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Influence Of Political Ties On The Link Between Board Attributes And Intellectual Capital Reporting

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ABSTRACT

In the contemporary knowledge-based economy, organizations increasingly rely on intellectual capital, shifting away from traditional asset structures towards intangible assets. Traditional accounting standards and financial statements have inadequately provided non-financial data crucial for stakeholders, investors, and creditors. This gap has driven researchers, particularly in developed countries, to emphasize intellectual capital (IC) disclosure, given that conventional financial reports and accounting standards do not adequately address IC. Prior studies have predominantly used descriptive approaches to study IC disclosure, with few investigations examining the impact of board characteristics (BCs) on IC disclosure in developing countries. These limited studies have yielded mixed results concerning the relationship between BCs and IC disclosure. In developing countries, political influence plays a significant role, impacting the economic landscape. Companies often view political connections (PCs) as vital external resources to reduce capital costs and affect voluntary disclosure. This study diverges from the mainstream literature by not only exploring the direct relationship between BCs and IC disclosure but also examining the moderating effect of PCs on this relationship. Thus, the objective of this study is to establish a theoretical framework grounded in Agency Theory and Resource Dependence Theory to investigate the moderating role of political connections on the relationship between board characteristics and intellectual capital disclosure in developing countries.

Keywords: Intellectual Capital, Board Characteristics, Political Connections, Voluntary Disclosure, Agency Theory, Resource Dependence Theory, Developing Countries, Corporate Governance, Intangible Assets, Financial Reporting.

1. INTRODUCTION

The shortcomings of traditional accounting systems, highlighted by the global financial crises, have become evident due to their heavy reliance on financial information while neglecting non-financial and social aspects (Aburaya, 2012). This realization has heightened stakeholders' interest in the extent and quality of voluntary disclosures. Conventional financial statements have been inadequate in fully capturing intellectual capital (IC) because of its elusive nature.

Numerous empirical studies have focused on IC disclosure, particularly in developed countries, revealing a significant interest in intangible assets, including IC (Ahmed Haji, 2015; Ahmed Haji & Ghazali, 2013; Alfraih, 2018; Al-Maghzom, Hussainey, & Aly, 2016; Alotaibi, 2014; Alshhadat, 2017; Appuhami & Bhuyan, 2010; Barakat & Hussainey, 2013). However, there is limited research on how board characteristics (BCs) influence IC disclosure. The existing literature presents mixed results on this relationship. For instance, Cerbioni and Parbonetti (2007) identified a negative correlation between board size and the level of voluntary IC disclosure, whereas Ahmed Haji (2015) reported a positive relationship between these variables.

The focus has predominantly been on developed nations, with scant attention to the factors affecting IC disclosure in developing countries. This gap has led to a lack of clear evidence on the impact of BCs on IC disclosure within these regions. Moreover, prior studies often examined the BCs-IC disclosure relationship in isolation, without considering other influential factors like political connections.

This study aims to explore the effect of BCs on IC disclosure within the context of a developing country and to investigate how political connections might moderate this relationship. The key research questions are: Q1: How do board characteristics impact intellectual capital disclosure? Q2: How do political connections influence the relationship between board characteristics and intellectual capital disclosure?

The structure of this paper is as follows: the first section is the introduction; the second covers the literature review and conceptual framework; the third presents the development of hypotheses; and the final section concludes the study.

2. LITERATURE REVIEW

The existing body of research extensively examines the significance of intellectual capital (IC) disclosure (Ahmed Haji, 2015; Ahmed Haji & Ghazali, 2013; Alfraih, 2018; Al-Maghzom et al., 2016; Alotaibi, 2014; Alshhadat, 2017; Appuhami & Bhuyan, 2010; Barakat & Hussainey, 2013; Cerbioni & Parbonetti, 2007; Cuozzo, Dumay, Palmaccio, & Lombardi, 2017; Dumay & Cai, 2014; Falikhatun, Aryani, & Prabowo, 2011; Farhan, Obaid, & Azlan, 2017; Gan, 2010; Khan, Muttakin, & Siddiqui, 2012; Maaloul, Chakroun, & Yahyaoui, 2018; Ramadan, Dahiyat, Bontis, & Aldalahmeh, 2017; Saleh, Abdul Latif, & Bakar, 2018; Shin, Hyun, Oh, & Yang, 2018; Smriti & Das, 2018; Sudibyo & Basuki, 2017; Taliyang & Jusop, 2011; Terblanche & De Villiers, 2019; Tessema, 2017). Predominantly, IC is categorized into three main types: human capital, relational capital, and structural capital (Ramadan et al., 2017). According to Ramadan et al. (2017), human capital encompasses the knowledge, skills, experience, and capabilities of an organization's workforce. Structural capital refers to all external relationships that link the company with its surrounding entities, including suppliers, development partners, customers, creditors, and investors. Relational capital encompasses all forms of interactions with external parties or associates, such as customers, suppliers, competitors, industry associations, and other stakeholders, which can influence the firm's operations.

