

THE IMPACT OF CEO COMPENSATION AND GOVERNANCE DISCLOSURE ON FIRM VALUE MODERATED BY INTEGRATED REPORTING

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Abstract

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Firm value can increase market confidence, not only for current performance but also for the company's prospects in the future (Fama, 1978). To prove empirically the effect of chief executive officer (CEO) compensation and governance disclosure on firm value moderated by integrated reporting (IR) is the aim of this study. The study population is Asian companies registered in the Integrated Reporting database examples. Based on the specified sample criteria, 135 secondary data were obtained from 2019–2021. The analysis tool used to process the data is WarpPLS 7.0. This study gives the result that firm value is influenced by governance disclosure and IR moderates the effect of governance disclosure on firm value, while CEO compensation has no effect on firm value. The practical implications of this study are to confirm the importance of corporate governance disclosure, the role of IR in increasing the value of companies, and its impact on investment decisions. In addition, this study is also useful for regulators in relation to the preparation of corporate financial reporting policies so that they are transparent and accountable.

Keywords: Integrated Reporting, CEO Compensation, Governance Disclosures, Firm Values

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1. INTRODUCTION

Firm value is the market value of the company's equity (Titman et al., 2011). According to Fama (1978), the value of the company is reflected in its share price. Firm value can increase market confidence, not

only for current performance but also for the company's prospects in the future. Poor governance provides biased information that can be misleading in making investment decisions (Latif et al., 2017).

The emergence of corporate governance was triggered by the *Case of Enron*. Poor corporate

governance and low transparency from Enron had an impact on its share price. Various attempts have been made by Enron, but the efforts made by Enron still failed, because the information presented was unreliable, resulting in a decrease in the price of equity shares. This means that the information provided cannot be used as a signal for investors in relation to the creation of company value, in this case, the company must be transparent and accountable.

Transparency and accountability link between corporate governance and corporate reporting (Cooray et al., 2020). Corporate governance can guarantee the transparency and accountability of the information (Cooray, 2020). This means that governance is one of the factors that directly affect firm value (Cooray et al., 2020; Latif et al., 2017; Habib & Jiang, 2015). Corporate governance is one of the non-financial information, which is introduced to reduce agency problems (Cooray et al., 2020). There are two mechanisms in corporate governance, namely internal mechanisms and external mechanisms.

The chief executive officer (CEO) is an internal mechanism for corporate governance because the CEO has duties and responsibilities in developing the company. If the manager cannot maximize the value of the company, the CEO can provide input to the manager because one of the CEO's tasks is to evaluate the manager's tasks. The CEO, however, has a similar right to pay from the business. The CEO's compensation may have an impact on strategic choices, which may have an impact on the firm's value. This is in accordance with Park and Byun (2021), Utomo et al. (2021), and Velte and Stawinoga (2017) which explain that manager compensation and firm value have a positive relationship. But Basuroy et al. (2014) stated a different matter, CEO compensation and firm value had no effect. This is in line with Garcia-Sanchez et al. (2020) which states that CEOs with greater power oppose the disclosure of integrated information, and this behavior is not influenced by company incentives. Additionally, greater growth opportunities increase CEO resistance to disclosing integrated information regarding value creation, perhaps as a consequence of its possible use by competitors.

According to this justification, corporate governance makes it easier to adopt a comprehensive approach to strategy formulation, which leads to the integration of multiple value generating processes inside a firm (Cooray et al., 2020). This explanation is in accordance with Ng et al. (2021), Bhat et al. (2018), Latif et al. (2017), and Habib and Jiang (2015) state that corporate governance has a positive influence on firm value. While Akbar et al. (2016), Pandey et al. (2015), and Bebchuk et al. (2009) claim that there is a negative and no relationship between corporate governance and firm value.

The inconsistency of the research findings is in accordance with the explanation of Baron and Kenny (1986) which states that when the independent variable cannot have a direct effect on the dependent variable, a mediator variable is needed. This explanation can be used as a basis for using mediating and moderating variables. The appropriate moderating variable to strengthen this relationship is integrated reporting (IR).

IR can provide quality information (Lee & Yeo, 2016). IR is intended to address the information demands of all stakeholders, including investors. It provides firm information in economic terms on financial, environmental, social, production, and management indicators and completely represents strategy, risk, and the sustainability of business models (Kostenko et al., 2021) so that investors are interested in buying company shares because the information conveyed is very complex and can ultimately affect the value of the company.

