

**HUMAN RESOURCE DISCLOSURE AND PRACTICES:
EFFECTS ON FIRM FINANCIAL PERFORMANCE
AND VALUE**

BY

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ABSTRACT

The digital era has augmented the importance of non-financial information, specifically Human Resource Disclosure (HRD) in annual reports. Moreover, in line with the global recognition of human capital (HC) as a valuable intangible resource, it is essential that HR practices (HRP) of public listed companies be addressed through HRD to ensure that this value is captured by the market. Accordingly, the main objective of this study is to investigate the quality of HRD in Malaysia from 2010 to 2014. Next, the quality of HRD in the annual reports of 2016 was compared against the actual HRP in these companies. Additionally, this study tested the association between HRD against HRP as well as HRP with financial performance. The study also examined the value relevance of both HRP and HRD on firm value. Finally, this study analysed the mediation effect of HRD and firms' financial performance on the association between HRP and firm value. In order to meet these research objectives, both secondary and primary data were obtained through two methods: content analysis of annual reports and a questionnaire survey. Specifically, the analysis on the trend of quality of HRD was based on 1,175 firm-years' data. The measures of association between HRP, HRD, financial performance and firm value were based on data from 93 companies. This research employed Institutional Theory, Resource Based View Theory (RBV) and semi-strong form of Efficient Market Hypothesis (EMH) to develop the hypotheses. Overall, the findings reveal that there is an increasing trend of HRD quality from 2010 to 2014. However the significant increase is only between 2012 and 2013. Interestingly, companies are underreporting their HRD in their annual reports, despite its positive association with HRP. Nevertheless, quality of HRD, as well as HRP, have significant positive effects on firm value. However, the association between HRP and firms' financial performance is not statistically significant in this study. Additionally, HRD mediates the association between HRP and firm value, but not financial performance. This study provides empirical support for Institutional theory's coercive isomorphism, through its findings on quality of HRD. More importantly, the finding from HRP on firm value is in line with RBV theory, as HR and HC are considered resources to the companies. Finally, the mediating role of HRD in HRP and firm value relationship is consistent with the semi-strong form of EMH. The findings of this study are useful to regulators and the companies as it reveals that although regulation has resulted in an increase in quality of HRD, considerable improvement is still needed. HRD should be communicated in companies' annual reports, because this information has been found to be value relevant to market participants. Nevertheless, it should be reassuring for stakeholders to know that despite the low level of HRD quality discovered in Malaysian companies, most of these companies have implemented effective HRP.

