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# Effect of characteristics of board of directors on corporate social responsibility disclosure by Islamic banks: Evidence from Gulf cooperation council countries

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**Abstract -** Corporate social activities have become major subjects because of their effects on the quality of life of citizens, in particular, and on society at large. Currently, there is an increased awareness of social responsibility due to the challenges faced by financial institutions (particularly Islamic banking) globally. This paper examines the influence of characteristics of the board of directors, that is, board size, board composition, and the separation of the roles of chief executive officer (CEO) and chairman, on corporate social responsibility (CSR) disclosure. After controlling bank size, financial performance and the relevant public, the research focuses on 53 annual reports of Islamic banks of Gulf Cooperation Council (GCC) countries. Based on the framework of legitimacy theory, the findings show that CSR disclosure has a negative and insignificant relationship with board composition. By contrast, the study found a positive association, although insignificant, between CSR disclosure and other characteristics of the board of directors (board size and separation of the roles of CEO and chairman). With regards to the controlled variables, the study indicates that bank size and financial performance have a positive and significant influence on CSR disclosure, while the relevant public has no effect. Therefore, the results indicate that the corporate governance structure of a board of directors within Islamic banks of the GCC region does not play a major role in CSR disclosure, largely due to family control. These findings suggest a need to improve best practice of corporate governance for Islamic financial institutions by imposing additional constraints on the board of directors' characteristics. The importance of this evidence is that both policy makers and investors will be more aware and will understand better the role of the board of directors in relation to CSR disclosure.

*Keywords*: corporate governance, board of directors' characteristics, Islamic banks, GCC countries, bank performance, legitimacy theory

## 1. Introduction

Corporate governance has become a vital subject during the past twenty years (Chapra and Ahmed 2002). This is because of the recent high incidence of corporate collapses, such as Enron, WorldCom, HIH Insurance, and Global Crossing, together with the increased global awareness of the need for sound corporate governance based on stakeholder accountability and financial transparency (McLaren 2004).

Recently, Islamic financial institutions have experienced collapses similar to those of conventional banks, such as the failure in 2001 of Ihlas Finance House (IFH) in Turkey,

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this being the most famous case for Islamic financial institutions. This collapse happened because of the weak corporate governance being practiced (Dusuki 2006). According to Grais and Pellegrini (2006a), there are many reasons behind the failure of IFH, including collusion of the board of directors with the management, audit failure, and excessive risk taking by management.

Most studies previously have examined the impact of the corporate governance mechanisms, including the board of directors, on voluntary disclosure (Akhtaruddin et al. 2009; Li et al. 2008; Haufang and Jainguo 2007; Zeghal et al. 2007; Barako et al. 2006; Gul and Leung 2004; Eng and Mak 2003; Ho and Wong 2001). Other studies have investigated the association between the board of directors' structure and CSR disclosure in non-financial industries (Abdur Rouf 2011; Said et al. 2009; Rashid and Lodh 2008; Buniamin et al. 2008; Haniffan and Cooke 2005). However, few studies have examined the influence of the board of directors' attributes on CSR disclosure in the financial sector (Barako and Brown 2008; Khan 2010). No serious attempt has yet been made to study the influence of the structure of the board of directors on CSR disclosure within the Islamic banking industry. Islamic banks claim to follow Shariah principles and rules in their activities, which influence the welfare of community. This study contributes in four ways to current knowledge of the determinants of CSR disclosure based on the board of directors' structure in the unique sector of Islamic banking:

1. It addresses the question of whether the lack of association between board size and CSR disclosure, as observed in many other industries, is apparent within the context of Islamic banking.
2. The question of whether having a greater proportion of non-executive directors on the board is positively related to CSR disclosure, as found in previous studies, is explored.
3. There is an empirical examination of whether separation of the roles of CEO and chairman has the same impact on CSR disclosure among Islamic banks as is apparent from the current literature.
4. The results of the study may prove useful to regulators for evaluating current corporate governance standards, in terms of whether these requirements are sufficient for users of CSR information, such as investors, when making investment decisions. More important, the findings have policy implications for corporate governance mechanisms, which suggest that separation of the roles of CEO and chairman has no effect on CSR disclosure.

## 2. Islamic banks in GCC countries

The GCC comprises six oil-producing countries located in the Middle East: Qatar, the United Arab Emirates (UAE), Saudi Arabia, Kuwait, Bahrain, and Oman. The total population of GCC countries is around 42 million people. Currently, one of the most important strategies for achieving rapid economic growing in Islamic countries, such as those of the GCC, involves the banking sector. The banking industry in GCC countries is primarily owned by nationals due to the restrictions on foreign ownership. For instance, foreigners in Qatar are not allowed to possess more than a 49 percent share, whereas in Oman, the figure is only 35 percent ownership (Alkassim 2005).

Today, there are more than 300 Islamic financial institutions operating in 75 countries throughout the world, with the annual rate of 12–15 percent. The total assets of Islamic banks increased from US$822 billion in 2009 to US$1.3 trillion in 2010 (New Horizon-Islamic Banking 2010), and are expected to reach US$3 trillion by 2016 (Eurasia Review 2011). The greatest proportion of these financial institutions is found in the GCC countries, as the Gulf region is the main source of financing for Islamic banking transactions. At the end of 2007, more than 40 percent (US$262.6 billion) of the total Shariah-compliant financial assets (US$640 billion) was invested in GCC countries (Wilson 2009). The strength of the banking industry in GCC countries is based on large profits and assets (see Table 1); the profitable banking sector supports stability in the financial system and, consequently, a stable local economy (Zeitun 2011).

