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# The Influence of Corporate Governance on Relational Capital Disclosure among Technology and High Growth Companies

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## Abstract

This study examines the relationship between corporate governance elements (such as the characteristics of Board of Directors and the ownership structure of companies) with a relational capital disclosure from agency, supported by signalling and network perspectives. The benefits of signalling information about relationships i.e. relational capital could provide incentives for the board while the owners could pressure the management to provide voluntary disclosure. The results indicate that multiple directorships, institutional and government ownerships positively affect relational capital disclosure. Managerial ownership, on the other hand, reduces the incentives of the management to signal such information. In addition, we also find younger companies to have more incentives to disclose relational capital information compared to more established companies. The results enlighten us that important corporate governance determinants of relational capital disclosure can be predicted when signalling intention of the board and network arguments are considered. Our findings may have implications for regulators in emerging countries characterised by highly networked economy, whereby, business and personal networks are important for company sustainability.

**Keywords:** Corporate Governance, Relational Capital, Technology, Signalling

## 1. INTRODUCTION

Intellectual capital has been regarded as the most important resources for companies to have competitive advantage. It affects the internal level of innovation and creativity as well as improves the company's performance, in particular, and the economic growth of the country, generally (Nik Maheran, 2006). Disclosure of intellectual capital in the company includes its components, namely human, structure and relationship capitals. Disclosure of this information is beneficial to investors in reducing uncertainties about the future prospects of the company and could facilitate a company's valuation to be made (Bukh, 2003). The failure of the financial report in presenting the ability of a company in the value creation activity (Lev & Zarowin, 1999) through reporting of intellectual capital, have increased the asymmetry of information between firms and users of financial information (Healy & Palepu, 2001). Information asymmetry, generally, may result in inefficient allocation of resources in the capital markets (Li, Pike & Haniffa, 2008).

Relationship capital includes the relationships between the organisation and outside parties such as customers, competitors, suppliers and the Government (Bontis, 2001). Relationship capital is the key component of intellectual capital often disclosed in the company's annual reporting. Past research on intellectual capital in Ireland (Brennan, 2001), Italy (Bozzolan et al., 2003), Sri Lanka (Abeysekara & Guthrie, 2005) and Malaysia (Goh & Lim, 2004) show that companies tend to reveal more relational capital compared to other components of intellectual capital. However, no studies have specifically investigated the factors that contribute to relational capital. As such, most previous studies that examine the factors contributing to intellectual capital disclosure found inconsistent results. The inconsistencies of findings may be due to different factors determine different types of disclosure. That is, the important factors that can determine relational capital disclosure may differ from human and structural capitals disclosure. For example, Boards are found to have the inclination to disclose

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information about their friendship with the CEO because it can improve the perception of shareholders about the quality of decision they make (Rose et al. 2014). Therefore, incentives for disclosure are specific to the type of information disclosed. We expect the Managers or Directors may also have certain incentives in revealing other types of relational information. Reducing the uncertainties among investors and minimising agency cost, are examples of important reasons why companies may be motivated to make relational capital disclosure.

Motivated by this argument, this study expects that the determinants of relational capital disclosure can be detected via corporate relationship model which is used jointly with the signaling and the agency theories. A model on corporate relationships is adopted from Goerzen (2007). Because it is proven in prior studies that corporate governance practices can affect the company's information disclosure practices, the objective of this study is to examine the relationship between corporate governance elements (such as the characteristics of Board of Directors and the ownership structure of companies) with a relational capital disclosure.

Compared with previous studies, this study is different in several respects. First, past research generally develop disclosure index based on users' perception. The use of such an approach may be deficient due to the kind of information deem important by users may not be the driver for companies' growth and competitive advantage. Consequently, managers may not have the intention to signal the information. Different from past research, this study uses the conceptual model proposed by Goerzen (2007) to select elements and items of disclosure. A conceptual model by Goerzen (2007) that is developed based on network theory suggests that companies have an incentive to increase their competitive advantage by increasing network between organizations. This model suggests elements such as the size of the network, international network experience, geographically diverse networks and repeated network are key elements of network that can enhance the company's performance. Therefore, when the needs of some of these elements are met, the company may have an incentive to provide signal (in accordance with the signaling theory) to the market about the network which can lead to the companies' competitive advantage in the industry. Secondly, this study views the relationship between corporate governance and relational capital disclosure from a different point of view, i.e. from the angle of signaling. Consequently, this study is the first of its kind that specifically investigates the association between relational capital disclosures with the corporate governance practices. The predictions are made based on signaling intention of the corporate board and owners. Thirdly, we use Malaysia as a setting because network is considered to be important for businesses in this country, which is also labelled as "relationship based economy" (Adhikari, Derashid & Zhang, 2006). Within this context, we provide a formal test on the effect of young technology and high growth companies (versus other more established technology companies) listed on the Malaysian ACE and Main market. It is predicted that young technology and high growth companies relies and hence disclose more on relational capital compared to other more established companies. Young technology and high growth companies often do not have sufficient internal resources and capabilities of established companies (Xiong & Bharadwaj, 2011). In addition, for the young companies with limited performance records, relational capital can become observable signal to investors (Xiong & Bharadwaj, 2011). The signal, in the long run may also develop into corporate reputation (Florin, Lubatkin & Schulze, 2003).Thus, such setting may provide enough incentives for companies to provide relational capital disclosure.

