ISSN 2392-1641

Economics and Business Review

Volume 3 (17) Number 4 2017

CONTENTS

Poznań University of Economics and Business Press

Paper based publication

ISSN 2392-1641

POZNAŃ UNIVERSITY OF ECONOMICS AND BUSINESS PRESS
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postal address: al. Niepodległości 10, 61-875 Poznań, Poland

Printed and bound in Poland by:
Poznań University of Economics and Business Print Shop

Circulation: 215 copies

Economics and Business Review, Vol. 3 (17), No. 4, 2017: 66-86
DOI: 10.18559/ebr.2017.4.5

Governance of director and executive remuneration in leading firms of Australia[1]

***Zahid Riaz*[2], *James Kirkbride*[3]**

Abstract: The aim of the paper is to examine how the introduction of state regulation and self-regulation impacts on the disclosure of director and executive remuneration in Australia. In doing so, we step beyond the simple state-market dichotomy in the extant literature, and proposes a symbiotic association between both regulatory modes for remuneration governance. The study reveals that remuneration disclosure levels are significantly higher after the advent of both self-regulatory and state regulatory reforms rather than state regulation alone. Furthermore, foreign-MNCs which experience increased agency problems due to spatial complexities and increased liabilities of foreignness do not have a superior disclosure level of director and executive remuneration: findings with important messages for policy makers and for regulators.

Keywords: Corporate governance; globalization; agency theory; institutional theory; disclosure level of director and executive remuneration.

JEL codes: G30, G38, J30, J38.

Introduction

In recent times, a major challenge facing the world economy is how to address some deep seated flaws in corporate governance systems of modern corporations, which allegedly contributed to the recent global economic crises (Kirkpatrick, 2009; Aras & Crowther, 2016, pp. 4-5; Letza, 2017, p. 184). The OECD has reported that, although the recent global financial crisis indicates the governance failures at the level of individual firms, it does not account for differences at national level amongst the OECD member countries (OECD, 2009). For instance, as an OECD member country, this difference is evident

[1] Article received 30 April 2017, accepted 16 October 2017.

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from Australia's experience. Despite some dramatic local impacts, Australia found itself uniquely positioned to recover rapidly within a short period of time. There is a view that Australia's strong and robust corporate governance system led by a legal-normative approach was a rallying force in weathering the storm and a source of leadership (Bell, 2009; Hill, 2012; OECD, 2009). Might this be true?

Was it engineered exclusively by state regulation, or was it a product of a naturally evolving self-regulatory system that adopted best practices in a classic market mode? Growing–academic thinking, backed by empirical research, appears to suggest that appropriate regulation is not a choice between state regulation and self-regulation but a mix of both (Ferran, 2001; Sheehan, 2009; Levi-Faur & Parker, 2010). However, little evidence is forthcoming to demonstrate the effect of such a mix on corporate governance practices, including disclosure behaviour relating to director and executive remuneration. Further, with the exception of a handful of studies (Ford, 2010; Riaz, 2016; Smith, 2004; Verbruggen, 2009), little attention has been given to design and applied governance outcomes.

Some empirical studies propound governance through self-regulatory codes is the best, as it is likely to contribute to greater shareholder value (Desmond, 2000; Nordberg, 2017). Financial theorists in line with neo-liberalists claim that corporate governance regulatory mechanisms should be allowed to operate freely, as any interference with the market based regulatory mechanisms is irrational, and will have a distorting effect (Hart, 1995). Neo-liberalists argue that state regulation can distort the efficient functioning of the market and firms can only be best disciplined through market mechanisms. Yet, can society rely entirely on a complete laissez-faire style or should corporate entities need additional governance mechanisms, for example, through statute? If these regulatory models are not mutually exclusive then what would be the ideal mix of law, self-regulation or even individual company policy.