خلاصة البحث

عزّز العصر الرقمي من أهمية المعلومات غير المالية، ولا سيما الإفصاح عن الموارد البشرية في التقارير السنوية، وتمشيًا مع الاعتراف العالمي برأس المال البشري موردًا قيّمًا غير ملموس؛ من الضروري معالجة ممارسات الموارد البشرية للشركات المدرجة في البورصة علنًا من خلال إدارة الموارد البشرية؛ لضمان أن هذه القيمة استفادت منها السوق، ومن ثم؛ كانت الأهداف الرئيسية لهذا البحث هي التحقق من جودة تنمية الموارد البشرية في ماليزيا ما بين عامي 2010-2014م، ثم مقارنة جودة تنمية الموارد البشرية في التقارير السنوية لعام 2016م مقابل خطة الاستجابة الإنسانية الحقيقية في الشركات المختارة، واختبار العلاقة بين الإفصاح عن الموارد البشرية وممارساتها، وكذا بين ممارساتها والأداء المالي، وتبيّن أهمية القيمة لكل من ممارسات الموارد البشرية والإفصاح عن القيمة الثابتة، وأخيرًا؛ تحليل تأثير الوساطة في تنمية الموارد البشرية والأداء المالي للشركات في العلاقة بين ممارسات الموارد البشرية وقيمة الشركة، ومن أجل تحقيق هذه الأهداف جُمعت البيانات الثانوية والأولية من خلال تحليل محتوى التقارير السنوية والاستبانة، فاعتمد التحليل على اتجاه جودة تنمية الموارد البشرية على 1175 سنة من بيانات الشركة؛ إذ إن الارتباطات بين الإفصاح عن الموارد البشرية وممارساتها والأداء المالي وقيمة الشركة تستند إلى بيانات 93 شركة، واستخدم هذا البحث النظرية المؤسسية، ونظرية العرض القائم على الموارد وشكل شبه قوي لفرضيات السوق المؤثرة لتطويع الفرضيات، وتكشف النتائج عن اتجاه متزايد إلى جودة تنمية الموارد البشرية ما بين 2010-2014م؛ ولكن كانت الزيادة الكبيرة فقط بين عامي 2012-2013م، وتبيّن أن الشركات لا تُبلغ عن الموارد البشرية في تقاريرها السنوية على الرغم من ارتباطها الإيجابي مع ممارساتها، علمًا أن لجودة الإفصاح عن الموارد البشرية وممارساتها تأثيرات إيجابية كبيرة على قيمة الشركة، إلا أن العلاقة بين خطة الاستجابة الإنسانية والأداء المالي للشركات ليست دالة إحصائيًا في هذا البحث، وتتوسط إدارة الموارد البشرية في الارتباط بين ممارسات الموارد البشرية وقيمة الشركة من دون الأداء المالي، ويُقدم هذا البحث دعمًا تجريبيًا للتشكل القسري للنظرية المؤسسية من خلال النتائج التي توصل إليها عن جودة تنمية الموارد البشرية، فنتوافق نتائج الإفصاح عن الموارد البشرية على القيمة الثابتة مع نظرية العرض القائم على الموارد؛ إذ تعدّ الموارد البشرية ورأس المال البشري موارد للشركات، وأخيرًا، كما أن الدور الوسيط لممارسات الموارد البشرية في العلاقة بين الإفصاح عن الموارد البشرية وقيمة الشركة؛ يتفق مع الشكل شبه القوي لفرضيات السوق المؤثرة، وهذه النتائج مفيدة للمنظمين والشركات؛ لأنها تكشف أنه على الرغم من أن التنظيم أدى إلى زيادة في جودة تنمية الموارد البشرية؛ لا تزال هناك حاجة إلى تحسينات كبيرة، كما يجب الإبلاغ عن إدارة الموارد البشرية في التقارير السنوية للشركات، فهذه المعلومات ذات صلة بالمشاركين في السوق، ويجب أن يطمئن أصحاب المصلحة إلى معرفة أنه على الرغم من المستوى المنخفض لجودة تنمية الموارد البشرية المكتشفة في الشركات الماليزية؛ طبقت الشركات خطة الاستجابة الإنسانية المؤثرة.

APPROVAL PAGE

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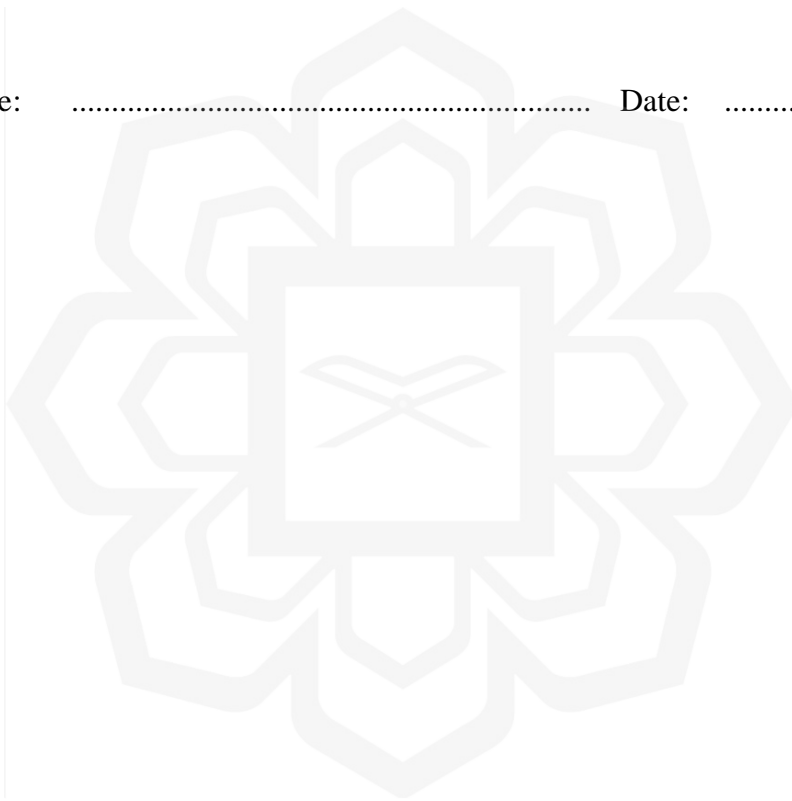
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DECLARATION

