# Corporate Governance And Voluntary Disclosure In France

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**ABSTRACT**

*This paper investigates the effect of corporate governance practices on the extent of voluntary disclosure in France. Using a panel of 206 non-financial French listed firms during the period 2006–2009, we find evidence that voluntary disclosure in annual reports increases with managerial ownership, board and audit committee independence, board meeting frequency, and external audit quality. We also find that frequency of audit committee meetings and diligence of board and auditing are associated with decreased disclosure. Additional findings show that larger, more profitable, and less indebted firms have greater voluntary disclosure.*

**Keywords:** Voluntary Disclosure; Corporate Governance; Board of Directors; Common Correlated Effects Estimators

## 1. INTRODUCTION

In the aftermath of recent corporate scandals, corporate voluntary disclosure, a key element of capital market dynamics, has become the focus of increased attention. A variety of reforms and codes of best governance practices have been implemented worldwide to promote transparency and restore confidence in the financial markets (e.g., the Sarbanes–Oxley Act of 2002 in the United States and the Financial Security Law of 2003 in France). Academics have always stressed the importance of disclosure quality. In a seminal work, Jensen and Meckling (1976) suggest that a good disclosure policy reduces agency costs and mitigates information asymmetry between managers and shareholders. In the same vein, Diamond and Verrecchia (1991) argue that the amount of information conveyed by large transactions is lower for firms that provide more details about their activities, which indicates that voluntary disclosure reduces information asymmetries between investors. Empirically, many studies have shown that firms' voluntary disclosures are associated with improved stock liquidity (e.g., Healy et al., 1999; Leuz and Verrecchia, 2000), lower stock price synchronicity (e.g., Haggard et al., 2008), lower costs of capital (e.g., Botosan, 1997), larger analyst following (e.g., Francis et al., 1998), and less mispricing of accruals (e.g., Levi, 2008), among other things.

Numerous studies have investigated the drivers of corporate disclosures. Notably, considerable attention has been paid to the role of corporate governance in shaping disclosure policies. For instance, ownership structure (e.g., Eng and Mak, 2003; Chen et al., 2008), the board of directors (e.g., Cheng and Courtenay, 2006; Patelli and Prencipe, 2007), the audit committee (e.g., Bronson et al., 2006), and audit quality (e.g., Piot and Janin, 2007) have been identified as determinants of the extent of voluntary disclosure. Although many insights are gained from the literature, it is still difficult to draw clear-cut findings since corporate governance attributes interact with each other and may serve as complements or substitutes in influencing voluntary disclosure. Using a more comprehensive model—including all these mechanisms and taking into account the interactions between them—advances our understanding of the relationship between corporate governance and voluntary disclosure.

The present study extends previous research efforts and analyzes the effectiveness of certain corporate governance practices in affecting voluntary disclosure by French listed firms. In particular, it focuses on voluntary disclosure in annual reports, since these are the main documents published by firms and are used by various parties to assess firm performance during the fiscal year (e.g., Lang and Lundholm, 1996). Recent years have witnessed

dramatic changes in the quantity and quality of firms' mandatory disclosure in France. Information in annual reports is more abundant and diversified nowadays than ever before. In addition to financial information, French firms publish in their annual reports governance, risk, strategic, environmental, and social information.

Despite this tendency to greater transparency, much less attention has been paid to voluntary disclosure in the France. Moreover, the French judicial environment is deemed to be suffering from weak investor protection rules and an inefficient law enforcement system and the French stock market regulatory authorities have been criticized for delays in implementing high-quality disclosure standards (e.g., La Porta et al., 1997, 1998; Coffee, 2001; Piot and Janin; 2007). In this context, corporate governance practices are expected to be important in shaping firm disclosure policies. It is therefore crucial to investigate the effects of corporate governance on the extent of voluntary disclosure in France, which is the purpose of this study.

The present study differs from the current literature in two ways. First, we consider voluntary disclosure the outcome of characteristics of both managerial ownership and governance bodies (the board of directors and the audit committee). Hence, we focus on governance mechanisms that may contribute directly—as managerial ownership, audit quality, and board and audit committee independence (and diligence)—to facilitating firm voluntary disclosures and simultaneously check whether the quality of firm governance practices influences disclosure practices in French firms. Second, in contrast to earlier studies (e.g., Botosan, 1997; Chau and Gray, 2002; Eng and Mak, 2003; Lim et al., 2007; and Francis and Nanda, 2008), we consider that the extent of voluntary disclosure in annual reports varies across time. Thus, we are one of very few studies (e.g.; Watson et al., 2002) that extend the analysis over several fiscal years.

Himmelberg et al. (1999) argue that many prior cross-sectional studies fail to control for unobserved firm heterogeneity and therefore the documented relations may be spurious. Relying on a panel approach therefore allows us to better control for time-invariant firm effects as well as other endogeneity concerns. Moreover, our paper analyzes corporate governance disclosure during 2006–2009 with a common correlated effects model (Pesaran, 2006) that can control for common factors on a sample of French publicly listed firms. The theoretical justification for heterogeneity in governance disclosure among firms is based on Grossman and Hart's (1986) model of ownership and Gourlay and Seaton's (2004) evidence that firm-level heterogeneity and industry characteristics account for the variability in the diversification behavior of UK firms. Unobserved heterogeneity can bring about spurious correlations in cross-sectional studies, which can distort conclusions regarding the relationship between corporate governance variables and disclosure scores.

This research aims to deepen our knowledge of the extent of voluntary disclosure in France by assessing the effectiveness of governance mechanisms in explaining differences in voluntary disclosure. Using a panel of 206 non-financial French listed firms belonging to the Société des Bourses Françaises 250 index (SBF 250)[1] during the period 2006–2009, we find that managerial ownership, board and audit committee independence, the frequency of board meetings, and the quality of external audit are positively associated with voluntary disclosure. We also find that frequency of audit committee meetings and diligence of the board and auditing are associated with decreased disclosure. Additional findings show that larger, more profitable, and less indebted firms have greater voluntary disclosure. These results should be of interest to academics and regulators since they shed light on the disclosure behavior of French firms and can help accounting policy makers develop a coherent set of disclosure requirements.

