Board Characteristics and Corporate Voluntary Disclosure:

An Iranian Perspective

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Abstract
This study empirically examines the relationship between certain board of director characteristics and the extent of voluntary disclosure in a sample of 95 publicly traded Iranian firms. Using three different dimensions of board of director namely board independence CEO duality and board ownership based on a Multiple Regression analysis, the result shows that board independence is positively related to the voluntary disclosures. We also find that firms with CEO duality are associated with lower levels of voluntary disclosures. However, our study does not find evidence to support the notion that lower board ownership is effective in improving the levels of voluntary disclosures.

Keywords: Board Independence, CEO Duality, Board Ownership, Voluntary Disclosures

1. Introduction
Economic theory argues that agency costs arise from the separation of ownership and decision control in corporations (Fama and Jensen, 1983). Agency costs arise when the owner-manager sells equity claims on the corporation and when debt claims exist against the corporation. Monitoring mechanisms are implemented to minimize agency costs by limiting the aberrant activities of top management that are responsible for decision control (Jensen and Meckling, 1976). As suggested in prior research, the board is an effective internal governance mechanism in monitoring management in the interests of shareholders. The board’s monitoring role encompasses financial reporting, and since the voluntary disclosure extent comes under the discretion of the board of directors, we expect that a more effective board should result in higher levels of disclosure by management.

While prior research on the relationship between Board Characteristics and voluntary disclosure has been done in the developed countries, a few studies have been made to examine this relationship in the emerging countries particularly in Iran market. As such, the focus of the study is to acquire an understanding of whether the corporate board mechanisms, namely board independence, CEO duality and board ownership are effective on the extent of voluntary disclosure amongst Iranian publicly listed firms. This study also aims to provide additional evidence that supports or rejects prior research findings in the developed countries and to determine whether the findings can be generalized in Iranian market.
Our findings, based on the analysis of the 95 publicly-listed Iranian firms, indicate that, board independence is positively associated with the extent of voluntary disclosure, while CEO duality is significant and negatively associated with the voluntary disclosure. On the other hand, board ownership was not found to have any significant impact on level of voluntary disclosure. Our results are important because they provide information to academics, regulators, companies, and investors concerning the effect of Board Characteristics on the level of voluntary disclosure.

The remainder of this paper is organized as follows. In the next section, we develop empirically testable hypotheses. In Section 3, we describe the research design and variable measurement. In Section 4, we describe the sample, discuss the results, and describe our analyses. We then provide concluding comments in Section 5.

2. Previous Research

The board of directors should, in principle, be one of the major checks on the management as it is directly elected by the shareholders to act on their behalf. The board of directors constitutes an important internal mechanism of control and it is in the heart of the managers’ control mechanisms. Thus, we can’t talk about good corporate governance without mentioning the efficiency of the board of directors. This board prepares annual reports under its responsibility. Therefore, its composition structure affects the strategic choices of disclosure in annual report and more specifically the extent of voluntary disclosure. The present study concentrates on discussing and analyzing the effect of corporate board characteristics on the level of voluntary disclosure. Hence, several hypotheses are developed that identify and link some specific attributes of board of directors to voluntary disclosure.

2.1 Board Independence

The board of director’s independence is one of the important aspects of board effectiveness. From an agency perspective, it is argued that board independence will be more valuable because of their capabilities in checking and monitoring managers and thus reducing agency problem (Fama & Jensen, 1983).

Several studies present evidence suggesting that effective governance with board independence improve firm performance (Agrawal and Knoeber, 1996), while the dominance of non-executive directors (in terms of numbers) could provide them with more power to force management to improve the quality of firm disclosure (Haniffa and Cooke, 2002). Chen and Jaggi (2000) provide evidence that suggests a positive relationship between the proportion of Independent directors and disclosure. Cheng and Courtenay (2006) provided further evidence that firms with a higher proportion of independent directors have significantly higher levels of voluntary disclosure than firms with balanced boards. In addition, Huafang and Jianguo (2007) examine the association between board independence and voluntary disclosure and show that an increase in independent directors increases corporate voluntary disclosure. Hence, previous empirical findings seem to suggest that as proportion of outside directors increases, firms are more likely to provide voluntary disclosure, thus leading us to the following hypothesis:

H1: There is a significantly positive association between Board independence and the extent of voluntary disclosure.

2.2 CEO Duality

Another dimension of the board of director control is the duality of the board chairman and CEO positions. Where the chairman of the board of directors also takes control of the executive arm, the effectiveness of the board of control decreases. When the chairman also holds the CEO role, he has the responsibility for making the decisions and monitoring those decisions. Further, he has more power with which to pursue personal interests instead of shareholders’ interests (Jensen, 1993).