IR has benefits, but there are two different views regarding IR, according to Lee and Yeo (2016) one view explains that IR can provide complete information so that information asymmetry can be reduced, which can later increase firm value. This means that this view further explains that IR can provide benefits for companies and stakeholders. This is in accordance with studies by Islam (2021), Obeng et al. (2020), and Lee and Yeo (2016). Meanwhile, another view explains that IR is a burden that must be borne by the company because the information provided by the company can help competitors read the company's strategy it will have an impact on decreasing the value of the company. This view is in line with the study by Landau et al. (2020) which provides an explanation that the market value is negatively affected by IR. This is the same as the view of Nurkumalasari et al. (2019) that IR has no effect on company value, which implies that IR is not yet the signal needed by stakeholders in the Asian region.

The explanation above means that a study on this matter is important because even though corporate governance facilitates the adoption of a holistic view of strategy making, which results in the integration of various aspects of value creation within an organization, it is still not enough. Based on Baron and Kenny (1986) this is not enough, because there are still many companies that ignore IR, even though IR provides complete information so that it can reduce information asymmetry and can reduce agency costs. Therefore, the research question is:

RQ: Do the CEO compensation and governance disclosure have an influence on firm value either directly or moderated through IR?

So, the aim of this study is to empirically prove the influence of CEO compensation and governance disclosure on firm value which is moderated by IR.

The remainder of the article is organized as follows. Section 2 reviews the relevant literature. Section 3 analyses the methodology that has been used to conduct empirical research using secondary data. Section 4 presents the research results and their discussion. Section 5 describes the conclusions of the study, limitations and suggestions for future research.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Theoretical background

2.1.1. Agency theory

This theory explains that shareholders entrust agents to manage their resources with the aim of maximizing shareholder value (Jensen & Meckling,

1976). However, sometimes the information conveyed is not in accordance with the actual conditions. This situation is called information asymmetry. Eisenhardt's (1989) assumption building states that the different interests of principals and agents will cause agency problems. The principal's ignorance of the agent's actions will cause problems. These problems can be divided into two, namely *adverse selection* and *moral hazard*. When an agent has not succeeded in demonstrating its ability to fulfil a predetermined contract, this is known as adverse selection. But when the agent performs an action without the principal knowing and the action is for his own benefit and against the wishes of the principal, this is called a moral hazard. This will be done by agents when they cannot achieve the goal of maximizing shareholder value. So, to reduce this problem, agency theory provides suggestions for utilizing other methods such as voluntary disclosure, such as governance disclosure or compensation planning.

This explanation is in accordance with Cooray et al. (2020) who state that agency theory has frequently been used to explain the connections between various aspects of corporate governance. In order to alleviate agency issues, corporate governance procedures have been established. These mechanisms aim to supervise managers' behavior by overseeing or monitoring their performance and assuring their transparency and accountability to shareholders (Cooray et al., 2020). Research by Akleng (2014) explains that improved corporate governance mechanisms are likely to curb opportunistic behavior by managers, minimize risks associated with the quality of financial reporting, and increase firm value. Agency theory can also describe IR relationships and the extent of information conveyed by companies (Lee & Yeo, 2016) because IR is a framework that serves as a new type of reporting that fully reflects strategy, risk, and the sustainability of business models while disclosing company information in economic terms on financial, environmental, social, production, and management indicators. It is intended to satisfy the information needs of all company stakeholders, including investors (Kostenko et al., 2021).

2.1.2. Stakeholder theory

The pioneers of stakeholder theory are Freeman and David (1983). Stakeholder theory explains that organizations and corporations must share benefits for all their stakeholders because companies operate not only to fulfill their own interests. Stakeholder theory emerged to understand and fix problems. Therefore, companies need support from stakeholders to maintain the existence of the company. According to Ullman (1985), the strategic stance taken by the corporation is correlated with stakeholder strength. He defines strategic posture as the approach used by the company's top decision-makers in response to social expectations. Stakeholder theory, therefore, essentially views the outside world from a managerial perspective (Gray et al., 1995). Organizations may adopt an active or passive strategic posture. Organizational interactions with stakeholders who are viewed as influential or important will be influenced by companies that adopt an active strategic stance (Ullman, 1985). This

shows that an active strategic posture not only identifies stakeholders but also determines which stakeholders have the greatest ability to influence the allocation of economic resources to the company. Conversely, companies with a passive strategic posture do not have to keep an eye on stakeholder activity while purposefully not looking for the best ways to get their attention. Low levels of social information disclosure and poor company social performance will result from not paying enough attention to stakeholders (in a passive posture strategic strategy) (Ullman, 1985).

