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Corporate Governance and Strategic Information Disclosure in Malaysian Listed Banks: Panel Data Analysis

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Corporate governance issue has attracted the researchers, especially the Malaysian researchers due to the 1997-1998 economic crises. Furthermore, it is undeniable that the banking sector is the heart of the economy in any country since it is the main source in mobilizing the monetary system. Thus, this study investigates the impact of corporate governance on strategic information disclosure of Malaysian listed banks by using a panel data analysis. Good corporate governance is proxied by board leadership structure, board composition, board size, director ownership, institutional ownership and block ownership. Strategic information disclosure index is developed and content analysis is conducted by cross checking between the strategic information disclosed in the annual reports and the disclosure index developed by the researcher. The disclosure score used in this study is weighted disclosure score after considering the opinions of accountants and financial analysts who represent preparers and users of the accounting information respectively. INE_BZ (at 1% Sig. level, BOWN (at 5% Sig. level) and BLS and DOWN are in line with hypothesis while BZ (at 1% Sig. level) and IOWN are not. Thus, it can be concluded that separate board leadership structure, higher INE_BZ, higher BZ, lower DOWN, lower BOWN and lower IOWN have more strategic information disclosure. With regard to control variables, only LNTA has a significant impact on disclosure but the finding from leverage, i.e. TD_TE. The current prevailing situations in Malaysia are discussed to highlight the reasons behind these research findings.

Keywords: bank, corporate governance; strategic information; GLS; generalized least square; panel data; agency theory; Malaysia

1. Introduction

Corporate governance became an attractive issue for Asian researchers, especially for Malaysians in the late 1990s. At the same time, transparency and disclosure of the information about the corporation has been recognized as a sign and heart of a good corporate governance system. Thus, in Malaysia, the finance committee has issued Malaysian Code on Corporate Governance (MCCG) in 1998 and then it was amended in 2000 and 2007 gradually. MCCG clearly states that boards of directors are responsible for the information disclosure of the annual report. Consequently, corporate governance of bank is focused by the regulators since banking sector plays an important role in contributing the better economy of any country. The banking industry is required to abide not only MCCG, but also the corporate governance guidelines issued by the Central Bank of Malaysia.

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There are many researched conducted in the corporate governance area. However, to researchers' knowledge, there is no research has been done to investigate the impact of corporate governance on strategic information disclosure of the listed banks on Kuala Lumpur Stock Exchange. Therefore, the researcher is motivated to fill up the research gap. The objective of this study is to find out to what extent corporate governance can contribute towards more transparent and useful strategic information disclosure of the banks. Among the different types of information, disclosure on strategic information is focused in this study because it provides background information about the company, corporate strategy, corporate governance and projected information. Moreover, this strategic information disclosure enables the investors to predict the potential performance of the firms. Hence, the research question of this study is whether there is any significant impact of corporate governance on the strategic information disclosure.

This paper is organized in five sections. The second section presents the theoretical framework and literature review. The third section discusses on the development of hypotheses and research design. The fourth section elaborates on finding of this study and the last section concludes.

2. Theoretical Framework and Literature Review

Jensen and Meckling (1976) state that the separation of ownership and control is the main source of the agency problem. However, this problem can be minimized by implementing a good corporate governance system (Gursoy & Aydogan 2002; Judge, Naoumova & Koutzevol 2003) since it promotes goal congruence among principals and agents (Conyon & Schwalbach 2000). In addition, information disclosure is one of the tools to reduce the cost of capital and agency conflicts will reduce if 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 most relevant the empirical finds related to this research.

Agency Theory and Board Leadership Structure

If the CEO and the chairman of the board is the same person, there would be no other individual to monitor his or her actions and CEO will be very powerful and may maximize his or her own interests at the expense of the shareholders (Brickley, Coles & Jarrell 1997; Weir 1997). Thus, Agency theory argues for a separate leadership structure (Jensen & Meckling 1976; Fama & Jensen 1983; Jensen, 1993). The independence of the board attained by separate leadership is necessary. Once the board is independent, it will be able to give pressure on the management led by CEO in disclosing the more material information about the company. This information will protect the interest of the shareholders. Hence, it could be assumed that the separate leadership structure will lead to better strategic information disclosure about the companies. This assumption is in line with the theoretical expectation advocated by Ho and Wong (2001), Gul and Leung (2004), Lakhal (2005), Byard, Li and Weintrop (2006) and Huafang and Jianguo (2007). This means that there is a positive relationship between separate leadership structure and strategic information 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.

