# OWNERSHIP CONCENTRATION AND CORPORATE GOVERNANCE DISCLOSURE – THE CASE OF FINANCIAL INSTITUTIONS

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*Disclosure and the quality of corporate governance system are more often appreciated as closely related concepts - the higher the level of transparency, the better the quality corporate governance practices. As regards disclosure, if in a widely held company (ownership dispersion) its role is to signal that the managers are acting in the best interests of the principals, in a highly concentrated company (ownership concentration), it comes to annihilate the conflicts of interest between "insiders" (controlling shareholders and managers) and outside investors.*
*Basing on this background, we focused on corporate governance disclosure, analyzing possible influences over it coming from corporate governance dimensions. Therefore, the objective of our paper is to identify possible associations between corporate governance features and the level of disclosure through annual reports in case of banking institutions listed at London Stock Exchange focusing on ownership concentration.*
*Most empirical studies that have tested the correlation between ownership concentration and the level of disclosure reached to a negative relationship (Barako et al., 2006; Tsamenyi, et al., 2007; Haniffa and Cooke, 2002; Huafang and Jianguo, 2007; Patelli and Prencipe, 2007; Chau and Gray, 2002; Cooke, 1989). However, there are also studies that could not find any association (Arcay and Vazquez, 2005; Ghazali and Weetman, 2006; Holm and Scholer, 2010; Parsa, et al., 2007; Baek, et al., 2009; Makhija and Patton, 2004; Depoers, 2000). Basing both on assertions supported by the agency theory that companies with concentrated ownership do not have to rely on external disclosures to the same extent as companies with dispersed ownership, as well as on most prior empirical findings that provide evidence in this respect, we proposed the following hypothesis:*
*"(H): There is a negative association between ownership concentration and the extent of disclosure".*
*The research methodology used for achieving our goal is based on econometric analysis using statistical tools - correlations for identifying the relationships and regressions for assessing them - all of these being performed using SPSS software. In this respect, firstly, we developed a disclosure index made of three sub-indices, one for each type of disclosure: mandatory, recommended and voluntary.*
*The results of the performed analysis reveal significant negative influences of ownership concentration on the level of disclosure, thus confirming our assumptions that the extent of disclosure is negatively associated with ownership concentration. Thus we can assert that the higher the dispersion of shareholders, the higher the level of transparency, our results being consistent with some general prior literature findings on the same topic (e.g. Barako et al., 2006; Tsamenyi, et al., 2007; Haniffa and Cooke, 2002; Huafang and Jianguo, 2007; Patelli and Prencipe, 2007; Chau and Gray, 2002; Cooke, 1989).*
*Unlike prior research studies which were focused on similar goals - to test possible influences of corporate governance features over the level of corporate governance disclosure at companies level, our paper provides a particular approach on a specific business field, the banking one that was little explored on this topic before. Thus, we had the chance to enrich the research literature with this empirical study, whose disclosure index developed ensures it as well with originality.*
*Keywords: corporate governance, disclosure, ownership concentration, banking, UK*
*M10, G30*

## 1. Introduction

The lack of transparency and disclosure was often considered as one of the major cause of the latest corporate scandals and governance failures, adversely affecting public confidence in the reliability of corporate and financial reporting, too. Thus, while we assisted at a "wake-up" for better corporate governance and transparency all over the world, these also became one of the most attractive, dynamic and challenging research subject.

Moreover, disclosure and the quality of corporate governance system are more often appreciated as closely related concepts - the higher the level of transparency, the better the quality corporate governance practices. Basing on this background, we focused on corporate governance disclosure, analyzing possible influences over it coming from corporate governance dimensions.

Therefore, the *objective of our paper* is to identify possible *associations* between *ownershi*p features and the level of *disclosure* through annual reports in case of *banking institutions*.

Unlike prior research studies which were focused on similar goals - to test possible influences of corporate governance features like board of directors size and independence, CEO duality or various ownership' features over the level of corporate governance disclosure at companies level, our paper provides a particular approach on a specific business field, the banking one that was little explored on this topic before, focusing on one of the most important attribute of corporate governance – *ownership concentration*, thus adding value to research literature on this field.

