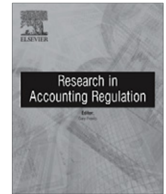
Research in Accounting Regulation 25 (2013) 101–107

Contents lists available at SciVerse ScienceDirect

Research in Accounting Regulation

journal homepage: www.elsevier.com/locate/racreg



Research Report

Family firm disclosure and accounting regulation reform in the Middle East: The case of Jordan

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ARTICLE INFO

Article history:
Available online 14 December 2012

Keywords:
Family firms
Accounting regulation
Mandatory disclosure
Voluntary disclosure

ABSTRACT

We examine the quality of accounting disclosures by family firms using mandatory and voluntary disclosures as proxies for the quality of disclosure. We find that family firms comply more fully with mandatory disclosure requirements than do non-family firms but they disclose significantly less voluntary information. We also document that the enhanced accounting regulation improves the strength of the association between family ownership and mandatory disclosure compliance. Another important finding is the greater disclosure, both mandatory and voluntary, for firms with high family ownership compared to firms with low family ownership.

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1. Introduction

Family ownership is a common and important ownership structure worldwide. In Jordan, family owned business groups are commonplace, with the average control position for the top 48 listed companies being about 30% of shares (ROSC, 2005).[2] Studies of family firms and their characteristics were motivated by the importance of understanding the economic efficiency of different governance mechanisms (Shleifer & Vishny, 1997). Prior research examining the disclosure practice of family firms has generally focused on voluntary disclosure and is mostly conducted in developed markets such as the United States where strong enforcement mechanisms exist. In this context, companies tend to comply fully with mandatory disclosure requirements and reveal additional information to the public on a voluntary basis. By contrast, the Middle Eastern region is characterized by weak regulatory environment, inefficient judicial systems and weak shareholders' rights. Yet, the region witnessed vast reforms to the disclosure and governance regulations (Al-Akra, Eddie, & Ali, 2010), hence, the aim of this study is to examine the disclosure practices of family and non-family firms' within two regulatory environments. Disclosure literature draws on agency theory to explain disclosure behavior of the different types of owners. It builds on two types of agency problems that arise from the differences in ownership structure, Type I (manager opportunism or the misalignment effect) and Type II (owner opportunism or the entrenchment effect) (Wan-Hussin, 2009). However, the effect of ownership structure on corporate disclosure remains disputed. On one hand, Wang (2006) argues that family firms are less likely to engage in opportunistic behavior. This is largely due to their desire to pass the firm onto subsequent generations, and concerns over family and firm reputation. As such, they would value firm long term survival (Anderson, Mansi, & Reeb, 2003). Also, Chen, Chen, and Cheng (2008) contend that family firms are more likely to internalize both the benefits of disclosure and the costs of nondisclosure. Accordingly, we expect that family firms' compliance with mandatory requirements to be higher than non-family firms since non-compliance entails reputation costs which are important for families. On the other hand, Fan and Wong (2002) argue that the entrenchment effect and the proprietary-information effect associated with concentrated

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[2] The number of listed companies at Amman Stock Exchange was 227 in 2007.

1052-0457/$ - see front matter © 2012 Elsevier Ltd. All rights reserved.
http://dx.doi.org/10.1016/j.racreg.2012.11.003

ownership result in reduced informativeness of accounting earnings. Moreover, family owners have longer investment horizons than other shareholders suggesting that additional voluntary information reflects little benefits to family owners (Chen et al., 2008). Also, family owners' active involvement in firms' management results in lower information asymmetry between themselves and managers. And, since family firms hold large shareholdings, they have more incentives to monitor management (Russ, Previts, & Coffman, 2009); the demand for information from non-family owners to monitor managers is lower due to the substitutive relation between direct monitoring and public disclosure. Therefore, it is expected that family firms' disclosure of voluntary information to be less than that of non-family firms. Jordan provides an ideal setting because (1) family firms are prevalent (ROSC, 2005), and (2) the Jordanian government introduced disclosure and governance regulatory reforms; hence, understanding the impact these reforms has on family firms' disclosure practices, takes on particular importance. Jordan enacted the 2002 Securities Law which mandated the adoption of the full version of IFRS and introduced penalties for non-complying firms. Further, this law strengthened legal investor protection and mandated the appointment of non-executive directors and audit committees and emphasized the board of directors' responsibilities in ensuring improved disclosure practices.