The significance of this study is that it sheds some light and provides additional explanations to practice of relational capital disclosure made by companies from a different perspective i.e. signaling and agency. We believe that investigations of corporate disclosure must be made on specific dicslosure issue. By doing this, specific incentives for disclosure (in specific signaller – some corporate governance mechanisms) can be identified and tested. In addition, specific disclosure items can be derived from a justified framework i.e. in this case network perspective. The study may prove that the use of the agency theory alone may not able to describe the relational capital disclosure practices. Thus, the agency theory can be used in conjunction with the signaling theory in order to predict the disclosure of important relational capital information that can give competitive advantages to the companies.

This paper is arranged as follows. The next section discusses the past research and formulation of hypotheses. The section is followed by research method. Section four is the analysis and discussion, followed by the fifth-section, the conclusion of the study.

## 2. PAST RESEARCH AND FORMULATION OF HYPOTHESIS

Relational capital includes the elements of organisational development such as relationship with customers, competitors, suppliers and the government (Bontis, 2001). Prior studies show that relationships increases companies' stock market performance (e.g., Kalaignanam, Shankar & Varadarajan 2007; Swaminathan & Moorman 2009) and corporate reputation (Florin, Lubatkin, & Schulze 2003). Due to its importance, relational capital is the most often disclosure provided in the company's annual reporting compared with other components of intellectual capital i.e. human and structural capitals (Brennan, 2001; Bozzolan et al. 2003; Goh & Lim, 2004; Abeysekara & Guthrie 2005). Disclosure of relational capital information, as part of voluntary disclosure, could results in reductions in cost of capital and debt, more analysts ' following and/or an increase in securities trade transaction. Nevertheless, no studies thus far have specifically looked at factors that contribute to the disclosure of relational capital. Most previous studies have examined the factors contributing to intellectual capital disclosure as an aggregate measure of human, structural and relational capitals found inconsistent results. It is predicted that the inconsistencies is caused by factors that determine relational capital disclosure is different than factors that determine human and structural capitals.

Information about relationships (relational capital) in a company can be considered as private information as this piece of information is not measureable or quantifiable and its disclosure as additional information to the financial statement is not made mandatory. It is worth looking at this issue from signaling and agency theories point of view. Consistent with signaling theory, it is acknowledged that managers who have superior knowledge about companies' information may have the intention to communicate the information through voluntary disclosure to the users. The intention to provide additional voluntary disclosure may come from the benefits of disclosure as described above. Jensen and Meckling (1976) suggest that signalling of private information can reduce agency costs and hence the costs of financing. In addition, reduction of information asymmetry between the preparers and the users of corporate information may results in improvement in companies' reputation and make the stocks more attractive for investment. Thus, disclosure of relational capital information can maximise a firm's value and, consequently, increase the aggregate effect of the contracting parties. Therefore, it is rational to expect that the board, representing the shareholders, to demand such disclosure to be provided as it can improve company value. Traditionally, internal corporate governance mechanisms may influence disclosure of information, which includes board size, independence, multiple directorships and ownership structure. In addition, these internal mechanisms are directly involved in, or at least have pressure on, the decision to disclose relational capital information. However, we acknowledge that other external board mechanisms such the market for corporate control, regulations, labour and the market for products may serve as additional explanatory variables that could affect disclosure in general. These factors are not the focus of this study because investigation of each effect requires the research to be carried out in a specific context. Therefore, the effects of board size, independence, multiple directorships and ownership structure are discussed in turn.

## 2.1 Board size

According to agency theory, the well-functioning of board of directors is central in good corporate governance. The board is a mechanism whereby the principal (mainly shareholders) can monitor the agent (management). The performance of a company run by the management can be scrutinised in a board meeting. Among important characteristics of the board is the size of board. There are two main effects of board size, first is the ability of the board to make decision increases as the number of member increases, and second, is the coordination within the board is lower when there is excessive number of members on the board. Prior research shows that large size board could increase the quality of decision (Hermalin & Weisbach, 2003), and lowers the domination of the CEO (Zhou & Chen, 2004). As a board decides the level of disclosure to be made, it is a question whether more board members could influence the level of relational capital disclosure, which eventually reduces information asymmetry and agency costs.
As more members are on the board, they are representing more constituents of stakeholders. Therefore, demands for information disclosure from different types of stakeholders can be considered in a large board. In addition, as the size of the board grows, the diverse board members may have helped the company to develop more relationships. As such, these companies have more relationships to be disclosed to the stakeholders. Due to the benefits of disclosure, the board is willing to disclose this information. Thus, the larger the board, it can be expected that the higher the level of relational capital disclosure and hence lower information asymmetry exist between the company and the users of information (Chen & Jaggi, 2000).

$H_1$: There is a positive relationship between board size and relational capital disclosure.

