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INCENTIVIZING OPENNESS: THE INFLUENCE OF MANAGERIAL COMPENSATION ON VOLUNTARY DISCLOSURE

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Abstract

This paper analyzes the relationship between voluntary disclosure and managerial compensation in the French context. Our analysis is based on a sample of non-financial French firms listed on the SBF120. By using a score of voluntary disclosure, the results show a significant and positive relationship between managerial compensation and the score of voluntary disclosure. The findings of this study also indicate that there is a relationship between voluntary disclosure and firm's characteristics. Our results provide a better understanding of voluntary disclosure practices and draw more attention of regulatory authorities to the importance of managerial compensation to improve transparency and voluntary disclosure.

Keywords:
Voluntary Disclosure, Managerial Compensation, Score, Corporate Governance.

1. Introduction

The main source of divergence of interests between managers and shareholders is that shareholders do not hold or are not assimilating the complete information about the firm. Thus, they are not necessarily able to control all decisions taken by the management. The manager's latitude may raise some doubt about the validity and the credibility of decisions made by the CEO. To align the interests of managers with those of shareholders, a motivating compensation policy will encourage them to take decisions that enhance firm value. Thus, executive compensation may be an incentive scheme to encourage managers to increase the level of transparency and to motivate and encourage the managers to disclose more voluntary information (Franco *et al.,* 2013). Nevertheless, many studies have detected fraudulent manipulation of information by managers around the use of stock-based compensation (Cheng et al., 2020). Many recent studies focused on the relationship between voluntary disclosure and corporate governance (Enache and Hussainey, 2020, Saha and Kabra, 2022, Cheng, et al.,2021, Kumar, 2024) but few on the compensation of the manager as a factor influencing the voluntary disclosure. Using a sample of non-financial firms belonging to the SBF120 index over the period 2012-2020, we will investigate whether greater transparency via voluntary disclosure score leads to improved managerial rewarding. We provide evidence that shareholders offer managers of SBF120 firms greater compensation to disclose voluntary information. We contribute to the empirical literature by taking into account the relationship between executive compensation and voluntary disclosure of information. Another contribution of this study is to provide some guidance to French listed companies and policymakers about the importance of managerial incentives to encourage voluntary disclosure since heavy reliance is placed on stock-options incentives while other forms of compensation are neglected.

2. Theoretical Framework and Research

The capital market holds a share of responsibility with the implementation of aggressive compensation plans that prioritize short-term gains results (Hao and Fu, 2023). The pressure faced by managers may lead to have an opportunistic behavior and to manipulate and distort information since they generally focus on the short term due to their time horizon and myopia (Bolton et al., 2006). According to the optimal contract theory, shareholders and manager will establish a contract. But the risk is that the manager will not expend enough effort according to shareholders and will instead seek to maximize his own wealth. This relationship is even more conflicting between the principal (the shareholders) and the agent (the manager) because there is

an information asymmetry between the two parties. Since managers have information that the principal cannot observe, the incentive should be high enough to dissuade the manager from extracting private benefice. This theory can be deployed in the context of voluntary disclosure to the extent that an optimal compensation contract would ensure that managers will act in the interest of the company and make greater efforts in information disclosure. From the point of view of the contractual perspective, disclosure allows the board to control the managers more effectively. However, if their power is too important in the firm, then all the benefits of this control are not going to be received by shareholders, but a part of these benefits will be captured by the manager via higher compensation (Hermalin & Weisbach, 2012). The managerial power theory assumes that there is a divergence of interests between shareholders and managers. It is based on two assumptions: First, managers have considerable power within the board since they can influence and guide decisions according to their objectives (especially if they hold both the CEO and Chairman position or if they are part of the compensation committee or the nomination committee). They may also exert a psychological power over internal directors to ensure their loyalty in the approval of their decisions (Bebchuk & Fried, 2003). Second, managers may tend to use their power to capture more private benefits without reflecting an improvement in the profitability of the firm. Several studies have investigated the relationship between pay-performance and voluntary disclosure (Lundholm & Myers, 2002; Franco et al., 2013). Theoretically, a strong performance-based compensation encourages executives to make more effort to run the company and to undertake risky projects that enhance the value of the firm. Thus, increasing the sensitivity of managerial compensation to performance will align interests of shareholders with those of CEOs. Executive compensation can be a powerful tool to reduce agency conflicts between shareholders and managers, but can also become a source of agency costs if it is not well managed. Johnson and Natarajan (2005) also hypothesize that the tendency of the managers to the voluntary disclosure is influenced by its compensation structure. They argue that the compensation will influence both the quantity and the type of information (good or bad news) disclosed by the manager. They find that equity-based compensation as well as golden parachutes are positively related to the amount of information disclosed by the manager. In addition, the authors find that managers whose compensation is based on performance tend to communicate bad news in order to reduce investors' expectations of future performance. They state that there is a positive relationship between the sensitivity of cash compensation to performance and the willingness of managers to disclose bad news. Hermalin and Weisbach

(2012) argue that managers are usually reluctant to release information voluntarily because the costs they incur in the dissemination of information may exceed the benefits generated. The authors predict that executive compensation will improve with a certain lag. The authors find also that an increase of the disclosure of 1% will improve managerial compensation of 0.696%. Franco et al., (2013) analyzed the effect of voluntary disclosure on cash executive pay by taking into account the effect of endogeneity in managerial decisions and using the management guidance as a proxy for voluntary disclosure. They find that sensitivity of cash managerial pay to performance is more important for firms that disclose information about voluntary earnings forecasts and management guidance.

