NON-AUDIT SERVICES, BUSINESS PERFORMANCE AND CORPORATE SOCIAL RESPONSIBILITY: THE CASE OF SMALL AND MEDIUM MANUFACTURING COMPANIES IN MALAYSIA

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By

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DEDICATION

To My Father, the late "Mr. Ganesan Muniandy"

&

My Mother Madam Letchime Subramanian Pakiry

and

Family Members

ACKNOWLEDGEMENT

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PERKHIDMATAN BUKAN AUDIT, PRESTASI PERNIAGAAN, TANGGUNGJAWAB SOSIAL KORPORAT: KES SYARIKAT PERKILANGAN KECIL DAN SEDERHANA DI MALAYSIA

ABSTRAK

Menyedari manfaat yang boleh diperolehi daripada amalan Tanggungjawab Sosial Korporat (CSR) di kalangan perniagaan kepada negara, kerajaan telah melaksanakan pelbagai dasar, peraturan dan telah melabur sejumlah besar wang untuk menggalakkan syarikat-syarikat untuk mengamalkan CSR. Walau bagaimanapun, kajian yang lalu menunjukkan bahawa tahap amalan CSR di kalangan syarikat-syarikat Malaysia masih tidak pada tahap yang memuaskan, terutamanya dalam sektor perkilangan. Tambahan pula, terdapat kekurangan penyelidikan CSR dalam konteks Perusahaan Kecil dan Sederhana (PKS), yang membentuk sebahagian besar daripada syarikat-syarikat yang ditubuhkan di seluruh dunia dan memainkan peranan yang penting dalam ekonomi, masyarakat dan alam sekitar. Oleh itu kajian ini dijalankan untuk menghuraikan mengenai isu ini daripada perspektif PKS. Objektif kajian ini adalah untuk (i) mengkaji hubungan antara penggunaan perkhidmatan bukan audit dan prestasi perniagaan, (ii) mengkaji hubungan antara prestasi perniagaan dan amalan CSR, (iii) mengkaji sama ada prestasi perniagaan menjadi pengantara hubungan antara perkhidmatan bukan audit dan amalan CSR dan (iv) mengkaji sama ada pemilikan berperanan sebagai *moderator* hubungan antara prestasi perniagaan dan amalan CSR. Bagi mencapai objektif kajian, 600 borang soal selidik telah dihantar kepada PKS di sektor perkilangan. Sebanyak 126 respons telah digunakan dalam analisis. Dapatan kajian menunjukkan bahawa perkhidmatan bukan audit mempunyai kesan yang signifikan terhadap prestasi perniagaan dan prestasi perniagaan mempunyai kesan yang

ketara terhadap amalan CSR. Kajian ini juga mendapati bahawa prestasi perniagaan menjadi pengantara hubungan di antara perkhidmatan bukan audit dan CSR. Malangnya, pemilikan tidak mempunyai peranan sebagai *moderator* dalam hubungan prestasi perniagaan dengan CSR. Dapatan ini menggambarkan bahawa akauntan luar dapat meningkatkan prestasi perniagaan PKS melalui perkhidmatan bukan audit manakala PKS dalam sektor perkilangan lebih tertumpu kepada dimensi CSR yang berkaitan dengan perniagaan seperti pelanggan, pekerja, pemegang saham dan pembekal. Di samping itu, kajian ini juga mendapati bahawa tiada perbezaan dalam mengamalkan CSR di antara syarikat yang dimiliki oleh keluarga dengan bukan dimiliki oleh keluarga. Penemuan ini dapat menyumbang kepada pengetahuan akademik dalam bentuk bukti empirikal dan ujian teori. Selain itu, kajian ini dapat membantu pihak berkuasa yang berkenaan untuk memahami amalan CSR dan penggunaan perkhidmatan bukan audit di kalangan PKS sektor perkilangan. Ia akan membantu agensi-agensi yang bertanggungjawab merancang program CSR dengan sewajarnya bagi PKS dan mempromosikan penggunaan perkhidmatan bukan audit kepada PKS.

NON-AUDIT SERVICES, BUSINESS PERFORMANCE AND CORPORATE SOCIAL RESPONSIBILITY: THE CASE OF SMALL AND MEDIUM MANUFACTURING COMPANIES IN MALAYSIA

ABSTRACT

Realising the benefits that could be brought from Corporate Social Responsibility (CSR) practice among businesses to the nation, the Malaysian government implemented many policies, regulations and invested a significant amount of money to encourage companies to practice CSR. However, past literature showed that the level of CSR practice amongst Malaysian companies was still not at a satisfactory level, mainly in the manufacturing sector. Furthermore, there was a lack of CSR research in the context of Small and Medium Enterprises (SMEs), which make up a significant portion of companies' establishments around the world and plays an important role on economy, society and environment. Therefore, this study was undertaken to shed some light on the issue from SME's perspective. The objectives of this study were to (i) investigate the relationship between utilisation of non-audit services (NAS) and business performance. (ii) investigate the relationship between business performance and CSR practice. (iii) examine whether business performance mediated the relationship between NAS and CSR practice, and (iv) examining whether ownership moderated the relationship between business performance and CSR practice. To achieve the research objectives, 600 questionnaires were sent to SME manufacturing companies. A total of 126 useable responses were used in the analysis. The research findings indicated that non-audit services have a significant effect on business performance and business performance has a significant effect on CSR. It was also found that business performance mediates the relationship between NAS and CSR.

Unfortunately, ownership does not have moderate role in the relationship business performance and CSR. The finding depicts that the external accountant able to add value to SMEs thought the NAS, meanwhile SMEs in the manufacturing sector were found to be more focused on business-related CSR dimensions, such as customers, employees, shareholders and suppliers. In addition, this study found that there were no differences between family and non-family firms in practicing CSR. The finding will be able to contribute to the knowledge of academic in the form of empirical evidence and theoretical testing. Moreover, this study helps the relevant authorities to understand CSR practices and usage of NAS among SMEs in manufacturing sector. It will help the responsible agencies to plan CSR programs accordingly for SMEs and promoting NAS to SMEs.

