# CHAPTER THREE

# THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

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## 3.1 THEORETICAL PERSPECTIVE

A number of theoretical perspectives have been used to study the relationship between corporate governance mechanisms, specifically board diversity and CSR. This study focus on two theories, namely agency theory and resource dependence theory, in order to underpin how corporate governance mechanisms and board diversity influence the level of CSR disclosure. The agency theory has been widely used in corporate governance literature, and has received a great deal of attention from researchers (Jensen and Meckling, 1976; Fama and Jensen, 1983; Wang and Coffy, 1992; Bartkus et al., 2002; Webb, 2004; Ayuso and Argandona, 2007; Said et al., 2009; and Bear et al., 2010). According to this theory, the main function of the board of directors is to monitor management on behalf of the shareholders. However, resource dependence theory has been employed in board diversity literature as a possible explanation of the relationship between board diversity and CSR. This theory asserts that the provision of resources needed by the firm is the main function of the board. This section reviews the theories of boards and governance mechanisms, which are relevant to this study, namely agency and resource dependence theory.

### 3.1.1 Agency Theory

Agency theory is based on the idea of separate ownership (principal) and management (agent). The relationship between principle and agent was defined by Jensen and Meckling (1976) as, "a contract under which one or more persons (the principals) engage another person (the agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent." Agency theories suppose that agents and principles have different needs and interests, and aims to maximise utilities. This leads to a conflict of interest between the principle and the agent's goals. This conflict is the agency's problem. Esiesnhardi (1989) remarked that agency problems occur when there is a conflict of goals between the principal and the agents, and when it becomes expensive and difficult for the principal to monitor the agent. The agency problem tends to increase the agency's cost, which is defined as the sum of monitoring costs, bonding costs, and residual losses (Jensen and Meckling, 1976). To address these agency problems, scholars proposed using corporate governance mechanisms. Davis et al. (1997) argued that governance mechanisms are used to minimise agency costs, protect shareholder interests, and ensure agent-principal interest alignment. The most important governance mechanism used to address this issue is the board of directors. Boards are selected by shareholders to perform certain functions, such as monitoring and controlling managerial decision-making, in order to protect the shareholders' interests. Agency theory suggests that the main function of the board of directors is to monitor management on behalf of the shareholders, which leads to reduced agency problems and monitoring costs between the shareholders and the managers. Therefore, the board of directors must be strong enough to meet the monitoring task perfectly. Accordingly, agency theory calls for an

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increasing representation outside of directors on the board. Fama and Jensen (1983) argued that outside directors may enhance the effectiveness of the board, because they have incentives to develop reputations as experts in decision-control, and reduce managerial consumption of prerequisites thus reducing the agency's problem.

Agency theories also consider the ownership structures. Different ownership structures lead to a rise to two types of agency problems. In the case of ownership dispersion where the share is widely held, problems arise from the separation of ownership and management (Jensen and Meckling, 1976). Firms will increase the voluntary disclosure in order to reduce information asymmetry and agency costs (Ho and Wong, 2001). Alternatively, in ownership concentration especially family owned firms, where the share is closely held and in the hands of family members, agency problems arise between controlling and non-controlling shareholders (Gilson and Gordon, 2003) causing the demand of disclosure is low.

Agency theory has been used to explain the relationship between corporate governance and CSR disclosure. The theory suggests that disclosure can improve through governance mechanisms such as separate CEO and chairman roles (CEO duality), and ensure the independence of board member as well as audit committee. According to this theory, corporate governance serves as control mechanisms to monitor management's actions and mitigate the conflict of interest in the firm thereby reducing agency costs. Consequently, firms tend to disclose more special, social, and environmental information as tools used to reduce agency costs (Ho and Wong, 2001), monitor management(Cheung and Chan, 2004), mitigate agency problems, and reduce information asymmetry (Htay et al., 2012).

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With regards to board diversity, the agency theory suggests that greater diversity in the directors on the board, the better the monitoring of management, because board diversity leads to increased board independence (Carter et al., 2007). For example, directors of different ages, genders, ethnicities, and cultural backgrounds, may ask questions that would otherwise not come from directors with more traditional backgrounds. Therefore, more board monitoring leads to improved quality of disclosure, because the board will be more responsive to stakeholders thereby improving the company's compliance with disclosure requirements (Chen and Jaggi, 2000).

### 3.1.2 Resource Dependence Theory

Resource dependence theory was first proposed by Pfeffer and Salancik in 1978. This theory views a firm as an open system that is dependent upon its external environment for survival (Hillman et al., 2009). This theory proposes that the main function of the board of directors is to provide access to the resources needed by the firm by linking the firm with its external environment. This function refers to the ability of the board to bring resources to the firm (Hillman and Dalziel, 2003). The board is viewed as a resource provider to the firm. Pfeffer and Salancik (1978) suggested that directors provide four types of resource to a firm: (1) advice and counsel, (2) creation of channels of information communication between the firm and external organisations, (3) provision of commitments of support from important organisations or groups in the external environment, and (4) legitimacy. Hillman et al. (2000) placed directors into four categories, based on the four benefits that directors provide to a firm, namely insiders, business experts, support specialists, and influential community members.

