The Effect of Corporate Governance Mechanism on the Voluntary Internet Financial Reporting: A Case of Malaysia

REKHA THANGATORAI
ROMLAH JAFFAR
ZALEHA ABDUL SHUKOR
School of Accounting
Universiti Kebangsaan Malaysia
43600 Bangi, Selangor
MALAYSIA
rekhagal@gmail.com; romlah@ukm.my; zbas@ukm.my

Abstract: The recent corporate accounting scandals in Malaysia have led to higher demand for more voluntary accounting information disclosures. This study employed voluntary internet financial reporting (VIFR) as a tool for more corporate transparency disclosures. This study examines the relationship between corporate governance mechanisms namely the characteristics of board of directors (board independence, dominant personality, family members on board, financial experts on board and director ownership) with VIFR. This study used data from 265 companies listed on Bursa Malaysia’s Main board for the year 2011. Based on the stewardship theory, the study expects there is a significant association between board independence, dominant personality, family members on board, financial experts on board, and director ownership with VIFR. The result of this study shows that board independence, financial experts on board, family members on board and director ownership has a significant influence towards the level of corporate VIFR disclosure. However, dominant personality of board members does not have a significant influence towards VIFR. This study contributes in understanding the role of corporate governance on VIFR disclosure. This study would provide input to regulatory bodies to develop a guideline of VIFR to enhance the corporate transparency level among Malaysian public listed companies.

Keywords: voluntary disclosure, internet financial reporting, corporate transparency.

1 Introduction

Internet financial reporting (IFR) provides an efficient means for companies to communicate with investors, decrease cost of distributing hard copy information and increase the frequency of information disclosure [5]. Internet also provides flexibility to the type of information disclosed and format of presentation. Prior studies found that IFR may be an effective tool for improving disclosure transparency [20] and good corporate governance (CG) practice [12]. Hence it is believed that a good corporate governance mechanism will influence companies in Malaysia to use websites to disclose additional voluntary financial information to their shareholders apart from providing mandatory financial information required by the regulatory bodies on their websites.

According to Malaysia Code of Corporate Governance (MCCG), board composition is one of the important elements of a good governance to be established in an organization. Promoting stronger governance could also promote more transparent disclosure on company websites.

The earliest study of IFR in Malaysia was carried out by Ruhaya et al. [23] who have investigated the extent of IFR practice and types of information in the firm’s websites. Later, other researchers have expanded the study by analysing the level of IFR [11], usefulness of IFR and disclosure strategy of IFR [19]. There are also prior studies that look at the determinants of IFR such as firm size, profitability, leverage, firm ownership, type of industry, level of technology, shareholders concentrations and CEO duality [1, 4].

Around the globe many prior studies have also investigated the level of IFR in their respective countries or making cross-sectional studies between countries [8]. These studies have also looked into the determinants of IFR practices [20, 25]. Globally significant determinants for the practice of IFR are firm’s size [8, 13], level of technology [8], profitability [8, 18], leverage [8, 10], proportion...
of independent directors [20, 25], and ownership [20; 25].

There are also some studies that look at the CG characteristics and the level of voluntary disclosure in the annual reports. Part of CG characteristics included in these studies are board characteristics such as ownership structure [25], the proportion of independent directors [25, 12], CEO duality [12, 14], and board expertise [14]. Prior studies, according to our knowledge, have not examined the effect of board characteristics upon the level of voluntary disclosure through internet financial reporting (IFR). Therefore, in our opinion, results of prior studies of the relationship between CG characteristics on annual report reporting cannot be generalised to IFR. This is because the content in IFR, which is prepared on a more timely basis, is expected to be different from the content in annual report is prepared on yearly basis. Therefore it is very important to examine the association between voluntary internet financial reporting (VIFR) and CG characteristics to get an additional insight of factors that could influence the reporting.

This study is an extension from prior studies to further examine the effect of CG mechanism on VIFR among Malaysian listed companies. This study employs stewardship theoretical perspective that emphasis the trust given by principals/shareholders to managers/agents.

The result of this study shows that board independence, financial experts on board, family members on board, and director ownership have a significant influence towards the level of corporate voluntary internet financial reporting (VIFR) disclosure. However dominant personality of board members does not have a significant influence towards VIFR. The next section further elaborates on the detail of the study.