CHAPTER 1

INTRODUCTION

1.1   Introduction

This chapter will provide an overview about this study. It begins by discussing the background of this study and the problem statement. Next, the research objectives and research questions will be explained. After that, the significance of this study will be discussed followed by the definitions of key terms used in this study. Finally, the organisation of the remaining chapters of this thesis will be explained.

1.2   Background of the study

There is substantial growth of interest in Corporate Social Responsibility (CSR) in recent years (Gulyás, 2009; Taneja, Taneja, & Gupta, 2011). This topic has not only received attention from academia, but it is becoming a major issue for companies (Renneboog, Ter Horst, & Zhang, 2008) and governments. Even though there is no common definition and term for CSR, there are currently many studies being conducted that are related to CSR. These studies are from various fields of research, such as marketing, human resource management, organisational behaviour, operations and others. (Aguinis & Glavas, 2012).

As highlighted by Golob and Bartlett (2007), CSR is not a new issue. It was discussed since the 1950s and it grew in momentum in the 1970s, then subsided and gained importance again in the 1990s and 2000s. Previous literature claimed that companies should be engaged in CSR practices because any actions or activities of the company will affect not only the company itself, but also the external environment,

which includes business environments, people, communities and the environment where a company resides (Balabanis, Phillips, & Lyall, 1998). The social responsibility of a company is not only for current members of society, but also for the future generation because the decisions or activities of the company will also affect society in the future and the environment. Crowther and Aras (2008) listed some of the effects of business activities, which includes the utilisation of natural resources, creation of employment opportunities for local communities, distribution of wealth, changes in environmental landscape due to waste products' storage as well as the extraction of raw materials, climate change, and emission of gases.

Despite the reasons that were discussed, some firms involved themselves in CSR activities because of instrumental (e.g. expected financial outcomes) and normative reasons (e.g. doing the right thing) (Aguinis & Glavas, 2012; Geva, 2008). The research conducted in Malaysia on SMEs found that they were involved in CSR activities due to values and religious thoughts, their own beliefs that are good things, pressure and encouragement from stakeholders (Nejati & Amran, 2009). In addition, some literature claimed that SMEs actually practices silent or sunken CSR, which refers to practices that are CSR in nature, but they do not realise it is so (Moyeen & Courvisanos, 2012). Moreover, previous research highlighted that firms involved in CSR practices have a certain advantage or benefit compared to firms that do not practice CSR. The benefits stated were a decline in staff turnover, increased customer satisfaction, increased firm reputation (Galbreath, 2010), increased employees' productivity (Geva, 2008), product quality, improved management practices, attractiveness to investors, operational efficiencies, and enhanced demographic diversity (e.g. ethnic minorities and women) (Aguinis & Glavas, 2012).

Because SMEs formed a large proportion of all incorporated companies and generate almost 65% of employment in the world, collectively, SMEs' role in Corporate Social Responsibility (CSR) is important (Hsu & Cheng, 2011; Jamali, Zanhour, & Keshishian, 2009; Lepoutre & Heene, 2006). This is because SMEs that are engaged in CSR are able to contribute to the development of the country (Ciliberti, Pontrandolfo, & Scozzi, 2008; Perrini & Minoja, 2008), society and can assist in preserving the environment. Some researchers argued that SMEs need to be involved in CSR due to their irreplaceable role in local communities (Nejati & Amran, 2009) and contribute around 60% of all carbon dioxide emissions and 70% of all pollution (Parker, Redmond, & Simpson, 2009). In the United Kingdom, the main cause for environmental problems was the manufacturing sector (Williamson, Lynch-Wood, & Ramsay, 2006). Murillo and Lozano (2006) asserted that public attention and government actions to promote CSR stopped focusing exclusively on large companies and begun to concentrate on the majority group of SMEs. This is true in the Malaysian scenario, when a call made by Dato Hafsah Hashim, the chief executive officer of SMEs Corporation Malaysia (SME Corp Malaysia) to all SMEs to embrace CSR initiatives because the sustainability of business depends on a good business ecosystem that includes a healthy and educated workforce, as well as adequate resources and a capable government to enable businesses to compete effectively (Hashim, 2012).

Moreover, CSR practices are essential for SMEs because it brings benefits and sustains their business. Particularly in Malaysia, because the government aims in the SME Masterplan 2012-2020 to bring SMEs to be global players and contribute to the social wellbeing. Malaysian SMEs must practice CSR to achieve the vision of the Masterplan and to sustain their business due to SMEs contributing more than 50% of employment. In addition, the literature on CSR mentioned that those SMEs that are not

ready for CSR may be excluded or disadvantaged in international trade (Lu & Castka, 2009). For example, companies without CSR will experience 'lost opportunity', because there were restrictions that were imposed for tendering for certain projects and services, both locally or internationally for companies that are not engaged in CSR. It is supported by the statement made by the Minister of Finance II, Tan Sri Nor Mohamed Yakcop, '*Given the current dynamism and exponential growth of CSR, in the future, it will no longer serve as an "Order Winner" but will also be the prerequisite "Order Qualifier.*' This statement means that CSR practices will be the precondition for customers to consider doing business with enterprises. He further explains that a good CSR is the key towards ensuring the sustainability of business and Malaysian companies in the years ahead (Yakcop, 2004).