This study examines the above mentioned debate further by measuring *the impact of market-based mechanisms – over and above the effects of a robust state regulation, on remuneration disclosure in Australia*. The aim of this paper is to investigate how the introduction of state regulation and self-regulation impacts on the disclosure of director and executive remuneration in Australia. In so doing, we step beyond the simple state-market dichotomy in the extant literature, and proposes a symbiotic association between both regulatory modes for remuneration governance. The econometric modelling of the impact of legislation on a large number of Australian firms including the subsidiaries of the foreign multinational corporations (MNCs) presents interesting insights into the salience of institutional reforms, both formal and informal, undertaken in Australia to improve the disclosure of director and executive compensation in the first decade of the 21st century. Moreover, the study presents a context and evidence for an understanding of the need to encourage a collibration of regulatory approaches, informed by stakeholder positions and the informal but powerful position of 'regulatory conversations' (Kirkbride & Letza, 2003, 2004; Riaz et al., 2013).

Section 1 of the paper provides a brief overview of the relevant context in which this research has been conducted. This section is followed by Section 2 that present theoretical underpinnings and research hypotheses in order to examine governance of director and executive remuneration in Australia. Section 3 underlines the details regarding the research design. The findings and discussion are provided in Section 4. Finally, the implications of this research for policy makers and business practitioners are discussed in Section 5.

1. Research background

Sustained growth during the 1990s and Australia's successful escape from the Asian financial crisis created a sense of complacency about corporate governance and consequently exacted a heavy price on the business community in the form of the series of corporate collapses in the early 2000s. Indeed the year 2001 was declared as the year of corporate collapses (Kohler, 2001). During the first three months, Joseph Gutnick's Centaur Mining and HIH Insurance both collapsed. A couple of days later, Harris Scarfe – a retailer, went bankrupt and at the end of May, 2001, it was One Tel. Again in September, when the 'world was reeling over the terrorist attacks in' America, Ansett, the second largest airliner in Australia, was put into voluntary administration. Later, mining company Pasminco suffered huge losses caused due to change in foreign exchange rates. The total damage of all these failures was more than $13 billion and at least 20,000 jobs lost (Kohler, 2001). Surprisingly, these series of collapses were not associated with any debt problems or failures of either stock or property markets – the common factors which were quite evident in previous corporate collapses. The most shocking of all these collapses were the fall of HIH Insurance and One Tel. The United States of America (USA) also experienced a series of massive corporate collapses ranging from the collapse of Enron to Lehman Brothers (Betta, 2016).

Corporate collapses tended to occur in waves according to Sykes (1998) who argued that corporate scandals were not the result of economic cycles as generally assumed, but were the outcome of the 'greed and folly of the people who run them' (Sykes, 1998). In a similar manner, the investigative findings of the HIH Insurance in Australia, revealed that this corporate scandal was caused by expensive business acquisitions and excessive corporate lavishness, based on the fallacy that the cash was there in the business (Bailey, 2003). As well, there was much publicity about payouts to outgoing and failed CEOs in Australia such as the CEO of National Australia Bank (Bolt, 2004) and James

Hardie Group (Charles, 2004). In the wake of colossal corporate collapses where public firms were losing billions, yet executives received bonuses in millions, a heated debate ensued regarding the empirical validity of the executive pay-for-performance model.

2. Theory and hypotheses

Agency theory asserts that managers as agents may pursue their own interests at the expense of principals or shareholders (Jensen & Meckling, 1976). Agency conflict arises when an agent engages in self-serving behaviour or shirks responsibilities by exploiting firm resources including time for personal use. In the presence of incomplete information, the agent is aware of his behaviour but the principal is not (Eisenhardt, 1989; Gomez-Mejia & Balkin, 1992). Inherent information-asymmetries between the principal and agent regarding compensation subvert the concept of interest alignment and functioning of the market for corporate control. Information asymmetries, eventually, give rise to a situation of moral hazard.

For subsidiaries of foreign multinational firms, the monitoring of their agent performance and activities is even more difficult due to spatial complexities (Windsor, 2009; Zaheer, 1995; Kostava, Nell & Hoenen, 2016). The increased reliance on foreign customers and factors of production also boosts the specialised knowledge of subsidiary executives by strengthening their insider advantage over principals. For multinational corporations, information asymmetry problems can further escalate due to the agency relationships between subsidiary and parent firm (Luo, 2005; Nell, Puck & Heidenreich, 2015; Riaz et al., 2015). Due to these distinctive agency conflicts, the firm's globalisation motive heightens the agency problems particularly associated with moral hazard agency conflicts (Aguilera & Jackson, 2010).