The remainder of the paper is organized as follows. Section 2 presents the institutional framework. Section 3 surveys the literature and develops the hypotheses. Section 4 outlines the sample, describes the data, and defines the variables used in the empirical analysis. Section 5 reports and discusses the main empirical findings. Section 6 concludes the paper.

[1] The SBF 250 is a French stock market index that represents the 250 most highly capitalized and most liquid stocks from all economic sectors traded on the Paris Bourse.

## 2. FRENCH CORPORATE GOVERNANCE LANDSCAPE

Family firms dominate the French corporate landscape and feature highly concentrated ownership structures. Faccio and Lang (2002) show that family firms accounted for roughly 65% of French listed firms in 1996. Boubaker (2007) finds family firms accounted for 69.61% of French listed firms in 2000, 90% of which were run by members of the controlling family. In France, as in other Western Continental European countries where ownership structure is highly concentrated, listed firms appear to be reluctant to voluntarily provide investors with extra information and privilege private communication channels to public disclosure (Boubaker and Labégorre, 2008). Such conditions motivate us to study the corporate governance characteristics that encourage voluntary disclosure in France, thus mitigating information asymmetry.

Several codes of best corporate governance practices have been established in France since the mid-1990s to enforce minority shareholder rights and improve market transparency. These codes, including the Viénot reports (1995, 1998) and the Bouton report (2002), draw the outline of corporate governance. They have encouraged French firms to appoint independent directors, separate the functions of chief executive officer (CEO) and chair of the board, create board committees, and voluntarily disclose more information to improve market transparency and attract shareholders back to the financial markets. In 2003, the French Parliament adopted the Financial Security Law to uphold and strengthen the legal provisions related to corporate governance. This law—in the spirit of the Sarbanes–Oxley Act—aims to increase CEO responsibilities, promote internal control, and reduce or eliminate sources of conflict of interests.

Notwithstanding the newly enacted laws and recently adopted governance codes, businesses failures and accounting scandals continue to surface, which has shaken up the confidence of French corporate environment (e.g., Vivendi Universal and the Sentier II financial scandals in 2001 and the Autorité des Marchés Financiers (AMF)[2] penalties against BNP Paribas and Société Générale in 2007). Examining the financial reporting practices of CAC 40 firms in 2004, Fitch Ratings (2004) concludes that these firms can do better in terms of financial disclosure and accountability. It also observes significant differences in the content of annual reports across these firms without explaining the reasons for these disparities.

## 3. THEORETICAL FRAMEWORK

The relevant literature advances several arguments that explain why some firms provide more comprehensive voluntary information than others do. Ownership structure, the board of directors, the audit committee, and audit quality have been identified as determinants of the extent of voluntary disclosure.

### 3.1. Managerial ownership and voluntary disclosure

The separation between ownership and control is considered by researchers and practitioners the main source of conflicts between managers and firm owners. Jensen and Meckling (1976) argue that agency problems arise when owners (principals) hire a manager (agent) to run the firm but they do not have similar objectives. This divergence of interests encourages managers to engage in self-serving activities such as indulging in excessive perquisites, shirking responsibilities, and empire building. Therefore, they may have incentives to withhold information to hide their private benefits of control from outsiders.

Managerial ownership can alleviate these agency conflicts between managers and shareholders, thus reducing potential agency costs (Jensen and Meckling, 1976). Managers with greater ownership have less incentive to expropriate shareholders and therefore indulge in fewer diversionary activities to hide private benefits. Thus, their costs of voluntary disclosure and benefits of retaining information are lower. The higher the level of managerial ownership, the more inclined managers are to act in the best interests of shareholders. Therefore, they may release more information to reduce the monitoring costs that the shareholders would bear to prevent agency problems. From the above arguments, we draw the following hypothesis.

[2] The AMF is the regulatory authority for the French capital market and the French equivalent of the U.S. Securities and Exchange Commission.

*$H_1$: Ceteris paribus, the extent of voluntary disclosure in annual reports increases with managerial ownership.*

### 3.2. Independent directors and voluntary disclosure

The corporate governance literature assigns four critical roles to the board directors: monitoring and service, strategy, and resource provision (Zahra and Pearce, 1989). Monitoring is a valuable corporate governance mechanism in the presence of agency conflicts (Jensen and Meckling, 1976). Boards of directors are ultimately accountable for ensuring the reliability, integrity, and transparency of financial reporting systems (Jensen, 1993). Voluntary disclosure—as a component of transparency—is pillar of any monitoring process.

The presence of independent directors on boards is pivotal since they contribute their experience to the firm and protect its overall interests against potential opportunistic behavior that benefits only a narrow constituency of shareholders. This monitoring role is largely echoed in the academic research. Weisbach (1988) and Borokhovish et al. (1996) argue that independent directors bear high reputation costs that encourage them to effectively monitor managers' actions, thus limiting their opportunistic behavior. Beasley (1996) suggests that independent directors play a crucial role in influencing disclosure decisions. Lim et al. (2007) examine the association between board composition and voluntary disclosure in annual reports in Australian firms. They find that independent boards positively influence the overall level of voluntary disclosure in annual reports and more voluntarily provide key forward-looking and strategic information. Patelli and Prencipe (2007) argue that independent directors play an important monitoring role in encouraging firms to disclose more information to outside investors in the presence of a controlling shareholder. In such cases, they protect the interests of minority shareholders against potential egregious behavior by the controlling owner.

Empirical research consistently shows that more independent directors on boards (and audit committees) increase the issuance, frequency, and accuracy of voluntary management earnings forecasts (e.g., Ajinkya et al., 2005; Karamanou and Vafeas, 2005), improve the accuracy of analyst forecasts (e.g., Byard et al., 2006), and reduce the possibility of fraudulent information (e.g., Mak and Li, 2001 and Chen and Jaggi, 2000).[3] Kelton and Yang (2008) provide consistent results for voluntary disclosure via the Internet and show that an independent board enhances corporate disclosure on the Web.[4] The role of independent directors seems to be country invariant. Cheng and Courtenay (2006), Patelli and Prencipe (2007) and Akhtaruddin et al. (2009), for instance, provide evidence that voluntary disclosure in annual reports increases with the number of independent directors in Singapore, Italy, and Malaysia. More recently, García-Meca and Sánchez-Ballesta (2010) reach the same conclusion for countries with high investor protection rights after meta-analyzing 27 worldwide empirical studies. Based on these arguments, we propose the following hypothesis.

