Information Disclosure by Family-Controlled Firms:
The Role of Board Independence and Institutional Ownership

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1. Introduction

In a modern corporation, where the separation between management and shareholders exists, differences in interests between the two parties may arise (Jensen and Meckling, 1976). Due to their superior knowledge on the firm's resources, managers may have opportunities to make decisions that are not in the best interests of shareholders. However, the traditional concept of agency problems, which is referred to as "Agency Problem I", tends to apply only in corporations with dispersed ownership structure, which appears to be a common phenomenon in a few markets, such as the U.S., the U.K., Ireland, and Canada. As documented by La Porta et al. (1999), Claessens et al. (2000), and Faccio and Lang (2002), in most capital markets around the world, publicly-listed companies mostly have concentrated ownership structure, where there is a controlling shareholder which has effective control of the firm. In such firms, the interests of management and the controlling shareholder tend to be aligned. However, the so-called "Agency Problem II" may occur therein, where the controlling shareholder has greater opportunities to expropriate the firm's resources at the expense of minority shareholders (Shleifer and Vishny, 1997).

As Healy and Palepu (2001) explain, managers or the controlling shareholders tend to have superior informational advantages compared to other stakeholders, leading to the occurrence of information asymmetry. The asymmetry could be mitigated through various ways, including the disclosure of information in published reports that can be accessed by those in needs (Narayanan et al., 2000). The information disclosure is expected to be a sound basis for stakeholders, including minority shareholders, to make economic decisions regarding the allocation of economic resources. Attig et al. (2006) contend that insufficient disclosure will exacerbate information asymmetry, enabling the controlling shareholder to rely on insider information in making economic decisions, which may benefit him or her but could harm the interests of non-controlling shareholders. Further, Chau and Gray (2010) suggest that the disclosure of information can be used by outsiders to monitor the firm's management or controlling shareholder.

There has been an extensive body of empirical research examining factors that influence voluntary information disclosure within the contexts of both developed and emerging markets. While the earlier studies are more focusing on the influence of firm characteristics on voluntary disclosure (e.g. Cooke, 1989; Hossain et al., 1995), studies conducted during the past decade have increasingly investigated how the firm's ownership structure influences information disclosure (e.g. Ajinkya et al. (2005), Karamanou and Vafeas (2005), Leung and Horwitz (2004), and Haniffa and Cooke (2002)).

With respect to the type of the controlling shareholder, Claessens et al. (2000) and Faccio and Lang (2002) have documented that family control appears to be the most common form of corporate control in most capital markets worldwide, and Indonesia is no exception. However, studies investigating the association between family control and information disclosure are still relatively rare in the literature. Employing a sample of firms listed on the Indonesia Stock Exchange (IDX), the objective of this study is twofold. *First*, this study examines the influence of family control on the level of voluntary disclosure. *Second*, the present study also seeks to investigate whether corporate governance mechanisms can explain the association between family control and voluntary disclosure. Different from Achmad's (2007) study, our sample comprises IDX's listed firms from all non-financial sectors. Further, unlike most studies previously conducted, the present study sheds some lights on the role that corporate governance mechanisms can play in encouraging greater transparency among publicly-listed, family-controlled firms.

Indonesia appears to be of interest in our study due to its economic significance; the country is the largest economy in Southeast Asia and the eighteenth-largest in the world. The country is also home to one of Asia's emerging capital markets, which continue to attract global investments from various parts of the world. Compared to their East Asian counterparts, Indonesian listed firms show a higher level of ownership concentration and family control (Claessens et al., 2000).

The results of this study may bring about practical implications. For capital market investors, the results are expected to provide insights in setting expectations regarding the extent of information disclosure when investing in family-controlled firms. For the capital market regulator, empirical findings reported in this study may provide insights in conducting effective regulation and supervision on information transparency among listed firms on the IDX. The findings may also apply in other jurisdictions that share a similar institutional environment.

2. Literature Review and Hypothesis Development

Cooke (1989) explains that the objective of a firm's information disclosure is to convey economic information to stakeholders, who may use such information to make decisions on the allocation of scarce resources. Applicable regulations generally require disclosure at a minimum level, thereby disclosure of information not required by the regulations is considered voluntary (Achmad, 2007). One of the media employed by a firm in delivering the information is the annual report (Meek et al. (1995)).

