Global Review of Accounting and Finance
Vol. 3. No. 2. September 2012. Pp. 128 – 142

The Impact of Corporate Governance on the Voluntary Accounting Information Disclosure in Malaysian Listed Banks

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Financial accounting information is the main part of the annual reports on which investors rely. The reliability and relevance of the financial accounting information is on the shoulders of directors. It has been highlighted in the corporate governance literature that information disclosure about the companies is the heart of the good corporate governance system. In Malaysia, there is no research conducted to examine the relationship between corporate governance and voluntary accounting information disclosure although it is important to examine it. Therefore, the objective of this research is to investigate the impact of corporate governance on voluntary financial accounting information disclosure of Malaysian listed banks. The sample includes twelve listed banks on Bursa Malaysia from1996 until 2005. The findings of the panel data regression show that higher INE_BZ (at 1% Sig. level), lower DOWN (at 10% Sig. level) and higher BZ (at 5% Sig. level) have more voluntary financial accounting information disclosure. The other variables such as BLS, IOWN and BOWN are in line with hypotheses while BZ is not and the main reason for BZ not being in line with hypothesis is the sample firms already have optimal board structures.

Keywords: voluntary financial accounting reporting, bank, corporate governance; GLS; generalized least square; panel data; agency theory; Malaysia

1. Introduction

Corporate governance is an important issue all over the world and it is no exceptional case for Malaysian corporations as well. Poor corporate governance is stated to be one of the main causes of crisis. Many theories like agency theory and many corporate guidelines mutually agree that having good corporate governance systems will strengthen the internal control procedures of the corporations and will enhance the disclosure of information about the performance of the corporation (Apostolos and Konstantinos, 2009). In addition, corporate governance of banks seems to be more important than other industries because the banking sector plays a crucial financial intermediary role in any economy (Matama, 2008). Poor corporate governance of the banks can drive the market to lose confidence in the ability of a bank properly to manage its assets and liabilities, including deposits which could, in turn, trigger a liquidity crisis and might lead to economic crisis in a country and pose a systemic risk to the society at large (Basel Committee on Banking Supervision, 2005; Garcia-Marco &

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Robles-Fernandez, 2008). Therefore, it is of interest to examine the importance of corporate governance mechanisms in the banking sector.

Similarly, the importance of the disclosure of information in the annual reports has been highlighted as one of the important aspects of good corporate governance. According to Basel Committee on Banking Supervision (2005), Xue (2008) and Tian and Chen (2009), information disclosure is important as it is the heart of corporate governance. They further state that voluntary information disclosure is essential to signal the performance of the corporation, to reduce the information asymmetry, to clarify the conflict of interests between the shareholders and the management and to make corporate insiders accountable. Among the different types of information disclosed in the annual reports, disclosure on voluntary financial accounting information is focused on in this study because disclosing financial information is necessary since investors mainly rely on the information disclosure in the annual report and more voluntary information will enhance transparency, reduce opportunistic behaviours and information asymmetry and management cannot hold the important information for their own benefit (Marleen, et.al., 2005; Apostolos and Konstantinos, 2009). However, most of the developing countries do not have strong policies on voluntary financial accounting reporting (Ionescu, 2010). This study fills up the gap by examining the impact of corporate governance on voluntary financial accounting reporting in the financial sector. Therefore, the research question in this study is "whether there is any impact of corporate governance on voluntary financial accounting information disclosure of listed banks on Bursa Malaysia".

It could be summed up that governance seems to be at the heart of the corporation, especially in the banking sector and to have an influential power on information disclosure of the annual reports. Hence, the aim of this paper is to investigate the impact of corporate governance on the voluntary financial accounting information disclosure of the banks. This research is presented in 5 sections. The second section discusses the relevant literature. The third section elaborates on the development of hypotheses and research design. The fourth section explains findings and the last section reports the conclusions.