## 2.2 Board independence

Independent non-executive directors are in a better position to monitor the management (Cotter & Silvester, 2003). Consistent with agency theory, independent non-executive directors on the board becomes a control mechanism over the management, to make sure the management acts in the interest of the shareholders, including the minority shareholders. Independent directors are related to effective monitoring on company activities (Fama & Jensen, 1983) and maximising companies value (Bueno et al., 2004). As such, it can be expected that these directors have the incentives to monitor companies' disclosure so as to make sure stakeholders receive sufficient signals about company information for stakeholders to make informed decision. In addition, independent board members are representing stakeholders, other than the majority owners or block holders who often have their representatives on the board. As such, the demand for information from these stakeholders can be channelled through the presence of independent board in the board meeting. Consistent with this, prior research found that companies with more proportion of independent non-executive members on the board have the tendency to disclose more intellectual capital and voluntary disclosure (Eng & Mak, 2003; Haniffa & Cooke, 2005; Li et al., 2008; Patell & Prencipe, 2007; Lim, Matolcsy & Chow, 2007; Hossain, 2008). As such, consistent with agency and signalling theories, it is expected that an increase in the proportion of independent directors on the board, would likely results in an increase in the disclosure of relational capital. The prediction is as follows:-

$H_2$: There is a positive relationship between board independence and relational capital disclosure.

### 2.3 Multiple directorships

Haniffa and Hudaib (2006) define multiple directorships as directors who sit on more than one board. In Malaysia, multiple directorships are common practice among the publicly listed companies (Haniffa & Cooke, 2005). Prior research found that large sized companies tend to have more multiple directorships than small-sized companies in order to have more relationships with external parties (Booth & Deli, 1996). However, too many directorships may limit the ability of directors to provide meaningful contribution to the company because of time pressure (Benson et al., 2015). As such, multiple directorships may not usually beneficial to companies.
There has been limited research on multiple directorships and firm performance in Malaysia (except for Tan, 2005; Haniffa & Hudaib, 2006). Tan (2005) and Sarkar and Sarkar (2009) found that multiple directorships can improve company performance. This study suggests that multiple directorships may help companies in developing relationships with external parties. The relationships can form web of networks that companies could utilise to increase their performance. The signalling point of view suggests that, because these networks are important assets for the companies, it can be expected that managers may have the intention to give the signal to users. Therefore, as multiple directorships increases, disclosure of relationship capital is expected to increase.

$H_3$: There is a positive relationship between multiple directorships and relational capital disclosure.

### 2.4 Ownership structure

Ownership structure is, among others, an important factor that can determine corporate disclosure level. In this study, we analyse the impact of managerial, family, institution and government ownerships on relationship capital disclosure.

*Managerial ownership*

Managerial ownership is the percentage of shares owned by the management (Eng & Mak, 2003). This practice could reduce agency problem because managerial share ownerships could align the interest of the managers with the owners. Therefore, consistent with Jensen and Meckling (1976), companies owned by the management may provide more disclosure than other firms to increase the liquidity of the company. However, significantly high ownership by managers may reduce the necessity to provide voluntary disclosure resulting in lower level of disclosure (Eng & Mak, 2003; Mohd Ghazali, 2007; Chau & Gray 2010). The findings by these authors are consistent with signalling theory that, the owners may not have adequate motivation to signal information to outsiders as their share ownership increases. As such, it can be expected that as managerial ownership increases, relational capital disclosure decreases.

$H_4$: There is a negative relationship between managerial ownership and relational capital disclosure.

*Family ownership*

The presence of family ownership and family members on the board of directors are traditional characteristics of businesses in Malaysia (Claessens et al., 2000; Mohd Ghazali & Weetman, 2006), as well as in other Asian countries (Ho & Wong, 2011). A majority of prior literature such as Haniffa and Cooke (2002), Mohd Ghazali and Weetman (2006), Chow and Gray (2010) and Al-Akra and Hutchinsons (2013) found evidence that family influence in companies could influence voluntary disclosure practices downwards. This practice is consistent with two effects i.e. alignment effect versus entrenchment effect. Alignment effect of family ownership with the majority of other shareholders may cause the intention to signal information is reduced. The demand for disclosure is reduced since a significant portion of the shareholding is held by families.

Thus, the motivation to disclose information in order to get better terms of external financing contracts may be reduced. The trust and familiness culture among family members may also become a factor for reduced signalling motivation. However, according to entrenchment effect, families on board and the management team may lead to improper governance practices, which could results in expropriation activities. Therefore, implying from Fan and Wong (2002) and Francis, Schipper and Vincent (2005) that such activity may cause the owners to limit information flows to outside parties, in order to conceal their activities from known by the outsiders. The family may block their relational information more than others because these relationships or connections may uncover their expropriation activities such as through tunnelling activities. This argument implies that family owners may block or reduce signals about relationships or connections to outside parties. Thus, both arguments suggest that an increase in the family ownership would result in lower disclosure of relational capital information.