Voluntary disclosures in the annual report may be explained by agency theory. As Karamanou and Vafeas (2005) explain, company management tends not to disclose information in order to minimize the market's ability to effectively monitor the company's performance, thereby creating "disclosure agency problems". Hence, strong corporate governance structure could encourage more transparent information disclosures (Chen and Jaggi, 2000). As contended by Dechow et al. (1995), corporate governance attributes play an important role in assuring that a firm has complied with applicable regulations and has fairly disclosed corporate information to its stakeholders.

The existing empirical studies have investigated how family control influences various mechanisms of corporate governance. For example, Setia-Atmaja et al. (2009) examine the association between family control and board structure, which is considered one of the most important governance mechanisms. Cheng and Firth (2006) investigates the relation of family control to the level of executive compensation. There have also been a number of studies, yet limited, that focus on the link between family ownership and information disclosure, but such studies are mostly conducted within the context of developed markets. Evidence from emerging economies is still considerably rare. Achmad (2007) has conducted such a study using the Indonesian setting, but his sample only comprises manufacturing firms listed on the Jakarta Stock Exchange (JSX). In addition, his study does not address the role of corporate governance attributes in explaining information disclosure in family firms.

Hypothesis Development

Prior empirical studies examining the effect of family control on information disclosure are mostly conducted using the context of developed markets. Ali et al. (2007) investigate the extent of information disclosure by U.S. public corporations listed in the S&P 500 index. They report that family-controlled firms demonstrate a higher level of earnings quality and a lesser extent of voluntary disclosures than do their non-family counterparts. Employing a larger sample size, i.e. U.S. firms in the S&P 1500 index, Chen et al. (2008) confirm that family-controlled firms tend to have relatively weaker information disclosures, proxied by financial forecasts and conference calls.

Such evidence, albeit very limited, is also provided by some Asian studies. Based on a sample of publicly-listed firms in Hong Kong and Singapore, Chau and Gray (2002) have documented that family-controlled firms tend to show a weaker practice in terms of information disclosures in the annual report. A similar finding is also reported by Ho and Wong (2001) in Hong Kong. However, when family ownership within a firm is highly prevalent (above 25 percent), Chau and Gray (2010) find that information disclosure tends to increase.

Publicly-listed, family-controlled firms are frequently associated with cohesive forces, such as family forces, illiquid ownership, and active involvement of family members. This condition potentially leads to the entrenchment of family control (Faccio et al., 2001). In Indonesia, where the institutional environment is relatively weaker, it is predicted that family-controlled firms tend to have lower incentives to disclose information in their annual reports. Hence, the first hypothesis is formulated as follows:

Hypothesis 1: Family control is negatively associated with the extent of voluntary disclosures in the annual report.

Due to potential conflicts of interests between the controlling shareholder and minority shareholders, firms may employ either internal or external corporate governance mechanisms, which are expected to contribute to mitigating agency issues and information asymmetry. Following prior studies, such as Bhojraj and Sengupta (2003), Sharma (2004), and Ajinkya et al. (2005), we address the role of board independence and institutional ownership, which represent the internal and external mechanisms of corporate governance, respectively.

To reduce agency conflicts, the presence of outsiders or independent directors on the board plays an important role. It is argued that boards with a higher proportion of outsiders are able to better monitor and control the opportunistic behavior of management (Jensen and Meckling, 1976; Rindova, 1999). In contrast, it is also argued that a high proportion of outsiders on the board may also lead to disadvantageous effects. Boards with a large number of outsiders may lead to excessive monitoring (Baysinger and Butler, 1985). In terms of voluntary disclosure, the results of prior studies is inconclusive. Chen and Jaggi (2000) find that there is a positive relationship between information disclosure and the proportion of independent directors. Differently, Eng and Mak (2003) report that the two variables are negatively related.

It is believed that the participation of institutional investors in corporate ownership leads to improved firm value due to more effective monitoring (Shleifer and Vishny, 1986). With resources and expertise they have, institutional investors have stronger incentives to monitor management, preventing managers from making suboptimal decisions and behaving opportunistically (Tihanyi et al., 2003; Velury and Jenkins, 2006). With respect to voluntary disclosure, a number of studies have documented the positive influence of institutional ownership (Bushee and Noe, 2000; Ajinkya et al., 2005; Karamanou and Vafeas, 2005). However, other studies report different results (e.g. Haniffa and Cooke, 2002).

