Voluntary disclosure and corporate governance

Introduction:

Theforces that give rise in demand of information disclosure in modern capital market stems from the information asymmetry and agency conflicts existing between the management and the stockholders. Therefore, the solution to agency conflicts lies in the ownership structure and the function of board of directors.

(Jensen and Meckling 1976) found that the Ownership structure is assessed by the proportion of shares held by managers and blockholders. So managerial ownership which is (the proportion of shares held by the CEO and executive directors) and blockholder ownership which is (the proportion of ordinary shares held by substantial shareholders) are two major governance mechanisms that help control agency problem. In addition, [Fama 1980] argues that the board of directors is the central internal control mechanism for monitoring managers.

Financial reporting and disclosure are important resources for management to communicate firms' performance and success of efficient capital market (ECM). Fama (1991) defined ECM as a market in which new information is accurately and quickly reflected in share prices.

The incentive to voluntarily reveal information still under interest to both analytical and the empirical researchers. Analytical research concerned and verified issues as how competition affects disclosure, (Darrough and Stoughton 1990). Empirical researchers documented the influence of firm characteristics like size, leverage, listing and managerial ownership on disclosure.

Firms provide disclosure by financial statements, management discussion and analysis, footnotes, furthermore some firms involved in voluntary supply such as internet sites, press releases, conference calls, management forecasts.

Corporate disclosure is proxied by an aggregate discloser score of annual report, including background information, summary of historical results, non financial statistics, projected information and management decision and analyses. (Botosan 1997])and (Endg and Mak 2003).

Voluntary disclosure is measured by the amount and detail of non mandatory information that is contained in the management decision and analyses in the annual report.

Research problem:

Corporate governance mechanism that is well practiced could benefit shareholder financially by exercising more control in the companies' management. Moreover, the corporate governance characteristic can be seen as proxies for independents and the alignment of interest between management and the shareholder in minimizing the agency conflict.

Many researches have been done among different countries to find out which factors could contribute to more disclosure by companies in their financial annual reports. Accordingly this research examines the impact of ownership structure, the profitability and board composition on corporate disclosure, in other words examining the relationship between corporate governance and voluntary disclosure, because the disclosure of information helps to reduce the cost of agency problems when there is an information asymmetry between management and shareholders .

The efficiency gab has been narrowed in the world’s major economies but there remain important gabs in what we know. In particular, we lack a sufficient understanding of the complicated ways in which the various corporate governance mechanisms interact with each other and with other characteristics of firms and economies.

Research Questions:

1. Is there any relationship betweenlevel of profitability and the extent of voluntary disclosure?
2. Is there any relationship between managerial ownership and the extent of voluntary disclosure?
3. Is there any relationship betweenthe family member sitting on the board and the extent of voluntary disclosure?

Research Objectives:

The main objective of this study is to examine whichamong the variables contribute to voluntary disclosure and which attributes drive management toward increase disclosure levels. Specifically, the objectives of this study are listed below:

- To examine whether level of profitability affect the extent of voluntary disclosure of companies in Jordan.
- To examine whether managerial ownership structure affects the extent of voluntary disclosure of companies in Jordan.

- To examine whether the family member sitting on the board affect the extent of voluntary disclosure of companies in Jordan.

Significance of Study:

There are many parties will get benefits from this study, corporations, regulators, policy makers, the analytical, andempirical researches. This research will improve their understanding on which corporate governance factors affect the extant of voluntary disclosure and will increase their information about this area via providing additional evidence on corporate governance and disclosure.

CHAPTER 2

LITERATURE REVIEW

Since separation of ownership and control is the predominant form of corporate governance, previous studies have investigated the relationship between the corporate governance mechanisms and firm's disclosure behaviors. Many different theoretical perspectives and research methods have been employed by a wide range of research questions covering different countries and time periods. For example studies have been done by Chow and Wong-Boren (1987); Penmann (1988), Cooke (1991), Hossain et al. (1994) and Balachandran (2004).

2. 1 Corporate governance

The prior study mentions that the corporate governance refers to the way companies are directed and controlled. A primary concern is the likelihood of a deviation in the objectives of corporate managers from those of shareholders due to the agency costs involved in monitoring managerial behavior (Berle and Means 1932).

