

**THE INFLUENCE OF FIRM CHARACTERISTICS
ON THE LEVEL OF CSR DISCLOSURE OF THE
FOOD PROCESSING COMPANIES IN MALAYSIA
– UTILIZING HALAL CERTIFICATION AS
MODERATING VARIABLE**



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**FACULTY OF BUSINESS, ECONOMICS AND
ACCOUNTANCY
UNIVERSITI MALAYSIA SABAH
2014**

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**THESIS SUBMITTED IN FULFILLMENT FOR THE
DEGREE OF MASTER OF ACCOUNTING**

**FACULTY OF BUSINESS, ECONOMICS AND
ACCOUNTANCY
UNIVERSITI MALAYSIA SABAH
2014**

DECLARATION

I hereby declare that the material in this thesis is my own except for quotations, excerpts, equations, summaries and references, which have been duly acknowledged.

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kestyo

ABSTRACT

There are previous studies examining the relationship between firm characteristics and the level of CSR disclosure, but the results are inconclusive. Limitations of the previous studies are: (i) they examine the level of total CSR disclosure instead of each type of CSR disclosure and (ii) they use general reporting frameworks rather than those intended for specific industry. This study makes efforts to deal with the limitations of previous studies by (i) examining the influence of firm characteristics (firm size, firm age, leverage, audit firm and profitability) on the level of each type of CSR disclosure such as food processing sector disclosure (FPSD), environmental disclosure (ENVD), and social disclosures (SOCD) within specific food processing companies and (ii) applying a disclosure index which is derived from the Food processing Sector Supplement (FPSS) of the GRI guidelines. Further, Halal certification is utilized to moderate the influence of firm characteristics on the level of FPSD, ENVD, and SOCD. The population of this study is the 2011 annual reports of 43 food processing companies listed in Bursa Malaysia. Partial Least Square (PLS) is applied to carry out the regression analysis. The results of this study show that, on average, the percentage number of Halal certified companies providing FPSD, ENVD, and SOCD is lower than those of Not Halal certified companies. They also reveal that firm size positively influences the level of ENVD and SOCD; firm age positively influences the level of SOCD; and leverage positively influences the level of FPSD, ENVD and SOCD. However, Halal certification only appears to reduce the positive influence of leverage on the level of ENVD and SOCD. This study might be useful for managers of the food processing companies to choose their disclosure strategy as well as give insights towards the legitimizing effect of Halal certification.

ABSTRAK

PENGARUH CIRI-CIRI FIRMA PADA TAHAP PENDEDAHAN CSR SYARIKAT PEMROSESAN MAKANAN DI MALAYSIA – MENGGUNAKAN PERSIJILAN HALAL SEBAGAI VARIABLE MODERAT

Terdapat kajian sebelum ini yang memeriksa hubungan antara ciri-ciri firma dan tahap pendedahan CSR, namun hasilnya tidak meyakinkan. Batasan kajian sebelum ini ialah: (i) mereka memeriksa tahap jumlah pendedahan CSR bukan setiap jenis pendedahan CSR dan (ii) mereka menggunakan rangka kerja pelaporan am dan bukannya mereka yang bertujuan untuk industri tertentu. Kajian ini membuat usaha-usaha untuk menangani batasan kajian lepas dengan (i) memeriksa pengaruh ciri-ciri firma (saiz firma, umur firma, leverage, firma audit dan keuntungan) kepada tahap setiap jenis pendedahan CSR seperti pendedahan sektor pemprosesan makanan (FPSD), pendedahan alam sekitar (ENVD), dan pendedahan sosial (SOCD) dalam syarikat-syarikat pemprosesan makanan dan (ii) menggunakan indeks pendedahan yang diperolehi daripada the Food processing Sector Supplement (FPSS) daripada garis panduan GRI. Selanjutnya, pensijilan Halal digunakan untuk memoderasi pengaruh ciri-ciri firma kepada tahap FPSD, ENVD dan SOCD. Populasi kajian ini adalah laporan tahunan 2011 syarikat pemprosesan 43 makanan yang disenaraikan di Bursa Malaysia. Partial Least Square (PLS) digunakan untuk menjalankan analisis regresi. Keputusan kajian ini menunjukkan bahawa, secara purata, jumlah peratusan syarikat-syarikat yang disahkan Halal menyediakan tahap FPSD, ENVD dan SOCD yang lebih rendah berbanding dengan syarikat-syarikat yang tidak disahkan Halal. Mereka juga mendedahkan bahawa saiz firma secara positif mempengaruhi tahap ENVD dan SOCD; umur firma secara positif mempengaruhi tahap SOCD; dan keuntungan secara positif mempengaruhi tahap FPSD, ENVD dan SOCD. Walau bagaimanapun, pensijilan Halal hanya muncul untuk mengurangkan pengaruh positif keuntungan kepada tahap ENVD dan SOCD. Kajian ini mungkin berguna untuk pengurus syarikat-syarikat pemprosesan makanan untuk memilih strategi pendedahan mereka serta memberi pandangan ke arah kesan legitimasi daripada pensijilan Halal.

