INFLUENCES OF PROPRIETARY AND POLITICAL COSTS ON DISCLOSURE OF DIRECTORS' AND EXECUTIVES' REMUNERATION AND OWNERSHIP

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Abstract

Remuneration to, and ownership by, directors and top executives (D&Es) of listed companies have been subjected to calls for transparency as part of the corporate governance movement. Using the annual reports of 161 Australian listed companies, this study investigates the comparative impacts of proprietary and political information costs on management 's voluntary disclosure decisions concerning D&Es' cash-based and equity-based remuneration, termination benefits, related-party transactions, shares held, and changes in ownership in their company. A firm's investment opportunity set (using both market-based and accounting-based measures) is treated as a proxy for proprietary costs, while media attention and shareholder activism are used to proxy for political costs of voluntary disclosure. Results of this study provide evidence of the relative importance of two major types of information costs, proprietary and political, in influencing management's (i.e., D&E's) decision concerning the extent to which they disclose sensitive details of their remuneration and ownership.

Keywords: Director and executive remuneration, proprietary cost, political cost, investment opportunity set, media attention, shareholders' activism

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1. Introduction

Company directors' and top executives' (D&Es') remuneration and other personal business gains arising from their position, as well as their ownership and changes in rights to ownership of their company, has been subjected to calls for transparency as part of the corporate governance movement. Disclosure of such information is a sensitive management decision which will publicly exposure D&Es' personal information about remuneration and wealth allocations to themselves. However, from a corporate governance perspective, it is the shareholders and other stakeholders' interests that are deemed to be paramount in decisions to make such information transparent.

Shareholders' ability to make informed judgments about whether D&E remuneration plans are structured in their own interests will depend, obviously, on the extent of corporate disclosures made (i.e., signaling undertaken by management), particularly regarding cash-based and equity-based remuneration, termination benefits, shares held, and shares and options granted and exercised which generate changes in ownership for D&Es. As well, the extent of disclosure of other personal business benefits derived by D&Es through their position, particularly related-party transactions, will affect shareholders' ability to make informed judgments about whether D&Es have acted in the best interests of the shareholders. An improved understanding of influences on management's decisions to disclose more or less information about D&Es' remuneration and ownership, therefore, would be sought by shareholders (and possibly other stakeholders such as debtholders and employees).

The aim of this study is to examine competing information cost influences on the voluntary disclosure of information about D&Es' remuneration and ownership. In particular, it is contended in this study that such disclosure decisions will be based largely on a trade-off between perceived proprietary costs to the entity that can arise from greater disclosure, and perceived political costs to both the entity and individual D&Es from lesser disclosure.

The theoretical perspective taken in this study is that D&Es have an incentive to disclose more D&E remuneration and ownership information because it signals they are acting in shareholders' interests, thereby representing a bonding strategy under agency theory. But this benefit could be outweighed by proprietary costs embedded in the information that could potentially lead to a competitive disadvantage. For example, disclosure of remuneration package details of top executives could be relevant to executive recruitment agents seeking to identify top executives to poach to a competitor organization. A second theoretical perspective invoked in this study is that D&Es have an incentive to disclose more information about their remuneration and ownership to enhance the company's and their own legitimacy. If company or personal legitimacy is damaged, additional disclosure is a means of repairing it, and failure to repair it could result in political costs. For example, excessive CEO remuneration benefits can lead to public criticism of sustained intensity and loss of customers, bringing about various public relations tactics by the company including increased disclosure of D&E remuneration (as Benton & Cote (2006) showed in the Canadian banking industry).

2. Motivation for the Study

There is a paucity of empirical evidence regarding the comparative impacts of proprietary and political costs on corporate disclosures, and no published empirical study has related these costs to D&E remuneration and ownership disclosure. Therefore, this study aims to provide evidence of the extent to which voluntary disclosure in corporate annual reports of information about D&E remuneration and ownership is associated with proxy measures of proprietary costs and political costs of such disclosure.

The context chosen for the study is the corporate disclosure environment in Australia during 2003 and 2004 when reporting entities faced relatively broad and poorly-defined legislative requirements on D&E remuneration disclosure. The then current D&E remuneration legislation, *Company Law Review Act 1998 section 300A* required information in directors' reports about "the nature and amount of each element of the emolument of each director and five officers receiving the highest emolument". But it created confusion by not defining "emolument" or "officer" which enabled companies to justify exclusion of certain types of disclosure, especially the value of options granted to executives (Clarkson et al., 2006). The introduction of detailed and explicit reporting and disclosure standards was anticipated in the forthcoming implementation in 2005 of AASB 1046 *'Director and Executive Disclosures by Disclosing Entities'* and AASB 2 *'Share-based Payment'*. It is also a period when the Australian financial press gave prominence to the issue of executive remuneration (Clarkson et al. (2006). This setting is conducive to the study of incentives for D&Es to be responsive to anticipated regulatory change by signalling greater proprietary information to securities markets which can "reduce information asymmetry, increase the liquidity of the firm's stock, thereby lowering the firm's cost of capital" (Johnson & Natarajan, 2005, p.5). At the same time, the setting of an increase in public pressures regarding perceived overly generous D&E remuneration is conducive to the study of D&Es incentives to manage company legitimacy, and potential political costs, through increased voluntary disclosures.