Islamic banking provides a large range of services and products that are in conformity with Shariah principles and rules. The main principle of Islamic financing is profit-loss sharing. There are a number of principles that make

**Table 1.** Leading Islamic banks by asset values (US million).

| Islamic ranking 2010 | Institution | Country | Assets | Profits |
|---|---|---|---|---|
| 22 | Emirates Islamic Bank | UAE | 6.886 | 35.5 |
| 23 | Masraf Al Rayan | Qatar | 6.627 | 242.0 |
| 27 | Dubi Bank | UAE | 4.737 | –79.1 |
| 28 | Investment Dar Co. | Kuwait | 4.697 | 469.2 |
| 29 | Bank AlBilad | Saudi Arabia | 4.643 | –66.2 |
| 30 | Alima Bank | Saudi Arabia | 4.615 | 161.4 |
| 31 | Noor Islamic Bank | UAE | 4.591 | –302.5 |
| 33 | Qatar International Islamic Bank | Qatar | 4.547 | 140.5 |
| 34 | Arcapita Bank | Bahrain | 4.372 | –87.9 |
| 35 | Sharjah Islamic Bank | UAE | 4.350 | 70.8 |
| 37 | Amlak Finance PJSC | UAE | 4.315 | 54.4 |
| 39 | Kuwait International Bank | Kuwait | 3.976 | –28.6 |

*Source*: Asian Banker Research.

Islamic banks different from conventional banks (Zeitun 2011; Chong and Liu 2008; Olson and Zoubi 2008):

- The most important principle of Islamic banking is the prohibition on interest (riba).
- Investments must be in non-prohibited activities.
- All operations must be free from uncertainty (gharar) and gambling (maiser).
- Zakah must be paid by an Islamic bank or shareholders to eight kinds of people as mentioned in the Quran.
- All transactions of Islamic banks must be consistent with Shariah principles and rules.

For financial operations to be Shariah-compliant, there must be a reliable affirmation mechanism. Islamic banks in GCC countries took steps to establish boards of specialists in Islamic Commercial jurisprudence (figh al-muamalat) in order to give advice on the financial services and products provided. Each Islamic financial institution has its own Shariah board that provides approval for new kinds of finance services. Indeed, particularly in GCC countries, the Shariah compliance system develops the markets by offering various products and expanded customer alternatives.

## 3. Corporate governance in Islamic banks

Corporate governance is defined as a "set of relationships between a company's management, its board, its shareholders and other stakeholders" (Chapra and Ahmed 2002), and aims to achieve justice to all stakeholders by increasing transparency and accountability. It also aims to monitor and control management in order to maximize company value. The main components of corporate governance include investors' relations, as well as relationships between stakeholders, including employees, clients, and customers.

From the Islamic perspective, the framework of corporate governance is quite distinctive under Islamic banks because they must follow a unique set of principles based on the Holy Quran and the Sunnah.

According to Bhatti and Bhatti (2009), scholars of Shariah stated that the concepts of Islamic corporate governance and corporate social responsibility (CSR) were quite similar. The fundamental objective of Islamic financial institutions, such as banks, is compliance with Shariah principles, which contain principles of social justice and accountability (Farook and Lanis 2005). In the context of Islam, the ethical objectives of the community must be integrated with the objectives and policies of Islamic banks. Accordingly, Hassan and Abdul Latiff (2009) asserted that the CSR is a primary condition of Islamic banking transactions. Actually, the CSR is involved in the Corporate Governance standard of AAOIFI (Governance Standard for Islamic Financial Institutions No. 7: Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions). The Shariah rulings and the principles of Islamic economy and finance must be set to determine a suitable structure of corporate governance for Islamic banks. Zakah, prohibition of riba, prevention of gharar, prohibition of hoarding, and the sharing of profit and loss are the major principles of Islamic economics. All these principles influence the corporate governance structure of Islamic banks. The Islamic corporate governance structure is derived from the structure of conventional corporate governance, but based on the ethical codes of Shariah.

The model of corporate governance for Islamic banks is supposed to be grounded on the principle of property rights in Islam; the system that is set must comply with Shariah rulings and the protection of the rights of stakeholders, who consist of shareholders, investors, creditors, employees and wider society as well (Bhatti and Bhatti 2009; Hasan 2008). According to Grais and Pellegrini (2006a), the unique attributes of Islamic banks must be clarified in order to produce a regulative structure that supports the development of their corporate governance.

In the last two decades, Islamic banks have experienced collapses similar to those of the conventional banking sector, because of the weak corporate governance being practiced within these financial institutions. According to Grais and Pellegrini (2006b), the reasons behind these failures are the collusion of the board of directors with the top management, the collapse of audit, and extreme risk-taking by management. The best examples of the collapses of Islamic financial institutions are the failure of Ihlas Finance House of Turkey in 2001 (Dusuki 2006) and, in 2003, the Patni Cooperative Society of Surat of Indian (Grais and Pellegrini 2006b).

In the light of these scandals, organizations have taken steps to strengthen their corporate governance, not only by making the board of directors more independent, but also by enhancing the firm's transparency through the adoption higher disclosure standards (Hauswald and Marquez 2006).