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CHAPTER 1

INTRODUCTION

1.1 Background

Corporate Social Responsibility (CSR) may be considered as an important factor towards the success of companies (Maloni & Brown, 2006). CSR gains its importance as companies are blamed for having great impacts on the environment and society, such as climate change, eroding of ozone layer, declining of biodiversity, and global water crisis (Intergovernmental Panel on Climate Change, 2007).

The survey of KPMG (2011) shows that 95 percent of the 250 largest global companies disclose their CSR practices which represents an increase of 14 percent compared to 2008 survey. KPMG (2001) concludes the motivations of companies to disclose CSR, among others, are: reputation or brand, ethical considerations, employee innovation, innovation and learning, risk management and risk reduction, access to capital, economic considerations, strengthened supplier relationships, market share improvement, improved relationships with governmental authorities, and cost savings.

The awareness of CSR is increasing in Malaysia as shown by non-governmental organizations and professional accounting bodies such as the Federation of Malaysia Consumer Association, Consumer Association of Penang and World Wide Fund for Nature (WWF) Malaysia, Business Ethics Malaysia and Association Certified Chartered Accountant (ACCA) which are actively involved in promoting CSR awareness and initiatives among public companies (Abdul Hamid and Atan, 2011). In the efforts to improve CSR status in Malaysia, Bursa Malaysia (2006) encourages Public Listed Companies (PLCs) in Malaysia to practice CSR as well as, report their CSR activities. The other effort is made by the Malaysian government in which the Malaysian government (i) incorporates social and environmental considerations in its policy framework; (ii) incorporates CSR

practices within the government-linked companies' (GLC) Transformation Plan; and (iii) incorporate CSR as an integral part in achieving Malaysia's vision 2020 (EPU, 2006).

The World Business Council for Sustainable Development (WBCSD, 1999, p.3) emphasizes the importance of CSR:

"Corporate Social Responsibility is 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"

The concept of CSR is introduced by Carroll (1991) through Carroll's pyramid which describes four components of CSR, namely (i) economic responsibilities which acts as foundation of the pyramid and represents the basic objective of companies to make profit; (ii) legal responsibilities which represents the objective of companies to obey the law; (iii) ethical responsibilities which represents the objective of companies to meet the society's needs beyond legal requirements; and (iv) philanthropic responsibilities which represents the obligation of companies to voluntarily conduct philanthropic activities. The philanthropic activities may be conducted in the form of contributing to the development of arts, providing assistance to the educational institutions, and participating in charitable activities that enhance the quality of life within local communities.

Elkington (1993) contributes to the development of CSR through the introduction of triple bottom line (TBL) which relates CSR with the concept of sustainability. TBL lies under the paradigm that companies' performance should not only be measured by traditional/financial aspects but also social/ethical and environmental aspects. It consists of economic prosperity, environmental quality, and social justice. These enable companies to consider all financial, social, and environmental aspects in formulating their business strategy.