The findings from this study can have relevance to the investment community and corporate governance regulators. A primary reason for the widespread interest from shareholders and corporate governance regulators in the remuneration and ownership policies, contracts, payments, entitlements, related-party benefits and ownership holdings of a company's D&Es is that the structuring of remuneration and ownership for D&Es can mitigate the agency problem of conflict of interests between management and shareholders. Shareholders rely on detailed disclosures about D&Es' remuneration and ownership, and changes therein, in order to be able to monitor the alignment of D&Es' rewards and financial interests with shareholders' interests. The need for greater transparency in this area is an important element of good corporate governance.

3. Literature Review and Generation of Hypotheses

3.1 Proprietary Cost and Discretionary Disclosure

Non-proprietary information is information that does not directly affect firms' future cash flows. Proprietary information on the other hand is defined as 'information whose disclosure potentially reduces the present value of cash flows of the firm endowed with the information' (Dye, 1986). Such information, according to Dye (1986), would include 'marketing and financial plans and internal accounting reports' (p.331). It is also reasonable to add information about changes in D&E remuneration policies, contracts, payments and equity holdings, which could provide signals to competitors, shareholders and creditors about changes in the value placed by a company on its D&Es, changes in the strength of incentives to D&Es to improve corporate performance, and changes in the alignment between management's and shareholder's interests. By signalling their proprietary information to rival businesses and to creditors, management can incur potential costs associated with competitive disadvantages (Chow, Haddad & Hirst, 1996). For example, such disclosure could trigger an action by rival companies to head-hunt top executives once a significant change in their remuneration package becomes known. It could even trigger the launching of a hostile takeover bid if new disclosure is provided of a poor alignment between shareholders' interests and directors or CEOs remuneration packages and ownership.

The literature on the relationship between proprietary costs and voluntary disclosure indicates that various relationship models based on game theory have been developed to investigate the impact of proprietary costs on voluntary disclosure (Darrough & Stoughton, 1990; Dye, 1986; Feltham & Xie, 1992; Gigler, 1994; Jung & Kwon, 1988; Li, Richardson & Thornton, 1997; Milgrom (1981); Verrecchia, 1983, 1990; Wagenhofer, 1990). By modelling the conflicting incentives on voluntary disclosure as a game, researchers then predict the possible outcomes taking into consideration the three major players of the game: the manager of the incumbent firm; the potential entrant; and the investor or financial market. The manager of the incumbent firm is reluctant to release proprietary information as the dissemination of such information may reduce the firm's future earnings by the entry of rivals. However, such disclosure is necessary to increase the financial market valuation of the firm (Scott, 1994). Verrecchia (1983) in his model on discretionary disclosure argues that the degree of uncertainty caused by managers withholding information is related to a threshold level of disclosure, which is dependent on the expected size of the proprietary costs. Scott (1994) investigates the incentives and disincentives of voluntary disclosure for defined benefit pension schemes of Canadian firms. His findings support Verrecchia's (1983) model by determining that the larger the proprietary cost, the greater is the incentives for firms not to voluntarily disclose information.

These theoretical works on voluntary disclosure assume goal congruence between a firm and its D&Es. Nagar (1999) relaxes this assumption of incentive alignment. Nagar assumes that rather than maximizing the value of the firm, risk-averse CEOs maximize the value of their personal wealth, which is comprised of their own human capital. Disclosure of the CEO's (and other D&E's) private information, such as the presence of a golden parachute or sensitive related-party transactions, may cause a downward revision in investors' assessments of the CEO's (or other D&E's) human capital, leading to their loss of reputation. Loss of reputation is a special concern for independent directors who rely on their personal reputation to attract and maintain directorships in multiple organizations.

3.2 Hypothesis about Proprietary Cost using Investment Opportunity Set (IOS)

In this study, the impact of proprietary costs on management's voluntary disclosure decisions is investigated for companies with antecedent conditions of investment growth opportunities (a surrogate for the level of potential competition). The concept of investment growth opportunities of a firm was first termed by Myers (1977) as 'investment opportunity set' (IOS) to refer to the extent to which a firm's value depends on the future discretionary expenditures made by the firm. In this sense, the concept is directly associated with the firm's expected future cash flows. According to Myers (1977) firm value is divided into two components: assets-in-place, and investment (growth) options. Mason & Merton (1985) point out that expenditures made by management to expand the capacity of projects, to introduce new product lines, to advertising brand names, or even to maintain and replace existing assets, amounts to growth options.

A review of the literature reveals that the concept of investment growth opportunities has been empirically modelled in the study of corporate policy choices, corporate performance and corporate governance, accounting policy choices and corporate voluntary disclosure levels. The latter area of corporate voluntary disclosure levels is relevant to this study. Empirical investigation on IOS and its relationship with voluntary corporate disclosure levels is limited and has mixed findings. Bamber & Cheon (1998) investigate the effects of the cost of disclosure on managers' decisions on how and where to disclose earnings forecasts. They find a negative relationship between the growth opportunities of companies and their degree of specificity of disclosure. Firms experiencing high growth opportunities or a concentrated product-market are more reluctant to disclose earnings forecast. They conclude that the higher the proprietary information costs, the less information management is willing to reveal and the less specific is the forecast.

In another study, Harris (1998) finds that management protects proprietary information by using segment reporting to conceal abnormal profits for business segments with greater growth opportunities. Harris (1998, p.126) suggests that '… managers attempt to conceal information that would allow rival firms to capture their profits by not reporting less competitive operations as business segments'. Further support for this inverse relationship between IOS and disclosure is given by Darus (2006) in a study of disclosure of proprietary information relevant to financial instruments. She finds that companies with higher IOS voluntarily disclose less proprietary information related to their financial instruments, particularly forward contracts and hedges, in the period prior to the implementation of a relevant accounting standard on financial instruments disclosure requirements.