Research has established a connection between board characteristics (BCs) and IC disclosure. Numerous studies concur that BCs significantly impact IC disclosure (Ahmed Haji, 2015; Alfraih, 2018; Al-Maghzom et al., 2016; Alshhadat, 2017; Appuhami & Bhuyan, 2010; Farhan et al., 2017; Gan, 2010; Taliyang & Jusop, 2011). The BCs explored in these studies include board size, board independence, and CEO duality. Drawing from Agency Theory, Appuhami and Bhuyan (2010) analyzed the relationship between corporate governance mechanisms and IC in Australia, finding a notable link between CEO duality and IC, but they could not demonstrate the impact of board size on IC disclosure.

Similarly, Taliyang and Jusop (2011) studied the relationship between corporate governance mechanisms and IC disclosure in Mexico, finding a significant positive correlation between board size and IC disclosure. Falikhatun et al. (2011) also examined this relationship in the annual reports of listed banks in Malaysia but found no evidence to support the impact of board size on IC disclosure. Contrarily, Anifowose, Rashid, Annuar, and Ibrahim (2017) identified a significant relationship between board size and IC disclosure among IPO companies in Malaysia, despite the conflicting results of previous studies conducted in the same country.

Political connections (PCs) are prevalent worldwide, particularly in developing nations with unclear economic systems. Firms in these regions often establish strong political ties to achieve their objectives (Binh, 2013). Saleh et al. (2018) defined a firm's political connections as a strong association between its major shareholders, board directors, or executive officers and government officials. Maaloul et al. (2018) noted that company officers and directors leverage political power to influence laws and regulations, thereby reducing uncertainty. Shin et al. (2018) argued that political connections are crucial for firms as they facilitate access to resources for financing and operations.

Vanini and Rieg (2019) contended that accounting regulations restrict mandatory IC disclosure, prompting firms to rely on voluntary disclosure to inform stakeholders about their IC. They also highlighted that voluntary IC disclosure is costly and may lead to knowledge leaks. Companies are compelled to provide this disclosure despite its associated risks. Similarly, Tessema (2017) argued that firms use extensive voluntary disclosure to lower their capital costs, though it can be costly and may result in knowledge leaks. Therefore, companies seek alternative, less costly methods that do not lead to knowledge leaks. Political connections offer a less expensive means to reduce capital costs by attracting investors (Ramadan et al., 2017). Firms can leverage these connections to mitigate risks and overcome financing challenges.

Any robust quantitative research must anchor itself in theory to elucidate the causal relationships among study variables. However, prior studies examining the connection between board characteristics (BCs) and voluntary disclosure have not converged on a singular theoretical framework to explain this relationship. The primary theories utilized by researchers to explore the BCs-voluntary disclosure nexus include Agency Theory, Signaling Theory, Capital Need Theory, Stewardship Theory, Legitimacy Theory, Stakeholder Theory, and Political Cost Theory (Ramadan et al., 2017; Saleh et al., 2018; Shin et al., 2018; Smriti & Das, 2018; Sudibyo & Basuki, 2017; Taliyang & Jusop, 2011; Terblanche & De Villiers, 2019; Tessema, 2017).

Conversely, despite the limited research into the relationship between BCs and intellectual capital (IC) disclosure, scholars have not established a definitive theoretical framework. Instead, they have drawn upon a combination of theories such as Agency Theory, Legitimacy Theory, Stakeholder Theory, and Resource Dependency Theory (Ahmed Haji, 2015; Alfraih, 2018; Al-Maghzom et al., 2016; Alotaibi, 2014; Alshhadat, 2017; Appuhami & Bhuyan, 2010; Barakat & Hussainey, 2013; Cerbioni & Parbonetti, 2007; Cuozzo et al., 2017; Dumay & Cai, 2014; Falikhatun et al., 2011; Farhan et al., 2017; Gan, 2010; Khan et al., 2012; Maaloul et al., 2018; Ramadan et al., 2017; Saleh et al., 2018; Shin et al., 2018; Smriti & Das, 2018; Sudibyo & Basuki, 2017; Taliyang & Jusop, 2011; Terblanche & De Villiers, 2019; Tessema, 2017). Among the various accounting theories, Agency Theory stands out as the most frequently employed by researchers to elucidate the interactions among different parties within the corporate environment and to analyze corporate governance mechanisms.

Emerging in the early 1970s as an economic theory concerning the corporate environment, Agency Theory conceptualizes the firm as a contract between owners and managers, empowering managers to run the company's operations. Initially introduced by Jensen and Meckling (1976), the theory posits that maximizing shareholder utility involves designing appropriate contracts. This economic perspective was swiftly applied to corporate governance to address agency conflicts by enhancing information disclosure to external users. Under this framework, managers are obliged to provide comprehensive information and disclosures to owners, facilitating oversight of managerial performance and decisions, thereby representing the company's overall performance (Aburaya, 2012; Alfraih, 2018).

