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The Effect of Proprietary Costs and Ownership Structure on the Disclosure of Directors' Share Options

Faizah Darus[1,*], Khasniza Abdul Karim[2], Roslani Embi[1]

[1]Accounting Research Institute and Faculty of Accountancy, Universiti Teknologi MARA, Shah Alam 40450, Malaysia
[2]Commerce Department, Politeknik Sultan Salahuddin Abdul Aziz Shah, Shah Alam, 40450, Malaysia

Abstract This study examines the proprietariness of information and the influence of ownership structure on the disclosure of information on directors' share options of 140 Malaysian public listed companies over a 2 year period (2004-2005). Results revealed that family and government ownership dominate managers' disclosure decision of directors' share options information. The proprietariness of information did not seem to affect the disclosure decisions of managers in providing directors' share options information.

Keywords Directors' Share Options, Proprietary Costs, Ownership Structure

1. Introduction

The issue of executives' remuneration frequently attracts public attention as stakeholders' are interested to know about directors' remuneration packages. Performance incentive payments to top executives in the form of share options rather than cash bonuses are popular in practice. Management with information about such payments to directors has the incentive to disclose such information to stakeholders as the disclosure of such information signals that they are acting in the shareholders' interests. However, the benefit of such disclosure could be outweighed by the proprietary costs of disclosing such information that could potentially lead to a competitive disadvantage to the company. A company's varying corporate ownership structure could also have differing influence on management's disclosure strategy. This study examines the proprietary costs of disclosure of directors' share options and the influence of ownership structure on management disclosure decision for Malaysian public listed companies for a two year period prior to the implementation of Financial Reporting Standards (FRS) 2 – *Share-based Payments* in Malaysia.

2. Literature Review and Hypotheses Generation

2.1. Investment Growth Opportunities

To investigate the effect of proprietary costs on the disclosure of directors' share options, this study will examine the disclosure of directors' share options information among companies with investment growth opportunities to proxy for proprietary costs. This is because companies with investment growth opportunities indicate the presence of proprietary costs, which could influence the firms' voluntary disclosure policy relating to directors' share options. Taylor et al (2007) pointed out that companies with higher growth opportunities would be more cautious about disclosing directors' remuneration because they are more likely to have competitors looking for such information with a view to attracting these successful directors' a better remuneration. Therefore, it is hypothesized that:

H1: The percentage change in investment growth opportunities is negatively related to the extent of disclosure of directors' share options information.

2.2. Agency Theory and Ownership Structure

Jensen and Meckling (1976) suggests that where there is a separation of ownership and control of a firm, the potential for agency costs arises because of conflicts of interest between contracting parties. The effect of the agency theory on the extent of disclosure of directors' share option is examined by independent variables related to various elements of corporate ownership structure.

2.2.1. Family Ownership

Family firms are characterized by the founding family's concentrated ownership and the founding family members' active involvement in firms' management either as top executives or as directors (Anderson and Reeb, 2003). Gaining effective control of the company allows the controlling owner to control the production of the company's accounting information and reporting policies (Fan & Wong,

* Corresponding author:
faiza634@salam.uitm.edu.my (Faizah Darus)
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2002). As such, family owned companies is expected to limit the supply of accounting information flows to outside investors and have less incentive to disclose the extent of payments made to directors.Thus, it is hypothesized that:

H2: The percentage of family ownership is negatively related to the extent of directors' share options disclosure.

2.3.2. Government Ownership

Consistent with the argument by Eng & Mak (2003) government owned companies have higher incentives to make detailed disclosure of financial information to signal that are acting in the interests of outside investors and the nation. As such government's commitment to improve transparency on directors' remuneration information will lead to an increase in managers' incentives to disclose directors' share options information. Therefore, it is expected that government owned companies will disclose more information on directors' share options. It is hypothesized that:

H3: The percentage of government ownership is positively related to the extent of directors' share options disclosure.

2.3.3. Foreign Ownership

Xiao et. al. (2004) reveals that higher foreign ownership encourages information disclosure. This is because foreign ownership increases dispersion of corporate ownership and managers will have higher incentives to disclose more detailed information to reduce agency conflicts (Barako et al., 2006). Craswell and Taylor (1992) conclude that different shareholders demand different disclosures and the demand is greater when it is foreign owned, due to the separation between management and owners geographically. Thus it is hypothesized that:

H4: The percentage of foreign ownership is positively related to the extent of directors' share options disclosure.

3. Research Methodology

The data for this study was obtained from content analysis of published annual reports of 140 public listed Malaysian companies for the year 2004 - 2005. The two year window period prior to the adoption of FRS 2 in 2006 in Malaysia was chosen because compensation to directors by the issue of shares or share options during these period were accounted for in equity and would be voluntarily disclosed by management in the companies' annual reports. Table 1 presents the definition and measurement of the variables for the study.

