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Determinants and Consequences of Extended Disclosure under Concentrated Ownership Environment: The Indonesian Evidence

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Abstract: This study is aimed at providing evidence with regard to: the economic consequences of the quality of voluntarily/extended disclosure and the influence of ownership and director characteristics on the quality of extended disclosure. Using 260 firm years, this study finds that the increase of disclosure quality was found to have a positive correlation with the increase of share price 5 days after the announcement date and the increase of ROA. In regard to ownership and director characteristics, this study finds that government ownership and board size had a positive relationship with disclosure quality while management and block-holder ownership were found not to be relevant in increasing disclosure quality. The individual characteristics of independence and financial expertise/background of directors were not found to have any relationship with the quality of extended disclosure.

Key words: Voluntarily disclosure, concentrated ownership, corporate governance, independent director, ROA

INTRODUCTION

The World Bank has reported that a lack of disclosure qualities and minority shareholder protection re still the main weaknesses of corporate governance practices in developing countries such as Indonesia. Low quality of disclosure will result in asymmetric information which consequently decreases the confidence of investors. On the other hand, it is argued that extended disclosures provide investors with ample information in correcting any misevaluation and increases investor's interest and stock liquidity (Healy *et al.*, 1999).

The less-dispersed ownership which is considered as a prevalent practice in many developing countries has been identified as lowering the quality of disclosure as dominant shareholders might have more access to information (Bauwhede and Willekens, 2008). Ownership concentration may substitute other control mechanisms and can be used by block-holders to facilitate expropriation (Bozec and Bozec, 2007). On the contrary, a diffused ownership company may have more incentives to provide voluntarily disclosure in order to reduce agency costs, as voluntarily disclosure facilitates public communication which results in lower information asymmetry and adverse reaction from investors (Sanchez-Ballesta and Garcia-Meca, 2007).

As a result the World Bank has recommended some important improvements in the agenda of corporate governance practices in Indonesia which mainly focus on improving regulations regarding the disclosure and the effectiveness of independent commissioners in order to improve corporate governance practises. However, the benefits and determinants of extended disclosure as well as the relationship between ownership characteristics and disclosure quality in developing countries especially in Indonesia are still rarely observed which result in limited knowledge in regard to the association between disclosure and ownership structures.

This study examines the economic benefits of voluntarily disclosure and the determinants of voluntarily disclosure in Indonesia which is characterized as highly concentrated ownership environment. The economic benefit factors which are ROA and stock return were tested to correlate with voluntarily disclosure. Factors influencing the quality of disclosure which include ownership and director characteristics were also examined as director characteristics are the important parts of corporate governance mechanisms.

This research attempts to address gaps in the current literature as: studies about determinant and economic consequences of voluntarily disclosure are mostly conducted in developed countries which have different capital markets and ownership environments; the knowledge about the reasons of low disclosure is still limited as many institutions such as the World Bank and the Asian Development Bank (ADB) reported that a lack of disclosure is the main weakness of corporate governance in Indonesia and other emerging countries,

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abetter understandingof the determinants of extended disclosure is useful for regulators to improve the disclosure regulation; knowledge of economic consequences is also still needed to explore. The economic consequences awareness among the business players may increase the willingness of firms to improve the quality of disclosure; the study involves two important variables, namely ownership variables and corporate governance variables argued as the most important determinants of voluntarily disclosure in emerging countries which to some extent are overlooked.

Voluntarily disclosure: Transparency through disclosure is regarded as one of the most important aspects of good corporate governance. Based on agency theory, disclosure is expected to reduce asymmetry information between owners and managers. Disclosure might enable shareholders to monitor managerial performances and minority shareholders to control block-holders (Chau and Gray, 2010).

Capital market theory states that although there is no regulation which demands firms to disclose information, firms may still prefer to disclose information to lever market value (Clarkson *et al*., 1994). This contention is based on the argument that managers try to convey good news by disclosing more information.