Another study also mentions that the quality of corporate disclosures is associated with corporate governance characteristics. According to Bujaki and McConomy (2002), corporate governance has been described as “ the process and structure used to direct and manage business and affairs of the corporation with the objective of enhancing shareholder value”. Corporate governance has also been defined by the Finance Committee Report (1999) as “ the manner in which firm’s top officers are being monitored and discipline accordingly with the objective ofenhancing shareholders value”. It is also claimed that “ Corporate governance is the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long term shareholder value”.

Dey (1994) stated that proper corporate governance system can help ensure an effective division of authority among shareholders, the board of directors, and the management. According to recent reports by Newby (2001), investors are increasingly basing their investment decisions on companies’ corporate governance records and are willing to pay more for shares of well-governed companies compared to those of poorly governed companies. This premium for well-governed companies is explained by the role of corporate governance in a company’s overall risk management strategy.

2. 2 The agency theory

Jensen & Meckling (1976)in the agency theory provides a framework linking disclosure behavior to corporate governance. Corporate governance mechanisms are introduced to control the agency problem and ensure that managers act in the interests of shareholders. Theoretically, the impact of internal governance mechanisms on corporate disclosures may be complementary or substitutive. If it is complementary, agency theory predicts that a greater extent of disclosures is expected since the adoption of more governance mechanisms will strengthen the internal control of companies.

Further, agency theory provides a framework for analyzing financial reporting incentive between managers and owners. Signaling theory explains why firms have an incentive to report voluntarily to the capital market even if there were no mandatory reporting requirements, and voluntary disclosure is necessary in order to come successfully in the market for risk capital, the ability of the firm to raise capital will be improved if the firm has a good reputation with respect to financial reporting.

2. 3 Voluntary disclosure

Penmann (1988) stated that financial disclosure could be divided into mandatory and voluntary disclosures. Mandatory disclosure is defined as any financial item disclosed in companies annual reports that are prescribed by accounting standards and or the stock exchange regulations. However, voluntary disclosure is defined as any financial item or data disclosed in annual reports of companies that are not prescribed by the companies act and or accounting standards, and, in addition, for public-listed companies, the stock exchange regulations. Further, Meek, Roberts & Gray (1995) defined voluntary disclosures as disclosures in excess of requirements, representing free choices on the part of company managements to provide accounting and other information that deemed relevant to the decision needs of users of annual reports.

Many studies have been carried out to explain voluntary information disclosure such as Chow and Wong-Boren (1987); Cooke (1991) Hossain et al. (1994) and so forth in their attempt to determine different levels of disclosures and the association between firm's characteristics such as firm's size and industry type and the levels of disclosure.

In addition, good reporting is expected to lower firms cost of capital because there is less uncertainty in firms that reporting extensively and reliably. Therefore, there is less investments risk and lower required rate of return.

According to Welker (1995), managers are not likely to withhold information for their own benefits under an intensive-monitoring environment, because this could lead to improvement in disclosure comprehensiveness and quality of financial statements. On the other hand, if the relationship is substitutive, companies will not provide more disclosures for more governance mechanisms since one corporate governance mechanism may substitute one another. If information asymmetry in a firm can be reduced because of the existing internal monitoring packages, the need for having additional governance devices is considered smaller. These apparently conflicting viewpoints on the impact of corporate governance have not been totally resolved, in spite of this theoretical ambiguity.

Companies that perform well have a strong incentive to report their operating results. Competitive pressures would also force companies to report even though they did not have good results. Silence of a failure to report would be reinterpreted it as bad news. Companies with bad news would be motivated to report their results in order to avoid being suspected of having poor result. Such a situation would also force bad news firms to disclose results in order to maintain credibility in the capital market.

2. 4 The reasons for voluntary disclosure

Management of companies provides voluntary items in their annual reports because they perceived those items as important to be disclosed. Management wants to give information to users through annual reports in such a way that they are capable of meeting various needs of users for decision-making.

There are various user groups of annual reports and each group has different perception regarding the voluntary items. One group may perceive item A as more important than item B. These differing perceptions among groups might be caused by different information needs to fulfill their specific purposes. Through annual reports, users can obtain more firms' information relating to their decision-making. Although there are many sources of information regarding business entity, an annual report is considered the most important and valued source of information Vergoosen (1993).

