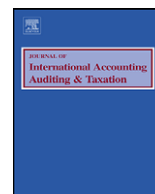




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Family ownership, board independence and voluntary disclosure: Evidence from Hong Kong

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ABSTRACT

This paper empirically examines the relationship between the extent of voluntary disclosure and levels of family ownership and board independence including the influence of an independent chairman. Using hand-collected data on voluntary disclosure for a sample of 273 listed firms in Hong Kong for the year 2002, the results show that at moderate to low levels of family shareholding (25% or less), the convergence of interest effect is dominant and the extent of voluntary disclosure is relatively low. At higher levels of family shareholding (more than 25%), the entrenchment effect dominates and is associated with higher voluntary disclosure. In addition, the results show that the appointment of an independent chairman is positively associated with the level of voluntary disclosure. Most importantly, the appointment of an independent chairman appears to mitigate the influence of family ownership on voluntary disclosures, and holds for firms with a non-independent chairman. While the extent to which independent non-executive directors are appointed to the board is positively associated with voluntary disclosure, the role of such directors is mitigated by the role of chairman.

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1. Introduction

The primary purpose of this paper is to extend prior research on voluntary disclosure to Hong Kong (HK) by examining whether the association between the extent of voluntary disclosure and the level of family ownership is non-monotonic based on the convergence of interest and management entrenchment hypotheses. Various studies (Claessens, Djankov, Fan, & Lang, 2002; Claessens, Djankov, & Lang, 2000; Lemmon & Lins, 2003; Morck, Shleifer, & Vishny, 1988; Shleifer & Vishny, 1997) show that when firms become controlled effectively by individuals or families, deviations in the control of cash flow rights induce the controlling shareholders to expropriate wealth by seeking personal benefits at the expense of minority shareholders. This result represents a special agency problem of conflict between controlling shareholders and minority shareholders. It is conjectured that when the owner's holding increases, convergence of interest between the controlling shareholders and outside investors occurs. Thus, an increase in the owner's holding will decrease investors' needs to monitor insiders, thereby reducing the need for financial disclosure. On the other hand, high ownership can also entrench insiders, causing the presence of information asymmetry problems between the insiders and outside investors. When investment decisions are more likely to be made to maximize the insiders' wealth at the expense of outside investors, outsiders will find it necessary to oversee owner managers by increasing the extent of financial disclosures.

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This research also examines the impact of the inter-relationship between three corporate governance attributes (independent chairman, independent non-executive directors (INEDs) and family ownership) on the level of voluntary disclosure. This inter-relationship in the context of voluntary disclosure in an East Asian setting has not been fully examined in the accounting literature to date. [Chen and Jaggi \(2000\)](#) investigated board independence and its inter-relationship with family ownership in HK; [Ho and Wong \(2001\)](#) investigated board independence in HK; [Chau and Gray \(2002\)](#) investigated the influence of outside ownership in HK; [Eng and Mak \(2003\)](#) investigated ownership and board composition in Singapore; [Gul and Leung \(2004\)](#) investigated CEO/chairman duality, board independence and the inter-relationship between these two variables in HK; and [Wang, Sewon, and Claiborne \(2008\)](#) examined the influence of ownership structure in China.

In addition, the research investigates whether an independent chairman has an impact on the level of voluntary disclosure. Because an independent chairman is considered to be less influenced by management, he/she may be less likely to withhold unfavorable information to outsiders. Finally, we also investigate whether a higher proportion of INEDs on the board enhances the quality of voluntary disclosures. It can be argued that a higher proportion of INEDs on boards is likely to result in a more effective monitoring of boards, resulting in higher levels of voluntary disclosure.

