

## Human Capital Disclosure (HCD) and Share Price

Marsita Mustafa  
School of Accounting  
Faculty of Economic and Management  
Universiti Kebangsaan Malaysia  
E-mail: [marshe1305@gmail.com](mailto:marshe1305@gmail.com)

Mohamat Sabri Hassan  
School of Accounting  
Faculty of Economic and Management  
Universiti Kebangsaan Malaysia  
E-mail: [msabri@ukm.edu.my](mailto:msabri@ukm.edu.my)

Mara Ridhuan Che Abdul Rahman  
School of Accounting  
Faculty of Economic and Management  
Universiti Kebangsaan Malaysia  
E-mail: [mara@ukm.edu.my](mailto:mara@ukm.edu.my)

### ABSTRACT

The aim of this study is to examine the relationship between disclosure of human capital information (*HCD*) and share price (*SP*) of the top 100 companies listed on Bursa Malaysia. Human capital (*HC*) has been considered as a valuable asset in the knowledge-based economy. Knowledge and skills possessed by the individual are regarded as a key source of competitive advantage and value creator to companies. Prior research acknowledges the importance of human capital information to investors, where they may have to rely on disclosures in the annual report when evaluating a company's future direction, potential, value and prospects. However, companies only disclose limited information on this asset. Therefore, this study investigates the role of HC information in influencing share price. In this study *HCD* is seen from the perspective of signalling and efficient capital market theories. Following previous study we incorporate human capital information and its two components; i.e. human capital information related to directors and employees in the Ohlson model. Our study indicates the aggregate human capital information is not lead in determining firm's share prices. This finding in line with the argument that human capital information does not directly lead to any capital market reactions in short-term but reliable and relevant for investors in their long-term investment decisions. However, an additional analysis indicates human capital information related to directors is value relevant.

Keywords: Human capital disclosure, share price, value relevance.

### ABSTRAK

*Tujuan kajian ini adalah untuk mengkaji hubungan antara pendedahan maklumat modal insan (HCD) dan harga saham (SP) di kalangan 100 syarikat yang tersenarai di Bursa Malaysia. Modal insan (HC) telah dianggap sebagai aset yang berharga dalam ekonomi berasaskan pengetahuan. Pengetahuan dan kemahiran yang dimiliki oleh individu merupakan sumber utama kepada kelebihan daya saing dan pembentuk nilai syarikat. Penyelidikan lalu mengiktiraf kepentingan maklumat modal insan kepada pelabur, di mana mereka perlu bergantung kepada pendedahan di dalam laporan tahunan bagi menilai hala tuju masa depan, potensi, nilai dan prospek syarikat. Walau bagaimanapun, syarikat-syarikat hanya mendedahkan maklumat yang terhad berkenaan aset ini. Oleh itu, kajian ini menyiasat peranan HC dalam mempengaruhi harga saham. Dalam kajian ini HCD dilihat dari perspektif teori isyarat dan teori kecekapan pasaran modal. Seperti kajian sebelum ini kami menggabungkan maklumat modal insan dan dua komponennya; iaitu maklumat modal insan yang berkaitan dengan pengarah dan pekerja dalam model Ohlson. Kajian kami menunjukkan agregat maklumat modal insan tidak mempengaruhi harga saham. Penemuan ini selaras dengan hujah bahawa pasaran modal tidak memberikan reaksi terhadap maklumat modal insan serta tiada perubahan jangka pendek dalam nilai pasaran tetapi relevan kepada pelabur dalam membuat keputusan pelaburan jangka panjang. Walau*

*bagaimanapun, analisis lanjutan menunjukkan maklumat modal insan yang berkaitan dengan pengaruh mempunyai kerelevanan nilai.*