Besides that, previous literature mentioned that in order to become a supplier for MNC or GLC, the SMEs must practice CSR. It was supported by a study conducted by Thompson (2003) that explained that SMEs were suppliers to foreign multinational companies that insisted on ISO 14001 certification to be a prerequisite for doing business with them. Moreover, the GLC Transformation Manual lists out a set of guidelines on how GLCs can contribute to society in a responsible manner and create a positive impact for their business. One of the areas the GLC can contribute is through supplier partnership. GLC must work with business partners and suppliers to adopt socially responsible practices (Bidin, 2008). In Malaysia, most of SMEs in the manufacturing sector produce a component for finished goods (e.g. IC for laptop, headlights for cars). These companies need to practice CSR in order to play a significant role in the global market by being a supplier for big companies.

The CSR research in SMEs is gaining importance in Malaysia because the New Economic Model (NEM) and Vision 2020 needs the support of the SMEs. The NEM consists of three major areas: (i) high income, (ii) sustainability and (iii) inclusiveness, which aims to increase the quality of life of citizens. The practice of CSR is a must for SMEs because the vision and two components of NEM, sustainability and inclusiveness directly relates to CSR. Meanwhile, the CSR is relevant to Vision 2020 due to three out of nine challenges in Vision 2020, which reflect the fundamental principles of social responsibility. They are: (i) a moral and ethical community, (ii) a fully caring culture, and (iii) an economically just society (Amran, Ling, & Yahya, 2007; Najib, 2004). Furthermore, the importance of CSR in SMEs can be seen through the recent organised road show by the Malaysian Institute of Integrity (IIM) and the Company Commission of Malaysia (CCM) to promote awareness of CSR among local small and medium sized companies (Amran, Zain, Sulaiman, Sarker, & Ooi, 2013). It was therefore essential to conduct a study to understand the level of CSR practices in SMEs. Furthermore, the status of CSR practices among Malaysian SMEs was unclear since SMEs were not required by any regulations to report their CSR activities yearly.

Although there is a growing interest in CSR research, the majority of the research were in regards to large companies other than SMEs (Jenkins, 2006; Liu & Fong, 2010; Spence, 2007). There was a lack of studies that were related to CSR in an SME environment (Burton & Goldsby, 2009; Spence, 2007), mainly in developing countries (Jamali, 2008; Liu & Fong, 2010; Luken & Stares, 2005; Morsing & Perrini, 2009). Although there were SMEs that conducted CSR, they remain discreet about their practices (Jenkins, 2006, 2009; Vives, 2006). More research on SMEs is vital because the characteristics or cultural aspects of SMEs are not similar to large companies (Lepoutre & Heene, 2006; Ma, 2012), and therefore, the findings from larger firms do

not necessarily represent the SME environment (Jenkins, 2004; Spence, 2007). For example, SMEs normally have fewer resources, informal organisational structures and their emphasis is on future survival (Parker et al., 2009). Therefore, they are less likely to engage in CSR (Spence, 2007) as compared to larger firms. Previous literature noted that cost was one of the barriers that SMEs are facing to undertake CSR activities (Lepoutre & Heene, 2006; Nejati & Amran, 2012; Sweeney, 2009; Vives, 2006). Research conducted in Malaysia by Nejati and Amran (2012) regarding the perception of the cost/benefit of CSR on 92 SMEs found that there was a difference in perception between private limited firms and sole proprietorship firms. Private limited firms considered CSR to be a cost, but sole proprietorship firms have a strong belief that CSR will benefit them. This portrays that those types of shareholders will influence CSRs differently because different ownership have a different motivation and characteristics (Amann, Jaussaud, & Martinez, 2012; Oh, Chang, & Martynov, 2011). This is supported by past studies, where significant differences between the CSR practices of family and non-family firms have been found (Block, 2010; Dyer & Whetten, 2006).

Furthermore, in the context of larger firms, some researchers found that firms with weaker financial performance were less likely to be involved in socially responsible corporate behaviour compared to firms with stronger financial performance (Margolis & Walsh, 2001; Orlitzky, Schmidt, & Rynes, 2003; Waddock & Graves, 1997). Similarly, Lepoutre and Heene (2006) found that a lack of financial resources serves as a barrier for small-business owner managers to engage in CSR.

A lack of financial resources can be attributed to the low level of business performance shown by SMEs. Specifically, the financial performance of an SME is tied to its business performance. When the SME is performing well, it is likely that there

would be higher financial resources that can be used to invest in CSR activities. However, the business performance of Malaysian SMEs, as evaluated from their contribution to the Malaysian Gross Domestic Product (GDP), was not as significant compared to the total establishments of SMEs in Malaysia. In Malaysia, 99% of businesses established were SMEs, but they merely contribute 32% to the GDP. This contribution is low compared to other regional economies like South Korea, Taiwan and Thailand where their SMEs contribute around 40% to their GDP (NSDC, 2012b). The low contribution was due to the constraints and challenges that Malaysian SMEs face, such as low expertise in management (NSDC, 2007; Wang, 2003), low access to financing (NSDC, 2007, 2012b; Ting, 2004; Wang, 2003), legal and regulatory environments (NSDC, 2012b; Wang, 2003), and innovation and technology adoption (NSDC, 2012b; Ting, 2004; Wang, 2003).

Therefore, this study would like to explore the level of CSR practices among Malaysian SMEs and whether business performance[1] influences the level of CSR in the context of SMEs, particularly in the manufacturing sector. The manufacturing sector was chosen as the sector has significant impact on the environment and society (Williamson et al., 2006). For example, in Malaysia, the manufacturing sector is the main contributor of pollution (Ramli & Munisamy, 2010, 2013; Razak, Ahmad, Bujang, Talib, & Ibrahim, 2013) and has the highest reported cases for unhealthy and unsafe working environments (Aziz et al., 2015b). Concurrently, this research will test the relationship between non-audit services (NAS) and business performance of SMEs because previous studies highlighted that SMEs will look for the external advisor, mainly accountants to overcome their weakness and constraints in order to improve

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[1] In this study, business performance is a proxy for financial performance.

their business performance (Bennett & Robson, 1999; Berry, Sweeting, & Goto, 2006; Xiao & Fu, 2009). It was supported by previous studies, which showed that NAS provided by an external accountant was able to increase the business performance of the company that obtained the services (Carey, 2008; Kamyabi & Devi, 2011). An example of the NAS are accounting services, taxation services, corporate services, business consulting services.