So, when a company discloses information through non-financial reports such as social and environmental responsibility reports, stakeholders are taken as the main consideration in order to maintain the relationship between stakeholders and the company. This is in line with Hill and Jones (1992) which explains information that must be received in the relationship between stakeholders. Likewise, Freeman and McVea (2001) were able to provide evidence that companies should try to take building and maintaining these relationships seriously, companies will not last long without their existence, because they are the social and environmental elements of the company.

2.1.3. Signaling theory

The purpose of company reports is to provide information related to the company's activities, as well as to signal to stakeholders about other things, such as the company's concern for the environment, the company's social concern, etc. It is expected that this signal will be received positively by the market and may influence the company's market performance, which is reflected in the company's stock price. Thus, signaling theory emphasizes that companies are likely to provide more complete information to gain reputation, attract investors, and, therefore, greater profits than companies that do not disclose information. Investors require quick, reliable, and comprehensive information as an analytical tool when making investment decisions. Signaling theory is based on pragmatic accounting theory, as information provided by the company is the main driver of change in information user behavior. Non-financial report disclosure is one of the signals that businesses send, thus it is anticipated that the stock price of the company will alter as a result.

2.2. Hypotheses development

2.2.1. Direct and indirect effects of CEO compensation on firm value

Stakeholder theory explains that companies act not only to satisfy their own interests. Therefore, they need support from stakeholders. For this reason, the company must provide information to stakeholders, which can later be used as a major factor in maintaining the relationship between the stakeholders and the company. The information provided is not only in the form of financial reports, but also non-financial statements. This information is expected to provide a signal to stakeholders to make investment decisions. Signals sent by a company must be transparent and accountable to reduce information asymmetry and reduce agency costs.

The information provided by the company depends on the company's management policies. This is in accordance with Simnett and Huggins (2015), who explain that management decisions influence a company's performance, such as the decision to set the selling price of a product, tactics to deal with competitors, target markets and other factors. The capacity of the company's management is simply one factor that affects the quality of decisions made. In addition, management compensation has an impact on how decisions are made in order to maximize value for shareholders. In other words, the value of the firm will be higher the higher the CEO's compensation, since decisions will be wiser; conversely, firm value will fall the lower the CEO's compensation. This hypothesis is consistent with Park and Byun's (2021), and Utomo et al.'s (2021) explanation that managerial pay and firm value have a positive relationship. Similar findings were made by Velte and Stawinoga (2017), who explain that CEO power makes a difference in the association between corporate social responsibility (CSR) and successful financial performance.

Indirectly, the impact of CEO compensation and firm value can also be moderated by company reporting. The reporting that combines financial and non-financial reporting is called IR. IR is felt to be able to provide company information, both financial and non-financial information which is used as a signal for its stakeholders and can reduce agency costs, which in turn can provide an increase in company value. This explanation is in accordance with Shim and Kim (2015), who explain that the Sarbanes-Oxley (SOX) Act has an impact on the reliability of financial reporting because it requires a stronger internal control system so that it can encourage CEOs to increase shareholder value. Therefore, in the context of implementing IR, a transparent and accountable financial reporting system can be an alternative. Then the hypotheses are formulated as:

H1: There is a significant influence between CEO compensation and firm value.

H2: Integrated reporting moderates the effect of CEO compensation and firm value.

2.2.2. Direct and indirect effects of governance disclosure on corporate values

Companies are encouraged to perform financial reporting. This financial reporting is not only in the form of financial reports but also non-financial reports. The market is currently paying more and more attention to environmental issues, so every company is encouraged to disclose information that can provide a signal to its stakeholders. The positive perspective of investors and stakeholders will increase when companies publish governance reports because this is a form of corporate transparency and accountability. According to the stakeholder concept, high disclosure compliance raises corporate reputation, which is linked to good corporate efficiency because it can lower agency costs and improve firm value.

In addition, companies are also encouraged to disclose governance information, because currently, the market is paying more and more attention to governance issues. Therefore, businesses must implement executive compensation, board diversity,

organizational transparency, and relationships with shareholders and the board of directors. In addition to their required financial reports, companies' voluntary release of governance reports can lessen information asymmetry and improve stakeholders' and investors' perceptions of CSR and transparency. Based on stakeholder theory and agency theory and to provide signals to its stakeholders, the more transparent and accountable the company is, the higher the compliance with governance disclosures, which can improve the firm's reputation, due to the high efficiency of the firm which has an impact on the firm's value.

Indirectly, this can be strengthened by IR, because IR describes the extent of information conveyed by the company (Lee & Yeo, 2016). Additionally, IR is a framework for a new kind of reporting that fully reflects strategy, risk, and the sustainability of business models discloses company information in economic terms on financial, environmental, social, production, and management indicators, and is intended to meet the information needs of all company stakeholders, including investors (Kostenko et al., 2021). This explanation is used as the basis for constructing the following hypotheses:

H3: Governance disclosure has a significant effect on firm value.