Accordingly, this study contributes to the literature on family ownership and disclosure practice in several important ways. First, while a number of studies examined the quality of disclosure practices of family firms, to date, no study examined the compliance of family firms with mandatory disclosure requirements. Further, studies of mandatory disclosure are lacking (Alexander, Ettredge, Stone & Sun, 2011); hence, our study makes another significant contribution to disclosure research.

Second, it extends previous research by investigating the association between family ownership and disclosure both mandatory and voluntary providing a comprehensive view of disclosure practice of family firms. Finally, it examines the effect of different regulatory regimes on the association between family ownership and disclosure quality.

Our sample consists of 160 firm-year observation for the years 2000 and 2004 (80 matched pairs of firms). Utilizing two checklists for the years 2000 and 2004, and using univariate testing and pooled regression models, we find a significant positive difference in the mandatory disclosure compliance of family firms compared to their non-family counterparts, and a significant negative difference in the voluntary disclosure of family firms compared to non-family firms. Further, the results show that the regulatory reforms enhanced the strength of the association between family ownership and mandatory disclosure compliance.

The remainder of the article proceeds as follows. The next section provides an overview of the regulatory reform in Jordan. Section 3 provides the research questions and develops the hypotheses. Section 4 presents the research design and methodological aspects of the study and the results are analyzed in Section 5. Finally, the last section concludes the paper.

2. Accounting regulatory reform in Jordan

The quality of Jordanian firms' disclosure was considered suboptimal (Solas, 1994), leaving the users of financial statements concerned about the reliability and adequacy of the information disclosed (Abu-Nassar & Rutherford, 1996). In 2002, Jordan enacted Securities Law No. 76. The law required all entities to fully comply with IFRS in the preparation of their annual reports. Most importantly, the 2002 Securities Law introduced enforcement mechanisms. Such mechanisms aim at enhancing reporting outcomes (Moehrle, Jonas, Kozloski & Reynolds-Moehrle, 2012). Jordan Securities Commission (JSC), the regulator of the capital market, was empowered by the 2002 Securities Law to issue fines, suspend trading or delist issuers. The JSC staff members are responsible for monitoring the quality of disclosure (ROSC, 2005).

Moreover, the 2002 Securities Law introduced elements from the OECD principles of corporate governance. It required listed entities to form audit committees comprised of three non-executive directors.[3] Most importantly, the 2002 Securities Law provided for stringent enforcement of rules through strengthening the powers of the JSC, ASE[4] and SDC (ASE, 2009). The law significantly strengthened the powers of JSC in protecting investors requiring all listed companies to register their shares ownership at the SDC (ROSC, 2005).[5]

3. Research questions

There are two types of agency costs. Type I costs arise from the separation of corporate ownership from corporate management. This can lead to conflict-of-interests if managers took actions that are not in the best interest of the owners. In order to align the interests of managers and owners, owners have to incur monitoring costs which managers bear. Thus, Type I agency costs for firms managed by non-owners are higher than owner-managed firms, and several studies provide evidence in that regard (Ang, Cole, & Lin, 1999; Fleming, Heaney, & McCosker, 2005; Singh & Davidson, 2003). Type II costs, on the other hand, exists when owner–managers become entrenched and can exploit minority owners (Shleifer & Vishny, 1997) resulting in "owner opportunism" (Anderson et al., 2003; Shleifer & Vishny, 1997).

However, certain factors mitigate the overall difference in agency problems between family and non-family firms. Compared to other shareholders, family owners usually have large concentrated equity holdings and are less

[3] The audit committee must meet at least four times a year to examine and discuss the company's internal control mechanisms and to monitor compliance with the requirements of the Securities Law (ROSC, 2004).

[4] Amman Stock Exchange (ASE) is in charge of many functions such as listing enterprises on the Exchange, monitoring and regulating market trading in coordination with the JSC, attaining a fair market and investor protection, ensuring the provision of timely and accurate information of issuers to the market and disseminating market information to the public (ASE, 2009).

[5] The Securities Depository Centre (SDC) is charged with safe keeping records of ownership of securities; registering and transferring ownership of securities traded on ASE; and settling the prices of securities among brokers (ASE, 2009).

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