

RELATIONSHIP BETWEEN BOARD INDEPENDENCE AND CSR SPENDING OF ISLAMIC BANKS IN BANGLADESH

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ABSTRACT

This study examines the relationship between board independence and CSR expenditures on education, health and human and disaster relief for the case of Islamic banks in Bangladesh, using unbalanced panel data from 2010 to 2020, the results indicate that board independence is positively and significantly associated with CSR expenditures on education and human and disaster relief sectors but is insignificantly related to the CSR expenditure on health. Thus, in forming the governance framework of Islamic banks, there is a need to have board independence to promote the social responsibility of Islamic banks. Indeed, our results suggest that it should be a regulatory requirement.

Keywords: CSR expenditures, Board independence, Islamic banks, COVID-19 pandemic, Bangladesh.

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I. INTRODUCTION

1.1. Background

Corporate social responsibility (CSR) has attracted a great deal of attention from policymakers, academics and researchers, driven in great part by increasing public awareness of firms' responsibility to society and the environment (Dusuki, 2008). It has been well acknowledged that firms can support society and the environment through corporate philanthropic activities (Giacomini et al., 2021) and in the process these activities would bring benefits to the firms, among them include enhancing shareholders' wealth by increasing the value of an enterprise and building their reputation or prestige (Ryu, Chae & Song, 2021). In the literature, many studies have been conducted on identifying factors that lead firms to engage in CSR. While there are many factors that have been identified, board independence has been at the center of empirical attention.

Principally, board independence is the proportion of independent directors in the board of directors. They are appointed by a firm to advise and supervise the firm's managerial decisions (Pham & Tran, 2019). According to Yekini et al. (2015), independent directors discharge essential functions in the company because they can offer valuable information and experience that can enhance the contributions of business entities to societal development and maintain good relationships with various groups in the community. Also, being independent, they are in better position in safeguarding the firms from wrongdoings and in advising on information to be disclosed to ensure the protection of the interests of all stakeholders (Rashid & Hossain, 2021). In other words, board independence alleviates conflicts of interest in the organization.

While a large number of empirical studies have been carried out, the relationship between board independence and CSR activities is yet firmly established (Jizi et al., 2014; Isa & Muhammad, 2015; Yekini et al., 2015; Issa, 2018; Jizi, 2017; Naseem et al., 2017; Bansal et al., 2018; Al Fadli et al., 2020; Alipour et al., 2019; Pucheta-Martínez & Gallego-Álvarez, 2019; Pham & Tran, 2019; Chijoke-Mgbame et al., 2020; Cui et al., 2020; Khaireddine et al., 2020; Rashid & Hossain, 2021). In most existing studies, a key limitation is the measurement of CSR. That is, it is based on a checklist comprising items expected to be disclosed in the annual reports, say 100 or 65 items. They apply a dichotomous method whereby "1" is awarded if an item is disclosed and "0" if not disclosed. Umar & Musa (2021) argue that the major limitation of the approach is that it gives little or no consideration to the expenditure by firms on the welfare of the poor and the needy. They add that a company could be found to have adequately disclosed its CSR activities but incur little or no CSR expenditures to assist the underprivileged. Arguably, the amount of expenditure by firms on CSR would be more relevant as it would have a direct impact on the poor and the needy and thereby contributing to poverty alleviation and attainments of the Sustainable Development Goals (SDGs). This is of particular importance to countries with high poverty rates such as Bangladesh.

It is against the above background that this study examines the empirical relationship between board independence and CSR expenditures for the case of Bangladesh. In the analysis, we focus on Islamic banks. Many Muslim countries have witnessed fast-growing Islamic banking sector and Bangladesh is no exception. Historically, the banking sector of Bangladesh has been actively

engaged in benevolent activities in the form of donations to various charitable organizations, poor people and religious institutions, among others (Ullah & Rahman, 2015). The CSR policies and guidelines of banks in Bangladesh provide details and explanations about CSR administrative setup, CSR budgets, CSR activities to cover and end-use monitoring procedure of CSR expenditures and activities (Bangladesh Bank, 2015; 2020).

Islamic banks are established to assist people irrespective of their status or personal characteristics (Al Rahahleh et al., 2019). In other words, Islamic banks have moral obligations to discharge social responsibilities to assist the poor and the needy. Wan Jusoh & Ibrahim (2016) note the followings. First, Islamic banks are endeavored to ensure a just, fair and balanced society as envisaged by the principles of Islamic economics. Second, Islamic banks are established based on the concept of brotherhood and cooperation that strongly encourage profit and loss sharing. Therefore, Islamic banks are expected to continuously commit to discharging CSR activities whether their financial performance improves or otherwise (Umar & Musa, 2021). Accordingly, as far as Islamic banking is concerned, it is crucial to assess whether board independence can aid Islamic banks in fulfilling their promises in upholding fairness and establishing a sharing society.