Jensen (1993) argues that when the CEO also holds the position of chairman of the board, internal control systems fail as the board cannot effectively perform its key control functions. Gul and Leung (2004) report that CEO duality is associated with lower levels of voluntary corporate disclosures. Similarly, Huafang and Jianguo (2007) provide evidence that CEO duality is negatively related to voluntary disclosures. Based on the above arguments and evidence, we expect the extent of voluntary disclosure to be negatively related to the CEO duality. As such, the next hypothesis, which is related to CEO Duality and voluntary disclosure, is set as follows:
H2: There is a significantly negative association between CEO Duality and voluntary disclosure.

2.3 Board Ownership

When the directors hold an important proportion of the company capital, the ownership and the management are combined. Thus, the company has no interest to disclose further information while agency costs are low. Eng and Mak (2003) document a significant and negative association between managerial ownership measured by the percentage of share held by managers and voluntary disclosure.

Akhtaruddin and Haron (2010) argue that firms with higher levels of equity ownership by board are associated with lower levels of voluntary disclosures. Based on the foregoing discussion, it can be inferred that the board ownership might have an adverse impact on disclosure practices, thus we posit the following hypothesis (in alternate) form:

H3: There is a significantly negative association between Board Ownership and voluntary disclosure.

3. Research Design

3.1 Sample

We select all publicly-listed companies in Tehran Stock Exchange (TSE) over the entire duration of the estimation time period (2005–2010) as initial samples. Of these initial 785 firm-year observations, firms that have either missing financial variables or insufficient data are eliminated. Financial institutions, banking, finance and investment firms are also eliminated, since their accounting and reporting environments differ from those in other industries. This gives a final sample of 570 firm-year observations from the fiscal years 2005 to 2010.

3.2 Variables Measurement

3.2.1 Dependent Variable

Voluntary Disclosure index: to measure the extent of voluntary disclosure in annual reports we have compiled the set of 46 informational items that express disclosure policy. In order to analyze the reporting practices of firms, we used the modified Meek et al. (1995) disclosure checklist based on Iranian regulatory environment. This checklist is classified into three major types of information: strategic, nonfinancial, and financial, since these three types of information are directed at different users of the annual report. We have built a composite index for each company using unweighted items. All voluntarily disclosed items investigated in this study were considered equally important. We have assigned the value of “1” to every item disclosed on the company’s annual report and value “0” otherwise. A voluntary disclosure index is then calculated for each company. Finally, the voluntary disclosure index (VDisc) used to measure the level of voluntary disclosure quantitatively is determined with the formula:

\[
V_{\text{Disc}} = \sum_{i=1}^{D_i} \frac{D_i}{n}
\]

Where:

\(V_{\text{Disc}}\) = the aggregate voluntary disclosure index;

\(D_i = 1\) if the \(i\)th item is disclosed or \(0\) if it is not disclosed; and

\(n\) = the maximum score each company can obtain.

3.2.2 Independent Variables

Corporate board characteristics: three variables that represent board of directors’ attributes are the proportion of independent directors, CEO duality and board ownership. The proportion of independent directors on the board is measured by dividing the total number of independent non-executive directors by the total number of board members. CEO duality is the separation of the role of chairman and CEO, where firms that combined the title are labelled “1” and firms that separated the title are labelled “0”. Finally, board ownership is computed as the proportion of executive share ownership to total shares of the firm.

3.2.3 Control Variables

The choices of control variables used in this study are based on a prior research on voluntary disclosure and
the following variables included in the regression are: firm size, ROE, growth prospect, and Big4 auditors. Large firms are more sensitive to political costs and will disclose more information to allay public criticism (Watts and Zimmerman, 1978). ROE is included on the expectation that more profitable firms may differentiate themselves from others by disclosing more information (Lang and Lundholm, 1993). We also included growth prospect since high growth firms are less likely to disclose information voluntarily in order to protect their competitive advantages. Another important control variable is Big 4 auditor, because Big4 audit firms risk damage to the value of their reputation if they are associated with clients whose reporting practices are perceived as lower quality. Hence, they encourage clients to disclose more information.

3.3 Regression Model
This study uses ordinary least square multiple regression as the main statistical technique to test the hypothesis. The main regression model is defined in the following equation:

\[ V_{Disc} = \beta_0 + \beta_1 BIND_{i,t} + \beta_2 CEO_{i,t} + \beta_3 BOWN_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 ROE_{i,t} + \beta_6 GWTH_{i,t} + \beta_7 Big4_{i,t} + \varepsilon_{i,t} \]

Where, for firm i at the end of year t:
- \( V_{Disc} \) = Voluntary Disclosure index expressed as Percentage total voluntary disclosure out of all items.
- \( BIND \) = board independence defined as percentage of independent non-executive directors on board.
- \( CEO \) = Indicator variable with the value of “1” if the roles of chairman and CEO are combined and “0” otherwise;
- \( BOWN \) = proportion of executive share ownership to total shares of the firm.
- \( SIZE \) = natural log of firm’s total assets.
- \( ROE \) = return on equity defined as income before tax and interest to total equity.
- \( GWTH \) = growth prospect defined as the market value of equity divided by book value of equity.
- \( Big4 \) = dummy variable that takes the value of 1 (0) if the firm is affiliated with a Big 4 (non-Big 4) auditor.
- \( \varepsilon \) = the error term.