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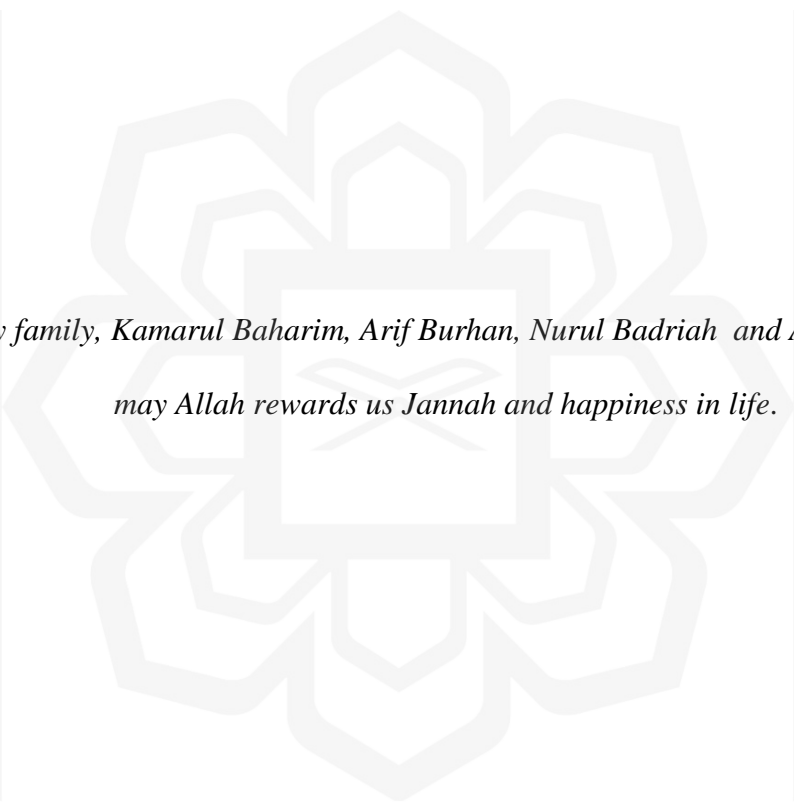
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*To my family, Kamarul Baharim, Arif Burhan, Nurul Badriah and Aman Khairi,
may Allah rewards us Jannah and happiness in life.*

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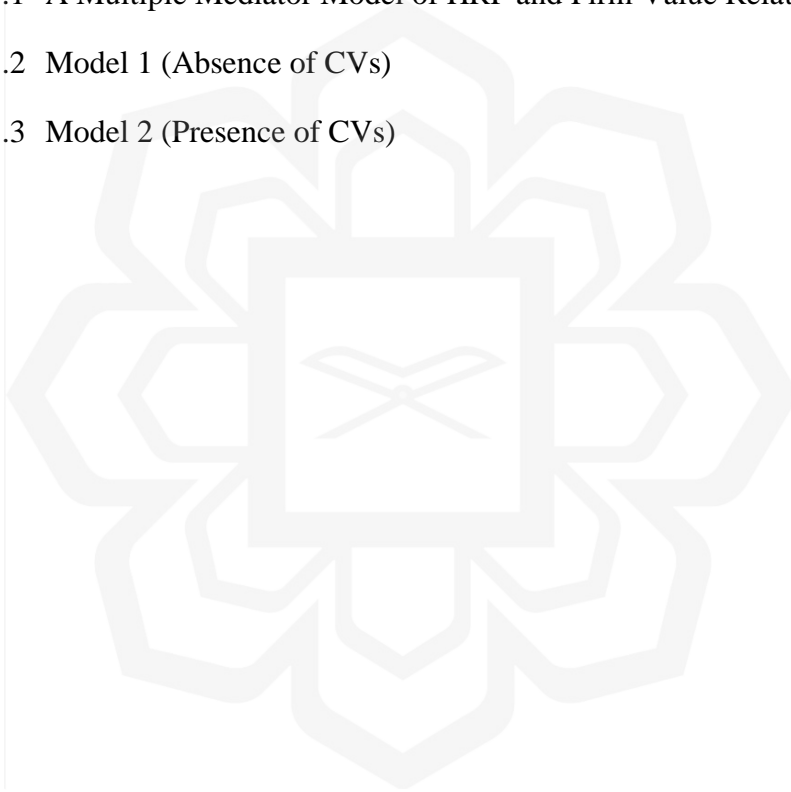
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LIST OF ABBREVIATIONS

