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**THE EMERGENCE OF HUMAN CAPITAL DISCLOSURE:
EXPLORING THE INFLUENCE OF BOARD COMPOSITION**

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Abstract

Human Capital Disclosure (HCD) has remained unregulated in Malaysia until now. As a result, some Malaysian companies are reluctant to disclose the information related to their employees. This study examines the quality level of HCD and the influence of board composition on the HCD of 17 PN17 companies listed in Bursa Malaysia's main market as at 5th January 2017. The study employed content analysis to analyse the annual reports of Malaysian listed companies' from 2010 until 2015. It was found that the HCD for the PN17 companies in Malaysia is still low for every component. Out of the five components, employee welfare showed the highest disclosure, while employee measurement showed the lowest disclosure compared to equity issue, training and education, and employee safety. Besides that, there is a negative significant relationship between foreign directors and HCD, whilst, board size, audit committee independence, remuneration committee independence and women director have an insignificant relationship with HCD. These findings are important for practitioners and policy-makers to enhance the transparency and improve the accountability of human capital in the company. Besides that, the study is able to assist the stakeholders in putting more attention on foreign directors in determining HCD of companies.

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Keywords: Human capital disclosure (HCD), board composition, PN17, transparency, Malaysia.



1. Introduction

Human Capital (HC) is a blend of knowledge, skills, attitudes and relationships formed in the minds, bodies, and behaviours of employees in a company (Gamerschlag, 2013). A company's HC is viewed as a form of valuable resources in creating a sustainable competitive advantage. According to Fontana and Macagnan (2013), an efficient HC can develop better business opportunities and create new ideas, increases a company's confidence and makes it less vulnerable when facing any risks. Therefore, it is important for a company to have an effective HC (Felicio, Couto, & Caiado, 2014).

Other published studies indicate that Human Capital Disclosure (HCD) is important for companies in enhancing the transparency of information (Alvarez Dominguez, 2012). In this regard, transparency is important as it is used by potential investors to make the right decision concerning their investment. According to Jindal and Kumar (2012), this information can be judged based on the utilisation of assets reported in HCD. Besides that, Abdullah, Al-Smadi, and Almsafir (2015) added that transparency can be enhanced by having comparable, relevant and understandable information. Thus, HCD can help a company creates potential value by exposing the HC efficiency of the company (Choo, Luther, Tayles, & Haniffa, 2013). The Malaysian Code of Corporate Governance (MCCG, 2017) states that the board is accountable for the success of a company in a long run and consequently, give an increase of value for their stakeholders. The board has a high responsibility in setting a good manner by providing thoughts and guidance for the company. The board plays a major role in supporting good governance and ethical practice in the organisation. Specifically, the board structure is influenced by board composition to support board efficiency and leadership while board composition affects the board's ability in accomplishing its oversight duties. Past corporate scandals have increased the call for board composition to specify guidelines and to restructure corporate governance (Yekeni, Yekini, Adelopo, & Andrikopoulos, 2015).

2. Problem Statement

Despite the many benefits of disclosing human capital information, some companies are still reluctant to disclose their HC due to several reasons. Che Abdul Rahman, Mohammed Ahmed, and Hassan (2016) found that there is no existing law for companies which states that HCD is mandatory. As a result, under-performing companies tend to not disclose their HC. This argument is supported by Choo, Zainal Abidin, and Jusoff (2008) which highlighted the lack of available specific accounting standards that act as a guideline in reporting HC. Furthermore, Mccann (2016) found that HC experts cannot predict the effect of disclosure in providing value to the investors unless it is disclosed in detail. Due to these reasons, HC is the least reported in corporate annual reports in Italy (Bozzolan, Favotto & Ricceri, 2003) and Malaysia (Abhayawansa & Abeysekera, 2008; Goh & Lim, 2004).

Moreover, the board's responsibility towards influencing the disclosure of financial and non-financial report is questionable (Baldenius, Melumad, & Meng, 2014). As studied by Mustafa, Hassan, and Che Abdul Rahman (2015), most companies will only disclose board-related information. They are only interested to disclose aspects outlined by MCCG which encouraged minimal information disclosure. This is caused by the lack of enforcement to the companies to disclose HCD. In this regard, the board's main function is assisting the decision-making process of the management in matters related to disclosure. This is because having high quality HCD could build investors' confidence regarding the company's HC

capability and increase the credibility of management in managing HC for all stakeholders (Jindal & Kumar, 2012).