The challenge therefore is to provide measures and rewards such that individuals pursuing their own self-interest will also pursue the collective interest. The market's solution is to determine the optimal contract for the agent's service (Eisenhardt, 1989). Thus when devising the optimal contract, the principal has to decide whether a behaviour-oriented contractual governance arrangement (e.g. salaries, hierarchical governance) is more efficient than an outcome-oriented contractual governance mechanism (e.g. commissions, stock options, transfer of property rights, markets for corporate control) (Eisenhardt, 1989).

The adoption of outcome-based contracts or pay for performance models (hereafter) can have unintended effects – in America it resulted in an enormous increase of equity based compensation of company executives during the latter part of the twentieth century (Cheffins, 2003), but not necessarily performance.

The same trend was followed by the rest of the Anglophone countries including Australia. Empirical research on top management compensation spanning seven decades generally shows a low level of association between pay and performance (Barkema & Gomez-Mejia, 1998). Recently, Kay and Van Putten (2007) found a positive and significant correlation but no causality between CEOs' pay and the performance of the 1000 American corporations from 2002 to 2005, inferring that higher performance may lead to higher salaries or vice versa, confounding causality. The meta-analysis of the 137 CEOs' pay studies also reveals that the 'firm performance accounts for less than 5% variance in total CEO pay' (Tosi et al., 2000). In regard to MNCs, Carpenter and Sanders (2004) found CEOs remuneration was not related to firm performance and there was also a negative relationship between the total pay gap of CEO – top management team and firm performance.

With respect to the failure of interest alignment efforts, the foregoing evidence indicates that market-based regulation that relies on pay-for-performance model is inadequate as a mechanism of remuneration governance. The inadequacy of pay-for-performance model demands additional mechanisms. State based regulation for corporate governance, often involves passing laws or prescriptive standards, typically as a response to crises or catastrophes (Hood, 1996). A typical example of this type of regulation is the Sarbanes Oxley Act 2002. However legislation which is highly prescriptive is often resisted by the market. In fact financial theorists and neoliberalists claim that markets should be left to their own devices as any interference with the market mechanism would be distortionary (Hart, 1995; McMurtry, 2013).

Australia has used both state regulation and self-regulation by utilising its formal and informal institutions of corporate governance to address moral hazard agency conflicts. This evidence and its analysis also allow us to examine the extent of distortion in market activities which is caused due to state regulation as argued by financial theorists and neo-liberalists. To examine this argument further, we discuss the state and self-regulatory initiatives in the Australian context.

From 1998, the Australian government became more intimately involved in developing a set of regulatory frameworks with the aim of bringing protection to investors through improvements in the level of compensation disclosure and transparency (Slipper, 2004). Formal institutional reforms were introduced eventually led to the CLERP Act 2004 or commonly known as CLERP 9 replacing the earlier Company Law Review Act (CLRA)[4] 1998. CLERP 9 demanded

[4] Before CLERP 9 another Act known as CLRA 1998 had come under heavy criticism because of its vague nature (Clarkson et al., 2006, Quinn, 1999) – with substantial confusion surrounding the interpretation of the '*emoluments*' term. This compelled the Australian Securities and Investments Commission (ASIC) to issue an interim period practice note – *PN68* in November 1998 for clarification. Subsequently, this note was deleted after the enactment of the CLERP Act

mandatory disclosure of director and executive compensation thereby facilitating greater accountability and transparency in corporations. Disclosure requirements in relation to director and executive compensation solicited detailed information including the pay-for-performance model (Clarkson et al., 2006; Hill, 2006; McConvill, 2004). The Government also empowered the shareholders to raise their concerns about director and executive remuneration (behaviour) through an advisory vote – a 'say on pay' phenomenon, to allow investors to make better and informed choices about doing future transactions with agents. Besides the disclosure requirement, the second major reform agenda of the CLERP Act 2004 was the reform of audit practices (du Plessis et al., 2005; Farrar, 2005; McConvill, 2004). This aspect of the Act brought an array of reforms with respect to the independence of auditors and auditing activities. To implement them, the Australian government took sweeping new initiatives to strengthen the role of the regulatory institution – the Australian Securities and Investment Commission (ASIC) (McConvill, 2004). ASIC administered and enforced the Corporations Act 2004, including the CLERP 9 provisions of mandatory disclosure of director and executive remuneration.