Agency Theory and Board Composition

According to Choe and Lee (2003), board composition is very important to effectively monitor the managers and reduce the agency cost. 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 1997; Firth, Fung & Rui 2002). In addition, the agency theory highlights that higher proportion of the independent non-executive directors on the board will provide higher disclosure of the material aspects of the company. This will also increase the transparency since independent boards will be able to encourage the management to disclose more information. This highlights the importance of the presence of outside directors on the board. The findings of Chen and Jaggi (2000), Gul and Leung (2004), Byard, Li and Weintrop (2006), and Cheng and Courtenay (2006) and Norita and Shamsul Nahar (2004) are in line with theoretical expectation. Gul and Leung (2004) find that the extent of the negative association between combined leadership structure and voluntary disclosure is weaker for firms with higher proportion of outside directors. In addition, Leung and Horwitz (2004) study 376 Hong Kong listed companies in 1996 and find that contribution of non-executive directors to enhance voluntary segment disclosure is effective for firms with lower director ownership but not for concentrated ownership firm. When there is concentrated ownership firm, it is difficult for the independent directors to influence the management to disclose more information.

Agency Theory and Board Size

Florackis and Ozkan (2004) mention that boards with more than seven or eight members are unlikely to be effective. They further elaborate that larger board size result in less effective coordination, communication, and decision-making, and are more likely controlled by the CEO. It is expected that smaller board size is better to monitor the decision made by the management related to the information disclosure. This expectation is supported by the findings of Byard, Li and Weintrop (2006). They study 1279 firms over the years 2000 to 2002 and find 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 and Ownership

Agency theory emphasizes the importance of ownership structure and it system in order to improve the corporate governance by looking at these three different perspectives, which are; director ownership, block ownership, and institutional ownership. According to Jensen and Meckling (1976) when the directors become shareholders and they monitor the management by themselves, they might not be interested to force the management to disclose more information. Similarly, block owners have their own proxies holding the top management positions and they are normally well informed about the companies by their proxies. Consequently, they might also be less motivated to give pressure on management to disclose more information, especially, strategic information due to the competitive disadvantage of the companies. Therefore, the negative relationship is expected between director ownership or block ownership and strategic information disclosure. Theoretical expectation seems to be supported by Chau and Gray (2002), Eng and Mak (2003), and Leung and Horwitz (2004). Huafang and Jianguo (2007) find that there is no relationship between them. In contrast, Ballesta and Garcia-Meca (2005) find that higher director ownership provides higher quality of financial reporting because when managers act as owners, they act in the interest of the firms and thus result in financial statement are less likely to attract audit qualification. Norita and Shamsul Nahar (2004) prove that executive director ownership has a positive influence to voluntary disclosure level.

In the case of the relationship between block ownership and strategic information disclosure, Lakhal (2005) find there is a significant negative association between ownership concentration and voluntary disclosure. He explains that large shareholders tend to retain the information they are able to assess and the French-listed firm are facing insufficient accounting regulation related to earning releases. Therefore, they are other factors can influence companies' reporting practices. Eng and Mak (2003) conclude that there is no relationship between block holders ownership and disclosure. Chau and Gray (2002), Lou, Courtenay and Hossain (2006), Huafang and Jianguo (2007) and Norita and Shamsul Nahar (2004) find that extent of outside block ownership is positively associated with voluntary disclosures.