2. Literature Review

Jensen and Meckling (1976) mention that due to the separation of ownership and control, agency problems, i.e., moral hazard (hidden action) and adverse selection (hidden information) could occur and the directors might maximize their own interests at the expense of the shareholders. Thus, the main issue from the agency theory is the existence of agency cost (Williams et al., 2006). The suggested mechanism to minimize this cost is good corporate governance (Judge et al., 2003) since it promotes goal congruence among principals and agents (Conyon & Schwalbach, 2000). Cheung and Chan (2004) also describe that the ultimate goal of corporate governance is to monitor the management decision-making in order to ensure that it is in line with shareholders' interests and to motivate managerial behaviour towards enhancing the firm's wealth. It is also highlighted in this study is that information disclosure is one of the tools to reduce the cost of capital and to provide more transparent information to the shareholders. By doing that, agency conflicts will be reduced since the shareholders are able to monitor the management based on the information disclosure. The following discussions provide some explanations of corporate governance mechanisms from the agency theory perspective and the most relevant empirical findings related to this research.

Regarding the issue of board leadership structure, agency theory and most of the corporate guidelines recommend separate board leader structure in order to ensure that the performance of the CEO is independently monitored by a different person, i.e.,. board chairman (Jensen & Meckling, 1976; Florackis & Ozkan, 2004). The independence of the board attained by separate leadership is necessary so that the board will be able to put pressure on the management led by CEO in disclosing the more material information about the company, which is in line with the interests of the shareholders. Hence, it could be assumed that the separate leadership structure will lead to better voluntary financial accounting disclosure about companies. The findings of Ho and Wong (2001), Gul and Leung (2004), Lakhal (2005), Byard, Li and Weintrop (2006) and Huafang and Jianguo (2007) are in line with theoretical expectations. This means that there is a positive relationship between separate leadership structure and disclosure. In the case of study by Norita and Shamsul Nahar (2004), the results show that separate leadership structure is not associated with voluntary disclosure.

According to Choe and Lee (2003), board composition is very important effectively to monitor the managers and reduce agency costs. Although the executive directors have specialized skills, expertise and valuable knowledge of the firms' operating policies and day-to-day activities, there is a need for the independent directors to contribute the fresh ideas, independence, objectivity and expertise gained from their own fields (Weir, 2003). Hence, agency theory recommends the involvement of independent non-executive directors to monitor any self-interested actions by managers and to minimize agency costs (Florackis & Ozkan, 2004; Williams et al. 2006). In addition, it can be derived from agency theory that a higher proportion of independent non-executive directors on the board will result in higher disclosure of the material aspects of the company in order to increase the transparency since independent boards will be able to encourage the management to disclose more information. The findings of Chen and Jaggi (2000), Gul and Leung (2004), Byard et al. (2006), and Cheng and Courtenay (2006) and Norita and Shamsul Nahar (2004.) are in line with theoretical expectation.

In order to have the effective number of board size, Jensen (1983) and Florackis and Ozkan (2004) suggest not having more than seven or eight members to avoid less effective coordination, communication and decision making. Smaller board size seems to be more conducive to board member participation and thus would result in a positive impact on the monitoring function and the voluntary financial accounting decision-making capability of the board and independence from the management (Huther, 1997). It is expected that smaller boards would be able to monitor the decisions of the management related to the information disclosure. This expectation is supported by the findings of Byard et al. (2006). They studied 1279 firms over the years 2000 to 2002 and found that financial disclosure related to forecast information decreases with board size. However, the findings of Lakhal (2005) show that there is an insignificant and weak association between board size and disclosure.