4. Findings
4.1 Descriptive Statistics
The Descriptive statistics of the regression variables used in the sample are shown in Tables 1. For our sample, the minimum value of \( V_{Disc} \) is 8.12% and the maximum is 59.23%. As shown in table 1, both the mean and median value of \( V_{Disc} \) are about 42%, with a standard deviation of 18.14%.

Boards of directors of the sample firms have on average (median) board composition of outsiders of 36.85 (33.02) percent. In terms of CEO duality, about one-fifth of the sample firms (21.72 percent) did not segregate the board chairperson and CEO/president positions. Firm size, determined as the natural logarithm of total assets has a mean (median) of 6.7981 (6.4364). Profitability, given as the ratio of EBIT to total equity, registers a mean value of 0.1621 suggesting a ROE of 16.21%. Table 1, also shows that 65 percent of the sample firms employ Big4 audit firms as opposed to only 35 percent of the companies employing non-Big4 public accounting firms as their auditors (Table 1).

4.2 Multivariate Hypothesis Test
Table 2 reports the results of the regression analysis conducted for this study. The use of Multivariate hypothesis test is based on the assumption of no significant multicollinearity between the explanatory variables.

To investigate the existence of multicollinearity, the Variance Inflation Factors (VIFs) for each of the explanatory variables are computed. as reported in column 5 of Table II, the maximum VIF is 1.529, which is lower than ten, a number that is used as a rule of thumb as an indicator of multicollinearity problems (Belsely, 1991). Thus, these results support the lack of presence of multicollinearity in the research model. The results of the regression analysis can, therefore, be interpreted with a greater degree of confidence. As shown in Table 2, the adjusted R2 of 62.26 percent provides confidence for the explanatory power of
the model. The H1 proposes that there is a significantly positive association between board independence and level of voluntary disclosure. As reported in this Table, the BIND coefficient is positive, as predicted, and is statistically significant at the 0.01 level, which indicates a significant positive relationship between board independence and voluntary disclosure; Thus H1 is supported. The H2 predicts that CEO duality is significantly negatively associated with the level of voluntary disclosure. As predicted by H2, the results in column 3 indicate that there is a negative association between the CEO duality and voluntary disclosure at the 0.05 level; hence H2 is also supported. Finally, The H3 states that the board ownership is significantly and negatively associated with the level of voluntary disclosure. However, inconsistent with the prediction in H3, there is no significant association between the board ownership and voluntary disclosure; thus the hypothesis is not supported (Table 2).

Turning to control variables, the coefficient on SIZE confirms the positive relation between firm size and voluntary disclosure documented in other studies. This supports the theory that larger firms are subject to more public and regulatory scrutiny (Watts and Zimmerman, 1978) and thus are likely to voluntarily disclose more information to muster public support for reducing political costs.

The significantly negative coefficient on GWTH indicates that firms with favorable growth prospect are less likely to disclose information voluntarily. On the other hand, we fail to find evidence that ROE and Big4 auditors are associated with the level of voluntary disclosure.

5. Conclusion

We examined the effects of the role of the board of directors, in monitoring and influencing the level of voluntary disclosure made by management. Based on a sample of 570 firm-year observations from the TSE for fiscal years 2005 to 2010, and using three attributes of the board of directors including board independence, CEO duality and board ownership, the empirical tests indicate that Firms with more independent boards have more level of voluntary disclosure. This finding is consistent with those found by Cheng and Courtenay (2006) and Huafang and Jianguo (2007) who reported that board independence is associated with higher voluntary disclosures. We also find that, CEO duality is negatively related to voluntary disclosures. In this regard, the finding is similar to that found by Gul and Leung (2004) and Huafang and Jianguo (2007) who found a negative relationship between presence of CEO duality on the board and disclosure. However, no evidence is found linking board ownership with the levels of voluntary disclosures in Iranian listed firms.

In closing, we mention some potential caveats of the study. First, while suggestive of the link, our study does not show a causal relationship between corporate board characteristics and voluntary disclosure. Instead, we rely on association tests to document the relation. Second, the sample only covers six years of Iranian data and an external validity problem exists that the results may not be transportable over different time periods and locations. Despite these factors, this study takes an early step in understanding of how some board characteristics relates to financial reporting quality, among Iranian market.