With regard to reasons why companies disclose voluntary items, theory suggests that many of the reasons why managements disclose items voluntarily to users are centered on the need to raise capital at the lowest possible cost (Cooke 1989). The following explanations may support reasons why companies disclose information voluntarily:

1. Additional disclosures may help to attract new shareholders thereby helping to maintain a healthy demand for shares. Additional disclosure by providing more information relating to the present and future

condition of firm's wealth in order to build an image that may generate goodwill for future benefits (Iqbal et al 1997)

2. Increased information may assist in reducing informational risk, which could lower the cost of capital.
3. For the purpose of raising capital on the market, companies may increase their voluntary disclosure in annual reports. Consequently, listed companies are more likely to have a higher level of disclosure than unlisted companies
4. Multiple listed companies often have an interest in foreign capital markets since foreign operations are often financed by capital (Choi & Mueller 1992). Disclosure level might be increased to adapt to local customs to meet the requirements of banks and other suppliers of capital.
5. Listed and multiple listed companies might increase their social responsibility disclosure to demonstrate that they act responsibly (Watts & Zimerman 1979). Companies may have attained their status on the securities markets and are able to attract new shareholders for raising fund because they act responsibly (Cooke 1989)
6. Under the capital markets transactions hypothesis, managers who plan on making capital market transactions (i. e., issuing public debt or equity) have incentives to provide voluntary disclosures to reduce information asymmetry between the managers and investors (Healy and Palepu 1995).
7. According to the litigation cost hypothesis, the threat of litigation can encourage firms to increase voluntary disclosure (Skinner 1994).

Table 1: Summary of previous studies examining

Firm characteristics and the level of voluntary disclosure

Year of study	Author	Country	Variables used	Result
1987	Chow and Wong – Boren	Mexico	Firm size, financial leverage, and assets in place.	The extent of voluntary disclo significantly related to firm si not to firm leverage and assets place.
1991	Cooke	Japan	Company size, Stock market listing, and industry types.	Size was the single most impo variable in explaining variatio voluntary disclosure. Stock m listing was also found to be a significant predictor, and manufacturing firms were fou disclose more information tha types.
1994	Hossain et al.	Malaysia	Firm size, ownership structure, foreign listing status, leverage, assets in place, and size of audit firm.	Firm size, ownership structur listing status is statistically rel the level of information volun disclosed by publicly traded companies. In contrast, levera in place and size of audit firm appear to be important factor explaining voluntary disclosu firms.
2001	Ho, Wong	Hong Kong	independent directors, voluntary audit committee, dominant personalities, family members on the board, voluntary disclosure	The results indicate that the e of an audit committee is signif and positively related to the e voluntary disclosure, while th percentage of family members board is negatively related to extent of voluntary disclosure.
2004	Balachandran	Malaysia	Voluntary disclosure, CEO duality and the proportion of independent directors on the board and on audit committees	He found that CEO duality is associated with lower levels o voluntary corporate disclosur also found a positive relations between the proportion of ind non-executive directors on bo

board and the audit committe extent of voluntary corporate disclosure.

CHAPTER 3

HYPOTHESIS DEVELOPMENT

3. 0 Introduction

Upon existing academic literature several determinants explain why a firm may provide more information voluntarily than mandatory. Different theories such as agency theory, signaling theory, political cost theory, capital needs theory and so forth have also been used to explain those voluntary disclosures

This chapter covers the theoretical framework, the hypotheses, the model specification and measurements of variables, disclosure index development and finally this chapter presents the model of the study.

3. 1 Variables and framework

3. 1. 1 Profitability

(Foster 1986) suggests that profitable, will managed firms have incentives do distinguish themselves from less profitable firms in order to raise capital on the best available terms by providing voluntary disclosures. Managers are motivated to disclose more detailed information to support the continuities of their positions and remuneration. Therefore, more profitable firms can be expected to disclose more voluntary information. (Haniffa and cooke 2002) find a positive and significant association between the firms profitability and the extent of voluntary discloser. This means that when there is increase in the profitability the voluntary discloser of this firm will increase. Therefore, it is hypothesized that:

H1: there is a relationship between company's profitability and the extant of the voluntary disclosure

3. 1. 2 Managerial ownership

(Jensen and Meckling 1976) mention that agency theory argues that in a diffused ownership environment, firms will disclose more information to reduce agency costs and information asymmetry. In a more concentrated ownership situation, the impact on voluntary disclosure is more complicated. The argument can be made in either direction indicate that since managers pursue their own interest, higher management shareholding would imply a larger sharing of the loss, and ultimately, a lower possibility that management would lower corporate value.