Our contribution to the literature is threefold. First, while existing studies rely on the CSR disclosure index constructed from checklists of mostly non-financial items, this study employs the CSR spending instead. We believe that this is a better way in looking at how firms can uplift the welfare of the poor and the needy. Second, in addition to aggregate CSR expenditures, we also examine how board independence affects key sub-categories of CSR spending, namely, education, health and human and disaster relief. And finally, our study contributes to the literature on Islamic banking in general. In the literature, much attention has been given assessing Islamic banking performance such as risk, stability, profitability, financing and others. Very limited attention has been on Islamic banks' CSR performance. Then, from the governance perspective, the focus has predominantly been on Shariah governance. Thus, we bring in the fore the role of board independence in affecting CSR performance of Islamic banks.

The rest part of the paper is arranged as follows. Section 2 provides background and reviews the relevant literature. Section 3 explains the research methodology used. Section 4 deals with the results and analysis. Finally, section 5 concludes the paper.

II. BACKGROUND AND LITERATURE REVIEW

This section provides first the background related to CSR regulations in Bangladesh. Then, it reviews the literature and present hypotheses to be tested.

2.1. CSR Regulations in Bangladesh

In Bangladesh, the financial sector has actively engaged in community services and development, focusing on both one-off emergency human and disaster relief and continuous initiatives to assist the weaker and underprivileged in the country on various issues like healthcare, training and education (Rahman & Rahman

2017). The actual banking practices for social protection in Bangladesh began in the 1990s (Ullah & Rahman, 2015). Various regulations promote CSR practices in the Bangladeshi financial sector. The first CSR regulations were issued by the Bangladesh Central (Bangladesh Bank) for compliance by both banks and non-financial institutions. Bangladesh Bank (2015) describes the CSR regulations as follows:

In 2008, Bangladesh Bank initiated the mainstreaming of CSR campaigns in the financial sector of Bangladesh. This initiative has inspired increasing depth and diversity of CSR engagements of banks and NBFIs, both in direct budgetary expenditure and financial inclusion drives, in the greening of their internal practices and processes and lending to environmentally benign projects. These increasing levels of financial involvement in CSR engagements have raised concerns about proper end-use monitoring (pp.7).

The former Bangladesh Bank Governor, Atiur Rahman, stated that because of CSR regulations, the CSR expenditures by commercial banks increased 5.5 times from Tk 554m in 2009 to more than Tk 3bn in 2012 (Dhaka Tribune, 2013). Besides, more CSR regulations for firms to increase their CSR expenditures were issued. Ullah & Rahman (2015) provide them as follows:

- On July 1, 2010, the Government of Bangladesh, under the SRO No. 270-Ain/2010, itemized 22 areas of CSR activities that enable firms to enjoy a 10% tax rebate.
- In December 2010, the Bangladesh Bank directed all the banks to set up independent CSR desks to primarily concentrate on the CSR activities provided in the government regulations.
- In 2011, the National Board of Revenue (NBR) of Bangladesh released a statutory regulatory order (SRO) that exempts CSR spending of corporate bodies.

Moreover, on December 22, 2014, the central bank released guidelines to all financial institutions that provide administrative setup, budgetary allocations, targeted CSR activities and end-use processes to monitor the country's CSR expenditures and activities (Bangladesh Bank, 2015). These guidelines are provided to ensure all CSR activities and spending are carefully monitored to ensure the ultimate goals set by the central bank are efficiently and effectively achieved.

Against the backdrop of the COVID-19 pandemic, the Bangladesh Bank released additional guidelines to ensure that financial institutions contribute significantly towards curtailing its adverse consequences. Dhaka Tribune (2021) reports the directives given by the Central Bank of Bangladesh to ensure the efficiency and effectiveness of their CSR practices as follows:

- The Bangladesh Bank directed all banks to increase their CSR budgets for 2021 by 1% of the net profit earned in 2020 to increase their CSR expenditures to raise more funds to deal with the second wave of the COVID-19 pandemic.
- The Bangladesh Bank required the banks to prioritize the provision of essential food items, health care items and assisting unemployed people in preparing their CSR budgets.
- To ensure CSR activities of the banks are not centralized or restricted to a particular area, 50% of the total CSR budgets should be allocated to the city corporation areas and the remainder to be allocated to a union, Upazila and district levels.