3. Research Questions

This study has outlined two research questions. These questions are, ‘what is the quality level of HCD in the annual reports of PN17 companies in Malaysia’ and ‘what are the board composition elements that affect the level of HCD in a company’s annual report.’

4. Purpose of the Study

This study aims to examine the extent of HCD’s quality in annual report among PN17 companies in Malaysia. Besides that, this study will examine the influence of board composition (board size, audit committee independence, remuneration committee independence, women director and foreign director) on HCD.

5. Research Methods

This study focuses on PN17 companies listed in the Bursa Malaysia as at 5th January 2017. PN17 refers to the companies with lower shareholders’ equity and total assets, winding up of their subsidiaries, received an adverse or disclaimer opinion from auditors, and face on-going concerns over inability and default payment (Bursa Malaysia, 2017). This study focuses on PN17 companies because other studies have stated that a good board of director can improve corporate governance practices which affect a company’s performance (Mohamed Shahwan, 2015). Besides, HCD can help the company in having a good strategy about its investment on HC (Abeysekera, 2012). This strategy is important as HC efficiency can influence the performance of the company. Thus, it is an alternative to delist the company from PN17 as good corporate governance practices helps company to overcome the financial distress. 13 companies were selected from a sample of 17 companies. In this study, the companies’ annual reports from a period of six years (2010 to 2015) were used to obtain the data for analysis. Therefore, only companies that have annual reports for every year of the six-year period were selected as samples. Thus, the final population sample is 78 as the sample selected (13 companies) was multiplied by six years.

5.1. Measurement of human capital.

The dependent variable of this study is HCD. There are five HC components adopted from previous studies and there are 44 items of disclosure.

Table 01. Human capital index disclosure

HC component	The component determinants	Source (s)
Employee measurement	Employee skills inventory, employee contract and employee performance	Du, Jian, and Lai (2017); Kaur, Raman, and Singhania (2016); Akbas (2016); Alvarez (2015); Ahmed Haji (2015); Alvarez Dominguez (2012); Abeysekera (2012)
Employee welfare	Employee disbursements and employee benefits	

Equity issue	Demographic information of employee	
Training and education	Policies and programme	
Employee safety	Safety policy and procedures	

A content analysis of annual reports was conducted to collect all relevant information for this study. This study used a four-point scale adopted from Wang, Sharma and Davey (2016) and Mat Husin, Hooper and Olesen (2012) to measure the quality level of HCD. All HC information expressed using text will be captured through counting number of sentences with one sentence will be counted as one and will be categorised accordingly according to the quality of disclosures categories described in Table 02 below. In this study also, to ensure the reliability of analysis, only visual images with either a caption, a line/row in the chart/table or a picture regardless of size, will be included in the analysis as one HCD.

Table 02. Four-point scale measurement

Type of scale	Scale	Description
No Disclosure	0	Disclosure information does not appear in annual reports.
Obscure	1	Disclosure information is discussed using narrative with limited reference or value comment.
Descriptive	2	Disclosure of items is discussed in details using narrative (without visual images or number).
Strongly Descriptive	3	Disclosure of items a is discussed using narrative and supported with either number (monetary or nonmonetary) or visual image.

After each HC component has been categorised based on its disclosure, the total disclosure is calculated as follows:

Total human capital disclosure = \sum [weight of form of disclosure* total scores for each IC item in the respective IC category]

5.2 Measurement of board composition.

The measurement of independent variables is further explained in Table 03.