In this study, the inverse relationship between proprietary information cost and the extent of disclosure of D&E remuneration and ownership is investigated for firms with antecedent conditions of investment growth opportunities. This investment growth condition reflects a company's level of potential competition and, hence, its level of potential proprietary cost of competitive disadvantage embodied in proprietary information disclosed. For example, companies with higher growth opportunities and higher potential competition could be more cautious about disclosing D&Es' remuneration and ownership information because they are more likely to have competitors looking for such information with a view to attracting these successful D&Es with better remuneration and ownership deals. Furthermore, from the perspective of D&Es' own human capital, it will be easier for D&Es in firms with high IOS to set cash-bonus performance targets for themselves that are generous, but readily achievable. In these circumstances it is in their interests not to disclose details about their cash-bonuses.

It is hypothesized that:

H1: The higher a company's investment opportunity set (IOS), the lower will be the comprehensiveness of disclosure of information related to its D&Es' remuneration and ownership in the company's annual report.

3.3 Legitimacy, Political Cost and Discretionary Disclosure

In several areas of reporting (especially environmental and social responsibility activities, corporate governance structures and risk management mechanisms), managers have increasingly gone beyond the legal requirements for reporting financial information to shareholders (Gibbons, Richardson & Waterhouse, 1990; Patten, 1992; Brown & Deegan, 1998; Buhr, 1998; (Deegan, Rankin & Tobin, 2002) for legitimation reasons. Legitimation by way of managing the activities examined by the public eye will help to improve companies' public status in their social network (Ogden & Clarke, 2005).

Legitimacy theory, from a narrower operational perspective, is that failure by companies to voluntarily disclose information (perhaps due to its proprietary nature) may result in these companies incurring political costs. Politicians, trade unions, consumer associations, stakeholder groups and the general public may decide to impose political costs on these companies due to their failure in making adequate disclosure. 'Political costs are wealth re-distributions away from the entity to the government and other sectors of the economy' (Whittred & Zimmer, 1990, p.32-33). The extent to which a company fails to report accounting numbers and related disclosures can affect whether it is criticized or supported by members of the public (e.g. consumers, employees, environmental groups) and whether such public scrutiny results in impositions of regulations or taxes by governments aimed at the entity (Lemon & Cahan, 1997).

To repair legitimacy when the company's position is threatened by withdrawal of resources by providers or imposition of regulations by governments, management will seek to re-establish its credentials through the disclosure of additional information, particularly to provide positive interpretations of controversial actions (Arndt & Bigelow, 2000). These interpretations involve impression management tactics as a means of portraying organizational policies and actions in ways that are intended to secure endorsement and support from shareholders and the community. Industry or securities regulator's codes of corporate governance that have been issued in many countries around the world typically contain a recommendation about making D&Es' remuneration packages and payments more transparent to stakeholders. Hence, societal norms have shifted towards expecting transparency from D&Es about their personal remuneration from, ownership in, and dealings with their company or related-parties as a matter of good corporate governance. Failure by management to adequately supply such information could be construed negatively by shareholders and the public, and give rise to political costs. The company could incite heightened shareholder activism and media attention due to a lack of disclosure of D&E remuneration. This can lead to prospects of shareholders reducing the value of the firm or the media demanding greater regulatory impositions on corporate disclosures or wider governance practices. This represents the potential political cost of non-disclosure (e.g., Watts & Zimmerman, 1978; Whittred & Zimmer, 1990; Lim & Mickinnon, 1993)

3.4 Hypotheses about Political Cost due to Media Attention and Shareholder Activism

The size of a company is commonly used as a proxy for the political costs embodied in that company's lack of disclosure. This study does not use size as a proxy for political costs because, as a determinant of the comprehensiveness of disclosure, size embodies the confounding effects of greater availability to large companies of the expertise and resources needed to produce comprehensive information in annual reports.

Rather, this study focuses on two important circumstances that point to the presence of a need for management to engage in legitimation, and hence, mitigate political costs, through discretionary disclosures of D&Es' remuneration and ownership. The first circumstance is when a company has received media attention, especially when it is specifically named in the press, in relation to a corporate event or issue. Previous studies have shown that heightened media attention, particularly print media attention, to a corporate issue can create a legitimacy gap for implicated firms. This will create a management incentive to increase corporate disclosure to minimize any political costs. For example, evidence is provided that management will increase specific disclosures in annual reports to counter unfavourable media coverage about their social and environmental activities, or activities in their industry, in order to maintain legitimacy (e.g., O'Donovan, 1999; Brown & Deegan, 1998; Hutchings & Taylor, 2000).

It is contended in this study that negative media attention on CEO's, other executives' and directors' receiving cash payouts, extra share rights and options, or personal financial dealings with related-parties will lead a company to react by publicly providing its own information about the topic being publicized. There are many example of negative press in Australian newspapers. As illustrations, it was reported in the print media that Ergon Energy wrongly included redundancy in a payout of almost $500,000 to a former CEO who resigned (Raggatt, 2004). In an example of more wide-reaching publicity, it was reported that 52 companies were investigated by the Australian Securities and Investments Commission (ASIC) because their directors provided inadequate disclosure to ASIC about rewarding themselves lucrative share options packages and gaining business from the company for themselves (Charles, 2003). It is likely that companies will respond by providing increased disclosure as a legitimacy management tactic. Hence, it is contended in this study that the more media attention relating to D&Es that a company receives within a year, the more incentive management will have to ensure additional (discretionary) disclosure on this matter in the company's annual report. Such reasoning leads to the formulation of the following hypothesis:

H2: The higher the media attention during the year on D&Es' remuneration from, or ownership in, their company, the greater will be the comprehensive-ness of disclosure of such information in the company's annual report.