## 2. Literature review and hypotheses development

Due to the separation of ownership and control, there is a likelihood of agency conflicts (Jensen and Meckling, 1976) and the probability to incur is higher when shares are widely held than when it is in the hands of a few (Fama and Jensen, 1983). Also, the agency costs of equity are higher where a company's shares are being held by a relatively small number of shareholders (Friedland, 2003).

Thus, diffuse ownership structure yields higher information asymmetry, while information asymmetry is negatively related to corporate disclosures (Warfield et al., 1995). According to the agency theory, in a diffused ownership situation, firms increase disclosure by providing additional information to signal that the managers are acting in the best interests of the principals, in order to reduce information asymmetry, and thereby agency costs.

Consequently, ownership diffusion is appreciated as a required feature for a good corporate governance mechanism, at least from the following reasons: the impossibility of shareholders to influence company's reporting practices (Zeckhauser and Pound, 1990); each shareholder's intention to scrutinize managerial performance, thereby improving corporate governance (Coulton et al. 2003).

In case of a concentrated ownership, the situations becomes more complicated because 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 (Jensen and Meckling, 1976). Also, in this case, conflicts of interest are not between managers and shareholders, but between large and small shareholders (Shleifer and Vishny, 1997). When ownership control is high enough to ensure its position, management has the incentive to behave against the interests of other smaller shareholders because of its strong voting power to appoint someone it trusts to be CEO, directors and/or board chairman (Morck, et. al., 1988). Besides expropriating minority interests directly, these controlling shareholders can enrich themselves through connected party transactions in which profits are transferred to other companies they control (Chau and Gray, 2010).

According to prior studies, ownership concentration appreciated as an issue of bad governance, mainly due to:

- the ability and motivation of large stockholders to monitor their interests directly (Shleifer and Vishny, 1997). Thus, it is considered easier for fewer shareholders to voice an opinion to which management will be forced to listen (Yeoh and Jubb 2001);
- the direct access to the information by dominant owners (Cormier et al. 2005). Thus, in a concentrated ownership environment, the flow of information is affected which in turn reduces corporate transparency and increases agency costs (Fan and Wong, 2002). This may lead to increased demands for organizational information that can be used to monitor management (Gelb, 2000).

Ownership concentration appears to be closely linked to managerial ownership. As prior literature reveal, in case of ownership concentration, outside ownership can help reduce agency conflicts because they have the power and incentive to prevent expropriation by insiders (Shleifer and Vishny, 1997) and the extent of voluntary disclosure proved to be higher (Morock 1988), as well as the organizational performances (Gavrea and Stegeran, 2011).

Most empirical studies that have tested the correlation between ownership concentration and the level of disclosure reached to a negative relationship (Barako et al., 2006; Tsamenyi, et al., 2007; Haniffa and Cooke, 2002; Huafang and Jianguo, 2007; Patelli and Prencipe, 2007; Chau and Gray, 2002; Cooke, 1989). However, there are also studies that could not find any association (Arcay and Vazquez, 2005; Ghazali and Weetman, 2006; Holm and Scholer, 2010; Parsa, et al., 2007; Baek, et al., 2009; Makhija and Patton, 2004; Depoers, 2000).

As regards disclosure, if in a widely held company (ownership dispersion) its role is to signal that the managers are acting in the best interests of the principals, in a highly concentrated company (ownership concentration), it comes to annihilate the conflicts of interest between "insiders" (controlling shareholders and managers) and outside investors.

Basing both on assertions supported by the agency theory that companies with concentrated ownership do not have to rely on external disclosures to the same extent as companies with dispersed ownership, as well as on most prior empirical findings that provide evidence in this respect, we proposed the following hypothesis:

*H: There is a negative association between ownership concentration and the extent of disclosure.*

## 3. Research methodology

The sample of our paper is made of all credit institutions listed on London Stock Exchange (46 banks according to the information available for the 2011). Data collection was based on information provided by banks' websites, the process being divided into two parts. Firstly, we measured the level of disclosure by using a checklist developed in this respect. For this, we used banks' annual reports for year 2010 by downloading them from their websites. Secondly, we collected data related to banks' governance system by searching in addition through their financial statements and general information provided by their website.