$H_5$: There is a negative relationship between family ownership and relational capital disclosure

*Institutional ownership*

Ten largest companies in Malaysia are owned by institutional investors (Saleh et.al, 2010). In fact, institutional investors play crucial role in developing the economy. Therefore, institutional investors play an important role in the design of governance in the investee companies. Part of the governance process to monitor the progress and performance of investee companies is the corporate transparency and disclosure (David & Kochhar, 1996; Saleh et. al, 2010). Kim and Nofsinger (2004) suggest that voluntary disclosure is used as a mechanism used by institutional investors to monitor companies. In addition, institutional investors actually invest on behalf of retail investors. Therefore, the institutional investors are more aware of the demand for information from the retail investors. As such, prior studies found a positive relationship between voluntary disclosure and institutional investors (Barako et al. 2006; Magena & Pike, 2005). Consistent with this finding, Iatridis (2013) found quality disclosure is associated with institutional ownerships. Overall, it can be concluded that the demand of information to monitor companies by institutional investors could become a motivation for companies to signal their private information in the form of voluntary disclosure. In addition, more voluntary disclosure could also attract more investments from institutional investors as company reputation increases. The reputation of companies can increase if they could prove by disclosure of information that the business is well accepted by their reputable business partners. It is proven that corporate reputation that comes with relational capital affects competitive advantage of companies (Wang, 2014). Therefore, we expect an increase in institutional ownership should results in an increase in relational capital disclosure;

$H_6$: There is a positive relationship between institutional ownership and relational capital disclosure.

*Government ownership*

Conventionally, it is expected that there is negative effect of government ownership on corporate performance (Qi et al. 2000; Wei et al. 2005; Lin & Zhang, 2009). This effect could be due to companies need to allocate funds for politicians (Sapienza, 2004) and more political interventions in government owned companies (Gul, 2006; Johnson dan Mitton, 2003). In Malaysia, Government Linked Companies (GLC) are controlled directly by the government through equity ownership by its investment arm, Khazanah Nasional Berhad. These companies involved in a range of sectors i.e. financial, communication and media, utility, information technology and transportation. We expect the relationship between government ownership and relational capital is positive for a number of reasons. First, consistent with the government's aspirations to develop a knowledge based economy, the implementation of such policy is expected to be taken place in GLCs. As part of knowledge, relational capital is important in a knowledge based economy. Therefore, a high government ownership should results in high disclosure of relational capital. Second, government influenced companies may make more relationships or connections (including political connections) than other companies. Managers believe these connections as value maximising activity that can assure long term sustainability of the company, thus having the incentives to disclose the information. A study by Chen et al. (2013) suggest that there is higher value of politically connected companies compared to non-politically connected companies "due to the expected value of preferential treatments, preference in project selections and access to state benefits" (page 477). Third, government may also act on behaf of the public at large. Due to the pressure to present good investments made in the parliament, government owner may request investee companies to provide comprehensive reporting of the strength of the companies by voluntarily disclosing relational capital. Thus, it can be expected:-

$H_7$: There is a positive relationship between government ownership and relational capital disclosure

## 3. RESEARCH METHOD

Samples are comprised of companies listed on the Bursa Malaysia. However this research selects companies in the technology industry that are listed on the Main and ACE Market of Bursa Malaysia. Technology-based companies were chosen because companies within this industry depend more on intellectual capital (and hence relational capital) in the activities and operations of their business than in any other industries. Generally, companies in the technology industry disclose 44% of relational capital items, 38% of structural capital and 18% of human capital items.

Following prior research (such as, Guthrie & Petty 2000; Brennan 2001; Bozzolan et al. 2003; Abeysekara & Guthrie 2004), the data was collected from published annual reports in year 2011 to 2013. Annual reports are company documents issued to the public, physically (Campbell 2000), or electronically (Kamarulbaraini dan Khairul 2005; Iqbal 2005), that has a significant influence on the capital markets and public perception about the company (Anderson & Epstein 1995). Year 2013 was the latest annual reports available at the time this study was conducted. All annual reports are obtained from the Bursa Malaysia website. There were 229 technology company-year observations. The number of companies selected for this study is as follows:-

Table 1: Sample

| **Year** | **2013**<br>**#** | **2012**<br>**#** | **2011**<br>**#** |
|---|---|---|---|
| Main Market (Technology Industry) | 21 | 30 | 31 |
| ACE Market | 22 | 63 | 62 |
| Total | 43 | 93 | 93 |

The dependent variable is the level of relational capital disclosure (RCD). There are seven (7) independent variables tested in this study i.e., board size (BRDSIZE), board independence (BRDIND), multiple directorship (MULTIDIR), managerial ownership (MGROWN), family ownership (FAMOWN), institutional ownership (INSTOWN) and government ownership (GOVOWN). Control variables are company size (COSIZE), leverage (LEV) and profitability (PROFIT).

$$RCD_{it} = \beta 0 + \beta 1BRDSIZE_{it} + \beta 2BRDIND_{it} + \beta 3MULTIR_{it} + \beta 4MGROWN_{it} + \beta 5FAMOWN_{it} + \beta 6INSTOWN_{it} + \beta 7GOVOWN_{it} + \beta 8COSIZE_{it} + \beta 9LEV_{it} + \beta 10PROFIT_{it} + \varepsilon_{it} \ldots\ldots(1)$$

| | | |
|---|---|---|
| *RCD* | = | Relational capital disclosure |
| *β* | = | Coefficients |
| *BRDSIZE* | = | Board size |
| *BRDIND* | = | Board independence |
| *MILTIDIR* | = | Multiple directorship |
| *MGROWN* | = | Managerial ownership |
| *FAMOWN* | = | Family ownership |
| *INSTOWN* | = | Institutional ownership |
| *GOVOWN* | = | Government ownership |
| *COSIZE* | = | Company size |
| *LEV* | = | Leverage |
| *PROFIT* | = | Profitability |
| ε | = | Errors |
| *i, t* | = | Company and year subscripts, respectively |