*$H_2$: Ceteris paribus, the extent of voluntary disclosure in annual reports increases with the percentage of independent directors on the board (or audit committee).*

### 3.3. Meeting frequency and voluntary disclosure

Vafeas (1999) argues that the time needed to gather sensitive information in preparation for board meetings makes the dates of these meetings important. Board directors require deep background knowledge and timely updates about firm activities and results. Thus, a higher meeting frequency implies greater pressure on managers to provide supplementary information. This view is supported by Brick and Chidambaran (2010), who suggest that frequent board (and audit committee) meetings are a pledge to continuously share information with managers. Beasley et al. (2000) provide evidence that a lower frequency of audit committee meetings is associated with a higher likelihood of financial statement fraud. A similar study by Farber (2005) shows that the audit committees of firms engaged in fraudulent activities have fewer independent members and do not meet frequently.

[3] One of the roles of the audit committee is to assist the board of directors in overseeing the quality of financial reporting information (Pincus et al., 1989). Literature supports its significant positive role in firm disclosure policy (see, e.g., Vefeas, 2005; Prawitt et al., 2009; Caskey et al., 2010). Bronson et al. (2009) show that independent audit committees have real monitoring benefits, especially when the audit committee is fully independent.

[4] Contrariwise, few studies, including that of Adams and Ferreira (2007), argue that CEOs are less inclined to share information with their boards to avoid tight monitoring.

The related evidence conforms to the suggestion of Abbott et al. (2003), who argue that a board (or audit committee) that meets regularly is more diligent in the discharge of its fiduciary duties. More diligent audit committees (e.g., with more frequent meetings) are more likely to pay higher external audit fees (Carcello et al., 2002)[5], have lower levels of discretionary accruals (Xie et al., 2003), be more scrupulous about compliance with accounting standards (Mangena and Tauringana, 2007), voluntarily disclose financial information on the web (Kelton and Yang, 2008), and disclose more information with respect to their executive compensation practices (Laksmana, 2008). Vafeas (1999) finds that firm performance increases after years of frequent board meetings.

Drawing on the above-mentioned studies, we expect a board's (audit committee's) meeting frequency to be related to its monitoring performance, leading to greater voluntary disclosure. Hence, we posit the following hypothesis.

*$H_3$: Ceteris paribus, the extent of voluntary disclosure in annual reports increases with the frequency of board of directors (or audit committee) meetings.*

### 3.4. Meeting attendance and voluntary disclosure

Irregular attendance at meetings of the board of directors is incompatible with the due diligence of directors and best corporate governance principles. Greater participation in board (or audit committee) meetings allows directors to provide useful advice, share points of view, and benefit of each other's experience. Hence, higher attendance rate decreases information asymmetry between them and promotes more effective functioning of the board and its committees. Moreover, busy directors are less likely to question managerial proposals and decisions and are therefore less effective monitors. In this respect, Jiraporn et al. (2009) and Ahn et al. (2010) suggest that directors holding multiple outside directorships face tight time constraints and their limited attention capacities may hamper their capacity to properly fulfill their monitoring duties, which in turn negatively affects firm performance. Similarly, Ferris et al. (2003) posit that, because of lack of time, busy directors are unable to serve on various board committees.

The complexity of accounting and financial reports reviewed by the audit committee requires significant resources in terms of directors and time spent for the monitoring mission. Regular attendance at board (or audit committee) meetings shows directors' strong commitment to earnestly perform their supervision duties. Their presence pressures top management to provide further information to reduce oversight. Moreover, directors who usually attend board meetings are expected to ask for more detailed and varied information to assess management performance, implying more voluntary disclosure. In light of these arguments, we present the following hypothesis.

*$H_4$: Ceteris paribus, the extent of voluntary disclosure in annual reports increases with participation in board of director (or audit committee) meetings.*

### 3.5. Audit quality and voluntary disclosure

Jensen and Meckling (1976) consider external auditors an important corporate governance mechanism since they are entrusted with rendering a fair opinion on the quality of disclosed information. DeAngelo (1981) argues that auditor size is a proxy for audit quality since the revenues of larger auditors do not depend on any one single audit client. Larger audit firms are more inclined to provide high-quality services to preserve their reputation capital and avoid losing their customers in case of misreporting. Consequently, they are less likely to acquiesce to client pressure to not provide accurate, detailed, and comprehensive disclosure. In this respect, Titman and Trueman (1986) suggest that hiring a big auditing firm signals to the financial market the high quality of the disclosed information.

Previous empirical studies show a positive effect of audit firm size on the extent of voluntary disclosure (see, e.g., Craswell and Taylor, 1992 and Inchausti, 1997). Similar results are found by Debreceny et al. (2002), Xiao et al. (2004) and Kelton and Yang (2008)-for the specific case of Web-based voluntary disclosure. This line of reasoning leads to the following hypothesis.

[5] Higher audit fees correspond to higher audit quality due to the greater amount of audit work for greater assurance.

*$H_5$: Ceteris paribus, the extent of voluntary disclosure in annual reports increases when firms are audited by a Big-4 accounting firm.*

## 4. DATA

### 4.1. Sample selection and data sources

Our initial sample consists of all French listed firms belonging to the SBF 250 index during 2006–2009. As in prior studies, we exclude regulated utilities (Standard Industrial Classification, or SIC, codes 4900–4999) and financial firms (SIC codes 6000–6999) since they operate in an environment where disclosure is more likely to be the result of specific legal and regulatory requirements rather than a response to concerns of agency conflict. We discard all firms with missing financial or corporate governance data. We obtain a final sample of 206 firms. Financial data are retrieved from the Worldscope database. Board and audit committee data, as well as managerial ownership data, were excerpted from firms' annual reports, available from the AMF's website.