- Banks should collaborate with the concerned deputy commissioner, non-governmental organizations (NGOs), and micro-finance institutions (MFIs) to effectively carry out their CSR activities.
- The Association of Bankers Bangladesh (ABB) should coordinate and facilitate the proper implementation of CSR activities on time.
- Banks should submit reports to the Central Bank's Sustainable Finance Department in Bangladesh showing the completed CSR activities in July 2021.

Apart from the CSR expenditures, the CSR activities of banks in Bangladesh involve campaigns to improve the level of financial inclusion by serving underserved rural and urban people with financial services together with the provision of fruitful agricultural and non-agricultural micro, small and medium enterprises (MSMEs) (Rahman & Rahman 2017). Briefly, it is understandable that there are many effective CSR regulations, particularly in the financial sector, that assist and support less-privileged people in Bangladesh. Discharging CSR activities has become necessary for each company in Bangladesh, especially banks (Ahmed, 2017). The regulations were found to have positively impacted the nature and extent of CSR disclosure in the banks' annual reports. Accordingly, people in Bangladesh have become more aware of Islamic banks' CSR activities than their conventional counterparts, as the former provides more services up to their expectations when compared to the latter (Ali & Rahman, 2015).

2.2. Literature Review

The relation between board independence and CSR activities has its theoretical basis in the agency theory, stakeholder theory and legitimacy theory (Wan Jusoh & Ibrahim, 2016; Amran et al., 2017; Rashid & Hossain, 2021; and Umar et al., 2022).

According to the agency theory, a board with a higher proportion of independent directors is likely to monitor the CEOs more effectively and minimize incentives to pursue their personal interests, leading to improvement in performance (Alipour et al., 2019). The stakeholder theory also posits that different information should be disclosed to all stakeholders (Rashid & Hossain, 2021) who expect companies to report their CSR activities to minimize information asymmetries and assess the extent to which firms engage in CSR activities (Pucheta-Martínez & Gallego-Álvarez, 2019). A study by Liao et al. (2015) applies the stakeholder theory and establishes that a board characterized by diversified and independent members as well as an environmental committee, could achieve both financial and non-financial goals with limited resources and reduce the possible conflicting expectations among stakeholders who have diverse interests. Moreover, the stakeholder theory confirms that independent directors are expected to continue supporting CSR disclosure because it is beneficial to a wide range of interest groups (Rashid & Hossain, 2021). According to Fernández-Gago et al. (2018), the more the board of directors is independent, the higher the quality of information to disclose, which is expected to guide stakeholders in decision-making. Finally, the legitimacy theory explains the effect of directors' attributes on CSR disclosure by Islamic banks (Bukair & Rahman, 2015). Al Fadli et al. (2020) believe that independent directors on the board could motivate firms to disclose more CSR information to legitimize their operations to meet the expectations of various stakeholders. Moreover, disclosing

CSR activities in the annual reports becomes a way of legitimizing the activities of firms (Chijoke-Mgbame et al., 2020). In light of these theories, the presence of a high number of independent directors on the boards who are detached from CEOs is expected to strongly pressure CEOs to disclose CSR information, ensure successful implementation of shareholders' vote for disclosing CSR and provide a better way of enforcing self-regulation (Pham & Tran, 2019). Fernández-Gago et al. (2018) find an independent director with a political background and diverse education to significantly and positively influence CSR reporting based on the Global Reporting Initiative standards. An independent director can connect firms with external communities by promoting companies' participation in CSR activities (Rashid, 2021). Therefore, board independence is an essential board attribute that is believed to influence CSR reporting.

Empirically, the findings on the board independence – CSR nexus remain mixed. Jizi et al. (2014) utilize a sample of large commercial banks in the US to analyze the association between corporate governance and CSR disclosure. The study reveals that board independence has a significant positive relationship with CSR reporting. Liao et al. (2015) investigate the impact of board attributes on the voluntary disclosure of greenhouse gas (GHG) emissions by utilizing a sample of the 329 largest firms in the UK. The study establishes that a board with a higher proportion of independent directors tends to disclose more ecological information. Yekini et al. (2015) use a panel dataset from UK FTSE350 to evaluate the effect of board independence on community activities disclosure. The result indicates that board independence has a significant positive relationship with the quality of information disclosure for community activities. Jizi (2017) collects a sample of FTSE 350 firms from 2007 to 2012 to evaluate the impact of board composition on firm sustainable development reporting and the result shows that an increase in board independence tends to facilitate the conveyance of a firm's good corporate citizenship image through societal conscience. In France, Khairreddine et al. (2020) examine the effects of board attributes on governance, environmental and ethics disclosure by using a sample of 82 firms listed in the SBF 120 index (French stock exchange companies) over six years (2012-2017). The study find that board independence has a significant positive association with governance, environmental and ethics disclosures.