Relational capital disclosure (RCD) is measured based on total score of relational capital index. The index is developed based on conceptual model of Goerzen (2007) and Garcia-Meca & Martinez (2007) study. From “alliance network” view point, Goerzen (2007) suggests that geographic diversity, repeated partnersips, network size, international experience are among other factors that can determine company performance due to reductions in transaction costs. Based on this view and prior literature, Goerzen (2007) views companies have the incentives to get involved in networks with other companies to improve market access, reduce innovation time span and complement technology capabilities needed for performance. Overall, networking is viewed as an effort to reduce cost and uncertainties as well as to create competitive advantage. Due to these advantages, we believe companies may have the intention to signal the information about their alliance network or relational capital to the stakeholders. Based on the model and prior literature, we develop an index of relational capital. It appears that Garcia-Meca & Martinez (2007) index is not comprehensive. Based on Goerzen (2007), four (4) elements were added to the index i.e. foreign ownership commitment, commitment in foreign subsidiaries, repeated partnerships and business geographical diversity. To this end, this study makes an improvement on the index. There are nine elements (9) covering sixteen (16) items in the index.

Data on the index was collected manually based on disclosure made in company annual reports. To deal with inherent judgment limitations and subjectivity, we use two coders and test on the difference in the coding to make sure consistency of the data. Adjustments were made where necessary. Then, we divide the total disclosure score observed for each company (OD) by the maximum disclosure score a company could get (TD) to represent the level of relational capital disclosure (RDC). This study also adjusts for non-relevant items, whereby these items will be deducted from the total number of the denominator.

$$RCD = \frac{\sum OD}{\sum TD} \ldots\ldots\ldots\ldots\ldots \quad (2)$$

The definition of independent variables is as follows:-

Table 2: Definition of independent variables

| **Independent variables** | **Expected relationship with dependent variable** | **Measurement (all measurement items are obtainable from annual reports)** |
|---|---|---|
| *BRDSIZE* | + <br> $H_1$ | Total number of board members (Mohd-Saleh et al., 2005) |
| *BRDIND* | + <br> $H_2$ | The ratio of independent to total board members (Mohd-Saleh et al., 2005) |
| *MILTIDIR* | + <br> $H_3$ | Percentage of external directors serving more than 3 corporate boards (Mohd-Saleh et al., 2005) |
| *MGROWN* | - <br> $H_4$ | Percentage of share ownership by executive directors (Mohd-Saleh et al., 2005) |
| *FAMOWN* | - <br> $H_5$ | Percentage of share ownership of more than 1% by families of the members of the board (Munir et al., 2013; Mohd-Saleh et al. 2014) |
| *INSTOWN* | + <br> $H_6$ | Percentage of share ownership of more than 5% by institutional investors (e.g. Employees Provident Fund, insurance, Permodalan Nasional Berhad, commercial and investment banks) (Ahmad et al., 2012) |
| *GOVOWN* | + <br> $H_7$ | Percentage of share ownership of more than 5% by the Government Linked Companies |
| *COSIZE* | + <br> (Guthrie et al. 2006) | Log of total assets (Guthrie et al. 2006) |
| *LEV* | + <br> (Gerpott et al. 2008; Hossain et al.1995) | The ratio of total liability to total assets (Mohd-Saleh *et al*. 2008) |
| *PROFIT* | + <br> (Singhvi & Desai 1971; Patton & Zelenka 1997; Owusu-Ansah 1998) | The ratio of net profit to total assets (Hassan et al., 2012) |
| *MAIN* | - | If a company belongs to the Main board = 1, otherwise, 0 |

Table 2 summarises measurement of variables used in this study. Following prior research as indicated in the table, we predict that company size (COSIZE), leverage (LEV) and profitability (PROFIT) to have positive relationship with relational capital disclosure. Company size, which is related to available resources, is predicted to have positive relationship with disclosure level (Ahmed & Courtis, 1999; Eng & Mak, 2003 Lopes & Rodrigues, 2007). On the other hand, leverage is related to committed costs which give rise to business risk (Embong et al., 2012). Thus, to reduce the perceived riskiness, companies may have the intention to provide more disclosure. We also predict that profitable companies have the incentives to distinguish themselves from less profitable companies (one way to do this is through voluntary information disclosures) in order to raise capital on the best available terms (Meek et al., 1995). We also include whether board listing on the main board or ACE market (MAIN) has significant effect on RCD. It is believed that young companies that belong to the AE market (has less number of years before listing), are more eager on getting external source of financing. Thus, these companies have more incentives to signal information through relational capital disclosure in order to get favourable terms from financier, compared to companies from the Main market. As such, MAIN is predicted to be negatively related to relational capital disclosure.

## 4. FINDINGS AND DISCUSSION

Table 3, Panel A descriptively presents several popularly disclosed relational capital elements in annual reports of companies. The table shows that the most disclosed element is customer relationship element i.e. related to trademark/brand/image and conference and training related to customers, followed by community relationship i.e. related to educational support and social responsibility. The results indicates that most companies have the intention to create reputation by signalling (disclosing) their trademark or brand or image in the annual reports. This signalling is also mostly taken place in the mission statement, where typically forward looking information are disclosed to get the attention of the users of annual reports. Overall, these types of information deemed important by the signaller i.e. management of companies, for value creation, to the customers, community at large, or to the shareholders (business itself).