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Resource dependence theory concern on how board capital leads to the provision of resources to the company. In this regards, board capital consists of both human and relational capital. Based on the board's human capital resources (i.e., skill, reputation experience), Bear et al. (2010) pointed out that different types of directors will provide different resources to the firm. For example, insiders provide expertise in specific areas, such as finance, law, company strategy, and operation, business experts provide expertise on business strategy, decision-making, and problem solving, support specialists provide legal and regulatory affairs. Finally, the community provides knowledge and relationships with external stakeholders, including the government and local communities. However, as a result of linking the firm with its external environment, the board will provide more valuable and diverse resources and skills, which will help to reduce external dependency, transaction costs, environmental uncertainty, thus producing better firm performance (Hillman et al., 2000).

With regards to CSR, resource dependence theory suggests that selecting outside members on the board will bring resources to the firm, such as skills, information, experience and legitimacy (Hillman et al., 2000). Therefore, outside directors tend to be more knowledgeable about the changing demands of various stakeholders and thus, more sensitive to society's needs than inside directors who focus on financial measures (Ibrahim et al., 2003).

Resource dependence theory provides a key argument for board diversity. The theory suggests that board diversity will increase the resources provided by board members resulting in greater introduction of information sources to the firm. Therefore, diverse directors (through age, gender, and ethnicity) provide unique information to the

management for better decision-making. Moreover, board diversity brings new insights and perspectives to the firm, in addition to increasing creativity and innovation (Ayuso and Argandona, 2007). Accordingly, more diverse board members leads to better understanding and problem-solving, which can enable the board to effectively address the business environment and encourage positive ratings for CSR (Bear et al., 2010).

Resource dependence theory has been used to explain the relationship between CSR disclosure and corporate governance mechanisms especially board size and multiple directorships. According to this theory, large boards have a variety of knowledge experts who are better qualified and better able to manage capital resources (Al-Janadi et al., 2013). They also have more access to external resources thereby improving decision-making (Siciliano, 1996). Based on resource dependence theory, Ruigrok et al.(2006) suggested that multiple directorships allow boards to be linked and connected to important resources and networks offering new insights to the board resulting from their experience and knowledge from other firms. This will encourage the board to disclose more CSR in their annual reports.

Different theories have been used to explain and analyse CSR disclosure practices and corporate governance mechanisms such as agency theory, stakeholder theory, and resource dependency theory. Alone, none of these theories offer a comprehensive explanation of disclosure practices. Reviewing these theories indicates that each theory views disclosure from different perspectives. The agency theory focuses more on economic activities and aims to achieve the shareholders goals, while the stakeholder theory concerns itself with the way an organisation manages its

stakeholders (Gray et al., 1996). Resource dependence theory aims to provide an essential resource to an organisation through their linkages to the external environment.

Criticisms have been raised against agency theory because it concentrates on two groups of stakeholders, managers and shareholders, and ignores other interested parties in society, such as creditors, suppliers, and governments (Gray et al., 1995). This theory fails to account for non-financial motivations for suppressing disclosure (Okcabol and Tinker, 1993). Criticisms also have been raised against stakeholder theory. Gray et al. (1996) argued that the stakeholder theory is flawed because, under the managerial branch, the company ignores important influences of society as a whole regarding the organisation's provision of information. The level of attention it will be given is based on how those stakeholders can benefit the organisation, or in other words, it will be based on market forces (Gray et al., 1996).

## 3.2 CONCEPTUAL FRAMEWORK

This study examines the relationship between corporate governance and board diversity with CSR disclosure, and considers the moderating role of board size. Referring to the theoretical framework in Figure 3.1, the study suggests eight independent variables, namely gender diversity, age of directors, independent directors, nationality of directors, role duality, multiple directorships, family members on the board, and audit committee, which may influence the level of CSR (i.e., the dependent variable). The relationship between independent variables and CSR is moderated by board size (i.e., the moderate variable). Furthermore, this study uses

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two control variables, namely the firm's size and the firm's profitability. These variables are found to have an impact on the extent of CSR disclosure in Jordan (see, Al-Khadash, 2003; Suwaidan et al., 2004; Ismail and Ibrahim, 2008) and has been used by previous researchers as control variables in determining the relationship between corporate governance and board diversity variables with CSR disclosures (Haniffa and Cooke, 2005; Darus et al., 2009; Khan, 2010; Rusmanto, et al. 2014). Therefore, it is important to control these variables in order to identify the specific impact of independent variables on CSR disclosure and avoid these control variables affecting the explanation of the dependent variable.