TBL also initiates the development of CSR disclosure in which it provides a framework for companies to report their triple bottom line performances such as economic, social, and environmental wellness (Bursa Malaysia, 2006). CSR disclosure is sometimes known as Corporate Social Disclosure (CSD) or Corporate Social and Environmental Disclosure (CSED) (Said, Zainuddin, Haron, 2009).

The definition of CSR disclosure is emphasized by Gray, Owen, and Maunders (1987) in Janggu, Joseph, and Madi (2007, p.10) as:

"...the process of communicating the social and environmental effects of organizations' economic actions to particular interest groups within society and to society at large. As such, it involves extending the accountability of organizations (particularly companies), beyond the traditional role of providing a financial account to the owners of capital, in particular, shareholders. Such an extension is predicted upon the assumption that companies do have wider responsibilities than simply to make money for their shareholders"

Haron, Ismail, and Yahya (2007) defines CSR disclosure as a mean that management can discharge its social responsibility by providing detail information of company activities related to the physical environment, energy, human resource, products and community involvement.

Although CSR disclosure gains its importance, unfortunately, the current financial reporting framework may not accommodate social and environmental issues, because it is only limited to economic and financial matters (Guthrie and Farneti, 2008). Many organizations, such as Social Accountability 8000, Global Sullivan Principles, the UN Global Compact, OECD Guidelines for MNEs, the ILO, AccountAbility's 1000 Series; ISO 14000; and the GRI make efforts to address the limitation of the current reporting framework through providing various CSR reporting frameworks that may integrate company's social and environmental achievements and its financial results into a single unified extended performance account (Yongvanich and Guthrie, 2006).

The Global Reporting Initiative (GRI) is introduced by the Coalition for Environmentally Responsible Economics (CERES) and the Tell us Institute with the purpose to: (i) offer reporting formats; (ii) account for sustainability; (iii) assist corporations in presenting a balanced picture of their organization to stakeholders; (iv) promote the comparability of corporate sustainability reports; (v) stimulate benchmarking and the verifiable assessment of sustainability performance; and (vi) facilitate stakeholder engagement (GRI, 2006).

In order to measure the level of CSR disclosure, this study uses the GRI guidelines as reporting framework for constructing keywords of disclosure index with the following reasons: (i) it may provide a common framework for sustainability reporting that reflects current thinking or best practices of CSR (GRI, 2006); (ii) it is the most globally accepted reporting frameworks, so it may increase the validity of the result (Gamerschlag, Moeller, and Verbeeten, 2010); and (iii) it publishes the Food Processing Sector Supplement (FPSS) which is highly relevant for this study.

Several theoretical frameworks are used in previous studies to investigate the level CSR disclosure such as agency theory, signaling theory, political economy theory, legitimacy theory, stakeholder theory, and proprietary theory (Hackston and Milne, 1996). According to the legitimacy theory, companies may continue to exist if they operate their business in accordance with society's value system (Gray, Kouhy, and Lavers, 1996). Therefore, in order to get legitimacy from the society, companies need to disclose its CSR activities (Jones, 2010).

This study prefers to use legitimacy theory as theoretical framework for the following reasons: (i) it has been mostly used by studies in the field of CSR disclosure (Campbell, Craven, and Shrides, 2003) and (ii) it has the advantage that it provides disclosing strategies for companies, such as for gaining, maintaining, or repairing legitimacy, depending on the perceived society's pressures (O'Donovan, 2002).

Within CSR literature, there is a critic that social and environmental reporting is still on voluntary basis rather than mandatory basis. However, although it is voluntary, many companies are willing to report their social and environmental activities. In consequence, it leads researchers to study the motivations of companies to deliver social and environmental reportings, such as (i) to fulfill society's expectations; (ii) to comply with industry requirements, and (iii) to attract investment funds (Deegan, Rankin, and Tobin, 2002).

Guthrie, Cuganesan, and Ward (2010) examining the level of CSR disclosure within the Australian Food and Beverage Industry conclude that 'high profile' companies tend to deliver more CSR disclosures and apply more disclosure strategy with the aims to get legitimacy from the society than 'low profile' companies. The term "high profile" is applied for companies whose products get negative perceptions from the society, such as alcohol and cigarettes. The term "low profile" is applied for companies whose products get positive perceptions from the society.

The study of CSR disclosure also attracts the attention of academics and practitioners in Malaysia as indicated by the survey of the Association of Chartered Certified Accountants (ACCA, 2007). The results show an increasing number of CSR disclosures by Malaysian companies with the motivations to enhance and maintain reputation as well as to enhance shareholders value and increase stakeholder awareness. The other study by Zain (2004) concludes the objectives of CSR disclosure, among others are (i) to enhance corporate image; (ii) to avoid indirect pressure from the government; and (iii) to increase top management awareness as well as the accountability of reporting companies.

The development of CSR is also indicated by the increasing numbers of previous studies investigating the relationship between firm characteristics, such as firm size, firm age, leverage, audit firm size, and profitability and the level of CSR disclosure (Gray, Javad, Power, and Sinclair, 2001).

However, the results of previous studies are inconclusive because most of the previous studies examine the level of total CSR disclosure instead of each type

of CSR disclosure (Cowen, Ferreri, and Parker, 1987). Since providing CSR disclosure is costly, companies only want to disclose each type of CSR disclosure depending on the perceived society's pressures. The limitation of previous studies is also revealed by Guthrie, Cuganesan, and Ward (2008) stating that previous studies using general reporting frameworks while measuring the level of CSR disclosure may limit the results since the nature and patterns of CSR disclosure are different across industries.

This study aims to extend the body of literature, in which it (i) provides evidence on the influence of firm characteristics on the level of CSR disclosure within specific the food processing companies listed in Bursa Malaysia; (ii) uses the Food Processing Sector Supplement (FPSS) of the GRI guidelines as reporting framework while measuring the level of CSR disclosure; and (iii) examines the influence of firm characteristics on each types of CSR disclosure, such as food processing sector disclosure (FPSD), environmental disclosure (ENVD), and social disclosure (SOCD).

The Food Processing Sector Supplement (FPSS) of the GRI guidelines is consisting of 46 keywords that are useful for constructing disclosure index while measuring the level of each type of CSR disclosure. These 46 keywords are further divided into 14 keywords used for measuring the level of FPSD; 8 keywords used for measuring the level of ENVD, and 24 keywords used for measuring the level of SOCD.

There are two methods for measuring the level of CSR disclosure, namely disclosure index and content analysis. In this study, the author prefers to use disclosure index since this technique is more suitable for developing countries (Cahaya, Porter, Tower, and Brown, 2011) such as Malaysia since it is a developing country in which the economic, political, and social conditions are very different from developed nations (Nurhayati, Brown, and Tower, 2006) such UK.

The food processing industry may get pressures from society in terms of energy efficiency, noise pollution, air pollution, waste water, global climate

changes, controlled storage and distribution, functions of packaging, disposal of waste and expired inventories, and disposal of packaging (Global Reporting Initiative, 2006). Sustainability challenges and issues faced by food processing industry, among others, are: (i) to make safe, healthy and affordable food available; (ii) to reduce the depletion of scarce natural resources; (iii) to involve in the development of rural areas; (iv) to build complex and global supply chains; (v) to involve in fair and ethical trade practices; and (vi) to use packaging which do not impact on the environment and the health of consumers (Van der Stichele and Van der Wal, 2006)

The food processing industry has a major socioeconomic importance in Malaysia. According to Malaysian-German Chamber of Commerce & Industry (MGCCI), it has contributed about 10% of the Malaysian manufacturing output and increased job creations by 1.4% in 2008. The development of food processing industry in Malaysia is marked by the increasing development of the Halal food industry. In 2008, total sales of Halal food products in Malaysia reached 79.5% of the processed food product. The Malaysian government continues to give full support to the development of the food processing industry, in which the third Industrial Master Plan (IMP3), 2006-2020 aims to create Malaysia as a regional food production and distribution hub, with particular emphasis on Halal food (MGCCI, 2010).

The Malaysian government supports the position of Malaysia as an international Halal food hub, for the following reasons: (i) Malaysia is recognized as a modern Islamic country; (ii) Malaysia has the raw materials and supporting infrastructure as well as the processing technologies to produce and market the Halal products; (iii) Halal certification issued by the Department of Islamic Development Malaysia (JAKIM) is recognized world-wide; and (iv) the development of Halal food is strongly supported by the government (MoA, 2004).

Halal is defined as allowed or permitting according to *shariah* (Islamic) law and *thoyyiban* (good quality, safety, cleanliness, nutritious, and authentic). Shariah law acts as a guiding principle for Muslims that correlates the humankind with

natural environment, such as *tawheed* (Unity of God), *khilafah* (vicegerency), *umma* (community), *adl* (justice), *ihsan* (kindness), *hikma* (wisdom) and *tawadu* (modesty) (Al-Qaradawi, 1985).

As the country's sole halal certifying body, the Department of Islamic Development Malaysia (JAKIM) requires Halal certified food processing companies to comply with the following standards: (i) MS 1500:2009 (Halal Food – Production, Preparation, Handling and Storage – General Guidelines); (ii) MS 1480 (Food Safety according to Hazard Analysis and Critical Control Point/HACCP system); (iii) General Principles of Food Hygiene (MS1514); and (iv) MS 1900:2005 (Quality Management System: Requirements from Islamic Perspectives). Having fulfilled these requirements, Halal foods gain confidence from consumers in terms of higher quality, hygienic and food safety (Department of Standards Malaysia, 2009).

However, in many cases, the halal logo has been misused due to lack of enforcement by the government in monitoring the usage of certified halal logo. Therefore, the Malaysian government enacts the Trade Description Act (TDA) 2011 in which JAKIM is empowered to carry out enforcement against the misuse of Halal logo. The then Minister of Domestic Trade, Cooperatives and Consumer Affairs Datuk Seri Ismail Sabri Yaakob stated that from Jan 1 2012, only the Halal logo issued by JAKIM can be used and will be recognised (Mustafa and Kamilah, 2012).

There are previous studies examining the relationship between CSR and Islamic values (Al-Qaradawi, 1985; Dusuki and Dar, 2005; Mohammed, 2007; Mohammed, Rezai, Shamsudin, and Chiew, 2008; Rezai, Mohammed, and Shamsudin, 2012; Mohammed, Rezai, Shamsudin, and Chiew, 2008) that conclude the motivations of customers to purchase Halal food are as followings: (i) customers are confident with the Halal logo because it is approved by the government; (ii) customers are aware with the advantages of consuming Halal food that is safe and healthy; and (iii) customers are aware that Halal food is produced in compliance with the good manufacturing practices as well as the good hygienic practices. On the other hand, Rezai, Mohammed, and Shamsudin (2012) conclude the perceptions of non-Muslims on Halal principle are religious obligation,

environmental friendly, and concerns with food safety. While, Syed Marzuki, Hall, and Ballantine (2012) find restaurant managers prefer to purchase Halal food since they believe that Halal certification may guarantee that Halal food is safe and hygienic.

As conclusions, the previous studies show the following results: (i) social behavior is highly valued in Islamic lifestyle in which Shariah law guides Islamic companies to operate in morally, ethically and socially responsible manner (Dusuki and Dar, 2005); (ii) Halal is becoming symbol for quality assurance in which the standards require Halal food companies to comply with Shariah law, as well as, concern with the issues of safety, quality assurance, cleanness, hygienist (Rezai, Mohammed, and Shamsudin; 2012); and (iii) Halal regulation and certification should be developed by integrating Halal standards with norms and values of CSR as well as complementing Halal standards with business ethics and responsibility (Ismaeel and Blaim; 2012).