Managerial ownership is the percentage of ordinary shares held by the CEO and executive directors, and includes their deemed interests. When managerial ownership falls, outside shareholders will increase monitoring of manager's behavior (Jensen and Meckling 1976). To reduce monitoring costs by outside shareholders, the manager will provide voluntary disclosure. Thus, voluntary disclosure is a substitute for monitoring.

In addition, a study by (McKinnon and Dalimunthe 1993) found a significant association between ownership structure in diversified Australian companies and voluntary segment disclosure. (Hossain et al 1994) found that the level of disclosure of Malaysian companies is inversely related to the percentage of shares held by the ten most important shareholders. Further, empirical evidence shows that managerial ownership is negatively related to disclosure (Ruland, Tung and George 1990). Hence it is expected that voluntary disclosure increases with decreases in managerial ownership. Therefore it is hypothesized that:

H2: There is a relationship between managerial ownership and the extent of voluntary disclosures.

3. 1. 3 Family member on the board

When members of the board own a large number of shares and at the same time they are relatives from one family or a number of families, this may affect the financial disclosure practice of the firm. (Haniffa and Cooke 2002) in their study reported that the percentage of family ownership in any firm may influence the disclosure practice of the firm. It has been suggested that in countries where certain families have equity holdings there should be a little physical separation between those who own and those who manage the capital.

(Ho and Wong 2001) mention that, the family control phenomenon is still in existence nowadays. However, it is still not clear to what extent the unique corporate ownership structure would impact the effectiveness of other monitoring devices such as audit committee, independent non-executive directors and CEO duality in determining a firm's financial disclosure. Further, they stress that in a family-controlled firm, members of the controlling family would directly participate in the daily management of the firm by appointing themselves as executives and board directors. It is also assumed that every family member owns and votes its shares collectively. In theory, there are potential conflicts between the controlling and non controlling shareholders of a firm due to the formers propensity to extract private benefits through their involvement in the firm and other insider dealings.

(Nicholls and Ahmed 1994) argued that capital owners do not have to rely completely on voluntary disclosure to the public to monitor their investments because they have greater access to internal information rather than the general public and stakeholders. This conclusion and findings are based on the idea that since members on the board have more information than external users this will negatively affect the extent of voluntary disclosure. This means that when the family ownership is large the voluntary disclosure of this firm will be less.

It is assumed that companies with a family member sitting on the board are more likely to have lower level of voluntary disclosure than otherwise. Therefore, it is hypothesized that:

H3: There is relationship between the family member sitting on the board and the extent of voluntary disclosure.

3. 1. 4 Control Variables

From a review of the prior literature on voluntary disclosure, it was decided to include three control variables in the regression model for testing the main hypotheses. The control variables are firm size, leverage, and assets in place.

Firstly, Firm size (SIZE): as a view of the association with higher levels of disclosure and firm’s size, (Firth 1978) who examined the impact of firm size, stock market listing, and auditor’s presence on voluntary corporate disclosure found that firm’s size and stock market listing were positively associated with voluntary disclosure. (McNally et al 1982) found that the company's size has significant relationship with the level of voluntary disclosure items. (Hossain et al 1994) found that firm size and Ownership structure of foreign-listing status are statistically related to the level of information voluntarily disclosed by publicly traded companies.

Secondly, Assets in place (AIP): In relation to assets in place, (Hossain and Mitraa 2004) in their study examine the assets-in-place in determining the level of voluntary disclosure of data on foreign operations made by US multinational companies. The results indicate that assets-in-place influence the level of voluntary disclosure of data of US multinational companies. In contrast, (Chow and Wong-Boren 1987) examined the effect of proportion of assets in place on the voluntary disclosure. The results have not demonstrated any convincing evidence of any relationships.