Firm size is considered among the most corporate variables that explain CSR disclosure. Most empirical studies have indicated that firm size is positively and significant associated with CSR disclosure (Hackstone and Milne 1996; Al-Khadash, 2003; Suwaidan et al., 2004; Haniffa and Cooke, 2005; Ghazali, 2007; Ismail and Ibrahim, 2008; Said et al., 2009; Abdul Razak and Mustapha, 2013). Larger firms have more stakeholders and are thus more visible to the public and more politically sensitive than smaller firms (Watts and Zimmerman, 1978). Therefore, large firms are more likely to disclose CSR in order to enhance their reputation and to reduce political costs (Ismail and Ibrahim, 2008). Profitability is also considered among the most important corporate variables to have been used widely in CSR disclosure literature. From an agency theory perspective, the more profitable the company, the greater its CSR disclosure. This is because managers tend to disclose such information to reduce the problem of information asymmetry. Moreover, they have an incentive to disclose CSR information to enhance the firm image and maintain their positions (Giner, 1997). Studies on the relationship between profitability and CSR

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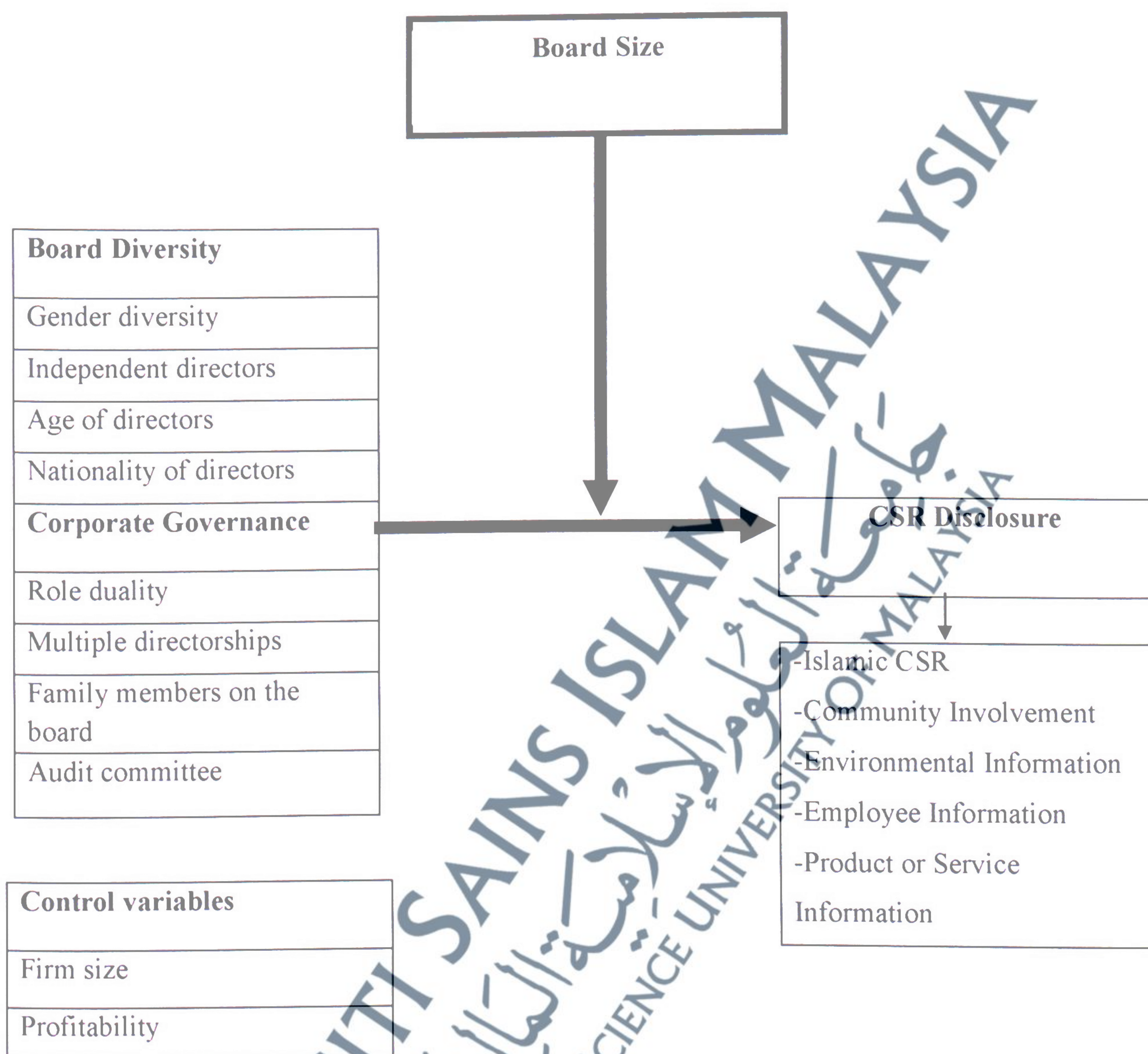
have produced mixed results. Roberts (1992), Suwaidan et al. (2004), Haniffa and Cooke (2005), Htay et al. (2012) and Mulyadi and Anwar (2012) found a positive relationship between profitability and CSR disclosure. On the other hand, Patten (1991), Hackston and Milne (1996), Al-Khadash (2003), and Alkababji (2014) found no significant association between CSR disclosures and profitability.