Because the main purpose of our study is to identify possible associations between corporate governance dimensions and the level of disclosure, two sets of dependent and independent variables for performing the correlation analysis are needed.

Thus, for measuring the level of disclosure, which is *the dependent variable*, we made use of a Disclosure Index (TD) especially developed in this respect that mainly consists of three sub-indices, each of them measuring a different type of disclosure, namely: *mandatory (MD), recommended (RD) or voluntary (VD)*. These indices measure the extent of each type of disclosure, being calculated as a ratio of the total number of items disclosed to the maximum possible number obtainable for each category of disclosure. Thus, we compiled three separate lists of disclosure, namely:

- a checklist of *mandatory disclosures* for entities listed at London Stock Exchange, based on the most recently Corporate Governance Disclosure Checklist (Delloite, 2011), considering The Listing Rules and The UK Corporate Governance Code, as well as the recently requirements

supplemented by The Disclosure and Transparency Rules on Audit Committees and Corporate Governance Statements (2008), The Revised Version of the Turnbull Guidance on Internal Control (2005), The Guidance on Audit Committees (2010). This checklist comprises 44 items divided into six main categories of information related to general aspects, leadership, effectiveness, accountability, remuneration and relation with shareholders;
- a checklist of *recommended disclosures* based on OECD Principles, which propose that the corporate governance framework should ensure that timely and accurate disclosure is made on companies' "financial situation, performance, ownership and governance" (OECD, 1999). This checklist comprises 51 items divided into four categories, according to the disclosures required by the principles, as follows: rights of shareholders and key ownership functions, equitable treatment of shareholders, disclosure and transparency, responsibilities of the board;
- a checklist of *voluntary disclosure,* based on the Standard & Poor's list of 98 transparency and disclosure questions used for its study developed for Europe in 2003. This checklist comprises 88 items divided into three categories outlining ownership, company performance and boards (governance). This approach of developing the disclosure index was often used in prior studies aiming on the same goal (Mangena and Tauringana, 2007; Tsamenyi, et al., 2007; Aksu and Kosedag, 2006).
After joining the three separate checklists, a final checklist of 142 items was structured, basing on S&P's study, into 4 main categories: *general provisions (2), ownership structure and investor rights* (43), *financial transparency and information disclosure* (46), *board structure and process* (78). This was supplemented with 8 additional items used in at least one previously published study focused on the same topic and 15 own items, thus resulting a comprehensive checklist list of 167 items consisted of 31 mandatory, 54 recommended and 82 voluntary disclosures.
For developing the disclosure index each item of the checklist was scored using *binary classification*, each issue from the list being treated a dummy variable, where "1" indicates that the annual report discloses the information and '0' indicates that there is not disclosed any information about that issue. The disclosure index was computed using an *un-weighted scoring approach* of the disclosure items, basing on the assumption that each item of information disclosure is of equal importance in the corporate information users' decision-making process. The main reason to do so is related to the subjectivity that might occur when different weights are assigned to reflect the importance of certain types of information. Our approach is supported by most prior studies aimed to develop such an index of disclosure, unlike weighted scores, which were rarely used before (Barako et al., 2006; Cheng and Courtenay, 2006; Patelli and Prencipe, 2007). *The independent variables* consists of one of the most controversial attribute of corporate governance that was widely debated in researchers' world and, according to prior studies proved to have significant influences over the level of disclosure – *ownership concentration (O_Conc)*, measured through the percentage of shares owned by the majority shareholder.

## 4. Empirical findings

For testing our hypothesis firstly we performed a correlation analysis between each dependent variables – disclosure indices (TD, MD, RD and VD) and the corporate governance attribute tested – *ownership concentration (O_Conc)*, whose results are detailed in Table 1.