### 4.2. Voluntary disclosure score

The dependent variable (*VDSCORE*) is the score of voluntary disclosure in annual reports, measured using self-constructed "disclosure indexes." We develop a disclosure checklist, based on relevant studies by Meek et al. (1995), Botosan (1997), Chau and Gray (2002), Eng and Mak (2003), Lim et al. (2007) and Francis et al. (2008), consisting of 112 items falling into four general categories, namely, strategic information (*STG-VD*, 30 items), non-financial information (*NFN-VD*, 35 items), financial information (*FN-VD*, 36 items), and governance information (*GOV-VD*, 11 items). As Cooke (1992) does, we conduct content analysis to identify the presence of any information in annual reports. Here *VDSCORE* is the total of the scores awarded for each item in the voluntary disclosure checklist. Table 1 presents the checklist of items included in the disclosure scores. To avoid subjectivity, we consider all disclosed items to be of equal importance, despite the fact that information content can vary substantially from one item to another. Hence, we assign a value of one when a given item is disclosed and zero otherwise. The total score of each sample firm is computed as the unweighted sum of the scores of all the items of the index.

### 4.3. Corporate governance variables

Managerial ownership (*ManagerOwn*) is measured by the proportion of shares held by the top management team. Board independence (*BoardIndp*) is proxied by the ratio of independent to total directors on the board. The intensity of board activity is proxied by board meeting frequency during the fiscal year (*BoardMeet*) and the average director participation rate (*BoardDiligence*). The independence of the audit committee (*ACIndp*) is proxied by the ratio of independent directors to the total number of directors on the audit committee. The intensity of audit committee activity is measured by the frequency of meetings during the fiscal year (*ACMeet*) and the average director participation rate (*ACDiligence*). Audit quality (*Big-4*) is proxied using a dummy variable that equals one if the firm's accounts are certified by at least one Big-4 accounting firm and zero otherwise. Table 2 reports the definition of all variables used in the empirical analysis.

### 4.4. Control variables

We rely on previous literature and include several control variables that proxy for firm characteristics to avoid any spurious relation between voluntary disclosure and corporate governance variables (e.g., Debreceny et al., 2002; Xiao et al., 2004). This literature suggests that firm profitability, leverage, and size can affect the extent of voluntary disclosure in annual reports. The variable *Profitability* is measured by the ratio of net income to total assets, *Leverage* is proxied by the ratio of total debt to common equity, and *Size* is measured by the natural logarithm of total assets.

**Table 1. The checklist of voluntary disclosure**

| Checklist of items | References | Checklist of items | References |
|---|---|---|---|
| **A - Strategic information** | | 5. Number of employees for 2 or more years | A, C, E |
| **A1. General information about the firm** | | 6. Average compensation per employee | A, B |
| 1. Brief history of company | A, B, C , E | 7. Added value per employee | A, B |
| 2. General description of the business | B, D | 8. Data productivity | A, B, C |
| 3. Main products | B, D | 9. Safety policy | A, B, C |
| 4. Main Markets | B, D | 10. Cost of safety measures | A, C |
| **A2. Corporate Strategy** | | 11. Data on accidents | A, C, E |
| 5. Statement of the main objectives | A, B, C, D, E | 12. Policy on communication | A, C |
| 6. Statement of the financial objectives | A, C, E | 13. Redundancy information | A, C |
| 7. Current Strategy | A, B, C, F | 14. Reason for changes in employees' number or categories over time | A, C |
| 8. Impact of strategy on current results | B | 15. Recruitment problems and related policy | A, C |
| 9. Future strategy | A, B, C | **B2. Information about the training policy** | |
| 10. Impact of strategy on future results | A, C, E | 16. Amount spent in training program | A, C, E |
| **A3. R & D activities** | | 17. Nature of training | A, C, E |
| 11. Description of R & D projects | A, C | 18. Policy on training | A, C, E |
| 12. Corporate policy on R & D | A, C | 19. Categories of employees trained | A, C, E |
| 13. Location of R & D activities | A, C, D | **B3. Social policy and value-added information** | |
| 14. Number employed in R & D | A, C, E | 20. Safety of products | A, C |
| **A4. Analysis and discussion of management Review of projects** | | 21. Program of environmental protection | A, C, E |
| 15. Review of operations | B | 22. Charitable Donations | A, C, E |
| 16. Competitive environment | B, D | 23. Community programs | A, C, E |
| 17. The most significant events | B, D | 24. Value added data | A, C, E |
| 18. Change in sales and profits | B, D | 25. Value added ratios | A, C, E |
| 19. Change in cost of goods sold | B, D | 26. Qualitative value-added information | A, C, E |
| 20. Change in expenses | B, D | **B4. Segmental Information** | |
| 21. Change in inventory | B, D | 27. Geographical distribution of invested capital | A, C, E |
| 22. Change in the share price | B, D | 28. Geographical distribution of net assets | A, C |
| **A5. Future prospects** | | 29. Geographical distribution of production | A, C, E |
| 23. Future development channels | A, B, C | 30. Expenditure in the business lines | A, C |
| 24. Qualitative forecast of sales | A, B, C, E | 31. Revenue by business line | A, C |
| 25. Quantitative forecast of sales | A, B, C, D, F | 32. Competitor analysis quantitative | A, C |
| 26. Qualitative forecast of profits | A, B, C, D, E, F | 33. Competitor analysis qualitative | A, C |
| 27. Quantitative forecast of profits | A, B, C, E | 34. Market share analysis-quantitative | A, C |
| 28. Assumptions underlying the forecast | A, B, C | 35. Market share analysis-qualitative | A, C |
| 29. Review of forecasts | A, B, C | **C-Financial Information** | |
| 30. Description of capital project committed | A, B, C | **C1. Performance indicators (without from the financial statements)** | |
| **B - No-financial information** | | 1. Performance indicators | A, B, C |
| **B1. Employees information** | | 2. Financial data for the last five years | A, B, C, D, E |
| 1. Geographical distribution of employees | A, C | 3. Turnover | A, B, C, D, F |
| 2. Number of employees by sex | A, C | 4. Net income | A, B, C, D, F |
| 3. Number of employees by age | A, C | 5. Shareholders' equity | A, B, C, D, |
| 4. Categories of employees by function | A, C | 6. Total assets | A, B, C, D, F |