Agency theory stresses the importance of ownership structure in enhancing corporate governance. It could be viewed from three different perspectives; (a) director ownership, (b) block ownership and (c) institutional ownership. If directors own shares, the directors as the owners themselves are directly instructing and monitoring the management of the companies (Jensen & Meckling, 1976). Hence, there are likely to be fewer agency problems as compared to the situation where directors, who are not the owners, supervise the management of the company. It is also supported by Seifert et al. (2005) who discuss agency conflicts. However, in the case of information disclosure, the effect of director ownership on disclosure might be different from that of the block holders and institutional investors. Directors who have a substantial share ownership might not want to disclose the information to the outsiders because they can use their discretionary powers to spend firm resources in ways that serve their own interest at the expense of other shareholders and then they might want to conceal fraud and incompetence, if any. Therefore, it could be expected that there is a negative relationship between director ownership and disclosure. The theoretical expectation seems to be supported by Chau and Gray (2002), Eng and Mak (2003) and Leung and Horwitz (2004).

With regard to block ownership, if an individual has a substantial amount of interest in a particular company (usually measured at 5%), he or she will be more interested in the company, compared to the shareholders who own a smaller number of shares because dispersed ownership may have less incentives to monitor management (Kim & Lee, 2003). Ownership by block holders is an important influence on higher disclosure since they have the voting power that could be used as a tool to monitor the agents (David & Kochhar, 1996). Agency theory also suggests that block holders have strong interests in firms; most likely they might put pressure on the management to disclose all the material information**.** This could be due to the significant proportion of shares held by block holders. Therefore, it could be expected that there is a positive relationship between block holders and disclosure. Chau and Gray (2002), Luo, Courtenay and Hossain (2006)[i], Huafang and Jianguo (2007) and Norita and Shamsul Nahar (2004) find that outside block ownership is positively associated with voluntary disclosures and hence their finding is in line with theoretical expectation. However, Eng and Mak (2003) find that block holder ownership is not related to disclosure.

Lastly, regarding institutional investors, Salleh and Mallin (2002), Kim and Nofsinger (2004), Leng (2004), Soloman and Solomon (2004), Seifert et al. (2005), Le et al. (2006), Langnan, Steven and Weibin (2007) and Ramzi (2008) collectively agree on the important role of institutional shareholders in the monitoring of firms. Ownership by the institutional shareholders is large enough to motivate them to monitor, compared to a shareholder with small amount of ownership. Therefore, it could be expected that there is a positive relationship between institutional investors and disclosure. The findings of Eng and Mak (2003) and Lakhal (2005) are in line with theoretical expectations. However, Huafang and Jianguo (2007) find that there is state ownership and legal ownership is not related to disclosure.

3. Development of Hypotheses and Research Design

Development of Hypotheses

Disclosing the material information, especially accounting information, reduces the information asymmetry between the management and the owners and will also reduce the agency conflicts between them (Apostolos & Konstantinos, 2009; Akhtaruddin & Hossain, 2008). Disclosure is an integral part of corporate governance because it shows the extent of how good corporate governance is (Patel et al., 2002; United Nation, 2003). Leong (2005) also mentions that disclosure and transparency are partners of good corporate governance. Moreover, Beekes and Brown (2006) studied 250 Australian firms rated in the 2002 Horwath Corporate Governance Report and find that better-governed firms do make more informative disclosure. Hence, the researcher is interested to examine whether corporate governance variables could affect the voluntary financial accounting information disclosure and the following hypotheses are developed.

H_{a1}: Voluntary financial accounting disclosure is positively related to separate leadership structure.

H_{a2}: Voluntary financial accounting disclosure is positively related to proportion of independent non-executive directors on the board.

H_{a3}: Voluntary financial accounting disclosure is negatively related to board size.

H_{a4}: Voluntary financial accounting disclosure is negatively related to director ownership.

H_{a5}: Voluntary financial accounting disclosure is positively related to block ownership.

H_{a6}: Voluntary financial accounting disclosure is positively related to institutional ownership.

Research Design

Variables and Empirical Model

Dependent Variable

A weighted voluntary financial accounting information disclosure score is used as a dependent variable; the questionnaire was developed to obtain views on the importance of each disclosure item from financial analysts and accountants. The list of disclosure items is set out inTable 1.