2 Literature Review and Hypotheses Development

2.1 Internet Financial Reporting Disclosure and Board Independence

Board independence is an important element in monitoring the corporate financial accounting process [20, 21] and affecting the reliability of financial reports [3]. A high percentage of independent directors on the board enhances the monitoring of managerial opportunism and reduces management’s chance of withholding information. Empirical evidence provides mixed association between corporate voluntary disclosure and board independence [10, 14].

Stewardship theorists argue that management of a firm would act for the best interest of the company that they are trusted to work for. A steward (manager) is influenced by collectivism behaviour. They will have high commitment to work harder to fulfil principal’s interest. Stewardmaximizes his or her utility as he/she achieve organizational objectives. Principal (shareholders) who supports stewardship theory will authorize the steward (management) with the information, tools and authority to make good decisions for the organization. The principal enables the steward to act in the best interest of the organization, trusting that the steward will make choices that maximize the long-term return for the organization. Hence, controlling the management through outside board directors will not be soproducative as it can weaken up the pro-organisational behaviour of the steward [12-Donalson]. This is because the outside directors are assigned to monitor the management. When there is a monitoring mechanism, a man will act as an agent instead of being a steward. Hence, for this study it is hypothesized that the proportion of outside directors is negatively associated with the level of voluntary disclosure. Hence, the hypothesis is stated as follows.

H1: The proportion of independent nonexecutive directors on board has negative association towards firm’s VIFR disclosure.

2.2 Dominant Personality (CEO Duality Role)

Dominant personality exists when the same person serve as a CEO of a company and Chairman of the board of director. Stewardship theory proposes that a CEO duality role would allow for a more effective action by the CEO and lead to high performance [24]. The theory further explains that a CEO who is acting as a steward in an organization, will be motivated when the corporate governance arrangement provide him/her higher authority and discretions. Leaders with greater discretions will be able to implement their strong decision. The stewardship theory allows a CEO who is playing a duality role to make strategies and have more power to make decisions without afraid of being penalized by the outside board of directors. Based on stewardship theory the power given to CEO with a duality role will enhance their pro-organisational behaviour. Accordingly, stewards will strive to maximize their self-utility as they achieve the organization objective.
The empirical results concerning CEO duality and financial reporting are somehow mixed. Arussi et al. [4], Xiao et al. [25], and Guland Leung [14] reported duality role has negative effect towards voluntary disclosure. On the other hand, Kelton and Yang [20] show there is no relationship between duality role and voluntary disclosure. However, Felo [12] and Ghazali and Weetman [13] reported there is a greater relationship between CEO duality and disclosure transparency through voluntary disclosure. Hence high demand for voluntary disclosures on websites will be facilitated by the CEO who is playing the duality role. Therefore it is hypothesized that CEO duality is positively associated with the level of voluntary disclosure. Hence, the hypothesis is stated as follows.

H2: Dominant personality positively associates towards firm’s VIFR disclosure.

2.3 Family Members on Board

Family owned business is normal in Malaysia or any emerging economy. Stewardship theory suggests that family members often possess sufficient self-motivation to act in the best interests of all firm stakeholders [7]. This attitude will be especially prevalent among family members who are having an important position on board.

Family firms have better financial reporting quality than non-family firms, suggesting that family firms are associated with a more transparent information environment [2]. In contrast, Anderson et al. [3] finds that family firms are less transparent than non-family firms. Since past studies shown mixed results, this study would like to re-examine the relationship between the number of family members on board and VIFR in Malaysia.

Based on stewardship role of board of directors, this study hypothesized that the higher proportion of family members will enhance the level of VIFR. Hence, the hypothesis is stated as follows.

H3: The proportion of family members on board positively associates with firm’s VIFR disclosure.

2.4 Financial Expertise on Board

Previous studies show that, the more board members have accounting and finance expertise, the more voluntary information they wish to disclose to reflect their credibility and reputation. Hence in this study it is predicted that, a director (steward) who has financial expertise will be more concern on reporting more financial information on voluntary basis on the corporate website as he has more group value concerns. In this study it is hypothesized that directors who are financially literate will play their steward role in providing more voluntary financial information on their corporate websites as it is widely being demanded by shareholders.