Strong corporate governance of a bank is a crucial component for the improvement of the Islamic finance industry; international corporate governance standards that are compliant with the Shariah can be accepted and applied.

The Code of Best Practices for Corporate Governance in Islamic Financial institutions (Chapra and Ahmed 2002), Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (IFSB 2006), and the standards of AAOIFI have set up corporate governance devices to improve transparency and accountability. Corporate governance comprises a number of practices including a requirement regarding the size of the board, an independent directors' board, the separation of CEO and chairman, and the independence of the chairman.

As for many other developing economies including Taiwan (Yeh et al. 2001), Thailand (Wiwattanakantang 2002), Turkey (Ararat and Ugur 2003), and South Korea (Joh 2003), banks in GCC countries are in many cases family-owned, with family members directly involved in management (Arouri et al. 2011).

Briefly, positive corporate governance is much more than a desirable concept. It supports the construction of capital, reduces capital costs, develops the climate of investment, and assists to create good markets. Therefore, the participants in the market with an vested interest in the improvement of sustainable national capital markets can also play an important role in elevating governance standards by setting the expectations of the market for what is preferable corporate behaviour.

## 4. Islamic social reporting in Islamic banks

The first and the major objective of reporting by Islamic financial institutions is to show that the transactions of banks are in compliance with Shariah principles and rules (Haniffa 2002; Baydoun and Willet 1997). Although considered to be the primary objective in the Western model, assessing the decision-makers in their making of economic decisions is a secondary goal for business organizations from the Islamic viewpoint (Maali et al. 2006; Mukhazir et al. 2006). For Islamic banks and financial institutions that have set by the AAOIFI, this main objective is included in the objectives of financial statement. Consequently, financial corporate reporting emphasizes the principles of full disclosure and accountability in meeting the needs of the society. The meaning of full disclosure is that Islamic banks should provide all necessary information to the society related to their transactions (Maali et al. 2006). Based on this concept, the community (ummah) has the right to know the influence of the banks' operations on the welfare of society, and to ensure that they are in compliance with the requirements of Shariah.

The truth is a very important issue in the Islamic context, and it must be disclosed as a duty for both businesses and individuals (Maali et al. 2006); Islam forbids the withholding of truth (Askary and Clarke 1997). The Quran emphasizes this duty in the following verse: "and cover not the truth with falsehood, nor conceal the truth when you know" (2:42). Six verses in the Quran refer to one meaning related to disclosure of all facts (Askary and Clarke 1997). As accountability to Allah includes an accountability to the community, the duty to disclose is owed primarily to Allah, as well as to society (Maali et al. 2006; Al-Mograbi 1996). The implication of this position for Islamic banks is that disclosure of the truth is intended to be in the public interest as the banks will know the influence of their transactions on the welfare of community. One of the primary objectives of Islamic banks is to eradicate poverty through generating jobs, and encouraging charitable activities that lead to help for the poor and needy. In the Quran Allah says: "of their goods take alms that so thou mightest purify and sanctify them" (9: 103). Furthermore, they are required to pay zakah as a religious obligation. Accordingly, Muslim investors need information related to spiritual, ethical, and other religious requirements, such as prohibition of riba (interest), payment of zakah, and the certification that banks do not engage in haram (unlawful) transactions (Mukhazir et al. 2006).

Maali et al. (2006) stated the three main objectives of Islamic social reporting:

1. Show compliance with Shariah principles through contracting fairly with various parties inside and outside business organizations, such as employees, shareholders, and government.
2. Clarify the influence the activities of Islamic businesses on the welfare of society.
3. Enable Muslims to perform their religious obligations easily.

In the context of Islamic reporting, it is expected that social issues would be a significant component of disclosure in the annual reports. Consequently, as suggested by prior studies, business organizations in Islam must be more transparent in their disclosure practices related to social activities, which affect the welfare of community (Cho and Patten 2007; Haniffa and Cooke 2005; Hamid 2004; Patten 1992). This would lead to achievement of the main objectives of Islamic social reporting, that is, social accountability and full disclosure (Othman et al. 2009; Baydoun and Willet 2000).

## 5. Theoretical framework

Legitimacy theory acts as the tool to build, maintain and legitimize economic and political regulations, organizations, and ideological groups, which add to the benefits of the company. According to Guthrie and Parker (1990), disclosures have the capability to transfer the social, political and economic meanings for a pluralistic set of people or groups receiving the report. Legitimacy theory has become one of the major theories quoted in the area of social and environmental accounting (Campbell et al. 2003; Deegan 2002). According to legitimacy theory, a corporation discloses CSR information in order to establish or sustain its legitimacy by obtaining community acceptability of its actions (Deegan 2002). In other words, based on legitimacy theory, the extent of a company's CSR disclosure is a response to the pressures by the public. In fact, the majority of recent studies on CSR utilize legitimacy theory (Brown and Deegan 1998; Deegan and Rankin 1997; Patten 1992; Guthrie and Parker 1990), which explains disclosures with regard to the environmental and social behaviour of organizations (Campbell et al. 2003; Hooghiemstra 2000). Furthermore, Gray et al. (1995) argued that legitimacy theory has an advantage over other theories in providing disclosing strategies. According to Ullman (1985), while stakeholder theory states that the company and management work in conformity with the needs and pressure of its different stakeholder interests, legitimacy theory concentrates on the firm's transactions with the community as a whole. Finally, in the context of legitimacy theory, social and environmental disclosure is a way to legitimize a firm's continued existence or operations in the society (Hooghiemstra 2000; Gray et al. 1995).