*Katakunci: Pendedahan maklumat modal insan, harga saham, kerelevanan nilai.*

## INTRODUCTION

*HC* plays a key role in the survival of a company (Abeysekera, 2008; O'Donnell et al., 2006). It is regarded as an important asset (Gamerschlag, 2013; Huang, Luther, Tayles, & Roszaini, 2013) which will add value to the company in the current business environment. Human capital also considered as one of the main elements that give a competitive advantage to the company (Huang et al., 2013). However, the *HCD* in the annual report of the company is limited. As the disclosure is on voluntary basis, therefore manager has a discretion to disclose such information (Nielsen & Madsen, 2009). The main factor that contribute to such behaviour is the absent on accounting standards or guidelines on *HCD*. Traditionally, companies rely heavily on tangible assets to determine the value of a company. However, with the emergence of a knowledge-based economy, intellectual capital (*IC*) contributes more to this value (Abeysekera & Guthrie, 2004). Nonetheless, among the *IC* components, human capital is limitedly disclosed and mostly in narrative form and cannot be expressed in terms of the financial implications (Huang et al., 2013). This has raised concern on the relevance of *HC* information in investment decision making especially in Malaysia which has been known as the legal system and capital market is well developed (Mohamad, Hassan, & Ariff, 2007) but the information environment is not rich (Ball, Robin, & Wu, 2003). Furthermore, Malaysia, a country which economy is small in size and open, is vulnerable to inconsistent market sentiment (Jarita & Salina, 2009) where investors are irrational as they may be acting on rumours or by the behaviour of other investors (Brahmana, Chee, & Ahmad, 2012; Kaminsky & Schmukler, 1999).

Study on *HC* disclosure in Malaysia is still at the infancy stage. Most of prior studies were focusing on intellectual capital which mostly are looking at the level and type of *IC* (Abeysekera & Guthrie, 2005; Goh & Lim, 2004; Haji & Ghazali, 2012; Musliha & Rashidah, 2013; Vafaei, Taylor, & Ahmed, 2011) and the value relevance of *ICD* to investors (Abdolmohammadi, 2005; Abdul-shukur, Ibrahim, Kaur, & Md-nor, 2008; Vafaei et al., 2011). Studies that examine *HC* disclosure have been reported in Abeysekera and Guthrie (2004); Fontana and Macagnan (2013); Huang et al. (2013); Noradiva, Mohamat Sabri, Zakiah, Azlina, and Shukriah (2013). However these studies were focusing on the disclosure practice based on a content analysis. Nevertheless, few studies had been conduct to examine the value relevance of *HCD* (Beattie & Smith, 2010; Gamerschlag, 2013), especially in Malaysia still limited. This has create an opportunity to provide evidence on how Malaysian investors value *HCD* in investment decision making. Therefore, the purpose of this study is to examine the role of *HCD* in influencing the firm's share price.

The rest of this paper is organized as follows. Section 2 reviews prior literature and hypothesis development. Section 3 describes the current research methodology. Section 4 presents the empirical results, and Section 5 summarizes and concludes the paper.

## LITERATURE REVIEW

### Hcd Information From Signalling and Efficient Capital Market Theory

*IC* is categorized into three components: human capital (*HC*), relational or customer capital (*RC*) and structural capital (*SC*). According to Huang, Luther and Tayles, (2007), *HC* is a key component of *IC*. Tayles, Pike and Sofian (2007) describe *HC* as knowledge, skills and professional experience and creativity of employees; *RC* involves market-related knowledge, customer relationships and network suppliers and government or industry and *SC* consists of innovation or intellectual property such as patents and process and procedures used by the company. This is almost similar to CIMA (2001). According to CIMA (2001), *HC* is defined as the knowledge, skills and experience possessed by employees and will be brought together when they leave the company. Some of this knowledge is unique to the individual, such as the ability to innovate, creativity, knowledge and previous experience, teamwork, employee flexibility, tolerance, motivation, satisfaction, learning capacity, loyalty, formal training and education. However, prior studies showed that *HCD* in the annual report is based on the voluntary discretion of the manager (Nielsen & Madsen, 2009). Therefore, in the absent of *HC* information, investors and other stakeholders cannot make an assessment of the actual potential of the

company. This is because there is an information gap between companies and their stakeholders (Anam, Fatima, & Majdi 2011; Lin, Huang, Du, & Lin 2012; Watson, Shrivies & Marston, 2002). Accordingly this 'important asset' should be disclosed in the annual report of the companies as a signal to stakeholders the real value and the ability of companies to success.

*HC* information can be a signal as it can reduce the information asymmetry and describe the human capital 'owned' by the company (Kirmani & Rao, 2000). However prior studies indicate the level of disclosure still low and require evidence on the important of this information to the investors. This is because investors, financial analysts and other stakeholders are said considering available information in their decision to sell or buy firm's shares (Gamerschlag, 2013). *HC* information might be one of the information relevant to their decision making. To explain the relevancy and reliability of *HC* information, efficient capital market theory is used. The theory suggests that the share prices always reflect all publicly available information (Fama, 1991).

Studies on disclosure of *IC* and *HC* are increasing and getting the attention of researchers. Prior studies in accounting related to *IC* are varied but focused mainly related to external reporting. However, according to Tayles et al. (2007), external reporting provides very limited information related to intangible assets and argues that the capital markets require more reliable information about corporate knowledge resources such as strategic direction, risk factors, experience, integrity and quality of management. Therefore, voluntary disclosure of information in the annual report of *HC* may assist investors in assessing the potential and efficiency of the employees of the company in generating profits. This disclosure gives a signal to the capital market on the company's ability to create the future through the expertise of its *HC*. This allows investors to make a more accurate assessment of the actual ability of the companies (Whiting & Miller, 2008), thus react positively to affects the share price. People make decisions based on public information which is available for free, and personal information, which can only be acquired by certain group of people. According to Barth, Beaver and Landsman (2001) the information is relevant if it can affect the market value of the company, which reflect the values confidence of investor. This statement was also supported by Deegan (2010) which states, additional disclosure beyond required by accounting rules, have benefit in the capital market. In relation to *HC* information, Gamerschlag (2013) provides evidence that Germany capital market regards *HCD* reliable and relevant for investors in their long-term investment decisions but not immediately, which is the disclosed information does not lead in determining firm's share prices in short term run. The question is does this finding represent other countries or jurisdiction especially developing countries like Malaysia.

### **Value Relevance of Human Capital Information**

Studies on *ICD* in Malaysia indicate an increasing trend on *HCD* (Haji & Ghazali, 2012). This leads to a conclusion on the relevance of *HC* information among stakeholders. However, empirical evidence on the value relevance of *HC* information is very limited, particularly the overall (especially nonfinancial) *HC* information provided in corporate annual reports (Gamerschlag, 2013). Gamerschlag (2013) investigates the relevance of *HC* information disclosure among Germany companies for a period between 2005 and 2008. The study indicates in the long run the *HCD* is value relevant. Among *HCD* components, human capital qualification is value relevant. In Gamerschlag (2013) study, *HCD* is categorised into three; i.e. qualification/competence, motivation/commitment and personnel.

Prior studies acknowledge cultural and regulatory aspects might limit generalizability of findings to other jurisdiction. Therefore, the value relevance of *HCD* in other countries, in particular developed countries, might not be applied in some developing countries. For example, Abeysekera (2007) indicates there are differences in *IC* reporting between Sri Lankan (developing) and Australian (developed) companies. He acknowledges that these differences can be attributed to economic, social and political factors. We aspect similar findings might be reposted in Malaysia as it has been known as a country where the capital market is vulnerable to inconsistent market sentiment (Jarita & Salina, 2009) and where investors are irrational (Brahmana et al., 2012; Kaminsky & Schmukler, 1999). However, in term of disclosure practice, Malaysian companies are said not disclose much *HC* information, in fact financial analysts and fund managers found some important human capital information (such as competence, expertise motivation and level of employee trainings) are not available in the annual report (Huang et al., 2013). Huang et al. (2013) indicate there is an information asymmetry between preparers and users of financial information in Malaysia. Therefore, this study seeks to extend the above studies by examining the reliability and relevancy of human capital information among Malaysian investors. We believe Huang et al. (2013) provide evidences Malaysian investors do value *HC* information important for their decision making. If so, it has to be translated with changes in the share prices of the company. Therefore, we hypothesised that:

$H_1$ : Human capital disclosure is significantly related to share price of the company.

## METHODOLOGY

### Sample Selection and Source of Data

The study focuses on 100 largest listed companies on the main board of Bursa Malaysia. The data were collected from the 2013 annual reports. Due to some missing data, 18 companies were excluded. The final data set for analysis consists of 82 companies. Table 1 offers a summary of the data sources, the dependent and independent variables, as well as their abbreviations.

### Content Analysis of Annual Reports

The main focus of this study is human capital disclosure (*HCD*) of firms listed on the main board of Bursa Malaysia. Similar to prior studies (example, Gamerschlag, 2013 and Abdolmohammadi, 2005), we measure *HCD* based on a content analysis, which involved reading the annual report of each company and coding the information contain therein in accordance with the *HCD* indicators (Guthrie & Petty, 2000). Table 2 presents 30 keywords related to human capital information which were classified into two categories. The categories are director-related information and employee-related information. The classifications were in accordance of the disclosure practice among companies in Malaysia (see Huang et al., 2013). The keywords were used as a checklist during the content analysis activity. The checklist was developed based on Abeysekera (2008) and Huang et al. (2013). The current study uses words as the unit of analysis. The keywords were first searched and the sentence was read carefully to check whether it was relevant and whether any further explanation or description was given. The extent of *HCD* was measured on a dichotomous basis (1 or 0), which is consistent with Alsaeed (2006), Fontana and Macagnan (2013) and Ousama, Fatima and Hafiz-Majdi (2012). The approach, which focuses on the absence or presence of the items in the disclosure checklist, used in scoring the level of the *HCD* assigns 1 if an item in the checklist appears in the annual report and 0 otherwise. The level of human capital disclosure (*LHCD*) can be obtained by the following formula:

$$LHCD = \frac{TADS}{MRDI}$$

where *TADS* is the total actual disclosure score for a company and *MRDI* is the maximum relevant disclosure items score.

### Valuation Model and Measurement of Variables

The valuation model is used to investigate the relationship between the accounting figures and the company values (Ota, 2001). According to Gamerschlag (2013), studies on value relevance use various valuation models, and usually, the equity market valuation is used as a benchmark to evaluate how certain accounting figures reflect information that investors may use. There are two types of model commonly used to study the relationship between the market value and the accounting figures; the price and the return models (Ohlson, 1995). These models are the most widely valuation models used (Ota, 2001). For the purpose of this study we extend the Ohlson (1995) price valuation model. We incorporate level of *HCD* and industry dummy in the Ohlson (1995) model. This is represented in the following regression model.

$$SP_{i,t} = \alpha_0 + \alpha_1 BVE_{i,t} + \alpha_2 NI_{i,t} + \alpha_3 LHCD_{i,t} + \alpha_4 IND_{i,t} + \varepsilon_{i,t} \quad (1)$$

where *SP* is the share price (of common shares) of company three months after year-end for firm *i* at time *t*; *BVE* is the book value of equity per share at year-end for firm *i* at time *t*; *NI* is the net income per share for firm *i* at time *t*; *LHCD* is the level of human capital disclosure for firm *i* at time *t* and *IND* is type of industry for firm *i* at time *t*. *LHCD* can be interpreted as the “other information” contained in the model.

## RESEARCH FINDINGS

### Descriptive Statistics

Table 2 presents the frequency of companies' disclosing each of the human capital items and the nature of such disclosure in their annual reports. It can be seen that companies tend to disclose mostly director-related information and less on employees. This is consistent with Huang et al. (2013). However, the level of disclosure for both categories was increasing in the current study as compared to Huang et al. (2013). Comparing with Huang et al. (2013), the current study except for directors' years of experience in business and directors qualifications, the level of other directors-related information disclosed in 2013 annual report is higher than Huang et al. (2013). Similar results were also reported for employee-related information. The level of employee-related information disclosed in 2013 annual report is higher in our study as compared to Huang et al. (2013). Our study indicates that the most frequently disclosed item was employee involvement in the community and employee thanked (81 per cent), while employees' profitability is the less item disclosed (6 per cent). Nevertheless, the score is higher than Huang et al. (2013). Table 3 presents the descriptive statistics after adjusting the outliers. The table indicates that the dependence variables' dispersion is on an acceptable level with Skewness .462 and Kurtosis -.142.

Table 4 presents the Pearson correlations for the dependent as well as the independent variables. Table 4 indicates share price (*LNSP*) is significantly related with net income and book value of equity. This is consistent with Gamerschlag (2013). The highest correlation is at 0.798, i.e. between *SP* and *NI*. However, no significant association can be identified between the *LHCD* and share price *SP*.