**Figure 3.1 The Conceptual Framework of This Study**

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## 3.3 HYPOTHESES DEVELOPMENT

### 3.3.1 Gender Diversity

Female directors on the board can be an important determinant of CSR practice, especially in areas of charitable contributions, employees, and community (Bernardi and Threadgill, 2010). Therefore, increasing the number of women on the board of directors will increase the board's attention to CSR issues (Ayuso and Argandona, 2007). This is because women have good social sensibility (Buregess and Tharenou, 2002) and show a more favourable attitude towards ethical behaviour than men (Luthar et al., 1997). Moreover, women are more willing to giving in a crisis, and they tend to view charitable giving as a means to help society (Williams, 2003). According to Wang and Coffey (1992), female directors are less business oriented and more sensitive to CSR issues and the welfare of diverse stakeholders, because females usually have legal, education, or non-profit backgrounds compared to male directors. Moreover, women directors pay more attention to the needs of a wide range of stakeholders (Bernardi and Threadgill, 2010; Brammer et al., 2009; Zhang et al., 2013), improve the quality of decisions making (Burgess and Tharenou, 2002; Carter et al., 2003; Walt and Ingley, 2003; Huse and Solberg, 2006) and are more likely to enhance firm reputation by disclosing more social and environmental information (Miller and Triana, 2009; Bear et al, 2010).

Majority of studies on gender diversity have yielded positive results. Barako and Brown (2008) reported that increased female representation on the board will significantly and positively influence CSR disclosure. Similarly, Bear et al. (2010)

found a positive relationship between the number of women on the board and CSR. Wang and Coffey (1992) also found that female directors had a positive and significant relationship with the firm's charitable contribution. These findings were supported by Williams (2003) who found that the more women serving on the board equated to greater charitable giving than firms who had lower numbers of women on the board. In Bangladesh, Khan (2010) found no significant relationship between female representation on the board and CSR reporting.

Unlike developed countries, such as Norway, which require listed companies to have at least 40% of women directors, no government policy has been adopted to appoint a specific percentage of females on the board of directors in Jordan. However, as of 2008, 22% of companies in Jordan have at least one female on the board of directors (ASE, 2009). Given the above, we hypothesise that:

**H1**: Companies with a higher proportion of female directors on the board are more likely to have a higher level of CSR disclosure.

### 3.3.2 Age Diversity

Resource dependence theory suggests that the diversity of the director's age on the board encourages different perspectives, which will lead to enhanced board performance and decision-making. There are different arguments on the relationship between age diversity and CSR. Some arguments support the proposition that age diversity of board members enhances board performance (Ness et al., 2010). This is because directors of different ages have different backgrounds, skills, experiences, and social networks. Furthermore, age diversity will improve the information

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provided by the board to managers. However, Hagendorff and Keasey (2012) argued that age diversity may lead to conflicts between board members when there are different points of view.

Older board members provide experience, wisdom, and economic resources, but they are more complacent and less likely to initiate change. Moreover, they are less likely to do their duties as directors (Webb, 2004). Therefore, they will be less connected to current stakeholders. However, younger board members may increase human capital, because directors with different ages may bring different perspectives and ideas to the firm. Ness et al. (2010) argued that younger board members are more innovative and are better able to process new ideas. Moreover, they are positively related to strategic change and more willing to participate in the monitoring process (Darmadi, 2011). Therefore, they will improve the organisation's philanthropy. Klineberg et al. (1998) found that younger Americans are more concerned than older Americans about environmental issues. This is supported by the study of Post et al. (2011) who found that young directors may focus more on CSR governance issues.

There are limited studies that investigate the relationship between the age of directors and CSR. However, Post et al. (2011) found that social and environmental disclosure was higher with boards containing the youngest directors. These results are consistent with Webb (2004), which concluded that Socially Responsible (SR) companies have more young directors than non-socially SR firms. In Indonesia, Handajani et al. (2014) found that older directors have a significant positive effect on CSR disclosure.

In Jordan, based on the Companies Law No. 22 of 1997, the age of board members should be more than 21 years. Based on prior findings, young board members may have a significant positive impact on CSR. This leads to the following hypothesis:

**H2**: There is a positive relationship between a young board of directors and CSR disclosure.

### 3.3.3 Independent Directors

Board independence plays an important role in monitoring the behaviour of top management (Fama and Jensen, 1983). Fama and Jensen (1983) argued that the role of independent directors on the board is to affect board monitoring through which to control the firm's activities. Therefore, the independent director is more effective than others, because they are able to do their duties on behalf of the shareholders, and are less likely to be manipulated by the CEO (Weeb, 2004). Resource dependence theory suggests that independent directors provide resources, information, skill, and legitimacy to the board (Hillman et al., 2000), which in turn, will enhance the board's decisions and add value to both the firm and the community. Therefore, they will be more concerned with the various stakeholders, and tend to be more sensitive to society's needs (Ibrahim et al., 2003). Hence, independent directors tend to disclose more information. Fama and Jensen (1983) argue that independent directors are motivated to increase disclosure to outside investors in order to enhance the firm's image. Said et al. (2009) argued that CSR should be disclosed as good news to reflect the good reputation of the company.

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Majority of previous studies presented positive results. Jo and Harjoto (2011) found that the proportion of independent directors had the most significant and positive corporate governance mechanism, which affected the firm's decision to engage in CSR. Similarly, Carter and Vos (2005) concluded that a larger number of independent directors led to an increased level of CSR in New Zealand companies. Webb (2004) also found that CSR firms had more independent directors compared to non-socially responsible firms. However, Said et al. (2009) failed to find an association between independent directors and CSR in Malaysian companies.

In Jordan, the corporate governance code for companies listed on the ASE requires that at least one third of the board members comprise of independent directors. However, a positive relationship between independent directors and CSR level was found in previous studies. Consequently, this study expects a positive association between independent directors and CSR level. Therefore, it is hypothesised that:

**H3**: There is a positive relationship between the proportion of independent directors and the level of CSR disclosure.

### 3.3.4 Nationality of Directors

Several governance guidelines support the appointment of different nationalities on the board of directors in order to reflect the nationality diversity of their customers, employees, and stakeholders. However, foreign directors tend to disclose greater CSR because they are more independent, are likely to make charitable contributions, and tend to be more sensitive to society's needs (Ayuso and Argandona, 2007). Ayuso and

Argandona (2007) pointed out that foreign directors supposedly play an important role in supporting CSR reporting strategies. This is due to their social and economic backgrounds (Wang and Coffey, 1992). because, foreign directors bring diverse opinions and perspectives such as language, religion, life experiences, culture, behavior, and norms comes from other country or region, which in turn enhances the decision-making (Ruigrok et al., 2007).

Previous studies that associated the nationality of directors with CSR have provided mixed results. Barako and Brown (2008) found no association between foreign directors on the board and CSR reporting in Kenyan banks. Meanwhile, Khan (2010) found a positive relationship between foreign directors and the level of voluntary CSR reporting, in Bangladeshi banks. Therefore, the following hypothesis is suggested:

**H4:** The higher the proportion of foreign nationals on the board, the higher the level of CSR disclosure.

### 3.3.5 Role Duality

Role duality occurs when the chair of the board of directors and the CEO positions are held by one person. According to agency theory, both the CEO and the chair positions should be separated in order to improve the monitoring function. A combination of the chair and CEO positions will lead to an absence of the chairperson's role of monitoring the CEO. Fama and Jensen (1983) argued that CEO duality leads to an absence of separation between management and controlling roles due to conflicts of

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interest. This will create a dominant personality, which will allow the CEO to control the board in terms of meetings, agenda, and the selection of board members (Haniffa and Cooke, 2002). Furthermore, some argue that duality creates an opportunistic behaviour of the CEO (Barako, 2007; Al Shammari and Al-Sultan, 2010). Consequently, they will focus on pursuing their personal advantages, rather than the stakeholders, by failing to disclose such information, because they tend to hide unfavourable information from outsiders (Al Shammari and Al-Sultan, 2010) thereby reducing the quality of reporting (Lam and Lee, 2008). Furthermore, less information disclosure and lower levels of transparency will result from CEO duality. Gul and Leung (2004) argued that when these two roles are combined, CEOs often disclose less information to conceal fraud. The CEO also has the ability to choose what to disclose, and CSR may be unimportant from their view and thus is not disclosed (Haniffa and Cooke, 2002).

Previous studies examining the relationship between CEO duality and CSR have produced mixed results. Buniamin et al. (2008), Said et al. (2009), Al Arussi et al. (2009), and Abdul Razak and Mustapha (2013) found no relationship between role duality and CSR. Meanwhile, Webb (2004), Gul and Leung (2004), Huafang and Jianguo (2007), and Mohamed and Faouzi (2014) found a negative relationship between role duality and CSR.

According to the corporate governance code for Jordanian companies listed on the ASE (2009), a single person is not allowed to hold the positions of chairman of the board of directors and any other executive position in the company at the same time. This indicated that the Jordanian authorities expected that companies with CEO

duality tend to disclose less social and environmental information in their annual reports. As such, we hypothesise:

**H5**: There is a negative relationship between CEO duality and the level of CSR disclosure.

### 3.3.6 Multiple Directorships

Multiple directorships refer to the directors who sit on more than one board. However, appointing multiple directorships on a board indicates that the directors are desirable, because they have a high quality of knowledge, experience (Webb, 2004), and credibility (Lorsch and MacIver, 1989). Some arguments for multiple directorships are based on resource dependence theory, which suggests that multiple directorships will bring experience, skills and new insights to the board, resulting from experience and knowledge gained from other firms (Haniffa and Cooke, 2005; Ruigrok et al., 2006). Consequently, this will lead to firms imitating the policies and strategies of other companies. Such a strategy will encourage the board to disclose more in CSR annual reports, because CSR disclosure practices may result in imitation of other companies (Darus, 2009).

Another argument, which supports multiple directorships, was suggested by Kiel and Nicholson (2006), who pointed out that multiple directorships will receive support from external stakeholders. Furthermore, it will be a channel for communicating information to and from the external environment. This will help in making information more transparent and encourage a sharing of experience (Haniffa and Cooke, 2002).

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A number of empirical studies support the relationship between multiple directorships and CSR. For instance, Webb (2004) found that socially responsible firms have directors who are on three or more boards. Haniffa and Cooke (2005) found a significant relationship to CSR disclosure, Courtois et al. (2011) found a positive association with environmental disclosures, while Darus et al. (2009) found an insignificant relationship with CSR disclosure.