Table 3: Relational capital disclosure

*Panel A: Some popular items*

| Elements | Items | Location | Number of annual reports |
|---|---|---|---|
| Customer relationship | Trademark/brand/ image | Mission Statement | 183 |
| | Conferences or training related to customers | Director's Statement | 124 |
| Community relationship (Social responsibility) | Educational support<br>Community projects | Review of Operation | 135 |
| New business and investment | Joint ventures<br>Merger and acquisition<br>Partnership | Director's Statement | 119 |

*Panel B: Disclosure by year*

| Items | 2011 | % | 2012 | % | 2013 | % | Total | % |
|---|---|---|---|---|---|---|---|---|
| List of main customers | 13 | 13.98 | 2 | 2.15 | 13 | 30.23 | 28 | 12.23 |
| Market share (%) | 18 | 19.35 | 15 | 16.13 | 18 | 41.86 | 51 | 22.27 |
| New customers | 19 | 20.43 | 31 | 33.33 | 19 | 44.19 | 69 | 30.13 |
| Loyalty programme | 19 | 20.43 | 17 | 18.28 | 19 | 44.19 | 55 | 24.02 |
| Customers satisfaction | 22 | 23.66 | 17 | 18.28 | 22 | 51.16 | 61 | 26.64 |
| Conference or training related to customers | 37 | 39.78 | 50 | 53.76 | 37 | 86.05 | 124 | 54.15 |
| Product fulfil customers need | 17 | 18.28 | 19 | 20.43 | 17 | 39.53 | 53 | 23.14 |
| Trademark/ Brand/ Image | 68 | 73.12 | 79 | 84.95 | 36 | 83.72 | 183 | 79.91 |
| Education support<br>Community projects | 47 | 50.54 | 64 | 68.82 | 24 | 55.81 | 135 | 58.95 |
| Joint ventures<br>Merger and acquisition<br>Partnerships | 49 | 52.69 | 45 | 48.39 | 25 | 58.14 | 119 | 51.97 |
| Supply chain<br>Distribution channel | 21 | 22.58 | 17 | 18.28 | 20 | 46.51 | 58 | 25.33 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Partnership agreement<br>Strategic alliance and contract | 35 | 37.63 | 26 | 27.96 | 22 | 51.16 | 83 | 36.24 |
| Average age of foreign ownership | 39 | 41.94 | 36 | 38.71 | 20 | 46.51 | 95 | 41.48 |
| Average age of foreign subsidiaries | 39 | 41.94 | 36 | 38.71 | 21 | 48.84 | 96 | 41.92 |
| Total repeated partnerships | 9 | 9.68 | 2 | 2.15 | 15 | 34.88 | 26 | 11.35 |
| Sales by country or geographical segments | 38 | 40.86 | 25 | 26.88 | 29 | 67.44 | 92 | 40.17 |

An example of relational capital disclosure related to new business relationship i.e. (HiTech Padu Berhad 2013 Annual Report, Review of Operations section, page 65): "We are proud to declare that the year 2013, saw HeiTech traversing foreign shores in the form of providing niche expertise to clients in East Asia, the Middle East and Africa, leveraging on the experience as one of the key players in elevating the Public Sector services to what it is today."

Regarding disclosure of strategic alliance through agreements, an example of disclosure is as follows: "In April 2013, ECS Astar signed a distribution agreement with Lenovo, the world's largest personal computer ("PC") maker, to introduce its entire range of smartphones to the domestic market. This effectively cemented our business relationship with Lenovo, which first commenced in 2011 for notebook and desktop PCs. In the same month, ECS Astar also signed a business-to-business distribution agreement with ECSB's long-time partner Samsung Malaysia Electronics Sdn Bhd to distribute its entire range of IT and mobility products to the enterprise market." (ECS ICT Berhad, 2013 Annual Report, Review of Operations section, page 11). The disclosure is important for users of information in order to assess the value creation ability of the company in the future.

Table 3, Panel B shows the total relational capital disclosure of the sample companies by years. Overall, there were 32.93% relational capital disclosure provided by companies in 2011, as compared to 32.33% in 2012 and 51.89% in 2013. There was a sharp increase in the disclosure of relational capital in 2013. This increase in the level of disclosure signifies an increase in the perceived importance of relational capital in the value creation process among the preparers.

