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Firm geographic location and voluntary disclosure

Imen Derouiche[a], Kaouther Jaafar[b], Ahmed Zemzem[b,*]

[a] Unité de recherche CREA,University of Luxembourg, Luxembourg
[b] University of Sousse, Tunisie

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ABSTRACT

This study aims to shed light on the effect of a firm's geographic location on its voluntary disclosure policy. It hypothesizes that a firm's geographic distance from metropolitan areas increases the cost of oversight of managerial actions, which creates incentives for remotely located firms to make more voluntary disclosures in their annual reports that improve information available to investors and hence mitigate agency conflicts. Based on a sample of 260 French listed firms spanning the period 2007–2010, we find support for our hypothesis that as a firm's distance from the Paris region increases, its level of voluntary disclosure in annual reports increases as well. This is consistent with the notion that remote firms are likely to pre-commit to higher voluntary disclosure so as to reduce oversight costs arising from geographic remoteness and mitigate agency conflicts. Our results are robust to alternative measures of voluntary disclosure, to several geographic location proxies, and to alternative estimation techniques. Collectively, they confirm the positive effect of distance on the extent of voluntary disclosure.

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1. Introduction

Despite technological advances, firm geographic location still plays a major role in determining investment decisions. Firm proximity to core investors such as mutual funds, hedge funds, investment banks, and financial analysts increases firm visibility and makes the task of monitoring by external shareholders less costly. Therefore, proximate investors, both individuals and institutions, exhibit a higher propensity to invest in geographically proximate firms. Anecdotal evidence shows that many venture capitalists prefer to fund start-up companies that are located within a 20–minute drive from their offices. For instance, the social networking website Facebook moved its base of operations to Silicon Valley in 2004 to benefit from easier access to venture capital; one year later it received its first round of financing from Accel Partners, located just four blocks away from (Tian, 2011).

The literature on the relevance of geography in finance has grown since the findings of Coval and Moskowitz (1999, 2001) that investors prefer stocks of local companies. It is argued that geographic proximity provides investors with better access to firm local information, and hence is associated with better investor return (Ivkovicí and Weisbenner, 2005), more accurate analyst forecasts (Malloy, 2005), and better price formation in securities markets (Pirinsky and Wang, 2006). More recently, several studies show that a firm's geographic location plays a critical role in shaping corporate behavior, such as firm financing, investment, and payout decisions (El ghoul et al., 2012; John et al., 2011; Loughran, 2008; among others).

* Corresponding author at: High Institute of Business Studies, University of Sousse, Sahloul III, PO Box 40, 4054, Sousse, Tunisia.
E-mail address: ahz963@yahoo.fr (A. Zemzem).

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The present paper sheds additional light on the agency motives for voluntary disclosure and examines the impact that firm geographic location has on voluntary disclosure policy. We argue that firm geographic location affects the ability of outside investors to monitor and oversee firm management and, as a consequence, its voluntary disclosure policy. We posit that decreased observability of managerial decisions in remotely located firms leads to high oversight costs by outside investors, and we hypothesize that remote firms are more likely to make more voluntary disclosure to mitigate these costs. Our conjecture is consistent with agency theory, suggesting that less monitoring by outside shareholders may encourage self-interested managers to engage in corporate misbehavior, such as empire building and consuming perks, which in turn reduces firm profitability and destroys its value. To reduce potentially high oversight costs incurred by outside shareholders, firms pre-commit to greater voluntary disclosure (Jensen and Meckling, 1976). In this perspective, Healy and Palepu (2001) discuss how disclosure can reduce agency costs by providing outside investors with a tool for monitoring, which improves their ability to relate managerial decisions to firm performance. Considering this line of reasoning, geographic location is likely to matter in explaining firm voluntary disclosure choices in the presence of agency costs.