**Table 1. The checklist of voluntary disclosure (continued)**

| Checklist of items | References | Checklist of items | References |
|---|---|---|---|
| 7. Earnings per share | A, B, C, | 28. Exchange rates used in accounting | A, B, C |
| 8. Dividend payout policy | A, B, C, | 29. Long-term debt by currency | A, C |
| 9. Transfer pricing policy | A, B, C, | 30. Short-term debt by currency | A, C |
| 10. Impact of any accounting policy changes on results | A, B, C, | **C5. Other financial information** | |
| 11. Advertising expenditure | A, B, C, E | 31. Share price at year end | A, C |
| 12. Effect of inflation on results | A, B, C | 32. Share prices trend | A, C, E |
| 13. Effect of inflation on assets | A, B, C | 33. Market capitalization at year end | A, C, E |
| 14. Effect of fluctuating interest rates on the result | A, B, C, E | 34. Trend of market capitalization | A, C |
| **C2. Financial ratios** | | 35. Size of shareholdings | A, C |
| 15. Liquidity Ratio | A, B, C, E | 36. Forecasted market share | A, C, D, F |
| 16. Turnover ratio of assets | A, B, C | **D- Governance information** | |
| 17. Debt ratio | A, B, C, E | 1. Ownership structure | A, C |
| 18. Profitability ratios | A, B, C, E, F | 2. Organizational Chart | A, B, C, E |
| 19. Other useful ratios | A, B, C, E | Composition of the board of director | |
| **C3. Forecasted information** | | 3. Personal Profile | A, C |
| 20. Cash flow forecast | A, B, C, D | 4. Description of the position occupied | A, C |
| 21. Estimates of capital increase | A, B, C | 5. Duration of belonging to the company | A, B, C |
| 22. Earnings estimates | A, B, C | 6. Number of shareholders belonging to the board of directors | A, B, C |
| 23. Effect of inflation currency fluctuations on future operation | A, C | 7. Academic profile of the directors | A, B, C |
| 24. Effect of currency fluctuation of interest rates on future operations | A, C | 8. Presence of Internal Audit Committee | A, B, C |
| **C4. Information on exchange rates** | | 9. Age of the executives | A, B, C |
| 25. Impact of currency fluctuations on current results | A, B, C | 10. Profile of the executives | A, B, C |
| 26. Impact of currency fluctuations on future operations | A, C, E | 11. Individual remuneration | A, B, C |
| 27. Estimates of currency fluctuations | A, B, C | | |

A: Meek, Robert, and Gray (1995)
B: Eng and Mak (2003)
C: Chau and Gray (2002)
D: Botosan (1997)
E: Lim, Matolcsy, and Chow (2007)
F: Francis, Nanda, and Olsson (2008)

### 4.5. Descriptive statistics

Table 2 presents the descriptive statistics of the variables used in the analysis. The level of voluntary disclosure in annual reports varies dramatically between sample firms. The *VDSCORE* ranges from a low value of six to a high value of 76. The mean score is 39.07, with a standard deviation of 11.63, indicating that there is enough variation within the sample to conduct a meaningful analysis. The median *VDSCORE* is 40, which indicates that roughly half of firms disclose less than one-third of the maximum possible information according to our checklist. This is consistent with the conclusions of the Fitch Ratings agency, that French firms can do better in terms of financial disclosure and accountability.

Managerial ownership (*ManagerOwn*) shows systematic differences across sample firms and ranges from a minimum of zero to a maximum of 99%, with a median value of 19.16%. To avoid outlier observations skewing the results or affecting regression standard errors and leading to spurious results, we winsorize this variable at the first and 99th percentiles. Board independence (*BoardIndp*) exhibits wide dispersion across sampled firms. Some firms have fully independent boards, whereas others have only insiders on their boards. Boards of directors with 40.44% independent directors are, on average, less independent than audit committees (47.01%).

The intensity of board (audit committee) activity, as proxied by *BoardMeet* (*ACMeet*), ranges widely from two (zero) to 27 (13) meetings during the fiscal year. The mean of the average participation rates of directors in board meetings (*BoardDiligence*) is 86.96%, higher than that in audit committee meetings (74.01%). With regard to external auditing, we find that only 14.10% of the sample firms were not audited by a Big-4 accounting firm, suggesting that SBF 250 firms prefer to be audited by large audit firms.

**Table 2. Descriptive Statistics of the Data 2006-2009**

| Variable | Description | Minimum | Maximum | Mean | Median | Standard deviation |
|---|---|---|---|---|---|---|
| Disclosure | The extent of voluntary disclosure in the annual report is measured by disclosure index | 6 | 76 | 39.073 | 40 | 11.634 |
| ManagerOwn | Managerial ownership is measured by the proportion of shares held directly by the top management team | 0 | 99 | 20.098 | 19.16 | 25.502 |
| BoardIndp | Board independence using the ratio of independent to total number of directors on the board | 0 | 100 | 40.440 | 40 | 24.946 |
| BoardMeet | The intensity of the board activity is proxied by its meetings number during the fiscal year | 2 | 27 | 7.390 | 7 | 3.691 |
| BoardDiligence | Average rate of the directors' participation in the meetings | 0 | 100 | 86.964 | 90 | 11.897 |
| ACIndp | Independence of audit committee is proxied using the ratio of independent to total number of directors on the audit committee | 0 | 100 | 47.015 | 50 | 37.316 |
| ACMeet | The intensity of the audit committee activity is measured using meetings frequency during the fiscal year | 0 | 13 | 3.2423 | 3 | 2.617 |
| ACDiligence | Average rate of the participation of the audit committee members in the meeting | 0 | 100 | 74.011 | 100 | 41.518 |
| (Big-4) | The audit quality is measured using a dummy variable that equals to 1 if firm's accounts are certified by at least one "Big Four" accounting firm, and 0 otherwise | 0 | 1 | 0.859 | 1 | 0.348 |
| ROA | Profitability is measured by the ratio of net income to total assets | -0.457 | 0.861 | 0.093 | 0.079 | 0.123 |
| Leverage | Leverage is proxied by the ratio of total debt on common equity | 0.02 | 821.215 | 80.744 | 56.16 | 105.988 |
| Size | Firm size is measured by the natural logarithm of total assets | 7.366 | 19.803 | 14.243 | 13.788 | 2.021 |