**Table 1. The correlation matrix between variables**

| | | TD_Index | MD_Index | RD_Index | VD_Index | O_Conc |
|---|---|---|---|---|---|---|
| TD_Index | Pearson Correl. | 1 | ,788** | ,944** | ,893** | -,555** |
| | Sig. (2-tailed) | | ,000 | ,000 | ,000 | ,000 |
| MD_Index | Pearson Correl. | ,788** | 1 | ,694** | ,513** | -,556** |
| | Sig. (2-tailed) | ,000 | | ,000 | ,000 | ,000 |

| | | | | | | |
|---|---|---|---|---|---|---|
| RD_Index | Pearson Correl. | ,944** | ,694** | 1 | ,765** | -,495** |
| | Sig. (2-tailed) | ,000 | ,000 | | ,000 | ,000 |
| VD_Index | Pearson Correl. | ,893** | ,513** | ,765** | 1 | -,450** |
| | Sig. (2-tailed) | ,000 | ,000 | ,000 | | ,002 |
| | N | 46 | 46 | 46 | 46 | 46 |
| ***Correlation significant at the 0.01 level / *. Correlation is significant at the 0.05 level* | | | | | | |

Source: own results using SPSS software

Basing both on assertions supported by the agency theory that companies with concentrated ownership do not have to rely on external disclosures to the same extent as companies with dispersed ownership, we hypnotizing that

*H: There is a negative association between ownership concentration and the extent of disclosure*

Pearson coefficient values reveal the existence of a negative correlation between variables tested, having a medium intensity (0,555 in case of total disclosure) and a probability of 99% (Sig. <0,01). Correlation analysis provide a stronger positive correlation in case of mandatory disclosure (0,556), while recommended and voluntary disclosures proved to be less associated with ownership concentration (0,495, respectively 0,450). Moreover, according to the linear regression results presented in table 2, the significant negative correlation of medium intensity and a probability of 99% (Sig. <0,01) identified between variables tested (0,555 in case of total disclosure) is explained in 29,2% of cases.

**Table 2. Linear regression analysis results**

| Coefficients[a] | | | | | | |
|---|---|---|---|---|---|---|
| Model | | Unstandardized Coeff. B | Unstandardized Coeff. Std. Error | Standardized Coeff. Beta | t | Sig. |
| 1 | (Constant) | 66,689 | 3,251 | | 21,130 | ,000 |
| | O_Conc | -,249 | ,056 | -,555 | -4,427 | ,000 |
| R Square: .308<br>Adjusted R Square: .292 | | | | F value: 19.597<br>F significance: .000 | | |
| a. Dependent Variable: TD_Index | | | | | | |

Source: own results using SPSS software

Medium intensity associations with the same significance were identified in case of disclosure sub-indices, too, Pearson's values being between 0,450 in case of voluntary disclosures and 0,556 in case of mandatory ones.

In conclusion, our hypothesis will be accepted and consequently we could state that the extent of disclosure is negatively associated with ownership concentration in case of banking institutions listed on London Stock Exchange system, being thus consistent with the prior research findings.

## 5. Conclusions

The relationship between various attributes of corporate governance and the level of disclosure was a highly debated topic of worldwide research, whose outcomes are mixed. Irrespective of prior studies, which were focused on corporate governance features like board of directors size and independence, CEO duality or various ownership' features, analyzing their possible associations at companies level, our study comes to add value to corporate governance literature by testing one of the most controversial corporate governance attribute – ownership concentration in banking sphere. Thus, because banking system was little explored on this topic before, we had the chance to enrich the research literature with this empirical study, whose disclosure index developed ensures it as well with originality. The results of the performed analysis reveal negative relationships between ownership concentration and the level of disclosure. Thus we can assert that the higher the dispersion of shareholders, the higher the level of transparency. Our results are consistent with some general prior literature findings on the same topic (e.g. Barako et al., 2006; Tsamenyi, et al., 2007; Haniffa and Cooke, 2002; Huafang and Jianguo, 2007; Patelli and Prencipe, 2007; Chau and Gray, 2002; Cooke, 1989)

Finally, being aware of our study's limitations, coming from the sample of banks, the limited number of factors and the fact that only one year data were considered for analysis, we are appreciating these as a challenge that give us outlooks for future research.

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