Regarding institutional ownership, David and Kochhar (1996) explain that institutional ownership can become an important player to have higher disclosure since their voting power can be used as a tool to monitor agents. Therefore, it can be concluded that positive relationship between institutional investors and disclosure is exist since the ownership by the institutional shareholders enable them to monitor compared to shareholders with small amount of ownership. The findings of Eng and Mak (2003), and Lakhal (2005) are in line with theoretical expectation since Eng and Mak (2003) use government ownership as a proxy for institutional shareholder and Lakhal (2005) use the foreign institutional investor's ownership as the proxy. However, Huafang and Jianguo (2007) find that state and legal ownership not related to disclosure. So, they suggest that the Chinese regulators should gradually encourage multi-ownership.

In sum, by referring to the agency theory, prior researchers conducted the research to examine the relationship between corporate governance variables and disclosure in general. However, they do not focusing on the strategic information disclosure. Thus, this study examines the impact of corporate governance on strategic information disclosure and the next section explains on the development of hypotheses and research design.

3. Development of Hypotheses and Research Design

Development of Hypotheses

Based on the agency theory, the researchers develop the following hypotheses examine whether corporate governance variables could affect the strategic information disclosure. They are as follows:

H_{a1}: Disclosure is positively related to separate leadership structure.
H_{a2}: Disclosure is positively related to proportion of independent non-executive directors on the board.
H_{a3}: Disclosure is negatively related to board size.
H_{a4}: Disclosure is negatively related to director ownership.
H_{a5}: Disclosure is negatively related to block ownership.
H_{a6}: Disclosure is positively related to institutional ownership.

Research Design

Variables and Empirical Model

Dependent Variable

Weighted strategic information disclosure score is used as a dependent variable and the questionnaire is developed to obtain views on the importance of each disclosure item from financial analysts and accountants. The list of disclosure items can be refereed to Table 1.

Table 1: List of Strategic Information Disclosure

A. STRATEGIC INFORMATION
I. General background Brief history of company
Organizational or corporate structure
Identification of principal products or services
Description of specific characteristics of these products or services
Identification of principal markets
Description of specific characteristics of these markets
Identification of senior managers
Description of senior management functions
II. Corporate strategy A statement of corporate strategy and objective -General -Financial -Financial -Social -Environmental
Impact of strategy on current and future results
Discussion of industry trends (e.g. competition)
Discussion of macroeconomic trends (e.g. inflation)
Discussion of impact of industry trends on current results
Discussion of impact of macro- economic trends on current results
III Corporate governance information General description of a firm’s system of internal control

Description of key procedures of the internal control system
Classification of executive directors, non-executive directors, and independent non-executive directors
Classification of chairman and CEO
List of the members _ Audit committee
List of the members _ Remuneration committee
List of the members _ Nomination committee
List of the members _ Risk management committee
Composition of the members_ Audit committee
Composition of the members _ Remuneration committee
Composition of the members_ Nomination committee
Composition of the members _ Risk management
Description of the roles and responsibility _ Audit committee
Description of the roles and responsibility _ Remuneration committee
Description of the roles and responsibility Nomination committee
Description of the roles and responsibility _ Risk management committee
Remuneration (fees and other emoluments) -CEO -Executive directors -Non-executive directors -Independent non-executive directors
Qualitative explanations of directors' remuneration schemes
Age of directors
Educational qualifications (Academic and professional)
Description of commercial experience of directors
Description of other directorship held by directors
Dates of the board meetings
Frequency of board meetings
Attendance of directors at board meetings
Audit committee meeting frequency
Attendance of audit committee meetings
Dates of audit committee meetings
Information on *Shari'ah* committee -List of the members -Description of the roles and responsibility -Educational qualification (Academic and professional) -Remuneration (fees and other emoluments)
IV Projected information Impact of opportunities on future income or profits
Impact of market risks on future results
Forecast of market share
Procedures to achieve the forecasted market share
Forecast of the next year's profit/income
Procedure to achieve the profit projection
Forecast of major industry trends (e.g. competition)

Before the actual questionnaire is sent, pilot test has been conducted and the findings show that alpha value is 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 question 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 an actual questionnaire.

The weighted strategic 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 Mann-Whitney U test. The reliability test results show that the alpha value is 0.9 and so the weighted disclosure score used in this study is reliable. The annual reports of the sample companies are checked against disclosure index developed by the researcher. The researcher uses dichotomous score, i.e. one is given if the company discloses the information, and zero for 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 are 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, questionnaire is constructed and sent to the 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 is 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 of 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, block ownership and institutional ownership). 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 follow.

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

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 strategic 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 block ownership (BOWN)
x_6= Proportion of institutional ownership (IOWN)

$x_{7=}$ Log of total assets (TA)
$x_{8=}$ Leverage (TD_TE)
μ= Error term

Sample Selection and Statistical Methods

Sample includes all listed companies whose main activity is banking from 1996 until 2005 and the total number of sample companies is twelve. Sample period is over a period of 10 years, i.e. 5 years before and after MCCG (2000) is introduced. 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. It left the final observations to 108 observations. Data were collected either from the annual reports of the companies or from Bloomberg. The main statistical method used in this study is panel data analysis (generalized least square method). Generalized least square method is used because the sample data are not normally distributed and the data have either heteroskedasticity problem, autocorrelation problem or both. According to Gujarati (2003), using generalized least square method will overcome all these problems.

4. Discussion on The Results

Table 2 shows the results on disclosure of strategic information. INE_BZ (at 1% Sig. level), BOWN (at 5% Sig. level), BLS and DOWN are in line with hypothesis while BZ (at 1% Sig. level) and IOWN are not. Thus, it can be concluded that separate board leadership structure, higher INE_BZ, higher BZ, lower DOWN, lower BOWN and lower IOWN have more strategic information disclosure. With regard to control variables, only LNTA has a significant impact on disclosure but the finding from leverage, i.e. TD_TE.

Table 2: GLS Results of Strategic Information Disclosure

	Coefficient	Z_value	P value
Independent variables			
BLS	15.31	1.60	0.11
INE_BZ	**68.01**	**4.66***	**0.00**
BZ	**7.19**	**5.91***	**0.00**
DOWN	-89.00	-1.25	0.21
IOWN	-21.63	-1.50	0.13
BOWN	**-32.20**	**-2.25****	**0.03**
Control variables			
LNTA	**36.48**	**6.24***	**0.00**
TD_TE	0.01	0.78	0.44
CONS	**-301.27**	**-5.39***	**0.00**
Chi-Sq. P value			**366.06*** **0.00**
Heteroskedastic (LR Test)	LR Chi^2 P value		**27.96*** **0.00**
Autocorrelation (Wooldridge Test)	F statistics P value		**61.68*** **0.00**
* Significant at 1% ** Significant at 5%			

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) in Rashidah and Fazilah (2006) 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, Adjasi and Abor (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 summed 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.

Regarding institutional ownership, similar to our findings, Luo, Courtenay and Hossain (2006) find that if government ownership exists, firms disclose less information about future performance. Based on the findings from the institutional ownership, it seems that the institutional owners play their role at very minimum and it might be due to the following reasons. First, the mean ratio of institutional ownership (17.38%) shows that not significant proportion of shares is owned by the institutional shareholders. Hence, the incentive to monitor the management might be less compared to the substantial amount of interest owned by them. Secondly, the institutional shareholders might have short-term objectives, not for long term and hence, they might not be interested in intervening or monitoring the management (Leng & Shazaili 2005). Thirdly, when most of the institutional ownership comes from the government agencies, it might result in less effectiveness in monitoring the management. It is because if the employment is one of the government's objectives, state-dominated companies have tendency to have more workers and so there will be lower labor productivity (Xu & Wang 1999). Corporate governance literature has highlighted the ineffectiveness of the monitoring role of the government ownership towards the management (Patibandla, 2006). It could be inferred that the role of shareholders, in general, and the institutional shareholders, in particular, in Malaysia is still weak. According to the Asian Productivity Organization (2007), the level of participation by the minority shareholders[i] is relatively low. The survey from the organization further explains the constraints or factors that make shareholder activism weak in Malaysia. These factors are as follows: (a) prevalence of large controlling shareholders in the companies they invest in, (b) Eastern social culture of no open confrontation particularly if the controlling shareholder is a high profile personality, (c) minority shareholders free-riding on the controlling shareholder if the company is consistently generating good returns, (d) private and individual investors do not hesitate to choose divestment as the easy way out, rather than slugging it out with management, (e) it is costly and time consuming to institute legal action and to obtain the compensation from the companies, (f) collective action problem of minority shareholders with regard to their need to seek legal resource and to procure sufficient vote for additional strength, (g) existence of information asymmetry, i.e. private and individual investor may lack the required knowledge to fully comprehend the disclosures and the impacts of any abusive transactions, (h) low awareness of shareholders' legal rights, and (i) culture of investment over the long term since investment motives may be driven by rumors and hearsay and rather than sound fundamentals. The problems of shareholder activism occur even though MCCG (2001) prescribes the importance of institutional investors in ensuring good corporate governance practices, in general, and institutional investors are expected to take an interest in the composition of the boards and the appointment of non-executive directors in specific. Apart from MCCG (2001), Malaysian government has established Minority Shareholder Watch Dog and the objective of the establishment is to encourage shareholder activism by institutional investors. According to Centre for Financial Market Integrity (2005), shareowners must be active and prudent in the use of their rights. In this way, shareowners must act like owners and continue to exercise the rights available to them in order to make sure that corporate governance structures work efficiently.

Regarding block ownership, the findings of Lakhal (2005) and Salim (2007) are similar with this research results. Lakhal (2005) finds that there is a negative association between voluntary earnings disclosure and ownership concentration. It might be due to the following facts. First, on the average, 53 percentage of ownership belongs to the block ownership and hence, it seems that block ownership has substantial ownership interest which motivates them to monitor the management. However, since block holders may have the substantial voting power, they might choose family members or trust persons to be the board members in order to monitor the management. Hence, they have ensured the performance of the management and they might not be motivated to put pressure to disclose more information. The prior researchers such as Ho and Wong (2001), Chau and Gray (2002) and Haniffa and Cooke (2002) also find that the level of information disclosure is likely to be less in insider or family-controlled companies. Secondly, since they have the controlling rights, they may be in a better position to expropriate company assets and exploit the interest of the minority (Leng and Shazaili 2005; Zulkarnain 2007). Due to that they might discourage the higher disclosure. Finally, Santema et al. (2005), Talha, Sallehhuddin and Mohammad (2006) and Lu, Liao and Yang (2007) mention the disadvantage of information disclosure. According to Santema et al. (2005), general disclosure costs consist of the cost of gathering, processing and auditing and disseminating the information, as well as possible litigation costs and cost that might create competitive disadvantage. Talha, Sallehhuddin and Mohammad (2006) who study the segmental reporting practice in Malaysia mention that the cost of disclosure includes competitor pressure, political pressure and customer pressure. Lu, Liao and Yang (2007) highlight that information disclosure may reduce shareholder value by revealing valuable information to competitors or by increasing legal costs for the firm even though they recognize the advantages of disclosure such as increase in institutional interest and liquidity of the firms and consequently there will be lower cost of capital and public relation benefits (Santema et al. 2005).

5. Conclusion, Limitation and Area for Future Research

This research findings show that separate board leadership structure, higher INE_BZ, higher BZ, lower DOWN, lower BOWN and lower IOWN have more strategic information disclosure. There are two limitations of this study. The first limitation is related to sample banks. Due to the unavailability of complete data for foreign banks, this study does not include the foreign banks in the sample selected. Second limitation is that this study focuses on the end product of corporate governance, i.e. strategic information disclosure in the annual report. This study does not examine the board decision process in determining which information should be disclosed or not. For future research, the researchers should consider other relevant theories which might suit the Malaysian context and extend this research by interviewing the board to directors regarding strategy that they adopt for the betterment of the firms and compare with the actual disclosure in the annual report.

Endnotes

[i] Minority shareholders are categorized into four main groups, namely, institutional investors (including both foreign and local), fund managers with smaller portfolios, retail or individual investors and market speculators (The Asian Productivity Organization, 2007).

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