Preliminary data analysis (unit root tests) is conducted. We implement the Harris-Tzavalis (1999) unit-root test and the Im-Pesaran-Shin (2003) test for panel data. The null hypothesis of a unit root is rejected for all series with and without a trend.[6] The small panel data set and the type of variables used (ratios and proportions) may explain this result.

## 5. RESULTS

The baseline model is a linear model that regresses voluntary disclosure on key variables and covariates, controlling for firm fixed effects:

$$VDSCORE_{it} = \alpha_i + \beta_1 VDSCORE_{it-1} + \beta_2 ManagerOwn_{it} + \beta_3 BoardIndp_{it} + \beta_4 BoardMeet_{it} + \beta_5 BoardDiligence_{it} + \beta_6 ACIndp_{it} + \beta_7 ACMeet_{it} + \beta_8 ACDiligence_{it} + \beta_9 Big\text{-}4_{it} + \beta_{10} Probitability_{it} + \beta_{11} Leverage_{it} + \beta_{12} Size_{it} + \mu_{it},\ i = 1, 2, \ldots, N;\ t = 1, 2, \ldots, T \quad (1)$$

[6] The results are not reported for the sake of brevity but are available from the authors upon request.

where *i* and *t* are subscripts denoting the firm ($N$ = 206) and time ($T$ = 4), respectively; $\alpha_i$ is a firm fixed effect; $\beta$ is an estimation parameter; and $\mu_{it}$ is an error term that possibly includes lagged values and deeper lags of *VDScore*. The disturbance term has two orthogonal components, namely, fixed effects ($v_i$) and idiosyncratic shocks ($e_{it}$), as displayed below, in Equation (2).

Table 3 presents both an ordinary least squares (OLS) and an Arellano–Bond dynamic panel data model with the one-step system generalized method of moments (GMM) (see Arellano and Bond, 1991; Arellano and Bover, 1995). The OLS model assumes that the error term is orthogonal to all explanatory variables, which may be unrealistic because changes in macro variables can affect firm characteristics such as leverage and profitability, which in turn likely affects the extent of firm disclosure. The error term captures leverage and profitability effects and is therefore correlated with the extent of firm disclosure. The Arellano–Bond model takes into account the possibility of endogenous covariates because causality can run in both directions and these regressors may therefore be correlated with the error term. Furthermore, time-invariant firm characteristics (fixed effects) such as geography and sector effects may be correlated with the explanatory variables. The fixed effects are contained in the error term in equation (1), which consists of unobserved firm-specific effects, $v_i$, and observation-specific errors, $e_{it}$:

$$\mu_{it} = v_i + e_{it} \qquad (2)$$
$$E[v_i] = E[e_{it}] = E[v_i e_{it}] = 0$$

Additionally, the presence of the lagged dependent variable gives rise to autocorrelation. Finally, the panel dataset has a short time dimension (T = 4) and a larger firm dimension (N = 206). Therefore, the Arellano–Bond (1991) difference GMM estimator first proposed by Holtz-Eakin, Newey, and Rosen (1988) is adopted to cope with these problems (endogeneity, fixed effects and small panel).

To cope with the endogeneity problem, we add to the regression the lagged levels of the endogenous regressors as instruments instead of using only the exogenous instruments listed above. This makes the endogenous variables pre-determined and, therefore not correlated with the error term in Equation (1). To cope with fixed effects, the difference GMM uses first differences to transform Equation (1). Transforming the regressors by first differencing removes the fixed firm-specific effect because it does not vary with time. In the Arellano–Bond estimator, the first-differenced lagged dependent variable is also instrumented with its past levels. Finally, the Arellano–Bond estimator was originally designed for small-T, large-N panels. In large-T panels a shock to the firm's fixed effect, which shows in the error term, will decline with time. Similarly, the correlation of the lagged dependent variable with the error term will be insignificant (see, Roodman, 2006). In these cases, one does not necessarily have to use the Arellano–Bond estimator.

The results in Table 3 show that the OLS and Arellano–Bond estimators for the coefficients of the extent of disclosure present the same signs but distinct values in the two regressions, the Arellano-Bond estimator (in column 4) being more statistically significant and about a third higher than the OLS estimator. This can be due to the covariates controlled for endogeneity, fixed effects and small panel data panel and thus the estimator measures the effect of the covariates changes that affect disclosure procedures and the covariates and thus mitigates possible biases caused by these factors.

The Arellano–Bond model implements the system GMM, which makes a Windmeijer (2005) finite-sample correction of the reported standard errors in the two-step estimation and offers forward orthogonal deviations, an alternative to differencing that preserves sample size in panels with gaps. It also allows finer control over the instrument matrix. Without this correction, the standard errors tend to be severely downward biased in the Arellano–Bond model.

The Hausman specification test is the classical test of whether the fixed or random effects model should be used in panel data. The research question is whether there is significant correlation between the unobserved firm-specific random effects and the regressors, signifying endogeneity. If there is no such correlation, then the random effects model may be more powerful and parsimonious. If there is such a correlation, the random effects model would be inconsistently estimated and the fixed effects model would be the model of choice. We accept the null hypothesis, that there is no correlation.