Outside the formal framework of reforms, Australia invoked informal market-based mechanisms aimed at facilitating better intercommunication amongst different private bodies for self-policing whose interests are usually in conflict. In the early 1990s, different business associations of Australia attempted to publish corporate governance codes for best practices, however, these initial attempts required the Australian Securities Exchange (ASX) to consolidate and formalise the universal codes. The ASX played a critical role by establishing the Corporate Governance Council which represented 21 different Australian business associations[5] and provided them with a common platform to communicate, develop, and enforce corporate governance standards for a common purpose – self regulation.

The Corporate Governance Council of the ASX (established in 2002) issued the first edition of the 'Principles of Good Corporate Governance Practice and Best Practice Recommendations' in 2003 (ASX, 2008). In this guide, the ASX council not only demanded better disclosure of executive remuneration but

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2004 which was enacted to restore and gain public confidence after the series of corporate collapses in the first year of the 21st century – 2001.

[5] Association of Superannuation Funds of Australia Limited, Australasian Investor Relations Association, Australian Council of Superannuation Investors, Australian Financial Markets Association, Australian Institute of Company Directors, Australian Institute of Superannuation Trustees, Australian Securities Exchange, Australian Shareholders' Association, Business Council of Australia, Chartered Secretaries Australia, CPA Australia Limited, Financial Services Institute of Australasia, Group of 100, Institute of Actuaries of Australia, The Institute of Chartered Accountants in Australia, Institute of Internal Auditors Australia, Investment and Financial Services Association, Law Council of Australia, National Institute of Accountants, Property Council of Australia and Securities & Derivatives Industry Association.

also persuaded firms to make structural changes in company boards to ensure better governance and transparency of director and executive remuneration (ASX, 2003). These governance standards of ASX recommended company boards to institutionalize the presence of a remuneration committee on the company board and having a majority of non-executive directors[6] on the compensation committee. It is imperative to note however that the aforementioned structural changes, as prescribed by the ASX, were not legally binding but these were the best practices recommended for companies, which firms could follow as per their circumstances. However, in case of non-compliance, an explanation had to be provided about the lack of compliance. These guidelines thus encouraged flexibility along with transparency, by making companies obliged to investors to *'if not'* and *'why not'* aspects of the recommended remuneration governance mechanisms.

ASIC was also involved in the educational role of good governance by engaging the ASX. Both these institutions signed a Memorandum of Understanding in 2004 regarding information sharing and enforcing the corporations Act on a mutual basis (ASIC and ASX, 2004). This document became open to the public, and was to be used for the implementation of the CLERP Act 2004 (ASIC and ASX, 2004).

The juxtaposition of formal and informal institutions provides an excellent context within which to evaluate the relative efficacy of state versus self-regulatory reforms to bring about institutional change in disclosure practices of Australian firms. Interestingly neo-liberal advocates of Australia including the Business Council of Australia[7] (BCA) had previously raised strident criticisms against the CLERP 9 (BCA, 2003). Particularly, the BCA argued against the participation of shareholders through an advisory vote in executive remuneration decisions – observing that CLEPR 9 would be a 'bad law' which could disturb the forces of the free market economy (Hughes, 2003).

Norms and values of professional bodies and stock exchanges to which firms adhere can become very powerful governance mechanisms (Fiss, 2008; Hill, 2005). Recalling that the ASX had recommended the presence of a compensation committee, we propose that the presence of a compensation committee can act as a powerful compensation governance framework within which the

[6] The Australian Securities Exchange (ASX) made a distinction between independent directors and nonexecutive directors in 2003 (ASX, 2008). Conversely, this study cannot follow this distinction because it cannot be observed in company documents for the financial year 2001-2002.