H4: The proportion of financial experts on board positively associates with firm’s VIFR disclosure.

2.5 Director Ownership

Director ownership is common in today’s corporate business environment. Directors who have self-actualizing and high level of organisational identification [22] will play a good steward. Share ownership status gives the directors a sense consciousness to feel their self-actualisation. These directors will expect for organisation’s excellent reputation and longevity, where they have the obligation to act in a socially responsible manner for its shareholders. These lead directors to stand out the competitive advantage, by building confidence of investors for the company in future by voluntary disclosures.

Prior researches find that firms with high managerial ownership have high level of voluntary disclosure in the annual report [13, 17]. Therefore, this study expects directors who are stewards and has ownership in an organisation would influence VIFR of the firm. Hence, the hypothesis is stated as follows.

H5: Directors ownership positively associates with firm’s VIFR disclosure.

3 Research Methodology

This study employs secondary data collection method to gather relevant information for the year of 2011. Specifically, data for the study are from two sources. The first source is from the company’s website to gather information on the voluntary internet financial disclosure. The second source of information is from annual reports of the sample companies to gather board information on the independent variables (percentage of independent non-executive directors, percentage of family members on board, CEO dominant personality, percentage of financial experts, and director ownership) and control variables (size, leverage, audit quality and profitability).

The dependent variable of this study is the voluntary internet financial disclosure (VIRF). There are 13 items used to measure the content of disclosure. The 13 items were derived based on the
previous work of Arussi,[4], Kelton and Yang, [20]. A pilot study was undertaken on 15 Malaysian listed companies to access the suitability of items. Score of 1 (for present) and 0 (for absent) was assigned to each disclosure item.

Independent board member is calculated based on the proportion of independent non-executive directors to total directors on the board. A dichotomous dummy variable; 1 if the CEO is also the Chairman of the board, and 0 otherwise is to determine the presence of dual leadership [16]. Family member on the board is calculated based on the proportion of family members on board to total directors on board, and financial expertise of board is calculated based on the proportion of members who are financially literate to total directors on board.

### 4 Finding and Discussion

Table 1 provides information of descriptive statistic of sample. The table shows that on the average the mean of voluntary internet financial disclosure (VIFR) is only about 5. The proportion of independent directors is about 45% which exceed the requirement of a minimum 30% requirement set by MCCG. The DUALITY value of 0.34 indicates the majority of sample separates the CEO role from the Chairman role.

| Table 1: Descriptive Statistics of Sample Firms (n=265) |
|-------------------------------|-----------------|-----------------|-----------------|
|                               | Minimum | Maximum | Mean   | Std. Deviation |
| VIFR                          | 0       | 13      | 5.27   | 3.434          |
| BIND                          | .15     | .80     | .45    | .12282         |
| DUALITY                       | 0       | 1       | .34    | .473           |
| FAMILY                        | .00     | .78     | .21    | .23120         |
| FINEXP                        | .10     | 1.00    | .3052  | .13968         |
| DIROWNS                       | .00     | .78     | .1169  | .16161         |
| ROE                           | -.16    | .42     | .0815  | .11193         |
| LEV                           | 2.00    | 134.00  | 40.6075| 22.27116       |
| SIZE (RM, 000)                | 49,750  | 11,837,011 | 1,487,776.48 | 2,919,317.586 |
| AUDTYP                        | 0       | 1       | .57    | .495           |

The regression results are presented in Table 2. The results shows there is a negative and significant relationship between board independence (BIND) and voluntary internet financial reporting (VIFR) at 1%, with coefficient of -8.288 (t = -5.084). This result explains that when there is higher proportion of independent non-executive directors on board, the VIFR disclosure is lower. This result supports hypothesis 1, which expects proportion of independent non-executive directors have a negative association towards corporate VIFR disclosure. The result is supported by results of previous studies [10, 14] explaining that the independent non-executive directors may act as a substitute for monitoring public disclosure. Hence they do not encourage for more financial disclosures on voluntary basis by firms except for the mandatory financial information required by regulatory body such as bursa Malaysia listing requirements. However the negative association result between board independence and VIFR is in line with the stewardship theory employed in this study.