10MP	10 th Malaysia Plan
11MP	11 th Malaysia Plan
ANOVA	Analysis of Variance
AR	Annual Reports
ASSET	Total Assets
BM	Bursa Malaysia
CA	Content Analysis
CSR	Corporate Social Responsibility
DV	Dependent Variable
e.g.	(<i>exempligratia</i>): for example
EMH	Efficient Market Hypothesis
et al.	(<i>et alia</i>): and others
FP	Financial Performance
G4	Fourth Edition of GRI
GRATE	Gross Rate of Capital Income
GRI	Global Reporting Initiatives
GTP	Government Transformation Plan
HC	Human Capital
HCD	Human Capital Disclosure
HPWS	High Performance Work System
HR	Human Resource
HRD	Human Resource Disclosure
HRDF	Human Resource Development Fund
HRM	Human Resource Management
HRP	Human Resource Practices
i.e.	(<i>id est.</i>): that is
IC	Intellectual Capital
ICD	Intellectual Capital Disclosure
IIRC	International Integrated Reporting Council
IPC	Infrastructure Project Companies
IR	Integrated Reporting
IV	Independent Variable
KPI	Key Performance Indicators
KR	Kuder –Richardson
LEV	Leverage Level
MASB	Malaysian Accounting Standard Board
MCAP	Market Capitalisation
MCCG	Malaysian Code of Corporate Governance
MFRS	Malaysian Financial Reporting Standard Board
MV	Mediating Variable
NEM	New Economic Model
NKEAs	National Key Economic Areas
OLC	Organisational Learning Capacity
OP	Organisational Performance
OSH	Occupational Safety and Health

PLCs	Public Listed Companies
QTT	Quantity
RBV	Resource Based View Theory
ROA	Return on Assets
ROE	Return on Equity
RQ	Research Question
SCM	Securities Commission Malaysia
SEC	Stock Exchange Commission
SPSS	Statistical Package for Social Science
TOBQ	Tobin's q
UNEP	United Nations of Environment Programme
USA	The United State of America



CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

Today's era of digitalisation has augmented the value of information. Based on the proposition that information has value, companies have been encouraged to disclose their non-financial information in addition to financial information. Non-financial information that could be of interest to stakeholders, hence value relevant, is human resource disclosure (HRD). This is because HRD should be reflective of key resources in a company, which is its human capital (HC) along with its effective human resource practices (HRP). Hence, HRD would be a means for good companies to signal about their essential resource, i.e. HC to the market.

In a developing country like Malaysia, even with computerization and automation, there is still considerable reliance on the workforce. A skilled workforce would be an advantage to any company. In the accounting literature, the term that is used for a skilled workforce is HC (Abhayawansa and Guthrie, 2004). Good HRP would be able to motivate the company's workforce to cultivate HC, thus create value for the firm. However, HRP is difficult to quantify, and investors, shareholders as well as other stakeholders would not be aware of the good practices within the company unless the company relays information about its good practices to the market through HRD. HRD is critical as such information helps shareholders predict the future value of companies (GIFT, 2018; Gamerschlag, 2013; Lin, Huang, Du and Lin, 2012; Micah et al. 2012).

