CHAPTER 2. LITERATURE REVIEW

2.1 INTRODUCTION

This chapter will present the background of the study. Most empirical studies to date provide a descriptive basis from which a number of disclosure patterns have emerged. Studies have also found associations between several corporate characteristics and CSRR. Most empirical studies on CSRR practices have focused on the reporting practices in developed countries like USA, UK, Australia as well as New Zealand. These studies are now reviewed before proceeding to studies conducted in Malaysian scenario.

2.2 EARLY STUDIES ON CORPORATE SOCIAL RESPONSIBILITY REPORTING

Early studies on the area, mostly done in the developed countries, concentrate on the emphasis made by the companies in disclosing different categories of social information. Their objective is merely on the incidence and the type of information disclosed rather than the amount. The most well-known study in this area and one of the earliest were those carried out by Ernst & Ernst between 1972 and 1978. The survey was based upon annual reports of the *Fortune 500* companies and the result showed a small decline in the number of companies that made social responsibility disclosures i.e. (from 91.2% to 89.2%) with the average number of pages devoted to social responsibility disclosure was only 0.56 pages. There was also a small decrease in the number of companies quantifying their disclosures that is from 60% to 59%.

Buzby (1974) examined 38 items of information in determining the extent to which they were included in the annual reports. Items were ranked by a panel of financial analysts, whom then constructed a set of weighted criteria for each item to be applied to a sample of 88 annual reports from small and medium-sized

organizations. Buzby concluded that many items were inadequately disclosed in the sample, and the correlations between the relative importance of items and the extent of their disclosures were low.

2.3 CORPORATE SOCIAL RESPONSIBILITY REPORTING STUDIES IN MALAYSIA

In Malaysia, there are only a handful of studies conducted on CSRR so far (Teoh and Thong, 1981; Ho, 1989; Lau, 1994) and a number of studies were carried out in comparing the social information disclosure practices between developed countries (Teoh and Thong, 1984; Foo and Tan, 1988; Andrew, Gul, Guthrie and Teoh, 1989). These studies and its findings will be reviewed in this section in discussing the development of the topic in the Malaysian scenario.

In 1990, funded by the Malaysian Institute of Accountants (MIA), Ho S. K. conducted a study on 100 randomly selected annual report of the public companies listed on the KLSE. The study concentrated on the form of social information presentation and analyses the incidence of companies in terms of their annual turnover during 1987. The results revealed a 66% incidence of public listed companies reporting on social responsibility. The study also showed that there was little evidence of any attempt by public listed companies to disclose on environmental aspect and the disclosure on energy appeared to be a totally neglected area. Ho (1989) went to conclude that there is a need for more quantitative information, as there was no attempt made so far, in Malaysia, to quantify the social impact information.

Foo S. L. and Tan M. S. conducted a comparative study of social responsibility reporting practices in Malaysia and Singapore in 1988. The study covers 299 i.e. 98% of Malaysian and Singapore companies listed on the Singapore Stock Exchange (SES). Of the 299, 184 companies were incorporated in Malaysia and 115 were from Singapore. The study determined the nature of the information

disclosed i.e. monetary or non-monetary nature and the extent of CSRR was also analyzed in terms of industrial sectors, market capitalization, asset value, paid-up capital, profit before tax and turnover. They concluded that the state of CSRR in Malaysia and Singapore is still in its infancy and large companies were found to have a higher incidence of CSRR than the smaller ones. The study also found that in respect of the nature of disclosure, the incidence of disclosure in respect of Human Resources, Products, Community Involvement, Environment and Fair Business Practices in Malaysia and Singapore companies shared equal ranking.

In 1989, Andrew, Gul, Guthrie and Teoh conducted another comparative study between Malaysia and Singapore of 119 annual reports of public listed companies in Malaysia and Singapore for the year ending December, 1983 that were obtained on an *ad-hoc* basis. The analysis showed that although declarative disclosures predominated, at least one-fifth of the disclosures contained some form of quantification almost equally distributed between monetary and non-monetary disclosures. Andrew *et al.* (1989) did attempt to further compare the analysis with Guthrie and Parker (1988) who conducted a study on social disclosure practices of top 50 Australian, UK and US companies and found that only 50% of large Malaysian/Singaporean companies made social disclosures compared with 98% of large companies in the UK and 85% of large companies in the US, that made similar disclosures. Andrew *et al.* (1989) also concluded that company size was a significant variable and difference existed in terms of themes, methods and extent of disclosure. They also went on to suggest that social disclosures in the developing countries were not as extensive as in the industrialized countries.

Another study in Malaysia was done by Lau (1994) which was a direct replication of the work by Burke (1980) that tried to establish the trend of corporate social responsibility disclosures in Malaysia by classifying the amount disclosed into Social Measurement Disclosure (SMD) and Meaningful Social Measurement Disclosure (MSMD). Disclosure will be classified as MSMD if there exist some

specific quantitative form of data[3]. A 1982-annual report for the 100 companies in the sample were compared with those in 1992 to see whether there exists any increment of social information disclosed. Lau (1994) concluded that voluntary disclosure of social information has increased tremendously since 1982 and there was a strong relationship between size of the company and the willingness to disclose social information. Most commonly reported information as documented by Lau (1994) is human resource followed by community involvement.

The most recent study done in Malaysia was conducted by Che Zuriana, Kasumalinda and Rapiah (2000) that examines the CSRR by Malaysian companies in all types of industry over a five-year period. A total of 100 companies listed on the main board for the year ended 1999 were randomly selected and the annual reports of these companies for five years were obtained. Altogether, 500 annual reports were examined. This study only used the number of disclosures in capturing the data through content analysis. Che Zuriana *et al.* (2000) concluded that the level of disclosures in 100 companies in all sectors is still low with less than 30% of them disclosed the CSR every year.

2.4 STUDIES THAT TRIED TO ESTABLISH POTENTIAL DETERMINANTS OF CSRR DISCLOSURE

According to Ullman (1985), there are three types of empirical studies done in various parts of the world in determining the factors that have an influence in the social reporting disclosure.

[3] Any disclosed information that indicates social awareness of any area of social concern is classified as SMD, even a vague statement or description will meet this criteria. For example, the "company continues to support youth sport activities". MSMD statements are those statements that satisfied the SMD criteria and there exist some specific quantitave form of data. Example like "company contributed RM 1.5 million to Football Association"

The first one examines the potential relationship between the extensiveness of a firm's social disclosure and its social performance with the hypothesis that the quantity and quality of social disclosure is positively correlated with its social performance. In all these studies, social disclosure were differently measured i.e. using social disclosure scale derived from Ernst and Ernst (1973), percentage of prose in the annual report, quality of disclosure in the annual report and the quantity of disclosure in the annual report. Accordingly, social performances were measured using various measures e.g. (a) using reputational scales from *Business Society and Review* ("How Business Student Rate Corporations", 1972; "Industry Rates Itself", 1972), (b) Moskowitz (1972) reputational scales, citizenship awards, (c) CEP pollution performance index and (d) student evaluation of industry reputation (Belkoui and Karpik, 1988, p.36 - 37).

The second type of study examines the potential relationship between social performance and economic performance, with the hypothesis that social performance and economic performance can be correlated in three ways: positively, negatively and association between extreme levels. The indicator of economic performance in all these studies include (a) measures of stockholder return, (b) measures of rate of return in either equity, assets, sales or capital, (c) measures of earnings per share, (d) measures of income and (e) measures of price-earnings ratio. The results of the studies, summarized by Belkoui and Karpik (1988), shows partial support for each hypothesis, i.e. no correlation, U-shaped correlation, positive correlation and spurious correlation.

The final type of study examines the potential relationship between social disclosure and economic performance with the hypothesis that social disclosures reduce investors' information uncertainty and social disclosures are correlated (positively or negatively) with economic performance. The hypothesis that social disclosures reduce investors' information uncertainty examines the relationship between social disclosure and economic performance based on market variables. The second hypothesis examines the relationship between social disclosure and economic performance based on accounting variables. In these

studies, the results vary from negative correlation to positive correlation as well as a U-shaped correlation.

This study will be categorized under the third type which will examine the potential relationship between social disclosure and economic performance i.e. does size, profitability and few other variables influences the amount of disclosure? This study will be a direct replication of the one conducted in the New Zealand by Hackston and Milne (1996). In addition to the above mentioned independent variables that may influence the amount of disclosure, this study will also establish whether the type of audit firm (big five or non-big five), leverage level may have an influence on the disclosure amount.

2.4.1 Firm Size

A number of empirical studies have verified that the size of the firm and disclosures of social information are positively related (see Pang, 1982; Cowen *et al.*, 1987; Patten, 1991; Hackston *et al.*, 1996). As for the finding of the Malaysian studies, Teoh and Thong (1984) confirmed that "corporate size is relevant in reflecting the degree corporate social involvement" and similar conclusion was also reached by Lau (1994) and Tan *et al.* (1990). Following the Hackston *et al.* (1996) study, market capitalization will be used to measure the firms' size. Additionally, listing is employed as an alternative measure for size. Several explanations were presented in various studies in explaining the relationship between size and disclosure.

Buzby (1979) suggested, "As the accumulation and dissemination of information is costly, smaller firms may not possess the necessary resources for collecting and presenting an extensive array of information". A similar explanation was given by Firth (1979) that large firms "are quite likely to collect information needed for corporate disclosure for their internal control". Cowen *et al.* (1987) argued that this relationship exist because of the fact that as larger companies undertake more activities, they make a greater impact on the society and have

more shareholders who might be concerned with social programmes undertaken by the company, and their annual reports provide an efficient means of communicating this information. The demand for financial information by financial analyst, as argued by Schipper (1991), large firms tend to attract more analysts than smaller ones, and may therefore subjected to greater demand by analysts for private information. Similarly, Hosain and Adams (1995) stated that large firms have market-based incentives to disclose more information voluntarily as the desire to reduce private acquisition of information or to protect firm value as non-disclosure may be interpreted as bad news.

There are however, some CSRR studies have demonstrated that there is no relationship between size and disclosure. Examples include Roberts (1992) that found no relationship in the US sample. Also, in New Zealand, both Davey (1982) and Ng (1985) failed to support the hypothesis between company size and CSR disclosures. To attest these findings, firm size will be tested to see its relationship with the level of social disclosure.

2.4.2 Industry

Several empirical studies have found associations between the types of industry the firms belong with corporate disclosure. Patten (1991) argues that industry, similar to company size "influences political visibility and this drives disclosures to ward off undue pressure and criticism from social activists". A particular industry may have the tendency to disclose more social information for specific reasons. According to Dierkes and Preston (1977), companies whose economic activities may modify the environment, like extractive industries, are more likely to disclose information about their environmental impacts than companies in other industries. Similarly, Cowen *et al.* (1987) argued that costumer-oriented companies can be expected to exhibit greater concern with demonstrating their social responsibility to the community as this will likely to enhance their corporate image and influence sales.

2.4.3 Type of Audit Firm

Various accounting literature on voluntary disclosure has identified that the audit firm employed by companies may influence the disclosure practices. Watts and Zimmerman (1986) contend that in agency theory, the primary mechanism for controlling the incentive conflict between principals and agent is the appointment of the external auditor. Hence, the type of the external auditor employed may be a potential determinant for the voluntary disclosure practices. Also, DeAngelo (1981) argued that large accounting firms have the incentive to provide higher quality audit and according to Klein and Leffler (1981), these firms may have an incentive to maintain high quality audit in order to retain their reputation.

Further, Hosain *et al.* (1995) contend that big-six[4] audit firms will encourage their clients firms to disclose comprehensive information in their annual reports and accounts. They went on to suggest that the type of audit firm is likely to be positively related to the voluntary corporate disclosures. Moving to Malaysian reporting scenario, Tan *et al.* (1990) found that the auditors have no influence with the level of voluntary disclosure. So far, in CSRR studies, this variable was never examined in determining the relationship with the amount of social information disclosed. Hence, it is hoped that this study will provide an empirical evidence of the association between the type of auditor and the amount of disclosure of the social information.

2.4.4 Financial Leverage

Although this variable was never examined before in CSRR studies in, this study will try to establish the potential relationship between the proportions of debts to ratio with the level of social information disclosure. As Watts and Zimmerman suggest that proportion of debt in the capital structure is higher for large firms, Bradbury (1992) goes on to argue that larger firms will disclose more information to reduce potential information asymmetry and conflicts among managers, shareholders and debtholders. Hosain *et al.* (1995) have demonstrated that there

[4] Now called big-five following the merger of PricewaterHouse and Coopers & Lybrand in 1999.

exist a positive relationship between the extent of voluntary disclosures and leverage. However, these findings are not supported by Chow and Wong-Boren (1987) in their study on voluntary financial disclosure by Mexican corporations.

2.4.5 NACRA

The only prior study that tried to determine whether social reporting by companies commended with awards differed from those not commended was conducted by Low, Koh and Yeow (1985) in Singapore. Low *et al.* (1985) concluded that commended companies disclosed social information more readily than the non-commended ones. This study will also try to determine the same i.e. whether the companies that are commended for good reporting by NACRA 2001 award disclose more social information that companies that are not. Tan *et al.* (1990) argued that the improvement in the reporting practices is further enhanced by the by the emergence of the annual corporate report awards. For the purpose of this study, the companies awarded with Certificate of Merit by NACRA 2001[5] will be used as a sample to determine whether there is any difference in the corporate social reporting between companies commended for good reporting and those companies that do not.

2.4.6 Profitability

Profitability has been considered as an important variable that may influence the decision to disclose social information i.e. by being more profitable; the companies could afford to be more actively involved in the social activities to promote their corporate image to the public (Lau, 1994). Empirical research on the profitability and social disclosure relationship, so far has produced mixed results. In New Zealand, all studies conducted have failed to find any significant association between level of profit and the disclosure of social information

[5]The Malaysian National Annual Corporate Report Awards (NACRA) is an annual event dedicated to promote excellence in the presentation and reporting of information by the organization to the stakeholders. KLSE, MIM, MIA and MACPA jointly sponsor the award. For NACRA 2001 award, the evaluation is made based on the annual reports for the year ended 2000.

(Davey, 1982; Ng, 1985; Hackston and Milne, 1996). In Malaysian context, Lau (1994) found that higher-profit companies have higher incidence of disclosure in their annual report as compared to lower-profit companies. Lau (1994) however did not quantify the amount of disclosures made by these more profitable companies. To determine whether level of profit is associated with the amount of social disclosure, this variable will be used in this study to further substantiate Lau (1994) findings.

2.5 STUDIES ON THE ATTITUDE AND PERCEPTION TOWARDS CSRR

The interdependence of individuals and society discussed in Chapter One cannot be argued. Various studies have been conducted to determine the attitudes and perceptions of individuals towards CSRR (for example, see Ostlund, 1977; Teoh and Thong, 1984; Holmes, 1976).

Holmes (1976) in her study titled "Executive Perceptions of Corporate Social Responsibility" mailed the questionnaires to top executives in 560 firms randomly selected from the 800 firms listed in the 1974 *Fortune* directory of the 500 largest industrial corporations and the 50 largest firms in each of the categories of commercial banking, life insurance, diversified financial, retailing, transportation and utilities. Among the conclusions that were reached is that executives in most industry agreed most strongly that business could be a major force in the alleviation of social problems. Also, special competencies of the corporation and the seriousness of a social need were believed to be the most influential in the selection of areas for corporate social involvement.

Oslunt (1977) surveyed randomly selected chief executives of Fortune 500 companies and altogether analyzed the data from 260 top managers and 326 operating managers. He concluded that both operating managers and top managers support of corporate social responsibility. However, it is also found that

operating managers constituted a source of inertia or resistance in implementing corporate social responsibility policies.

Moving to study conducted in Malaysian scenario, in 1981, Teoh and Thong conducted a personal interview questionnaire survey of a hundred companies. The standard questionnaire addressed three major issue areas: the concept of corporate social responsibility, the nature and extent of involvement in socially relevant activities and corporate social reporting. The questionnaires were addressed to the top-officers of the sample firms. The results showed that all the companies interviewed expressed awareness of the social role of business organization and they have been involved to different degrees in various socially relevant activities. Also, greater corporate attention was directed to improving the human resources and product/service to consumers compared to rendering community-related services or alleviating environmental deterioration. They also concluded that small companies were less inclined to assume a social role much beyond the traditional economic pursuits compared to large publicly-based companies.

So far, only a few studies have obtained the perceptions of the individuals, which includes, among others, chief executive officer, middle level management and investors, with regards to CSRR. Hence, this study will try to accomplish the perceptions and attitudes of the accounting practitioners in Malaysia towards CSRR by way of survey using questionnaires. The design of the questionnaire sent out to the accounting practitioners are based upon the two literatures discussed above.

2.6 CONCLUSION ON THE LITERATURE REVIEW

Most of prior studies have concluded that economic incentives do exist in determining the amount of social information disclosed. Based on the prior

literature discussed above, this study will provide some evidence on the association between the firm's attributes namely size, profitability, financial leverage, type of audit firm, and the industry to which the company belongs, with the level of social disclosures. In providing this evidence, this study will be a direct replication of Hackston and Milne (1996) study conducted in New Zealand. Additionally, this study will extend Lau (1994) study by improvising his measurement techniques i.e. employing all three methods used in Hackston *et al.* (1996) study. This study will also try to determine whether there is significant differences between social disclosures made between companies commended for good reporting by NACRA than those companies that do not. The next chapter will present the sampling and data collection method together with the statistical tests used in this study.