[7] The Business Council of Australia is an association of chief executive officers of leading corporations of Australia. This alliance provides a podium for Australian business leaders at which they can engage in and contribute to key policy debates in Australia. The members of BCA aggressively contributed to the debate over the CLERP 9 proposal and developed a submission for the Treasury of Australia. This submission welcomed the other reforms but showed serious concerns over the disclosure component of the CLERP Bill 2003 (BCA, 2003).

board can set compensation policies and align shareholder interests in a more transparent manner (Conyon & Peck, 1998). The delegated responsibility of a compensation committee is to design and review the employment contracts, set compensation, and more importantly to observe the interest alignment between executives and shareholders (Carson, 2002). In the absence of an independent compensation committee, Williamson (1984) argues that it would be similar to a situation in which an executive writes his/her employment contract with one hand and signs with the other. This governance mechanism can also force the board and executives to provide more transparency about their compensation policies (Liu & Taylor, 2008). Consequently, this influence can lead to increased level of disclosure; thereby we propose this association in the following hypothesis.

Hypothesis 1: The level of disclosure of director and executive remuneration will be positively impacted by the presence of remuneration committee on company board.

Another important governance mechanism is the practice of having a majority of nonexecutive directors on the compensation committee. Arguably, outside independent directors who have various directorships can be expected to act as more effective monitors than the insiders (Fama & Jensen, 1983). This inclination may be due to fact that they want to exhibit and establish their reputation as decision experts in conflictual situations. Outside directors are also found to be more vigilant than internal directors and this characteristic can reduce the chances of financial misstatements (Dechow et al., 1996). A positive link between the number of non-executive directors and the disclosure level of director and executive remuneration is therefore proposed in the second hypothesis.

Hypothesis 2: The level of disclosure of director and executive remuneration will be positively associated with the number of non-executive directors on the remuneration committee.

As mentioned earlier, a globalised setting represents a complex situation of moral hazard agency conflicts other than their domestic counterparts who experience a relatively less severe level of agency conflicts due to the limited scope of their operations (Luo, 2005). Bushman and Smith (2001) argue that the examination of information disclosure of firms with multinational operations provide a robust research design. The disclosure analysis of foreign MNCs can allow the examination as to how these firms address information asymmetry problems while operating in a relatively complex environment. Given these environmental pressures, it is likely that foreign MNC--subsidiaries would find it difficult to craft better information systems which can assist them to address these institutional tensions regarding a dualistic reporting structure (Cahan et al., 2005; Khanna et al., 2004; Luo, 2005; Meek et al., 1995; Riahi-Belkaoui, 2001; Riaz et al. 2015). Therefore it is pertinent to examine the efforts of foreign MNC-subsidiaries for legitimacy insofar as it concerns information disclosure (Kostava, Nell & Hoenen, 2016). A plausible hypothesis could predict a negative association between the multi-nationality status of the firm (the foreign MNC) and the disclosure level of director and executive remuneration.

Hypothesis 3: The disclosure level of director and executive remuneration is negatively related to the multi-nationality status of a firm.

Furthermore, the disclosure level of director and executive remuneration can be influenced by certain firm-specific factors such as company age, auditor type, leverage and firm size. These factors are associated with the corporate disclosure level and this association is evident in various studies (Ahmed & Courtis, 1999; Cerf, 1961; Cooke, 1992; Coulton et al., 2001; Owusu-Anash & Yeoh, 2005; Wallace & Naser, 1995; Yasser & Mamun, 2016) which have examined the association between the aforementioned company-specific characteristics and corporate disclosure levels. We include the aforementioned firm-specific factors as control variables.

In order to test for this interaction in an empirical setting, first, we determine the impact of state regulation alone on the disclosure level of director and executive remuneration. Second, we examine the impact of informal institutional aspects representing self-regulation. In the third stage of analysis; we examine the disclosure level of director and executive remuneration in the foreign MNCs and finally, our analysis control for the firm-specific characteristics.

3. Research design

Sample selection

The sampling frame for this research consisted of listed BCA member firms and S&P/ASX 100 index firms, which was drawn from a target population of 2,178 listed entities on the ASX. The sampling criteria takes into consideration the following aspects: first, the firms which are listed during or after 2001 are not included; second, foreign domiciled/registered firms are excluded because such companies do not come under the jurisdiction of the Australian corporate laws; and finally the firms which experience any abnormal activity that can affect their disclosure practices are primarily excluded from the selection of the final sample as highlighted in two stages sampling process as shown in Table 1 of Appendix. This sampling process drew a grand total of 81 listed entities analysed for the years 2002 and 2006. This analysis created a total 162 observations including the foreign MNCs.