In the case of Jordan, corporate governance code do not allow directors to sit on more than five boards. Therefore, it is hypothesised that:

**H6**: There is a positive relationship between multiple directorships and CSR disclosure.

### 3.3.7 Family Members on the Board

Agency theory argues that companies with a high concentration of ownership will disclose less information, because the demand for public disclosure will be low (Jensen and Meckling, 1976). In the case of family ownership, there is little separation between shareholders and managers, because the firm is controlled and managed by family members who are the CEO and board members from the same family. This usually means that conflicts of interest between managers and shareholders are unlikely, rather but between the owning family and minority shareholders (Shleifer and Vishny, 1999). Chau and Gray (2010) argued that family controlled companies tend to disclose less information because they have a greater access to internal financial and non-financial information. Therefore, the demand for public discloser will be low. Webb (2004) noted that family members on the board will lead to a

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weakening of the board's monitoring function, and less motivation to engage in CSR activities, because their goal is fundamentally to protect their own interests, rather than that of the stakeholders (Darus et al., 2009).

Many empirical studies attest that family members on the board affect CSR (Haniffa and Cooke, 2002; Webb, 2004; Darus et al., 2009; Mohamad and Sulong, 2010; Abdullah et al., 2011). They argue that companies with family members on the board disclose less information compared to non-family member boards. Darus et al. (2009) found a negative relationship between the proportion of family members on boards and CSR in Malaysian companies. They indicated that family members have less motivation to disclose CSR information to stakeholders due to their direct access to internal information. These findings are supported by Abdullah et al. (2011) who found that the percentage of family directors on a board is negatively associated with the extent and quality of CSR in Malaysia. Meanwhile, Al-Janadi et al. (2013) found no significant relationship between family members on boards and the level of voluntary disclosure (including CSR) in Saudi companies.

In Jordan, a number of companies are owned by families, which elected family members as the CEO and board members. Therefore, it is expected that a firm with a high proportion of family members is negatively associated with CSR in Jordan. As such, the next hypothesis is as follows:

**H7**: Companies with a high proportion of family members on the board tend to have a negative relationship with CSR disclosure.

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### 3.3.8 Audit Committee

Audit committee is an effective monitoring mechanism that improves corporate governance standards (Said et al., 2009) and enhances the quality of information between principle and agent (Barako et al., 2006). Agency theory suggests that independent directors in an audit committee will support the owners in monitoring the managers' activities (Mohamad and Sulong, 2010). This will reduce agency costs (Forker, 1992) and improve internal control (Ho and Wong, 2001). A company is expected to disclose more social and environmental information. Khan et al. (2012) argued that companies tend to disclose CSR information as indicators that the audit committee can ensure objective financial reporting. Moreover, companies with an audit committee are more responsive to stakeholders' demands for information (Arcay and Va´zquez, 2005).

Previous studies provide evidence of the relationship between audit committee and CSR. Said et al. (2009) argued that a higher proportion of independent members in an audit committee will increase CSR disclosure. They also found a positive relationship between the audit committee and CSR in Malaysian companies. Similarly, Khan et al. (2012) reported a positive association between CSR disclosure and audit committee in Bangladeshi companies. Gantyowati and Nugraheni (2014) found a positive relation in Indonesian companies. Meanwhile, Ienciu (2012) failed to find any association between audit committee and CSR in Romanian companies.

In Jordan, audit committees are mandatory for listed companies based on Securities Law No.76 of 2002, which has committed all listed companies to establish audit

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committee. The Jordanian corporate governance code for 2009 stated that the audit committee should be made up of at least three members of the board of directors, at least two of which must be independent members, including the chairman. This is expected to improve CSR in Jordanian listed companies because the proportion of independent directors on an audit committee will enhance corporate transparency and improve the quality of information disclosure (Forker, 1992). Hence, it is hypothesised that:

**H8**: There is a positive relationship between the number of independent directors sitting on an audit committee and CSR disclosure.

### 3.3.9 The Moderating Role of Board Size on CSR Disclosure

Board size refers to the number of members on the board. However, there are two different perspectives regarding board size. Some scholars argued that large boards increase CSR disclosure in the firms because large boards increase the link with the community which make the board more responsive to social pressure, and increase the quantity of social and environmental information (Halme and Huse, 1997). Resource dependence theory suggests that members of large boards have better access to external resources and provide better sources of information for directors thereby improving decision-making (Siciliano, 1996). Dalton et al. (1999) reported that large boards provide better advice to the CEO due to the presence of more outside directors. Members of such boards may advise companies to disclose more CSR information in order to respond to diverse stakeholders.

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On the other hand, some scholars argued in favour of smaller boards. Lipton and Lorsch (1992) and Jensen (1993) argued that a smaller board is more effective in monitoring the CEO's activities, because within a small board it is easier to coordinate and communicate. Said et al. (2009), Guest (2009), and Htay et al. (2012) argued that within large boards, coordination and communication problems arise resulting in less efficient decision-making. Such boards are more likely to be controlled by the CEO.

Previous studies that linked board size and CSR have provided mixed results. Buniamin et al. (2008) found a positive relationship between board size and environmental reporting in Malaysia. On the other hand, Ienciu (2012) found a negative relationship between the size of the board and environmental reporting in Romanian companies. He argued that a large board was not effective because Romanian companies have a very small ratio of independence within large boards and thus, the disclosure was low. Said et al. (2009) found no relationship in Malaysia but Htay et al. (2012) found that a small board size leads to higher social and environmental information disclosure in Malaysia. Siregar and Bachtiar (2010) came to a different result that boards had a positive relationship with CSR for Indonesian companies and non-linear with CSR.