**Table 3. The results of the regressions models (dependent variable: log Disclosure)**

$Disclosure_{t-1}$= the disclosure score of the previous year; ManagerOwn= the proportion of shares held directly by the top management team; BoardIndp= the ratio of independent to total number of directors on the board; BoardMeet= the meetings number of the board during the fiscal year; BoardDiligence= average rate of the directors' participation in the meetings; ACindp= the ratio of independent to total number of directors on the audit committee; ACMeet= the meetings frequency of the audit committee during the fiscal year; ACDiligence= average rate of the participation of the audit committee members in the meeting; Big-4= a dummy variable that equals to 1 if firm's accounts are certified by at least one "Big-4" accounting firm, and 0 otherwise; ROA = the ratio of net income to total assets; Leverage= the ratio of total debt on common equity; Size= the natural logarithm of total assets.

| Variables | OLS | OLS | Arellano-Bond | Arellano-Bond |
|---|---|---|---|---|
| Constant | 2.953<br>(14.78)*** | 0.177<br>(0.69) | — | — |
| Trend | 0.0002<br>(3.67)*** | 0.177<br>(0.69) | -0.008<br>(-0.56) | 0.00062<br>(0.04) |
| Disclosure (lagged) | — | 0.875<br>(9.41)*** | 5.591<br>(0.58) | — |
| ManagerOwn | 0.03<br>(4.68)*** | 0.000019<br>(0.07) | 0.004<br>(0.26) | 0.02<br>(4.48)*** |
| BoardIndp | 0.00043<br>(0.70) | 0.0002<br>(0.90) | 0.001<br>(0.05) | 0.025<br>(2.05)** |
| BoardMeet | 0.0053<br>(1.40) | 0.0021<br>(1.57) | 0.028<br>(0.27) | 0.205<br>(3.09)*** |
| BoardDiligence | -0.00005<br>(-0.98) | -0.000032<br>(-1.39) | -0.003<br>(-0.67) | -0.00096<br>(-2.23)** |
| ACindp | 0.00082<br>(1.64) | -0.000083<br>(-0.53) | -0.011<br>(-0.85) | 0.021<br>(3.40)*** |
| ACMeet | -0.029<br>(-3.07)*** | -0.0029<br>(-0.87) | -0.0573<br>(-1.06) | -0.444<br>(-3.67)*** |
| ACDiligence | -0.00085<br>(-2.50)** | -0.00007<br>(-0.95) | -0.0013<br>(-0.10) | -0.073<br>(-2.52)** |
| (Big-4) | -0.006<br>(-0.15) | -0.0018<br>(-0.21) | -0.031<br>(-0.25) | 0.786<br>(2.27)** |
| Profitability | 0.287<br>(2.43)** | 0.034<br>(0.92) | 2.207<br>(0.73) | 0.124<br>(4.58)*** |
| Leverage | -0.0002<br>(-2.45)** | -0.000036<br>(-0.91) | -0.0007<br>(-0.21) | -0.005<br>(-3.32)*** |
| Size | 0.019<br>(1.41) | 0.014<br>(1.79)* | 0.279<br>(2.16)** | 0.765<br>(5.52)*** |
| Sample Size | 821 | 616 | 410 | 410 |
| R-Square | 0.061 | 0.87 | — | — |
| F test<br>Prob>F | 7.59<br>(0.0000) | 171.31<br>(0.000) | 367.98<br>(0.000) | 4.81<br>(0.000) |
| Hausamn test | — | — | 76.32<br>(0.000) | 85.21<br>(0.000) |
| Sargan test (p-value) | — | — | 15.38<br>(0.98) | 21.71<br>(0.93) |
| First order serial correlation test (p-value) | — | — | -3.85<br>(-3.98) | -3.28<br>(-3.52) |
| Second order serial correlation (p value) | — | — | 3.85<br>(3.52) | 4.91<br>(3.68) |

(t-statistics) in parentheses are below the parameters. Those followed by ***, ** and * are significant at respectively 1%, 5% and 10% level.

The Sargan over-identifying restrictions test is a statistical test used to check for over-identifying restrictions of the estimated statistical model. It is based on the observation that the residuals should be uncorrelated with the set of exogenous variables if the instruments are truly exogenous. The estimated Sargan test does not reject the over-identification restrictions. Furthermore, the absence of first-order and second-order serial correlation is rejected, signifying that autocorrelation is satisfactory and the use of the lagged dependent variable as an instrument,

which is at the heart of the GMM, is validated. Therefore, the overall estimation of the model is satisfactory.

Based on the Arellano–Bond model, disclosure procedures among French firms increase with the trend, but this increase is not statistical significant. Disclosure increases statistically significantly with management ownership, board independence, the frequency of board meetings, the independence of audit committees, being audited by one of the Big-4 firms, profitability, and size. Disclosure decreases statistically significantly with board diligence, the frequency of auditing meetings, auditing diligence, and leverage.

Table 3 shows that Disclosure in year *t-1* is an explanatory variable that influences positively and significantly Disclosure in year *t*, which implies that French listed firms are likely to increase the extent of voluntary disclosure in their annual reports with time. Table 3 also shows that the coefficients of managerial ownership are positive and statistically significant. This result is consistent with the hypothesized relationship between managerial ownership and the extent of voluntary disclosure. Higher levels of managerial ownership align the incentives of managers with those of shareholders and reduce managerial incentives to extract corporate resources at the expense of shareholders. Managers are therefore expected to engage in fewer diversion activities to hide from outsiders, which makes voluntary disclosure less costly for them. Moreover, managers with higher ownership levels are more inclined to reduce the monitoring costs that outside shareholders would bear to reduce potential agency costs by releasing more voluntary information.

The results in Table 3 (column 4) also show that board and audit committee independence are positively and significantly associated with the extent of voluntary disclosure in annual reports. To fulfill their duties, independent directors may request extensive and complementary information other than the financial statement. Thus, they may induce managers to release more voluntary information in the firm's annual report. This result is in conformity with agency theory, which suggests that boards of directors have ultimate accountability for ensuring the reliability, integrity, and transparency of the firm's financial reporting system (Jensen, 1993).

The meeting frequency of boards positively and significantly influences the extent of voluntary disclosure in annual reports. This finding is consistent with our hypothesis and is in accordance with previous studies. Similar to Brick and Chidambaran (2010), we suggest that frequent board meetings are a pledge to continuously share information with managers. A sufficient number of board meetings can lead to monitoring effectiveness, pressuring management to improve their disclosure decisions.