| Table 2: Regression result |
|-------------------|---------------|-----------------|-----------------|
| Constant          | 6.870(6.237)*** |
| Independent variables |
| BIND              | -8.288(-5.084)*** |
| DUALITY           | 0.024(0.054)    |
| FAMILY            | -1.136(-1.277)* |
| FINEXP            | 4.655(3.312)*** |
| DIROWNS           | -0.855(-0.695)* |
| Control variables |
| ROE               | 3.661(1.982)**  |
| SIZE              | 0.004(0.399)    |
| AUDTYP            | 0.178(0.399)*** |
| INDTP             | 0.003(0.361)    |
| Adjusted R²       | 11.00           |
| F-Value           | 6.375           |
| Significant       | .000 ***        |

**Correlation is significant at 1%, 5% and 10% respectively**

The results also show that dominant personality (DUALITY) is positively associated with VIFR with coefficient value of 0.024 (t = 0.054). However the relationship is insignificant. Therefore hypothesis 2 is not supported. Hence there is no association between DUALITY and VIFR in Malaysian firms. The result of this study is supported by Kelton and Yang [20] who found no association between duality role and financial information disclosure on corporate websites.

The proposition of family members on the board (FAMILY) towards VIFR is negative and contradicts the expectation of hypothesis 3. The negative associationis supported by previous studies in Asian region [16, 6, 15]. Ho and Wong [16] found that companies in Hong Kong with higher proportion of family members on board are more likely to have lower level of voluntary disclosures. Haniffa and Cooke [15] also have provide evidence
that for Malaysian companies with proportion of family members on board have significant inverse association with the level of voluntary disclosures. Hence, hypothesis 3 is not supported.

The variable of financial experts on board (FINEXP) provides evidence to support hypothesis 4. FINEXP is found to have a positive significant relationship with VIFR. The result shows a coefficient value of 4.655 (t = 3.312) at 1% level. This positive association shows that the higher is the proportion of financial experts on board, the higher is the level of VIFR disclosure. This finding is consistent with the prediction of this study, that more financial experts on board are effective in improving or encouraging VIFR disclosure. Hence hypothesis 4 is supported.

The result also shows that Director Ownership (DIROWNS) is negatively associated with VIFR. The coefficient value is -0.855 (t = -0.695), and the relationship is significant at 10%. The finding does not support hypothesis 5 which expects director ownership to be positively associated towards firm’s VIFR disclosure.

However the significant negative association found can be explained by Eng and Mak[10], who found a negative association between director ownership and voluntary disclosures. According to Eng and Mak[10], director ownership serves to align the interest of shareholders and managers. Hence it reduces shareholders demand for monitoring. Thus director ownership on voluntary disclosure is a substitutive, such that need for more monitoring and more transparent disclosure is reduced by greater percentage of director ownership [13-Eng].

Table 2 also show that profitability (ROE), firm size (SIZE), auditor type (AUDTYP) and industry type (INDTYP) are significantly associated with VIFR. However, the effect of leverage (LEV) on VIFR is insignificant.

5 Conclusion and Discussion
The recent corporate accounting scandals in Malaysia have led to higher demand for more voluntary accounting information disclosures. Internet financial reporting (IFR) provides an efficient means for companies to communicate with investors, decrease cost of distributing hard copy information and increase the frequency of information disclosure. Internet also provides flexibility to the type of information disclosed and format of presentation. IFR may also be an effective tool for improving disclosure transparency and good corporate governance (CG) practice.

This study employed voluntary internet financial reporting (VIFR) as a tool for more corporate transparency disclosures. This study examines the relationship between corporate governance mechanisms namely the characteristics of board of directors (i.e. board independence, dominant personality, family members on board, financial experts on board and director ownership) and VIFR. The result shows that board independence, financial experts on board, family members on board and director ownership has a significant influence towards the level of corporate VIFR disclosure. However dominant personality of board members does not have a significant influence towards VIFR. This study contributes in understanding the role of corporate governance on VIFR disclosure. This study helps the regulatory body to develop a guideline on VIFR to enhance the level of transparency among Malaysian public listed companies.

References:


