DOES BOARD DIVERSITY MATTER IN DISCLOSURE? AN ANALYSIS OF THE ASSOCIATION BETWEEN BOARD DIVERSITY AND DIRECTORS' REMUNERATION DISCLOSURE

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ABSTRACT: *This paper aims to examine the determinants of directors' remuneration disclosure in Malaysia, which provides a distinctive research setting different from other developing countries. This is because Malaysia has a disclosure exercise that is still far below best practices as well as a unique Malaysian cultural and institutional environment. The disclosure was continuously tracked from 2007 to 2014, a period that includes two significant events such as the global financial crisis in 2007 and the changes in the Malaysian political atmosphere in 2008. Using the pool OLS regression, the study incorporates upper-echelon theory into the research framework to identify the characteristics of the top management team that could influence strategic disclosure. The analysis showed that there is a significant and negative relationship between the diversity of age and the disclosure of directors' remuneration. The remaining diversity variables such as gender, ethnicity, and educational background are not significant in influencing directors' remuneration disclosure.*

Keywords: directors' remuneration, disclosure, board diversity, upper echelon theory, emerging market

1. INTRODUCTION

Directors' remuneration has long attracted a great deal of attention from financial economists and academics due to its strategic role as a remedy to control agency problems. The key issue is the conflict between directors and shareholders on whether the remuneration is designed to maximize shareholders' value or to favor directors, who run the company on behalf of the investors. However, the conflict can never be detected when the disclosure of remuneration is not transparent. Therefore, this study is motivated to investigate the factors influencing directors' remuneration disclosure in Malaysia, in line with the emphasis on directors' remuneration in the Main Market Listing Requirements of Bursa Malaysia as well as in the latest Malaysian Corporate Code of Governance (MCCG) 2021. Prior studies in Malaysia have generally examined the relationship between corporate governance (CG) practices and various types of disclosure, such as mandatory accounting disclosure [1], voluntary disclosure [2], risk disclosure [3], segmental disclosure [4] and corporate social disclosure [5][6] but limited work has been done on directors' remuneration disclosure.

This study argues that the role of the board of directors is crucial to remuneration disclosure given that it is an outcome of the judgment, discretion, and decision-making process of the board. This is consistent with the prior researchers who have explored understanding the group of people that run a company on top of relying solely on the corporate governance of the institution to improve transparency [7, 8]. Hence, the objective of this study is to examine how managerial attributes, known as board diversity influence firms' strategic disclosure of directors' remuneration using upper echelon (UE) theory that emphasizes observable characteristics of the top management team (TMT). Furthermore, this study is the first that examines, theoretically and empirically, the relationship between board diversity and directors' remuneration disclosure using the UE theory in the context of emerging markets.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Park, Nelson, and Huson [9] claimed that the incentive for directors' remuneration disclosure is complex. This is because the main reason for disclosing comprehensive directors' remuneration is to reduce the information asymmetry between directors and shareholders. On the other hand, the main reason for not disclosing is to avoid the additional cost that entails disclosure. As a result, directors are expected to be more vigilant in disclosing their remuneration when they are the one who decides what information to be disclosed to the public. Due to that, many countries have made it harder for the boards by requiring a report justifying their compensation policy, such as in U.S [10] and the UK [11].

In Malaysia, the government sets a minimum guideline for remuneration disclosure including mandatory and non-mandatory requirements. The mandatory requirement is taken from Appendix 9C, Part A (11) of Main Market Listing Requirements which states "the remuneration of directors of the listed issuer for the financial year on a named basis, stating the amount received or to be received from the listed issuer and on a group basis respectively. The disclosure must include the amount in each component of the remuneration (e.g. directors' fees, salaries, percentages, bonuses, commission, compensation for loss of office, benefits in kind based on an estimated monetary value) for each director.". The non-mandatory requirements, on the other hand, are encouraged through the guidelines specified by the MCCG which provides more voluntary guidelines to encourage remuneration transparency such as the narrative of the pay-performance link. However, the challenge of having voluntary guidelines is depending on their TMT. Thus, this study investigates the characteristics of the top management team who are the decision-makers in determining the extent of directors' remuneration disclosure.

This study utilizes UE theory in explaining the variations in directors' remuneration disclosure. The theory employs a TMT to justify disclosure [8, 12, 6]. The characteristics of TMT could influence the strategic decisions in a firm due to the diversities between them through personalized interpretations, actions, own experience, values, and personalities [13]. According to Hambrick [14], UE theory presumes that directors vary and the presumption is far more valid in a society that is highly diversified. Malaysia is a multicultural country, thus most of the corporate board of directors is comprised of three main ethnicities, i.e. Malay, Chinese and Indian. The three ethics which pose cultures, attitudes and behaviors of each race in the society are believed to differ to some extent in terms of disclosure outcomes. Therefore, there are two fundamental reasons that justify the appropriateness of UE theory in this study. Firstly, Malaysia is known as a multiracial country where the diversity of board members historically exists as a result of the government agenda and secondly, this study specifically examines directors' remuneration disclosure, a topic which is open to opportunistic behavior [15,16].

Diversity can be explained from various angles and can also be drawn to various functional aspects. Given the emphasis being placed on delivering diversity within corporate boards recently, the relationship between board diversity and shareholder value deserves both theoretical and empirical investigation [17, 8, 19]. Since the objective of this study is to examine directors' diversity and its influence on firms' strategic disclosure of directors' remuneration, four observable variables have been selected namely gender, ethnicity, age, and educational background. Ethnicity represents the exclusivity of Malaysian society, while gender equality in Malaysia has been proactively implemented in response to the call by the government to accelerate women's access to board seats[20]. Age and educational background, on the other hand, are among the common attributes in determining disclosure [21].

Gender diversity is not only argued in terms of board diversity but has now become a topic of active policy-making and also general societal situations in many countries [22]. On top of European countries, there are a few developing countries recognizing the importance of having females on board such as India, China, and the Middle Eastern [23]. Malaysia, being one of the developing countries and the first Asian government announced its gender policy as early as 2004 stipulating that 30 percent of the decision-makers in all sectors should be women [24]. The same requirement has also been included in the recent MCCG 2021 which suggests that 30% of women directors on the board ensure gender diversity (MCCG 2021). In Australia, Rao, Tilt, and Lester [25] found a significant positive relationship between the extent of environmental reporting and the proportions of female directors on board using a sample of the largest 100 firms listed on the Australian Stock Exchange (ASX) in 2008 while Liao, Luo, and Tang [8] noticed a significant positive association between a number of female directors and voluntary greenhouse has disclosure in the UK. A limited similar study has been conducted in the emerging market due to the deeply rooted of cultural resistance towards gender equality among the countries [26, 27]. Nevertheless, Katmon, N. *et al.* [5] encountered a significant and positive relationship between gender diversity and the quality of CSR disclosure for 200 Malaysian listed companies from 2009 to 2013. Therefore, in line with the prior literature, the first hypothesis is outlined as follows:

Hypothesis 1: There is a positive and significant association between the extent of directors' remuneration disclosure and the proportion of female directors on the board.

Previous empirical results indicate that culture has a positive effect on disclosure [28]. A recent study by Ntim and Soobaroyen [21] had shown a positive impact of ethnicity and nationality in South Africa towards disclosure of the Black Economic Empowerment (BEE) report. The same goes for Norziana, Cotter, and Mula [29] who also noticed a positive association between the proportion of Malay directors towards CG voluntary disclosure based on 2007 annual reports. In contrast, a recent study by Katmon, N. *et al.* [5] found the insignificant effect of ethnic diversity on the quality of CSR disclosure using Malaysian listed companies. Despite that, there is consistent evidence in the literature proving that companies with higher proportions of Malay directors make more disclosure than those without Malay directors. Norziana, Cotter, and Mula [29] had shown contrasting results where Malay directors not significantly associated with directors' remuneration disclosure in specific. This indicates the distinctiveness of directors' remuneration disclosure as compared to other information on CG disclosure. Using UE theory to understand directors' demographic culture, the 2nd hypothesis is constructed as below:

Hypothesis 2: There is a negative and significant association between the extent of directors' remuneration disclosure and the proportion of the board dominated by non-Malay

Studies that specifically examine age diversity and disclosure behavior have received less attention as compared to firm performance [30]. Ntim and Soobaroyen [21] had shown evidence that a board with diversified age is positively and significantly related to the disclosure of BEE disclosure, using seven years of data among non-financial listed companies in South Africa. Hafsi and Turgut [31] found a contradicting result of a significant but negative relationship between age diversity and social performance indicators that consist of disclosure on corporate governance, employee relations, environment and product-related social issues. A recent study by Katmon, N. *et al.* [5] in Malaysia found that age diversity is negatively related to the quality of CSR disclosure. Hence, consistent with previous results, this study will add to the literature of age diversity and directors' remuneration disclosure using the UE theory with the following hypothesis:

Hypothesis 3: There is a negative and significant association between the extent of directors' remuneration disclosure and the age diversity of the board of directors

Empirical research that links educational background and disclosure is also limited in the past. In the US, Lewis, Walls, and Dowell [32] prove that educational background, represented by CEOs who poses MBA degrees make more voluntary disclosure on Carbon Disclosure Project (CDP). Similarly, Bamber, Jiang, and Wang [12] have encountered the corresponding result for directors with MBA degrees who tend to provide accurate disclosure as they are better at forecasting. Using a sample of firms listed in the Johannesburg Stock Exchange (JSE), Ntim and Soobaroyen [21] added to the literature a significant disclosure influenced by the higher educational background directors towards the BEE disclosure. Recently, Katmon, N. *et al.*[5] found that diverse education level is significantly and positively related to the quality of CSR disclosure among Malaysian listed companies from 2009 to 2013. Since this study is intended to examine the impact of educational background on the disclosure of directors' remuneration, the level of education is being operationalized rather than education specialization. Therefore, this study considers the number of educational backgrounds present on the board to measure education diversity in determining disclosure. Consequently, the final hypothesis in this study is:

Hypothesis 4: There is a positive and significant association between the extent of directors' remuneration disclosure and the educational background diversity of the board of directors.

3. DATA AND METHODOLOGY

The source of data comprises the companies listed on FTSE Burse Malaysia Top 30 (FTSE30) during the period from 2007 to 2014, a longitudinal study on a yearly basis that can trace the disclosure practice of a particular company over the years. The index is used because it represents the largest 30 companies by market capitalization listed on the Bursa Malaysia Main Market stock exchange that pass the relevant investment screens [33]. This is proven by the total market capitalization of the FTSE30 companies which represents 72 percent of the total market capitalization of FTSE100 companies in Malaysia. It is also believed that FTSE30 data is more reliable in view that 90 percent of them are audited by the Big 4 companies, and it is more likely to represent the best corporate governance practice practices in Malaysia. Therefore, this study adopts a panel dataset that consists of 232 observations (8 observations were not available as some of the companies were incorporated in the middle of the sampling period).

For this study, the disclosure index is the dependent variable that measures the level of directors' remuneration disclosure in the annual report. Regardless of that disclosure scoring index inevitably involves subjective judgment, previous studies have proven that it is a valuable research tool that will continue to be used in a disclosure focus area [34, 35]. The formulation of the disclosure index was derived from content analysis to appraise the level of remuneration disclosed in the annual reports. To ascertain the level of remuneration disclosure, this study focuses on the disclosure of short-term benefits (cash salary, bonuses, fees, and other special allowance), long-term benefits (long-term incentive plan, options, grant, termination), and the related process that derive to the remuneration amount such as the remuneration policy and narrative of pay-performance link [36][34, 37]. The disclosure list is then matched with the requirements and recommendations by the regulators, including mandatory and voluntary guidelines. This process has led to a final disclosing index that consists of fifteen (15) directors' remuneration items that consist of eight (8) weighted items and seven (7) unweighted items.

$$DISC_{it} = \beta 0 + \beta 1\ NONM\_\%_{it} + \beta 2\ FEM\_DUM_{it} + \beta 3\ AGER_{it} + \beta 4\ EDUR_{it} + \beta 5\ SUBSHD_{it} + \beta 6\ BSIZE_{it} + \beta 7\ BIND_{it} + \beta 8\ LGMV_{it} + \beta 9\ LEV_{it} + \beta 10\ ROA_{it} + \text{Year Effects} + \text{Industry Effects} + \varepsilon_{it}$$

Where,

DISC	= disclosure of directors' remuneration index;
β0	= value of the constant;
NONM_%	= proportion of non-Malay directors;
FEM_DUM	= proportion of female directors;
AGER	= age range;
EDUR	= education range;
SUBSHD	= substantial shareholders;
BSIZE	= total number of directors on board;
BIND	= % of independent board members;
LGMV	= log market value;
LEV	= leverage;
ROA	= return on asset.

4. RESULTS AND DISCUSSION

Table 1: Full regression result of directors' remuneration disclosure and board diversity

VARIABLES	DISC
FEM_DUM	0.00313
	(0.0181)
NONM_%	-0.00245
	(0.0352)
AGERANGE	-0.0288***
	(0.00994)
EDURANGE	0.0178
	(0.0138)
SUBSHD	-0.115*
	(0.0614)
BSIZE	0.0217***
	(0.00498)
BIND	0.0549
	(0.0839)
LGMV	0.0196
	(0.0226)
LEV	0.188***
	(0.0618)
ROA	0.00325***
	(0.000658)
Constant	0.0463
	(0.254)
Observations	232
R-squared	0.369
Industry Effects	Yes
Year Effects	Yes

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

According to Milne and Adler [38], reliability in content analysis is achieved by demonstrating the use of multiple coders and reporting the discrepancies between coders. Samples of annual reports were scrutinized by the independent coders with a set of decision rules that were produced for their reference [39]. Using similar inter-coder reliability methods by Melis, Gaia, and Carta [36], this study employs the percentage of agreement index and Cohen's kappa index, and the results meet the appropriate minimum acceptable levels of 80 percent and 0.7, respectively.

The following model is developed to test the relationship between board diversity and directors' remuneration disclosure. Using Stata, this study runs the pooled OLS regressions in determining the association between the dependent and independent variables

Table 1 shows that the directors' remuneration disclosure has a positive association with the proportion of female directors. It indicates that the level of directors' remuneration disclosure improves as more female directors presence in the boardroom. However, the association is non-significant. Hence, the study finds no support for the first hypothesis. The result also contradicts the previous studies in Malaysia, where female directors are significantly affecting firms' performance [26] and the quality of CSR disclosure [5]. The conflicting results speak for the importance of identifying the specific outcome in considering the performance of female directors. Thus, the implication of this study is to provide a guideline for the board members to carefully evaluate the performance of female directors by considering their unique personalities in influencing the different types of disclosure. For example, on the one hand, female directors may significantly affect performance disclosure such as profitability, but on the other hand, they do not influence directors' remuneration disclosure as a result of their ethical reporting behavior and risk-averse character.

The analysis in Table 1 shows that the directors' remuneration disclosure has a negative association with the proportion of non-Malay directors. It indicates that the level of directors' remuneration disclosure reduces as more non-Malay directors are present in the boardroom. However, the association is non-significant. Hence, the study finds no support for the second hypothesis. This finding leads to an important implication on whether cultural convergence brings a positive value to disclosure practices among the corporate business in Malaysia. The implications are evidenced by the type of disclosure which is mandatory and voluntary information. Mandatory related information, which is normally financial figures, requires a high level of accuracy in terms of disclosure, such as performance or the firm's actual accounting results. Hence, the combination of Malay directors who embrace the Islamic value of fear of God and Chinese directors who are mainly diligent will result in accurate financial information being publicly disclosed. Voluntary information, which is normally non-financial related, requires a high level of justification, such as governance-related reporting that includes directors' remuneration. Thus, the combination of the two main ethnicities further resulted in strategic and adequate disclosure due to the generosity of Malay directors and the harmony of Chinese directors. In summary, this study proves the demographic impact of each director that formed cultural convergence and finally contributes to the extension of the disclosure.