1.3   Problem Statement

Although the government and NGO invested a significant amount of money and put in place policies and regulations, such as tax exemption and have given grants to educate about CSR practices, the level of CSR amongst companies however, is still not satisfactory. As shown by the Department of Occupational Safety and Health, as well as the Ministry of Human Resources, the occupational diseases from the year 2005 to 2014 depicts an increasing pattern as shown in figure 1-1.

OCCUPATIONAL DISEASES STATISTIC 2005-2014
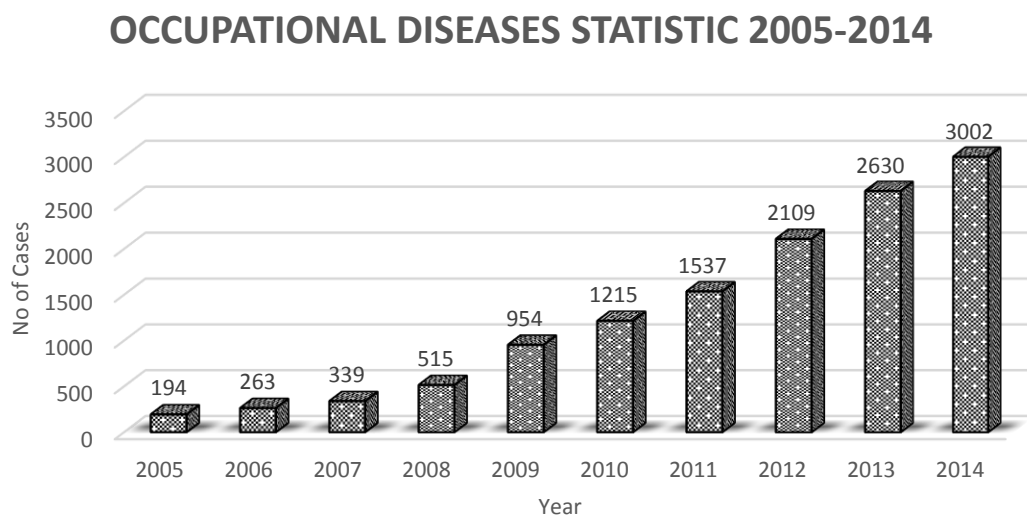
Figure 0-1: Occupational Diseases statistic 2005-2014

(Source: Department of Occupational Safety and Health, Ministry of Human Resources)

Figure 1-2 shows that employees lost their hearing due to noise pollution at their working place increased by 579% in a ten year period. Meanwhile, musculoskeletal diseases also showed an increasing trend, where in the year 2005 only 10 cases were reported, but this increased to 675 cases in the year 2014. This depicts a low CSR level for a company because it is an employer's responsibility to prepare an adequate health and safety work environment for their employees. Typically, the safety and health issues mainly happened in SMEs and the manufacturing sector were the highest cases reported (Auyong, Surienty, & Zailani, 2014; Aziz et al., 2015b). The reason pointed out by Aziz, Baruji, Abdullah, Nik Him, and Yusof (2015a) for this scenario was that a lack of financial resources by SMEs made them unable to develop or provide an adequately healthy and safe environment.

Musculoskeletal Diseases and Noise Induced Hearing Loss Statistic 2005-2014

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Musculoskeletal Diseases	10	14	26	77	161	238	268	448	517	675
Hearing Loss	53	77	90	86	153	114	260	235	226	360
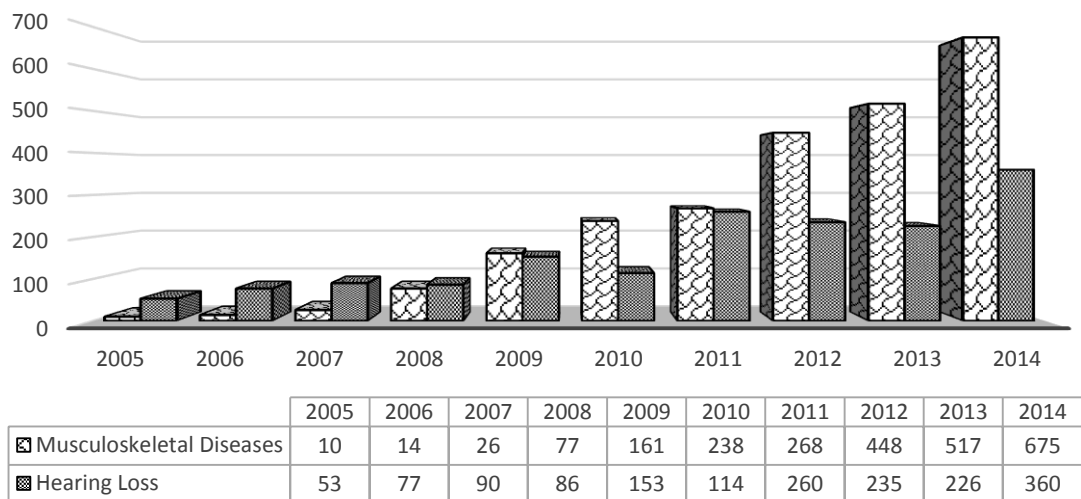
Figure 0-2: Musculoskeletal Diseases and Noise Induced Hearing Loss

(Source: Department of Occupational Safety and Health, Ministry of Human Resources)

Furthermore, the newspaper articles were able to articulate the level of CSR practices in Malaysia, which is inadequate. It was highlighted that 278 companies failed

to contribute EPF for employees (TheStar, 2014b), manufacturing companies do not comply with the minimum wage (TheStar, 2014c), companies ignored safety at their workplace (TheStar, 2014a), companies employed illegal workers (TheStar, 2014d), companies dumped waste illegally (Singh, 2014), and they carry out illegal earthworks (Hafiz, 2013). Meanwhile, the air pollution data in Malaysia showed an increasing pattern from the years 1970 to 2011 (Razak et al., 2013). Ramli and Munisamy (2010) asserted that the manufacturing sector were major contributors to environmental pollution, especially for water and air pollution. This situation happened because of financial limitations faced by the majority of SMEs in the manufacturing sector to implement good environmental practices (Sidek & Backhouse, 2014).

