UNIVERSITI TEKNOLOGI MARA

VOLUNTARY RISK DISCLOSURE AND FIRM VALUE CREATION: FROM THE PERSPECTIVES OF THE AGENCY AND SIGNALLING THEORIES

RINA FADHILAH BINTI ISMAIL

Thesis submitted in fulfillment
of the requirements for the degree of
Doctor of Philosophy

Faculty of Accountancy

February 2015

ABSTRACT

Managing the risks and uncertainties of businesses that operate in a volatile and complex market environment has attracted considerable attention among market participants. Such concerns are particularly related to how businesses deal with the occurrence of increased risks in their business operations. However, the concept of corporate risk reporting has never been the main focus of the Malaysian Code of Corporate Governance (MCCG) when the Code was first introduced in 2000. Even though, there were several effects of economic crisis in 2007 on to the public listed companies (PLC), risk reporting remains a voluntary exercise. One of the prominent characteristics of Malaysian PLCs relates to the highly concentrated ownership structure where companies are mostly owned either by family members and the government. It is expected that these PLCs may face some forms of governance conflicts from the perspectives of agency and signalling theories. Thus, this study aims to review and to examine risk reporting while there is also a tendency of "agency-signalling" conflict when reporting the risk and how it would influence the firm value creation. Specifically, this study adopts a quantitative investigation to capture the voluntary risk information in the annual reports of 233 PLCs, where the final sample involved a total of 656 firm-year observations over a four-year period. This study finds that the most fitting theory that could explain the variation in the choice of voluntary disclosure would be the Agency Theory. The voluntary risk disclosure indicates improvement during the post-financial crisis period (i.e. 2008-2009) due to the efforts of the regulators in promoting corporate transparency and governance. The study also finds that outsider ownership (i.e. government and foreign), board independence (i.e. INED) and board competency (i.e. leaders' commitment and support) indicate significant influences on management decisions pertaining to voluntary risk disclosure. This study confirms that insider ownership (i.e. family and management) has an insignificant influence on the voluntary risk disclosure, which indicates they are not willing to change for the betterment of the firms in achieving the highest level of transparent corporate reporting. However, their resistance to insider ownership could be weakened when there is an influential dominant decision by the CEO or top management in the firms. In addition, voluntary risk disclosure, specifically the information regarding the Operations Risk and Integrity Risk, has been shown to influence the creation of firm valuation. With further mediation tests, the study also corroborates that the voluntary risk disclosure can be used to persuade firms to engage in decisions to maximise the value of shareholders, which becomes a signal for better value creation through the eyes of other stakeholders. Overall, the results affirm that comprehensive as well as quality of voluntary risk disclosure is useful as a medium to support corporate transparency and enhance firm valuation. This study makes a contribution to the extant literature by incorporating the theory of signalling into the model to provide new insights whether it could exert pressure on management decisions despite the effective exertion of governance mechanisms among Malaysian PLCs. Finally, it is hoped that the findings of this study provide valuable insights to regulators, practitioners, investors as well as other stakeholders for the betterment of corporate transparency initiatives. The results are also expected to address concerns regarding new aspects of firm valuation assessment that could offer a competitive valuation on business decisions.

ACKNOWLEDGEMENT

بسم الله الرحمن الرحيم

Alhamdulillah, all praises to Allah SWT, The Most Gracious, The Most Merciful for granting me countless opportunities to embark upon this PhD journey. Without His blessing and guidance, I would not be able to complete my PhD thesis.

First of all, I would like to express my sincere gratitude especially to my supervisor, Associate Professor Dr. Roshayani Binti Dato' Arshad with her supports and encouragements. Her keen interests within the area of financial reporting bring in numerous comments; suggestions and criticisms to the research are most invaluable and appreciated. I am indebted to her guidance and mostly for her patience on all the problems occurred during my studies. My appreciation also is extended to Dr. Suaini Binti Othman, my co-supervisor for her invaluable supports and motivation that helps me to complete the analysis and discussion parts of the research.

I would like to express my appreciation to former and current PhD Programme Coordinators for their assistances and supports; and not forgotten the member of the Faculty of Accountancy, UiTM for their warmest co-operation throughout my studies. My personal thank you is also extended to all my friends, who are directly and indirectly contributed to this thesis, your kind supports and motivations means a lot to me.

I am also grateful to the Universiti Teknologi MARA Young Lecturer Scheme Program for the financial support, which enabled me to work as a full time doctoral student.

I would like to thank my parents, Dr. Ismail Abdullah and
for their support and encouragement throughout my life. My deepest appreciation goes to my family especially my beloved husband, Nik Sahazeman Bin Nik Abdul Majid for his love, understanding and patience throughout this journey. Thank you for always stood up beside me during my good and bad times. Without your continuous supports, I would not be able to finish my studies. For my children - Munir, Sarah and Hasif, thank you for your sacrifice, patience and co-operation during this difficult time. I am very grateful to have them in my life even I had to face difficulties in juggling between these commitments. I took these obstacles as a challenge that keeps me focused on my studies and it taught me a lesson that "Life is about an experience that no one can exchange things for it". May Allah bless all of us. Thank you very much.

TABLE OF CONTENTS

CHAPTER ONE
INTRODUCTION

1.1 PREAMBLE

Managing the risks and uncertainties of businesses that operate in a volatile and complex market environment has attracted considerable attention among market participants. In a unique corporate structure like Malaysia, the way businesses deal with the occurrence of increased risks in their business operations becomes a paramount issue. The Malaysian corporate structure is characterised by a highly concentrated ownership and control, a cross-holding and substantial shareholders' participation in management as compared to its neighbouring countries. For instance, the majority of the public listed companies (PLC) are either controlled by the family- or the institutional-owners (Mohd Ghazali & Weetman, 2006; Haniffa & Hudaib, 2006). Nevertheless, over a decade, the Malaysian capital market has been acknowledged by growing rapidly among other Asian countries despite several issues raised on governance and post-effects of global financial crisis.

In strengthening the corporate governance system, the need for voluntary disclosure pertaining to risk information is expected to mitigate the manager's conflicts between to fulfil the interests of majority-minority shareholders and to impress others by signalling the good performance of the firm. However, due to highly concentrated ownership, accommodating majority shareholders' desires would be the utmost priority among others, thus the level of sufficiency of voluntary risk disclosure in annual reports would exhibit the management best practices in fulfilling majority shareholders' needs. On the other hand, a good performance of capital market is much depends on how much firm could gain investors' trusts and confidence. As such, the decision to disclose substantial information indicates the effort to enhance the reporting transparency, thus it would expect to benefit both the shareholders and investors.

In a volatile capital market environment, availability of sufficient and adequate risk information would facilitate investors in their future investment opportunities. In general, firms would take appropriate actions to critically analyse and clearly