

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

In contemporary business, there is a growing global concern on the role of businesses in society. It is therefore timely that businesses are now paying attention to the increasing concern in this role. One aspect of this concern is the state of corporate social responsibility (CSR). CSR is used to show that companies are socially and environmentally responsible. The World Business Council for Sustainable Development (1999) defined CSR as “the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large”. Therefore, companies are responsible, not only to shareholders, but also to stakeholders and society. Said et al. (2009) stated that companies tend to disclose additional information and report their activities to the stakeholders as a means to reduce information asymmetry between the company and its stakeholders. With an increasing trend of firms engaging in CSR activities, researchers have begun examining the extent of disclosure, including type (i.e., environment, community, products and consumers), form (stand-alone report or chairman report), quality (i.e., monetary/non-monetary, good/bad news and forward- looking/historical) and quantity (i.e., amount or volume) of the information disclosed. With this, CSR disclosure has become an important issue for companies due to the increased demand

for such information by stakeholders especially investors (Saleh et al., 2011). According to them, investors are more likely to invest in companies that engage in CSR activities because CSR improves financial performance and access to capital, reduces operating costs, enhances corporate image and reputation, and increases customer loyalty (Said et al., 2009).

Being a small country with limited natural resources, CSR activities and disclosures in Jordan have received a lot of government attention. The last few years have witnessed a renewed importance attached to CSR activities and disclosures in Jordan due to the importance of such information to ensure the quality and reliability of the annual report as a means to attract foreign investment (Naser et al., 2002; Ismail and Ibrahim, 2008). However, CSR research in Jordan remains limited and in its infancy (Al-Khadash, 2003). In practice, there remains a low level of CSR disclosure from listed Jordanian companies (Abu-Baker and Naser, 2000; Al-Khadash, 2003; Suwaidan et al., 2004; Ismail and Ibrahim, 2008).

As for who is responsible for such disclosure, in Jordan, the board of directors is responsible for setting the company's disclosure and transparency policy, and for managing information disclosure in annual reports (Jordan Securities Commission, 2009). Therefore, corporate governance should be considered because it is the board of directors (as top management) who oversee and manage information disclosure in annual reports (Gibbins et al., 1990). Huang (2010) argued that good corporate governance ensures that companies are responsible, accountable, and transparent to all stakeholders. By enhancing transparency and improving information disclosure (Gul and Leung, 2004), the quantity and quality of disclosure improves and better

addresses the needs of various stakeholders (Lim et al., 2008; Jo and Harjoto, 2011; Khan et al., 2012). Consequently, CSR disclosure can be enhanced through corporate governance mechanisms (Lim et al., 2008) pertaining to the board of directors, audit committees, and ownership structure. Among these mechanisms, the board of directors is the most important element due to the important role played by its members. Nowadays, the role of the board of directors has expanded. Its aims are not only to achieve shareholders' goals, but also to take into account the interests of other recognised stakeholders. As such, the board must meet its obligation of accountability to both shareholders and stakeholders alike (Ayuso and Argandona, 2007).

Since the board plays an important role, it needs to ensure that its representation is balanced and reflects the firm's stakeholders and other groups in society. Some ways to achieve this is to appoint women, young people, and minorities to the board board (Miller and Triana, 2009; Bear et al., 2010). This is to ensure that all relevant aspects from all various perspectives are considered when making decisions. Having a diverse mix of individuals on a board of directors will increase board effectiveness and board independence (Erhardt et al., 2003; Carter et al., 2007), improves the board's decision-making (Walt and Ingle, 2003; Carter et al. 2003; Ayuso and Argandona, 2007; Ruigrok et al., 2007; Ness et al., 2010), increases the level of charitable giving (Coffey and Wang, 1998; Wang and Coffey, 1992; Williams, 2003), improves social performance (Siciliano, 1996), and improves CSR (Ayuso and Argandona, 2007; Khan, 2010; Bear et al., 2010; Post et al., 2011). Given the many aforementioned benefits, the main objective of this study is to empirically examine the impact of corporate governance mechanisms and board diversity characteristics on CSR disclosure in Jordan.

1.2 PROBLEM STATEMENT

Jordan is a small country with limited natural resources. In recent years, poverty and unemployment have become major issues challenging Jordan (Elian, 2005), with approximately 14.2% of the country's population in poverty as of 2008 (Department of Statistics (DOS), 2011). The unemployment rate also remains high with around 18% in 2010. As the Jordanian government appears to be unable to solve these issues, the government has focused its attention to the role of the private sector to play advance the Jordanian economy and by it reduce poverty and unemployment (Elian, 2005). Al-Hamadeen and Badran (2014) stated that the Jordanian private sector has a responsibility to engage in solving sustainability issues related to poverty, unemployment and other social concerns. One way of achieving this is through adopting and implementing CSR practices and reporting as tools that help firms to fulfil their duties towards society and the environment (Stay et al., 1996).