Although previous research showed a low level of CSR practices adopted by SMEs, some authors argue this is not the case. There were previous literature that highlighted that SMEs practice sunken or silent CSR. The difference in opinion depicts there is gap to be researched on CSR-SMEs, particularly in the manufacturing sector. Furthermore, there is a lack of evidence on the level of CSR in SMEs, especially in developing countries (Muwazir, 2011; Perrini, 2006). There is a need for a more extensive CSR research in the context of SMEs, because SMEs accounts to around 90% of the incorporated companies in the world (Hsu & Cheng, 2011). In Malaysia, as a collective group, SMEs have a substantial impact on CSR because SMEs consists of 98.5% from the total incorporated company (SMECorp., 2013). Indeed, SMEs' contribute more than 60% of the total employment in a country that enables them to have significant influence on enhancing wealth creation and contributing to the social well-being of a nation, which is a vision for most of the government model, such as SME Master Plan, Vision 2020 and New Economics Model.

Most of the research that was done previously on CSR was related to the outcome/benefits of the CSR practices. Although the research on financial performance and CSR were conducted by scholars more than three decades ago, there is still no conclusive evidence on the relationship and the direction of influence between these two variables (Margolis, Elfenbein, & Walsh, 2007). Previous literatures argued that firms with strong financial performance were more likely to be involved in CSR compared to firms with weak financial performance (Orlitzky et al., 2003) because the firms that were less profitable have fewer resources to use for CSR activities compared to firms that were more profitable (Waddock & Graves, 1997). There was a gap in this research to test the effects of business performance to CSR empirically in the context of SMEs because most of the previous research was done in the context of larger organisations.

Furthermore, the previous literature notes that financial resources serves as a barrier for SMEs to be involved in CSR activities. However, the scholar fails or ignores to test the relationship empirically. To fill the gap in the SME-CSR literature, this study will focus on the relationship between business performance and CSR on private limited companies based on the slack resource theory.

Moreover, previous research showed that SMEs have weaknesses, such as lack of managerial knowledge and skills that will affect their business performance. To overcome the weaknesses and to increase their performance, SMEs will seek the help of external parties, mainly external accountant services. (Bennett & Robson, 1999; Berry et al., 2006; Gooderham, Tobiassen, Døving, & Nordhaug, 2004). There was limited empirical evidence that relates to NAS provided by an external accountant and their effect on business performance of SMEs. Furthermore, the results were

inconclusive (Kamyabi & Devi, 2011). It is important to have more studies on a developing economy like Malaysia because the findings of the research in developed countries cannot be generalised due to differing institutional contexts, the difference in infrastructure's ability towards effects on business needs (Ihua, 2009), and the level of state intervention in economic activities and policy (Berry et al., 2006; Kamyabi & Devi, 2011). The differences in the requirement of the law and policy can produce different consequences (Kamyabi & Devi, 2011). For example, in Malaysia all private limited companies, although categorised as SMEs have to annually audit, although the company is dormant whereas certain other countries, such as Australia and the UK were given an audit exemption to SMEs. This environment will give a different result because some of the SMEs will obtain their business advisory indirectly from the external accountant when obtained from the auditing service. This study will address the gap by investigating the influence of non-audit services on business performance of SMEs based on the knowledge base view.

Furthermore, the knowledge base view can explain the relationship between the non-audit services and CSR. Because NAS that was provided by an accountant is knowledge base services, it is able to affect the CSR level. Previous research conducted on S&P companies concluded that NAS (tax management services) have a relationship with the CSR level of the company (Huseynov & Klamm, 2012). Notwithstanding, the lack of CSR activities in the SME context were due to a lack of knowledge of the owner (Vives, 2006). On the other hand, previous literature indicated that NAS has a significant relationship with business performance and business performance has a significant effect on CSR. But all the previous studies fail to test business performance as a mediator in the relationship between NAS and CSR. Based on the Resource Based View (RBV), an offering of non-audit services to companies will influence their

business performance, which in turn will influence the CSR practices of SMEs. For example, advice from an external accountant on reducing waste and optimising resources is able to reduce the cost of running the business, which will increase the profit of the company. Thus, enabling the company to have excess resources to spend on CSR activities. Therefore, in this study the business performance will test as the mediating in the relationship between non-audit services and CSR.

Meanwhile, previous research mentioned that the inconclusive findings in the relationship between financial performance and CSR were due to some variables not being included that might moderate the relationship. (Campbell, 2007; Fauzi, Mahoney, & Abdul Rahman, 2007; Margolis & Walsh, 2003). Previous research found that ownership will influence a firm's performance (Chu, 2011; Douma, George, & Kabir, 2006; Ghazali, 2010; Shakir, 2008; Sokolyk & Bradford, 2012), CSR (Amann et al., 2012; Dam & Scholtens, 2012; Oh et al., 2011) and so forth. The types of shareholders will influence CSR differently because different ownership have different characteristics (Amann et al., 2012), expectations (Grunig, 1979) and motivation (Oh et al., 2011). To add new knowledge to the literature, this study will include ownership in terms of family and non-family to test the interactions' effect on the relationship between business performance and CSR.

1.4   Research Objectives

In brief, the objectives of this study are:

(1)   To investigate the relationship between utilisation of non-audit services and business performance.