Table 03. The measurement of board composition

Independent variable	Measurement	Source
Board Size	The total number of directors on board.	Ahmed Haji (2015)
Audit Committee Independence	The percentage of independent directors in the audit committee.	Akbas (2016)
Remuneration Committee Independence	The percentage of independent directors in the remuneration committee.	Abeysekera (2012)
Women Director	The percentage of women directors on the board of director.	Akbas (2016)
Foreign Director	The percentage of foreign directors on the board of director.	Du et al. (2017)

5.3 Hypothesis development.

It has been argued that board size is one of the most important factors in sustaining companies' transparency. A study by Abdul Rashid, Ibrahim, Othman, and Fong (2012) showed that a larger board would have advantages on information resources and capabilities to have better disclosure. A study by Hashim, Nawawi, and Puteh Salin (2014) indicates that board size has an important function to impact the decision-making process specifically on the level of strategic information disclosure. However, a study by Alfraih and Almutawa (2017) showed that board size has a negative relationship in the level of voluntary disclosure because a larger board may only influence the performance of the company and does not have priorities on implementing voluntary disclosure. Therefore, this study predicts that the larger board size leads to more effective monitoring in the company resulting in HCD.

H1: There is a positive significant relationship between board size and the HCD.

The roles of an audit committee include ensuring that voluntary disclosure is implemented in the company so that the top management can make accurate decisions while aligning management and shareholder interests (Samaha, Khelif, & Hussainey, 2015). A study conducted by Ahmed Haji (2015) showed a significant positive relationship on the overall amount of intellectual capital disclosures, especially HCD. It is related to the higher presence of independent audit committee and changes of policy on HC in Malaysia. A recent study by Haldar and Raithatha (2017) found that independent audit committees are often linked to higher disclosure quality and present more reliable financial statements. Thus, in this study, it is postulated that an independent audit committee is positively influencing the effectiveness of internal control and will lead increasing transparency and disclosure to the stakeholders.

H2: There is a positive significant relationship between audit committee independence and the HCD.

The independence of the remuneration committee shows a significant positive relationship with voluntary narrative remuneration disclosure (Kanapathippillai, Johl, & Wines, 2016). The study stated that remuneration committee independence increases the disclosure and provide a better explanation on decision making. Moreover, the remuneration committee plays a role in monitoring the management to ensure the remuneration policy developed reflects the performance (Financial Reporting Council, 2016). Hence, this study expects that remunerations committee would monitor HCD as part of the company's remuneration policy.

H3: There is a positive significant relationship between remuneration committee independence and the HCD.

Arayssi, Dah, and Jizi (2016) study showed that a high percentage of women in the board will increase corporate governance through company's processes and interaction. The presence of women directors can increase the frequency and volume in regards to continuous disclosure towards the capital market. This is because women directors encourage more active monitoring and enhance the information environment (Saggar & Singh, 2017). This shows that there is a positive link between the presence of women in a board composition and disclosures.

H4: There is a positive significant relationship of women director and the HCD.

The recent years have seen an increase in the number of foreign directors in the company. However, Choi, Sul, and Min (2012) stipulated that the presence foreign directors could enhance the value and more focused in improving the governance and monitoring on management's activities. Thus, foreign directors have no interest in managing HCD as their responsibility is more towards enhancing the company's value and to increase governance. Moreover, Ayoib and Nosakhare Peter (2015) stated that foreign directors are more exposed towards corporate social responsibility disclosure since they are more concerned about the needs to increase the company's social influence and translucence. Thus, this study expects that companies with several foreign directors will be more focused on governance issue rather than disclosure issue which consequently, will reduce the HCD.

H5: There is a negative significant relationship of foreign director and the HCD.

5.4 Decision usefulness theory.

Hooks and van Staden (2004) stated that effective corporate reporting can help the management in making decision by providing useful and relevant information. HCD provides information regarding human capital which is one of the needed by the stakeholders of the company specifically the shareholders and employees. In this regard, traditional reporting have only focused on the tangible assets but the new reporting system requires the reporting on knowledge assets including human capital to measure the real economic value of the companies (Eccles, Herz, Keegan & Philips, 2001). Therefore, this study takes the assumption that HCD can help PN17 companies in creating a preventive plan to gain back the trust from stakeholders on their investment on HC and it is one of the alternative ways to delist the company from PN17.

6. Findings

Table 04 shows the summary of results on the dependent variable in this study which is HCD.