In the literature of social and environmental accounting, a number of researchers agree that CSR disclosure can be used by companies to mitigate the legitimacy threat and to decrease the legitimacy gap (see, for example, Chen et al. 2008; Deegan et al. 2002; Deegan et al. 2000). Consequently, legitimacy theory suggests that the top management of organizations is responsible for meeting the legitimacy gap, practising the necessary social activities, and making provision for the different groups of stakeholders, this including accountability. Therefore, the corporate governance structure of the board of directors (board size, board composition, and the separation of the roles of CEO and chairman) is expected to play an important function in decreasing the legitimacy gap by expanding the disclosures of CSR.

## 6. Relevant studies and development of hypotheses

### *Board size*

Empirical evidence in corporate governance suggests that the board size impacts the level of control, monitoring, and disclosure (Akhatruddin et al. 2009; Chaganti et al. 1985). The benefit of larger boards is an increase in the company value, because they provide a firm with specialist members from different fields of expertise. In addition, boards with more members have the capability of better monitoring and, therefore, have the ability to practice their function effectively with respect to governance and disclosure. The most important advantage of a greater number of members is that they have a greater capacity to solve problems. Despite these benefits of larger boards, the size may have a negative impact on decision-making and the costs of this could outweigh the advantages (Lipton and Lorsh 1992). An increase the number of board members leads to problems in co-ordination (Jensen 1993), and makes them less effective in monitoring top managers (Yermack 1996).

In the context of Islamic banks, while there is no limitation in terms of the number of members of a board of directors, the perfect number comprises between five to seven members (Florackis and Ozkan 2008; Jensen and Ruback 1983). Common the number of members of a board of directors in an Islamic bank is seven or more, which is consistent with the best practice of corporate governance (Hawkamah 2011). The greater number of members in a board of directors tends to be more effective in monitoring, and makes better collective decisions, according to resource dependency theory. The larger number of directors will further control and supervise the banks' transactions to make sure of conformity with Shariah principles. This type of board could provide more transparency, moral behaviour, respect for stakeholder groups, and maximize CSR disclosure. According to Chen and Jaggi (2000), a larger board size may decrease the possibility of information asymmetry. Moreover, the greater number of board members may also reduce uncertainty and the lack of information (Birnbaum 1984). The members of a board of directors should ideally be knowledgeable in Islamic law and economics rather than being specialized in business and accounting practice (fiqh almuamalat) (AAOIFI 2005). The combination of Shariah and financial experience among the members of a board of directors brings varied resources of information, skills, and legitimacy (Hillman et al. 2000).

Board size can add to the differences of viewpoints, offering greater choices for solutions and more decision criteria, so achieving the goals of the board and objectives concerning investors' behaviour (Eisenhardt and Bourgeois 1988; Schweiger et al. 1986). In the context of Islamic banks, it is expected that the board size will not affect CSR disclosure. This is, in fact, due to the teachings of Shariah that Muslim individuals and business organizations are responsible for performing their actions in the best way. So, there should be no differences in the disclosure level between banks that have a small or a large board size.

This leads to our first hypothesis, that, based the Islamic viewpoint, board size has no impact on CSR disclosure (hypothesis 1).

### *Composition of board*

The independent board of directors is considered to be the main corporate governance structure. It is expected that directors' independence can strengthen the board by monitoring management behaviour, and protecting investors' interests (Petra 2005), as well as reducing agency cost (Choe and Lee 2003). Because of the importance of the function of the non-executive members of the board, UK firms tend to increase the number of independent directors (Higgs 2003; Hampel 1998). The possible reasons for this are that external board' members have good skills and experience (Kor and Misangyi 2008); they are informed and more effective at monitoring (Linck et al. 2008); and, they are willing to confront undesirable CEO decisions (Rachdi and Ben-Ameur 2011).

The main role of the board of directors is advising and counseling top management, in addition to monitoring its activities (Anderson et al. 2004). From an Islamic perspective, the members of the board of directors must have the reputation of moral integrity and be technically qualified for the banking business in order to play their role effectively. They must also have additional abilities to enable them to understand and be aware of the principles and rules of Shariah, and the Islamic teachings related to business and finance.

Haniffa and Cooke (2005) asserted that corporate social disclosure practices can be viewed as a policy that is intended to close the legitimacy gap perceived between management and shareholders through the non-executive directors. In addition, non-executive directors are likely to respond to concerns about the reputation and obligations, and would generally be more interested in satisfying the social responsibilities of a company (Zahra and Stanton 1988) that may support their status and reputation in the community. Therefore, non-executive directors may be able to put pressure on firms to provide CSR information in their annual reports.

Furthermore, it can be derived from these arguments that a greater percentage of independent directors on the board will lead to greater CSR disclosure by Islamic banks, so increasing transparency, since the independent directors will be able to motivate the management to provide more social disclosure. Many studies indicate that board composition, as measured by the proportion of independent directors on the board, has a significant impact on CSR disclosure, which is in line with the theoretical expectation (see, for example, Htay et al. 2012; Khan et al. 2012; Jo and Harjoro 2011).

