also one of the world's largest exporters of semiconductor devices, electrical goods and appliances. (Economic Report, 2005/2006)

##### **4.1 The Survey 2007**

A sampled set of seventy (70) E&E manufacturing firms (approximately five percent (5%) of the total E&E firms in operation) has been taken from the Federation of Malaysian Manufacturers (FMM) Directory for 2007.

These sample firms comprise of twenty-nine (29) foreign owned firms, twelve (12) locally owned firms and twenty-nine (29) joint venture firms. Only firms with more than 100 employees and export their products to developed countries (as per the FMM Directory) have been selected for this study. Purpose sampling (Eisenhardt, 1989; Patton, 2002) was employed whereby firms with ISO/OHSAS certifications were chosen, as they were deemed to be information-rich cases that would provide us a better understanding of the linkage between CSR and OO. Between one to three interviews has been undertaken with each company and often with the person in charge of CSR or higher executive position. Additional data were provided (company reports, booklets etc) by the respondents or retrieved from company web pages, press reports etc. No factory visit was carried out in any case.

In addition, several interviews were made with representatives from Malaysian institutions and organisations which appeared to relate to the emerging CSR agenda, e.g. the Security Commission (SC), the Kuala Lumpur Stock Exchange/Bursa Malaysia (BM) and the ACCA organisation. Also, interviews were undertaken with the Centre for Environment, Technology and Development Malaysia (CETDEM) and the Malaysian Trades Union Congress (MTUC).

##### **4.2 Analytical Framework**

Based on the literature review and the integrated theoretical perspective of agency theory, GVC theory and stakeholder theory the study hypothesises three hypotheses: Firstly, the relationship between CSR practices and the degree of foreign sub(contracting) is expected to be positive. Secondly, other features of the OO relationship like firm size, foreign ownership and profitability will positively influence the CSR practices of the contracting firm while firm leverage will affect CSR practices negatively. Thirdly, the local regulatory environment neither influence the contracting firm's compliance with the codes of conduct nor support the upgrading of the contracting firm's CSR agenda.

For the purpose of this study, the focus will be on contracting companies in the OO relationship. It is also important to note that the study does not undertake an investigation of transaction relationships between the business parties. This means that the lead firm does not appear with capability and strategy in its own right. Instead it appears only as the driver of competitive principles (such as cost, quality and niche) as perceived by the contracting firms.

##### **4.3 Empirical Model**

The approach to the analysis of the OO-CSR nexus of Malaysian firms is to developed a data matrix comprising of the profiles of the companies, their CSR conceptions, implementation of quality standards, institutional support and their CSR organisation, activities and performance (upgrading) and relate these factors to the CSR capability as perceived by the Malaysian firms

#### 4.3.1 Specification of Dependent Variable

##### The degree of CSR practices

The operationalisation of the CSR practices is focused on three issue areas, namely occupational health and safety, environmental sustainability and labour practices. Content analysis is used as the technique for measuring CSR practices for this study. Content analysis is a technique whereby qualitative information is codified into categories in order to derive quantitative scales of varying levels of complexity. Information is commonly gathered from annual reports, company websites, surveys, interviews, personnel handbook and media sources. (Abbot and Monsen, 1979; Cochran & Wood, 1984; Bowman & Haire, 1975)

The biggest challenge has been to determine the proxies for each of these three issue areas. Apart from using international standards such as OHSAS 18001 and ISO 14001 and other codes of conduct such as the Electronics Industry Codes of Conduct (EICC), it is also important to take into consideration the contracting firms' voluntary initiatives, their demand on the suppliers to address CSR issues and their future plans to improve the firms' CSR profile, organisation and routine because these proxies reflect the actions and decision making of the firms pertaining to CSR practices. A dichotomous procedure was applied whereby a sample firm was awarded a score of one if a proxy was disclosed and a score of zero if it was not disclosed. (Mohd. Ghazali, 2007)

#### 4.3.2 Specification of Independent Variables

##### The level of OO activities

The level of OO was measured based on the average percentage of annual foreign contract or subcontracting deliveries over the total company sales turnover for the financial year ended 2007.