Table 04. Summary of result HCD

IC items	Quality of disclosure			Quantity
	1	2	3	
Employee measurement	2	0	20	22
Employee welfare	50	86	235	371
Equity issue	30	8	0	38
Training and education	46	16	23	85
Employee safety	12	71	5	88
Total	140	181	283	604

Based on Table 04, disclosure for HC items is not consistent among company as supported by previous studies (Sujan & Abeysekera, 2007; Guthrie & Petty, 2000). Employee measurement which measured by employee skills inventory, employee contract and employee performance shows only 3% of the total HCD. While, employee welfare which measures by employee disbursements and employee benefits shows the highest disclosure by 61.4% of the total disclosures. Overall, the HCD of the PN17 companies are low compared to the findings by Mat Husin, Ahmad, and Sapingi (2013) who found that there were 6,991 total disclosures made by the largest 100 public listed Malaysian companies in 2008.

Abdul Rashid et al., (2012) also reported a lower number of disclosures and found human resource disclosed in prospectus quite lower than compared to other categories in the intellectual capital at 30.91%. The low level of disclosure is because the companies have to incur additional cost to disclose their HC information to the public (Schaper, Nielsen, & Roslender, 2016). The costs include the implementation on programmes and activities for employees and the implementations of these activities consume more time and incur a higher cost.

6.1. Descriptive analysis of board composition.

The board composition for this study comprises of board size, audit committee independence, remuneration committee independence, women director and foreign director.

Table 05. Descriptive statistic for board composition

Independent Variables	Minimum	Maximum	Mean	Standard Deviation
Board Size	4.00	10.00	6.33	1.633
Audit Committee Independence	60.00%	100.00%	90.56%	14.075
Remuneration Committee Independence	0.00%	100.00%	81.12%	23.712
Women Director	0.00%	29.00%	7.36%	9.640
Foreign Director	0.00%	67.00%	14.33%	19.835

Table 5 shows that the mean board size is six members (6.33). The mean score for audit committee members independence is 90.56% (SD= 14.075) and remuneration committee members independence is 81.12% (SD=23.712). The mean score for women director is 7.36% (SD=9.640). Meanwhile, the variable of foreign director has recorded a mean of 14.33% (SD=19.835).

6.2. Correlation coefficient.

Pallant (2001) explained that correlation analysis is preliminary test need to be used to measure the relationship and the strength between the variables. From Table 06, the only negative significant relationship was observed between the presence of foreign director and HCD (39.5%), which means that if there is a higher number of foreign directors in a company, it will have less disclosure of human capital. Furthermore, there is a positive significant relationship between audit committee independence and remuneration committee independence (53%). It shows that the higher number of audit committee independence, the higher the remuneration committee independence. Meanwhile, a positive significant relationship was observed between women directors and foreign directors (37.5%), hence, when there is a higher number of women directors, there is a higher number of foreign directors. In addition, the variables do not show any multicollinearity issue since the r-value is less than 0.530.

Table 06. Correlation result

	HCD	BS	IAC	IRC	WD	FD
Human Capital Disclosure (HCD)	1.000					
Board Size (BS)	0.076	1.000				
Audit Committee Independence (IAC)	-0.071	-0.080	1.000			

Remuneration Committee Independence (RCD)	-0.030	-0.087	0.530**	1.000		
Women Director (WD)	-0.182	-0.011	-0.037	-0.190	1.000	
Foreign Director (FD)	-0.395**	-0.135	-0.091	-0.136	0.375**	1.000

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

6.3 Multiple regressions.

Pallant (2001) explained that regression analysis can estimate the relationship between the dependent and independent variables.

$$\text{HUMAN CAPITAL DISCLOSURE} = \beta_0 + \beta_1 \text{BSIZE} + \beta_2 \text{AUDIND} + \beta_3 \text{REMIND} + \beta_4 \text{WOMDIR} + \beta_5 \text{FORDIR} + \varepsilon$$

Table 07. Multiple linear regression analysis

Model	Coefficient	t-value	p-value
CONSTANT	14.986	3.201	0.002
Board Size	0.343	0.941	0.350
Audit Committee Independence	0.010	0.201	0.841
Remuneration Committee Independence	-0.044	-1.526	0.131
Women Director	-0.022	-0.316	0.753
Foreign Director	-0.083	-2.366	0.021*
R ²	0.141		
Adjusted R ²	0.082		
F-statistics	2.368		
p-value	0.048		
N	78		

*. Correlation is significant at the 0.05 level (2-tailed).