Based on the literature review, we formulate the following hypothesis:

There is a significant and positive impact of executive compensation on voluntary disclosure.

3. Methodology

The sample for the study consists of 80 firms belonging to the SBF120 index. To investigate the effect of managerial compensation on voluntary disclosure, a linear regression was conducted, as depicted in Model (1) below. Fixed effects were utilized in the regression estimation, as suggested by a Hausman test, indicating that fixed effects are the most appropriate estimators for our sample.

We also relied on the findings of Eng & Mak (2003) to specify control variables: firm size, debt, growth opportunities, firm age and firm performance.

$$VDS_{it} = \beta_0 + \beta_1.COMP_{it} + \beta_2.SIZE_{it} + \beta_3.MB_{it} + \beta_4.AGE_F_{it} + \beta_5.\ LEV_{it} + \beta_6.\ ROE_{it} + \varepsilon_{it}$$

Model (1)

Where

βi: coefficient ; i = firm indicator ; t = period indicator; ε = error term.

VDS= Voluntary disclosure score

COMP = Managerial compensation (= Natural logarithm of salary + Bonus + allowance)

SIZE = the firm size (the natural logarithm of total assets)

MB = Market to book (Market value of ordinary shares divided by book value of shareholder's equity)

AGE_F = Age of the firm (logarithm of number of years since the creation of the firm)

LEV = Leverage (long Term Liabilities divided by total assets)

ROE = Net Income divided by Shareholder's equity

Disclosure Index: We used an unweighted disclosure method to compute our index. We relied

on the study of Bruslerie and Gabteni (2014) in the French context to build our voluntary disclosure score. The score consists of items collected from annual reports categorized in strategic, non-financial and financial information. The final score assigned to each company equals the total points awarded (sum of items presents in the annual report) over the potential maximum score.

4. Results and discussions

The linear regression results of our first model are reported in Table 1 below. We have empirically tested the relationship between voluntary disclosure of information and managerial compensation as well as control variables.

Table 1: Regression Analysis

Variable	Coefficient	P value
Intercept	-.774	0.000*
COMP	.056	0.016*
SIZE	.035	0.000 *
MB	-.000	0.073
AGE_F	.186	0.000*
LEV	.069	0.017*
ROE	-.774	0.019 *

* Significance at the 0.05 level

Table 1 shows a significant and positive impact of managerial compensation on the score of voluntary disclosure ($\beta = 0.056$, $p = 0.016$). In accordance with our expectations, when the managerial compensation increases, the manager will be motivated to disclose more voluntary information. He shows his *appreciation* to shareholders by disclosing more voluntary information. In fact, although disclosure has benefits (reducing information asymmetry and improving transparency), it nevertheless entails costs. These costs are in the form of greater compensation to the manager in order to stimulate and motivate him to disseminate more information and improve the firm transparency (Bushman & Smith, 2003; Hermalin & Weisbach, 2012). We can therefore confirm our *hypothesis 1*.

The size of the company has a significant and positive impact on the score of voluntary disclosure of information ($\beta = 0.035$, $p = 0.000$). Larger firms generally have the needed expertise and resources to provide more voluntary information (Ahmed & Nicholls, 1994) and tend to be more followed by analysts and must therefore meet a growing demand for information (Hossain & Hammami, 2009).

The coefficient of firm age is positive and significant (β = 0.186, p = 0.000). Well-established companies are more inclined to disclose more information compared to newly founded ones. This tendency arises from their greater experience in communication practices. They are enjoying a greater reputation in the industry and will therefore pay more generously their managers (Chen et al., 2013).

Highly leveraged companies seem to disclose more voluntary information in their annual reports (β = 0.069, p = 0.017). These companies are generally facing higher demand of information from the creditors (Hammami & Hossain, 2009). By disseminating voluntary information, agency costs associated with debt will be reduced. It seems that poor performing companies are more likely to disclose voluntary information (β = -0.774, p = 0.019). This result could be explained by the fact to improve their image and reputation in the eyes of stakeholders.

However, it appears from the results that the growth opportunities do not have a significant impact on the score of voluntary disclosure.

5. Conclusion

The paper investigates the relationship between voluntary disclosure and managerial compensation of firms belonging to the SBF120 index over the period 2012-2020. We use fixed-effects panel-data estimator to answer our research questions. Consistent with our assumptions, our results show that there is a significant relationship between managerial compensation and voluntary disclosure score. We also controlled the effect of size, growth opportunities, leverage, performance and firm age on the extent of voluntary disclosure.

Overall, our paper provides an in-depth analysis of how voluntary disclosure and managerial compensation are closely linked. We contribute to the corporate governance and voluntary disclosure literature. This finding possesses important implications to theory, practice and future research. Our results show that managerial compensation is an important factor in determining voluntary disclosure supporting evidence of the managerial power theory. In fact, raising the level of managerial compensation is a motivating tool for CEOs to provide more voluntary information. Second, our results provide evidence that certain firms' characteristics contribute to the extent of voluntary disclosure. The results of this study have significant implications for stakeholders, policy makers and regulators.

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