Table 1: List of Voluntary Financial Accounting Information Disclosure

I. Summary of historical results Disclosure on the comparison of voluntary accounting information is categorized into two groups, i.e., (a) disclosure for 3 years and below and (b) 4 years and above.
(a) Operating results Profit before tax expense Profit after tax expense and minority interests Net interest income Net income from Islamic banking Non-interest income Staff costs and overhead costs Advances for losses on loans, advances and financing
(b) Key balance sheet data Total assets Loans, advances and financing Total liabilities Deposits from customers Commitments and contingencies
(c) Share information Basic earnings per share Diluted earnings per share Share price at local exchange and foreign exchange (if applicable) Share price at year end Share price trend (highest/ lowest) Market capitalization at year end Market capitalization trend Size of shareholdings Types of shareholders
(d) Financial ratio Profitability ratios Capital adequacy ratios Dividend ratios Liquidity / Gearing ratios Efficiency ratio
II. Segmental information Geographical analysis of profit, by category of incomes Geographical analysis of operating expenses Geographic analysis of total assets Line-of-business analysis of profit, by categories of income Line-of-business analysis of operating expenses Line-of-business analysis of total assets Market share analysis (Quantitative)
III. Contingent liabilities and contingent assets Nature of each class of contingent liability (Qualitative)

Nature of each class of contingent liability (Quantitative)
Nature of each class of contingent asset (Qualitative)
Nature of each class of contingent asset (Quantitative)
Declaration of non-existence of contingent liabilities and assets
IV. Other information Disclosure on the events after the balance sheet date but before the financial statements are authorized for issue
Disclosure on non-existence of events after the balance sheet date but before the financial statements are authorized for issue
Bank's dividend policy (Quantitative)
Bank's dividend policy (Qualitative)
Ratings by rating agencies
The nature and purpose of maintaining the reserve (Qualitative)
Allowance for losses on loans and financing (Quantitative)
Allowance for losses on loans and financing (Qualitative)

Before the actual questionnaire was sent, a pilot test was conducted and the findings showed that alpha value was 0.94 and so it has been concluded that the questionnaire is reliable. In addition, pilot test results show that the overall mean score for comprehensiveness of the questionnaire is 4.05, for understandability of the questions is 4.10 and for understandability of the instruction is 4.62. Therefore, it can be concluded that the pilot test questionnaire is good enough to be used as the actual questionnaire.

The weighted voluntary financial accounting information disclosure score used in this study is based on the opinions of one hundred and thirty-one accountants and fifty-one financial analysts. There is no non-response bias from the questionnaire received from the accountants and financial analysts based on T statistics and the Mann-Whitney U test. The reliability test results show that the alpha value is 0.9 and so the weighted voluntary financial accounting disclosure score used in this study is reliable. The annual reports of the sample companies were checked against the disclosure index developed by the researcher. The researcher used a dichotomous score, i.e., one is given if the company discloses the information and zero otherwise. Since the annual reports are checked against the disclosure index to provide the disclosure score, during this process, some of the disclosures in the annual reports were not clear for the researcher to decide whether some parts of annual report disclosure represent the items from the disclosure index. Hence, for these confusing items, a small questionnaire was constructed and sent to ten accountants and six financial analysts in order to seek their opinions on whether these confusing disclosures in the annual reports represent the items in the disclosure check list. It was found out that there is no significant difference between the score provided by the researcher and the answers provided by the selected accountants and financial analysts. Finally, the weight for each disclosure item is calculated by the mean score of each disclosure item provided by the accountants and financial analysts.