Table 07 shows that the model is significant with $f(4, 68) = 2.368$ with a p-value that is less than 0.001. The p-value less than 0.05 proved that with 95% confidence level, there is a significant linear relationship between five board composition elements and HCD. The adjusted r-squared for this model is 0.082 indicating that 8.2% of the variation in HCD could be explained by the variation of board size, audit committee independence, remuneration committee independence, women director and foreign director.

Hypothesis H1 states the positive relationship between board size and HCD. The findings showed that board size has an insignificant positive relationship with HCD since the t-value is 0.0941 with a p-value of 0.350. This indicates that larger board size would lead to unnecessary debates and create poor communication (Othman, Ishak, Arif, & Aris, 2014). Moreover, the decision to disclose or not on HCD may be due to the decision of other board committees for example, the audit comm. Therefore, hypothesis H1 is rejected as it can be concluded that board size does not influence HCD.

Moreover, there is an insignificant positive relationship between audit committee independence and HCD which the t-value is 0.201 with the p-value of 0.841. The primary assumption is that the audit committee focuses on overseeing financial reporting quality which caused them to neglect the role of the committee in disclosing non-financial information (Ahmed Haji, 2015). Thus, the presence of an independent audit committee does not influence HCD. Therefore, H2 is rejected indicating that an independent audit committee does not influence HCD.

In regards to remuneration committee independence, there is an insignificant negative relationship with HCD where the t-value is -1.526 with a p-value of 0.131. A study by Abdul Malak (2015) found that there though the company's remuneration committee, is led by an independent director, the director is more responsible on the remuneration policy plan rather than the disclosure of the HC. Hence, H3 is rejected, and it is concluded that remuneration committee independence does not influence HCD.

There is a negative and insignificant relationship between the presence of women directors and HCD where the t-value is -0.316 with a p-value of 0.753. According to Rao and Tilt (2016), women directors pay more attention towards the community. Women directors are also more open and focused towards reporting the company's social responsibility rather than HCD. Thus, even with the higher percentage of women directors, the disclosure of HCD is still low. Therefore, H4 is rejected indicating that the presence of women directors does not influence HCD.

There is a negative significant relationship between HCD and foreign directors with 0.01 levels (2-tailed) where t-value is -2.366 with a p-value of 0.021. The result shows the higher the number of foreign directors led to the lower the level of HCD. According to Choi et al. (2012), HCD level is low as foreign directors in the companies are more focused more in improving the monitoring of management activities. Thus, foreign director has little interest in managing HCD as their responsibility is to improve the company value and to increase governance. Therefore, H5 is accepted and it can be concluded that the presence of foreign directors influences HCD. This result is supported by the decision usefulness theory since the directors have a better understanding of the stakeholders' needs in regards to HCD as they come from the similar culture and market condition.

7. Conclusion

In conclusion, by using a sample of PN17 companies in Malaysia, this study aims to examine the level of HCD. Moreover, this study aims to examine the influence of board composition on HCD. Based on the findings, the level of HCD was low where employee measurement which measured by employee skills inventory, employee contract and employee performance shows only 3% of the total HCD. Besides, the board that has a low number of foreign directors will able to influence more HCD. Thus, the government should consider mandatory disclosure to increase the level of HCD and helps the government to keep track on current strategies and developments since HC is the main element and key success in National Transformation 2050 (TN50) and the Malaysia's Economic Transformation Programme (ETP). Companies should consider reducing the number of foreign directors in the board composition since the company with a high number of local directors are more interested in disclosure.

Due to the limited literature on HCD, this study recommends future researchers and regulators to focus on HCD of PN17 companies. This study will be beneficial to the existing literature since there are more value added in improving the knowledge towards HCD and PN17 companies. Researchers may assist the government in deciding whether to enforce HCD policy towards all listed companies in order to support government initiatives to have human capital development. Additionally, companies including PN17 companies may be more convinced to do voluntary disclosure systematically. Additionally, policy makers should develop guidelines for practitioners to prepare HCD statement more systematically.

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