Compensation disclosure as dependent variable

In Australia, disclosure requirements in relation to director and executive remuneration, amended through the CLERP Act 2004, solicited detailed information including the pay-for-performance model (Clarkson et al., 2006; Hill, 2006; McConvill, 2004). CLERP Act 2004 required companies to disclose much more detailed information than its earlier version CLRA 1998 – especially regarding three aspects of executive compensation: 1) general disclosure of director and executive remuneration pertaining to the requirements of section 300 (A) and the Australian Accounting Standard Board; 2) disclosure of the company's pay-for-performance model related to section 300 (A); and 3) the engagement and participation of shareholders in deciding executive remuneration as per sections 250 (R), 250 (S) (A), 200 (F) and 200 (G). These three aspects serve as the bases for constructing our research instrument, the disclosure index, which is developed to measure disclosure practices of the Australian firms. To quantify disclosure practices of each company, a scoring template was used to derive a disclosure index. Disclosure index methodology has been widely used by researchers (Ahmed & Courtis, 1999; Donnelly & Mulcahy, 2008; Owusu--Anash & Yeoh, 2005; Riaz, Ray & Ray, 2015). The formulation of the disclosure index was based on the general principles of content analysis of company annual reports (Beattie et al., 2004) and a category system. In establishing the index, we draw on the abovementioned three aspects of executive compensation.

The validated disclosure index computed the actual disclosure score for each company in pre (2002) and post (2006) eras of CLERP Act 2004. Moreover, there are more disclosure requirements in the later years as compared to the earlier years; thereafter, we computed a *relative index* of disclosure for each company for 2002 and 2006 following the methodology used by Owusu-Ansah and Yeoh (2005) as shown in equation 1:

$$\text{Relative disclosure index}_{ijt} = \frac{\sum_{i=1}^{m_{jt}} d_{ijt}}{\sum_{i=1}^{n_{jt}} d_{ijt}} \tag{1}$$

where *dijt* is the disclosure value for a disclosure index item *i* is related to company *j* in year *t* (where year t can be 2002 and 2006), coded as 1 if item was disclosed or 0 if it was not disclosed by company *j*; moreover, *mjt* is the number of disclosure items which are relevant to company *j* and were actually disclosed in its annual report for year *t*; and *njt* is maximum number of disclosure items that can be disclosed by company *j* in its annual report in year *t*. For this study, the relative disclosure index is the dependent variable that measures the change in disclosure levels of director and executive compensation before and after the introduction of the CLERP Act 2004 and compensation governance mechanisms. All data for independent variables was obtained from annual reports of ASX listed companies.

The model

In our study, the relationship between the dependent variable and the independent and control variables were expressed in four separate models. The equations were derived from the hypothesized relationships amongst the multidimensional constructs of this research.

$$\text{Model 1: Relative Disclosure Index}_{ijt} = \beta_0 + \beta_1 LawPresence_{jt} + e_o \tag{2}$$

$$\text{Model 2: Relative Disclosure Index}_{ijt} = \beta_0 + \beta_1 LawPresence_{jt} + \beta_2 Compensation\ committee_{jt} + \beta_3\ Non\text{-}executive\ directors_{jt} + e_o \tag{3}$$

$$\text{Model 3: Relative Disclosure Index}_{ijt} = \beta_0 + \beta_1 LawPresence_{jt} + \beta_2 Compensation\ committee_{jt} + \beta_3\ Non\text{-}executive\ directors_{jt} + \beta_4 ForeignMNCs_{jt} + e_o \tag{4}$$

$$\text{Model 4: Relative Disclosure Index}_{ijt} = \beta_0 + \beta_1 LawPresence_{jt} + \beta_2 Compensation\ committee_{jt} + \beta_3\ Non\text{-}executive\ directors_{jt} + \beta_4\ ForeignMNCs_{jt} + \beta_5\ Age_{jt} + \beta_6\ Auditor\ type_{jt} + \beta_7 Leverage_{jt} + \beta_8 Size_{jt} + e_o \tag{5}$$

where e_o is the stochastic disturbance or error term and assumed to be independent and normally distributed with the same variance. The definitions of variables are provided in Table 1.