Firms may disclose information through financial reports as demanded by regulations. Furthermore, firms may engage in voluntarily disclosure such as management forecasts, analyst presentations and other corporate reports. There are six hypotheses which explain why managers, engage in voluntarily disclosure (Healy and Palepu, 2001). First, capital market transaction hypothesis which argues that firms will try to reduce asymmetry information risks which result in high cost of capital by increasing disclosure. Second, corporate contest hypothesis as managers are worried to lose their jobs due to poor stock performance, they tend to disclose information to convey good news through voluntarily disclosure. Third, stock compensation hypothesis as managers are rewarded using stock bonus, they will try to reduce allegation risks of insider trading by disclosing more information to capital market. Fourth, litigation cost hypothesis states that litigation threat from investors due to inadequate and untimely disclosure may induce managers to disclose and not disclose as inaccurate disclosure may increase litigation risks. Fifth, proprietary cost hypothesis, managers may not disclose certain information which could harms their product competitiveness. Six, management talent signaling theory argues that talented managers will make voluntarily disclosure to reveal their types.

Ownership concentration: Ownership and control can not be completely separated within a firm as owners have a control right and the controllers frequently have equity ownerships. Therefore, ownership structure is a part of the important elements of corporate governance. The traditional agency conflict between owners and controllers (managers) has given rise to the proposition for greater overlap between ownership and control. Managerial ownership is perceived to reduce conflict of interest between controllers and owners and thus, to increase firm value (Denis and McConnell, 2003).

However, the concentration of ownership is not an effective mechanism to reduce agency problems in certain environment. Yunos (2011) states that managerial ownership would not reduce conflict of interest in countries where ownership structure is highly concentrated such as in East Asian countries. In such countries, the controlling owners have access to private information and might take advantage of it by jeopardizing the interests of the minority shareholders. A high concentration of ownership would cause a conflict interest between large shareholders and minority shareholders, leading to low financial performance (Yunos, 2011). Thomsen *et al.* (2006) had a similar argument by providing evidence in continental European countries where minority shareholder protection is low. High block-holder ownership was reported as related to lower firm value and accounting profitability. This finding did not conclude that ownership concentration had no contribution to firm value; nevertheless if the level of block-holder ownership is considered too high by minority shareholders, it would have a negative effect on the following year of financial performance (Thomsen *et al*., 2006).

Economic consequence of voluntarily disclosure: Public disclosure may facilitate the reduction of information asymmetries for investor (Kim and Verrecchia, 1994). If all investor well informed, then investors are confident that stock prices which occur during an announcement date are fairly valued. As a consequence, extended information may result in more stock liquidity. Research has documented the economic consequences of high voluntarily disclosure in many countries. Healy *et al.* (1999) found that an increase of disclosure rating of 97US firms is followed by the increase of stock return, institutional ownership and stock liquidity. This research indicates that extended disclosure attracts institutional investors and analysts as well as increases the confidence of investors. A positive relationship between increased disclosure and a firm's growth and size was also identified by some research. Iatridis (2008) reports higher size, growth and leverage of high quality disclosure of UK's firms. Firms tend to disclose more sensitive accounting issues to convince investors of the credibility of their accounting policies. However, Yang (2012) argues that stock reaction of extended disclosure will depend on the credibility of such disclosure. Stock reaction of management forecast disclosure is reported higher if historical forecast disclosures of managers show higher accuracy.

As research focuses on the US setting, Bailey *et al.* (2006) observe the economic consequences of extended disclosure of non-US firms which are listed in the US capital market has been deserved. It is assumed that the US capital market has better disclosure regulations compared to non-US countries. Surprisingly, they find that firms which are listed in the US capital market experience larger abnormal return and volume trading in home capital markets. Furthermore, the high quality disclosure of 387 non-US firms leads to larger abnormal return and volume trading compared to those of US firms. However, the level of voluntarily disclosure of samples was not measured as well as the comparation of the economic consequences between samples and other firms in home countries which results in limited knowledge about economic consequences of high disclosure firms in home countries. Mitton (2002) provides evidence with regard to the relationship between the disclosure quality and performance during a crisis period. Firms in five Asian countries which had better disclosure and lower ownership concentration showed better performance during the 1997-1998 crises. As such the first hypothesis of this paper is formulated as:

- H_1: there is a positive correlation between voluntarily disclosure quality and stock return as well as return on assets

Determinants of voluntarily disclosure: Ownership structures and corporate governance are hypothesized to influence a company's policy in regard to disclosure as these factors help reduce agency problems. Previous research suggests the relationship between ownership structure and disclosure that Institutional ownership is reported as a determinant of voluntarily disclosure (Kim and Verrechia, 1994; Rouf and Harun, 2011). Darmadi and Sodikin (2013) provide evidence about the relationship between institutional ownership and disclosure in Indonesia. They propose an argument that institutional ownership reduces information asymmetry, especially in firms where family ownership is prevalent. This argument is based on Claessens and Fan (2002) who argue that institutional ownership might improve corporate governance practices in East Asian countries in which ownership is concentrated in few investors or family members.

However, the research on the relationship between ownership concentration and voluntarily disclosure is limited and provides inconsistent results (Sanchez-Ballesta and Garcia-Meca, 2007). High ownership concentration firms tend to have low voluntarily disclosure was found by Legenzova (2008). The same evidence is also provided by Chau and Gray (2002). While Brammer and Pavelin (2006) support a positive relationship. This study argues that as the Indonesian regulation still has a lower protection on minority shareholders, ownership concentration is used by investors to control managers. As dominant share holders have a direct access to private information, firms tend to convey less information.

In Indonesia, the government still takes a major role in business. Many Indonesia large companies are owned by the government. These state-owned companies are assumed to provide more information to public as they will more control from the public. Using Singaporean companies as samples, Eng and Mak found that significant government ownership has a high relationship with disclosure level. Therefore, hypothesis 2, 3 and 5 of this study are proposed as:

- H_2: Ownership concentration has a negative relationship with the degree of voluntarily disclosure
- H_3: Managerial ownership has a positive relationship with the degree of voluntarily disclosure
- H_4: Government ownership has a positive relationship withthe degree of voluntarily disclosure

Literature on corporate governance states that corporate governance mechanisms may influence the degree of disclosure, especially the board of director composition. Outside directors who are independent from managers are assumed to encourage firms to disclose more information in order to reduce asymmetric information.

Additionally, Karagul and Yonet provide evidence about the relationship between disclosure quality and board size as larger board size reflects more monitoring which results in a higher transparency. As directors have a monitoring role, expertise in finance and accounting is essential for them in doing monitoring duties. Lanfronconi and Robertson (2002) argue that the collapse of Enron and WorldCom was perceived to be caused by the deficiency of financial knowledge of board members:

- H_5: Independent director has a positive relationship with the degree of voluntarily disclosure
- H_6: Size of director has a positive relationship with the degree of voluntarily disclosure
- H_7: Financial expertise of board members has a positive relationship with the degree of voluntarily disclosure

MATERIALS AND METHODS

There are 130 firms selected as sample data for the 2 years period. Hence, the number of observations is 260. In selecting the sample data, this study uses a purposive sampling method. The criteria used in selecting the sample are:

- It should be listed on the Indonesian capital market in period of 2010-2011
- It should report a positive earning
- It should have annual reports available in the Indonesian capital market website
- It should have a financial report ended on 31 December

The variables are measured as follows:

- Voluntarily Disclosure (DI) is measured using index which contains 76 items. Index is formulated using content analysis of the annual report. Any available item will be scored 1, while unavailable items will be scored 0. The items of voluntarily disclosure are based in the decree of the Indonesian capital market oversight body No. KEP-134/BL/2006
- Stock Prices return (SPC) is calculated using the share returns around the announcement dates of the annual report. The study observes the increase/decrease of stock prices 5 days before the announcement and 5 days after the announcement of the annual report date
- Return on Assets (ROA) is calculated as Net profit/Total assets
- Leverage (LEV) is measured as Total debt/Total assets
- Ownership concentration (BHOWN) is measured by the percentage of ownership held by block-holders
- Managerial Ownership (MOWN) is measured by the percentage of ownership held by management
- Government Ownership (GOWN) is calculated using the percentage of government ownership
- Independent Director (ID) is measured by the ratio of independent director to total number of director
- Size of director (SZB) is the log of total number of directors
- Financial Experience of Board (BEXP) members is measured using the percentage of board members who have financial experience or education to the total number of board members
- Size of firm is measured as the log of total assets

The multivariate model is formulated as:

$$DI = \beta_1 BHOWN + \beta_2 MOWN + \beta_3 GOWN + \beta_4 ID + \beta_5 SZB + \beta_6 BEXP + \beta_7 SZF + \beta_8 LEV + e$$

The variables of leverage and size of firms are included as control variables. The univariate test is conducted using a Pearson Correlation Model to observe the economic consequences of extended disclosure.

RESULTS AND DISCUSSION

From Table 1, some important findings can be concluded:

- The sample firms relatively good quality have of disclosure shown by the average of disclosure index being 0.636
- Management and government are not dominant shareholders, as on average they only take 2.6% and 4.8% of total ownership
- The board members who have financial experience or education are relatively dominant which on average 40% of the board members having financial background or expertise
- The number of independent directors takes a portion of almost 40% of total number of director while on average the size of the board is 4 while the maximum number of members is 10
- During the observation period around the announcement date, on average the sample firms experienced negative returns as shown by the change of share return after 5 days after the announcement date compared to 17.26, 5 days before the announcement date

Economic consequences test results: Univariate test using Pearson Correlation Model is employed to observe the economic consequences of voluntarily disclosure. From the results of the Pearson Correlation Model, it can be seen that the disclosure quality has a relationship with neither ROA nor Share returns (SPC). The p-value of the correlation between ROA and DI is 0.247 while the p-value of the correlation between DI and the change of share return during the announcement date is 0.096. The Pearson correlations results are presented in Table 2.

The study investigates further regarding the relationship between performance measures and disclosure quality. The change of Disclosure quality or

Table 1: Descriptive statistics

Parameters	N	Minimum	Maximum	Mean	SD
DI	260	0.32	0.87	0.64	0.09
BHOWN	260	0	0.98	0.33	0.30
MOWN	260	0	0.44	0.02	0.07
GOWN	260	0	0.9	0.05	0.17
ID	260	0	0.8	0.38	0.15
SZB	260	2	10	3.82	1.27
BEXP	260	0	1	0.43	0.77
LEV	260	0.01	3.21	0.52	0.39
ROA	260	0	0.89	0.08	0.10
SPC	260	-9300	4630	-17.26	711.93
SZF	260	8.2	15.18	12.25	0.86

Table 2: Correlation Coefficients of DI, ROA and SPC

Parameters	DI	ROA	SPC
DI			
Pearson correlation	1	0.072	0.008
Sig. (2-tailed)	-	0.247	0.904
N	260	260	260
ROA			
Pearson correlation	0.072	1	-0.021
Sig. (2-tailed)	0.247	-	0.733
N	260	260	260
SPC			
Pearson correlation	0.008	-0.021	1
Sig. (2-tailed)	0.904	0.733	-
N	260	260	260

Table 3: Correlation coefficients of SPC, DIC and ROACHG

Parameters	SPC	DIC	ROACHG
SPC			
Pearson correlation	1	0.122*	0.084
Sig. (2-tailed)	-	0.049	0.176
N	260	260	260
DIC			
Pearson correlation	0.122*	1	0.325**
Sig. (2-tailed)	0.049	-	0.000
N	260	260	260
ROACHG			
Pearson correlation	0.084	0.325**	1
Sig. (2-tailed)	0.176	0.000	-
N	260	260	260

*, **Correlation is significant at the 0.05, 0.01 level (2-tailed)

Index (DIC) is calculated to know whether the quality of disclosure has changed during the observation period and whether the increase or decrease of disclosure quality has a relationship with the Share returns (SPC) and the change of ROA (ROACHG). The results of further investigation are presented in Table 3.