Independent Variables

There are six independent variables which comprise three structural measures of corporate governance (i.e., board leadership structure, board composition and board size) and three measures of ownership structure (i.e., director ownership, institutional ownership and block ownership). Among the corporate governance variables, the above mentioned variables are selected as independent variables based on the prior research as well as the availability of data. Finally, the empirical model of the study also includes two control variables related to firm-specific characteristics (i.e., firm size and leverage). The complete empirical model is as follows.

$$Y_{it}= \beta_o + \beta_1 x_{1it}+\beta_2 x_{2it} - \beta_3 x_{3it} - \beta_4 x_{4it}+\beta_5 x_{5it} + \beta_6 x_{6it} + \beta_7 x_{7it} + \beta_8 x_{8it} + \mu_{it}$$

Where,
i = 1,2,3,4,5,6,7,8,9,10,11,12
t=1, 2, 3, 4, 5,6,7,8,9,10
Y= Weighted voluntary financial accounting information disclosure score
$x_{1=}$ Board leadership structure (BLS)
x_2= Proportion of independent non-executive directors on the board (INE_BZ)
x_3= Board size (BZ)
x_4= Proportion of director ownership (DOWN)
x_5= Proportion of institutional ownership (IOWN)
x_6= Proportion of block ownership (BOWN)
$x_{7=}$ Log of total assets (TA)
$x_{8=}$ Leverage (TD_TE)
μ= Error term

Sample selection and Statistical Methods

The sample includes the twelve listed companies whose main activity is banking from 1996 until 2005. The total number of observations is 120 observations. However, some of the observations need to be dropped due to unavailability of data and some companies were not classified as banks in all the ten years' period. This reduced the final observations to 108 observations. The data were collected five years before and after the Malaysian Code on Corporate Governance was introduced in 2001. Data were collected either from the annual reports of the companies or from Bloomberg. The statistical method used in this study is panel data regression since the data comprise the nature of both time series and cross section.

4. Profile of the Respondents

Overall, both male and female respondents seem to be equally distributed since forty-nine percent of the respondents are male and fifty-one percent of them are female. Regarding educational background, the majority of them are bachelor degree holders and the balance are professional certificate holders. Since fifty-seven percent of the respondents are from the audit firms and forty-three percent of them are from the non-audit firms, the opinion seems not to be too much influenced by one particular group although the majority of the respondents are accountants. The age range of the majority is between twenty and twenty-nine, followed by the age range between thirty and thirty- nine. In terms of working experience, the majority of the respondents, i.e., forty-three percent, are below three years in the current profession and twenty-three percent of them have working experience between three to seven years.

5. Discussion on the Results

Table 2 shows the descriptive statistics of the variables used in the study. In case of board leadership structure, its mean value (0.81) shows that a majority of the companies have a separate leadership structure although the minimum value (zero) shows that there are companies which have combined leadership structure. Similar to the recommendation of the MCCG (2001), the sample mean value (0.36) shows that ratio of independent directors is slightly more than one-third of the total number of the directors. The mean value (8.23) of board size shows existence of a quite a reasonable board size, e.g., Jensen and Ruback (1983) suggest that a board size of not more than 7 or 8 members is considered reasonable in ensuring effectiveness. For ownership, the mean values of director ownership and institutional ownership are 0.02 and 0.17, respectively. The ownership of shares by directors can be considered very low where, on average, only 2 percent of shares were owned by the directors. On the other hand, institutional investors, on average, owned 17 percent of shares which could still be considered low although it is significantly higher than the ownership by the directors. In the case of block ownership, its mean value (0.53) shows that a significant portion of the shares is owned by large shareholders. The mean value of weighted voluntary financial accounting disclosure score is 176.23. As for the firm-specific characteristics, the sample companies have the means values of RM45992.19 millions for total assets and 344.73 for the ratio of total debt to total equity.