4. Findings and discussion

Hierarchical multiple regression analysis was used to understand the impact of formal and informal institutional arrangements on the disclosure level of director and executive remuneration – the variables entered in a pre-specified sequential manner according to their theoretical and logical importance (Tabachnick & Fidell, 2001; Field, 2013, p. 322).

The results of the first model (Table 2) suggested that there was a significant impact of law, i.e. the CLERP Act 2004 on disclosure level of director and executive remuneration [Model 1: Adjusted $R^2 = 0.77$ and $p < 0.001$]. This illustrates that corporate disclosure compliance in Australian corporations has improved significantly (Law Presence: $p < 0.001$, with $\beta = 0.88$) as a consequence of the legal enforcement by the Australian state consistent with the findings of (Clarkson et al., 2006); (Andjelkovic et al., 2002); and (Owusu-Ansah & Yeoh, 2005). These results endorse the arguments presented by (Coffee, 1984; Easterbrook, Fischel, 1984; Fox, 1997) and reinforces that state regulation can

Table 1. Variable definition and descriptive statistics (*N* = 81)

Variable name	Definition	Frequency/mean		Percentage/standard deviation	
		2002	2006	2002	2006
Relative Disclosure Index	A measure of disclosure level of director and executive remuneration both in a pre and post-era of the Corporate Law Economic Reform Programme Act 2004 also known as CLERP 9. It is a ratio between the actual disclosure of each company in its annual report and the maximum level of disclosure it can exhibit	0.21	0.77	0.14	0.18
Law Presence	Dummy variable to indicate the presence of law. Variable is coded as 0 for the base year (2002) and 1 for the comparison year (2006)	N.A.	N.A.	N.A.	N.A.
Remuneration Committee	Indicator variable to record the presence of remuneration committee on a company board and coded as 0 = Absent and 1 = Present	65	74	80%	91%
Number of Non-executive Directors	This variable records the actual number of non-executive directors on a remuneration committee	2.85	3.35	2.16	1.53
Foreign multinational subsidiary	Indicator variable for the type of firm; 1, if a firm is a foreign multinational subsidiary and 0, if otherwise	10	10	12.35	12.35
Age	This variable illustrates the age of sample firms. Age is measured as the number of years since the inception of the company	72.59	76.49	53.70	53.80
Auditor Type	Indicator variable for the type of external auditor; 1, if auditor is affiliated with a Big-4 international audit firm, 0 if otherwise	75	78	93%	96%
Leverage	Debt to asset ratio is the proxy measure for firm leverage and it indicates the proportion of assets which are being financed by debt	0.51	0.57	0.24	0.20
Size	Firm size is measured through the natural log values of firm revenues	8.99	9.29	0.98	0.77

improve disclosure level of director and executive remuneration. Thus legalised disclosure can reduce the occurrence of the moral hazard agency problem by reducing information asymmetry for the principal (Denis, 2001; Husted, 2007; Mahoney, 1995; LaPorta et al., 2000).

Interestingly, informal institutional arrangements also have a significant impact on disclosure levels – shown by an improvement in the coefficient of determination as displayed in Table 2 [Model 2: Adjusted $R^2 = 0.83$ and $p < 0.001$]. The presence of a remuneration committee has a positive and significant impact on the disclosure level of director and executive remuneration (Remuneration Committee: $p < 0.001$ with $\beta = 0.22$) although the impact of non-executive directors on a remuneration committee did not turn out to be significant.

For the third model [Model 3: Adjusted $R^2 = 0.84$ and $p < 0.10$], our results also show a significant and negative relationship between the disclosure level of director and executive remuneration and the multi-nationality status of the sample firms (Foreign MNCs: $p < 0.10$ with $\beta = -0.05$). In the last model, we control for firm specific factors [Model 4: Adjusted $R^2 = 0.86$ and $p < 0.001$] and this result indicates an improvement in the significance level of the multi-nationality status (Foreign MNCs: $p = 0.01$ with $\beta = -0.08$). These findings