Thirdly, Leverage (LEVERAGE): the definition of leverage is the degree to which an investor or business is utilizing borrowed money. For companies, leverage is measured by the debt-to-equity ratio, which is calculated by dividing total debt by shareholders' equity. The more total debt there is, the greater the financial leverage and the greater the risk of the company falling on its face. For investors, leverage means buying on margin or using derivatives such as options, to enhance return on value without increasing investment. Leveraged investing can be extremely risky because you can lose not only your money but the money you borrowed as well. Voluntary disclosure of information concerning debt fund may allow shareholders and bondholders to make better predictions about the growth, risk and return prospects of companies. Therefore, firms with higher leverage tend to disclose more information than the lower ones. (Cadbury 1995) in his study found that there was a positive association between leverage and the extent of voluntary segment disclosure among New Zealand firms.

3. 1. 5 Framework

Considering all factors of the independents and dependent variables, the model of the study is depicted the following figure.

3. 2 Measurement

Dependant variable	**Definition**	**Measurement**
DSCORE	Discloser score	Total number of points awarded for voluntary disclose strategic, non-financial and financial information (codi 1" if the company disclose and Zero " 0" otherwise)

Independent variables	Definition	Measurement
ROA	Profitability	Return on Assets
MOWN	Managerial ownership	The proportion of ordinary shares held by the CEO and executive directors (dividing the directors shares on t shared issued and fully paid)
FMB	Family member in the board	Coding one (1) if there is family ownership and zero (0 otherwise
Control	Firm size	This variable is measured by the log (base ten) of tota

variables

Size

LEV	leverage	The ratio of total debt of total equity value of the firm
AIP	Asset in place	The ratio of net book value of fixed assets to total ass

3. 3 Disclosure Index

There is no agreed theory on the number and selection of items that should be included in a disclosure index. (Cooke and Wallace 1989) argued that the measurement of accounting disclosure is a procedure that has some inherent limitations and subjectivity. To reduce the subjectivity, the literature suggests that the following steps should be taken into consideration when constructing the index (see for example in Hossain et al. 1994).

* Review the previous literature to draw a list of voluntary disclosure items.

* Check that these items are not required by regulations and eliminate or omit any mandatory items.

* Refine the list and get the views of academics and professionals on the items.

Disclosure level can be measured in a number of different ways. The commonly used approach has been adopted using a discretionary item scores " 1" if it is disclosed, and " 0" if it is not disclosed. This method of scoring is known as the un-weighted approach based on the assumption that each item of disclosure is equally important. An un-weighted approach has been used in several prior studies like (Wallace 1988) and (Cooke 1989) in their study employ un-weighted disclosure index.

(Gul and Leung 2004) reported that the final disclosure list contained 44 discretionary items such as background information, financial performance information and non-financial performance information. The background information includes matters that cover corporate goals, competition, products and markets. On the other hand, performance information includes items such as changes in sales, gross profits and R&D expenditures. Furthermore, Non-financial information includes number of employees, and staff training and products segment analysis. For each item in the disclosure index, the company receives a score of ‘‘ 1” if it voluntarily discloses information on the item and ‘‘ 0” if otherwise.

Furthermore, In (Balachandran 2004) study, he measures the disclosure score index that comprises the consideration of 66 discretionary items. He mentions that the study used approximately 60% of the discretionary items as used in the previously detailed studies. Further, (HO and WONG 2001), in their study measured also the reported disclosure by using a relative disclosure index. It was derived by first compiling a comprehensive list of voluntary disclosure items that companies may provide in their annual reports in Hong Kong. The index consists of total 20 items of most important that disclosed in annual report.

However, in the present study, the extent of voluntary disclosure was measured by using a disclosure index which contains of items that disclosed in the annual report. For each item in the disclosure index, a company receives a score of ‘‘ 1” if it is voluntarily disclosed information on the items and ‘‘ 0” for otherwise.

3. 4 Data Collection

This research will use secondary data obtained from the annual reports of all the Jordanian companies.

3. 5 Sample Selection

The sample for this thesis is all Jordanian companies which are listed on Amman Stock Exchange; therefore the sample includes ninety three companies and covers the period 2002-2007.

3. 6 Data Analysis:

3. 6. 1 The Descriptive Statistics

This descriptive study produced the mean, minimum, maximum and standard deviation for each variable for Jordanian companies during 2002-2007.

3. 6. 2 The Correlation of variables

This study shows how one variable is related to another. The results of this analysis represent the nature, direction and significant of the correlation of the variables used in this study and the correlation between variables is analyzed by using