Some scholars suggest finding a balance between small and large boards. They agreed that optimal size is the best choice. Ning et al. (2010) proposed that firms should consider both agency theory and resource dependency when setting board size. By using the resource dependency theory, the firm tends to increase the board size when the board size is smaller than the optimal size. However, the agency theory suggests the board size when larger than the optimal size, should be reduced. This expectation

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is consistent with the result of Siregar and Bachtiar (2010) who found that large boards have positive relations with CSR but small and very large boards do not positively affect CSR.

There is no agreement about the optimal size for a board. However, Lipton and Lorsch (1992) suggested that the optimal board size should be eight or nine members. Whilst, Jensen (1983) argued that a board size of seven or eight directors is optimal to function effectively. Ning et al. (2010) found that the optimal board size for firms in the USA ranged from eight to 11 directors. In the case of Jordan, the corporate governance code stated that board members should not be less than five and not more than 13. This makes for an average (optimal) board size of nine members.

Besides the direct effect of board size on CSR, board size may also moderate the effect of board diversity on CSR. As the board size increases, the representation of diverse board members also increases (Carter et al., 2003; Adams and Ferreira, 2007; Brammer et al., 2007; Kang et al., 2007). Firms tend to increase the representation of diverse members on the board such as independent and women in order to respond to public pressure. In this case, directors will add a member to the board rather than replace a director. Brammer et al. (2007) explained another association between board size and board diversity. They found that larger boards have higher board diversity, especially with nationality and gender due to greater demand for demographic diversity. They suggested that large boards provide a diverse demographic. Thus, firms tend to appoint more diverse directors on the board in order to improve the quality of decisions-making (Post et al., 2011). This does not mean that board size is

determinant of board diversity but larger board may provide more opportunities to appointing divers directors rather than small board.

As can be expected, board diversity increases with an increase in board size. There is a need for more outside directors on the board as resource dependence theory suggests that appointing more outside board members will provide more resources, information, and legitimacy to the board. Large boards have access to a wider range of resources and are more likely to provide the expertise and skills and knowledge that companies need. Therefore, the addition of outside directors results in larger boards. Ruigrok et al. (2007) suggested that outside directors present a higher degree of board diversity. Larger board provides more opportunities to women, the young, foreigners, and independent directors because of their background and expertise that add value to the board in order to enhance the monitoring and advisor function, which collectively improve CSR.

Based on the above discussion, we expect board size to moderate the relationship between board diversity and CSR. Accordingly, it is hypothesised that:

**H9**: Board size moderates the positive effect of women directors on CSR disclosure.

**H10**: Board size moderates the positive effect of the younger member of the board of directors on CSR disclosure.

**H11**: Board size moderates the positive effect of independent directors on CSR disclosure.

**H12**: Board size moderates the positive effect of foreign directors on CSR disclosure.

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With respect to corporate governance mechanisms, board size also moderates the relationship between the corporate governance mechanisms of multiple directorships, role duality, family members on the board and audit committee with CSR disclosure.

Webb (2004) and Haniffa and Cooke (2005) found multiple directorships to be associated with CSR. Jiraporn et al. (2009) suggested that multiple directorships are more prevalent in large boards. They argued that an increase in the number of outside board members on the board represents the director's reputation. As such, he/she is likely to be appointed in multiple directorships because of his/her good reputation. Multiple directorships are more likely to be appointed on large rather than small boards. When the number of board seats is limited, directors may be unwilling to serve on several board committees because they are busy. On the contrary, firms with large boards more readily accept multiple directors because they are not concerned if they are busy, but are more concerned with their value and reputation, which will add to the board. Consequently, if the board size increases, the multiple directorships is expected to increase, which will encourage the board to disclose more regarding CSR to preserve their reputation. Accordingly, it is hypothesised that:

**H13**: Board size moderates the positive effect of multiple directorships on CSR disclosure.

Large boards seem to be more independent because large boards will increase board diversity (Carter et. al. 2003; Adams and Ferreira, 2007; Brammer et al., 2007; Kang et al. 2007). In the case of CEO duality, agency theory suggests that both the CEO and the chair positions should be separated to improve the effectiveness of monitoring

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activities. Therefore, large boards are better able to oversee management (Siregar and Bachtiar, 2010). One way to make monitoring the activities more effective is to separate the positions of Chair and CEO. An increased board size will enhance the negative effect of CEO duality on CSR and pressure him to disclose more CSR information CSR. Therefore, we hypothesise.