Table 2. Results of multiple regression analysis

	Model 1	Model 2	Model 3	Model 4
Law Presence	0.88*** (23.35)	0.84*** (25.70)	0.84*** (25.86)	0.83*** (27.44)
Remuneration Committee		0.22*** (4.95)	0.21*** (4.91)	0.15*** (3.54)
Number of Non-Executive Directors		0.05 (1.23)	0.05 (1.22)	–0.01 (–0.14)
Foreign multinational subsidiary			–0.05† (–1.66)	–0.08** (-2.62)
Age				0.08* (2.42)
Auditor Type				–0.04 (–1.23)
Leverage				0.11** (2.95)
Size				0.08* (1.98)
R^2	0.77	0.84	0.84	0.87
Adjusted R^2	0.77	0.83	0.84	0.86

***significant at $p \leq 0.001$; **significant at $p \leq 0.01$; *significant at $p \leq 0.05$; and †significant at $p \leq 0.10$

with respect to globalisation aspects were in accordance with the propositions of this study. It is evident that due to heightened agency problems; the subsidiaries of foreign MNCs are unable to disclose the information which is solicited by the host country. Conversely, the following studies (Riahi-Belkaoui, 2001; Cahan et al., 2005; Khana et al., 2004; Meek et al., 1995) found a positive relationship between globalisation factors and the level of corporate disclosure.

Firm age depicts a significant link with disclosure level suggesting that older firms have a better disclosure level than younger firms. Furthermore, higher leverage has a significant impact on disclosure level and implies that firms with a higher level of leverage disclose more information. The firm size was also found to have a significant impact on the disclosure level. In addition, bigger firms attract more media attention (Liu & Taylor, 2008) and to avoid negative publicity; large companies put greater effort into legitimizing their management practices.

5. Implications

The Australian evidence presented in the study and its analysis through the lens of institutional theory allow us to make an important empirical contribution by demonstrating that corporate governance not only needs market based mechanisms but also requires the visible hand of the state to manipulate and strengthen the market. State regulation catalyses market-based best practices of corporate governance which can minimize the moral hazard problem. Our study findings lend support to the emerging body of literature which highlights the use of formal and informal institutions as a more pragmatic approach for regulating the modern corporation in today's globalized world. State intervention through legislation (CLERP Act 2004) improves the governance of director and executive compensation by catalysing the self-regulatory practices such as compensation committee – demonstrating that well-intended regulatory efforts can indeed balance state regulation with market governance. To a great extent the state regulatory framework encourages and facilitates the 'conversations' which make regulation effective.

Corporate governance, an institutional process to address agency problems, requires the active engagement of and mutual participation amongst multiplicity of institutions including public, private and professional bodies and associations, often with conflicting interests. In the policy making process, governments should encourage the diverging parties to communicate their concerns and understand perspectives of others more effectively. Especially, for better conformity with national laws and norms, the international institutions should also be actively engaged by both formal and informal institutions of a country. To the neoliberal advocates of the market, the results demonstrate that a consensus-based market-friendly intervention can attenuate corporate governance problems, especially in times of global economic crises. Thus, the synergetic approach of co-regulation, supported through regulatory conversations, can assist governments in the effective enforcement of regulatory interventions illustrated in our study.

Conclusions

This paper seeks to posit a theoretical framework, which measures the association between institutional change and disclosure – in the empirical setting of the Australian economy. In doing so, it demonstrates how both formal and informal institutions influence the shape and outcome of agency conflicts. It suggests that co-action between the state and the market, in the context of changing institutional dynamics, has become a very potent force in the management of a modern economy. Even in the presence of pervasive and prescriptive state regulations, market based controls induced through professional associations or alliances appears to be a critical prerequisite to support their effectiveness– whether this is simply a recognition of the pragmatism of the need for regulatory conversation, as an aspect of co-regulation or mere act along the spectrum of stakeholder theory and management, remains uncertain, but its influence on the effectiveness of the regulation is certain.

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Appendix

Table 1. Sampling process

Stage 1	
Total BCA members	108
Less non-listed BCA members	50
Less firms which do not meet the sampling criteria	13
Final sample-1	45
Stage 2	
Total S&P/ASX100 index firms	101
Less BCA listed member firms already included in stage one	39
Less firms which do not meet the sampling criteria	26
Final sample-2 or non-BCA member firms of S&P/ASX 100 index	36
Grand total of research sample – adding final samples 1 and 2.	81

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Economics and Business Review is indexed and distributed in ProQuest, EBSCO, CEJSH, BazEcon and Index Copernicus.

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