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A discussion of 'corporate disclosure by family firms'

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Abstract

Using a unique empirical setting, family firms in the S&P 500, Ali et al. [Ali, A., Chen, T.-Y., Radhakrishnan, S., 2007. Corporate disclosures by family firms. Journal of Accounting and Economics, doi:10.1016/j.jacceco.2007.01.006] contribute to a growing body of research on the relation between corporate governance and corporate disclosure quality. Using an indicator variable for sub-sample membership as an instrument for differing agency costs, the authors interpret their findings as consistent with family firms facing lower overall agency costs and providing higher quality corporate disclosures. However, their empirical findings are open to alternative interpretations and in totality present relatively weak, indirect evidence of a relation between corporate governance and the quality of corporate disclosure.
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1. Introduction

Several years before the fall of Enron, regulators and other capital market participants made known their growing concerns about questionable disclosure practices and the quality of earnings reported by US Corporates (see Levitt, 1998; Brown, 1999; Parfet, 2000). Since Enron, corporate America has come under even greater scrutiny and increased regulation. E.g., Sarbanes Oxley is, at least in part, intended to enhance the role of corporate governance in safe guarding the quality of reported earnings and overall corporate disclosure.

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With growing interest in the topic, recently researchers have attempted to examine directly whether and how corporate governance affects earnings quality and overall corporate disclosure quality. Specifically, several research teams use the international setting to compare internationally the quality of corporate governance and disclosure (see e.g. Ball et al., 2003; Bushman et al., 2004; Khanna et al., 2004). While demonstrating that higher quality governance is associated with higher quality disclosure and greater transparency, the international research does not provide direct evidence on how specific differences in corporate governance practices across US firms affects the quality of their reported earnings and disclosure practices. Ali, Chen and Radhakrishnan (2007, hereafter ACR) attempt to address this very interesting question: Does cross-sectional variation in US corporate governance practices help to explain cross-sectional variation in managerial choices of corporate disclosure policies?

Using *Business Week*'s split of the S&P 500 into family and non-family firms, the ACR paper examines whether family firms' corporate disclosure policies differ from those of non-family firms. They argue that family firms face less severe agency problems arising from the separation of ownership and control, but more severe agency problems arising between controlling and non-controlling shareholders. The authors use an indicator variable for sub-sample membership as an instrument for differing agency costs and examine the relation between agency costs and corporate disclosure choice. The authors interpret the evidence presented as largely consistent with family firms facing lower overall agency costs and providing higher quality corporate disclosures.

The paper is a reasonable first attempt at demonstrating an association between agency costs and corporate disclosure within the US setting, in as much as it uses an interesting empirical setting—family firms in the S&P 500. However, the decision to examine family firms also raises concerns that key results are spurious. As I discuss below, if family firms only retain ownership and control of successful firms and if, as documented by Miller (2002), disclosure quality is positively related to firm performance, then the relation between family firms and disclosure choices may be spurious. Other empirical findings presented in the paper are also open to alternative interpretations. Thus, in totality the paper presents relatively weak and indirect evidence of a relation between corporate governance and the quality of corporate disclosure.

Section 2 outlines the research questions examined by ACR. Section 3 discusses *Business Week*'s definition of 'family firms', sample selection bias, and descriptive information. Section 4 comments on the tests reported in the paper and the interpretation of results. Section 5 summaries the contribution of the paper and provides suggestions for future research.

2. Research questions

The family firm versus the non-family firm distinction is employed to identify firms facing differing unresolved agency problems. Then, tests are developed to assess whether differences in agency problems are associated with differing corporate disclosure practices. The authors examine several aspects of corporate disclosure: Quality of earnings, disclosure of bad news through management earnings forecasts, and voluntary disclosure of corporate governance practices in regulatory filings.

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