Our key conjecture is that distance to metropolitan areas is associated with increased monitoring costs by outside shareholders. Indeed, geographic distance decreases the ability of outside shareholders to oversee and monitor managerial actions, thereby increasing oversight costs that shareholders face. Unlike local investors, distant investors are less likely to inspect remotely located firms and to acquire knowledge about the management and internal operations. Gaspar and Massa (2007) argue that shareholders located away from company headquarters are less prone to undertake valuable monitoring activities, due to the higher costs of understanding the technical aspects of a firm's internal operations and obtaining information about the management culture.

The objective of this research is therefore to generate empirical evidence on the relation between a firm's geographic location and the extent of its voluntary disclosure in annual reports, within the agency theory framework. We specifically focus on the decision made by insiders to voluntarily disclose additional information in annual reports in a setting characterized by greater agency problems. We argue that geographic distance reduces the effectiveness of external monitoring by limiting the observability of managerial actions, and hence encourages remotely located firms to adopt voluntary disclosure practices in a way that improves information available to investors. Our analysis is conducted on French firms, which are characterized by a high level of concentrated ownership, and where the controlling shareholder is often at the helm of the firm (Faccio and Lang, 2002). In such an environment, the main agency problem arises between dominant shareholders and minority investors, rather than between managers and shareholders. Using geographic remoteness as a proxy for monitoring costs, we investigate the impact of firm geographic location on its voluntary disclosure policy in a setting characterized by greater agency problems between controlling and minority shareholders.

We use the distance between corporate headquarters and the Paris region to proxy for monitoring costs. We suggest that firms headquartered inside the Paris region have many potential investors nearby, while remotely located firms have fewer investors in their vicinity. Therefore, firms headquartered in and around the Paris region are expected to have lower monitoring costs, whereas firms headquartered far away from the Paris region are expected to have higher monitoring costs.

The present study is conducted in the French context, which presents an interesting, if not unique, setting for addressing the effect of distance on voluntary disclosure. First, ongoing corporate transparency challenges have urged French authorities to draw up several guidelines to encourage listed firms to increase their voluntary disclosure, such as Bouton report and Afep–Medef codes on corporate governance. French firms are, however, typically controlled by dominant shareholders who are more willing to take advantage of firm opacity to obtain private benefits of control. These opposite forces at work on corporate transparency make it interesting to address the issue of voluntary disclosure in France. Second, except for the study of Boubaker et al. (2015) examining the effect of geography on corporate cash holdings, there is no research linking geography and corporate practices in the French context. Different from the U.S. featuring metropolitan decentralization, the Paris region is considered as the unique influential metropolitan area in France (Guillain and Le Gallo, 2010). All these factors make of France a suitable laboratory for examining how remoteness from metropolitan areas can affect the extent of voluntary disclosure.

To test the impact of firm location on the extent of voluntary disclosure in annual reports, we use a sample of 1040 firm–year observations for 260 French listed firms spanning the period 2007–2010. We hand-collect data on voluntary disclosure from firms' annual reports. We analyze the content of the annual reports of sampled firms to determine the level of voluntary disclosure of each company based on a self-constructed index following prior voluntary disclosure studies. We find that as firms' distance from the Paris region increases, the extent of voluntary disclosure in their annual reports increases. This result supports our hypothesis that greater distances from metropolitan areas increase information distortions in remotely located firms, which reduces the observability of managerial actions to shareholders. Thus, remote firms have greater incentive to voluntarily disclose more information in their annual reports to improve information available to investors and increase firm value. Moreover, our results are robust to alternative variable definitions and to alternative estimation techniques.

This research contributes to the literature on the effect of geographic proximity on corporate finance decisions. It empirically tests the impact that a firm's location has on its voluntary disclosure policy. There are a handful of papers in the corporate finance literature that examine the relevance of geography on corporate policies. For instance, Loughran (2008) highlights that rural firms are less likely to conduct seasoned equity offerings compared to urban firms, since geographic remoteness inhibits outside investors, who are at a significant information disadvantage regarding remotely located firms, from buying rural stocks in the event of an offering. At the same time, Kedia et al. (2008) report that acquirers earn signif-

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