Table 4: Descriptive statistics and correlation analysis

| | **Mean** | **s.d.** | **1** | ***2*** | ***3*** | **4** | **5** | **6** | **7** | **8** | **9** | **10** | **11** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *1. RCD* | 0.372 | 0.219 | 1 | -.003 | .023 | .224** | -.191** | -.042 | .138* | .076 | .109 | .037 | .033 |
| *2. BRDSIZE* | 0.816 | 0.108 | .035 | 1 | -.389** | .027 | .036 | -.036 | .053 | .088 | .226** | .085 | .160* |
| *3. BRDIND* | 0.453 | 0.150 | .000 | -.331** | 1 | -.037 | -.071 | .007 | .051 | .023 | -.091 | -.059 | -.012 |
| *4. MILTIDIR* | 0.197 | 0.204 | .277** | .019 | -.068 | 1 | -.081 | -.048 | .073 | -.131* | .141* | .077 | .081 |
| *5. MGROWN* | 0.177 | 0.189 | -.196** | .017 | -.071 | -.062 | 1 | .133 | -.023 | .099 | -.096 | .121 | .033 |
| *6. FAMOWN* | 0.009 | 0.042 | -.067 | .010 | -.039 | -.102 | .173* | 1 | -.067 | .123 | -.065 | -.051 | .025 |
| *7. INSTOWN* | 0.035 | 0.095 | .177** | -.032 | .069 | .107 | -.074 | -.018 | 1 | .025 | .032 | .154* | .022 |
| *8. GOVOWN* | 0.002 | 0.015 | .082 | .105 | .001 | -.102 | .051 | .200** | -.011 | 1 | .011 | .008 | -.055 |
| *9. COSIZE* | 7.571 | 0.672 | .154* | .145* | -.028 | .101 | -.035 | -.067 | -.010 | .051 | 1 | .404** | .320** |
| *10. LEV* | 0.032 | 0.094 | .025 | -.002 | .090 | .102 | .057 | .033 | -.007 | .000 | .130* | 1 | .033 |
| *11. PROFIT* | -0.087 | 0.600 | .057 | .058 | .086 | -.031 | .065 | -.118 | .017 | .012 | .489** | -.153* | 1 |

Note: Figures above (under) diagonal represents Spearman (Pearson) correlation coefficients. **, * denotes significant at 1% and 5% levels (2-tailed) respectively.

Descriptive statistics of the data and correlation analysis are provided in Table 4. The mean of relational capital disclosure is 37.2% across the three year period. This result is in similar range as Goh & Lim (2004) study (41%), while an earlier study by Haniffa & Cooke (2002) report 31.3% level of relational capital disclosure. The difference could be due to different sample period. Board size is logged to reduce heteroscedasticity problem. It appears that on average, 45.3% of the total board members consist of independent members, nearly 20% of the members have three or more directorships in other companies, and about 17.7% of the shares are owned by the management.

Consistent with our prediction, multiple directorships, which represents director's network is positively correlated with relational capital disclosure. Similarly, there is a positive correlation between relational capital disclosures with institutional ownership indicating that pressure from sophisticated investment companies (the institutional investors) may be effective to demand for important relational capital information to be disclosed. The correlation also suggests the higher managerial ownerships, the lower relational capital disclosure, which is consistent with our predicted relationship. Other than these correlation, it is also observed that board size is negatively correlated with board independence (r=-0.389), suggesting additional members on the board that contribute to a large board size are mainly non-independent members. It is also interesting to note that as company size increases, multiple directorships also increase. This result suggests the need for reputable but "busy" directors is higher in large compared to small-sized companies. Overall, the correlation analysis also reveal that the highest correlation is only 48.9%, which is way below the threshold to make us concern about multicollinearity issue. However, we also test the existence of multicollinearity problem using VIF (variance inflation factor). We scan each variable for outliers. To deal with outliers, Profitability variable was winsorised at top and bottom 1% i.e. to the point equivalent to the top and bottom 1% level of the ranked variable. Winsorising technique limits the effect of outliers but at the same time retain the statistical properties of the variable.

The multivariate regression results are presented in Table 5. The result shows the OLS model is significant and 32% variance in relational capital disclosure can be explained by independent variables. The second column shows random effect panel data analysis of the data. The low level of VIF suggests that multicollinearity is not a major concern. Both results are consistent. It appears that variables supported strongly by signalling theory are significantly related to relational capital disclosure. As predicted, multiple directorships, institutional ownerships and government ownership are significantly related to relational capital disclosure. The result for multiple directorships is consistent with prior literature on voluntary reporting using Malaysian data (Haniffa and Cooke, 2005). Multiple directorships may have helped companies in developing relationships with external parties and because networks are important assets for the companies, managers may have the intention to give signal to users. Similarly, consistent with prior literature, information are disseminated due to demand of information from institutional owers (D'Souza, Ramesh and Min Shen, 2010; Iatridis, 2013). This result implies institutional owners are aware of the demand for information from the retail investors who invest in their company provides sufficient pressure for the company to disclose relational capital information. The result for government ownership is consistent with Eng and Mak (2003), that government ownership influences voluntary disclosure positively. The government, who represent the community at large may demand information to be disclosed, particularly with respect to business relationship with the community. It can also be said that the government that has aspirations to develop a knowledge based economy wanted to show the implementation of such policy is taken place in companies that they have investment in.