The second important circumstance that might engage management in disclosures in order to limit potential political costs is when the company submits a proposed resolution to its shareholders' meeting for a change in D&Es' remuneration benefits or share entitlements. It is a circumstance that places this issue directly in the eye of the shareholders. It is, therefore, likely to incite greater shareholder activism. Shareholder activism refers to the active role of shareholders in monitoring and controlling management. Coombes (2004) explains that shareholder activism is becoming of greater importance in the U.S. and Europe in the wake of corporate scandals and corporate governance reforms. He points to codes drawn up by trade bodies representing fund managers in Europe and the global body called *International Corporate Governance Network* requiring institutional investors to become more active. Companies with poor financial or share price performance compared to their industry peers, or companies with governance-related issues are usually selected as targets of shareholder activism by those institutional investors (Hawley & Williams, 2000).

In this study, it is argued that shareholder activist groups could potentially view a proposal in a Notice of Annual General Meeting (AGM) to grant more company shares or options to the CEO or other top executives or directors, or enhance their remuneration policy or ownership, as representing excessive perquisites to management. Boyd (1994) provides examples from the business press and citations from CEOs about the fact that paying D&Es excessively can "destroyed their effectiveness" as perceived by shareholders. Thus, such an AGM proposal has the potential to create shareholder activism. In anticipation, as a legitimisation tactic, management could be expected to increase the extent of disclosure in the company annual report in the year that such an AGM agenda item is put forward. Based on this reasoning, the following hypothesis is formulated:

H3: The existence of an agenda item to increase D&Es' remuneration or ownership at a company's AGM will positively impact on the comprehensiveness of disclosure of such information in the company's annual report.

4. Methodology

4.1 Empirical Procedure

The relationships developed in the three hypotheses can be depicted in an empirical schema as given in Figure 1. The dependent variable is separated into the main source of disclosure and a supplementary source. The main source is disclosure about all aspects of remuneration, benefits and increases in entitlements to D&Es (labelled DISCREMUN), whereas the supplementary source is limited to D&Es' equity and changes in equity held in the company (labeled DISCOWNER). The reason for separately testing determinants of DISCREMUN and DISCOWNER is that management may view the information costs associated with these two areas of disclosure differently. A higher ownership in a company amongst the Board members has been linked to lower transparency, especially when the company's performance is poor (Leung & Howitz, 2004). The inference is that potential political costs are viewed as less significant by management when they arise from a lack of disclosure of changes in ownership by D&Es than from a lack of disclosure of payments, entitlements and other compensatory benefits to D&Es.

4.2 Sample of Companies

To test the hypotheses, publicly available company data was collected. A sample size of 191 companies was selected randomly from the top 1000 Australian companies as reported in the *Business Review Weekly (BRW)*, July 2004. Standardised financial highlights data for the sampled companies was drawn this BRW source and cross-checked against *Thompson One* financial database, but the remaining data on the extent of disclosure of executive remuneration was drawn from full Annual Reports of 2003 and 2004 for listed companies using the *Connect4* electronic database.

In order to control, to some extent, for the effect of company size on the dependent variables, the smallest 30 companies in the sample (based on total assets) were removed from the analysis. The final sample was 161 companies, of which 83% were in the top 500 companies on the Australian Stock Exchange (ASX) based on total assets, and the industry spread covered 10 industries based on the Global Industry Classification Standards (GICS).