H4: Integrated reporting mediates the effect of governance disclosure on firm value.

3. RESEARCH METHODOLOGY

This type of research is quantitative and synthesizes from several previous studies (Swanson & Holton, 2005). The source of information used is secondary data obtained from the Bloomberg database. The research subjects are all public companies located in Asia. However, the sampling process uses predetermined criteria, namely: 1) public companies, 2) registered in the Integrated Reporting database¹, and 3) providing complete data sequentially from 2019 to 2021. WarpPLS 7.0 is used as a data analysis tool. Testing the goodness of fit of the structural model is one of the stages used in testing the hypotheses.

The partial least squares (PLS) is a structural equation model (SEM) that uses components or variants. PLS is an alternate strategy that switches the SEM technique from covariance-based to variance-based. When it comes to testing theory or causation, covariance-based SEM is typically more focused on predictive models than PLS. Nonetheless, there is a distinction between component-based PLS and covariance-based SEM, specifically in the application of structural equation models for hypothesis testing or prediction development. SEM-PLS is advised when the analysis relates to evaluating the theoretical framework from a prediction standpoint, when the structural model is intricate and comprises numerous constructs, indicators, and/or model relationships, and when the goal of the research is to understand growing complexity through theoretical explorations of the theories that are currently in place (Hair et al., 2021).

The measurements of each variable of CEO compensation, governance disclosure, as evaluated by Tobin's Q, IR and business value are as follows:

¹ https://examples.integratedreporting.ifrs.org/ir-reporters/?app_region=24

- CEO compensation is calculated using the natural logarithm of the total annual salary and bonuses received during the financial year (Javeed & Lefen, 2019; Shim & Kim, 2015).

- The governance disclosure variable is based on the score obtained from Bloomberg, data that contains information about the structure and operations of the board, executive salaries, and board committee activities are used to measure governance disclosure (Ioannou & Serafeim, 2017). The amount of disclosure in the IR divided by the sum of the IR's components yields a score for the measurement of the IR.

- Tobin's Q, which has the formula $(MVS + D) / TA$, serves as a proxy for measuring company value in the meantime (Lindenberg & Ross, 1981), where *MVS* is the market value of all outstanding shares or the share price divided by the number of shares outstanding; *TA* represents the total assets of the firm; and *D* represents the total debt of the company.

4. RESULTS AND DISCUSSION

The total number of companies in Asian countries registered in the Integrated Reporting database is 129 companies. However, 84 companies consistently failed to provide the required complete data. Thus, the data selected for use as the research sample comprised only 45 companies. These companies originate from Japan, Singapore, Hong Kong, Thailand, India, Malaysia and Sri Lanka, the observation period is three years (2019-2021), so the total number of observation data is 135. Data were processed for analysis and obtaining research results using WarpPLS 7.0. The results are presented in Table 1.

The average path coefficient (APC) value is 0.164 with $p = 0.012$ according to fit criteria < 0.05 , so it is said that this result is accepted because it meets the established fit criteria. The average R-squared (ARS) value is 0.099 with $p = 0.060$, which means that the result is accepted. Likewise with the average

adjusted R-squared (AARS) with a result of 0.071 with a value of $p = 0.010$ according to the criteria of $P < 0.05$, then this result is said to be accepted. The average block variance inflation factor (AVIF) value is 1.077 with the fit criteria to be accepted if fit criteria ≤ 5 , and if fit criteria ≤ 3.3 the result is ideal. The average full collinearity VIF (AFVIF) value is 1.305 with fit criteria to be accepted if fit criteria ≤ 5 , and if fit criteria ≤ 3.3 the result is ideal. The Tenenhaus GoF (GoF) value in this model is 0.315, with fit criteria declared small (≥ 0.1), medium (≥ 0.25), and large (≥ 0.36), meaning that this model belongs to medium. The Simpson's paradox ratio (SPR) value is 1.000 with the fit criteria to be accepted if fit criteria ≥ 0.7 , and if fit criteria = 1 the result is ideal. The R-squared contribution ratio (RSCR) value shows a value of 1.000 with fit criteria to be accepted if fit criteria ≥ 0.9 , and if fit criteria = 1 the result is ideal. The statistical suppression ratio (SSR) value shows a value of 0.750 with the fit criteria ≥ 0.7 , meaning that the result is accepted. The nonlinear bivariate causality direction ratio (NLBCDR) value shows a value of 0.875 with fit criteria to be accepted if fit criteria ≥ 0.7 , meaning that the result is accepted.