(2) To investigate the relationship between business performance and level of CSR practice.

(3) To examine whether business performance mediate the relationship between non-audit services and level of CSR practice.

(4) To examine whether ownership moderate the relationship between business performance and level of CSR practice.

1.5 Research Questions

(1) Is there any relationship between utilisation of non-audit services and business performance?

(2) Is there any relationship between business performance and level of CSR practice?

(3) Does business performance mediate the relationship between non-audit services and level of CSR practice?

(4) Does ownership moderate the relationship between business performance and level of CSR practice?

1.6 Significance of the Study

This research will benefit several parties. Firstly, it will contribute to the academic world mainly for SMEs and CSR researchers because it provides empirical evidence of the relationship of NAS to business performance and business performance to CSR. As far as it could be ascertained, this is the first study to examine the mediating effect of business performance on the relationship between NAS and CSR in the context of SMEs. Additionally, this study contributes to family firms' literature by enhancing the understanding of the interaction effect of ownership (family or non-family firm) in the

relationship between business performance and CSR. Meanwhile, this study will enhance the application of the knowledge based view (KBV) theory to explain the relationships of this study. In the KBV perspective, the most important resources are knowledge and heterogeneous knowledge is the core throughout the companies, which is the primary determinant of differences in performance (Decarolis & Deeds, 1999). Other literature in KBV mentioned that firms can seek knowledge from external parties if the knowledge was not available internally. (Cameron, 1992; Feldman, 1994). Since non-audit services were provided by external accountants related to the knowledge based services, KBV explains the relationship between non-audit services and performance of SMEs.

Secondly, this study will benefit the Malaysian government because SMEs are the largest portion of total entity companies in Malaysia. It is important for the government to have knowledge about the CSR in the context of SMEs. There is no available data for CSR practices in SMEs because there is no requirement for SMEs to disclose the CSR activities yearly. Therefore, this study will be a useful insight for policy makers, SME Corporation and the Federation of Malaysian Manufacturers to better understand about the level of CSR practice by SMEs and be able to use the study as guidance for drafting the CSR plans for SMEs.

Finally, the study also benefits the accounting profession because it will examine the effect of non-audit services on business performance of SMEs. The accountants will be able to do effective strategies and plans to provide services that will enhance the business performance of SMEs based on the findings from the research.

1.7 Definitions of Key Terms

The definitions of key terms are given in order to understand the study more easily.

1.7.1 Non-audit services

Different terms can be used for NAS, such as non-assurance service or business advisory service. NAS define as any services that is above and beyond the related audit services or services other than the traditional CPA works (Albrecht & Sack, 2000). The types of services rendered are accounting, tax compilation, management consulting or advisory services and insolvency and business recovery. (Gill & Cosserat, 1996)

In this study, the NAS referred to are bookkeeping, financial statement compliance, budgeting/forecasting, product/services costs, customer profitability analysis, financial planning, internal audit, internal control review, financial due diligence, forensic audit, tax compliance, tax planning, tax dispute resolution, tax incentives application, goods and services tax, fundraising, financial management services, company secretarial services, mergers & acquisitions, business strategy & planning, performance management, IT consulting advisory, business restructuring, insolvency & receivership, HR consulting, risk management, and control system. These services can be categorised into six groups as accounting services, assurance services (beside statutory audit), taxation services, corporate services, corporate finance services and business consulting services.

1.7.2 Business Performance

Business Performance was defined to be the outputs or outcomes in utilisation of resources. One method to measure business performance is by financial profitability (Daft, Sormunen, & Parks, 1988). To measure business performance, many

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measurements have been utilised by past studies such as return on assets (ROA), return on sales (ROS) and return on equity (ROE). In this study, business performance was measured by ROA as it is widely used and well understood compared to other types of measurements (Carpenter, 2002). Besides that, ROA is considered the more consistent measure of profitability across a wide variety of manufacturing firms (Daft et al., 1988).

1.7.3 Corporate Social Responsibility

Corporate social responsibility (CSR) is a practical concept that covers environmental, social, and economic issues by internal and external parties, such as employees, customers, society, and suppliers. Top management should ideally view CSR to be a concept that allows them to create wealth and at the same time contribute towards society overall. Hackston and Milne (1996) define or classify CSR to be environment, human resource, energy, community involvement and products. This study will classify the CSR in terms of stakeholders, which are customer, community, employees, environment, shareholder and supplier.

1.7.4 Small and Medium Enterprises (SMEs)

SME was defined by the National SME Development Council on 9 June 2005 based on two criteria: Number of employees, or annual sales turnover. In addition, SMEs were further defined by SME Corp into the following sectors:

1. Manufacturing, Manufacturing-related services and Agro-based industries with full time employees not exceeding 150 or annual sales turnover not exceeding RM 25 million.

2. Services, Primary Agriculture and Information & Communication Technology (ICT) with full time employees not exceeding 50 or annual sales turnover not exceeding RM 5 million.

On 11 July 2013, a new definition of SMEs that will effect from 1 January 2014 was announced by the Prime Minister at the 14th National SME Development Council meeting. The new definition was able to classify more firms as SMEs and facilitate the country's transformation to high income through the initiatives under the SME Masterplan. This study will use the new definition to categorise the SMEs. The new definition was as follows:

1. Manufacturing with full time employees not exceeding 200 or annual sales turnover not exceeding RM 50 million.

2. Services and other sectors with full time employees not exceeding 75 or annual sales turnover not exceeding RM 20 million.