##### Firms' attributes

Previous studies have been carried out to examine the relationship between the CSR practices/disclosures and firms' attributes such as size, ownership, profitability and leverage. (Trotman and Bradley, 1981; Hackston and Milne, 1996; Mohamed Zain, 1999; Mohamad and Ahmad, 200; Mohamed Zain and Janggu, 2006) The results were

mixed. To the best of the researcher's knowledge, there is no prior academic research in Malaysia studying the significance of firms' attributes on the CSR practices of E&E firms that engaged in OO activities. Thus, for the present study, the following firms' attributes were measured and examined:

- Firm size (SIZE) - Most of the past studies on CSR measured company size by using indicators such as the firm's assets, paid up share capital, profitability and turnover on CSR. (Spicer, 1978; Watts and Zimmerman, 1978; Cowen, Ferreri & Parker, 1987; Mohamad and Admad, 2001; Mohamed Zain and Janggu, 2006). In view that the present study is examining labour and environmental related issue areas, it would be appropriate to measure firm size by the number of employees. Hence, SIZE was measured as:  
SIZE = actual employment of sampled firms in 2007
- Foreign ownership (OWN) – Foreign ownership is the extent in which the firm's equities are being owned by foreigners. For the present study, foreign ownership was estimated as follows:  
OWN = foreign equity/total equity
- Profitability (PROF) – Profitability as used in this study refers to:  
PROF = average return on asset (ROA) for the period 2003 to 2007 (5 years) as extracted from the annual reports
- Leverage (LEV) - Financial leverage is about the availability of cash flow to meet contractual obligations. Leverage was measured as follows:  
LEV = average total debt to total assets (D/A) for the period 2003 to 2005 (5 years) as extracted from the annual reports.

#### 4.3.3 Data Analysis

Correlation coefficient analysis (CCA) and Ordinary Least Square (OLS) regression analysis were used to test the hypothesis that the relationship between CSR practices and the degree of foreign sub(contracting) is expected to be positive. The OLS model used is as follows:

$$CSR = \alpha_0 + \beta_1 OO + \beta_2 SIZE + \beta_3 OWN + \beta_4 PROF + \beta_5 LEV + \mu$$

Notes:

CSR = the degree of CSR practices; OO = the percentage of foreign(sub)contracting over total turnover; SIZE = the number of employees; OWN = the percentage of foreign ownership of the sample firms; PROF = mean ROA from financial period 2003 to 2007; LEV = mean D/A from financial period 2003 to 2007;  $\alpha_0$  = intercept;  $\beta$  = regression coefficients;  $\mu$  = the stochastic error term.

Before the results of the analysis were discussed, the



assumptions of CCA and OLS regression analysis were first investigated. The normality, linearity and homoscedasticity assumptions were determined based on the analysis of residuals, histogram, scatterplot of the standardized residuals against predicted values and the normal P-P Plot. The tolerance and variance-inflation factors were computed to detect for multicollinearity problem. No violation of the assumptions was found.

## 5. ANALYSIS OF THE INTERPLAY BETWEEN OO AND CSR AMONG E&E FIRMS IN MALAYSIA

### 5.1 General Findings

Table 5.1(a) shows the distribution of CSR practices for the seventy sample firms:

**Table 5.1(a) Distribution of CSR practices among the sample firms**

Issue Areas	Proxies	No. of Firms that Achieve/Adopt	Percentage based on 70 Firms
Occupational health and safety	International standards/directives: * OHSAS 18001 * Other standards and directives	20 1	29% 1%
	Voluntary initiatives	10	14%
	Demand on suppliers	2	3%
	Future plans	11	16%
Environmental Sustainability			
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