Corporate voluntary disclosure and its determinants have been of interest to accounting researchers since the 1970s. The issue has been investigated based on agency theory ([Jensen & Meckling, 1976](#)), signaling theory ([Hughes, 1986](#)) and competition theory ([Darrough & Stoughton, 1990](#)). Empirical research on the determinants of voluntary disclosure has a long history, dating back to work carried out by [Cerf \(1961\)](#). This research has resulted in two streams of subsequent studies. One stream is focused on the impact of firm specific characteristics such as size, listing, leverage, profitability and growth on voluntary disclosure (see, for example, [Buzby, 1975](#); [Choi, 1973](#); [Cooke, 1991](#); [Firth, 1979](#); [Frost & Pownall, 1994](#); [Meek & Gray, 1989](#); [Meek, Robert, & Gray, 1995](#); [Turpin & DeZoort, 1998](#); [Wallace & Naser, 1995](#)). The other stream documents the impact of some important corporate governance variables such as ownership structure, board composition and board independence on the level of voluntary disclosure. Studies on governance variables include [Forker \(1992\)](#), who found a negative association between disclosure and CEO/chairman duality. [Chen and Jaggi \(2000\)](#) reported that board independence is positively related to financial disclosures and this relationship becomes weaker for family controlled firms. Further, [Ho and Wong \(2001\)](#) documented that the extent of voluntary disclosure is positively associated with audit committee and negatively related to family ownership. [Chau and Gray \(2002\)](#) found a positive relationship between the level of voluntary disclosure and outside ownership. [Eng and Mak \(2003\)](#) reported also that the extent of voluntary disclosure is negatively related to outside directors and managerial ownership. [Gul and Leung \(2004\)](#) found that CEO duality and board independence is associated with lower levels of voluntary disclosures. [Wang et al. \(2008\)](#) documented the positive relationship between ownership structure and the level of voluntary disclosure. In addition, analysis of the relationship between voluntary disclosure and ownership structure has found it to be linear in form (see [Turpin & DeZoort, 1998](#) for the U.S.; [Craswell & Taylor, 1992](#) for Australia; [Chau & Gray, 2002](#); [Eng & Mak, 2003](#); [Gul & Leung, 2004](#); [Ho & Wong, 2001](#); [Wang et al., 2008](#) for an East Asian setting).

This study investigates the linkage between corporate governance and voluntary disclosure in the unique setting of Hong Kong. While the separation of ownership and control is the dominating form of corporate governance in the U.S. and UK, family control is prevalent in HK ([Fan & Wong, 2002](#); [Jaggi & Leung, 2007](#); [La Porta, Lopez-De-Silanes, & Shleifer, 1999](#)). About 9 out of 10 listed companies in HK had one shareholder or one family group owning 25% or more of their issued capital according to a survey by the HK Society of Accountants (HKSA, 1997). Unlike the market-based corporate environment in countries such as the U.S., and the mixture of family-based and government-based ownership in Singapore, corporate governance in HK could best be described as a family-based corporate environment with a closely intertwined management and ownership structure. High ownership concentration in HK, especially among family shareholders, means that the traditional agency problem resulting from the separation of ownership and control is seldom observed in HK. Instead, this highly concentrated family ownership structure in HK may result in a special agency problem between controlling shareholders and minority shareholders. Thus, this unique setting in HK provides an opportunity to examine empirically the association between corporate governance and voluntary disclosure in a market where highly concentrated family ownership predominates.

This study is important for the following reasons. First, poor accounting information disclosure has been regarded as one of the major causes of the financial crisis in HK in 1997 ([Gul & Leung, 2004](#)), and additional demands are being made currently by regulatory bodies in HK for greater corporate governance. Second, [Gul and Leung \(2004\)](#) suggested that future HK studies should examine how family ownership structure is associated with corporate voluntary disclosures since this may result in a special agency problem between owner-managers (insiders) and minority shareholders. In addition, they argued that “voluntary disclosure is an issue of much concern for emerging markets such as Hong Kong where the development of the market relies heavily on reducing the information gap between insiders and investors” ([Gul & Leung, 2004](#), 352). Investors in emerging markets, such as HK, in comparison with their counterparts in other developed markets in the U.S. and UK, may require more corporate disclosure in order to make a proper assessment of a company’s performance. Third, good corporate governance and disclosure are essential to continuously attracting international investors and reducing firms’ cost of capital. Finally, this study is important for international investors in the HK stock market. For 2007/08, the contribution from international investors to HK stock market turnover value amounted to U.S.\$1200 billion, representing 41% of total turnover value ([HKEx, 2009](#)). Knowing the disclosure characteristics of HK companies could help investors make proper investment decisions.

The results of this study show that at moderate to low levels of family shareholding (25% or less), the convergence of interest effect is dominant and the extent of voluntary disclosure is relatively low. At higher levels of family shareholding

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