Our second hypothesis is that board composition has positive influence on CSR disclosure (hypothesis 2).

### *Separation of roles of CEO and Chairman*

Another aspect to examine in relation to the independence of the board is the "dominant personality" phenomenon (Chapra and Ahmed 2002; Ho and Wang 2001; Forker 1992). The issue refers to role duality, in which the same person undertakes both the roles of CEO and chairman. Segregation of the two roles gives the necessary checks and balances of power and authority on management behavior (Chapra and Ahmed, 2002; Blackburn 1994). From an Islamic perspective, there is an obvious separation of accountabilities in the top management of an Islamic bank through the separation of CEO and chairman, who perform two distinct functions. This leads to one of the most important constraints on the management of Islamic banks, which is that a key decision should not be made by one person (Chapra and Ahmed 2002).

On the other hand, role duality can facilitate the CEO managing the functions of the board such as meetings, agenda discussion, as well as choosing the board's members (Al-Arussi et al. 2009). Role duality also allows the CEO to regulate the company in achieving its goals and enhances the leadership in a firm (Dahya et al. 1996). From stewardship theory, there is no problem if the two functions are combined.

Forker (1992) showed that CEO duality is correlated with a lower level of voluntary disclosure, and separating the roles of CEO and chairman could help enhance the monitoring of quality and improve the disclosure quality. Consistent with this result, Huafang and Jianguo (2007) and Gul and Leung (2004) found a negative significant association between duality and disclosure. Their findings are also supported by Al-Arusi et al. (2009), who found an association between the separation of the function of chairman and CEO and voluntary financial and environmental disclosure by Malaysian firms. On the other hand, Said et al. (2009), Li et al. (2008), Barako et al. (2006), Eng and Mak (2003), and Ho and Wong (2001) found an insignificant relationship between duality and disclosure.

In the context of Islamic banks, role duality is not common, but the possible effect on disclosure is considered to be an important consideration. This is because numerous firms have combined the roles of chairman and CEO on their boards, and are working successfully, as well as having the capacity to keep the top management in check (Haniffa and Cooke 2002; Eisenhardt 1989).

Hence, it could be argued that separation of roles of the CEO and chairman has no effect on the CSR information disclosed by Islamic banks, particularly since the majority of these banks are family owned.

Therefore, our hypothesis is that separation of the roles of the CEO and chairman has no influence on CSR disclosure (hypothesis 3).

## 7. Research design

### *Sample and data gathering*

The study used cross-sectional data from the annual reports of Islamic banks for the year 2008. The sample includes 53 banks operating in five GCC countries (see Table 2). The fiscal year of 2008 was chosen for this research as most of the banks had uploaded their annual reports in their websites.

**Table 2.** Sample distribution by country.

| Country | Number of banks |
|---|---|
| Bahrain | 22 |
| Kuwait | 17 |
| Qatar | 4 |
| Saudi Arabia | 4 |
| UAE | 6 |
| Total | 53 |

The sample size multivariate regression should preferably be one to ten (Roscoe 1975), or five (Coakes 2005; Green 1991), for each variable tested. The sample size of 53 is quite sufficient in light of the effort required for the process of data collection.

### *Specification of the model*

The study uses regression analysis to examine the association between the structure of the board of directors and the disclosure level of CSR. In addition, it tested the assumptions of normality and multi-collinearity according to the analyses of skewness and kurtosis and the variance inflation factor (VIF). The following is the regression equation:

$$\begin{aligned} \text{CSRD} = \alpha &+ \beta 1 \text{ BOARDSIZE} + \beta 2 \text{ BCOM} + \beta 3 \text{ SCEO} \\ &+ \beta 4 \text{ BSIZE} + \beta 5 \text{ BPERFOR} + \beta 6 \text{ RELPUB} + \varepsilon \end{aligned}$$

where:

CSRD = corporate social responsibility disclosure index
BOARDSIZE = size of board of directors
BCOM = proportion of non-executive directors to total directors on the board
SCEO = dummy variable, 1 if CEO ≠ chairman, 0 otherwise
BSIZE = natural logarithm of total employees
BPERFOR = return on equity (net profit divided by total assets)
REVPUB = percentage of Muslim population to total population in a country

The characteristics of the board of directors are the size of board of directors (BOARDSIZE), board composition (BCOM), and the separation roles of CEO and chairman (SCEO). Furthermore, the study employed control variables, which have been used widely in previous studies regarding social disclosure. This study used control variables consisting of bank size (BSIZE), bank performance (BPERFOR), and relevant public (REVPUB) that will enhance the association between board of directors structures and CSR disclosure.

BOARDSIZE is the number of directors on the board. When the board size is large, the board is likely to be more effective in terms of monitoring the management and, consequently, will provide greater social and environmental information (Buniamin et al. 2008). BCOM is the proportion of non-executive directors on the board. Non-executive directors, who have no executive position in the corporation, may have more effect on environmental and social disclosure (Haniffa and Cooke 2005), and may be more interested in satisfying the company social responsibility (Zahra and Stanton 1988). SCEO refers to the separation of roles between the CEO and chairman on the board. Distinction of the function of CEO from that of chairman is more likely to be related to a higher level of CSR disclosure, since there may be a lesser degree of CEO discretion, and this may enable the CEO to practice more accountably in the stakeholders' interest (Gul and Leung 2004; Haniffa and Cooke 2002).