Table 1-1
New Definition of SMEs in Malaysia effective 1 January 2014

	Category	Micro enterprises	Small enterprises	Medium enterprises
1.	Manufacturing	Sales turnover of less than RM 300,000 OR Full - time employees less than 5.	Sales turnover from RM 300,000 to less than RM 15 million OR full-time employees from 5 to less than 75.	Sales turnover from RM 15 million to not exceeding RM 50 million OR full-time employees from 75 to not exceeding 200.
2.	Services and others sectors	Sales turnover of less than RM 300,000 OR Full - time employees less than 5.	Sales turnover from RM 300,000 to less than RM 3 million OR full-time employees from 5 less than 30.	Sales turnover from RM 3 million to not exceeding RM 20 million OR full-time employees from 30 to not exceeding 75.

(Source: SMECorp. (2013))

In this study, the new definition of SMEs were used to determine the size of the firm and the focus was only on manufacturing companies that have 5 to 200 employees and were incorporated as a private limited company. This study has excluded the micro

enterprise population from the sample of the study because of the different managerial approach and low degree of CSR formalisation compared with small and medium enterprises (SMEs) (Russo & Tencati, 2008). In fact, several studies have excluded micro enterprises from their research (Santos, 2011; Shah, Hinostroza, & Nunez, 2008) which is in line with the suggestion given by Russo and Tencati (2008) to separate the micro firm category from other categories in the assessment of impact on social, economic and environmental contexts.

1.8   Organisation of Remaining Chapters

This study is presented in six chapters with the first chapter as an introduction as well as an overview of the study. Chapter 2 will start with the history of Malaysia's SME and then reviews the literatures, which outlines the previous research undertaken in relation to the study, meanwhile chapter 3 explains the theoretical framework and hypotheses development. Chapter 4 discusses about the sample collection and measurement of the variables, data gathering, and methods of data analysis. Chapter 5 will discuss the results of findings from data analysis focusing on statistical analysis, descriptive, regression and correlation analysis. Finally, Chapter 6 will discuss and conclude the research findings, outlining the limitations of the research and suggestions for further research.

CHAPTER 2

BACKGROUND OF STUDY AND LITERATURE REVIEW

2.1 Introduction

This chapter will start discussing the background of Malaysian SMEs and then discuss previous literature on corporate social responsibility that include CSR in Malaysia's context, non-audit services, business performance and ownership. In addition, this chapter will illustrate the association among the variables.

2.2 Background of SMEs in Malaysia

If the history of any large company is traced back, in most instances, these companies began as a small or medium establishment, or even as a micro-enterprise before graduating to what it is today. Therefore, SMEs were long recognised to be the backbone of any economy because they were an important generator of employment and growth. Furthermore, it cannot be denied that SMEs also play a significant role in the environment and society. In Malaysia, SMEs were defined according to employee size, sales turnover and sectors. Definitions[2] of SMEs in Malaysia fall into 2 categories:

1. Manufacturing, manufacturing-related services and agro-based industries

    • Full-time employees not exceeding 150, OR

    • Annual sales turnover not exceeding RM25 million

2. Services, primary agriculture, and Information and Communications Technology (ICT)

    • Full-time employees not exceeding 50, OR

    • Annual sales turnover not exceeding RM5 million

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[2] Start from 1 January 2014, new definition for SME will be used in Malaysia.

In summary, an enterprise was considered to be a SME in each of the respective sectors based on annual sales turnover or number of full-time employees as shown in Table 2-1.

Table 2-1
Definition of SMEs in Malaysia

	Category	Micro enterprises	Small enterprises	Medium enterprises
1.	Manufacturing, Manufacturing related services and Agro-based Industries	Sales turnover of less than RM250,000 OR less than 5 Full-time employees.	Sales turnover between RM 250,000 and RM10 million OR full-time employees between 5 to 50.	Sales turnover between RM 10 million and RM25 million OR full-time employees between 51 and 150.
2.	Services, Primary Agriculture, and Information and Communication Technology (ICT)	Sales turnover of less than RM200,000 OR less than 5 Full-time employees.	Sales turnover between RM200,000 and RM1 million OR full-time employees between 5 and 19.	Sales turnover between RM1 million and RM5 million OR full-time employees between 20 and 50.

(Source: http://www.smidec.gov.my/node/33)

Table 2-2
Number of Establishment by Sector.

Sector	Micro	Small	Medium	Total SMEs	Total SMEs	Large Firms	Total Establish-ments
	Number of Establishments				% Share	Number	Number
Manufacturing	21,619	13,934	2,308	37,861	5.9	1,808	39,669
Services	462,420	106,061	12,504	580,985	90.1	10,898	591,883
Agriculture	3,775	1,941	992	6,708	1.0	2,121	8,829
Construction	8,587	6,725	3,971	19,283	3.0	2,857	22,140
Mining & Quarrying	57	126	116	299	0.05	119	418
Total SMEs	**496,458**	**128,787**	**19,891**	**645,136**	**100.00**	**17,803**	**662,939**

(Source: DSM (2012))

According to the 2011 economic census report by the Malaysian Department of Statistics, SMEs incorporate 97.3 (2003: 99.2%) of the total 662,939 (2003: 552,804) establishments in Malaysia comprising of manufacturing, services, mining and

quarrying, with construction and agriculture being the major five economic sectors. Within this, five quarters of the total SMEs were micro establishments, which accounted for 77%, mostly consisting of services (93.1%) and manufacturing sectors (4.4%). Once again, 20% is made up of small companies and 3% of medium companies.