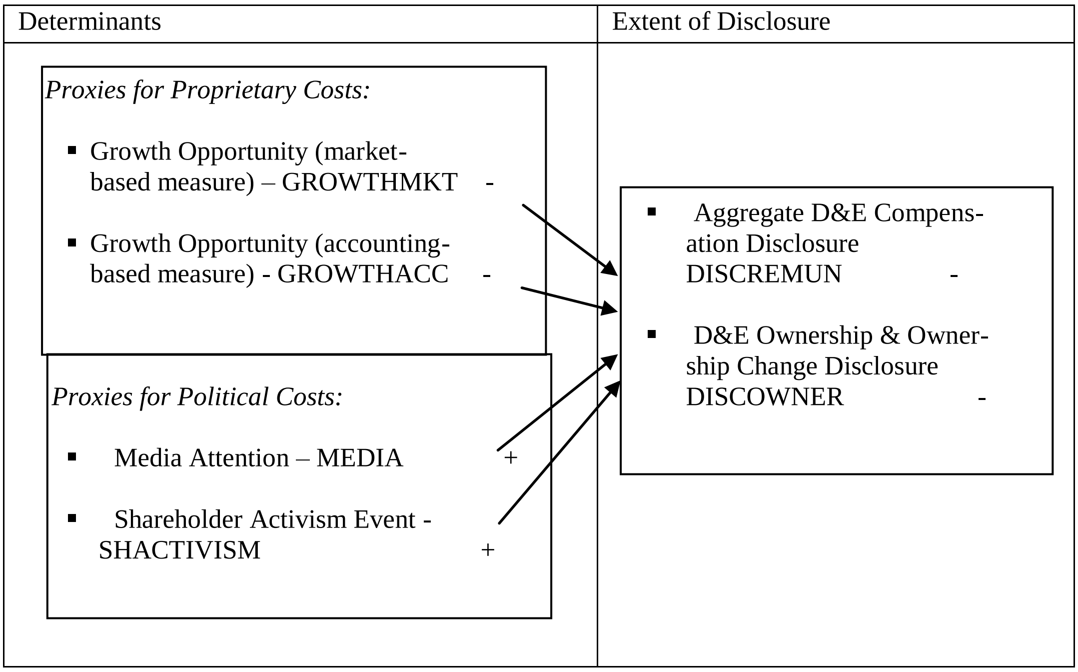

Figure 1. Empirical Schema of Proxies for the Proprietary and Political Costs Trade-off Decision by Management about Disclose of D&E Remuneration

4.3 Variable Measurement

The definition and measurement of variables is listed in Table 1.

Table 1. Definition and Measurement of Variables

Variable Acronym	Definition	Measurement
DISCREMUN	The extent of total disclosure about remuneration for directors and up to five top executives	Number of words of disclosures in a company annual report about D&E remuneration principles/policies generally, and D&E remuneration contracts, share rights and options granted and held, salaries/fees/cash-payments, termination/retirement entitlements, and related-party benefits for individual D&Es.
DISCOWNER	The extent of disclosure about equity-based remuneration and ownership in their company by directors and up to five top executives	Number of words of disclosures in a company annual report concerned with D&E share rights and options granted and exercised, and D&E shares held in the company.
GROWTHMKT	Investment growth opportunity of the company as perceived by the equity market	Percentage change in market capitalization for the past year (i.e., % change between beginning and end of year in the multiple of share price x number of issued ordinary shares)
GROWTHACC	Investment growth opportunity of the company as reported in accounting numbers	Percentage change in Revenues for the past year (i.e., % change between beginning and end of year in consolidated revenues – defined as gross inflows of economic benefits received and receivable by the entity)
MEDIA	Media attention on the company regarding D&E remuneration	The number of times during the 12 months prior to the company's annual general meeting (AGM) that a company's name is stated in relation to D&E remuneration in the printed media (using *Factiva* to trawl 15 Australian newspapers and business magazines)
SHDACTIVISM	Potential shareholder activism due to a proposal to the shareholders to approve a change in D&E remuneration	Existence of a resolution in the company's Notice of AGM regarding a proposed change to any of the D&E's remuneration, coded as 1 or 0.

As given in Table 1, the dependent variables DISCREMUN and DISCOWNER are measures based on the content analysis of relevant text in company Annual Reports. In line with the study of Brown and Deegan (1998), the number of words (and numbers that are counted as equivalent to words) is summed to measure the extent of disclosure. A research assistant was used to read the Annual Reports to categorise the content relevant to these two variables and count the number of words. The authors randomly selected sampled companies to independently repeat the content analysis in order to achieve accuracy of categorisation and count of the dependent variable measures. In searching through annual reports, information about D&Es' remuneration and ownership was found in various sections, including the corporate governance section, the directors' report and notes to financial statements (such as separate notes on directors and executives remuneration, shares and options, retirement benefit, and related party transactions). For companies reported relevant information in separate sections in annual reports repeatedly, the words were counted more than once. The justification is that repetitive words in a report will strengthen the impact on readers.

For the independent variables, surrogate measures of proprietary cost (GROWTHMKT and GROWTHACC) and political cost (MEDIA and SHDACTIVISM) are given in Table 1. First, in relation to GROWTHMKT and GROWTHACC, several proxies have been used in the accounting and finance literature to capture the proprietary cost concept of investment opportunity set (IOS). Kallapur & Trombley (1999) classified IOS into three types: price-based proxies, investment-based proxies and variance measures. In relation to price-based proxies, the idea is that if growth prospects of the firm are at least partially impounded in share prices, then growth firms will have higher increases in their market capitalisation. This study chooses it as the basis for measuring GROWTHMKT. In relation to investment-based proxies, the idea is that a high level of investment activity is positively related to the IOS of the firm. Among the investment-based proxies that have been used by prior studies are the ratio of research and development (R&D) expenditure to sales (Skinner, 1993). Lack of data on R&D expenditure in most sampled annual reports prevented to use of this measure. In relation to variance-based proxies, the idea is that options become valuable as the variability of returns on the underlying asset increases. One simply accounting measure of variance used to proxy the firm's IOS is variance of sales (Ho, Lam & Sami, 2004). This study chooses it as the basis for measuring GROWTHACC.

Second, the variable media attention (MEDIA) was obtained from a trawl of articles across all print media sources available in the *Factiva* database. The *Factiva* database comprises of newspapers, newswires and business magazines with the largest circulation in Australia (e.g., *Australian Financial Review, BRW, AAP newswire, The Australian, The Advertiser, The Courier Mail, The Daily Telegraph, The Herald Sun, The Melbourne Age, The Mercury, The Sydney Morning Herald and The West Australian).* The extent of print media attention is approximated by the number of times that company's name appears in articles relating to executive and director remuneration during a relevant year. Key words used in the search of *Factiva*, based on the theme of the study, were "executive remuneration and disclosure", "executive package and disclosure" and "annual reports and executive remuneration". The number of times that a company is mentioned in these print media sources represents the degree that it attracted public attention. For example, BHP Billiton was mentioned 12 and 33 times in 2003 and 2004 respectively. Therefore, the score for media attention is 12 and 33 in 2003 and 2004 respectively. If a company's name didn't show on the print media, score 0 is given. This measurement approach is company-specific, unlike Brown and Deegan (1998) who only used a period-specific measure of media attention by counting the total number of articles (about corporate environmental disclosure) in print media for each year. Third, SHDACTIVISM (based on data from companies' Notice of AGM) was also found in the *Factiva* database. In this study, a proposed resolution or information item in the Notice of AGM about any of the D&Es' remuneration or ownership (cash payments, shares, options, fees, loans or retire entitlements) for a particular company is scored as 1. Otherwise, it is scored 0.