Larger companies are intended to provide more information (Haniffa and Cooke 2005). Bigger corporations respond to significant awareness from different stakeholder groups in the community and, therefore, would be under strong public pressure to provide social activities to legitimize their businesses. Profitable firms provide more CSR disclosures (Haniffa and Cooke 2005). Profitability allows management the freedom and flexibility to practice, and to give additional information related to social responsibility activities to all stakeholders, particularly shareholders. Profitable corporations demonstrate their contribution to the welfare of the community, and legitimize their existence by providing social information. Companies that face more pressure from a relevant public (community) provide additional CSR information to legitimize their activities (Farook et al. 2011; Newson and Deegan 2002). This variable is used to control the political and economic differences within GCC countries.

### *Dependent variable—corporate social responsibility disclosure*

The study employed a content analysis approach in order to gather data from the annual reports of Islamic banks. This method has been used widely in previous studies of social disclosure (Abdul Rahman et al. 2010; Menassa 2010; Guthrie et al. 2008; Maali et al. 2006; Gray et al. 1995; Zeghal and Ahmed 1990; Guthrie and Parker 1989).

This research developed a self-constructed disclosure index to measure the level of CSR disclosure. The items contained in the disclosure index are identified based on the Islamic literature review related to CSR disclosure (Haniffa and Hudiab 2007; Maali et al. 2006; Muwazir et al. 2006). Fourteen themes were identified from previous studies: vision and mission statement; top management; SSB; unlawful transactions; zakah; quard hassan; charitable and social activities; employees; late repayments and insolvent clients; environment; products and consumer; customers; poverty; and, other aspects of community involvement.

The CSR information is gathered from the reading and analysis of annual reports from Islamic banks'. Each item is coded onto coding sheets related to the theme under which the item belongs based on chosen standards. Each incidence of an item was coded according to the number of occurrences and the frequency of incidences. The disclosure nature is classified as either quantitative or qualitative, and the frequency of events (i.e., number of sentences) which are commonly observed. The study has extended to Islamic social reporting the same procedures and exercises recorded in the literature as used for corporate environmental reporting..

To increase reliability in recording and analyzing data, credible coding instruments with well-specified decision rules have been developed to reduce discrepancies and meet objectivity, or re-analyze the discrepancies that have existed and resolve the variations (Guthrie et al. 2008). By doing so, the need for the costly use of multiple coders can be reduced. The following rules covering the application of content analysis were developed:

- All CSR disclosure must be related to the Islamic bank and its operations.
- When the same sentence of CSR is disclosed more than once in the annual report, it must be recorded each time it is mentioned.
- Where a single sentence of CSR includes more than one main idea, the sentence should be recorded related to the activity most emphasized in the sentence.
- Any sponsorship activity which includes CSR has no problem in terms of how often it is advertised.

Additionally, the coder should have sufficient training to achieve reliability by reviewing a small sample of annual reports during the pilot study stage. Furthermore, sentences were chosen as the units of measurement for content analysis in order to increase reliability (Milne and Adler 1999).

This study uses the number of sentences to determine the disclosure level of CSR for several reasons. First, Ingram and Frazier (1980) chose sentences as the unit of analysis stating that "the sentence was selected as the unit of analysis for the final research since a sentence is easily identified, is less subject to inter judge variations than phrases, classes and themes, and has been evaluated as an appropriate unit in previous research". Also, sentences are more accepted units of written English communication than individual words (Hughes and Anderson 1995), and the use of single words also has been discarded as words do not convey any meaning without sentences (Milne and Adler 1999). Compared with words and pages, a sentence is a conformist unit of speech and writing, whereas a part of the page measurement is not, and there is no need to compute for, or standardize, the number of words (Walden and Schwartz 1997; Hackston and Milne 1996). Most prior studies in the content analysis of social disclosure have used sentences as the basis for coding data, as the sentence provides perfect, reliable and meaningful data for more analysis (Oxibar and Déjean 2003; Milne and Adler 1999).

To examine the internal consistency (the reliability of measurement) of the CSR disclosure index, the Cronbach coefficient alpha was employed (Cronbach 1951). The examination is based on the average correlation within items (Nunnally and Bernstein 1994). The Cronbach coefficient alpha is used to repeat the measurement for evaluating the degree to which correlation within the measurements is narrowed to the random error (Botosan 1997). The logic behind this examination is that if the inter-correlations within the items are great, the measurement of items will be the same among the construct. Sureshchandar et al. (2002), Hair et al. (1998), and Liouville and Bayad (1998) declared that if the alpha is less than 0.60, it is considered poor, while it is acceptable at 0.70; in the meantime, if alpha is over 0.80, it is considered to be good. The Cronbach coefficient alpha is 0.697 for all themes, which exceeds the minimum acceptance level of 0.60. This finding is accepted rather than the alpha of 0.51 and 0.62 in the studies of Aribi and Gao (2010) and Gul and Leung (2004), respectively.