Traditionally, during the industrial era, businesses focused on tangible assets when defining the “wealth” of the company. A company’s objective was generally limited to reducing expenses in order to increase profitability, which is essentially translated into financial performance of the company. However, global business competition in this post-industrial era has changed the landscape of the business economy. The rapid growth of information technology during the emergence of knowledge-based industries at the end of the twentieth century, as well as currently in the digital era, has created a shift in which the business world has become dependent upon internal resources, which includes HC, as a new source of competitive advantage. Realising this, companies have developed more HC through good HRP, hence should signal these good practices to the market through HRD in their annual reports.

In 2013, the International Integrated Reporting Council (IIRC) has also suggested on the same issue that, in the long term, HC is one of the key value drivers of companies. This is consistent with a more recent finding by the Global Intangible Finance Tracker (GIFT) in October 2018, which provided statistics that on average 52% of a company’s market value consists of intangible assets, of which HC is an essential element. Thus, the HR and HC related information mentioned through HRD in the annual reports would enable relevant stakeholders to make informed decisions, particularly investors who want to estimate a company’s firm value.

As HC is essential to a company’s success, the government of Malaysia has taken the initiative to address the issue by promoting the development of HC. In fact, initiatives to develop HC have begun since the 1960s¹ through the Malaysia Plan (MP) and the related HC policy continues to be emphasised today. For example, in the 11th

¹ Refer to Chapter 2 for details 2.3.2

Malaysia Plan that covered the period from 2016 to 2020, the focus is placed on accelerating the HC development, especially towards knowledge-intensive activities. This objective is also in line with the 10th Malaysia Plan (10MP), which spanned the period between 2011 and 2015². Amongst others, 10MP aimed to generate and equip a more skilled workforce that can meet Malaysia's target of becoming a high-income economy. Accordingly, in order to realize this goal, Malaysian companies, particularly those in the private sector, are expected to support the implementation of the 10MP by focusing on HR programmes that generate HC, which in turn creates firm value that will eventually boost the nation's wealth.

1.2 BACKGROUND OF THE STUDY

Literally, HC is a subset of HR. In its simplest form, HC means the knowledge intensity of an employee, which may include the employee's expertise, relevant job experience, motivations and commitment (Huselid, 1995; Branco and Rodrigues, 2006; Collier and Esteban, 2007; Abhayawansa and Abeysekera, 2008). HR, on the other hand, is a more general term for common or typical nature of workforce that encompasses the normal attribute of a person (Schlutz, 1972)³. Therefore, in general, HC is the productive component of HR, which brings benefits to the entity that possesses it.

As mentioned before, HC is nurtured from effective HRP. In the management literature, this is termed as 'human resource management' (HRM) (Abhayawansa and Abeysekera, 2008; Branco and Rodrigues, 2009). Nevertheless, since this study is an accounting research, the terms HC and HRP are used as this study does not include the

² 10MP was tabled by Dato' Seri Najib Tun Abdul Razak on June, 10, 2010 in the Dewan Rakyat.

³ Details will be explained in Chapter 2.

management perspective. In relevant literature, prior studies have revealed that HRP (Delery and Doty, 1996; Collins and Clark, 2003; Wright, Gardner and Moynihan, 2003)⁴ and HC (Riley, Michael, and Mahoney, 2017; Coff and Raffiee, 2015; Coff and Kryscynski, 2011; Crook, Todd, Combs and Woehr and Ketchen, 2011) promote better financial performance. This could be due to the fact that the HC of each company is distinct, hence could provide the business with a competitive advantage over competitors (Wright, McMahan and McWilliam, 1994), consequently creating firm value (Branco and Rodrigues, 2006; Abhayawansa and Abeysekera, 2008; Gamerschlag, 2013; GRI, 2018). As HC may be value relevant (Lin et al., 2012), this should be relayed to the market through HRD (Gamerschlag, 2013; Lajili and Zeghal, 2006).

The next section discusses the problems specifically in relation to the context of the study.

1.3 PROBLEM STATEMENT

In the Malaysian context, although Bursa Malaysia requires more disclosure, including non-financial information, an often overlooked aspect is HRD. Thus far, HRD has been studied as part of a larger component, i.e. Corporate Social Responsibility (CSR) disclosure (Tsang, 1998; Nik Ahmad and Sulaiman, 2004; Thomson and Zarina, 2004; Kuasirikun and Sherer, 2004). Otherwise, a subset of HRD, specifically human capital disclosure (HCD), has been studied as part of Intellectual capital disclosure literature (Abdolmohammadi, 2005; Ousama, Fatima and Hafiz, 2011; Haji, 2016). Hence, HRD

⁴ Details of prior literature in Chapter 2

has not been given specific attention in previous studies. This may be considered a crucial neglect as employees (HC) is still a fundamental resource for a developing country like Malaysia.