It is important to highlight that the extant studies have very rarely examined how corporate governance mechanisms play a role in promoting grater information disclosure by family-controlled firms. In their study on Hong Kong firms, Chen and Jaggi (2000) report that board independence positively explains the positive association between family control and the extent of disclosure. Their result indicates that independent directors play a significant role in promoting greater transparency in such firms. Additionally, Claessens and Fan (2002) report that institutional investors might improve corporate governance practices in East Asian firms.

In the context of Indonesia, which is featured by a relatively weaker institutional environment and a higher level of ownership concentration, it is also expected that corporate governance mechanisms will contribute to reducing information asymmetry and, hence, promoting a greater extent of information disclosures. As such, we propose the following hypotheses:

Hypothesis 2a: Board independence positively explains the association between family control and voluntary disclosures in the annual report.
Hypothesis 2b: Institutional ownership positively explains the association between family control and voluntary disclosures in the annual report.

3. Research Design

The initial sample of the present study comprises all firms listed on the IDX. Further, financial sector firms will be eliminated because they are subject to more specific regulatory requirements. Next, among firms eligible to be included in the sample, a stratified random sampling will be performed, where sample firms are randomly drawn from each non-financial industrial sector. Such sampling is conducted by taking into account the number of firms in each sector, as well as firm size, so that the sample can sufficiently represent the population.

Data on the extent of voluntary information disclosure are obtained through content analysis on the annual reports, which are downloadable from the websites of the IDX or sample firms. From the annual reports, we also hand-collect data on ownership structure. Additionally, data on financial accounts (such as total assets, leverage, and profitability) are obtained from the *IDX Factbook*.

To test the first hypothesis addressing the influence of family influence on voluntary disclosure, we employ a cross-sectional regression model specified in Equation (1). In addition to family control as the main explanatory variable, we also include a number of control variables, namely firm size, leverage, profitability, and the external auditor.

Voluntary disclosure = f (family control, firm size, leverage, profitability, external auditor) (1)

To test Hypotheses 2a and 2b, we employ models specified in Equations (2) and (3), respectively. In investigating the role of corporate governance mechanisms in explaining information disclosure by family-controlled firms, we use the interaction term between family control and respective corporate governance mechanisms.

*Voluntary disclosure = f (family control, board independence, family control * board independence, firm size, leverage, profitability, external auditor)* (2)

*Voluntary disclosure = f (family control, institutional ownership, family control * institutional ownership, firm size, leverage, profitability, external auditor)* (3)

The dependent variable is the extent of voluntary information disclosure, which is proxied using the disclosure index obtained from content analysis on the annual report, as also employed in many prior studies. Family control is measured using two proxies, namely a dummy variable (equals 1 if the firm is family-controlled and 0 otherwise) and the proportion of shares held by the controlling family. Following Claessens et al. (2000), Faccio and Lang (2002), and Setia-Atmaja et al. (2009), the controlling shareholder is defined to be the largest shareholder that holds 20 percent of common shares or more.

Board independence is computed as the number of independent commissioners divided by the total number of members on the Board of Commissioners. Institutional ownership is defined to be the proportion of shares held by institutional investors, which include insurance companies, pension funds, banks, mutual funds, and investment banks. Firm size is proxied by the natural log of the book value of total assets. Leverage is measured using the debt-to-equity ratio (total liabilities divided by total equity). Profitability is defined to be return on assets (net income divided by total assets). The external auditor variable is dichotomous, equaling 1 if the firm is audited by one of the Big 4 audit firms (PricewaterhouseCoopers, Ernst & Young, KPMG, and Deloitte) and 0 if audited by non-Big 4.

4. Timeline

No.	Research Stage	Sem 1 2019	Sem 2 2019	Sem 1 2020	Sem 2 2020	Sem 1 2021	Sem 2 2021
1	Research Proposal						
2	PhD Confirmation						
3	Writing: Introduction						
4	Writing: Institutional Background						

5	Writing: Literature Review						
6	Writing: Hypothesis Development and Research Methods						
7	Data Collection						
8	Data Analysis						
9	Writing: Data Analysis and Discussion						
10	Writing: Robustness Checks						
11	Writing: Conclusion and Implication						
12	Finalisation of PhD Thesis						

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