## 8. Empirical findings

### *Descriptive statistics*

Table 3 shows the descriptive statistics for the dependent and independent variables used in the present study. The average CSR disclosure is 83.3 sentences. This average

**Table 3.** Descriptive statistics (N = 53).

| Variables | Min | Max | Mean | Med. | Std. Dev. | Skewness | Kurtosis |
|---|---|---|---|---|---|---|---|
| CSRD | 20.00 | 166 | 83.30 | 87.5 | 39.22 | 0.276 | –0.863 |
| BOARDSIZE | 4.00 | 13 | 8.30 | 9 | 1.98 | 0.058 | –.369 |
| BCOMP | 0.14 | 1 | 0.81 | 0.88 | 0.21 | –1.540 | 1.933 |
| SCEO | 0.00 | 1 | 0.92 | 1 | 0.27 | –3.309 | 9.297 |
| BSIZE | 18 | 8299 | 917.35 | 250 | 1700.41 | 3.374 | 13.652 |
| PERFOR | –30.06 | 22.87 | 2.86 | 11.9 | 6.76 | –1.432 | 11.897 |
| REVPUB | 76.20 | 97 | 85.97 | 0.75 | 7.89 | 0.303 | –1.736 |

is more than the 25 sentences found in the study by Maali et al. (2006). The mean board size is 8.3 directors, indicating the existence of a quite a reasonable size to ensure effectiveness, as suggest by Jensen and Ruback (1983). The sample average board independence value is 0.83 percent, showing that a majority of Islamic banks have a board of directors, which is fully independent. The mean value of leadership structure (SCEO) is 0.92 percent, indicating that most banks have a separate leadership structure. This result is consistent with the best practice of corporate governance for Islamic financial institutions that requires the two occupations to be held by different persons. As for control variables, the sample banks have the mean values of 917.35 employees for BSIZE, and 2.86 percent for the financial performance (PERFOR), which are quite low values. The average value for the proportion of Muslim population to the total population (REVPUB) is 85.97 percent.

Table 4 reports the correlation matrix between the dependent and independent variables employed in the multiple regression of the study. Corporate social responsibility (CSR) disclosure is positively correlated with board size (BOARDSIZE) ($p = 0.321$), financial performance (PERFOR) ($p = 0.313$), and the separation of the roles of CEO and chairman (SCEO) ($p = 0.087$). However, CSR disclosure is negatively associated with board composition (BCOMP) ($p = –0.299$), and relevant public (REVPUB) ($p = 0.340$). Thus, it can be summarized that a larger BOARDSIZE, lower number of non-executive members on the board of directors, and separation of the roles of CEO and chairman have higher CSR information disclosure. Furthermore, BOARDSIZE is positively correlated with all independent variables except board composition (BCOMP).

## *Ordinary Least Square (OLS) regression results*

Table 5 presents the empirical findings of OLS regression. It indicates that the coefficient of $R^2$ is 35 percent, and the adjusted $R^2$ is 27 percent, and shows a computation of the reasonable variance proportion. The table also shows that the p-value of the model is significant at 0.002. Because all values of tolerance exceed 0.10, there is no problem of multi-collinearity between the explanatory variables (Menard 1995). Additionally, the VIF for all independent variables is very far from 10, indicating that there is no issue of multi-collinearity between the variables (Naser et al. 2006; Haniffa and Cooke 2005; Myers 1990; Kennedy 1998).

The table reveals that the greatest values for the t statistics are 2.562 (p-value < 0.05), and –1.721 (p-value < for bank size, and relevant public, respectively, which indicaes that the two variables have a significant effect on CSR disclosure at a 0.05 and 0.10 level, respectively. Expressly, these two variables are considered by Islamic banks as the foundation for making decision to disclose CSR information.

Board size has a positive and insignificant impact on CSR disclosure. This result is supports hypothesis 1, but not legitimacy theory, and is consistent with previous studies (Said et al. 2009; Matoussi and Chakroun 2007; Arcay and Vázquez 2005; Lakhal 2003). This finding may be explained by the Islamic viewpoint that there is no reason why a bank with more members on the board of directors would provide more CSR information than a bank with fewer directors, since all Islamic banks must disclose information related to CSR in their annual reports according to the Islamic principle of full disclosure. The negative and insignificant t statistics of board composition (BCOMP) highlight the

**Table 4.** Correlation matrix (N = 53).

| Variables | CSRD | BOARDSIZE | BCOMP | SCEO | BSIZE | PERFOR | REVPUB |
|---|---|---|---|---|---|---|---|
| CSRD | 1 | 0.321** | –0.299** | 0.087 | 0.327** | 0.313** | –0.340** |
| BOARDSIZE | 0.321** | 1 | –0.114 | 0.190 | 0.245* | 0.255* | –0.078 |
| BCOMP | –0.299** | –0.114 | 1 | –0.069 | 0.041 | –0.173 | 0.338** |
| SCEO | 0.087 | 0.190 | –0.069 | 1 | –0.060 | 0.315** | –0.330** |
| BSIZE | 0.327** | 0.245* | 0.041 | –0.060 | 1 | –0.093 | 0.039 |
| PERFOR | 0.313** | 0.255* | –0.173 | 0.315** | –0.093 | 1 | –0.322** |
| REVPUB | –0.340** | –0.078 | 0.338** | –0.330** | 0.039 | –0.322** | 1 |