5. Analysis and Results

5.1 Descriptive Statistics

Descriptive statistics for components of disclosure within the D&E remuneration and ownership variables are given in Table 2. The category with the highest number of words of disclosure is policies and principles (PRINCIPLES), although this category also has the highest standard deviation. The lowest disclosure relates to D&Es' retirement entitlements or termination payouts (RETIRE&TERM). In this category, only 43 companies in 2003 and 24 companies in 2004 disclosed any information in their annual reports.

5.2 Effects of anticipated regulatory change

In discussion of the findings in Table 3, the significant increase in the comprehensiveness of disclosure of D&E remuneration relating to the information categories of principles, contracts and summaries of remuneration for individual D&Es, indicates that discretionary disclosure decisions by company management (i.e., D&Es themselves) are influenced by an *anticipated* change in the regulatory requirements.

Table 2. Descriptive Statistics for D&E Remuneration and Ownership Disclosure
(number of words or equivalent)

Disclosure categories within DISCREMUN	2003			2004		
	Mean	Std Dev.	Sum	Mean	Std Dev.	Sum
Principles & policies on the nature and structure of D&Es' remuneration (PRINCIPLES)	996	941.04	206,609	1579	1366.01	285,319
Explanation of service contracts for specific D&Es (CONTRACT)	96	445.33	30,164	418	768.23	68,013
Summary of types and amounts of remuneration to non-Executive Directors during the year (SUMMARYNONEXDIR)	273	153.07	52,198	464	278.88	88,732
Summary of types and amounts of remuneration to Executive Directors and other 'specified' Executives during the year (SUMMARYEXEC)	248	181.21	47,354	389	298.43	74,391
Retirement entitlements and termination payouts to D&Es (RETIRE&TERMIN)	23	66.20	4,343	21	89.54	3,930
Related-party benefits to D&Es (particularly details about loans and dividends from the company and related companies) (RELATEDPARTY)	732	475.77	139,976	698	468.14	133,259
Disclosure category within DISCOWNER: Details of D&E shares held in the company, and change in D&E ownership in the company through share rights and options granted and exercised. (OWN&CHANGEOWN)	321	423.30	63,107	827	798.14	156,045

The same increase is evident in Table 3 for disclosure of D&Es' ownership. Companies have responded in 2004 by early-adopting some aspects of AASB 1046 *'Director and Executive Disclosures by Disclosing Entities'* (issued in January, 2004) which was to become operative for 2005 annual reports. Legitimacy theory is likely to explain why companies significantly increased their voluntary disclosure of several items associated with the forthcoming AASB 1046. The descriptive statistics provide preliminary evidence that D&Es became more proactive in supporting voluntarily company disclosure of information about themselves in response to heightened public attention, professional debate and certainty of the forthcoming AASB 1046 from 2003 to 2004. (This theory is tested in the next section). In contrast, the disclosures of D&Es' retirement and termination entitlements and benefits (RETIRE&TERMIN), as well as D&Es' related-party transactions (RELATEDPARTY) did not significantly increase from 2003 to 2004. AASB 1046 had not prescribed forthcoming disclosure requirements in these two areas.

Table 3. Independent Samples Test of Differences
between 2003 and 2004 D&E Remuneration and Ownership Disclosure

	Levene's test for Equality of Variances		t-test for Equality of Means		
Disclosure categories within DISCREMUN:	F	Sig.	t	Sig. (2-tailed)	Mean Difference
PRINCIPLES	19.83	0.000	-4.86	0.000	-583.55
CONTRACTS	30.43	0.000	-4.99	0.000	-321.16
SUMMARYNONEXDIR	48.55	0.000	-8.31	0.000	-191.28
SUMMARYEXEC	27.04	0.000	-5.60	0.000	-141.55
RETIRE&TERMIN	0.02	0.895	0.27	0.789	2.16
RELATEDPARTY	0.32	0.570	0.73	0.467	35.17
Disclosure of DISCREMUN:					
OWN&CHANGEOWN	36.25	.000	-7.74	.000	-505.90

5.3 Multivariate Analysis

Linear multiple regression is used as the basis of analysis for testing the three hypotheses. The hypothesized relationships are modelled as follows:

$$\text{DISCREMUN or DISCOWNER} = \alpha + \beta_1 \text{ GROWTHMKT}_i + \beta_2 \text{ GROWTHACC}_i + \beta_3 \text{ MEDIA}_i + \beta_4 \text{ SHDACTIVISM}_i + \varepsilon$$

where variable definitions are given in Table 1.

The results for separate regression analyses for the DISCREMUN model and the DISCOWNER model, each for the separate pre-IFRS adoption years of 2003 and 2004, are given in Table 4. In all these four regression models, multicollinearity is tested using the variable inflation factor and tolerance levels, and found to be well within the satisfactory range.