Towards this end, significant steps have been taken by the Jordanian government to improve CSR in Jordan. Such steps include the enactment of legislation and regulations that mandate Jordanian organisations to disclose social and environmental information in their annual reports (i.e., Securities Commission law of 1998 and Companies Act 1997) to ensure the quality and reliability of the annual report as a means to attract foreign investments (Naser et al., 2002; Ismail and Ibrahim, 2008). Consequently, the CSR disclosure has been mandatory since 1998.

Despite attempts by the Jordanian government to improve CSR activities, past studies in Jordan revealed that the level of CSR disclosure remains relatively low. For

example, Al-Khadash (2003) found that 26% of the companies did not have any form of social and environmental disclosure in their annual reports. Suwaidan et al. (2004) found that only three companies received disclosure scores of more than 30% of CSR disclosure items. There is strong evidence of a disclosure gap between the expectations of investors, government and society and what is actually disclosed. This problem reflects bad corporate image and poor governance both of which will negatively affect investment opportunities. Similarly, such a state of affairs could lead to increased public pressure on companies to better exercise their ethical responsibility toward society. It is the right of society to know what and how much these companies will contribute to the community as well as environment. In order to respond to this problem, the present study focuses on the role of corporate governance and board diversity as powerful and important factors in improving CSR disclosure.

Nowadays, there is an urgent need for a good governance system in Jordan in order to improve corporate transparency in CSR disclosure, especially in the annual reports which are considered the main sources of CSR information provided to investors (Ismail and Ibrahim, 2008). Corporate governance provides a set of a monitoring mechanisms that force management to act in the best interest of stakeholders which in turn lead to increasing the quantity and quality of disclosure (Lim et al., 2008; Jo and Harjoto, 2011; Khan et al., 2012).

The board of directors as the highest legal authority in companies constitutes an important significant governance structure for determining CSR disclosure (Barako and Brown, 2008). As the board of directors is responsible for setting the company's disclosure and transparency policy, it needs to ensure that board representation is

balanced to discharge their duties effectively. Board diversity will increase the resources provided by board members such as skills, information, legitimacy, and access to key constituents (e.g., suppliers, buyers, public policy decision-makers, and social groups) (Hillman et al., 2000). Therefore, diverse directors (through age, gender, nationality) provide unique information to the management for better decision-making (Ayuso and Argandona, 2007) thereby improving the effectiveness of corporate leadership, provides legitimacy to firms and global relationships (Carter et al., 2007; Ferreira et al., 2010), improves the CSR strategy at the board level resulting in improved CSR disclosure (Post et al., 2011).

1.3 RESEARCH QUESTIONS

1. What is the level of CSR disclosure in the annual reports of Jordanian companies?
2. Is there a significant difference in CSR disclosure levels during the pre and post corporate governance code in Jordan?
3. Is there a difference in CSR disclosure levels between the first and second market?
4. Is there a significant relationship between corporate governance mechanisms and the level of CSR disclosure in Jordanian companies?
5. Do board diversity characteristics such as independence, age, gender, and nationality of directors influence CSR disclosure in Jordanian companies?
6. What is the role of board size as a moderating variable on the relationship between board diversity and corporate governance with CSR disclosure?

1.4 RESEARCH OBJECTIVES

The main objectives of this study are:

1. To determine the current CSR disclosure practices amongst Jordanian listed companies.
2. To compare CSR disclosure levels before and after the implementing of corporate governance code in Jordan.
3. To compare CSR disclosure levels between the first and second markets for Jordanian listed companies.
4. To examine the relationship between corporate governance mechanisms, such as role duality, multiple directorships, family members on the board, and audit committee, with the CSR disclosure of Jordanian listed companies.
5. To determine the influence of board diversity, specifically gender diversity on the level of CSR disclosure.
6. To examine board size as a moderator between board diversity and corporate governance with CSR disclosure.

1.5 SIGNIFICANCE OF THE STUDY

The importance of this study hinges on the attempts made by the Jordanian government, with regards to social and environmental reporting, to encourage and improve foreign investment, as well as reduce poverty and unemployment levels in Jordan. Such efforts are expected to contribute to the nation's economy. A study of the Arab region conducted by Saidi (2004) indicated that investors are ready to pay more for shares in firms that have good corporate governance and CSR reporting. The

'Global Investor Opinion Survey' by McKinsey (2002) found that 80% of 200 investors (who control \$3 trillion in assets) are willing to pay a premium of approximately 40% for shares in companies located in the Arab world, which are well governed and socially responsible. In Jordan, the market capitalisation of listed companies amounted to Jordanian Dinars (JD) 19 billion, representing 93.5% of GDP in 2012. This ratio reflects the importance of the Amman Stock Exchange (ASE) in the national economy. Thus, it is expected to gain around JD7.6 billion for the increase of stocks. Consequently, Jordanian companies are expected to add value to the national economy by increasing the rate of GDP growth, which will help reduce poverty and unemployment in Jordan.

This study is important because it aims to bridge the gap in existing CSR literature in Jordan, covering the following three areas.

Firstly, existing CSR literature in Jordan is focused only on the influence of corporate characteristics on CSR (Abu-Baker and Naser, 2000; Al-Khadash, 2003; Suwaidan et al., 2004; Ismail and Ibrahim, 2008). These studies failed to examine the association between corporate governance (especially board diversity) and CSR. Therefore, corporate governance should be considered, as it is the board of directors that oversees and manages information disclosure in annual reports (Gibbins et al., 1990). This complies with the corporate governance code for companies listed on the Amman Stock Exchange (ASE), which identifies and defines the duties and responsibilities of the board of directors. According to this code, the board of directors is responsible for setting the company's disclosure and transparency policy, and for overseeing its implementation in accordance with the requirements of the regulatory authorities and laws in force (Jordan Securities Commission, 2009).

Secondly, there is an absence of CSR literature with regards to the influence of female directors in Arab and Muslim countries, especially in Jordan. Despite this, Jordanian women lead other Arabic women in terms of literacy rates and are classified amongst the top five in the Middle East and North African (MENA) countries (World Bank, 2005). In addition, Jordanian women tend to have higher levels of academic achievement than men in both high school and college. In 2007, approximately 52% of all university students in Jordan were female (DOS, 2009). The appointment of five women as ministers in 2009 is clear indication that Jordanian women have reached the decision making level in Jordan. Furthermore, the Ministry of Justice adopted a policy to appoint more female judges with a target of 40% female judges from the total number of judges by 2015. This is in comparison to other countries like Norway, whose government required listed companies to have at least two females by 2006, and 40% by 2008 (Cabo et al., 2009). No government policy has been adopted in Jordan to appoint a specific percentage of women on the board of directors. However, in 2008, at least 22% of all boards of directors in Jordan had at least one female (ASE, 2009). Compared to developed countries, this percentage is low, for example, in Australia, 50% of all companies had at least one female director in 2004. Meanwhile, 62% of the top 200 European companies had at least one female director in 2004, whilst in the USA, Fortune 500 companies had 86 female directors in 2003 (CWDI Report, 2006). Studies have found that an increase in 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 greater social sensibility (Buregess and Tharenou, 2002) and show more favourable attitudes to ethical behaviour compared to 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).

Jordan, like most Muslim countries, continues to struggle with the issue of women participation on the board of directors. In general, there is a gap between Islamic teachings and the practice of Muslims regarding gender equity (Williams and Zinkin, 2005). Islam prohibits discrimination on the basis of gender and emphasises the right of woman to access and participate on social, educational, economic and political levels (Azmi et al., 2011). Allah clearly states in the Qur'an, "O mankind! We created you from a single pair of a male and a female, and made you into nations and tribes, that you may know each other (not that you may despise each other). Verily the most honoured of you in the sight of Allah is he who is the most righteous of you. And Allah has full knowledge and is well acquainted with all things" (Al-Quran. Al-Hjurat 49:13). In addition, Prophet Muhammad (pbuh) said, "Assuredly, women are the twin halves of men" (Hadith. Jami' Tirmidhi, Book 1, #113). Unlike developed countries, no study has examined the influence of female directors on CSR amongst Arab or MENA countries.

Thirdly, the CSR literature thus far conducted on Jordan have solely focused on the first market or large companies. There is therefore a need to study second market companies. These markets are divided according to liquidity and company profits. The researcher expects that the influence of corporate governance mechanisms on CSR differs between first and second market companies, due to differences in the natures of both listed companies. It is therefore important for investors to know the difference between both markets to assist them in investment decisions. Such

decisions will increase the share prices and trade volumes (Nor and Ahmad, 2004). On the other hand, companies (specifically, those listed on the second market) want to attract more invest in their shares to increase the liquidity of the stocks thereby helping in their transfer from the second to the first market. It is therefore important for regulators to understand the difference between both markets regarding CSR reporting and how this could increase the number of first market companies which dropped from 112 in 2007 to 55 in 2012 (ASE, 2013).

1.6 STUDY CONTRIBUTION

This study offers several significant contributions to existing CSR literature.

First: This is the first study that examines the impact of corporate governance mechanisms and board diversity on CSR disclosure in Jordan. Existing CSR literature in Jordan focuses only on the influence of corporate characteristics (Abu-Baker and Naser, 2000; Al-Khadash, 2003; Suwaidan et al., 2004; Ismail and Ibrahim, 2008). This study provides empirical evidence of the association between board diversity and the level of CSR for companies listed in the ASE, especially since 2009, when the corporate governance code was implemented. By comparing CSR levels from before and after this code's implementation, this study will help authorities and stakeholders evaluate current corporate governance practices and assess the existing CSR levels among Jordanian companies.

Second: To introduce the new variable of females on the board of directors. This will provide information about females on the board of directors in Jordan as both a Muslim and Arabic country. As far as this research is aware, no study has previously

examined this variable either in Jordan or among other Arabic and MENA-region countries. In the case of Jordan, women have made big leaps in participating in decision-making levels and educational progress compared to other Arab countries, such as Saudi Arabia where, women are still not allowed to drive a car and travel alone. Jordanian women lead other Arabic women in terms of literacy rates and are classified amongst the top five in Middle East and North Africa (MENA) countries (World Bank, 2005). This study will provide insights into the impact of female directors in Jordan on CSR. It will also draw the attention of policymakers and regulators in Jordan and in the Arab world to the importance of adopting policies that require listed companies to appoint a specific percentage of women to their boards of directors.

Third: This is the first study that uses board size as a moderating variable to examine the effect of board diversity and corporate governance mechanisms on CSR in Jordan. Previous studies solely examined the direct effect of board size on CSR (Buniamin et al., 2008; Said et al., 2009; Siregar and Bahtiar, 2010; Ienciu, 2012; Htay et al., 2012). This study provides further evidence on the role of board size in moderating the relationship between board diversity and CSR.

Fourth: The introduction of new CSR items (*zakat*, *waqf* and *Qard al Hassan*) deemed important to the Jordanian environment were introduced, yet to date, no study has examined Islamic CSR in Jordan. Muslims believe that these items are the most powerful instruments for achieving socio-economic justice and alleviating poverty and unemployment (Khaf, 1998; Sadeq, 2002; Ahmad, 2004; Kahf, 2004; Sarif and Kamri, 2009; Bello, 2009; Suhaib, 2009; Abdul Karim, 2010; Budiman and Kusuma,

2011; Nurrachmi, 2012; Sarea, 2012). Such claims have already been demonstrated In Jordan (Al-Aqaileh, 2008). In this study, the focus on these items as proxies on Islamic CSR because the main current concentration in government strategies are on these items, since these items considered the most important mechanisms for achieving economic and social justice in Jordan, while also helping reduce unemployment and poverty in Jordanian society. For example, *Qard al Hasan* is used as an instrument for urgent financing such as medical treatment. However, other Islamic CSR such as *halal* (permitted) services and products do not take place in Jordan and are not part of the current focus. This study will help the policymakers in Jordan and Muslim stakeholders to assess Islamic CSR practices within Jordanian companies in order to ensure that these companies are in compliance with *shari'ah* requirements, thereafter assisting Muslim stakeholders to make appropriate religious and economic decisions.

Fifth: This is the first study to compare CSR disclosure practices in the first and second markets in Jordan. Previous CSR literature concerning Jordan has focused only on the first-market or large companies. It is therefore important to study second-market companies, as this will assist regulators and investors by highlighting significant differences that may exist between main-board and second-board companies with regard to CSR disclosure.

1.7 OUTLINE OF THE THESIS

This thesis consists of six chapters. Chapter one provides an overview of the study, followed by the research questions and research objectives. It explains the

significance of the study and its contribution to the existing body of knowledge. Chapter two provides a review of the relevant literature. It discusses the role of corporate governance and board diversity on determining the level of CSR and Islamic CSR. Chapter three presents a theoretical framework and explains the theories used in this study, namely the agency and resource dependency theory. In addition, this chapter presents and describes the hypotheses development. Chapter four discusses the research methodology adopted in this study. It describes the sample, data collection, variable measurements, and the data collection and analysis procedures. Chapter five explains and discusses the analysis and findings. Chapter six concludes the study and consist of a summary of the research and a discussion of the limitations of this study, followed by suggestions and recommendations for future research.