**H14**: Board size moderates the negative effect of the CEO duality on CSR disclosure

Board size also affects on family members on the board. Corbetta and Salvato (2004) argued that an increased board size will reduce family power by increasing the proportion of unaffiliated outsiders and mitigate CEO duality issues. Amran and Ahmad (2011) found that family firms resort to increasing the number of board seats to allow outsiders to join the boardroom in order to improve the external networking and reputation. On the other hand, Darus et al. (2009) found a negative relationship between the proportion of family members on boards and CSR. Thus, family firms with a larger board size may decrease family controlled companies and provide new insight and resource to the board thus, encourage more information to be disclosed. Based on the arguments, it is hypothesised that:

**H15**: Board size moderates the negative effect of family members on the board on CSR disclosure.

Finally, board size is also expected to moderate the effect of audit committee on CSR reporting. Agency theory suggests that independent directors in an audit committee will support the principals in monitoring the managers' activities (Mohamad and

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Sulong, 2010) and improve the quality of information flow between principle and agent (Barako et al., 2006). Therefore, the audit committee should be strengthened to do their duties effectively and efficiently. Baxter (2010) argued that firms have the incentive and the ability to strengthen their audit committees by adding additional outsiders to the committee to be more active and independent. Consequently, the larger the board of directors, the more independent directors sit on the audit committees which bring experience and knowledge and increase the effectiveness and efficiency of the board in monitoring thereby enhancing corporate transparency and disclosure. Accordingly, it is hypothesised that:

**H16**: Board size moderates the positive effect of independent directors sitting on an audit committee on CSR disclosure.

### 3.3.10 CSR Disclosure Pre and Post Corporate Governance Code

In general, regulations play a vital role in improving information disclosure (Cheng and Courtenay, 2006). Albassam (2014) stated that governance codes will help companies develop and improve good governance and disclosure practices. According to institutional theory, management has incentives to disclose more CSR information to comply with regulation requirements in order to justify their actions and to avoid any criticism regarding CSR reporting. Darus et al. (2009) argued that regulatory efforts are an important mechanism and significant force to promote greater corporate transparency and quality in CSR disclosure because regulations will increase

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managers' awareness regarding CSR disclosure and reflect managers' responses to regulatory disclosure requirements (Choi and Meek, 2008).

There are limited studies comparing CSR disclosure levels before and after the introduction of a corporate governance code. Damagum and Chima (2013) found a significant increase in voluntary information disclosure after the introduction of CG codes in Nigeria (from 2005 to 2009) compared to before code implementation (from 1999 to 2003). Similarly, Albassam (2014) concluded that information disclosure has been improved after implementing the code of corporate governance in Saudi listed firms from 2006 to 2010.

In Jordan, the corporate governance code for companies listed on the ASE requires companies to disclose social and environmental information in their annual reports. This regulation will improve and strengthen corporate governance mechanisms in Jordan (such as independent directors, audit committee and CEO duality) which in turn enhances the level of CSR disclosure. Consequently, this study expects that the level of CSR disclosure after implementing corporate governance code is significantly different from before implementing this code. Therefore, the following hypothesis is suggested

**H17:** There is a significant increase in the level of CSR disclosure from the pre (before CG code) - to the post (after CG code) regulation year in Jordanian listed companies.

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### 3.3.11 CSR Disclosure in the First and Second Market

The third objective of this thesis is concerned with testing for a difference in CSR disclosure levels between the first and second market. As earlier mentioned, the difference between both markets is determined by the capital, number of shareholders and net shareholders' equity. In general, first market consists of large and mature companies, while the second market consists of small and newly listed companies. Mohamad et al. (2010) used companies listed on the main board as a proxy for large company and second board for small company. According to agency theory, large firms have incentives to disclose more information than small firms in order to reduce agency costs since they have higher information asymmetry between managers and shareholders (Jensen and Meckling, 1976). Moreover, larger companies have more stakeholders and are thus more visible to the public and more politically sensitive than smaller firms (Watts and Zimmerman, 1978). Therefore, large firms are more likely to disclose CSR in order to enhance their reputation and to reduce political costs (Ismail and Ibrahim, 2008).

The majority of previous studies focused on the first market or large companies and presented positive results between large firm and CSR disclosure (Hackstone and Milne 1996; Al-Khadash, 2003; Suwaidan et al., 2004; Haniffa and Cooke, 2005; Ghazali, 2007; Ismail and Ibrahim, 2008; Said et al., 2009; Abdul Razak and Mustapha, 2013). However, Mohamad et al. (2010) found that companies listed on the main board disclose higher information than those in the second board of Malaysian listed companies.

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In Jordan, companies listed in the first market have large capital and a greater number of shareholders than those in the second market. Therefore, it is expected that companies listed on the first market in ASE tend to disclose more information than those on the second market. Hence, it is hypothesised that:

**H18**: Companies listed on the first market are more likely to disclose more CSR information than those in the second market.

## 3.4 CHAPTER SUMMARY

This chapter provided an overview of theoretical perspectives that is commonly applied in literature reviews. The agency theory and resource dependence theory have been used in this thesis to study the relationship between corporate governance mechanisms, specifically board diversity and CSR. Agency theory has been widely used in corporate governance literature, while resource dependence theory has been employed in board diversity literature as a possible explanation of the relationship between board diversity and CSR.

This chapter presented the conceptual framework of this thesis. Eight independent variables were identified, namely gender diversity, age of directors, independent directors, nationality of directors, role duality, multiple directorships, family members on the board, audit committee, as well as board size as moderate variables. The predicted influence of these variables on CSR levels was explained in the hypotheses development section. There are sixteen hypotheses in this study. The first eight hypotheses test the relationship between board diversity and corporate governance

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variables on CSR and the final eight hypothesis tests the moderating effect of board size on the relationship between independent variables and CSR.

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