As mentioned before, it is HC and not HR that is the value-creating resource in the company; however, as HC is difficult to measure, HRP could be used to indicate the potential HC in the company. Nevertheless, HRP is generally privy to only management. Consequently, the stakeholders and the market would not be aware of the valuable resource of HC in the company unless it is publicly disclosed. In fact, since Malaysia is a developing country, its capital market is likely to be a semi-strong form of Efficient Market Hypothesis (EMH). Based on this form of EMH, only publicly available information would be valued by the capital market. Hence, if there is insufficient HRD, it is possible that the Malaysian companies would be undervalued by the market.

Therefore, based on the above, HRD should be reflective of HRP in the companies, as the latter could be an indication of their HC capabilities. However, although Bursa Malaysia has required CSR disclosure, the specific disclosure about HR has been left to the discretion of each company. Consequently, companies may be underreporting their HRP or even exaggerating them in their annual reports. Based on the semi-strong of EMH, an inaccurate representation of companies' HRP in their HRD could lead to misevaluation of a company's value by the market.

Nevertheless, this misevaluation of firm value would only occur if the semi-strong form of EMH actually applies to the context of Malaysia's capital market and if HRD is actually value relevant. However, due to the dearth of studies on HRD in Malaysia, and specifically lack of empirical evidence on HRD and firm value, the value

relevance of HRD remains a conundrum. Hence, this study attempts to resolve the matter of whether HRD is value relevant.

Moving on to the aspect of financial performance, although prior studies found HRP to be associated with financial performance, these studies used perception-based variables to proxy for companies' financial performance or they were carried out in developed countries. In the context of developing countries such as Malaysia, companies may find HRP to be costly, thus having a negative effect on their profitability. The lack of Malaysian literature on whether HRP is a determinant of financial performance using actual performance measures of these companies warrants an investigation.

In addition to financial performance, HRP could also have an effect on firm value. However, prior literature states that the association between HRP and firm value is considered "a black box" as there seems to be a missing mediating variable in this relationship. In accounting, there is a possibility of two variables that could mediate this association, which is financial performance and HRD. Based on the Resource-Based View (RBV) theory, HC and HRP are valuable internal resources that enhance financial performance, and this financial performance could be captured by the market. On the other hand, based on the semi-strong form of EMH, it is HRD that reflects HRP, and this disclosure is the one that could be relevant to the market participants. This "black box" needs to be made transparent, particularly in the context of listed companies in Malaysia.

Based on the above discussion, this study hopes to address these issues as stated in the following objectives.

1.4 RESEARCH OBJECTIVES AND QUESTIONS OF THE STUDY

Firstly, this study aims to investigate the quality of HRD in Malaysia from 2010 to 2014.

The first research question is developed below:

- i. Has HRD in annual reports improved from 2010 to 2014?

This longitudinal study provides an indication of the possible influence of the 10MP, implemented in 2011. Data was collected from annual reports via a developed HRD index. Then, the trend of HRD was analysed using paired sample T-test to determine if the HRD had increased significantly over the consecutive years.

Secondly, the study aims to investigate actual HRP in the disclosing companies selected in the first objective. Hence, the second research question is as follows:

- ii. What is the level of actual HRP undertaken by Malaysian public listed companies (PLCs)?

The data was collected via a survey. This is a crucial step because it enables the researcher to further investigate the actual HRP in sample companies.

In the third objective, the association between HRD and HRP is analysed. The third research question is as follows:

- iii. Is there an association between the HR information reported by PLCs (i.e., HRD) and their actual HRP?

This analysis may provide some critical insights into whether HRD is accurately reflective of HRP. In order to compare HRD against HRP, HRP measures obtained through questionnaires were compared with HRD in the annual reports of the respective companies. Paired sample T-test was used to compare HRD with the actual HRP. Moreover, a regression was run to determine the association between HRP and HRD.