Table 4. Multiple Regression Results for Directors' & Executives' Remuneration and Ownership Disclosures

Dependent Variable: DISCREMUN (i.e., D&E remuneration disclosure)						
	2003 (Model 1)			2004 (Model 2)		
Variables	Beta	t	Sig.	Beta	T	Sig.
(Constant)		8.561	0.000		12.078	0.000
GROWTHACC	-0.137	-2.126	0.135	-0.071	-0.913	0.467
GROWTHMKT	-0.062	-0.928	0.355	0.019	0.289	0.773
MEDIA	0.102	1.335	0.145	0.251	3.954	0.001
SHACTIVISM	0.175	2.605	0.010	0.146	2.248	0.026
Model Fit	R Square = 0.233, Adjusted R Square = 0.191, F = 14.091, Sig. = 0.000			R Square = 0.255, Adjusted R Square = 0.218, F = 13.183, Sig. = 0.000		
Dependent Variable: DISCOWNER (i.e., D&E ownership and change in ownership disclosure)						
	2003 (Model 3)			2004 (Model 4)		
Variables	Beta	t	Sig.	Beta	T	Sig.
(Constant)			0.000			0.000
GROWTHACC	-0.098	-1.266	0.152	-0.040	-0.603	0.547
GROWTHMKT	-0.129	-1.930	0.052	-0.277	-3.835	0.001
MEDIA	0.057	0.914	0.378	0.092	1.109	0.215
SHDACTIVISM	0.121	1.793	0.075	0.135	2.061	0.038
Model Fit	R Square = 0.239, Adjusted R Square = 0.205, F = 8.675, Sig. = 0.000			R Square = 0.306, Adjusted R Square = 0.224, F = 9.523, Sig. = 0.000		

The results in Tables 4 are now discussed in terms of tests of each of the hypotheses established in this study. First, H1 states that the proprietary costs surrogate variable, IOS, will be inversely related to D&E remuneration and ownership disclosure. Table 4 reveals that the result is sensitive to the measure chosen for IOS – whether an accounting-based measure GROWTHACC, or a market price-based measure GROWTHMKT. The accounting-based measure of investment opportunity growth, GROWTHACC, has the predicted sign but is not significant in any of the models in Table 4. However, GROWTHACC may not be a good proxy for IOS. Kallapur & Trombley (1999), in a review of alternative IOS measures used in prior studies, found that accounting-based measures were weaker than market price-based measures in correlating with realized growth. The market-based measure, GROWTHMTK, is found in Table 4 to have no significant relation to DISCREMUN. Therefore, H1 is rejected in terms of the effect of proxies of proprietary cost on DISCREMUN. This finding suggests that D&Es do not perceive information about their remuneration and other accrued entitlements and benefits to have sufficient signalling potential to create competitive disadvantage for the firm.

On the other hand, Table 4 reveals that disclosure of greater details about D&Es' ownership and changes in ownership are affected by the level of potential proprietary costs, as measured by GROWTHMKT. In models 3 and 4 of Table 4, GROWTHMKT is significantly inversely related to DISCOWNER. H1 is accepted for these variables. This finding suggests that management perceives information about changes in ownership levels by D&Es through their share acquisitions (usually at a discount) or granting of rights or options in shares of their company, as signals on which rival companies or investors might potentially act to create disadvantage to the firm (or the D&Es personally). Whether D&Es have an incentive to protect proprietary information about their ownership in order to safeguard growth opportunities of their firm, or safeguard their own welfare, cannot be established from this finding. Nevertheless, this result supports an inference from Leung and Horwitz's (2004) finding that higher ownership in a company amongst the board members is linked to lower transparency. The inference is that information about changes in ownership and ownership entitlements held by D&Es is of a sufficient proprietary nature for companies with high growth opportunities (as measured by increase in market capitalization) to potentially incite competitor action such as becoming a takeover target.

Second, H2 states that the extent of D&E remuneration and ownership disclosure will be greater due to higher media attention because media attention creates greater potential political cost to the company of non-disclosure. The results in the Table 4 are mixed. In 2003, MEDIA had no significant effect on DISCREMUN or DISCOWNER, and therefore, H2 is not supported. However, in 2004, there was a significant positive relationship between MEDIA and DISCREMUN, but not between MEDIA and DISCOWNER. Therefore, H2 is partially accepted. Legitimacy theory would reason that management provides more corporate disclosure as a legitimacy management tactic in response to higher media attention (Brown & Deegan, 1998). But the evidence provided in Table 4 is that management appears to adopt this tactic only in a certain circumstance and for certain information. The circumstance is when there is a climate of high investor awareness of the extent of transparency expected from companies, as in 2004 when regulatory changes were most anticipated and debated in the media. It is speculated that company directors may tend to view the heightened climate of investor awareness as a matter affecting their own personal legitimacy with shareholders, as well as the general legitimacy of their company. The type of information to be disclosed is also a factor affecting management's response to media attention. DISCREMUN is found in Table 4 to be significantly positively affected by media attention, but DISCOWNER is not. As suggested earlier in this paper, failure to disclose payments, entitlements and other compensatory benefits to D&Es is more likely to give rise to potential political costs than failure to disclosure changes in ownership of D&Es.