### Regression Analysis

To examine the value relevance of *HCD* the regression Equation 1 was used (result referring to table 5). However prior to that, we estimate equation 1 without the dummy variable of *IND*. The purpose of this estimation is to identify whether *LHCD* really important for shareholders. Our analysis (not reported) indicates that *BVE* and *NI* are significantly related to share price of the companies. However, *LHCD* is not value relevant. These findings remain after we include *IND* (a dummy variable which represent Finance, Trading, Consumer and Plantation industries) in our estimation (Equation 1). Our finding is consistent with Gamerschlag (2013) which indicates in a short run period, the human capital disclosure is not value relevant. However, we believe some of the component of human capital information might be value relevant as our content analysis (Table 2) and findings from prior studies indicate the level of disclosure among human capital information is biased toward certain component. Therefore, we re-estimate Equation 1 by separating the *LHCD* into level human capital disclosure related to director (*LHCD\_D*) and human capital disclosure related to employees (*LHCD\_E*).

Table 6 presents results for this analysis. Table 6 indicates, besides the accounting numbers, shareholders in Malaysia regard the level human capital disclosure related to director (*LHCD\_D*) as reliable and relevant for their investment decision making. The analysis reveals a positive relationship between *LNSP* and *BVE*, *NI* and as well as with *LHCD\_D* with  $p < 0.01$ . However the other independent variables are not value relevant, especially *LHCD\_E*. Our findings provide evidence to confirm Gamerschlag (2013) that human capital information does not directly lead to any capital market reactions in short-term. However, in this study, we provide evidence human capital information related to directors is value relevant, this finding contradict with Huang *et al.* (2013) which indicates that directors whom may be figureheads with little impact on the way companies are run and in creating value for the companies.

## CONCLUSIONS

The objective of this study is to provide evidence on the value relevance of human capital information. We extend Gamerschlag (2013) by providing evidence on the value relevance of human capital information in a developing country for an immediate period of time. Consistent with previous studies we provide evidence on the level of human capital information disclosed in the annual report has been increased. However, companies tend to disclose mostly director-related information and less on employees. The emphasis on directors may be to comply with the Malaysian Code of Corporate Governance for legitimation rather than fulfilling decision-usefulness purposes. The result shows that, there is no connection between overall *HC* information and share price. However, further analysis

indicates that human capital information related to directors is value relevant. This finding is slightly contradict with Huang et al. (2013). Therefore, the current study contributes to the literature on the role that voluntary *HCD* plays in Malaysia capital markets to reduce information asymmetries arising between the companies and the capital market players. In addition, the findings related to *HCD* relationship with share prices can help standard setters in determine the kind of information companies should disclose on human capital issues. Our findings provide evidence to companies such information can create value of the firm.

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TABLE 1: Source of Data

Variable	Abbreviation	Measure Explanation	Sources
Share price	SP	Share price at the end of the reporting period (quarter)	Kuala Lumpur Stock Exchange (KLSE) info <a href="http://www.klse.info">http://www.klse.info</a>
Book value of equity per share	BVE	Book value of equity per share	Thomson One <a href="https://www.thomsonone.com">https://www.thomsonone.com</a>
Net income per share	NI	Net income per share	Thomson One <a href="https://www.thomsonone.com">https://www.thomsonone.com</a>
Total disclosure index	HCD	Extracted from the reports by means of content analysis	Annual reports from companies/ Bursa Malaysia website

TABLE 2: Human Capital Information Disclosure Frequency

	<b>Human capital information</b>	<b>Frequency</b>	<b>Percent</b>
<b>Director-related information</b>	Directors' years of experience in business	82	100.0
	Directors' qualifications	81	98.8
	Directors' skills	81	98.8
	Directors' training programme	82	100.0
	Directors' education	82	100.0
	Directors' knowledge	76	92.7
	Directors' expertise	63	76.8
	Directors' competence	57	69.5
<b>Employee-related information</b>	Leadership qualities of directors (management team)	34	41.5
	Recruitment policy	23	28.0
	Employee training programmes	74	90.2
	Succession plan	39	47.6
	Employees' skills	65	79.3
	Employees' competence	40	48.8
	Employees' innovation/ entrepreneurial spirit	32	39.0
	Employees' expertise	21	25.6
	Leadership qualities of employees	44	53.7
	Employees' knowledge	42	51.2
	Employees' education	24	29.3
	Work safety and health	69	84.1
	Employee loyalty	20	24.4
	Employee incentive scheme	30	36.6
	Employees' motivation	19	23.2
	Employees' profitability	6	7.3
	Employee satisfaction	18	22.0
	Employee involvement in the community	81	98.8
	Union activity	16	19.5
	Employee thanked	81	98.8
Employee numbers	36	43.9	
Equity issues: race, gender and religion	40	48.8	