References


Table 1. Descriptive Statistics for all Variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>N</th>
<th>Mean</th>
<th>Median</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>VDisc</td>
<td>570</td>
<td>0.4207</td>
<td>0.4198</td>
<td>0.0812</td>
<td>0.5923</td>
<td>0.1814</td>
</tr>
<tr>
<td>BIND</td>
<td>570</td>
<td>0.3685</td>
<td>0.3302</td>
<td>0.0000</td>
<td>1.0000</td>
<td>0.3164</td>
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<tr>
<td>CEO</td>
<td>570</td>
<td>0.2172</td>
<td>0.0000</td>
<td>0.0000</td>
<td>1.0000</td>
<td>0.107</td>
</tr>
<tr>
<td>BOWN</td>
<td>570</td>
<td>0.2536</td>
<td>0.2079</td>
<td>0.0000</td>
<td>0.3941</td>
<td>0.4255</td>
</tr>
<tr>
<td>SIZE</td>
<td>570</td>
<td>6.7981</td>
<td>6.4364</td>
<td>3.012</td>
<td>7.5113</td>
<td>0.6172</td>
</tr>
<tr>
<td>ROE</td>
<td>570</td>
<td>0.1621</td>
<td>0.1495</td>
<td>-0.1722</td>
<td>0.4138</td>
<td>0.5111</td>
</tr>
<tr>
<td>GWTH</td>
<td>570</td>
<td>1.5619</td>
<td>1.4223</td>
<td>0.578</td>
<td>2.1773</td>
<td>0.8413</td>
</tr>
<tr>
<td>Big4</td>
<td>570</td>
<td>0.6503</td>
<td>1.0000</td>
<td>0.0000</td>
<td>1.0000</td>
<td>0.0917</td>
</tr>
</tbody>
</table>

Notes: VDisc-Voluntary Disclosure index expressed as Percentage total voluntary disclosure out of all items; BIND- percentage of independent non-executive directors on board; CEO- Indicator variable with the value of “1” if the roles of chairman and CEO are combined and “0” otherwise; BOWN-proportion of executive share ownership to total shares of the firm; SIZE- natural log of firm’s total assets; ROE- return on equity defined as income before tax and interest to total equity; GWTH- growth prospect defined as the market value of equity divided by book value of equity; Big4- Indicator variable with the value of “1” if audited by Big4 and “0” otherwise.
Table 2. Multiple Regression Results

<table>
<thead>
<tr>
<th>Explanatory Variable</th>
<th>Expected Sign</th>
<th>Coefficients</th>
<th>t-statics</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>intercept</td>
<td>?</td>
<td>0.2016**</td>
<td>4.2586</td>
<td>-</td>
</tr>
<tr>
<td>BIND</td>
<td>+</td>
<td>0.4135**</td>
<td>6.3524</td>
<td>1.487</td>
</tr>
<tr>
<td>CEO</td>
<td>-</td>
<td>-0.1108*</td>
<td>-2.2618</td>
<td>1.312</td>
</tr>
<tr>
<td>BOWN</td>
<td>-</td>
<td>-0.3278</td>
<td>-1.0596</td>
<td>1.529</td>
</tr>
<tr>
<td>SIZE</td>
<td>+</td>
<td>0.5977**</td>
<td>4.6358</td>
<td>1.102</td>
</tr>
<tr>
<td>ROE</td>
<td>+</td>
<td>0.2519</td>
<td>0.9527</td>
<td>1.166</td>
</tr>
<tr>
<td>GWTH</td>
<td>-</td>
<td>-0.1043*</td>
<td>-2.0065</td>
<td>1.347</td>
</tr>
<tr>
<td>Big4</td>
<td>+</td>
<td>0.1871</td>
<td>1.2311</td>
<td>1.288</td>
</tr>
</tbody>
</table>

Adjusted R\(^2\)  
Durbin Watson

| 62.26 | 1.932 |

F-value  
P-value of F-test

| 21.144 | 0.000 |

Notes: * statistically significant at the <5 percent level, one-tailed test; ** statistically significant at the <1 percent level, one-tailed test; BIND- percentage of independent non-executive directors on board; CEO- Indicator variable with the value of “1” if the roles of chairman and CEO are combined and “0” otherwise; BOWN- proportion of executive share ownership to total shares of the firm; SIZE- natural log of firm’s total assets; ROE- return on equity defined as income before tax and interest to total equity; GWTH- growth prospect defined as the market value of equity divided by book value of equity; Big4- Indicator variable with the value of “1” if audited by Big4 and “0” otherwise.