Third, H3 states that the existence of an agenda item in the Notice of AGM proposing an increase of D&Es' remuneration or ownership will positively impact on D&E disclosure in the annual report presented at that AGM. Such an agenda item will place the issue of D&Es' remuneration or ownership directly under the attention and decision-making influence of the shareholders (i.e., create potential SHDACTIVISM and hence, potential political costs). The results in Table 4 reveal that SHDACTIVISM is significantly positively related to both DISCREMUN and DISCOWNER in both 2003 and 2004 (at sig.< .10 level). The conclusion from these results is to accept H2. The evidence indicates that SHDACTIVISM is an important political cost driver of higher D&E disclosure, regardless of whether the type of disclosure is remuneration or ownership, or whether the prevailing circumstances involve a strongly anticipated change in the regulatory climate or not. Since the shareholders could potentially view an AGM proposal to increase D&Es' remuneration or ownership as representing excessive perquisites to management, and potentially compromising their legitimacy and even "destroying (their) effectiveness" (Boyd, 1994), the legitimacy tactic of increased disclosure in the annual report is evident in this study.

Conclusion and Limitations

There is widespread interest from corporate shareholders and wider stakeholders in the remuneration and ownership policies, contracts, payments, entitlements, related-party benefits and ownership holdings of the company's D&Es. A primary reason for this interest is that the structuring of remuneration and ownership for D&Es can mitigate the agency problem of conflict of interests between management and shareholders. Shareholders rely on detailed disclosures about D&Es' remuneration and ownership, and changes therein, in order to be able to monitor the alignment of D&Es' rewards with their interests as owners. The need for greater transparency in this area is an important element of good corporate governance. Yet prior research has not investigated whether proprietary costs and political costs embedded in D&Es' remuneration and ownership information are factors that significantly influence management's disclosure decisions about this information.

This study makes a contribution to the corporate disclosure literature by providing new evidence about the trade-off effects of perceived proprietary and political information costs on the extent of corporate disclosure of D&Es' remuneration and ownership. But first it finds that management decisions about the comprehensiveness of disclosure are influenced by anticipation of forthcoming mandatory disclosure requirements. The results reveal that there was a significant increase in the disclosure of D&Es' remuneration principles, contracts, cash-based and equity-based payments from 2003 to 2004, in response to a rise in public and shareholder awareness of forthcoming changes in accounting standards. The implication of this finding for accounting standards-setters is that high early-adoption of aspects of an anticipated standard will result when public awareness of it is high.

In relation to the off-setting effect of perceived proprietary and political information costs on the extent of corporate disclosure of D&Es' remuneration and ownership, the signs of the regression co-efficients in Table 4 reveal some existence of this off-setting effect. The evidence is that positive effects of political costs outweigh the negative effects of proprietary costs in their influence on D&E information disclosure. Management's perceptions of political costs embodied in D&E remuneration and ownership information are found to give rise to greater disclosure in response to the prospect of shareholder activism in all circumstances, but only in response to media attention in limited circumstances. In contrast, management's perceptions of proprietary costs embodied in D&E remuneration and ownership information are found to give rise to less disclosure only for ownership information and only when a company's market-based growth opportunities are high.

An implication of these findings is that shareholder activism has the prospect of becoming an increasingly significant component of corporate governance. The greatest source of influence on discretionary disclosure of D&E remuneration and ownership is found to be shareholder activism. It has a more comprehensive positive effect than media attention. Another implication of the findings is that rivals are unlikely to take actions on information disclosed about D&E *remuneration* that might competitively disadvantage the disclosing company. However, there is evidence of the potential for competitive disadvantage to occur through the discretionary disclosure of D&E ownership information.

In drawing these conclusions, it needs to be recognized that a competing explanation for the increase in voluntary disclosures in this sensitive area of D&E remuneration is related to corporate governance structures and monitoring mechanism. Research findings of a positive relationship between corporate governance and D&E remuneration disclosure, are provided by Ajinkya et al. (2005) and Karamanou & Vafeas (2005).

This study has limitations in its empirical modeling and variable measurement. First, the empirical modelling is for two comparative years, during which a major event may have occurred for a particular company or industry which has a confounding effect on the relevant disclosure (such as dismissal of a company's CEO or the industry effect of a major international competitor entering the industry who practices greater voluntary disclosure). A further modeling limitation is that the extent of disclosure has been measured by total word counts for different categories of disclosure, without separating those parts of disclosures that are reported under minimum mandatory disclosure requirements from those parts that are discretionary. This means that the extent of disclosure under mandatory requirements (which was not substantial in 2003 and 2004) is assumed to be constant for all sampled companies. Second, data collected to measure some variables does not comprehensively cover the construct being measured. Specifically, investment opportunity set (IOS) only measures changes in market capitalization or revenue without anchoring such growth as a relative to the company's resources base. Further, media attention only measures the number of citations of company names within the text of relevant newspaper articles or columns. It does not consider font size, accompanying pictures, length of article, page in the newspaper or weight of importance of the newspaper. Also time differences throughout a year between the publishing of print media articles and the release of a company's Annual Reports were not adjusted for in the measure of media attention.

Future research could take the following directions. First, this study could be extended to 2005 and 2006 when the adoption of IFRSs became effective for all reporting entities, in order to test Dye's (1986) proposition that when mandatory disclosure of proprietary information increases, discretionary disclosure will also increase. Second, the perspectives taken in this study on determinants of voluntary disclosure of D&E remuneration and ownership could be integrated into more complex models that included the perspectives of corporate governance monitoring mechanism and/or more prescriptive disclosure regulations.

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