Table 1. Structural goodness of fit model

Criteria	Parameter	Annotation
APC	0.164, $p = 0.012$	Accepted
ARS	0.099, $p = 0.060$	Accepted
AARS	0.071, $p = 0.100$	Accepted
AVIF	1.077	Ideally
AFVIF	1.305	Ideally
GoF	0.315	Medium
SPR	1.000	Ideally
RSCR	1.000	Ideally
SSR	0.750	Accepted
NLBCDR	0.875	Accepted

Source: Authors' elaboration based on processed secondary data.

The following is the result of research data processing, which can be seen in Figure 1.

Figure 1. Research result

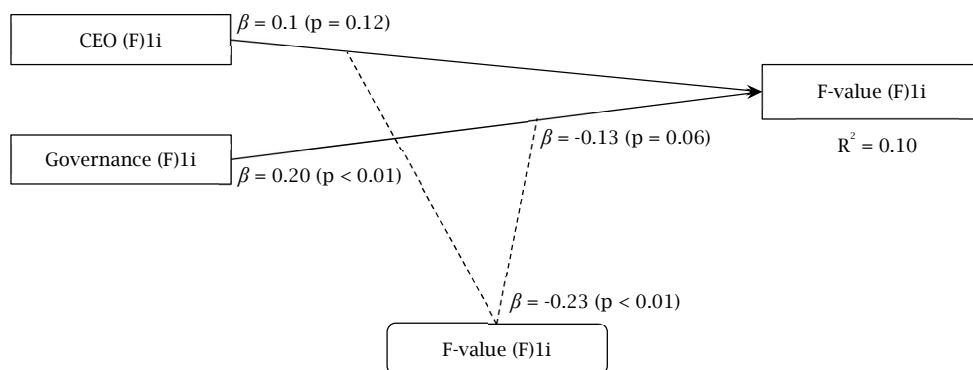


Figure 1 shows that firm value is not affected by CEO compensation because the p-value is 0.12 which indicates that it exceeds the significance limit of 10%. This means that the rise and fall of company value are not influenced by CEO compensation, this happens because stakeholders pay more attention to other factors, such as voluntary disclosure because it provides more useful information in stakeholder decision-making. This argument is in accordance

with Basuroy et al. (2014) which states that firm value is not affected by CEO compensation. However, the findings of this study are not the same as Park and Byun (2021), Utomo et al. (2021), and Velte and Stawinoga (2017) which state the opposite, namely firm value is positively influenced by CEO compensation.

This study also shows that non-financial reporting, namely governance disclosure also has

a direct impact on firm value, because the p-value is based on the test results of 0.06 which does not exceed the 10% significance limit. In addition, the relationship is moderated by IR, it can be seen that the p-value obtained is < 0.01 , which does not exceed the 10% significance limit. This means that the importance of non-financial reporting is to increase firm value. Stakeholders, especially investors, are getting smarter and cleverer in making investment decisions. The basis for their decision-making is not only based on financial reports, but they also pay attention to non-financial reports disclosed by companies, namely governance disclosures.

This explanation is in accordance with Siew et al. (2013), that non-financial reporting has an impact on company performance. The results of this study are the same as Ng et al. (2021), Bhat et al. (2018), Latif et al. (2017), and Habib and Jiang (2015) which explain that corporate governance has a positive influence on firm value. In addition, this explanation is also in line with agency theory, stakeholder theory and signaling theory. Agency theory explains that disclosure of corporate governance makes companies more transparent and accountable so that they can reduce information asymmetry and have an impact on reducing agency costs. Stakeholder theory explains that companies cannot live alone, therefore, companies must provide information to their stakeholders. The information conveyed by the company is used as a corporate signal for its stakeholders, it is hoped that with the signal given by the company, the market will

react so that it can increase firm value. However, this study is not the same as Akbar et al. (2016), Pandey et al. (2015), and Bebchuk et al. (2009) which explains that there is no relationship between corporate governance and corporate value.

5. CONCLUSION

This research concludes the importance of non-financial reporting to increase company value. Either directly or indirectly governance disclosure can affect the value of the company. In addition, IR can also strengthen governance disclosure on company value. Therefore, all companies must pay attention to non-financial reporting because it has an impact on company value.

The limitation of this study is R-square value on the test is only 10%, so the suggestion for further research is to modify the research model and, if necessary add other mediating or moderating variables such as national culture because each country has a different culture in implementing IR. The practical implication of this research for companies is the importance of non-financial reporting to reduce information asymmetry so that it can provide signals to stakeholders that have an impact on increasing company value. The practical implication for regulators is that this research can contribute ideas in formulating policies to improve the non-financial reporting of companies in Asia.

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