There are also empirical studies conducted for developing countries. For example, Isa & Muhammad (2015) examine the relationship between board attributes and CSR disclosure of the listed food products in Nigeria from 2005 to 2014. The result reveals that board independence has an insignificant relationship with CSR disclosure. Similarly, Rashid (2021) collects 707 firm-year observations to evaluate the association between board independence and CSR reporting in Bangladesh. The study establishes an insignificant effect of board independence on CSR disclosure. Conversely, another Nigerian study is conducted by Chijoke-Mgbame et al. (2020). They utilize 841 firm-year observations to check whether corporate governance can moderate the relationship between CSR disclosure and firm performance in Nigeria over ten years (2007-2016). A key finding of the study shows that board independence has significantly and positively moderated the effect of CSR disclosure on firm performance. A very relevant study was undertaken by Akhter & Kabir (2018), who investigate the impact of corporate

governance on the CSR expenditure of banks in Bangladesh between 2012 and 2016. A key finding establishes a significant positive relationship between board independence and CSR expenditure.

Similarly, Jahid et al. (2020) assess the relationship between board attributes and CSR disclosure of 30 listed public banks in Bangladesh between 2013 and 2018. The results suggest a significant positive association between board independence and CSR disclosure. In Pakistan, Naseem et al (2017) analyze the association between corporate governance attributes and CSR reporting of a sample of 179 listed firms between 2009 and 2015. The study reveals a significant positive association between board independence and CSR reporting. Al Fadli et al. (2020) explore how board independence influenced the CSR disclosure of the non-financial listed firms in Jordan between 2006 and 2015. The result indicates that independent directors on the board have strongly and positively impacted firm CSR disclosure. Rashid & Hossain (2021) also establish a significant positive relationship between board independence and CSR disclosure of listed banks in Bangladesh between 2013 and 2018.

Some studies cover many countries to establish the impact of board independence on CSR disclosure as one of their objectives. For instance, Pham & Tran (2019) compile a panel dataset of 244 Fortune World's Most Admired (FWMA) firms between 2005 and 2011, comprising 117 one-tier and 127 two-tier board models selected from 20 countries. The results, among others, reveal that board independence has a significant positive relationship with CSR reporting of two-tier board MNCs but is insignificant in the case of one-tier board MNCs. Cui et al. (2020) use a dataset of 151 multinational corporations (MNCs) based in China, Japan, the UK, and the USA and establish that board independence has significantly and positively influenced environmental disclosure. In contrast, Pucheta-Martínez & Gallego-Álvarez (2019) investigate the relationship between board characteristics and CSR reporting by utilizing 13,178 firm observations from 39 countries. The study establishes that board independence has a significant negative association with CSR reporting. Issa (2018) explores the determinants of CSR disclosure in the Kingdom of Saudi Arabia. A key relevant finding indicates a significant but negative relationship between board independence and firm CSR reporting.

Bansal et al. (2018) evaluate the relationship between board independence and CSR disclosure and whether such a relationship can be moderated by family ownership by drawing a sample of companies from 29 countries between 2006 and 2014. The study establishes a significant negative relationship between the presence of independent directors and CSR disclosure. However, family ownership is found to have a moderating effect of turning the relationship into a significant positive. Some studies show the ability of the board's independence to moderate the other relationship favorably. For example, Alipour et al. (2019) use a sample of 120 Iranian companies from 2011 to 2016 to establish whether board independence can moderate the relationship between environmental disclosure quality and firm performance. The result reveals that board independence has significantly strengthened the positive impact of environmental disclosure on firm performance.

Based on the above theories and empirical results, board independence can significantly and positively influence firm CSR reporting. Therefore, it is an essential board attribute that promotes CSR activities. Hence, the following hypotheses have been proposed to examine the effects of board independence on sector-wise CSR expenditures of Islamic banks in Bangladesh:

H1. *Ceteris paribus*, board independence is significantly and positively associated with CSR expenditure on education.

H2 *Ceteris paribus*, board independence is significantly and positively associated with CSR expenditure on health.

H3. *Ceteris paribus*, *Ceteris paribus*, board independence is significantly and positively associated with CSR expenditure on human and disaster relief.