TABLE 3: Descriptive Statistics after adjusting the outliers

	<b>N</b>	<b>Min</b>	<b>Max</b>	<b>Mean</b>		<b>SD</b>	<b>Skewness</b>		<b>Kurtosis</b>	
	<b>Statistic</b>	<b>Statistic</b>	<b>Statistic</b>	<b>Statistic</b>	<b>SE</b>	<b>Statistic</b>	<b>Statistic</b>	<b>SE</b>	<b>Statistic</b>	<b>SE</b>
<i>LNSP</i>	82	-.08	4.20	1.8081	.1006	.9111	.462	.266	-.142	.526
<i>BVE</i>	82	.085	13.204	3.2674	.2918	2.6428	1.558	.266	2.563	.526
<i>NI</i>	82	-.520	2.880	.4705	.0576	.5212	2.358	.266	7.484	.526
<i>LHCD_D</i>	82	.133	.267	.2456	.0032	.0286	-1.493	.266	2.461	.526
<i>LHCD_E</i>	82	.067	.700	.3472	.0166	.1500	.423	.266	-.214	.526
<i>LHCD</i>	82	.300	.967	.5927	.0176	.1595	.481	.266	-.259	.526

TABLE 4: Pearson Correlations – dependent and independent variables

	<i>LNSP</i>	<i>BVE</i>	<i>NI</i>	<i>LHCD_D</i>	<i>LHCD_E</i>	<i>LHCD</i>
<i>LNSP</i>	1					
<i>BVE</i>	.551**	1				
<i>NI</i>	.798**	.387**	1			
<i>LHCD_D</i>	.136	-.250*	-.010	1		
<i>LHCD_E</i>	.151	-.032	.162	.251*	1	
<i>LHCD</i>	.166	-.075	.151			1

\*\* and \* are significant at  $p < 0.01$  and  $P < 0.05$ , respectively.

TABLE 5: Regression analysis – value relevance of human capital information  
Coefficients<sup>a</sup>

	<b>Model</b>	<b>Unstandardized Coefficients</b>		<b>Standardized Coefficients</b>	<b>t</b>	<b>Sig.</b>
		<b>B</b>	<b>Std. Error</b>	<b>Beta</b>		
1	(Constant)	.588	.245		2.404	.019
	<i>BVE</i>	.106	.024	.308	4.416	.000
	<i>NI</i>	1.144	.134	.654	8.567	.000
	<i>LHCD</i>	.555	.377	.097	1.472	.145
	Finance	-.094	.192	-.038	-.487	.628
	Trading	.038	.160	.019	.235	.815
	Consumer	.096	.198	.040	.485	.629
	Plant	-.043	.187	-.017	-.228	.821

Adjusted R Square                      0.690  
 F-value (probability)                    26.742

TABLE 6: Regression Analysis – Value Relevance Of Human Capital Information (Further Analysis)  
Coefficients<sup>a</sup>

	Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.993	.496		-2.002	.049
	<i>BVE</i>	.127	.023	.369	5.506	.000
	<i>NI</i>	1.147	.124	.656	9.254	.000
	<i>LHCD_D</i>	7.647	2.009	.240	3.807	.000
	<i>LHCD_E</i>	-.055	.389	-.009	-.140	.889
	Finance	-.032	.180	-.013	-.180	.858
	Trading	.038	.149	.019	.257	.798
	Consumer	.021	.185	.009	.115	.909
	Plant	-.144	.176	-.058	-.819	.416
Adjusted R Square		0.733				
<i>F</i> -value (probability)		28.759				