Table 5: Multivariate regression results (N=229)

| **Variables** | **Predicted sign** | **OLS Coefficients (t-Stats)** | **Panel Data Random effect Coefficients (z-Stats)** |
|---|---|---|---|
| Constant | ? | -0.456* | -0.449* |
| | | (-1.867) | (-1.900) |
| *BRDSIZE* | + | 0.044 | 0.131 |
| | | (0.319) | (0.326) |
| *BRDIND* | + | -0.043 | -0.025 |
| | | (-0.426) | (0.980) |
| *MILTIDIR* | + | 0.285*** | 0.274*** |
| | | (4.055) | (4.140) |
| *MGROWN* | - | -0.172** | -0.174** |
| | | (-2.249) | (-2.350) |
| *FAMOWN* | - | -0.243 | -0.375 |
| | | (-0.757) | (-1.150) |
| *INSTOWN* | + | 0.498*** | 0.498*** |
| | | (3.113) | (3.510) |
| *GOVOWN* | + | 1.551** | 1.862** |
| | | (1.735) | (2.050) |
| *COSIZE* | + | 0.106*** | 0.098*** |
| | | (3.798) | (3.710) |
| *LEV* | + | 0.056 | 0.055 |
| | | (0.380) | (0.712) |
| *PROFIT* | + | -0.008 | -0.014 |
| | | (-0.253) | (-0.540) |
| *MAIN* | - | -0.160*** | -0.172*** |
| | | (-4.714) | (-5.040) |
| 2011 | ? | 0.008 | - |
| | | (0.251) | |

| | | | |
|---|---|---|---|
| 2013 | ? | 0.125*** (3.216) | - |
| $R^2$ | | 0.320 | 0.238 |
| Adjusted $R^2$ | | 0.272 | - |
| | | F Stat = 6.651*** | Wald Chi2 = 66.98*** |
| Highest VIF | | 1.936 | Hausman Test not significant |

Overall, these results imply that networks created from multiple directorships, institutional ownerships and government ownership influences the signalling behaviour of managers. However, if the companies have large managerial ownership relational capital disclosure is expected to be reduced i.e. managerial ownership is found to have negative relationship with relational capital disclosure. The result is found because share ownership by the management aligns the interest of shareholders with the management. As their interests are aligned, the necessity to provide additional disclosure is reduced, thus reducing the incentive for the managers to signal information through relational capital disclosure. Therefore, $H_3$, $H_4$, $H_6$ and $H_7$ are supported.

It is also interesting to note that although not hypothesised, younger companies (other than companies from the Main board –i.e. MAIN) are disclosing more relational capital information. This result is consistent with signalling theory that while lacking in terms of historical track records and assets, young companies have stronger incentives to signal information that may have positive impact to the company in the future.

The results however do not $H_1$, $H_2$ and $H_5$. Board size has two main effects of board size i.e. the ability of the board to make decision, and the coordination within the board. Since these two effects suggest different effect on voluntary relational capital disclosure, the effect can be cancelling each other. The first effect may occur when board size is small, while the second effect may dominate when board size is large. We test on the non-linearity of board size relation with RCD in additional analyses.

Although theoretically independent directors are related to effective monitoring on company activities, the existence of the directors does not affect the level of relational capital disclosure. The result implies that independent directors who are expected to represent other than blokholders and controlling owners do not have sufficient motivation to demand for more relational capital information to be disclosed. The result is somewhat contradict prior literature (such as Eng & Mak, 2003; Haniffa & Cooke, 2005; Li et al., 2008; Patell & Prencipe, 2007; Lim, Matolcsy & Chow, 2007; Hossain, 2008). Some researchers relate the effectiveness of independent board members to grey directors i.e. while complying with the definition of independence, they are not truly independent.

*Additional analyses*

To test the possibility of non-linearity relation between board size and relational capital disclosure, we introduce BRDSIZE2 into the equation. While the results for other variables are qualitatively similar, we find that BRDSIZE and BRDSIZE2 are insignificantly related to relational capital disclosure.

To deal with the possibility of non-normality of the residuals, normal transformation procedure as suggested by Cooke (1998) is also employed in the multivariate analysis. The procedure effectively assigns ranks to the non-normal data and transforms the ranks with numbers on normal distribution. Following Young (1998), Van der Wardean approach of normal transformation is employed. This procedure has been used by many other researchers on corporate disclosure (such as Mokhtar & Mellett, 2013). We estimate the equation again using transformed data and find the results are intact.

## 5. CONCLUSION

In this study, we expect the agency supported by the signaling theories can be used to explain a specific disclosure of relational capital information in company annual report. This study contributes to the literature by examining the relationship between selected corporate governance elements (such as the characteristics of Board of Directors and the ownership structure of companies) with a relational capital disclosure. Different from a majority of prior literature, we use alliance or network view in selecting variables as well as in developing our measurement and model. By doing this, we extend the body of knowledge by extending the long standing agency theory explanation on disclosure with additional insight from signalling and network view. Relational capital disclosure is a good case to test this view.

The results indicate that multiple directorships, institutional and government ownerships positively affect relational capital disclosure. Managerial ownership, on the other hand reduces the incentives of the management to signal such information. In addition, we also find younger companies to have more incentives to disclose relational capital information compared to more established companies. The results enlighten us that important corporate governance determinants of relational capital disclosure can be predicted when signalling intention of the management and network or alliance argument are considered.

While exposing the significant effect of signalling and network perspectives on relational capital disclosure, it remains ambigous whether such perspectives can be used on other types of disclosure and become a public policy. Future research may address this issue. Our findings may have implications for regulators in emerging countries characterised by highly networked economy, whereby, business and personal networks are important for company sustainability. However, specific character of different market may also affect the intention of the management. Therefore, further studies on other markets may enrich our understanding the applicability of these perspectives on disclosure.

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