III. METHODOLOGY

3.1. Data

The data are from the annual reports of eight (8) Islamic banks comprising six (6) fully Shari'ah-compliant Islamic banks and two (2) conventional banks that provide Islamic financial products with Shari'ah supervisory committees in Bangladesh. Only banks that report their CSR expenditures sector-wise and disclose them in their annual reports are considered. The Bangladesh Bank (Central Bank of Bangladesh) mandates all banks in the country to discharge CSR activities on a sector-wise basis and report them in their annual reports. Unbalance panel data are compiled from their annual reports over eleven years (2010-2020). The sectors include human and disaster relief, education, health, sports, arts, literature and culture, environment and others (Umar & Musa, 2021). However, this study considers only education, health and human and disaster relief sectors as they are the most important and relevant sectors that can contribute to the welfare of the poor and the needy under challenging times.

3.2. Variables and their Measurements

The dependent variables are CSR expenditures incurred for education, health and human and disaster relief sectors. The independent variable is the board independence and control variables are Shari'ah-supervisory committee meeting (SSBM), return on asset (ROA), size, leverage and the ratio of fixed assets to total assets. The measurements of the variables are as follows:

- Dependent variables: Dependent variables are CSR expenditures for education, health and human and disaster relief by the banks. Consistent with earlier studies, they are converted into natural logarithm values (Mokuolu & Oladele, 2018; Saha, 2019; Hosain, 2020).
- Independent variable: The independent variable is the board independence and is measured as the proportion of the independent directors on the board (Liao et al., 2015; Yekini et al., 2015; Cui et al., 2020; Rashid, 2021).
- Control variables: The control variables are as follows:
- Shari'ah supervisory committee meetings (SSCM): This is measured as the total number of meetings held by the Shari'ah supervisory committee (SSC) during the year adapted from a study by Basiruddin & Ahmed (2020) who converted

the number of meetings into natural logarithm.

- Return on assets (ROA): This is the proportion of net-income to total assets (Pucheta-Martínez & Gallego-Álvarez, 2019; Rouf & Hossan, 2021; Al-harbi, 2022).
- Size: Natural logarithm of total assets (Orazalin, 2019; Al-harbi, 2022; Azmat et al., 2020).
- Leverage: Total liabilities divided by total assets (Pucheta-Martínez & Gallego-Álvarez, 2019).
- FATA: fixed assets divided by total assets (Su et al., 2019).

3.3. Econometric Model Specifications

We link expenditures for three (3) CSR sectors, namely education, health and human and disaster relief, which are important to the welfare of underprivileged people, to board independence and controlled variables by the following econometric models:

$$\text{CSRED}_{it} = \beta_0 + \beta_1 \text{BI}_{it} + \beta_2 \text{SSCM}_{it} + \beta_3 \text{ROA}_{it} + \beta_4 \text{SIZE}_{it} + \beta_5 \text{LEV}_{it} + \beta_6 \text{FATA}_{it} + \varepsilon_{it} \quad (1)$$

$$\text{CSREH}_{it} = \beta_0 + \beta_1 \text{BI}_{it} + \beta_2 \text{SSCM}_{it} + \beta_3 \text{ROA}_{it} + \beta_4 \text{SIZE}_{it} + \beta_5 \text{LEV}_{it} + \beta_6 \text{FATA}_{it} + \varepsilon_{it} \quad (2)$$

$$\text{CSRER}_{it} = \beta_0 + \beta_1 \text{BI}_{it} + \beta_2 \text{SSCM}_{it} + \beta_3 \text{ROA}_{it} + \beta_4 \text{SIZE}_{it} + \beta_5 \text{LEV}_{it} + \beta_6 \text{FATA}_{it} + \varepsilon_{it} \quad (3)$$

where all variables are as defined above. We estimate the models using the heteroskedastic panel-corrected standard errors (HPCSE) to establish the relations between CSR expenditures and their determinants.

IV. RESULTS AND ANALYSIS

4.1. Descriptive Statistics and Correlation Matrix

Table 1 shows descriptive statistics of the variables used in the study, namely CSR expenditures for education (CSRED), health (CSREH) and human and disaster relief (CSRER), board independence (BI), Shariáh supervisory committee meetings (SSCM), return on assets (ROA), SIZE, leverage (LEV) and fixed assets to total assets ratio (FATA). It shows that the minimum values of all three CSR sectors are negative. However, this does not mean the banks incurred negative CSR expenditures but happened because the expenditures measured in a million were converted into their natural logarithm values. Consequently, the minimum values of the sectors' expenditures become negative. The human and disaster relief sector has the highest mean value for the expenditure, followed by the education sector and the health sector. This signifies that, on average, the banks prioritize the human and disaster relief sector over the other two.