The hypothesized relationships are modelled as follows,

$$DISSHARES = ß_0 + ß_1\ GROWTHMKT + ß_2\ GROWTHACC + ß_3\ GOV + ß_4\ FAM + ß_5\ FOR + \varepsilon_t$$

Table 1. Definition and Measurement of Variables

Variables	Measurement
Dependent Variable	
The extent of disclosure of directors' share options (DISSHARES)	Number of words
Independent variables	
Investment Growth Opportunities as perceived by equity market (GROWTHMKT)	% change in market capitalization for the past year
Investment Growth Opportunities as reported in accounting numbers (GROWTHACC)	% change in revenues for the past year
Government ownership (GOV)	% of shares owned by government institutions
Family members (FAM)	% of family members on the board
Foreign ownership (FOR)	% of shares owned by foreign owners
Control variable	
Profitability (ROA)	Proportion of profit after tax over total assets

4. Findings and Discussion

4.1. Descriptive Analysis

Table 2 provides the descriptive statistics for the variables.

Table 2. Descriptive Statistics for the Variables for 2004 and 2005

Variables	Mean	
	2004	2005
DISSHARES	1017.51	1047
GROWHMKT	14.67	5.66
GROWTHACC	23.45	23.85
FAM	27.8	46.55
GOV	11.37	16.25
FOR	3.77	4.45
ROA	6.51	5.84

Results from Table 2 indicate that the extent of voluntary disclosure of directors' share options (DISSHARES) increase between the 2 years suggesting that the companies were increasingly disclosing information relating to wealth allocation made to directors in the form of share options. Such a move is in line with good corporate governance as such allocation to directors should be made transparent to stakeholders. The impending introduction of FRS 2 in 2006 where compensation by share options to directors needs to be expensed rather than disclosed seems to have no effect in reducing the disclosure of information on directors' share options

With regards to investment growth opportunities the mean GROWTHMKT decreased in 2005 (5.66%) indicating a decrease in share price over the two year period and such a decrease are also affecting the profits of the companies. This is indicated by the decline in the ROA. The ownership structure (FAM, GOV and FOR) all showed a consistent increase over the 2 years.

Table 3 provides the results of the multiple regression analysis in 2004. The multiple regressions reveal that the Adjusted R square is 0.230. The F-statistic for the model is 4.222 and the p-value is significant (0.002) indicating that the overall model is significant and can be used to explain DISSHARES.

Table 3. Multiple regression results - 2004

Variable	Coeff	SE	*t*	Sig
ROA	2.892	3.022	.957	.171
GROWTHMKT	.241	.341	.707	.760
GROWTHACC	-.269	.503	-.535	.297
FAM	-9.036	2.931	-3.083	.002***
GOV	8.445	2.927	2.885	.003***
FOR	-13.674	3.559	-3.842	1.00
R square	0.300			
Adjusted R square	0.230			
F value	4.222			
F significance	0.002			

** Significant at 5% level (1-tailed); *** Significant at 1% level (1-tailed)

Table 4 presents the results of the multiple regressions for 2005. The F-statistic for the model is 2.939 and the p-value is significant at 0.05 level (0.027) with an adjusted R square of 0.279.

Table 4. Multiple regression results - 2005

Variable	Coeff	SE	*t*	Sig
ROA	-1.203	4.046	-.297	.616
GROWTHMKT	2.104	.735	2.864	.996
GROWTHACC	-.263	.854	-.308	.381
FAM	-6.785	2.612	-2.597	.008***
GOV	5.402	2.558	-2.112	.023**
FOR	-8.460	3.027	-2.795	.0995
R square	0.424			
Adjusted R square	0.279			
F value	2.939			
F significance	0.027			

** Significant at 5% level (1-tailed); *** Significant at 1% level (1-tailed)

The results are consistent for both years where only family and government ownership are significant. This suggests that family and government ownership influenced companies' decision to disclose details about their directors' share options. The study confirms that there is a negative relationship between family-owned companies and the level of disclosure of directors' share options while for government-owned companies, there is a positive relationship. With these results, H2 and H3 are supported. These findings suggest that government ownership is a potential monitoring mechanism that can strengthen corporate governance while family owners seem to mitigate regulatory efforts to improve corporate transparency. The insignificant results reported for foreign ownership is inconsistent with prior findings. A possible explanation is because there is a relatively low percentage of foreign ownership (mean = 3.77% 2004, 4.45%, 2005) in the sample suggesting that with the low presence of foreign ownership such foreign owners were unable to demand greater public disclosure of directors' share options information from management. Findings revealed no significant association between investment growth opportunities and disclosure for both years. This suggests that directors do not perceive information about their share options to have sufficient signaling potential to create competitive disadvantage for the firm.

5. Conclusions

Results of the study reveal that the proprietary costs of information on directors' share options did not inhibit disclosure for government owned companies as the benefits of disclosing such information seems to outweigh the proprietary costs of disclosure. Family owned companies on the other hand are reluctant to make such disclosure since as owner managers they have greater access to internal information and thus have less incentive to voluntarily disclose information to outside investors.

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