From Table 3, it can be seen that the increase of disclosure quality has a positive relationship with the increase of share returns and ROA. These results indicate that the improvement of disclosure quality has economic consequences which result in improvement on share return and ROA. This result is consistent with the research conducted by Bailey *et al.* (2006) who provide the evidence of share return consequences of higher disclosure. Therefore, the improvement of disclosure is able to impress investors.

Table 4: Regression coefficients

Variables	Standardized coefficients	t-value	p-value
MOWN	0.067	1.089	0.277
BHOWN	-0.032	-0.501	0.617
GOWN	0.151	2.371	0.019*
ID	-0.059	-0.941	0.348
SZB	0.201	3.111	0.002**
BEXP	-0.090	-1.515	0.131
LEV	-0.155	-2.601	0.010*
SZF	0.020	0.306	0.760

*, **Significant at the 0.05, 0.01 level

Determinants test results: Multivariate test is employed to investigate the determinants of voluntary disclosure. The study investigates whether ownership and director characteristics induce firms to extend their disclosure. Three ownership variables are tested to have relationships with voluntarily or extended disclosure quality. Three characteristics of the board are hypothesized to have positive relationships with disclosure quality which are ratio of independent director, size of board and financial expertise/education background of board. The multivariate test is conducted using the multivariate regression model. The results of the multivariate model are presented in Table 4.

From Table 4, it can be concluded that 3 variables influence the quality of disclosure, namely Government Ownership (GOWN) with t = 2.371, Size of Board (SZB) with t = 3.111 and Leverage (LEV) with t = -2.601. The block-holder ownership as the focus of this study is found not to have an influence of disclosure quality. This result is not consistent with the result of Legenzova (2008) and Chau and Gray (2002) who found a negative relationship between ownership concentration and quality of disclosure. However, this result is consistent with the finding of Eng and Mak, who did not find a relationship between disclosure and block-holder ownership. In Indonesia, the block-holders are dominantly occupied by families and large institutions which have a direct access to private information. Thus, it seems they have a lack of interest to increase disclosure as they are able to access information more. However such situation is not suitable for the minority protection.

It is found that government is more effective to force firms to disclose more information compared to block-holder as the p-value of government ownership variable is 0.019. This result is consistent also with the evidence provided by Eng and Mak using Singaporean firms as samples. Higher ownership concentration seems to be an irrelevant variable in influencing quality of disclosure. Although, the ratio of the independence of the board is found not to correlate with disclosure quality, this study finds that the size of the board has a positive correlation with the degree of voluntarily disclosure (p = 0.002). It seems that the individual characteristic of board members may not have a significant power to force firms to disclose more information while the board as a group significantly influences firms to have a high degree of disclosure. Boards with larger memberships may have more power to control which results in higher disclosure enforcement. Of the control variables, lower leverage is related to higher extended disclosure. Again this finding is consistent with the evidence provided by Eng and Mak. This paper's findings provide consistent evidence about the characteristics of extended disclosure and governance in emerging countries.

CONCLUSION

Although, the concentrated ownership environment is assumed to result in lower disclosure, the disclosure quality still has positive economic consequences. The study has found that the disclosure improvement is related to the increase of share return and return on assets. The improvement of disclosure could be seen as a positive indicator of better transparency. The improved financial performance may also induce firms to disclose more information.

Larger size of board and government ownership is related to higher extended disclosure. Block-holder and management ownership are found to be irrelevant in inducing disclosure quality. The individual characteristics of board members directors measured by independence and financial expertise do not determine the quality of disclosure. This study has contributed the extension of the knowledge about the economic consequences of disclosure quality and the factors influencing disclosure quality in a highly concentrated ownership environment.

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