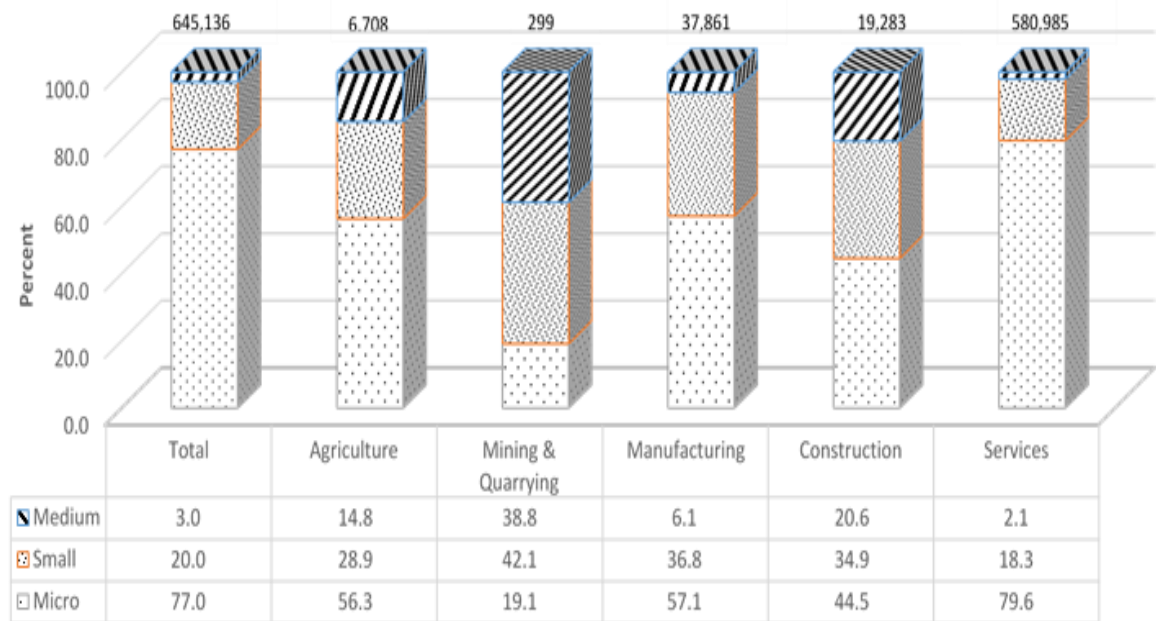|	Total	Agriculture	Mining & Quarrying	Manufacturing	Construction	Services
Medium	3.0	14.8	38.8	6.1	20.6	2.1
Small	20.0	28.9	42.1	36.8	34.9	18.3
Micro	77.0	56.3	19.1	57.1	44.5	79.6

Figure 2-1: SMEs by Sector and size, 2010
(Source: DSM (2012))

Detailed explanations and descriptions on the three major components are as follows:

(i) Manufacturing Sector

Micro enterprises consist of the largest number in the manufacturing sector, which is 57.1%. This is followed by small sized category at 36.8% and medium sized category at 6.1%. In the industry, SMEs' distribution is mainly in wearing apparel (24%), food products (15.1%), fabricated metal products (10.5%), printing (7.7%) and other groups; such as paper and electrical equipment (14.6%) (DSM, 2012).

In regards to geographical location in Malaysia, Selangor had the largest number of SMEs with 8,314 establishments (22%). This is followed by Johor with 12.8% or 4,828

establishments. In addition to these two states, another four states recorded more than 2000 SMEs and they were Kuala Lumpur, which includes Putrajaya (4,201 or 11.1%), Perak (3,833 or 10.1%), Kedah (2,809 or 7.4%) and Penang (2,614 or 6.9%).

(ii) Services

The SMEs in the service sector consists around 98.2% (580,985) out of the total establishments at 591,883. Most of the SMEs in the service sector were micro establishments, which represent over 79.6% of the total SMEs in this sector. This was followed by small size establishments at 18.3% whereas the proportion of medium size establishments were only 2.1%. From this sector, distributive trade, such as retail trade, wholesale and repair of vehicles and motorcycles constituted of 49.9% of SMEs, followed by 24.6% for food and beverages, 6.3% for private services (e.g. beauty centre, repair, laundry), 6.9% transportation and storages, and 3.3% of professional services. The other groups, which consists of lodging, health, education accounted for 9.1% (NSDC, 2012a).

Furthermore, the Malaysian Standard Industrial Classification defined the professional sub-sector service to be Technical and Non-technical services. Engineering, architectural, surveying and other technical activities were related to Technical and for Non-technical, such as business and management consultancy, accounting, legal and advertising.

(iii) Agriculture Sector

In the agriculture sector, 76% (6,708) from 8,829 companies were SMEs. This sector also showed the same pattern where micro businesses were predominant, accounting for more than half with 56.3%, 28.9% for small enterprises and 14.8% for medium size

enterprises. From the total number of SMEs in this sector, 70.4% were in agriculture crops, livestock at 13.4%, fisheries at 11.6%, and 4.6% were forestry and logging (NSDC, 2012a). In regards to the distribution of SMEs in agriculture sector by state; Johor has the highest number of SMEs with 14.8% or 994 establishments, followed by 14.3% or 962 establishments in Perak, Selangor with 12.4% or 834 establishments, and Sabah with 12.1% or 812 establishments.

(iv) Construction Sector

A total of 19,283 or 87.1% were SMEs from 22,140 establishments of construction companies in Malaysia. Around 44% of companies in the construction sector were at the micro level, followed by 35% in small enterprise and the medium enterprise proportion was 20.6%. In this sector, SMEs were mainly in the special trades sub-sector, constituting 40.2% of total establishments in the sector. Special trades refer to the construction of parts of buildings and civil engineering works without responsibility for the entire project. Followed by non-residential buildings at 21.5%, civil engineering 21% and 17.3% of residential buildings (NSDC, 2012a).

(v) Mining and Quarrying Sector

A total of 418 companies were incorporated in Malaysia for the mining and quarrying sector. From the total establishments, around 71.5% were SMEs. This sector was characterised by small and medium size establishments, which formed of 42.1% and 38.8% respectively, while micro establishments only accounted for 19.1%. In this sector there were only two subsectors, which are stone quarrying and mineral mining. Most of the SMEs in this sector were involved in stone quarrying (84%). The differences between the mining & quarrying sector with other sectors are that the majority of SMEs in the mining and quarrying sector operate as private limited