**/*: correlation is significant at 0.05/0.10 level, respectively.

**Table 5.** OLS regression findings (N = 53).

| Variables | Pred. Sig. | Beta | *t* | Sig. | Tolerance | VIF |
|---|---|---|---|---|---|---|
| CSRD | | | 3.027 | 0.004*** | | |
| BOARDSIZE | No | 0.164 | 1.264 | 0.213 | 0.837 | 1.194 |
| BCOM | + | –0.182 | –1.427 | 0.160 | 0.868 | 1.152 |
| SCEO | No | –0.085 | –0.645 | 0.522 | 0.820 | 1.219 |
| BSIZE | + | 0.319 | 2.562 | 0.014** | 0.907 | 1.103 |
| PERFOR | + | 0.220 | 1.652 | 0.105 | 0.791 | 1.264 |
| REVPUB | + | –0.235 | –1.721 | 0.092* | 0.755 | 1.325 |
| R Square | 0.353 | | | | | |
| Adjusted R Square | 0.269 | | | | | |
| F-value | 4.181 (0.002***) | | | | | |
| Durbin-Watson | 2.163 | | | | | |

***, ** and * Significant at the 0.01, 0.05 and 0.10 level respectively.

fact that when the proportion of non-executive directors on the board increases, the level of CSR disclosure decreases. Thus, hypothesis 2 is rejected. This result is supported by the previous studies of Barako et al. (2006) and Eng and Mak (2003). It implies that Islamic banks with boards having fewer non-executive directors would emphasize societal interests and organizational legitimacy and, therefore, would provide more CSR information. The result shows a positive and insignificant relationship between the separation of the roles of the CEO and the chairman, and the disclosure level of CSR. Expressly, it implies that the separation of the function of CEO and chairman does not affect CSR disclosure by Islamic banks and so supports hypothesis 3. This finding is consistent with previous studies (Said et al. 2009; Li et al. 2008; Barako et al. 2006; Eng and Mak 2003; Haniffa and Cooke 2002; Ho and Wong 2001). A possible explanation is that a person who is held to act as chairman and CEO of an Islamic bank at the same time is likely also to be a shareholder; hence, whether or not the two functions are separated presents no problem. This result is in line with the stewardship theory. Furthermore, the role duality allows the CEO to manage the company in achieving its objectives, and enhancing the leadership in a bank (Dahya et al. 1996).

With regards to the control variables, the results show that bank size (BSIZE) has a positive significant effect on CSR disclosure. Larger Islamic banks provide more CSR information showing their compliance with the principles of accountability and full disclosure, since they have more resources, such as human capital, and greater investments. This result is consistent with previous studies (Akhtaruddin et al. 2009; Othman et al. 2009; Haniffa and Cooke 2005; Hamid 2004), and indicates that the banks use annual reports as a channel to publicize their image and legitimize their social activities. The association between size and CSR disclosure supports the legitimacy theory (Gray et al. 2001; Patten 1991). Also, the findings reveal a positive and insignificant association between financial performance (PERFOR) and the disclosure level of CSR. The insignificance of PERFOR is consistent with previous studies (Barako 2007; Barako et al. 2006; Garcia-Ayuso and Larrinaga 2003; Hackston and Milne 1996; Cowen et al. 1987). This indicates that the decision to provide CSR information is not affected by the financial performance level. However, the results reveal that the relevant public (REVPUB) has a negative and significant impact on CSR disclosure at the 0.10 level. This result contrasts with the findings of Farook et al. (2011). From an Islamic perspective, a possible underlying explanation is that there is no reason why a country with a great population would necessarily have banks that provide more CSR information than a country with a lower population, since all Islamic banks must comply with Shariah principles and rules.

## 9. Discussion and conclusion

The objective of this study is to examine the effect of characteristics of the board of directors (board size, board composition, and the separation of the roles of CEO and the chairman) on CSR disclosure by Islamic banks of GCC countries. The study found that none of these three attributes of the board of directors has any impact on CSR disclosure, this being due to the absence of some important aspects of corporate governance practices. These results are consistent with the extant literature (Said et al. 2009; Barako et al. 2006; Eng and Mak 2003). The key conclusions from the empirical results are that the decision to provide CSR disclosure is guided by bank size, and relevant public, but not by governance structure.

The insignificance of the board of directors' characteristics lies in the different legal and cultural factors that appear to affect bank governance mechanisms on CSR disclosure. Furthermore, the system of corporate governance in GCC countries is derived from major shareholders, which means that the influence of agency problems on CSR activities is small. This is due, in fact, to the larger shareholders monitoring the internal bank governance system, and being responsible for approving a bank's transactions and management policies regarding CSR activities.

The paper highlights the potential effect of the characteristics of a board of directors on the CSR disclosure for Islamic banks of GCC countries. It expands the literature regarding the influence of company-specific attributes on CSR disclosure in the banking industry by examining some of the board of directors' variables. This may help users of CSR information, such as investors in making investment decisions. The study also shows that there may be a need to motivate the policy makers of Islamic banks to ensure that banks practise the mechanisms of corporate governance effectively. This practice should be compatible with the business environment of GCC countries, including adopting the same governance standards in order to ensure uniformity of disclosure level among the banks (Dudley 2004; Karim 2001). It is expected that employing the best practice of corporate governance characteristics will contribute to improving efficiency, effectiveness and monitoring in the Islamic banks of GCC countries; and this can only be applied by developing the regulatory and enforcement frameworks.

Future research into other important corporate governance mechanisms, such as ownership structure, audit committee attributes, and cultural factors should be considered. Further research into the effect of the board of directors' characteristics on CSR disclosure by Islamic banks of GCC countries might use larger samples over a longer timeframe, and apply a different methodology for data collection.

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