The average proportion of the number of independent directors on the board is 14.60, with 0% and 30.80% as a minimum and maximum proportions, respectively. This indicates that some banks have no independent directors on their boards while others have up to 30.80%. The minimum value of 0.000 shows that the Shariáh supervisory committees (SSCM) of some Islamic banks in the country held no meetings in some years. Average profitability as measured by ROA is 0.7%, with the highest and lowest values of 2.80% and 0.1%, respectively. The mean value of bank size (measured as the natural logarithm of total assets) is 5.493, which has the lowest and highest values of 4.612 and 6.168, respectively. The average leverage is 0.938. This means that on average the total liabilities of the banks accounted for 93.8% of their total assets, with a minimum value of 91% and a maximum of 96%. The average value of the ratio of fixed assets to total assets (FATA) indicates that fixed assets constituted 0.018 of total assets, which suggests that on average, fixed assets constitute 2% of the banks' total assets, with the lowest value of 0.6% and the highest value of 3.5%.

Table 1 also shows the skewness and kurtosis results indicating the extent to which the variables deviate from the normality assumption. The results indicate the absence of outliers except for LEV. Consequently, lev was winsorized at 5%, which transformed their skewness and kurtosis values to 0.002 and 2.807, respectively.

Table 1.
Descriptive Statistics

Variable	Mean	Std. dev.	Min	Max	Skewness	Kurtosis
CSRED	1.204	0.795	-0.602	3.326	0.086	2.894
CSREH	0.783	0.740	-0.122	2.354	-0.317	3.335
CSRER	1.541	0.683	-0.009	2.811	-0.400	2.757
BI	0.146	0.084	0.000	0.308	-0.266	2.472
SSCM	5.678	6.210	0.000	28.000	1.787	5.869
ROA	0.007	0.004	0.001	0.028	1.712	8.387
SIZE	5.493	0.353	4.612	6.168	0.136	2.645
LEV	0.938	0.017	0.911	0.965	2.871	18.190
FATA	0.018	0.007	0.006	0.035	0.656	2.807

Source: Authors Computation Using Stata Version 16

Table 2.
Correlation Coefficients and VIF

	CSRED	CSREH	CSRER	BI	SSBM	ROA	SIZE	LEV	FATA	VIF
CSRED	1									
CSREH	0.39	1								
CSRER	0.668	0.169	1							
BI	0.392	0.023	0.497	1						1.19
SSCM	0.567	0.4	0.434	0.157	1					1.31
ROA	-0.169	-0.041	-0.062	-0.158	0.263	1				2.65
SIZE	0.441	0.266	0.119	0.094	0.126	-0.552	1			2.18
LEV	0.346	0.055	0.344	0.267	-0.123	-0.693	0.418	1		2.54
FATA	-0.071	0.111	-0.155	-0.291	-0.057	-0.002	0.334	-0.3	1	1.71

Source: Authors Computation Using Stata Version 16

Table 2 shows correlations among variables used in the study. The values of most coefficients indicate negligible correlations where they fall within the range of 0.00 – 0.30. Only a few coefficients show moderate correlations. The correlation coefficients of the impact of board independence (BI) on CSR expenditures for education (CSRED) and human and disaster relief (CSRER) are 0.392 and 0.497, respectively. The results provide preliminary support for the predicted relationships. The VIF presented in the Table, which ranges between 1.19-2.65 suggests that multicollinearity is not an issue in our specification.

4.2. Regression Results

Table 3 shows the regression results for the three models designed to assess the relationship between board independence (BI) and sector-wise CSR expenditures of Islamic banks in Bangladesh using heteroskedastic panels corrected standard errors (HPCSE).

Table 3.
Regression Results Using Heteroskedastic Panels Corrected Standard Errors (HPCSE)

EV	Model 1		Model 2		Model 3	
	DV= CSRED		DV= CSREH		DV= CSRER	
	z	p-value	Z	p-value	z	p-value
BI	2.60	0.009***	-0.42	0.675	3.82	0.000***
SSCM	5.09	0.000***	3.02	0.003***	3.79	0.000***
ROA	0.71	0.476	-0.25	0.804	1.33	0.182
SIZE	2.20	0.028**	0.83	0.407	-1.18	0.238
LEV	2.29	0.022**	0.30	0.761	3.19	0.001***
FATA	0.24	0.807	0.58	0.565	1.43	0.153
CONS	-2.74	0.006	-0.46	0.645	-3.03	0.002
Prob>chi2	0.0000***		0.0233**		0.0000***	
Wald chi2	69.29		14.63		55.33	
R2	0.5873		0.2192		0.5025	
Hausman's test	18.37(p=0.0054)		19.35(p=0.0036)***		32.27 (p=0.0000)***	
Hetero. Test	173.92 (p=0.0000) ****		42.69 (p=0.0000)***		20.12 (p=0.0099)***	