Table 2: Descriptive Statistics: Independent, Dependent And Control Variables

	Mean	Std. Dev.	Min	Median	Max	Skewness	Kurtosis
Independent variables							
(a) CG variables							
BLS	0.81	0.40	0.00	1.00	1.00	-1.57	0.46
INE_BZ	0.36	0.18	0.10	0.33	0.83	0.68	-0.49
BZ	8.23	2.34	4.00	8.00	14.00	0.33	-0.62
(b) Ownership variables							
DOWN	0.02	0.05	0.00	0.00	0.25	3.26	10.40
IOWN	0.17	0.18	0.00	0.09	0.64	1.00	-0.53
BOWN	0.53	0.21	0.00	0.58	1.00	-0.81	0.04
Dependent variable							
(e) Disclosure variable							
WDS	176.23	16.22	142.42	172.29	194.11	-0.77	0.69
Control variables							
TA	45992.19	40245.92	1120.36	33326.95	191895.30	1.54	2.28
TD_TE	344.73	331.14	14.03	223.80	1442.26	1.60	1.89

Note: WDS refers to weighted voluntary financial accounting information disclosure score.

Table 3 shows the results on disclosure of voluntary financial accounting information. INE_BZ (at 1% Sig. level) and DOWN (at 10% Sig. level). The other variables such as BLS, IOWN and BOWN are in line with hypotheses while BZ (at 5% Sig. level) is not in line with hypothesis. Thus, it can be concluded that higher INE_BZ, lower DOWN and higher BZ have more voluntary financial accounting information disclosure. Regarding the voluntary financial accounting disclosure, the main reason for BZ not being in line with hypothesis is the sample firms already have optimal board.

Table 3: GLS Results of Voluntary Financial Accounting Information Disclosure

	Coefficient	t_value	P value
Independent variables			
BLS	4.91	1.14	0.26
INE_BZ	**25.21**	**3.13**	**0.00****
BZ	**1.721**	**1.97**	**0.05****
DOWN	**-75.03**	**-1.93**	**0.06*****
IOWN	29.37	1.53	0.13
BOWN	3.21	0.35	0.73
Control variables			
LNTA	**8.31**	**3.06**	**0.00****
TD_TE	-.001	-0.15	0.88
CONS	-48.58	-2.12	0.04
R-Sq.			**0.88**
P value			**0.00****
* Significant at 1% ** Significant at 5% *** Significant at 10%			

Regarding board size, descriptively, the board size of the sample companies is relatively small compared to the average board size in UK and US. According to Allen and Gale (2001), in U.S. and U.K., the BZ is around 10 to 15 people. Furthermore, Jensen (1993) mentions that the limit of board size is around eight directors as any greater number will interfere with group dynamics and inhibit board performance. Coleman et al. (2007) highlight that a range of optimal board size of eight to eleven is feasible for good performance. The descriptive statistics results of this study show that on the average, the board size of the sample companies is around 8. Based on the average board size of the sample companies, it could be argued that, in general, the companies have the optimal board size and, consequently, it becomes difficult to examine the significant and consistent impact of board size on the dependent variables. Apart from that, according to the resource dependence theory, larger board size seems to be better since a large number of overall connections with organizations and directors outside the firm provide more sources of information for the director and a level of environmental awareness not readily available to the management (Muth & Donaldson, 1998). Hence, in the Malaysian context, the implication of resource dependence theory should be considered since the companies involved in the banking sectors might need more directors due to the risky nature of business activities.

6. Conclusion and Area for Future Research

In summary, the findings show that higher INE_BZ (at 1% Sig. level), lower DOWN (at 10% Sig. level) and higher BZ (at 5% Sig. level) have more voluntary financial accounting information disclosure. The other variables such as BLS, IOWN and BOWN in line with hypothesis while BZ is not in and the main reason for BZ not being in line with hypothesis is the sample firms already have optimal board. Hence, for future research, it can be extended by interviewing the board to directors about their perceptions towards voluntary financial accounting disclosure and compare with the actual disclosure in the annual report. In addition, the researchers should consider other corporate governance variables which might influence the banks to disclose more voluntary financial accounting disclosure.

Endnotes

[i] The existence of outside block ownership significantly decreases managers' ability to limit voluntary disclosure.

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