This study utilizes Halal certification as moderating variable with the following reasons: (i) Halal certificate issued by the Department of Islamic Development Malaysia (JAKIM) is accepted globally (MoA, 2004); (ii) the Malaysian Halal standard has become the basis for the development of the Halal food industries around the world (SME Annual Report 2006, 2007); (iii) the concept of Halal involving two basic principles, namely *halal* (permissible or Shariah compliant) and *thoyyibban* (wholesome: healthy, safe, nutritious, quality, hygienic, clean) is highly correlated with CSR values; and (iv) Shariah principles give a guidance for Halal certified companies to incorporate CSR values in their business operations (Yusanto and Widjayakusuma, 2002).

To the best of my knowledge, there are no previous studies examining the legitimizing effect of Halal certificate. According to the legitimacy theory, companies who get a high society's pressure are trying to gain legitimacy by providing the high level of CSR disclosure (Dowling and Pfeffer, 1975). Hence, this study aims to extend the body of literature in which it examines the legitimizing effect of Halal certificate by providing evidence that (i) the level of CSR disclosure within Halal

certified companies is lower than Not-Halal certified and (ii) Halal certificate moderates the influence of firm characteristics on the level of CSR disclosure. This study shall provide evidence that Halal certification may reduce the perceived society's pressures within the Halal certified companies.

1.2 Problem Statement

The food processing industry is getting a lot of attention from society related to issues such as obesity, food safety, hygiene, and packaging management (Guthrie, Cuganesan, and Ward, 2008). Patten, 1991 and Roberts, 1992 explain that any companies belonging to the "high risk" industry provide a higher level of CSR disclosure than those belonging to "low risk" industry, in which "high risk" industry refers to industry that increases the costs of natural resources or endanger the health of consumers. Based on the justification that the food processing industry has great impacts on the environment and society, this study classifies food processing industry as "high risk" industry. According to legitimacy theory, companies who get a high society's pressure are trying to gain legitimacy by providing the high level of CSR disclosure (Dowling and Pfeffer, 1975). Hence, this study examines the level of each type of CSR disclosure, namely FPSD, ENVD, and SOCD within the food processing companies listed in Bursa Malaysia.

Halal certificate issued by JAKIM enhances the level of confidence of consumers around the world since it gives assurance that Halal food is in accordance with *shariah* principle as well as safe, hygiene and high quality (Department of Islamic Development Malaysia, 2007). Since Halal certified companies fulfill *Shariah* and *thoyyiban* principles, which are highly correlated with CSR values, Halal certificate may reduce the perceived society's pressures as well as increase the reputation of Halal certified companies.

Therefore, the purpose of this study is to provide evidences on the legitimizing effect of Halal certificate through the followings:

- i. comparing the level of each types of CSR disclosure, namely food processing sector disclosure (FPSD), environmental disclosure

- (ENVD), and social disclosure (SOCD), within Halal certified and Not Halal certified companies;
- ii. investigating the influence of the various firm characteristics, such as firm size, firm age, leverage, audit firm size, and profitability on the level of FPSD, ENVD, and SOCD; and
 - iii. examining the moderating effects of the influence of firm characteristics on the level FPSD, ENVD, and SOCD.

1.3 Research Questions

The research questions of this study are:

1. Is the level of CSR disclosure (FPSD, ENVD, and SOCD) within Halal certified food processing companies listed in Bursa Malaysia lower than Not Halal certified?
2. Do firm characteristics such as firm size, firm age, leverage, audit firm size, and profitability influence the level of CSR disclosure (FPSD, ENVD, and SOCD)?
3. Does Halal certificate moderate the influence of firm characteristics on the level of CSR disclosure (FPSD, ENVD, and SOCD)?

1.4 Objectives

The objectives of this study are:

1. To examine whether the level of CSR disclosure (FPSD, ENVD, and SOCD) within Halal certified food processing companies listed in Bursa Malaysia is lower than Not Halal certified.
2. To examine whether firm characteristics such as firm size, firm age, leverage, audit firm size, and profitability positively influence the level of CSR disclosure (FPSD, ENVD, and SOCD).
3. To examine whether Halal certification weakens the influence of firm characteristics on the level of CSR disclosure (FPSD, ENVD, and SOCD).

1.5 Significance of the Study

This study is motivated by the fact that, to the best of my knowledge, there is no previous studies examining CSR disclosure in a specific food processing industry