Notes: *p <0.10; **p <0.05; ***p <0.01
 DV means dependent variable
 EV means explanatory variables (independent and control)

Source: Authors Computation Using Stata Version 16

Basic necessary tests are conducted to ensure that the most appropriate regression is selected from pooled OLS, fixed effect and random effects for each model. The Hausman test result for each model is statistically significant at 1%. Hence, the fixed-effect panel regression analysis is superior to the random effect (RE) and pooled OLS estimators. Furthermore, a modified Wald test for group-wise heteroskedasticity in the fixed effect regression model is performed for each model. The result for each model is statistically significant at 1%. Hence, heteroskedastic panels corrected standard errors (HPCSE) are adopted in the analysis.

Model 1 investigates the relationship between board independence (BI) and CSR expenditure on education (CSRED). The Wald chi2 (69.29) and p-value (0.0000) indicate that the model is statistically significant at 1%, indicating that the model is appropriate. The value of R^2 signifies that BI and control variables in the model explain 58.73% of the variation in the CSR education expenditures. The regression result shows that BI has a significant positive association with CSRED. Hence, the finding supports the formulated hypothesis (H1) that independent directors on the boards of Islamic banks in Bangladesh strongly support CSR expenditure for educational activities. The result corresponds with most previous studies, which show a significant positive relationship between board independence and firm CSR reporting (Jizi et al., 2014; Liao et al., 2015; Yekini et al., 2015; Jizi, 2017; Naseem et al., 2017; Al Fadli et al., 2020; Cui et al., 2020; Khairredine et al., 2020). However, it contradicts the findings showing a significant negative association between board independence and CSR disclosure of firms (Issa, 2018; Pucheta-Martínez & Gallego-Álvarez, 2019). In the case of control variables, SSBM, SIZE and LEV have a significant positive association with CSRED at 1%, 5% and 5%, respectively. However, ROA and FATA are found to be insignificant.

Model 2 assesses the impact of board independence (BI) on CSR expenditure on health (CSREH) by Islamic banks in Bangladesh. The finding indicates an insignificant relationship between board independence and CSREH. Hence, the proposed hypothesis (H2) is not supported and therefore states that board independence does support CSR expenditure for the health sector. The finding supports the earlier studies indicating that board independence does not support CSR disclosure of firms (Isa and Muhammad, 2015; Rashid, 2021). In the case of control variables, SSBM has a significant positive relationship with CSREH at a 1% significance level. The remaining control variables, i.e. ROA, SIZE, LEV and FATA, are however insignificantly related to CSREH.

Model 3 investigates the association between board independence (BI) and CSR expenditure for human and disaster relief (CSRER). The finding reveals a significant positive relationship between board independence and CSR expenditure for human and disaster relief (CSRER). Thus, the formulated hypothesis (H3) is supported, meaning that board independence strongly supports CSR expenditure for human and disaster relief. The control variables SSBM and LEV have a significant positive relationship with CSRER. On the other hand, ROA, SIZE and FATA have an insignificant positive relationship with CSRER.

Two key control variables to note are SSCM and ROA. SSCM is the control variable that is found to have significantly and positively influenced the CSR expenditures for all three sectors. This signifies the importance of SSCM to CSR expenditure of Islamic banks, as it is during the meetings, issues of zakat, non-Shari'ah compliant income and dividends are discussed for the socio-economic development of the members of society. In addition, during the SSCM, issues that will encourage Islamic banks to provide additional funds from their Shari'ah-compliant income to discharge more CSR activities might be discussed. Shari'ah supervisory committee plays a vital role in ensuring CSR disclosure by firms to their stakeholders (Rahman & Bukair, 2013). Also, in each model, the insignificant association between ROA and CSR expenditure indicates that profitability is not a factor that influences CSR expenditure. In other words, Islamic banks are expected to incur CSR expenditure even if their profitability does not increase.

4.3. Analysis

The results revealed how independent directors strongly support CSR spending for education and human and disaster relief, indicating that Islamic banks comply with the Shari'ah and the Bangladesh Bank requirements. This is in line with the view that board independence is an important attribute that enhances the level of a firm commitment to CSR practices and disclosure in the annual report. Independent directors are not connected to the company with any commercial or investment relation and therefore, their independence is un-compromisable (Pucheta-Martínez & Gallego-Álvarez, 2019). Besides, the findings of the effects of board independence on CSR expenditures for the education and human and disaster relief sectors prove the arguments of various theories, particularly the stakeholder theory and legitimacy theory, which show the strong support given by independent directors to improve firm CSR initiatives and activities (Liao et al., 2015; Fernández-Gago et al., 2018; Velte, 2019; Bukair & Rahman, 2015; Al Fadli et al., 2020).

