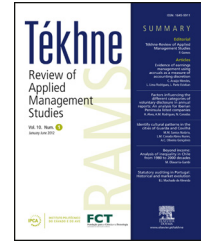




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ARTICLE

# Voluntary disclosure, information asymmetry and the perception of governance quality: An analysis using a structural equation model

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## KEYWORDS

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**Abstract** This study analyzes the direct and indirect relation between the governance rules and information asymmetry, through the voluntary disclosure and organizational performance, using Iberian Peninsula listed companies. The results show that for firms with high levels of disclosure the bid–ask spread is lower. However, in firms with a high ownership concentration investors tend to increase the bid–ask spreads and trade less. The results show us how the governance rules exert influence on the proxies of information asymmetry in the market. The failure to find the relationship between voluntary disclosure of information and the turnover ratio shows us that the liquidity of shares is more related to the greater or lesser concentration of shareholders, with the performance of their companies than with the access to information. Moreover, it is clear that the role that information disclosure plays in these markets is mainly at the level of price formation.

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## 1. Introduction

In the last years, authorities and market regulators considered corporate governance and disclosure as two inseparable key instruments for investor protection and the functioning of capital markets. This protection namely refers to the reinforcement of the administrators' loyalty and responsibility, the role of the non-executive independent

administrators as supervisors, the structure of supervision and, within the purpose of this work, the transparency between the company and the market. According to Buskirk (2012) the relation between disclosure and information asymmetry is multi-dimensional. Our purpose is to empirically examine the direct and indirect relation between the governance rules and information asymmetry, through the voluntary disclosure and organizational performance.

The separation of ownership and control in publicly listed companies gives rise to information asymmetries between managers and investors because managers have superior information on the firm's current and future performance to

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outside investors (Jensen & Meckling, 1976; Myers & Majluf, 1984). The literature recognizes that firms might find it advantageous to give additional pieces of information to outsiders, through the annual report or other communication channels (e.g. García Benau and Monterrey Mayoral, 1993). The information asymmetry between firms and potential investors, due to a low level of disclosure, increases the cost of capital by introducing the adverse selection between buyers and sellers of the firm's shares (Petersen & Plenborg, 2006). According to Rinaldo (2002) the information asymmetry refers to information not yet embodied in the fundamental asset value.

According to Welker (1995) considerable resources have been devoted to establishing and enforcing regulations intended to improve public perceptions of corporate disclosure practices. Past literature has pointed out the adverse effects that information asymmetries have on the functioning of markets (Akerlof, 1970). Information asymmetry is thought to promote a reluctance to trade and increase the cost of capital as investors "price protect" against potential losses from trading with better informed market participants (Bhattacharya & Spiegel, 1991). The results of prior studies about the relation between voluntary disclosure and information asymmetry suggest that voluntary public information can reduce the level of information asymmetry among market participants, and thus can help to form an efficient market. Analytically, Barry and Brown (1985), Diamond (1985), Diamond and Verrecchia (1991) and Kim and Verrecchia (1994) argue that more information generally reduces information risk on prices. Likewise, voluntary disclosure serves to reduce information asymmetry among traders. Empirically, Welker (1995), Healy, Hutton, and Palepu (1999) and Leuz and Verrecchia (2000) investigate links between voluntary disclosure and stock liquidity. Companies might pursue a disclosure strategy in response to perceived illiquidity for their shares in the market. Disclosure literature has shown that high quality of public disclosures reduce information asymmetry and, as a result, increase stock market liquidity. Welker (1995), Bushee and Noe (2000) and Leuz and Verrecchia (2000) argue that information asymmetry could be measured by both trade-based and order-based measures, i.e. transaction volumes and bid-ask spreads.

Voluntary disclosure is a channel through which existing and potential shareholders obtain value information about the firm, namely about the company's performance, been, for that reason, the connection between corporate "insiders" and capital market "outsiders". Through the 1970s and 1980s the research on corporate governance issues was largely focused on United States corporations. In more recent years, however, we have witnessed an explosion of research on corporate governance around the world, for both developed and emerging markets. Despite this, and according to Méndez and García (2007), in contexts featured by high ownership concentration and board of directors dominated by representatives of controlling shareholders, it is more difficult to extrapolate from studies on the Anglo-Saxon markets. Specific research is therefore needed to take in account these features, which are the norm in many countries (Shleifer & Vishny, 1997). The Spanish and Portuguese institutional setting has in common with other European Continental countries a relatively low number of

listed companies, an illiquid capital market and, above all, a high level of concentration in corporate shareholdings. According to Denis and McConnell (2003, p. 29), concentrated ownership can be a "reasonable response to a lack of investor protection". In this sense, Spain and Portugal provide a suitable environment to test the existence of interactions among governance rules, corporate voluntary disclosure and information asymmetry in the market. According to Esperança, Sousa, Soares, and Pereira (2011) good governance practices are essential to give confidence to investors. Given that the information provided reflects the degree of transparency and accountability of the organization with shareholders, it becomes one of the most important aspects of corporate governance. To Khlifi and Bouri (2010) the most important motive for corporate disclosure is to reduce information asymmetry between corporate management and outside investors. Recently Shroff, Sun, White, and Zhang (2013) and Hinson and Utke (2015) results show that voluntary disclosure quality reduces both information risk and information asymmetry.

We built a voluntary disclosure index based on the information firms provided in their annual reports and public websites and used the turnover ratio and the bid-ask spread as proxies for the information asymmetry in the market. We divided the governance characteristics in two constructs: directors' and supervisors' structures and ownership structure. By using the methodology of structural equation modelling, we are able to analyze the direct and indirect relations among the variables under study. Consistently with prior definitions in different regulatory national environments (Allegrini & Greco, 2011; Cooke, 1989; Depoers, 2000; Meek, Roberts, & Gray, 1995; Raffournier, 1995), we consider voluntary disclosure as the information released to the outside deriving from management's insider knowledge of the company, which are not required to be published in regulated reports. Voluntary disclosure is, therefore, produced by a management's reporting decision (Healy & Palepu, 2001; Meek et al., 1995). We analyzed the information disclosed by Iberian Peninsula non-financial listed companies, concerning the year of 2007. In this sense, we analyzed the information disclosed few time after the obligation of following International Financial Reporting Standards (IFRS) as endorsed by the European Union. Furthermore, in Spain, the Unified Good Governance Code, applicable from 2007 onwards, provided a common standard for the good governance practices of all listed firms. In Portugal, the recommendations on corporate governance were implemented in 2001, continuing to regularly improve its legislative framework through a process of bi-annual amendments. Therefore both countries share a common standard for the good governance and disclosure practices.

This paper is hereby intended to contribute to the study of the impact of the corporate governance rules in the voluntary disclosure of information and in the organizational performance, and hence in the reduction of information asymmetries, in the specific case and reality of the countries of the Iberian Peninsula. Furthermore, most of the prior research in this area has studied the link between corporate governance and disclosure and between disclosure and information asymmetry. Few studies directly examined the link between corporate governance and information asymmetry. One way of viewing the contribution of our study is that it

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