Haji and Ghazali (2013) employed Agency Theory and Resource Dependence Theory to elucidate the impact of corporate governance mechanisms on IC disclosure (Al-qadi et al., 2024). They attributed the positive relationship between board size and IC disclosure to Resource Dependence Theory and utilized Agency Theory to explain the negative relationship between director ownership and IC disclosure. Similarly, Gan (2010) integrated Agency Theory and Institutional Theory to investigate the relationship between corporate governance mechanisms and IC disclosure in the annual reports of Malaysian companies. Falikhatun et al. (2011) also relied on Agency Theory to explain the influence of corporate governance mechanisms on IC disclosure. This discussion underscores that researchers have not yet reached a consensus on a specific theoretical framework to explicate the relationship between BCs and IC disclosure (Alqadi et al., 2024).

3. THEORETICAL FRAMEWORK

Board characteristics (BCs) encompass various elements and mechanisms whose significance can differ across regions and nations, influenced by financial and legal contexts. This research focuses on BCs as defined by the Jordanian commercial law(Abdelrehim & Yahya, 2023). Addressing the primary research issue—mixed empirical outcomes regarding the impact of BCs on IC disclosure—this study zeroes in on BCs that have shown ambiguous results in past studies. In this context, BCs are the independent variable, comprising three elements: board size, board independence, and role duality.

Agency Theory serves as the principal framework for explaining how BCs affect voluntary disclosure of all kinds. The theory is predicated on the notion of agency conflicts, which arise due to managers' ability to control much of the information, potentially withholding it from stakeholders(Abdelrehim & Haji.Yahya, 2022). According to Agency Theory, managers tend to disclose information that benefits them, while stakeholders require accurate information to make informed decisions. Thus, BCs, under the assumptions of Agency Theory, should enhance the level and quality of IC disclosure (Абдельрехим et al., 2023b). Therefore, this study relies on Agency Theory to elucidate the impact of BCs on IC disclosure. Agency Theory suggests that board size, board independence, and role duality mitigate agency conflicts between managers and stakeholders by promoting IC disclosure(Абдельрехим et al., 2023a).

Agency Theory highlights the positive influence of BCs on IC disclosure by addressing agency conflicts and reducing information asymmetry between managers and stakeholders. Despite recognizing the importance of voluntary IC disclosure, companies often view it as costly and potentially risky, as it may expose sensitive information about their capabilities and resources. As a result, firms seek less expensive and safer alternatives to voluntary IC disclosure. In developing countries, political influence on the economy is significant, both directly and indirectly. Companies, therefore, strive to leverage political relationships to further their interests. Previous studies, as discussed in Chapter Two, have demonstrated that political connections can reduce information asymmetry and lower capital costs(Абдельрехим et al., 2023a).

Theoretically, Resource Dependence Theory posits that companies continuously seek external resources to help achieve their objectives, such as increasing profits and reducing costs(Al-qadi et al., 2024). Thus, Resource Dependence Theory can be utilized to explain the role of political connections as an external source of strength that companies rely on to decrease capital costs and minimize the risks associated with voluntary IC disclosure.

4. HYPOTHESES DEVELOPMENT

4.1. Board Size

Corporate governance mechanisms do not specify an exact number of board directors, and previous research has yielded mixed results regarding the impact of board size on IC disclosure. From a theoretical perspective, Agency Theory posits that an increased board size can play a positive role in reducing conflicts of interest between managers and stakeholders through enhanced voluntary disclosure. This study employs Agency Theory to elucidate the beneficial effect of board size on the level and quality of voluntary IC disclosure. Therefore, the hypothesis is formulated as follows:

H1: There is a significant positive effect of board size on IC disclosure.

4.2. Board Independence

According to Agency Theory, independent board members promote transparency and compliance, thereby mitigating conflicts of interest between managers and owners. These independent members often advocate for voluntary disclosure, viewing it as a crucial tool for ensuring transparency. Consequently, this study utilizes Agency Theory to explain the positive impact of board independence on IC disclosure. Based on this theoretical foundation, the following hypothesis is proposed:

H2: There is a significant positive effect of board independence on IC disclosure.

4.3. Political Connections

Political connections can act as a substitute for voluntary IC disclosure. Companies leverage these connections to lower capital costs, attract investors, and enhance their corporate relationships with surrounding communities. Political connections are among the most vital external resources that bolster a company's ability to achieve its objectives by reducing capital costs. Consequently, this study employs Resource Dependence Theory to explain the negative impact of political connections on the relationship between BCs and IC disclosure. Based on this theoretical perspective, the following hypothesis is proposed:

H3: There is a significant negative moderating effect of political connections on the relationship between board characteristics and IC disclosure.

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