Companies that claim to operate based on Islamic law principles are required to discharge CSR activities as it reveals the true spirit of Islam (Dusuki, 2008). Good CSR practices of Islamic banks have already been integrated with their operations, signifying that they concentrate more on religious and philanthropic activities (Wan Jusoh & Ibrahim, 2016). From an Islamic perspective, the underlying reason for organizations to engage in CSR activities is to fulfill their obligations first to Allah (God) and then to stakeholders (Darus et al., 2014). Also, firms are required to discharge CSR activities to promote their socio-economic justice and responsibility to the community. Prior studies like Tarique et al. (2017), Ahmed (2017) and Umar & Musa (2021) suggest that Islamic banks in Bangladesh comply with the guidelines of the Bangladesh Bank with respect to CSR expenditures for the welfare of the poor and the needy. Specifically, Tarique et al. (2017) find Islami Bank Bangladesh Limited (IBBL) to have spent its CSR expenditure in line with maqasid al-Shari'ah by prioritizing necessities. Similarly, Ahmed (2017) discovers that Islamic banks in Bangladesh disclose their CSR expenditures in the annual reports for various sectors, such as education, health, disaster management, sports, arts, literature and culture, environment and human and social welfare, as provided in the guidelines issued by the Bangladesh Bank. Moreover, Umar & Musa (2021) reveal that IBBL did disclose not only the sector-wise CSR expenditures but also the number of beneficiaries.

Generally, Islamic banks are supposed to communicate to the society and other stakeholders about their contributions to the welfare of society by assisting the poor and the needy by disclosing the nature of charitable and social activities sponsored by the bank, the amount spent on such activities and sources of the funds (which may include bank's funds or incomes earned from sources prohibited by the Sharia) (Maali et al., 2006). Islamic banks also strongly support the practice of mutual cooperation, universal brotherhood and social justice (Khan, 2016). Islamic banks, as vicegerents of Allah (SWT), are mandated to remain socially responsible by discharging their activities in such a way to actualize the maqasid al-Shariah to provide maslahah (public goods) (Darus et al., 2014). The creation of a standard and comprehensive Shari'ah-compliant CSR framework would surely contribute to the growth of Islamic banks and the protection of the interest of their stakeholders (Wan Jusoh & Ibrahim, 2015).

Apart from voluntary charitable donations, Islamic banks are mandated to pay zakat and spend unlawful income earned in ways that contravene the provisions of the Shari'ah for societal welfare, especially the poor and the needy. CSRE could play a vital role not only in protecting the environment but also in alleviating poverty or assisting the disaster-prone people because of the COVID-19 pandemic (Hosain, 2020). The fact is that CSR practice is deeply rooted in one of the five pillars of Islam, zakat, which obliges Muslims to give 2.5% of their savings to charity (Mir et al., 2016). One of the functions discharged by the Shari'ah supervisory committee (SSC) of Islamic banks is to compute zakat and ensure all non-Shari'ah-compliant income and dividends are utilized for charitable purposes.

V. CONCLUSION

This study investigates how board independence influences the sector-wise CSR expenditures of Islamic banks in Bangladesh. Three essential CSR sectors, namely education, health and human and disaster relief, which are believed to improve the welfare of the underprivileged persons in the country, are considered. The results indicate that board independence has a significant positive association with CSR expenditures for education and human and disaster relief sectors but an insignificant relationship in the case of the health sector. The support given by independent directors towards incurring CSR expenditures for education and human and disaster relief sectors of Islamic banks for the welfare of the poor and the needy might occur because Islamic banks have various sources of funds that are used to finance CSR activities, such as zakat, non-Shari'ah compliant income and other funds. These findings would be helpful to the board of directors to support CSR expenditures to help less-privileged people, particularly in difficult situations. They could assist the regulatory agencies and policymakers in developing policies that will mandate the appointment of a reasonable number of independent directors to encourage firm CSR expenditures for the benefit of the poor and the needy.

Despite the contribution of our study, it has two key limitations. First, it is restricted to Islamic banks in Bangladesh. Second, it considers only three CSR sectors; education, health and human and disaster relief. Other sectors like environment, social welfare and sport and culture, among others, are omitted in the study. Second, the study considers only the board independence. However, it may be argued that other board characteristics may influence banks' CSR expenditures as well. Thus, future research may extend the analysis of CSR to other countries that have Islamic banks, to include other board characteristics, and to consider CSR expenditures in other sectors.

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