In contrast with our hypothesis and previous studies (e.g., Jiraporn et al., 2009; Ahn et al., 2010), the extent of voluntary disclosure in annual reports is negatively and significantly affected by board diligence and audit committee activity and diligence. This may be explained by the argument that directors are more likely to establish personal ties with the firm insiders they are supposed to monitor when they participate frequently in boards meetings, which can reduce the effectiveness of monitoring, including that of disclosure decisions (Patelli and Prencipe, 2007). Moreover, an audit committee that meets frequently with all its members vehicles a signal of continuous monitoring to the market, reducing the need for public information disclosure in annual reports.

Firms can provide assurance in their annual reports through high-quality, independent Big-4 accounting firms. Appointing one of these firms is expected to be associated with better disclosure quality to firm shareholders. The results in Table 3 are consistent with hypothesis H5 and with prior research that indicate a positive association between audit firm size and voluntary disclosure (e.g., Craswell and Taylor, 1992 and Inchausti, 1997; Xiao et al., 2004; Kelton and Yuang, 2008).

Consistent with previous studies (e.g., Debreceny et al., 2002; Xiao et al., 2004), we find that larger and more profitable firms are more prone to release voluntary information in their annual reports. However, the coefficients of the variable *Leverage* are negative and statistically significant, which implies that firms that are more indebted have lower disclosure scores. This finding is consistent with prior research by Wallace et al. (1994) and Eng and Mak (2003), who consider that high leverage acts as a substitute for voluntary disclosure since it helps mitigate the free cash flow problem. In addition, the presence of restrictive debt covenants in debt agreements mitigates the agency costs of debt without resorting to increased disclosure of information in annual reports (Jensen, 1993).

## 6. ROBUSTNESS TESTS

The above results control for endogeneity, fixed effects, and a small panel data. We check the robustness of these results by analyzing whether our findings, mainly, the sign of our estimators hold if we use cross-effects (Wooldridge, 2002).

**Table 4.The results of robustness tests (dependent variable: log Disclosure)**

$Disclosure_{t-1}$= the disclosure score of the previous year; ManagerOwn is the proportion of shares held directly by the top management team; BoardIndp is the ratio of independent to total number of directors on the board; BoardMeet= the meetings number of the board during the fiscal year; BoardDiligence= average rate of the directors' participation in the meetings; ACindp= the ratio of independent to total number of directors on the audit committee; ACMeet= the meetings frequency of the audit committee during the fiscal year; ACDiligence is average rate of the participation of the audit committee members in the meeting; Big-4= a dummy variable that equals to 1 if firm's accounts are certified by at least one "Big-4" accounting firm, and 0 otherwise; ROA= the ratio of net income to total assets; Leverage= the ratio of total debt on common equity; Size is the natural logarithm of total assets.

| Variables | Arellano-Bond |
|---|---|
| Trend | 0.00003<br>(0.01) |
| ManagerOwn | 0.025<br>(2.81)*** |
| BoardIndp | 0.018<br>(2.61)*** |
| BoardMeet | 0.115<br>(2.85)*** |
| BoardDiligence | -0.001<br>(-1.28) |
| ACIndp | 0.116<br>(3.17)*** |
| ACMeet | -0.333<br>(-3.75)*** |
| ACDiligence | -0.086<br>(-3.63)*** |
| (Big-4) | 0.568<br>(1.30) |
| Profitability | 0.370<br>(0.17) |
| Leverage | -0.001<br>(-0.60) |
| Size | 0.732<br>(5.24)*** |
| Boardindp * BoardMeet | 0.0008<br>(0.61) |
| ACIndp * ACDiligence | 0.0004<br>(2.78)*** |
| Sample Size | 616 |
| F test<br>(p-value) | 7.83<br>(0.000) |
| Hausman test | 86.71<br>(0.00) |
| Sargan test<br>(p-value) | 21.32<br>(0.95) |
| First order serial correlation test (p-value) | 4.94<br>(3.73) |
| Second order serial correlation<br>(p-value) | 26.71<br>(2.97) |

(t-statistics) in parentheses are below the parameters. Those followed by ***, ** and * are significant at respectively 1%, 5% and 10% level.

The robustness tests validate previous results, since the cross-variables are statistically significant and the inclusion of cross-effects does not significantly alter the other parameters' values. However, some covariates are statistically significant in Table 3 (BoardDiligence, Big-4, Profitability and Leverage) but are not in Table 4. Therefore, the results with cross-effects are not different from those reported in Table 3, but the statistical results are distinct, signifying that robustness of these results is accepted but with the remark that some are not statistically significant.

## 7. DISCUSSION AND CONCLUSIONS

The present paper uses a panel of 206 firms covering the four-year period 2006–2009 to empirically analyze the effect of corporate governance characteristics on voluntary information disclosure practices in France. The OLS and Arellano–Bond panel data models are adopted. Both models give similar results but the Arellano–Bond model overcomes the OLS with more statistical significant parameters. Therefore the overall conclusion is that corporate disclosure in French firms is characterized by the presence of unobserved fixed effects, endogeneity, and, in the present case, a small panel.

Empirical results show that voluntary disclosure increases with management ownership, board independence, the frequency of board meetings, the independence of audit committees, and the quality of external audits and decreases with board diligence and audit committee meeting frequency and diligence. Lagged effects display persistence in the extent of disclosure among French listed firms during the sample period. Robustness tests analyzing cross-effects further validate our findings.

The current study has both theoretical and practical implications. First and foremost, it takes considers the interactions between different governance mechanisms when studying their effect on the extent of voluntary disclosure, controlling for endogeneity, fixed effects, and a small panel, whereas most relevant published studies ignore these effects. Second, it adds to our understanding the reasons behind the adoption of certain disclosure strategies. Third, our study can have substantial value to policy makers and regulators since it allows them to assess weaknesses in corporate governance rules and mandatory disclosure requirements.

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**NOTES**