Table 1 further illustrates that the directors' remuneration disclosure has a negative and significant association with the age of directors. It indicates that the level of directors' remuneration disclosure reduces with the presence of higher diverse age of directors in the boardroom. Therefore, the study accepts the third hypothesis, in line with prior research that found a negative and significant relationship between age diversity and disclosure [5, 31]. The adverse disclosure behavior noticed in this study is further justified by the character of old directors who has a better view of the industry. It is because the ability of a firm to credibly withhold voluntary information and strategically disclose mandatory information on remuneration rest with the wisdom and intelligence of aged directors [40]. Succinctly stated, this finding highlights the importance of age diversity that can be the firm's competitive advantage in making various type of disclosure, including the extent of directors' remuneration disclosure.

The analysis from Table 1 shows that the directors' remuneration disclosure has a positive association with the diverse educational achievement of directors. It indicates that the level of directors' remuneration disclosure improves with the presence of more directors with diverse educational backgrounds. However, the association is non-significant. Hence, the study finds no support for the fourth hypothesis. This result also contributes to the literature on board diversity, particularly on the linkage between educational background and disclosure. Earlier, Tsui, Egan, and O'Reilly [41] claimed that educational level received no support in the demographic board diversity as it is less salient in the self-categorization study, as compared to other traits. Therefore, this study adds to the evidence that the educational background role is not a strong predictor of demographic board diversity when it comes to strategic disclosure. Although prior studies have agreed on the advantages of having heterogeneous educational directors on board, this study proves a contradicting result when it comes to disclosure.

5. CONCLUSION

The regression results demonstrate that gender and educational level have a positive effect in influencing the directors' remuneration disclosure but both variables are insignificant. It also underlines the importance of placing female and knowledgeable directors on the board to improve the quality of disclosure other than directors' remuneration. In addition, the results also exhibit that diversity of age and ethnicity are negatively related to directors' remuneration disclosure, indicating that the presence of boards with diverse ages and ethnic will reduce the disclosure. This demonstrates that not all types of diversity are influential in improving the extent of directors' remuneration disclosure in the context of Malaysia. While age diversity is found to be significantly associated with directors' remuneration disclosure, ethnicity is insignificant despite that it is examined in the multi-culture country of Malaysia. This is further justified by the equality of board ethnicity on board and the cultural convergence that has been developed in Malaysian society, particularly for the top 30 firms being scrutinized. Previous scholars have considered that disclosing directors' remuneration in public is a risky strategy as it contains private information about the firm. Therefore, the result further proves that the ability to credibly withhold voluntary information and strategically disclose mandatory information rest on the wisdom of aged directors. Lastly, these findings are significant to support UE theory which recognizes the characteristics of the individuals among the top management in determining strategic decision-making.

This study fills the gap in the literature by providing evidence of broader board diversity and directors' remuneration disclosure, unlike other studies that focus on another type of disclosure. Furthermore, this study responds to the growing pressure on firms to address the lack of board diversity in developed and developing countries [42, 43]. While most of the current studies on board diversity have focused on gender diversity [26], a study on broader board diversity remains under-researched [17, 18]. Building on the assumptions that a broader concept of diversity is necessary to achieve an effective balance board, this study contributes towards filling this important gap with empirical evidence in an emerging country like Malaysia.

Practically, the findings are essential in providing a guideline for companies in determining a perfect board composition. It proves that the distinctive personality of each director can be a competitive advantage of a firm when it is properly transformed to make it congruent with the firm's objective so that maximum efficiency in decision-making can be achieved. The findings are also useful for the policymakers and regulators in Malaysia in setting the board diversity characteristics that suit with Malaysian context. This practice is in line with the updated recommendation in the recent MCCG 2021 that emphasizes the appointment of board and senior management that are based on merit and diversity in skills, experience, age, culture, and gender. Board diversity is essential to avert 'blind spots in the decision-making process particularly in determining the extension of directors' remuneration disclosure.

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